A HOOVER INSTITUTION ESSAY

Reinvigorating Economic Governance

ADVANCING A NEW FRAMEWORK FOR AMERICAN PROSPERITY

JOHN F. COGAN AND KEVIN WARSH

> If old truths are to retain their hold on men's minds, they must be restated in the language and concepts of successive generations.
>
> —Friedrich Hayek (1960)

The American economy is among the most powerful forces for good in the history of humankind. The nation's economic engine has driven living standards to heights unimaginable at the nation's founding. Steadily advancing prosperity—bolstered by bursts of scientific and technological discovery—has expanded productivity and greatly improved the quality and duration of life.

The duty of this generation is to ensure that the American economy sustains its strength. And the purpose of this essay is to outline an economic governance framework, based on our nation's foundational principle of natural liberty, to meet the challenges of our day.

In the twentieth century, America's military played the decisive role in defeating the major global threats to liberty—the Central powers in World War I and the Axis powers in World War II. America's economic and military strength largely checked the advances of the United States' cold war adversary, the Soviet Union, which ultimately collapsed under the weight of a failed ideology.

America's story, however, is neither linear nor assured.[1] Too often, economic policy discourages work and investment, exacerbates inequality of opportunity, and stifles economic growth. And in the realm of national security, major armed conflicts in Korea, Vietnam, Iraq, and Afghanistan ended without clear American victories.

Nevertheless, for most of American history, each generation of citizens enjoyed a higher standard of living, a safer, cleaner environment, and a stronger, more secure place in the world. Today, however, America faces a formidable set of detractors with a seemingly forbidding set of questions.

Is personal freedom not suitable to the challenges of our time? Is economic liberty no longer resonant to a broad range of citizens, including policy makers? Is the United States unwilling, unable, or unworthy to champion sound principles of economics to other nations? Is the ascendant intellectual Left in the United States offering a superior policy mix? Is the ascendant East offering a superior alternative to that of the West? Is the failure to convey the principle of economic liberty simply a matter of parlance or persuasion or personage? Or is it something more profound?

Major pillars of US society—government, business, other private organizations—are failing to deliver on realistic expectations of the citizenry. Americans are losing faith in institutions of all sorts, making our common creed harder to sustain and economic progress more difficult to achieve.[2] We are, as described by our late colleague George Shultz, at a "hinge point" in history.[3]

Three major shocks of the twenty-first century—the September 11 terrorist attacks, the 2008 global financial crisis, and the 2020 pandemic and lockdown—exacerbated existing trends and undermined the American ethos. In each crisis, government policies that were once unthinkable became inevitable, owing ostensibly to the exigencies of the circumstance. The size and scope of government—and the rationale thereto—expanded mightily.

Today, individuals and businesses find themselves subject to more intrusive government edicts, a national debt that exceeds national income, less security, less liberty, and less assured prosperity.[4]

The growth of government encourages businesses, unions, and other interest groups to look increasingly to the state for favors, subsidies, and bailouts. Rent seeking weakens competition, stifles progress, and undermines faith in our political and economic institutions.[5]

Internationally, threats to freedom by authoritarian-imperialists are not some relic of the past. The postwar global balance of power is threatened on many fronts: Russia's overt actions to eradicate an independent Ukraine, Iran-backed terror attacks throughout the Middle East, and China's "wolf-warrior" activities in Asia. The vaunted "rules-based global international order" is not self-enforcing. Strong economic governance—and credible military might—underwrite liberty.

America is no longer the single hegemon. In China, the United States is confronting a powerful new rival: a strong and confrontational regime with massive economic resources and grand geopolitical ambitions. The Chinese leadership appears eager to engage in a great power struggle, ideological and otherwise. President Xi's own remarks to the Communist Party Central Committee in 2013 make clear China's goals for its place in the world:

> There are people who believe that communism is an unattainable hope. . . . Facts have repeatedly told us that Marx and Engels' analysis of the basic contradictions in capitalist society are not outdated. . . . The eventual demise of capitalism and the ultimate victory of socialism will require a long historical process to reach completion.[6]

Doubts abound—among allies and adversaries alike—whether American governance is equal to the task. China's leaders believe that America has entered a period of late-stage capitalism that, as Lenin predicted, will ultimately augur a socialistic revolution. The sentiment is not found exclusively among socialists. In 1942 Joseph Schumpeter expressed skepticism that an American-style free-market economy—including one that places value on hard work and strong ethics—could be sustained amid prosperity.[7] In his telling, capitalism's fruits invariably lead to its undoing.[8]

We strongly disagree.

America's foundational principles are well suited to overcome the nation's most pressing challenges. Our nation's past accomplishments are, of course, no guarantee of future prosperity. The past playbook is an imperfect guide, but it's a guide nonetheless. The country's tradition, culture, and history are key elements in the task of charting a stronger path for the twenty-first century.

In this essay, we proffer an economic governance framework that befits the country's new challenges. We seek to identify, synthesize, and explain the essential features of a robust economic governance regime. We employ a triptych as a means of organizing the framework's central elements. We judge that ideas, individuals, and institutions are the *sine qua non* of American prosperity. A sound economic governance framework liberates the individual, encourages the promulgation of new ideas, and ensures the proper functioning of institutions.

Ultimately, policy makers will need to propose substantive reforms in economic policy for spending and taxes, debts and deficits, supervision and regulation, trade and tariffs, and interest rates and money printing. But it is premature to promulgate the policy agenda until we understand and articulate the core tenets of an optimal governance regime. Then—and only then—will it be time to apply the framework with rigor to the particular economic policy challenges that confront a great nation at a time of great consequence.

The balance of this century should be one of rising living standards for our citizenry: increased material wealth to be sure; but also a freer, more just and expansive civil life; communities free from threats to speech, belief, life, and property; and greater opportunity for our fellow citizens to thrive no matter their initial station. A country marked by abundance, governed by values of hard work and decency, and secure from foreign adversaries.

The proposed framework is intended to help our country—and its citizens—achieve such prosperity.

