

ISSUES IN PERSPECTIVE

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The Role of the US Government in the American Economy

The 2012 presidential election campaign should be about the role of the US government in our economy. In this edition of *Issues*, I want to focus on a brief history of that role and then detail the present role of the US government.

- First a historical review. Columnist David Brooks has written an insightful essay summarizing the role of the US government in our economy. From the beginning of the republic, the national government has played a decisive role in the economy. It promoted industrial development in the 18th century, transportation in the 19th, communications in the 20th and biotechnology in the 21st. However, that role has been sharply limited. Alexander Hamilton saw the role of the national government as one to enhance national power, not to make individuals rich or equal. Hence, through the early 20th century, the followers of Hamilton stressed long-term structural development, not providing jobs right now. Building infrastructure, education and research facilities defined the role of the state in the American economy. There was a concomitant rejection of all efforts to divide the nation between haves and have nots. What Brooks calls “nationalism” emphasizes dynamism and opportunity more than equality, security and comfort. Brooks writes that “While European governments in the 19th and 20th centuries focused on protecting producers and workers, the US government focused more on innovation and education.” Hence, during this period, the US government consumed about 4% of the GDP and even during the New Deal was consuming only about 10%. In defining the role of the US government in our economy, this Hamiltonian approach (i.e., Brooks’s “nationalism”) is no longer viable. It ended in three phases: 1. Phase 1 was the Progressive era, during which regulations to protect workers and consumers were increased and government planners began to rationalize national life. 2. Phase 2 was the New Deal, which, to find solutions to the Great Depression, began to focus on dealing with present issues and difficulties. “People do not eat in the long run but eat every day,” was the dictum. The unintended result of that logic was the gradual abandonment of future innovation and development and a panacea to stress tax cuts and deficit financing for everything government did. 3. Phase 3 was the great Society of LBJ. To seemingly end poverty in America, LBJ made investments in health care for the aged, expanded Social Security and created an entire web of middle class subsidies—i.e., an entitlement culture. A government that was once energetic and limited was turned into an omnidirectional and fiscally unsustainable monster. This presidential election must be about the role of government in our lives. We will never go back to the Hamiltonian approach to government but we must ask and answer not whether government is good or evil but exactly what does government do? “Does government encourage long-term innovation or leave behind long-term debt for short-term expenditure? Does government nurture an enterprising

citizenry, or a secure but less energetic one?” These are the questions that must frame the 2012 election.

- Second, how should we think about the role that private equity firms, such as Bain—the firm Mitt Romney used to lead—play in our present economy? Is Bain an example of “vulture capitalism,” as President Obama charges? Over 40 years ago, corporate America was bloated, sluggish and losing ground to Japanese and European competitors. But financiers, private equity firms and certain corporate executives began a series of reforms that changed corporate America. It was a brutal time but American businesses emerged leaner and more efficient than ever. For these reasons, President Obama’s attack ads on Bain are grossly unfair and, quite frankly, misrepresenting the truth. For example, one ad accuses Bain of looting a steel company called GST—and then dismissing all of its workers. What is the truth? GST was in terminal decline long before Bain came on the scene. Its workforce had fallen from 4,500 to less than 1,000. It faced closure when Bain took it over in 1993. Bain then induced banks to loan it money and poured \$100 million into modernization. Bain held the company for 8 years. Finally, like so many other American steel companies, GST went bankrupt in 2001, several years after Romney had left Bain. As David Brooks comments, “This is the story of a failed rescue, not vampire capitalism.” As Reiham Salam has shown in an important article in the *National Review*, in any industry there is an astonishing difference in the productivity of leading companies and the lagging companies. Private equity firms like Bain acquire bad companies and often replace management, compel executives to own more stock in their own company, and reform company operations. Usually, they succeed. In fact, research worldwide shows that companies acquired by private equity firms are more productive than comparable firms. Quite definitively, corporate America operates much differently than it did 40 years ago. But the government-dominated sectors of the economy—especially education, health care and the welfare state—operate in astonishingly similar ways and are not efficient, lean or productive. They desperately need transformation!! This presidential election is about the need for widespread transformation in the government-dominated sector of the United States. Romney believes he can bring such transformation to this sector. President Obama sees no need to do so.
- Third, the 2012 election should also be about debt. The astonishing debt of the US government, the state and local governments, as well as the governmental debt of the European countries, is primarily due to the innate selfishness of people. One of America’s founders, James Madison, put it this way: “As there is a degree of depravity in mankind, which requires a certain degree of circumspection and distrust: So there are other qualities in human nature, which justify a certain portion of esteem and confidence.” In a democracy, people will vote for those who promise them the most without any sacrifice. The result of this process is an entitlement culture, which now defines America and all of Western Europe. Governments in both areas have made promises to the people of their respective states that they cannot fulfill. Madison warned that democracy needs a self-restraining ethos to survive. Without that ethos, he believed the American Republic would not endure. That self-restraining ethos no longer characterizes America. David Brooks writes: “Congress is capable of passing laws with borrowed money, but it gridlocks when it tries to impose self-restraint. . . . Western democratic systems were based on a balance between self-doubt and self-confidence. They worked because there were structures that protected the voters from

themselves and the rulers from themselves. Once people lost a sense of their own weakness, the self-doubt went away and the chastening structures were overwhelmed. It became madness to restrain your own desires because surely your rivals over yonder would not be restraining theirs.” The debt crisis in America now meshes with the political dysfunction of our democracy; we seem paralyzed! Until we come to grips with human depravity, which produces selfishness and self-indulgence, there is little hope for the great western democracies, let alone the US. For now, we seem to believe that human depravity is nonexistent and self-indulgence a basic right, which government then funds with debt. What a recipe for cultural decline and financial disaster. Especially in the United States, there is still hope that we can once again restrain and police our depravity, not feed it with borrowed money! May God grant us leaders who face this reality and act!

See the incredibly valuable series of essays by David Brooks in the *New York Times* (22 May, 29 May and 7 June 2012)