Introduction

I take my stand absolutely, where every progressive ought to take his stand, on the proposition that private monopoly is indefensible and intolerable.

—Woodrow Wilson[1]

The American economy of the 1990s was the envy of the world. More than 20 million jobs were created, investment and productivity soared, and the fear of inflation that had haunted policymakers for forty years almost disappeared. The key question is why.

The resurgent economy was glorious in part because it came after a dismal beginning. The decade began with unemployment rising above 7 percent, the painful level that had prevailed for long stretches during the 1970s and '80s. Worse, most economists believed that joblessness could not drop much below 6 percent without reigniting inflation.

From 1992 until 1994, the economy improved, but the mood of the country remained sour. It was seen as a "jobless recovery"—although in fact the unemployment rate was falling fairly quickly. Then, almost miraculously, by mid-decade the American economy became sunshine itself. The whole country surged, while once-feared economic challengers, Japan and Europe, were stagnant and stumbling. By the latter part of the decade, unemployment had dropped to 4 percent, its lowest level in over thirty years, yawning budget deficits had turned into surpluses, and inflation seemed to be a thing of the past.[2]

The 2001 recession was painful, particularly in contrast to what had gone before: The boom years had been so good that even a relatively modest

recession hurt badly. The tech-centered speculation in stocks started to collapse in early 2000. When the terrorist attacks on September 11, 2001, shocked the economy again, corporate profits dropped dramatically, investment fell off sharply, job growth stopped, and job losses accelerated. Unemployment rose from 4 percent in 2000 to a peak of 6.3 percent in June 2003 before edging slowly back down to 5.4 percent by mid-2004.[3]

The contraction of employment in manufacturing was especially sharp because the growth of consumer demand slowed while productivity kept rising. When productivity improves during periods of slow growth, fewer people are needed to produce the goods and services that are being consumed. High technology, telecommunications, and finance—the hottest sectors of the economy during the 1990s—took especially big hits in the first years of the new millennium.

Investors and retirees felt the pain, especially those who had believed that the high-tech boom would last forever and had ignored warnings to diversify their portfolios. The Dow Jones Industrial Average dropped from 11,500 in spring 2001 to a low of about 7,200 in fall 2002. While the Dow in 2003 regained much of the ground it had lost—and is over 10,000 as this book goes to press—the memory of the meltdown remains sobering.

The U.S. economy in 2003 and 2004 has been growing faster than most other advanced economies, despite a much more uncertain world, so the persistence of unemployment at a level that is well above what it was in 1999 and 2000 should not be too discouraging. Rather than believing that the economic performance of the 1990s is out of reach, we should understand why the economy was so good then—and what we can do to recapture the magic.

What made the record-breaking economy of the 1990s possible? Who created it—and how? Treasury Secretary Robert Rubin suggested in 1998 that the factors involved were many and varied, and that economic historians would still be identifying them decades from now.[4] Were the causes really so complex and unknowable? I believe not. This book argues that the answers to these questions are both clearly understandable and quite different from what most economists and political pundits have been saying. Most of these commentators, regardless of politics, give too much weight to policies that had relatively little to do with the success of the 1990s, while giving too little credit to the real causes.

A quick review of several of the most popular explanations for growth and prosperity is in order. The "supply-side" argument has been particularly popular with many conservatives, such as Dick Armey, a former professor of economics, who retired as majority leader of the House of Representatives in 2003. This perspective is very influential among Republicans in Congress and the George W. Bush administration.[5] For this group, low taxes, especially on interest, dividends, capital gains, and inheritance, are crucial to growth because they are sources of capital investment. The supply-siders believe that tax cuts enacted by President Ronald Reagan in the 1980s (like the so-called Kennedy tax cut enacted under Lyndon Johnson in the 1960s) led to surging investment and are the key to prosperity. They argue that the rebound from the 2001 recession is due to the tax cuts championed by President Bush and enacted in 2001, 2002, and 2003.

Another broad group looks to the Federal Reserve and its long-serving chairman, Alan Greenspan, for economic leadership.[6] This group is less influential than it was when inflation was a nagging problem in the 1970s and '80s. Its adherents, however, revere Greenspan and believe that the conquest of inflation and the prosperity of the 1980s and 1990s were principally the result of wise monetary policies pursued by Paul Volcker from 1979 to 1986, and by Greenspan, his successor.

A third group of economists, many of whom worked with the Clinton administration, have their own explanation for the booming 1990s. For decades, Democrats were seen as the party of government spending and budget deficits, hostile to business. In part to combat these perceptions, Democrats recently have emphasized that private investment surged and deficits turned into surpluses under Clinton. They argue that this was due to Clinton's willingness in 1993 to raise taxes on upper-income taxpayers and restrain the growth of some government programs, which led to lower interest rates and encouraged the record-breaking surge in investment. To stimulate the economy in 2004, they would raise taxes on more affluent Americans, reduce the deficit, and encourage investment in the United States while preserving some tax cuts for lower- and middle-income taxpayers.