Foundational Principles of Human Progress

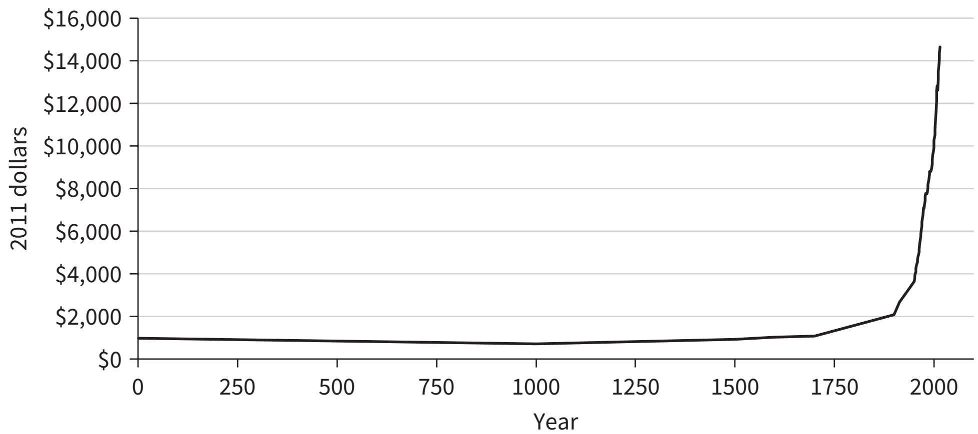
For most of human history, human progress was slow or nonexistent. Beginning with the Enlightenment in the eighteenth century, however, the pace of progress accelerated. As shown in figure 1, the acceleration continued through the Industrial Revolution to more recent years.

Before the dawn of the Enlightenment, world output per capita stagnated for hundreds of years. The Enlightenment ushered in revolutionary ideas about reason, progress, and civil society. Over the following three hundred years, world output per capita registered a tenfold surge.[9] These gains were widespread: extreme poverty rates fell globally (from over 80 percent in the early nineteenth century to about 10 percent at present).[10] The improvements go well beyond increases in material wealth. Since 1900, global life expectancies more than doubled.[11] Highly infectious diseases like smallpox, polio, and diphtheria were eradicated in most of the world.[12]

Essential, long-standing institutional arrangements serve as predicates for sustained human progress. These arrangements constitute the following foundational principles of prosperity:

- Private property rights
- The rule of law
- Free and competitive markets
- Limited government

Figure 1. Worldwide real GDP per capita



Source: Authors' calculations using the 2017 World Bank and Maddison data for global GDP (https://ourworldindata.org/grapher/world-gdp-over-the-last-two-millennia) and the estimated world population from *Our World in Data* (https://ourworldindata.org/grapher/population).

Private property rights allow individuals to reap the rightful rewards of their efforts. When broadly available, these rights provide society's members with the motivation to engage in productive activities that improve their quality of life. Absent established property rights, there is little reason for individuals to work or invest, inventors to create new products or find new ways of doing business, and entrepreneurs to establish new businesses. Property rights give individuals a powerful stake in society, auguring stability and growth alike.

The rule of law encompasses a system of clearly understood rules governing the bounds of permissible behavior. The rules are applied equally to all persons. They are fixed in advance of any transgression. Predictable and stable rules create greater certainty, thereby allowing individuals to prepare for the future. Such rules reduce frictions, allowing individuals to freely contract with one another to their mutual advantage. The rule of law also constrains arbitrarily intrusive actions by government authorities, which can interfere with the free exchange of goods and services.

Free and competitive markets are the essential means by which capital, goods, and services are efficiently sourced, produced, and allocated to their highest valued use. Free and competitive markets give individuals the opportunity to apply their talents, ideas, and skills to pursuits that maximize their well-being. They provide a level playing field in which efficiency and value creation are rewarded.

Governments serve a vital role in human progress beyond the promotion of a common defense. Governments enforce property rights, the rule of law, and competition. When governments go beyond these legitimate roles, however, they tend to weaken incentives to work and invest and reduce the efficiency of markets. Expansive governments are prone to violate the rule of law as rent-seeking activities become increasingly attractive.

Taken together, private property rights, the rule of law, free markets, and limited government provide the necessary incentives for the human condition to flourish. Indeed, the extraordinary rise in global living standards is the result of the widespread, albeit imperfect, adoption of these foundational principles.[13] Nations that abide by these foundational principles tend to achieve strong, sustained economic progress. Conversely, declining economic outcomes are associated with countries that failed to adopt these principles.

The foundational principles are embedded in America's constitutional framework.[14] America's founders devised a system intended to limit government interference in the realm of private activities. The Bill of Rights includes explicit protections for property rights and promotes the rule of law by prohibiting the infringement of enumerated rights. The Constitution's checks and balances further seek to limit government by dividing power among the branches of government. The Constitution also created two levels of sovereigns, dividing power between the states and the federal government. "Dividing power between a single federal government and, now, fifty state governments makes it difficult to achieve the unified economic planning" currently in vogue, notes constitutional scholar John Yoo.[15]

The Constitution recognizes that only a small number of powers are best executed by the federal government. For example, the Constitution's enumerated powers authorize Congress to provide essential public goods such as defense. They also assign Congress the responsibility to establish a system of intellectual property rights.[16] Much of the remainder is reserved for state and local governments.

Federalism helped protect people's liberty. And the courts established themselves on the front lines to protect individual rights.[17] A constitutional framework of dispersed power and limited authority has proved necessary but insufficient to ensure the success of the republic.

As the American experience with slavery and its aftermath demonstrates, ideas in the Constitution have not always been followed in practice. The principles, however, have served as guideposts to subsequent policy makers as they amended the founding document—and amended behavior—to right injustices. The nation's commitment to its foundational principles has yielded unrivaled economic gains.[18]

Most conceptions of civil society are predicated on a view of human nature. The Founding Fathers did not expect the citizens of the new republic to be angels. Nor did they consider the people who sought a new life in a new land to be intrinsically brutish. The new Americans were seeking comity and contentment in a civil society.

America's constitutional design and civil order were designed to incline the individual toward good. As Condoleezza Rice argues, "Civil society strengthens democracy by encouraging citizen participation, fostering democratic values, advancing the general welfare, providing for public goods, and counterbalancing the government."[19] Unfortunately, commitment to this design and its founding principles appears to be waning.

Reestablishing a firm commitment to our founding principles is essential to ensuring economic progress. A sound economic governance framework is also required.

A New Framework for Economic Governance

Building on the tradition of the country's founding, we set forth a framework to consider the proper governance of economic policy. It complements America's constitutional design and the tradition of freedom in political and civic affairs. It is clear-eyed about the connection between expanded liberty and stronger economic outcomes.[20] It is equally clear-eyed about the distinct role of private individuals and public institutions in ensuring strong, sustainable economic growth.

The governance framework relies on historic experience that shows a robust civil society is needed to ensure that free markets promote the common good. The triptych—ideas, individuals, and institutions—seeks to cultivate virtue.[21] The most important laws of the land aren't posted in the town square, but the qualities of prudence, diligence, kinship, and comity are found there. These micro-foundations of civil society lower transactions costs and engender strong community.

