

NISKANEN C E N T E R

Policy Essay

THE CENTER CAN HOLD: Public Policy for an Age of Extremes

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Introduction

As the 20th century drew to a close, faith in America's political and economic institutions was buoyed by their undeniable superiority to rival systems. The great ideological debate of the century — totalitarianism versus democracy, central planning versus the market economy — had just been resolved decisively in our favor with the collapse of the Soviet Union and the abandonment of communism around the world. Meanwhile, among the market democracies, America's particular brand of capitalism was surging ahead of its main competitors. While Japan was limping through a "lost decade" and western Europe was struggling with chronic, double-digit unemployment, the United States' Internet-fueled boom of the 1990s was opening up dazzling new vistas of economic possibility. Such heady triumphs led naturally

enough to triumphalism: the American model, it seemed, was the end point of history toward which all other nations were converging.

How things have changed in two short decades. Today, faith in America's political and economic institutions is badly shaken by their undeniable failure to measure up — not to other countries, but to our own past. Dragged down by the Great Recession and its aftermath, economic growth during the 21st century has averaged only half the pace sustained throughout the 20th. Productivity growth has been anemic, and new business formation is in long-term decline. At the same time that the economic pie has been growing more slowly, the slices have been getting more unequal: The rise in income inequality over recent decades has ensured that the benefits of growth, such as it is, have gone mostly to a narrow elite at the top of the socioeconomic scale.

Combine the effects of slow growth with those of high inequality, and the result is nothing less than the fading of the American Dream. Back in 1970, over 90 percent of 30-year-olds were making more money than their parents did at that age; by 2010, that figure had fallen to 50 percent.¹ And as of 2017, only 37 percent of Americans expected their kids to do better than they did.²

These bare statistics only hint at the depths of our disillusionment. The failures of American government, business, and society have registered like a succession of gut punches: the miserable quagmires of Iraq and Afghanistan; the greed, folly, and outright criminality of the housing bubble; and the devastation of the opioid crisis, leading to a shocking decline in life expectancy for three straight years.

With this pileup of disappointments and betrayals, the American electorate's confidence in governing elites and established institutions has been coming unglued. The percentage of Americans who trust their government all or most of the time plunged from 44 percent on the eve of George W. Bush's inauguration in January 2001 to 18 percent at the end of 2017. Over the same time period, public approval of Congress, the central institution of American democracy, plummeted from 50 percent to 17 percent.³

This collapse in confidence has led to remarkable volatility, with wave elections for the Democrats in 2006 and 2008, Republican waves in 2010, 2014, and 2016, and another Democratic wave in 2018. Voters have lurched back and forth between Team Red and Team Blue in the desperate search for sound leadership. Further, the political appeal of anti-system candidates of the kind once relegated to the fringe has soared: Bernie Sanders, a septuagenarian self-described socialist, came close to getting the Democratic nomination in 2016; Republican voters generated boomlets for Sarah Palin, Michele Bachmann, Herman Cain, and Ben Carson before actually nominating Donald Trump. With Trump's flukish victory in the 2016 general election, Americans have now elevated an extravagantly unfit demagogue to the most powerful position on the planet.

This is the perilous juncture at which we now find ourselves. The remainder of the Trump presidency, however long it lasts, carries grave risks: a possible constitutional crisis at home over the Russia investigation or otherwise, and the threat of crises abroad — on the Korean peninsula or elsewhere — brought about by bluster and miscalculation.

Even if these dangers can be avoided, we must recognize that the deeper crisis of legitimacy for America's political institutions is already upon us. It began with Trump's nomination and was underscored by his victory: Neither of these events could have occurred in a healthy, stable, well-governed market democracy. The center is failing to hold, and the passionate intensity of our worst impulses is filling the vacuum.

No matter how alarming the abuses and incompetence of the present administration might be, we face the prospect of much worse. Without bold and effective leadership, the nation's real and serious problems — which are the ultimate cause of our deranged politics — will only fester and worsen. Which, in turn, will only increase the political openings for future anti-democratic demagogues — who, unlike Trump, may possess the self-discipline and focus to translate their dark designs into explicitly authoritarian usurpations. It is no exaggeration to say that the future vitality and integrity of American republican self-government now hang in the balance.

There is only one sure way to quiet our populist distempers and restore faith in democratic institutions, and that is for those democratic institutions to deliver effective governance. The failures of governance are what got us into this mess; public confidence in government will return only when government demonstrates through successful problem-solving that such confidence is merited.⁴

The challenge before us is as simple to state as it will be difficult to achieve: to restore the promise of the American Dream. In other words, the goal is the return of widespread economic opportunity and broadly shared prosperity, so that all Americans — not just a lucky few at the top —

feel that the rules of the game are working well for people like them.

Success in this effort will require not just new policies, but a whole new way of thinking about policy. The center can hold, but first it must be fortified with new convictions. There are, to be sure, many reasons why our political system has failed to address the mounting problems and dissatisfactions of the 21st century. But one crucially important and widely neglected factor is that the two prevailing ideological lenses, on the left and right, have gaping blind spots that render the most promising path forward invisible.

On economic policy issues, the traditional axis of conflict is “pro-government” on the left and “pro-market” on the right. Overcoming our present malaise, however, will require bold moves in both directions simultaneously. We need *both* greater reliance on market competition *and* expanded, more robust, and better-crafted social insurance.⁵ We need more government activism to enhance opportunity, and less corrupt and more law-like governance. To clearly see these needs and how best to answer them, it is necessary to use a new ideological lens: one that sees government and market not as either-or antagonists, but as necessary complements.