A fourth group of analysts believes that the prosperity was the result of new technology. In this view, productivity surged during the 1990s

because investments in new technology made over previous years began to pay off. In other words, prosperity had little to do with particular policies or approaches, but was largely a nonpolitical, technical phenomenon.

These summaries greatly simplify more complex ideas, of course, but they capture the most important points. Despite large apparent differences, all have an essential common core: They stress broad policies that affect the whole economy—macroeconomics as economists call it—rather than policies that affect specific sectors and industries—microeconomics.

This book takes a different tack. I believe that policy decisions during the last thirty years that increased competition in individual sectors and industries are the most important forces behind America's prosperity. The secret of the 1990s and the substantial recovery from the 2001 recession lies not in broad policies relating to taxes and money supply but in more than two decades of bipartisan policymaking affecting specific industries, which ultimately made competition in these sectors far more intense. This fundamental approach to the economy—the promotion of competition in industry after industry—was more important than taxes, monetary policy, or even technology in making the prosperity of the 1990s possible.

Of course, sensible tax and monetary policies are important, as are efforts to keep government spending within bounds and to use tax money wisely. And new technology did, indeed, make a significant contribution. But it is impossible to understand why the American economy was so good in the 1990s—and why America did better than other countries—without understanding the role that more intense competition played. American industries as varied as automobiles, steel, telephones, airlines, trucking, finance, and retailing were far more dynamic than they had been in the 1960s and 1970s because of more vigorous competition within them, not because American tax and monetary policies or technology were better than those of other countries.

And there is a surprising political dimension to this story as well: Competition in industry after industry became more intense despite the strenuous efforts by powerful business and labor interests to limit it. These established interests wanted political leaders and the government to help them keep new competitors out, but by and large, they failed. The "special interests" threatened and begged, but they lost, and the country prospered as a result.

That is the surprising story of this book: hard political fights over the last thirty years were crucial to our success. The battles were often confusing, but in case after case, competition triumphed. Improving our performance will depend more on future efforts to expand competition in areas like health care and education, which are holding the economy back today, than on tax arrangements and changes in interest rates, which do little to make poorly performing industries more dynamic and successful.

What kinds of policies are important? Our recent experiences offer clear guidance:

- The auto industry and the rest of American manufacturing would never have modernized had it not been for trade policies that encouraged both competition from imports and greater foreign investment in the United States. Such policies will be just as important in the future, and the fights will be fierce.
- Key industries like transportation, communications, and energy were fundamentally changed by legal, regulatory, and legislative decisions that increased competition. These industries would never have changed if political battles had not been won by the advocates of greater competition. Clearly, similar policies encouraging price competition and new competitive entrants in other sectors of the economy will be vital to prosperity in the future.
- Strong enforcement of antitrust laws starting as early as the 1950s and '60s also helped increase competition in manufacturing, the regulated industries, financial markets, and retailing and opened these areas to new entrepreneurial firms. Antitrust lawsuits, for example, led to the end of fixed brokerage rates, opening up financial markets, helped new entrants break the AT&T monopoly, and made it impossible for established retailers to keep new competitors out. Antitrust will have to play a similar role in the future to maintain these gains and to create similar ones in sectors where competition is still weak.

In sum, a variety of policies and political decisions affecting specific sectors of the economy forced American businesses to compete more vigorously in the 1990s than they had earlier. This changed the way business had to be done in the United States, encouraged investment that increased productivity, and made low unemployment possible without triggering inflation. These policies were the key to prosperity. These fundamental changes also made the American economy the envy of the world, and forced the Japanese and Europeans to follow this model. Neither America's overseas rivals nor Americans, who often overestimate the power of special interests, fully appreciate how successful the country's flexible political system was in making established interests do what they did not want to do—or how important this willingness to challenge entrenched interests will be in the future.

The failure of most analysts of the economy to give credit to the role of policies that forced businesses to compete is especially bizarre because the conviction that competition is the key to prosperity dates back to Adam Smith and his great work, *The Wealth of Nations*. It also is no exaggeration to say that America was built upon the idea of competition in politics, and that the Founders understood competition's importance in economics. The Founders made competition—the clash of "opposite and rival interests," as they called it—the keystone of the American system of government, and they knew it would be central to economic prosperity as well.[7] Their aim was to set limits on economic as well as political power, and they understood that checks and balances in governmental institutions had a key role to play in preventing the abuse of both.

The American consensus on competition persisted well into the twentieth century. President Theodore Roosevelt, a Republican, made "trust-busting" a cornerstone of his approach. Woodrow Wilson, Roosevelt's Democratic rival, also was a great champion of dynamic competition. He fought to lower the tariff walls that kept foreign competitors out of our markets, and for the passage of antitrust laws. His aim was to use both foreign and domestic competition to liberate the country from the "trusts"—monopolies, in modern terms—that he believed were strangling creative entrepreneurs. Like Adam Smith and the Founders, Wilson also understood that competition would have to be defended by governments against attacks by powerful interests. But the Great Depression and World

War II shifted America's focus from competition toward the powerful effects of monetary and tax policies. The ravages of the Depression made it seem as though capitalism and the competition associated with it had failed the country and drove economists to look for other ways to promote national wealth and well-being.