A "system of natural liberty" is at the core of the proposed governance framework.[22] It best captures the sum of human choices about the good life and the good society.[23] It is a network of free and voluntary exchanges in which producers work and exchange their products for the products of others through prices arrived at voluntarily. Participants are free to engage with others. Tens of millions of exchanges in goods and services happen every day. As a consequence, living standards are improved. And frictions are reduced by individual traits considered by some as old-fashioned and out of favor: humility, restraint, comity, and diligence.

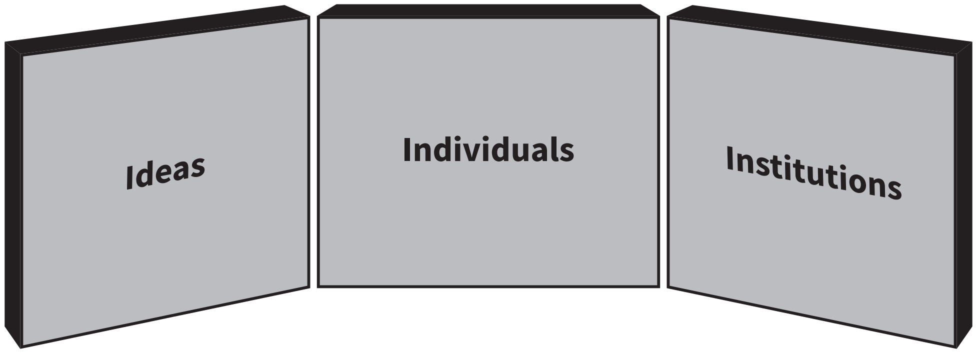
Adam Smith's *Theory of Moral Sentiments* (1759) preceded his more prominent *Wealth of Nations* by seventeen years. It also served as the moral basis for the free-market system he championed. Smith was no laissez-faire zealot.[24] He believed that a system of natural liberty delivers benefits when its rules are respected, private property is secured, and contracts are honored. No less central to societal advance is morality, which is intrinsic to the human condition. The sense of right and wrong, prudence, and justice guide citizens as much as laws and regulations. The profit-maximizing individual is a rational being, but commonly constrained by conscience.[25]

* * *

A sound economic governance model is designed to maximize the bounties of our economic system by institutionalizing the foundational principles. The economic success of the American experiment is the result of the proper functioning of three separate but interrelated elements of an economic system:

- Ideas that maximize human welfare
- Individuals that choose to conduct their affairs consistent with their talents, preferences, and the best of society's norms
- Trusted institutions—distinctly public or private—with enumerated responsibilities and clear accountability

Figure 2. The triptych: human progress is a function of ideas, individuals, and institutions



New ideas, individual initiatives, and faithful institutions are integrated features of the American system, as shown by the triptych illustrated in figure 2. Ideas, individuals, and institutions can either reinforce or undermine one another. That is, the best economic ideas are consistent with the inherent motivations of the citizenry. And our institutions, private and public, should facilitate putting ideas into practice to optimal effect. Poorly functioning institutions—ones that are corrupt or unaccountable or overly burdensome—will undermine the incentives of individuals and reduce future prosperity.

First Principles of Economic Governance

Key governance principles flow from America's foundational principles.

Economics is about making choices in a world of imperfect information and limited resources.[26] Standard goods in classical economics are rival: as more people consume a good or service, less exists for others. Scarcity is a fact of economic life, but that doesn't mean that society is zero-sum.

The trading of goods and services makes society better off. So too does the joining of inputs to produce a more bountiful supply of goods and services. The advent of new ideas makes the hackneyed battle between managers and workers, labor and capital, and current consumption and future consumption a false and misleading framing. A proper economic governance framework promotes societal benefits from new ideas, individual initiative, and well-functioning institutions.

Ideas, unlike other economic goods, are special. They are pure, nonrival goods. They are scarce until they are developed. Once developed, they are not depleted by their use. That is, greater use by some people of the latest software, search engine, or mobile device does nothing to lessen the ability of others to use the product or service concurrently. The idea that motivates innovation becomes more valuable with its prevalence.

Ideas—if they are found, nurtured, and disseminated—fundamentally upend the conventional economic dialectic. New ideas will shape the contours of the twenty-first century, as they have throughout history. Paul Romer, among others, explains that the search for new ideas is at the core of economic progress.[27] And the development of technological improvement is determined by the system of economic governance.[28] Absent new ideas, high levels of productivity growth and potential output growth would be unattainable.[29]

Ideas are not just about technological breakthroughs. Ideas manifest themselves in myriad ways: a new blueprint to construct a bridge, a novel drug formula to prevent infection or treat the symptoms of a virus, a new way of doing business directly with customers, the reorganization of a supply chain to lessen frictions, a song that inspires.

If the next decades are defined by maximum idea generation—and if those ideas are diffused broadly—then the United States' growth prospects will be especially strong. Over the long term, an economy's output depends on the stock of knowledge.[30]

Economic policy, hence, should place the creation and diffusion of ideas at center stage. An economic governance model should incorporate the following truths about idea creation and discovery:

1. Free and competitive markets are most conducive to the creation and dispersion of the best ideas.

2. The discovery of new ideas produces higher living standards.[31] Censoring ideas, whether controversial or unproven, produces stagnation.

3. A dynamic, growing population is more assured to incubate more and better ideas.[32]

4. Economic dynamism is integral to the proliferation of ideas to ensure sustained economic growth.

5. Ideas, when mixed with human and financial capital, lead to increasing economic returns and greater productivity.

6. Permanent oligopolies are antithetical to the creation and proliferation of ideas.

7. Intellectual property rights, by allowing entrepreneurs to retain exclusive rights to their ideas and inventions for a time, create powerful incentives for innovation.

8. The market's price signals are precious, relaying vast amounts of information and providing key signals in the creation and dissemination of ideas. Price signals that are distorted or corrupted lead to suboptimal idea generation.

9. The dissemination of the best ideas increases economic output and standards of living broadly across society.

10. Once a system of idea generation is optimized, distributional choices should be considered by policy makers.

Ideas are not hiding underground like industrial commodities. They aren't the province of government largesse dispensed like fiscal or monetary stimulus. They arise, often mysteriously, from the minds of individuals.