Idealism Without Utopia

Our approach to public policy begins with deep commitments to the basic liberal principles of a free and open society: individualism, understood as the belief that the ultimate standard for judging laws and policies is the dignity and welfare of actual, living, individual human beings; pluralism, or the recognition that there are many different conceptions of truth and the good life and that disagreement among reasonable people is therefore an inescapable fact of life; the rule of law; representative democracy; a competitive market economy; and a government that secures those collective goods that private efforts cannot supply well.⁶

To translate these broad principles into programs and policies, we believe there is no substitute for ongoing empirical investigation and critical scrutiny. In the United States and other advanced democracies, we are poised at the frontier of scientific, technological, economic, social, and cultural change. As a result, for many issues facing us the best path forward is far from obvious; we have no choice but to improvise and explore.

Although we hold to high ideals, we do not believe there is any clear theoretical blueprint for realizing those ideals in practice. Many political philosophers, and most adherents of well-defined political ideologies, believe that an ideal vision of the best social, economic, and political system serves a useful and necessary orienting function. The idea that a vision of an ideal society can serve as a moral and strategic star to steer by is both intuitive and appealing, but it is wrong.

To establish that a particular socioeconomic model is really best in terms of a chosen normative standard (e.g., liberty, equality, aggregate welfare), one must rank rival systems against that standard. A principled, nonarbitrary ranking requires evidence of what all these possible social worlds, including your favorite, would actually look like if they were realized. Otherwise you can't really say how these competing systems stack up, or that your favorite really comes out on top. Anyone committed to a radically revisionary ideal of the morally best society immediately runs into a huge problem: All our evidence about how social systems actually work comes from formerly or presently existing systems.

The greater the distance between an ideal vision of the best society and the historical examples that supply us with evidence about how social systems function, the more likely you are to be mistaken about how your ideal would work if it were realized. Which is to say, you can't know how it would really work, and therefore can't know how it stacks up against alternatives in terms of freedom, equality, social justice, national solidarity, or whatever it is you care about. If your favorite system is quite a bit different from any system that has existed, then even if it were true that it would rank highest in terms of your favorite

normative standard, you're probably not in a position to rationally believe it. Utopia is a guess.

There's little point in aiming toward a distant ideal when we lack sufficient reason to believe a more familiar alternative wouldn't be better. Counterfactual visions of the best society are more likely to lead us astray than to set us on the path of progress.

However, we aren't therefore condemned to do without ideals. We proudly uphold the broadly liberal ideal of the free and open society, but we do so without being committed irrevocably to some specific conception of ideal freedom and openness, or a specific vision of the social system that best realizes it. This doesn't mean we won't be able to recognize — or fight — corruption, oppression, and exploitation when we see it. You don't need a theory of the perfect shoe to feel where your shoe pinches, and you don't need a theory of perfect justice to grasp the injustice of the boot on your neck. We can make real headway toward a better society by spotting and rectifying the most obvious and egregious injustices. We don't need to know what awaits on the mountain's summit as long as we can tell the difference between “down” and “up.”

Emphasizing the minimization of cruelty and abuse, rather than relying on an orienting ideological lodestar, is how we combine moral idealism with a firm appreciation of the complexity of the social world and the limits of our knowledge. None of this means we shouldn't plot a positive course into the uncertain future. But it does suggest a modest, empirical, comparative approach to political economy and policy analysis. The best we can do is to evaluate existing social systems in terms of the values we care about, and see what we can learn.

Beyond Market and Democratic Fundamentalism

Our study of what actually works in the real world, and what doesn't, leads us to a set of principles that transcend the present-day polarization between a “pro-market”

right and a progressive, “pro-government” left. Our hybrid vision combines the best of both sides and marks us as clearly pro-market and pro-government simultaneously. In other words, we reject the current polarization as a false dichotomy. In our view, dynamic, innovative markets and strong, energetic government go together and cannot be separated.

Another way to put the same point is to say that we reject both market fundamentalism on the right and democratic fundamentalism on the left. In other words, we don't believe that either a well-functioning market economy or a well-functioning representative democracy is self-creating, self-executing, or self-sustaining. Market fundamentalists are prone to arguing that all you need to get markets up and running is to get government out of the way — in other words, the less government, the better. Democratic fundamentalists make the mirror-image mistake, arguing that all you need to get democracy to work better is to grant government more powers — that is, to shift more and more decision-making from private actors to officials of a democratically elected government. We, by contrast, believe that the functioning of both markets and democracy depends on how they are structured: The right structures produce good results, while the wrong structures can cause disaster.

We recognize that markets are creatures of regulation, law, and custom, not just the natural and spontaneous consequence of government inaction. Markets are products of design — for good or ill. When markets are well-designed, they can produce enormous advances in human welfare. But markets are very easy to design poorly. For instance, when we design markets that do not price the costs that a firm imposes on others — for example through pollution, or in finance through a failure to impose regulations that limit leverage — then we get far more of things that we don't want (like global warming and financial catastrophes). Environmental or financial regulation of this sort is not “anti-market”; on the contrary, it is essential to a properly constituted market where firms can't make excess profits by pushing off costs onto others.