The procompetitive policy changes in specific sectors that made the 1990s possible suggest that another round of rethinking is at hand. The success of the policies that made competition more intense between the 1970s and the 1990s indicates that such policies are still central to prosperity, and indeed that no country, industry, or enterprise works well without them. It also tells us that government has an indispensable role to play in making sure that private interests check and balance each other.

This book centers on the battles that began in earnest in the 1970s to make competition more intense than it had become during the immediate postwar years. It recounts the courageous efforts by American presidents and political leaders of both parties to help new competitors challenge entrenched business and labor interests—the Big Three auto companies and the United Auto Workers; Big Steel and the steelworkers union; AT&T and the Communications Workers of America; the trucking companies and the Teamsters union; the major eastern banks and financial institutions; and even powerful retailing interests and their employees and sympathizers who wanted to keep new competitors out.

New American entrepreneurs needed—and found—support in different parts of the political system to challenge the establishments. Ken Iverson built Nucor Steel in states far away from the old steel heartland. Jack "the Giant-Killer" Goeken started MCI in a corner of Illinois, but needed legal help from Washington to protect him from Ma Bell. Fred Smith of Memphis, Tennessee, founded Federal Express and helped open airlines to competition with Washington allies on his side. Financier Michael Milken beat out the established Wall Street financial houses and essentially invented junk bonds; he, too, had help. And discounter Sam Walton built Wal-Mart from a base in rural Arkansas into one of the largest corporations in America, fighting a host of status quo interests at every level. These men changed the way we do business in America, but they had allies in government.

Another sea change in American business was the erosion of the power of America's labor unions, whose strongholds usually were in industries

where competition was weak. Roy Siemiller, the president of the airline mechanics' union, beat President Johnson in the 1960s; but his union and others had lost power by the 1990s. They did not go without hard political fights, but the end result was that the industries that employed them grew faster, and consumers benefited.

There were political heroes—congressional leaders who held hearings, civil servants and regulators who listened and were persuaded that more competition would be good, and political appointees who told the powerful interests the bad news. They all worked with presidents in the 1970s, '80s, and '90s who took the political heat to make competition more intense. John Robson and Alfred Kahn at the old Civil Aeronautics Board led the fight (during the Ford and Carter administrations) to open air travel to competition. Republican Paul MacAvoy (working in Ford's White House) and Democrat Stu Eizenstat (in Carter's) both confronted the Teamsters in high dudgeon. And presidents Reagan, George H. W. Bush, and Clinton took political risks to face down powerful interests who wanted to limit competition.

In industry after industry, politicians and the American political system said no to the special interests that had seemed unassailable in the 1960s and '70s. By the 1990s, many of these battles were won—or at least, victory was in sight. Increased competition forced one sector of the economy after another to become more innovative, flexible, and productive. Competition in one area often led to competition in others. To thrive in this new environment, companies had to cut costs and prices, invest in new technologies, reallocate and reassign labor and capital, and become more efficient. Prosperity was the result.

These lessons are apparent when we look at what happened in each of these industries. If the past is any guide, they will repeat themselves. Political leaders will have to fight to maintain competition where it is strong now and to expand it in new areas, like education and health care, where it is still weak. Opposition to competition is always there, and new status quo interests will emerge and fight to handicap would-be competitors.

This book is organized to answer four basic questions. First: what happened? Chapter 1 compares two economies: the vibrant economy of the last decade, and the stagnant economy with high inflation and unemployment

of the 1970s. How had key industries and sectors changed, and what did those changes mean?

Chapters 2 through 6 detail how the changes took place in auto manufacturing, steel, transportation and communications, finance, and retail. It is essential we recognize who pushed for more competition, who opposed it, and how it became so much more intense by the 1990s.

Chapter 7 asks two perplexing questions: Given that competition is the most important idea in the last two hundred years of economics, and political competition (checks and balances) the most important idea in American politics, why have economists focused more on monetary and tax policies in recent years? And why do so many Americans continue to cling to the populist and Marxist myth that the special interests get what they want in America, when it is so clear that many of the most powerful special interests of the 1970s were vanquished by the 1990s?

Chapter 8 pulls together these themes and looks to the future. How can we maintain the productive, competitive environment that existed in the 1990s in the face of new economic and political challenges, and how can we bring genuine competition to health care, education, and other areas where investment and change driven by it could give the economy a real lift?

This is a big story about economic change, but it is not a technical treatment filled with economic jargon. The important changes that made the 1990s possible are not hidden in complex mathematical equations. They are clear to see when we examine the history of these industries. This book shows that an informal, almost ad hoc, competitive policy was the key to prosperity in the 1990s. It opened up huge areas of the American economy, created thousands of new companies, and gave millions of Americans work and a bigger piece of the American dream. The question is, what can we learn from this experience that will expand prosperity in the future and how can we apply it not only to parts of the economy that could slide back, but to other sectors that are not yet modernized?