Individuals are the core of civil society. Their talents, motivations, and decisions are key determinants of an economy's potential. What typical adults do as they set about their day matters immeasurably to the future prosperity of their country. A successful economic governance regime does not view the individual as indistinguishable from a group or as a mere cog in a machine; instead, it embraces the notion that individuals have beliefs, expectations, preferences, and ambitions, all shaped by civil society. Individual choices, hence, have significant effects on the path of the economy.

A successful economic governance plan maximizes the opportunity for individuals to pursue their objectives in civil society. The micro-foundations of the economy, including the learned behavior of the individual, matter more than broad macroeconomic policies. Small changes at the microlevel of economic governance portend large differences in macroeconomic outcomes.

A robust economic governance plan recognizes the following principles:

1. Individuals make the best decisions about their own well-being and the well-being of their families and communities.

2. Individuals, regardless of their place of birth or socioeconomic status, are essential contributors to a nation's productivity.

3. The development of human capital is essential to a society's flourishing.

4. Human capital (the sum of individuals' knowledge and abilities) and financial capital are more often complements than substitutes.

5. Societal welfare is improved significantly when individual merit determines advancement.[33]

6. Access to high-quality education expands human capital and idea generation.[34] It also broadens society's acceptance of economic dynamism.

7. Economic mobility contributes mightily to individuals' well-being and economic growth.

8. There is dignity in an individual's work that is not readily substitutable by income from other sources.

9. Individual responsibility is an economic and societal imperative.

10. Virtues minimize frictions in economic activity among individuals, proving essential to a sustainable, prosperous society.

The nexus between individuals and **institutions** can be determinative of a country's performance. Human agency affects institutions, and institutions affect human agency. The quality of a nation's institutions is more important than natural resource endowments.[35] The design of public institutions is a prerequisite for a country to achieve its potential. Private institutions, or associations, must be given space and scope to rise organically from free individuals pursuing their common interests.

Economic prosperity demands faithful institutions, especially in a governance system that puts individuals and their ideas at center stage. Institutions serve important mediating roles in harnessing the ideas of individuals to the benefit of the broader economy. Yuval Levin rightly calls institutions "the durable form of our common life."[36]

Variations in the quality of institutions—and the policies that emanate from them—are responsible for significant cross-country differences in per capita incomes.[37] As Mancur Olson describes, "The intricate social cooperation that emerges when there is a sophisticated array of markets requires far better institutions and economic policies than most countries have."[38]

In *The Great Degeneration*, Niall Ferguson explains:

> Not all sets of institutions, when you add up the sum of the parts are equal. There are good and bad combinations. In some sets of institutions, people can flourish freely as individuals, as families, as communities. That is because the institutions effectively incentivize us to do good things—like, for example, inventing new and more efficient ways of working, or co-operating with our neighbors rather than trying to murder them. Conversely, there are institutional frameworks that have the opposite effect: incentivizing bad behaviors like killing people who annoy us, or stealing property we covet, or idling away our time.[39]

The best governmental institutions serve as effective intermediaries between the "will of the people" and sound policy. The best institutions are powerful, but their powers are not unbounded. An institution's leaders must scrupulously abide by its remit. The first query of the most faithful governmental institution is whether the authority to decide rests within the institution or belongs to another.[40] If it concludes that the power resides comfortably in the four corners of its remit—and that the use of the power is wise—then it should carry out its decision dutifully.

Individual freedoms and idea creation are most consistent with the institutional notion of subsidiarity. That is, to maximize economic liberty and optimize economic growth, society is best served when no central authority does what can be done by a more local authority. No public authority should exercise power better managed by a private institution. And no formal institution should make decisions better left in informal, ad hoc private hands.

The founders sought a governance model to allow for individual flourishing. Echoing the founders, Edmund Burke recognized that the good life is established mostly in "little platoons"—family, faith, and community—that incline citizens toward republican virtues.[41] Habits are formed, traditions are established, and the natural liberty of the individual is channeled to the betterment of society. Social capital is established in associations that bind the republic. In the absence of platoons, forces less benign take root.[42]

Chief among the responsibilities of governmental institutions is to enforce contracts impartially, without fear or favor. Another important responsibility is to carry out detailed rulemaking consistent with legislation formulated by elected representatives and signed by the president.

Private institutions—corporations, universities, media organizations, nonprofits—are fundamentally different from their governmental counterparts. Private firms are not state actors. They do not have the ability to command behavior; individuals must consent. In competitive markets, individuals have the right and ability to choose with which private institutions to conduct their affairs. Tocqueville admired the free-form "voluntary associations" that give vitality to civic affairs.[43]

Sound economic governance is undermined when private firms act as if they are quasi-public—that is, when the state commandeers private firms to provide governmental functions. Good governance is also undermined when private firms choose to integrate, or ingratiate themselves, with particular governmental actors with the objective of determining governmental policy.

When private firms take on governmental obligations, or act as government-like actors, sound economic governance is threatened. Some large, too-big-to-fail firms are backed implicitly by the full faith and credit of the US government. The arrangement privatizes profits and socializes losses. It harms market structure. It upends the economic system predicated on commensurate risk and reward.

Corporations that act with public missions tend to lose their private character altogether.[44] Rent-seeking and oligopolistic behaviors follow.[45] It becomes harder to extricate people from the institutional arrangements of quasi-governmental institutions.

A sound economic governance regime must be governed by strong, faithful institutions, distinctly private or public, guided by the following principles:

1. The best institutions maintain epistemic humility.
2. Constitutional limits—and capable, humble leaders—are required to limit the natural tendency of government institutions to expand their authority at the expense of private associations.
3. Institutional power should abide by the principle of subsidiarity.
4. The greater the power of a governmental institution, the more it must be held accountable.
5. Government institutions channel freedom and liberty into rights and obligations.
6. Predictable policies from government institutions allow individuals and businesses to plan for the future and facilitate positive-sum economic transactions.
7. Strong private free-market-based systems demand strong, transparent, reliable, and accountable public institutions.
8. Institutions of all sorts should have the freedom to act within well-defined frameworks.
9. Institutions need a credible *ex ante* framework to manage problems that inevitably arise.[46]
10. To be trusted, institutions must be trustworthy.[47] And to be trustworthy, institutions must be competent.

In sum, a sound economic governance plan liberates the individual, encourages the promulgation of new ideas, and ensures the proper functioning of institutions.

Current Governance at Odds with the Model Framework

A governance framework should not be judged by some utopian standard, which exists only in the mind's eye. It must be judged against real alternatives that have been practiced or are currently observable.