When we sing the praises of “free markets,” we are focusing on certain attributes of economic activity under well-designed rules: free entry, free exit, free trade across national boundaries, freedom to hire and fire, freedom to take a job or quit, freedom to introduce new products or production methods without prior permission, and freedom to invest. We do not mean unregulated markets: The benefits of economic freedom are secured only within the context of a framework of rules designed to link the pursuit of private profit to the service of the public interest.

Our embrace of free markets stresses the central importance of competition — and the need for competition to be protected by the rules of the game. Capitalism does have some important tendencies toward collusion and excessive concentration, in large part because participants in a capitalist economy do not like competition. They will do everything they can — buy up potential competitors, break the law, lobby for constraints on their competitors, etc. — to avoid it. If you want competition, therefore, you need an active governmental bias in its favor.

Furthermore, there are many social goods where markets need a complex web of regulation, subsidy, and changes in customs or belief to work. Take education, for example. There is good evidence that charter schools work best in districts with a strong, relatively autonomous governing structure, rather than those characterized by a laissez-faire, anything-goes approach.⁷ That’s because educational competition, in the sense of light restrictions on market entry, needs a lot of social supports to actually function effectively. Effective educational markets require authorizers who, while being open to new providers, impose very strict rules on market exit for those whose schools do not work well (because, as it turns out, even bad charter schools will keep getting students). Successful districts also do a great deal to try to get parents to focus on the right ways to evaluate schools, which can be thought of as trying to inculcate a “market logic” in parents who may find this way of operating in the world scary or unfamiliar.

The question in all these cases is, given that markets are not necessarily natural or spontaneous, what are the rules and norms that will structure markets to produce, over time, the optimal social outcomes? We are in favor of having a political system that operates according to rules and limits discretion, but what those rules should be can only be assessed in the light of the outcomes they produce. Well-functioning markets and robust economic freedom thus require going beyond the minimal, night-watchman state.

We further distance ourselves from market fundamentalism by keeping at the center of our thoughts an insight that many on the right recognize but typically sweep to the side because it is so inconvenient. Regardless of the justice of our contemporary rules, people’s capacities, social standing, and social capital are inheritances of previous rules that may have been profoundly unjust. You can get very strong intergenerational transmission of subordinate status, therefore, even in the absence of contemporary unjust acts. Because we are citizens of a nation-state — that is, because we are members of a system of mutual cooperation over generations — we both benefit from the inheritances from the past and bear responsibility for the residue of past injustice. But because that process of inherited injustice cannot be fully traced — it is hidden by what Glenn Loury has called an “epistemological fog” — we cannot deal with it through tort-like remedies that make the victims of injustice whole and allow us to all just move forward.⁸ Instead, we need to operate with a strong presumption for widespread opportunity and an openness to redistribution.

Unlike some on the right, we are committed and ardent small-d democrats. We reject calls to put such strict constitutional shackles on government that virtually no regulatory intervention is even possible. This is partially because we think that the right to rule ourselves, within limits, is an important part of what it means to be free people. But it is also because we recognize that markets are institutionally constructed, in ways that cannot be fully constitutionalized, and therefore we have no alternative but to resort to political competition to help shape that construction. But just as we emphasize that markets are institutionally

constructed, so is democracy —and free-for-all democracy is no better than free-for-all capitalism.

This analytical symmetry distinguishes us from progressives, who are highly alert to market failures but much less focused on democratic dysfunction. Democracy works best when it is deliberative and aimed at the public good, but democracies have an intrinsic risk of devolving into a marketplace for favors and influence.⁹ In particular, democracies have a flaw in their DNA, which Mancur Olson recognized more than a half-century ago. If not properly designed, they will be far more sensitive to well-organized, smaller groups receiving small but concentrated benefits than to poorly organized, larger groups experiencing collectively high but diffuse costs.¹⁰ For example, local governments respond much more readily to coalitions of NIMBYs (“not in my back yard”) opposed to development on their block than to the much larger, but widely scattered population who care about access to housing at reasonable prices. Constraints on government to prevent it from responding to these concentrated interests are not anti-democratic — they can be what James Madison called a “republican remedy for the diseases most incident to republican government.”¹¹

In addition, democratic governments can sometimes produce more — or at least the wrong kind of — public action because politicians have an incentive to highlight the benefits of state action and hide or put off its costs. This is consistent with the incentives of the concentrated interests we just discussed. So, for instance, state governments for decades have handed over large pensions to state workers, which meant that they could pay them less in the short term while generating large obligations in the long term. Rules that require all pension obligations to be prefunded in various ways are not, therefore, anti-democratic — they are pro-democracy by ensuring responsible public deliberation, which requires that citizens balance benefits and costs.

Democracy without deliberative constraints also has a tendency to generate excessive complexity. American government is increasingly suffering from “kludgeocracy,”¹² the proliferation of

complicated, contradictory, ineffective, and inflexible policy mechanisms. In the American system, it is hard to get rid of old policies, but also hard to pass sweeping new ones. The result is the steady accretion of policies over time into an increasingly incoherent, incomprehensible mess that renders effective democratic responsibility impossible and, as Suzanne Mettler has so well described, alienates citizens from their government.¹³ What the modern state has in its favor over other actors is the ability to engage in big, straightforward interventions — clear rules, large systems of redistribution, etc. Rules that smooth the way for those kinds of interventions, while making the proliferation of small nudges harder, are also not anti-democratic — they ensure that when the state acts, it does so effectively and with a clear popular mandate.

