



# The American way

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**By ignoring the lessons of American history, we risk endangering social equity, prosperity and even democracy**

Government is critical to economic expansion and the development of a foundation for future economic growth. It is also critical to fostering and adapting to change. This central idea is evident time and again, with the global financial crisis providing us with the most recent reminder. In this respect, the historical experience of the United States is an interesting case study.

Throughout early American history, government was not the little brother of the economy, but in fact as vital as private enterprise and innovation. Government adopted regulations to ensure a reasonable distribution of land across the country, a cornerstone of both its prosperity and individualistic national character; it financed the canals, and built road networks; it protected farmers from abuse by big financiers and big finance from abuse by farmers; it subsidised half the cost of building the railroads, the dynamic industrial force for change during the second half of the 19<sup>th</sup> century; it provided free primary education provision, and then extended this to secondary education; and it developed technical colleges, the forerunners of MIT, Berkeley and Ohio State, to name but a few.

Finally, and far less noticed, it built the sanitation and water systems towards the end of the 19<sup>th</sup> century that ensured the great cities were free of debilitating disease. Cities with their businesses, marketing and intellectual interactions were, in turn, powerful sources of growth. The importance of government was reinforced during the Great Depression, with President Roosevelt emboldening the state to be an even more active agent for social justice, forward-looking change, and public investment.

Unfortunately, during the 1970s, history was forgotten or distorted, common sense and practical reason were lost. The debate became consumed with the notion that good government is less government. The failings of government – and they surely exist – were exaggerated by pundits

and even serious economists. Obsession with budget deficits and deregulation followed. Worse, the US model and ideology were exported, in particular to the United Kingdom and to some vulnerable countries in Europe. Milton Friedman was as admired in the United Kingdom as in America, and even more admired in Poland. The American model worked, and the rest of the world was told to look and learn.

In the meantime, America's transportation infrastructure failed, its thirst for oil became self-destructive, its public education system became increasingly unequal, its rapid wage growth faltered, and median wages for males fell intermittently over forty years. What sustained America, everyone believed, was a technological revolution fed by deregulated finance and America's entrepreneurial spirit. This turned out to be less than a half truth.

Speculative finance has supported the American economy since the early 1980s, much but not all of it revolving around housing. The most recent history of the United States economy is one of frequent crisis. There was the 1987 stock market crash, the savings and loan crisis of 1989, the Mexican crisis of 1992, a Wall Street mini-crisis also in 1992, the collapse of the hedge fund Long-Term Capital Management in 1998, and the bursting of the high-tech bubble in 2000. Then, of course, there was the housing "bubble of all bubbles," which reached its height between 2004 and 2006, fed by the meteoric rise of collateralised debt obligations that financed subprime mortgages.

In the most recent decade, as federal deficits grew, so did GDP. But wages barely rose and median household income never reached the heights of 1999. Housing speculation absorbed capital, not small business or even much big business. Profits rose, but they were spent on stock buybacks and much less than in the past on needed capital investment. Government failed to invest adequately in transportation, education, energy, and healthcare. Finance accounted for 40 per cent of American profits.

The American experience shows in vivid terms what happens when ideology turns against government. Government either removed regulations, failed to generate new regulatory regimes suited to our times, or simply looked the other way. It began to dismantle Glass Steagall in the 1980s; it refused to regulate derivatives in the 1990s; and it refused to stop mortgage deception and fraud in the 2000s.

The American story is also very relevant to Europe. While the United Kingdom and other European countries never fully embraced the American economic and social model, they have been heavily influenced by it. Some of this influence was voluntary, with many policy makers impressed by America's apparent economic success. But policy makers also often felt they had little choice, their options increasingly restricted by the forces of globalisation and pressure from vested interests.

Now the debate has shifted, and this is a relief. Governments can be credited with averting another 'Great Depression' by using Keynesian stimulus policies. But more government is not just the right response in moments of crisis; more government is also needed to rebuild an economy *after* the crisis. As European economies face up to the challenges posed by ageing populations,

climate change and increased competition from China and India, it is government that will need to take the lead in equipping individuals, communities, businesses and society as a whole to compete in the global marketplace.

That of course means it is not just more government that we need. We need *better* government as well. How to deliver better government is no easy question to answer. But if we return to the American experience, we can see that governments are a transformative force when they increase spending particularly on infrastructure, education and healthcare. European countries should never have followed America's lead when it came to rolling back the state in the 1980s and 1990s. A closer reading of American history shows that when Americans lose faith in government, they not only lose ground socially but economically too. It is time to restore sense and a reasonable reading of history, otherwise, we risk endangering social equity, prosperity and even democracy.

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