Even prior to the recent Russian invasion of Ukraine, three great shocks of the twenty-first century—9/11, the global financial crisis, and the coronavirus pandemic—left an indelible mark on the country, not least in lives lost and opportunities missed. Under the cover of exigent circumstances, ideas about individual freedom were upended, the role of the individual at the core of society diminished, and the established role and responsibility of institutions distorted. The cumulative effect risks fundamentally undermining American economic prosperity.

The coronavirus and the great lockdown may be the most consequential shock to American-style governance. It is difficult to gain perspective from events that are so immediate. The risks to liberty and prosperity of excessive government control should not be minimized. And in spite of the strong improvement in the economy, there is modest and belated pullback to date in “emergency” actions.

The pandemic and great lockdown is manifesting significant further deviations from the model governance principles. Not least, the surge of COVID-19 has revealed a lack of epistemic humility among policy makers. The expanded scope of federal government policies is affecting the incentives for individual initiative. Significant encroachments on state and local authority are threatening to upend the constitutional design. Mission creep by public and private institutions is conflating responsibilities and lessening accountability.

The deterioration in the country’s long-term fiscal outlook is weakening the nation’s medium-term resiliency.[48] The redistribution of power to the bureaucracy is making our elected leaders less responsive and our prized institutions more vulnerable to improper influence. The dismissal of ideas based on a collective ideology makes society less healthy and less prosperous. And the diminishment of individual freedom—whether in the name of group rights or collective needs—undermines the nation’s founding ethos.

What are the particular implications?

First, deviations from sound economic governance principles coincide with weaker economic output and outcomes, which invariably lead to calls for still more deviations from these principles. The biggest problem with statism is getting stuck in it. Nicholas Eberstadt describes the dynamic: “We are all too likely to temporize our way into a nightmare: an American future defined by a crushingly expensive social corporate welfare state, a stagnant politicized economy, and deep permanent financial dependencies on officialdom.”[49]

Second, as the federal government has grown, politics increasingly infects more aspects of daily lives and the common culture. The founders sought to lower the pervasiveness, if not the aspirations, of politics.[50] But, the tendency of politics to enter the boardroom, the factory floor, and the kitchen table with increasing vigor crowds out civil society. Citizens are coming to expect too much of politics and too little of themselves.[51]

Third, republican virtues of humility, restraint, and tradition are growing out of favor. Civil society’s shared sense of community is on the decline. Arguments between Right and Left, these days, are more about group identity than individual reason, personage rather than principle. Mediating differences is becoming increasingly difficult.

Fourth, the more expansive state enhances the size and strength of the largest ostensibly private enterprises. They face less competition and more regulation, raising the barriers to entry by would-be competitors. Corporations that take on a quasi-public role do not fit a system of economic liberty well, nor do corporations that rely on the backing, implicit or explicit, of the US government. An economic governance plan that elevates idea generation, innovation, and competition is anathema to some of the largest, most established firms.

Fifth, the current policy regime weakens America's ability to win the great power competition of the twenty-first century. State-run capitalism might be China's model, but it is antithetical to the principles of economic governance herein described. Corporate-controlled capitalism is a close cousin of state capitalism.

Taken together, these deviations from sound economic governance create the risk of a significant loss of individual liberty, a diminishment of societal trust, and considerably less comity in social interactions. In sum, the chasm between the current economic regime and a sound economic governance plan is large and growing.

The Way Forward: A Work Plan

As Nicholas Eberstadt reminds us: "It is hardly too soon to start thinking about how we want America to look in the post-COVID-19 world."[52]

Reinvigorating American economic governance requires a renewed focus on ideas, individuals, and institutions. America's system of natural liberty isn't an obstacle to recovery; it's the indispensable element.

Absent a new and compelling vision for the country—backed by the best of the country's traditions, adherence to sound principles of economic governance, and ultimately, strong, reform-oriented economic policies—recent trends will only accelerate.[53] And the country that led the twentieth century with purpose and prosperity will cede that ground in this century to those with very different aspirations.

The period ahead offers more hope and more danger than any point in previous generations. The suppression of freedom may be the most important catalyst to its reinvigoration, as Milton Friedman averred in the 1970s. The future offers danger because if the challenge is not rebutted, society as we know it will be broken. But it offers hope because the trouble at hand is the most effective catalyst against the forces that want to restrict liberty.[54]

We should apply the proposed economic governance framework to existing economic policies. The objective is to judge whether the deviations from the framework are prudent or justified. If we encounter a large governance gap—and believe that a concomitant economic output gap and societal gap will result—then the task is to fix the errant policy.

Fiscal policy, for example, is ripe for rigorous review under the proposed governance framework. Government spending is projected to be a permanently larger share of economic output long after the pandemic subsides. And the nature of the spending surge will likely have significant deleterious effects on individual liberty, idea generation, and institutional responsibilities, all.[55]

The current fiscal imbalance is not just the product of the COVID-related federal spending and borrowing surge. It is a consequence of more than seven decades of fiscal profligacy. During the United States' first 140 years, the federal government adhered to the norm of a balanced budget. Budget deficits were incurred only in times of war and economic recession. When peace and prosperity returned, the federal government ran budget surpluses to reduce the public debt. Beginning in the 1930s, however, the federal government broke from this norm and the modern era of rising government spending, chronic annual deficits, and increasing public debt began. Long-held ideas about the limits of federal spending and financial prudency were discarded. In its place, a new fiscal ideology emerged, existing institutions buckled, and a new view emerged that large numbers of individuals were no longer judged able to provide for themselves or their families.

Are constitutional changes necessary to help restore fiscal prudency? Or are other means available? How important was the adoption and distortion of the ideas of John Maynard Keynes in creating chronic budget deficits? Can a return to a fiscal model based on classical principles rein in the growth of spending and debt? How can the federal budget process be changed to create the proper incentives within Congress and between the executive and legislative branches to limit spending to available revenue? How can federal entitlements be reformed to reduce dependency and work disincentives while still providing aid to persons unable to provide for themselves?

The conduct of monetary policy should also be subjected to strict scrutiny under the proposed framework. In recent years, we have witnessed a fundamental regime change in the governing doctrine. Under Chairman Jerome Powell, newfangled Federal Reserve policy is at odds with the prior forty years of precedent in the conduct of policy. The Federal Reserve has extended the scale and scope of its activities. Its imprint on the real economy and financial markets is unprecedented. And inflation is running at more than triple the Fed's price-stability objective.

An assessment of the consequences of the Fed's recent regime change—and the implications for ideas, individuals, and institutions—should offer important insight. What are the implications of persistently negative real interest rates on capital investment, and hence, long-term improvements in living standards? Does the Fed's continued backstopping of financial markets have significant effects on idea generation and industry structure? Is the Fed's purchase of more than half of the net new issuance of Treasury debt in 2021 consistent with its institutional independence?