While we are opposed to the kinds of sweeping substantive constraints on democratic government that some on the right favor, we vigorously support what we call deliberative constraints. Those are rules that correct for democratic pathologies, but without taking away from the people the right to rule themselves. Going back to the early 20th century, progressives have argued for an essentially normless governance of economic life. We believe that this is a serious mistake: Democracy, like the market economy, needs to be properly regulated to function effectively.

We agree with progressives that market processes — as well as the inheritance of past injustices — can generate levels of inequality that are fundamentally unjust as well as destabilizing. But we are much more cognizant than progressives of the reality that the state is a problematic vessel for the vindication of social justice. We endorse the insight of theorists like F. A. Hayek and Michael Oakeshott, as well as James Scott, that constraints on access to relevant information pose a serious problem for any form of centralized regulation and control.¹⁴ In addition, governments are characterized by multiple forms of agency problems. Coordinating the hundreds of thousands of employees of a complicated, modern state to achieve any objective is difficult, even when it possesses the requisite information.

Consequently, and consistent with our anti-kludge principles, we prefer government that acts through simple, rule-like, direct interventions to ones that attempt to plan societies from the center. We like carbon taxes, for instance, more than complicated command-and-control regulations to deal with global warming.¹⁵ We prefer refundable child credits and wage subsidies like EITC to much of the existing welter of anti-poverty programs.¹⁶

Finally, unlike more left-leaning progressives, we are ardent supporters of what Joseph Schumpeter called “creative destruction.” Bringing to market new technologies and creating new ways of organizing market activity are the essential engines of economic growth and social progress. That explains why we have such a strong preference for unencumbered market entry and aversion to rules that hinder it. And that is why we are more skeptical of corporatism — using the government to balance and coordinate the interests of existing social partners — than social democrats often are. We don’t think that new industries like app-based ride hailing should be unregulated, but we are opposed to forcing tomorrow’s business models into the regulatory straitjacket of yesterday’s businesses.

Creative destruction has a geographic dimension. It involves moving around the factors of production, including people, and having a strong preference against propping up existing firms or clusters of production. The United States is not very good at economic coordination, in the way corporatist states are, but historically we have been good at letting people and capital move to wherever the newest and best opportunities are. More recently, though, in part because of a range of poor policies — zoning restrictions, occupational licensing, complicated welfare-state interventions — we’ve been getting worse at promoting and sustaining creative destruction.¹⁷ Getting better means, in significant part, getting rid of a lot of government intervention that progressives typically defend, or at least are unwilling to create strong rules to constrain.

Why Free Markets and Social Insurance Go Together

Nowhere has the false dichotomy between “pro-market” and “pro-government” led to deeper confusion than in the ideological conflation of social spending and regulation under the banner of “big government.” To the ideologue, left or right, there is no distinction to be made. Regulation is just redistribution by other means, collapsing any lingering nuance about the quality or character of government into a single quantitative spectrum, with the forces for “more” on the left and “less” on the right.

We reject the current package deals and offer a new package of our own: the free-market welfare state.¹⁸ Our package reflects not the relative status we happen to accord to government versus market actors, but the clear evidence that a wide scope for economic freedom and robust social spending are complements rather than antagonists. Consider the economic freedom rankings produced by the “pro-market” Heritage Foundation and Fraser Institute.¹⁹ In keeping with anti-government ideology, these indexes pool indicators of institutional quality (like rule of law, protection of private property, and ease of doing business) with indicators of government size (like total spending and tax revenues as a percentage of GDP). Yet the component data of these indexes directly undercut the assumption that “big government” is bad for economic freedom: larger social transfers tend to correlate *positively* with other measures of free markets and good governance.²⁰ The freest economies generally feature big welfare states.

This situation is no accident. As Schumpeter noted, capitalism is creative and destructive at the same time. New technologies and patterns of trade disrupt old industries and institutions, making us enormously richer over time, but not without significant short-run costs. Social insurance programs — by far the lion’s share of modern government budgets — are the chief mechanism societies have developed for promoting economic

security in a way that doesn't sacrifice the dynamism of the market.

Consider that workers in agrarian societies never dealt with issues of transitional unemployment or labor-market mismatch. Instead, the firm and the family coincided, with a degree of social insurance provided by kin- and community-based networks. This changed with the industrial revolution and the enormous increase in the division of labor, which in turn created idiosyncratic unemployment risks and a variety of novel labor-market search and information frictions. Public unemployment insurance schemes proliferated throughout the early 20th century as a result, as private insurance failed in the face of large adverse selection problems.

Whoever first described a modern government as an insurance company with an army was therefore on to something. In America, government spending accounts for about 36 percent of GDP. Yet of this total, roughly 20 percent represents income transfers to retirees through Social Security, 22 percent is health care expenditures, and 6 percent is funding for safety-net programs. Thus 48 percent, or nearly half of what counts as government "size," consists of social spending on particularly hard-to-insure risks, from the risk of outliving one's retirement savings to the risk of catastrophic health care costs.²¹

"The more wealth we have, the more government we can afford," notes economist Tyler Cowen, describing what he dubs "the package deal of modernity."²² The indiscriminate opposition to social spending by many on the right rejects this package deal and is thus a political nonstarter. The comparative advantage governments have in pooling risk produces enormous utility for society as a whole and is unlikely to ever be unwound, at least not without enormous levels of gratuitous suffering.

Fiscal conservatives nonetheless have an important role to play. Americans should get all the government they are willing to pay for, but not more. Ensuring that government commitments are in line with available resources is an essential element of good governance. But rather than

slashing and burning social spending, or abolishing any risk-pooling function through misleading "privatization" schemes, a viable fiscal conservatism should interpret its role as defending programs like Social Security and unemployment insurance, ensuring their long-run integrity through prudent public finance.

Less is not always more in many areas of traditional conservative concern. While the 1996 welfare reform is often lauded for nudging able-bodied mothers into the workforce, research suggests as much as half of the observed effect stemmed from the simultaneous increase in the Earned Income Tax Credit.²³ Indeed, the concern that spending on the poor creates "poverty traps" as spending is withdrawn is often best mitigated by longer phaseouts that extend spending up the income scale. Conversely, a hard-line stance against new spending has the perverse effect of making off-budget regulatory solutions more attractive, from individual mandates to punitive sanctions against behaviors the structure of benefits has otherwise incentivized.

Although less is not always more, simpler is almost always better. Pushing back against "kludgeocracy" can bring enormous benefits, and health care provides one of the clearest examples. Between Medicare, Medicaid, Veterans Affairs, the exchanges created by the Affordable Care Act, and insurance provided through employers, the organizing principle of the U.S. health care system is impossible to discern. Instead, repeated attempts to close gaps in coverage with expedient, inelegant fixes, or "kludges," has produced a system of unfathomable complexity. The costs go beyond mere burdens of compliance. Our employer-based system, in particular, is the source of a great deal of risk aversion among employees who might otherwise switch jobs or launch a business of their own.

Contrast our health care status quo with the simplicity and efficiency of the federal government simply insuring against catastrophic health costs directly through a common high-risk pool. From a public option to reinsurance among private insurers, Universal Catastrophic Coverage comes in many forms. And despite accomplishing

the progressive goal of universal coverage, it has a strong conservative pedigree, with versions having been proposed by Milton Friedman, the libertarian economist, and Martin Feldstein, the chief economic adviser to Ronald Reagan.²⁴

It's worth reminding ourselves what is at stake in this discussion. In the face of inevitable shocks caused by creative destruction, political systems can be fundamentally destabilized in the absence of effective systems of social insurance. The contemporary rise in anti-market populism in the United States is a clear case in point. Following China's entry into the World Trade Organization in 2001, nearly 2 million American manufacturing jobs were displaced by Chinese imports, accelerating the deindustrialization of the Midwest. Careful research has shown a knock-on effect in terms of increased ideological polarization, growing nativism, and support for anti-trade political candidates. While globalization has raised millions of people out of poverty and created enormous benefits for consumers at home, it has also come with real costs. Redressing those costs through robust social insurance systems is as much a bulwark against rising populist tides as it is a simple matter of positive-sum economic justice.

While some blame our myopia on the economics profession, the textbook case for free trade always made clear the need for strong adjustment policies to ensure outcomes are truly win-win. We just didn't listen. As Edward Alden notes in his book, *Failure to Adjust*, the size of the American economy relative to the rest of the world allowed a certain political complacency about trade shocks to set in.²⁵ As a result, the funding and accessibility of critical programs like unemployment insurance and Trade Adjustment Assistance were insufficient to meet the challenges that arose. In the areas most affected by Chinese import competition, Social Security Disability Insurance was more than twice as responsive to falling incomes as UI and TAA combined, and not for lack of strict eligibility requirements.²⁶

Rather than seeing the China shock as a failure of trade policy, we ought to see it as an indictment of our inadequate social insurance system and the

small-government ideology that left us unawares. Preparing for the next economic shock, be it from trade, a recession, or rapid technological change, calls for major enhancements to our unemployment and income security systems, up to and including a dedicated federal funding stream for subsidized employment programs.

Without strong income supports that put a floor beneath displaced workers and systems that smooth the transition to new employment, political actors and the public tend to turn against the process of creative destruction itself. Put differently, a lack of social *protection* begets *protectionism*, as the quite reasonable demand for economic security is instead translated into popular support for trade barriers, inflexible labor regulations, industry bailouts, and precautionary impediments to new technologies, all of which conspire to further undermine economic security over time through sclerosis and stagnation. This is why countries with some of the largest welfare states also have some of the most dynamic private-enterprise systems, and vice versa. By filling in for missing insurance markets, a robust welfare state works hand-in-hand with flexible market processes to produce broad-based prosperity.

The American system is admired around the world for the unique way it rewards risk-taking and productive investment through, for example, a bankruptcy code that permits generous fresh starts and a corporate law that makes it easy for businesses to scale. But we must remember that there is nothing "natural" about these aspects of our legal institutions. They were design choices that, fortuitously, helped make America the richest and most innovative country on earth. We ought to see our social insurance systems through the same lens, and transcend the politics of austerity in favor of reforms that build on social insurance's complementarity with innovation and entrepreneurship.

All Regulations Are Not Created Equal

Like most on the right, we see free markets as the irreplaceable engine of economic and social progress. Free entry by new firms, free exit by struggling firms that are unable to serve customers cost-effectively, and free competition on price, quality, and product mix among existing firms combine to create the most powerful system ever devised for generating and applying social usefully knowledge. In this system, as new ideas are constantly introduced and tested, good (i.e., profitable) ideas are imitated and attract additional resources, while bad or outdated (i.e., unprofitable) ideas are abandoned and the resources they once attracted are reallocated to more productive uses. In this way, the overall productivity of labor and capital ratchet steadily upward, creating new wealth to translate into higher living standards and expanded opportunities for human flourishing.