We believe the economic governance framework should be applied with equal rigor to the full suite of economic policies that affect the nation: regulatory policy, health care policy, antitrust policy, and trade policy, to name just a few.

* * *

The twenty-first century is off to a rocky start, most recently evidenced by Russia's invasion of Ukraine. Perhaps the scale, scope, and frequency of the shocks have changed something in the American psyche. Or maybe our government's inability to predict or prepare for these shocks has altered something important in the political or societal ethos.

Some official economic measures of output and employment appear strong, but something is seriously wrong in the nation. US inflation is running at a rate not seen in forty years. National debt is now greater than national output. Approval ratings for major American institutions have fallen dramatically. Nearly 70 percent of all Americans believe the country is on the wrong track. The chasm is bigger and more consequential than a particular data point, or readily remedied by a particular piece of legislation.

The road to freedom is not one-way. The constitutional, civic, and economic guardrails that have long benefited the country are being tested. We have moved a great distance from being a shining city on a hill. And it's high time we reinvigorate a model of economic governance. We must explain—with both reason and vigor—the way out of this hole we've dug for ourselves.

Against revolutionary foment, it is incumbent on those who disagree with the new grand ambitions to stand up, not roll over. With gratitude for the inheritance comes duty. We have a duty to guard the truth and combat error.[56] We have a duty to renew the promise of the nation's founding ideals. We have a responsibility to affect our common destiny. To use human agency—and the ideals learned in the last centuries—to complete the unfinished work of America.

The challenges posed to America are markedly different from those posed in the past century. External threats to the United States are manifold: state-sponsored terrorism, stateless cyber threats, Russian aggression, a resurgent China upsetting the post–Cold War balance of power, nuclear proliferation. Internal challenges are no less serious: namely, ensuring that America's economic governance model is not replaced with something at odds with America's long-standing ethos.

The most formidable challenges, foreign and domestic, are within our own power to affect. In 1947, George Kennan outlined the latent but growing Communist threat. Notably, his call to action was less about the Soviets than about ourselves:

> [This] is a test of overall worth of the United States as a nation among nations. . . . The United States need only measure up to its own best traditions and prove itself worthy of preservation as a great nation. . . . The thoughtful observer of Russian-American relations will find no cause for complaint in the Kremlin's challenge to American society. He will rather experience a certain gratitude to Providence which, by providing the American people this implacable challenge, has made their entire security dependent on pulling themselves together and accepting the responsibility of moral and political leadership that History plainly intended them to bear.[57]

We should not overestimate the strength of our geopolitical rivals. Nor should we imitate them. Autocracies show well until they don't. Their outward projection of strength, unity, and oft-mentioned long-term orientation is by design. China's demographic challenges and the risks associated with a single point of failure are not easily camouflaged.[58]

It is a bigger mistake to underestimate America's strengths. The nature of the US economic and political system often shows less well than it performs. Economic and societal dynamism can be messy, but it belies still-strong micro-foundations.

If we meet the challenges before us, America has a bright future with strong, durable economic growth, abundant economic opportunities, vibrant and secure communities, and a healthy environment. Future generations will inherit a dynamic economy capable of delivering technological advancements that will extend lives and promote human flourishing.

The economic governance principles that drove American peace and prosperity should serve as guideposts to navigate the balance of the twenty-first century. If we choose to empower the individual, encourage the development and dissemination of new ideas, and ensure the fidelity of institutions to their mission, then the United States can once again be a beacon to the world.

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NOTES

1 The early twentieth century, for example, featured significant economic and political disruptions. David Brady recounts the history: "By the turn of the century, the thirty-year period of economic productivity and growth had ended. Free trade and the gold standard behind it were at risk. Many nations—including the United States—turned to protectionism, passing anti-immigration policies to keep jobs for native-born citizens. Income inequality and the wealth of bankers became core political issues." David W. Brady, "Globalization and Political Instability," *American Interest* 11, no. 6 (March 8, 2016), available at https://www.the-american-interest.com/2016/03/08/globalization-and-political-instability.

2 Niall Ferguson, *The Great Degeneration: How Institutions and Economies Decay* (New York: Penguin Group, 2014).

3 George P. Shultz and James Timbie, *A Hinge of History: Governance in an Emerging New World* (Stanford, CA: Hoover Institution Press, 2020). See also the tribute from Henry Kissinger: "George left us at a moment when our national arguments are too often vindicated by passion rather than reason, by the debasement of the adversary rather than uplifting of purposes." Quoted in Kissinger, "George Shultz Had a Wise and Discerning Heart," *Wall Street Journal*, February 10, 2021.

4 This trend is not new. In "Capitalism and Its Discontents," his 1998 Adam Smith Address, Michael J. Boskin noted how "economic downturns or other perceived market failures create great opportunity for misplaced *permanent* expansion of government's role in the economy." The speech is available at https://web.stanford.edu/~boskin/Publications/Capi-Disc.html.

5 Notably, the K–12 educational system is failing to prepare students adequately for the jobs of the new era. Entrenched interest groups block much-needed reform, while students and parents suffer. See Terry M. Moe, *The Politics of Institutional Reform: Katrina, Education, and the Second Face of Power* (Cambridge: Cambridge University Press, 2019). The long-term consequences are already evident in the vastly different education outcomes across school districts and communities.

6 Full text released by China in 2019, six years after announcement. See Matthew Pottinger, "Beijing Targets American Business," *Wall Street Journal*, March 26, 2021.

7 Joseph A. Schumpeter, *Capitalism, Socialism and Democracy* (New York: Harper and Brothers, 1942).

8 An analysis of Schumpeter's arguments can be found in Ferguson, *Great Degeneration*.

9 Max Roser, "Economic Growth: The World Economy over the Last Two Millennia," *Our World in Data*, https://ourworldindata.org/economic-growth#the-world-economy-over-the-last-two-millennia.

10 Max Roser and Esteban Ortiz-Ospina, "Global Extreme Poverty," *Our World in Data*, first published in 2013; last revised in 2019, https://ourworldindata.org/extreme-poverty.

11 Max Roser, Esteban Ortiz-Ospina, and Hannah Ritchie, "Life Expectancy," *Our World in Data*, first published in 2013; last revised in October 2019, https://ourworldindata.org/life-expectancy.

12 Max Roser, Sophie Ochmann, Hannah Behrens, Hannah Ritchie, and Bernadeta Dadonaite, "Eradication of Diseases," *Our World in Data*, first published in June 2014; last revised October 2018, https://ourworldindata.org/eradication-of-diseases.