Where we differ from many on the right is in our insistence that free markets are not spontaneous and self-executing, but rather the product of well-crafted regulations. Specifically, regulations are necessary to ensure that the ideas that are profitable in the marketplace really are good ideas — in other words, that they actually advance social welfare and make society richer than before. Good regulations, then, are what make Adam Smith’s “invisible hand” possible: They align the private interest of profit-seeking with the public interest of wealth creation. Without this crucial alignment, competition to serve customers better can easily give way to a ruinous scramble to extract wealth from the unwitting and powerless.

Accordingly, while the cause of free markets is frequently associated with “deregulation,” we reject that buzzword as too simplistic and indiscriminate. In general, we support market-perfecting regulations that correct market failures and thereby counter perverse incentives to impose harms and costs on others. Meanwhile, we oppose market-distorting regulations that affirmatively create market failures by blocking entry and limiting competition.²⁷

Sorting out which specific rules fall into which category is not always easy. Policies that appear to serve valid objectives of, say, protecting health, safety, or environmental quality may nonetheless fail to meet those objectives because of poor policy design or unanticipated interactions with other policies.

The problem of well-intended regulation gone wrong is of special concern in the case of emerging technologies. Since harms caused by under-regulation (injuries, deaths, property damage) are highly visible while those caused by over-regulation (firms or industries that didn’t grow or were never even established) are not, there is a tendency to jump the gun with anticipatory restrictions that aren’t actually needed. Further, because regulatory compliance tends to impose fixed costs, it imposes a disproportionate burden on newer, smaller firms; accordingly, regulatory overkill can end up suffocating new firms and industries in the cradle. We therefore support more flexible, “soft law” approaches than can address regulatory issues at the technological frontier without locking in rigid rules that are hard to update in a fast-moving environment.²⁸

At present, U.S. public policy is plagued by major deviations from optimal regulation in both directions. As to sins of omission (i.e., inadequate regulatory responses to market failures), the most important at present is the failure to respond appropriately to the looming and serious risks posed by climate change. Although both the timing and magnitude of the negative effects of man-made global warming remain shrouded in uncertainty, our ignorance is no excuse for ignoring the problem. The current best estimates show that significant annual losses on the order of 1 to 3 percent of global GDP²⁹ — and a similar range for the United States³⁰ — await us in the 22nd century, and there is a nontrivial possibility of truly catastrophic harms to persons and property.³¹ Sound principles of risk management, applied as a matter of course in other policy domains such as national defense, demand prudent actions now to hedge against the range of climate change’s possible downsides. We support a carbon

tax as the most efficient and market-friendly regulatory response. By putting a price on carbon emissions, a tax aligns the incentives of market actors with the societal goal of reducing climate risks more cleanly and comprehensively than any alternative policy mix of emissions controls and alternative-energy subsidies.³²

The biggest sins of commission, in which government overreach undermines economic performance, are not found in those policy areas most frequently targeted by advocates of deregulation. The usual suspects of regulatory excess (at least in the eyes of many on the right) are rules to protect health, safety, workers, and the environment — that is, rules that impose costs on existing businesses to advance social objectives (namely reducing harms and internalizing externalities). Those businesses regularly claim that the costs are excessive and that “regulatory relief” is therefore in order. While those claims are sometimes justified, sometimes not, the most serious problems lie elsewhere: not in rules that impose costs on existing firms, but rules that confer subsidies on those firms either through fiscal supports or, more typically, by blocking entry by would-be competitors.

The Captured Economy, co-authored by Brink Lindsey and Steven Teles, casts an analytical spotlight on the widespread and worsening dysfunction caused by what economists call “rent-seeking,” or the pursuit of profits through the political process by rewriting the rules to stack them in your favor.³³ Regulatory capture is broadly defined as insider domination of the policymaking process resulting in regulation for the benefit of the industry rather than the public. This dynamic has led to badly distorted policies that throttle innovation and growth even as they redistribute income and wealth to a favored elite at the top of the socioeconomic scale. The result is massive misallocations of resources ranging from the financial sector to health care to where Americans live and work, and a corresponding diminution of economic dynamism and opportunity.

The bloated and crisis-prone U.S. financial sector is the beneficiary of mammoth regulatory

subsidies, including tax preferences for both debt and saving, the Fed’s lender of last resort function, deposit insurance, and implicit guarantees for financial institutions deemed “too big to fail.”³⁴ These subsidies prop up and perpetuate a highly unstable system dependent on extreme levels of leverage — and thus dangerously sensitive to relatively minor fluctuations in asset values.³⁵ Having flung the barn door wide open, regulators then try to control the bolting cattle of excessive risk-taking with a web of highly complex and thus easily gameable restrictions. The result is regular flirtations with disaster punctuated by periodic cataclysms, with terrible consequences for both economic and political well-being. And between crises, the financial sector chronically wastes resources and sacrifices productivity gains by misdirecting capital to those uses where financiers can most readily take a cut.³⁶