13 See Douglass C. North, *Institutions, Institutional Change and Economic Performance* (Cambridge: Cambridge University Press, 1990), and Daron Acemoglu and James A. Robinson, *Why Nations Fail* (New York: Crown Business, 2012).

14 McConnell, for example, argues that the Constitution "rests on a philosophy of individual rights that is most consistent with liberal democracy and private property; and it contains a number of safeguards designed to foster a free and prosperous economy." Michael W. McConnell, "Socialism and the Constitution," Hoover Institution,

Socialism and Free-Market Capitalism: The Human Prosperity Project (August 20, 2020): 1, https://www.hoover.org/sites/default/files/research/docs/humanprosperityproject_mcconnell.pdf.

15 John Yoo, "Socialism vs. the American Constitutional Structure: The Advantages of Decentralization and Federalism," Hoover Institution, *Socialism and Free-Market Capitalism: The Human Prosperity Project* (July 16, 2020): 2, https://www.hoover.org/research/socialism-vs-american-constitutional-structure-advantages-decentralization-and-federalism.

16 Stephen Haber, "Innovation, Not Manna from Heaven," Hoover Institution, *Socialism and Free-Market Capitalism: The Human Prosperity Project* (September 15, 2020), https://www.hoover.org/sites/default/files/research/docs/humanprosperityproject_haber.pdf.

17 Yoo, "Socialism vs. the American Constitutional Structure."

18 Real GDP per capita is now twenty-two times higher than it was at the time of the founding. Literacy rates have risen from 80 percent in 1870 to over 99 percent today, and life expectancies have more than doubled since 1880. Data are from *Our World in Data*: https://ourworldindata.org/grapher/maddison-data-gdp-per-capita-in-2011us?tab=chart&stackMode=relative&time=1775..2016&country=~USA (GDP), https://ourworldindata.org/new-literacy-dataset (literacy), and https://ourworldindata.org/grapher/life-expectancy?tab=table (life expectancy).

19 Condoleezza Rice, *Democracy: Stories from the Long Road to Freedom* (New York: Grand Central Publishing, 2017), 44.

20 John Taylor explains this connection: "The principles of economic freedom are naturally intertwined with political freedom—speech, press, assembly, religion. Excessive government interventions and economic controls will tend to constrain people's freedom to speak out or take public political positions for fear of retribution through more interventions and controls." John B. Taylor, "Jumpstart the Economy!," Hoover Institution, *Defining Ideas* (June 6, 2012), https://www.hoover.org/research/jumpstart-economy.

21 A triptych—most commonly used in the arts—is a set of three associated panels intended to be appreciated together.

22 See Irving Kristol, *Two Cheers for Capitalism* (New York: Basic Books, 1978).

23 American-style governance is often likened by its critics to Randian capitalism and unfettered individualism. But America's system of natural liberty was not—nor has it ever been—tantamount to unfettered liberty.

24 Individual economic liberty and free markets were crucial attributes to the founding of the republic. But *capitalism* was not commonly used to describe the US economic governance system. Nor is the term found in Adam Smith's *Wealth of Nations* when first published in the United Kingdom around the same time. The term was popularized by Karl Marx, some half a century later. No wonder capitalism gets such a bad name.

25 Berkowitz notes that "all political societies depend on the practice of virtue and the preservation of core values, but perhaps none more so than a liberal democracy, where equality in freedom enables individuals to live by their own lights and gives them large scope for making bad choices and indulging silly or false opinions." Peter Berkowitz, ed., *Never a Matter of Indifference: Sustaining Virtue in a Free Republic* (Stanford, CA: Hoover Institution Press, 2003), xix.

26 Taylor, "Jumpstart the Economy!"

27 Paul M. Romer, "Endogenous Technological Change," *Journal of Political Economy* 98, no. 5 (October 1990): S71–S102.

28 See Charles I. Jones, "Paul Romer: Ideas, Nonrivalry, and Endogenous Growth," *Scandinavian Journal of Economics* 121, no. 3 (June 13, 2019): 859–83, https://doi.org/10.1111/sjoe.12370. See also Schumpeterian growth theory in Philippe Aghion and Peter Howitt, "A Model of Growth through Creative Destruction," *Econometrica* 60, no. 2 (March 1992): 323–51.

29 Classical economics measures potential growth as the product of population growth and productivity growth. (See Romer, “Endogenous Technological Change.”) By example, Moore’s law—the doubling of the density of computer chips every two years—is, of course, no law. It’s the repeated result of the application of researchers and ideas to sustain an exceptional rate of performance improvement. By some accounts, it is getting harder to achieve. The number of engineers required is considerably larger today than it was in the 1970s. Studies suggest a decline in the rate of idea generation per person, including in chip design. In this example, more people are added, causing trend productivity and potential growth to fall. The benefits of a burst of new ideas could potentially make Moore’s law more readily achievable over time.

30 Jones, “Paul Romer,” 861.

31 See Charles I. Jones, “Taxing Top Incomes in a World of Ideas,” NBER Working Paper 25725, National Bureau of Economic Research (April 2019), https://web.stanford.edu/~chadj/toptax.pdf.

32 Cochrane makes a similar point in explaining the importance of globalization: “Growth comes from ideas, ideas are hard to come by, and expertise is specialized. The more people you are connected with, the more you grow.” John H. Cochrane, “Trade and Immigration,” in *Blueprint for America*, ed. George P. Shultz (Stanford, CA: Hoover Institution Press, 2016), 109–25.

33 See Adrian Wooldridge, *The Aristocracy of Talent: How Meritocracy Made the Modern World* (New York: Penguin Random House, 2021).

34 The economic gains from high-quality education are significant. For example, Hanushek and Peterson find that the “growth dividend” from raising US test scores to Canadian levels “has a present value of $77 trillion over the next 80 years.” Eric A. Hanushek and Paul E. Peterson, “The Vital Link of Education and Prosperity,” *Wall Street Journal*, September 11, 2013, https://www.hoover.org/research/vital-link-education-and-prosperity.

35 See literature related to the “resource curse” and compare with the success of Singapore, once starved of natural endowments.

36 Yuval Levin, *A Time to Build: From Family and Community to Congress and the Campus, How Recommitting to Our Institutions Can Revive the American Dream* (New York: Basic Books, 2020), 19.