Health care spending in the United States dwarfs that in other advanced countries while our life expectancy lags far behind the top performers. The runaway spending is driven by sky-high prices, which in turn reflect rent-seeking through the regulatory process. Patent law allows drug makers to jack up prices without actually innovating; occupational licensing and the medical profession’s control over medical education and training boost doctors’ incomes by restricting supply; certificate-of-need laws restrict the opening of new hospitals and other health care facilities, limiting competition and driving up prices; and perhaps most important, organized medicine’s influence over the arcane procedures of Medicare rate-setting (which then serves as a template for private insurers) inflates physician incomes and encourages overuse of highly expensive specialists.³⁷

Over the past several decades, economic innovation and productivity growth have become increasingly concentrated in big coastal cities and other “human capital hubs” — metro areas that contain relatively high numbers of college graduates. At the same time, however, rising policy barriers are making it harder and harder for people to move to where the jobs and opportunities are. Restrictive zoning and other land-use restrictions constrain new housing supply

and put rental and mortgage payments in the most desirable cities out of reach, while proliferating occupational licensing laws hinder interstate moves because most licenses don't transfer from one state to another. As a result of these barriers, income convergence between poorer and richer areas of the country is breaking down, causing big losses in national economic output. And in addition to hindering geographic mobility, licensing and zoning laws act as regressive income and wealth transfers, inflating professionals' incomes and bestowing windfalls on legacy homeowners.³⁸

Restoring the innovation and dynamism lost to regulatory capture will require deep structural reforms in the policymaking process. Although the details of appropriate reforms vary from case to case, what is needed generally is more open and inclusive decision-making in which all relevant interests, not just those of privileged insiders, receive due attention. Some possibilities include bolstering government's information-gathering and analytical capacities so that policymakers are not so dependent on self-serving information provided by regulated industries; greater philanthropic support for "countervailing power" in the form of activist groups and other nonprofits that can monitor and challenge rent-seeking across a broad range of policy domains; relocating decision-making authority to higher levels of government where a broader array of interests are taken into account; and heightened administrative and judicial review of regulatory decisions, especially when they are rendered in obscure venues without much broad-based input from the public.³⁹

Maintaining the Open Society

Because our policy vision so thoroughly scrambles the prevailing ideological categories of left and right, our worldview is hard to pin down with a handy, reductive label. Perhaps one will emerge over time, but for now we're happy for our combination of idealism about the ends of government, realism about the limits and downsides of government, and

pragmatism about how to advance our ideals in a pluralistic society to be intriguingly unclassifiable.

That said, we don't want there to be any mystery or confusion about the foundational ideals that inspire and inform our policy work. At the Niskanen Center, we are dedicated and unflinching partisans of what Karl Popper called the "open society": We believe in the equal moral dignity of every individual, the power of reason to guide human affairs, and the promise of peaceful cooperation and exchange among free and autonomous people.⁴⁰

These foundational ideals are now under sustained assault, not only in the United States but around the world. The wave of global democratization that followed the fall of communism is now in retreat, and authoritarian strongmen hold and are consolidating power from Russia to China to Venezuela and the Philippines. In the advanced democracies, authoritarian populism, overwhelmingly a right-wing phenomenon but also found on the left, is rapidly gaining strength on both sides of the Atlantic, at the expense of both center-right and center-left parties. Here in the United States, the illiberal outrages and abuses perpetrated by Donald Trump and his enablers include blatant corruption, racial and religious bigotry and divisiveness, incessant and shameless lying, and repeated attacks on the free press and independent law enforcement.

In the face of this dark menace, the Niskanen Center decided to expand its focus beyond policy analysis and reform. In November 2016, we started the Open Society Project to defend the philosophical and political foundations on which our system of government and social order stand.⁴¹ We have recruited scholars and intellectuals to restate the principles of the open society in terms relevant to contemporary challenges. We have joined and led efforts to defend the norms and institutions of liberal democracy against the corrosive onslaught of the Trump administration and its lackeys in Congress. And we have worked with other small-r republicans and small-d democrats to lay the groundwork for reviving a decent, constructive center-right.

Although the Open Society Project represents a departure from our more granular policy work, that policy work can best be understood as the main front in our defense of the open society. The trials we are now enduring are the result of a crisis of legitimacy for liberal democratic governance. The distinctive policy vision articulated here represents our response to that crisis. We believe that this vision offers America its best chance to show itself and the world that the liberal democratic capitalist welfare state — the best model of governance ever devised, producing the richest, healthiest, best-educated societies that ever existed — can still work to improve ordinary people's lives, expand their opportunities, and engage them with meaningful, respected roles in the great common endeavors of society.

While our focus is on our own country, we recognize that the ideals of the open society transcend political boundaries to embrace all of humanity. Accordingly, fidelity to those ideals leads us to appreciate the interdependence between the United States and the rest of the world, and to understand that Americans cannot thrive and flourish in isolation from, much less at the expense of, other countries. Maintaining the open society in America thus entails maintaining a considerable degree of openness to the rest of the world.

With our deep confidence in the creative power of markets and competition, we therefore strongly support open trade among nations and the U.S.-led global trading system that supports it. Openness to foreign competition puts downward pressure on prices and pushes American firms to be more productive, while access to foreign markets allows our most productive industries to expand and prosper.