37 “The only remaining plausible explanation is that the great differences in the wealth of nations are mainly due to differences in the quality of their institutions and economic policies.” Mancur Olson, “Big Bills Left on the Sidewalk: Why Some Nations Are Rich, and Others Poor,” *Journal of Economic Perspectives* 10, no. 2 (Spring 1996): 16.

38 Olson, “Big Bills Left on the Sidewalk,” 22.

39 Ferguson, *Great Degeneration*, 18.

40 In his dissent in *Bostock v. Clayton County, Georgia*, Justice Brett Kavanaugh explained: “Like many cases in this Court, this case boils down to one fundamental question: Who decides?” 140 S. Ct. 1731 (2020).

41 Edmund Burke, *Reflections on the Revolution in France* (London: James Dodsley, November 1790). Burke believed that those who fomented the French Revolution were harming civil society. In contrast, the traditions imparted by one’s predecessors are “necessary to cover the defects of our naked shivering nature.” The status quo can be improved upon, but “very plausible schemes, with very pleasing commencements, have often shameful and lamentable conclusions.” He averred that “it is with infinite caution that any man out to venture upon down an edifice which has answered in any tolerable degree for the ages the common purposes of society.” See also Harvey Mansfield, “Edmund Burke,” in *History of Political Philosophy*, ed. Leo Strauss and Joseph Cropsey (Chicago: University of Chicago Press, 1987).

42 In recent years, social media has filled the vacuum left by the erosion of Burkean platoons.

43 See chapter 29 in Alexis de Tocqueville, *Democracy in America*, trans. and ed. Harvey C. Mansfield and Delba Winthrop (Chicago: University of Chicago Press, 2000).

44 Irving Kristol, *On Corporate Philanthropy* (Washington, DC: American Enterprise Press, 1977).

45 George P. Shultz, Michael J. Boskin, John F. Cogan, and John B. Taylor, "Cheated by Collectivism," *Hoover Digest* (Hoover Institution), no. 3 (August 4, 2020), https://www.hoover.org/research/cheated-collectivism.

46 Mervyn King, *The End of Alchemy: Money, Banking, and the Future of the Global Economy* (New York: W. W. Norton, 2016).

47 Kevin Warsh, *Transparency and the Bank of England's Monetary Policy Committee* (London: Bank of England Press, 2014).

48 The decline in the long-term fiscal outlook applies to federal, state, and local governments. While the federal debt picture is widely known, Rauh estimates that the state and local government employee pension programs are underfunded by over $4 trillion. Joshua D. Rauh, "Hidden Debt, Hidden Deficits: The 2019 Update," Hoover Institution press release, June 11, 2019, https://www.hoover.org/news/hidden-debt-hidden-deficits-2019-update.

49 Nicholas Eberstadt, "Restore America's Promise as the Crisis Subsides," in *Governing Priorities: Advice for America's President for 2021 and Beyond*, ed. Yuval Levin (Washington, DC: American Enterprise Institute, 2020), 6, https://priorities.aei.org/restore-americas-promise-as-the-crisis-subsides/.

50 Francis Fukuyama, "Liberalism and Its Discontents: The Challenges from the Left and the Right," *American Purpose* (October 5, 2020), https://www.americanpurpose.com/articles/liberalism-and-its-discontent.

51 For example, Fiorina argues that "governments today are expected not only to provide peace and prosperity, but to attain social justice, to right all wrongs. And there seems to be no end to the discovery of new wrongs." Morris P. Fiorina, "The Democratic Distemper," *Governance in an Emerging World* (Hoover Institution), no. 719 (Spring 2019), https://www.hoover.org/research/democratic-distemper.

52 Eberstadt, "Restore America's Promise," 6.

53 See Matthew Continetti: "Until the defenders of the Founding are able to explain, in language persuasive to every American, why both constitutionalism and republican virtue are necessary for freedom and order and justice, they will continue to be on the defensive. . . . They had better get started reaffirming and demonstrating the moral basis of American civilization." In "American Civilization and Its Discontents," *Washington Free Beacon*, June 5, 2020, https://freebeacon.com/columns/american-civilization-and-its-discontents.

54 Milton Friedman and Rose Friedman, *Free to Choose* (New York: Harcourt Books, 1980).

55 John F. Cogan, *The High Cost of Good Intentions: A History of U.S. Federal Entitlement Programs* (Stanford, CA: Stanford University Press, 2017).

56 Michael Boskin argued in his 1998 Adam Smith Address: "Capitalism once again needs its defenders, teachers, exemplars, and champions."

57 George F. Kennan (as "X"), "The Sources of Soviet Conduct," *Foreign Affairs* 25, no. 4 (July 1947): 582.

58 McMaster argues that the Chinese Communist Party "views its centralized, statist economic system as bestowing advantages." In response, "the United States and other free-market economies need to demonstrate the competitive advantages of decentralization and unconstrained entrepreneurialism while defending themselves from Chinese predation." Excerpt from H. R. McMaster, *Battlegrounds: The Fight to Defend the Free World* (New York: HarperCollins, 2020), in "China's Statist System Is No Match for Free Markets," *National Review*, September 24, 2020, https://www.nationalreview.com/2020/09/battlegrounds-hr-mcmaster-china-statist-system-no-match-for-free-markets.

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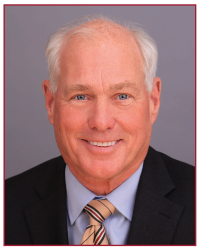
About the Authors



JOHN F. COGAN

John F. Cogan is the Leonard and Shirley Ely Senior Fellow at the Hoover Institution and a faculty member in the Public Policy Program at Stanford University. Cogan's research is focused on US budget and fiscal policy, federal entitlement programs, and health care. His book *The High Cost of Good Intentions* (2017) received the 2018 Hayek Prize.

KEVIN WARSH

Kevin Warsh is the Shepard Family Distinguished Visiting Fellow in Economics at the Hoover Institution and a lecturer at the Stanford Graduate School of Business. He is an advisor to Duquesne Family Office. Warsh has served as a member of the Federal Reserve's Board of Governors and special assistant to the president for economic policy.

Synopsis

The authors set forth a new framework to revitalize the governance of economic policy based on our nation's foundational principle of natural liberty. If we choose to liberate the power of the individual, encourage the promulgation and dissemination of new ideas, and ensure the fidelity of institutions to their mission, then the United States should significantly improve its economic performance and serve as a more formidable force in the world.

Hoover Institution, Stanford University
434 Galvez Mall
Stanford, CA 94305-6003
650-723-1754

Hoover Institution in Washington
1399 New York Avenue NW, Suite 500
Washington, DC 20005
202-760-3200

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