In keeping with America's finest traditions, we also see immigration as a crucial contributor to national prosperity.⁴² Overwhelming evidence shows that immigration raises incomes for virtually all native-born Americans, the net fiscal effect of new immigrants is positive across all levels of government, and immigrants commit crimes at lower rates than native-born Americans.⁴³ Furthermore, immigrants have contributed disproportionately to the founding of

America's most innovative and successful high-tech companies. According to one recent estimate, immigration's additions to the size and skill level of the U.S. labor force have accounted for two-thirds of GDP growth since 2011.⁴⁴

Immigration thus helps us even as it helps others. As to the latter, it is a highly effective tool in reducing global poverty and a godsend for refugees fleeing to escape war and violence. And even when it comes to helping refugees, the United States does well by doing good. A robust refugee resettlement program is an important bulwark of U.S. national security: It aids in the recruitment of intelligence assets abroad, increases the United States' global influence, undermines anti-Western propaganda, and helps promote stability in foreign countries.⁴⁵

What is true in the case of refugees is true more generally: U.S. national security is bolstered, not undermined, by engagement with the rest of the world.⁴⁶ Such engagement constitutes the core feature of American grand strategy since World War II, in which U.S. military power has been bound together with that of friendly powers in key regions of the world through a system of military alliances. By forming such alliances, the United States has helped underpin a liberal international order. This order consists of a web of legal, political, economic, and security institutions that facilitate cooperation among states, develop patterns of expected outcomes, and, generally speaking, provide the rules that govern the international system. These institutions help reduce competitive pressures in international politics, facilitating a more peaceful and stable international order and thus an international environment more conducive to a free society.

The U.S. engagement strategy undergirds the liberal international order in three main ways. First, it helps deter threats against us and our allies. Second, it reassures allies so they do not arm themselves, either conventionally or with nuclear weapons, and thus heighten the risk of regional conflicts. Third, it provides incentives for cooperation by reducing competitive pressures among many of the world's major powers.

That said, engagement comes with downsides and risks. Not all allies are created equal, and the United States has partnered with some highly unsavory regimes over the decades — sometimes as a matter of necessity, but sometimes to the detriment of long-term national interests. The engagement strategy also runs the risks of overextension, and forward-deployed troops make it easier to launch ill-advised wars. The responsibilities of superpower status are vast, and there is no substitute for prudent statesmanship — which, alas, has been too often lacking. To push back against the indiscriminate projection of U.S. military power, we support the imposition of a special, broad-based tax to be levied in the event of armed conflict, so that more Americans are forced to internalize the costs of war.⁴⁷

Bold Moderation

Our policy vision represents a sharp break from the prevailing orthodoxies of left and right. We also seek a sharp break from the status quo: Effectively addressing the social and economic dysfunctions of the present will require the embrace of bold measures. We want to recapture the daring, reformist spirit of generations past. Like the liberal reformers of the 18th and 19th centuries, we are eager to attack inherited concentrations of privilege that are the modern equivalents of the feudal structures that theorists like Adam Smith were so hostile to.

That said, we believe that the essential spirit of our vision is one of moderation. The goal of the moderate is not to achieve perfection according to a single, unbending standard, but to strike a rough and workable balance among a variety of valid yet competing and perhaps unreconcilable objectives. In these disordered times, restoring balance will require major policy changes, and we do not shrink from the challenge. Yet our goal is not to make the world conform to some abstract, rationalistic schema. Rather, it is to work successfully and effectively within the world as it actually is, with all its messiness and confusion.

The first principle of moderation is recognition of the plurality of political goods and the constraints

of human nature. Liberty is a vital principle of the open society, but so are community and equality. Absolutizing any of these political goods is the essence of ideological thinking, while moderation is a recognition that all of them are important. Such a recognition necessarily puts some constraints on the achievement of any of these principles. The principle of community, for example, requires that we put very significant responsibility for the organization of our lives in the hands of institutions that are neither the state nor the market — families, churches, neighborhoods. But doing so means that we necessarily reproduce a large amount of inequality, since those institutions are themselves unequal in their priorities, capacities, and values.

We are moderates because we do not see any way to liquidate this sort of tension. Instead we live with it, seeking to promote more equal opportunity while at the same time respecting the importance of a vital civil society.

The spirit of moderation also recognizes that conflict — political, social, intellectual — is productive and valuable. What Michael Oakeshott called the politics of faith and the politics of skepticism — the aspiration to society-wide standards of justice on the one hand, and a recognition on the other hand of the inherent limits of our tools for social action and the need for holding government responsible through institutions — can best be thought of as mutually correcting.⁴⁸ Both tendencies, if absolutized, can lead to their own destruction. None of us, therefore, should think of politics as a war between liberalism and conservatism, with a looming final battle in which one will eventually vanquish the other for all time. Rather, both sides hold a partial view of the good, which when balanced within a well-designed constitution can correct each other's pathologies. A moderate is one who is grateful for both liberalism and conservatism, and hopes for — and tries through their own work to move toward — the best version of each, in part in service to improvement in the other.

Finally, moderation goes together with a strong commitment to democracy. If we believe in a

system of laws created in concert with our fellow citizens, we need to recognize our obligation to understand those fellow citizens and treat them as partners in a collective enterprise even when we disagree. We have an obligation to try to justify our beliefs in terms they can recognize. That is hard, in part because the imperatives of social mobilization — revving up our troops — and persuading the other side draw on very different temperaments and tools. But democracy, of necessity, requires both modes. We need to generate enthusiasm and engagement, or else ordinary citizens will not participate in their own governance. But we need to be capable of persuasion, or we cease to see ourselves as a people engaged in a common enterprise, and politics simply becomes a kind of cold civil war. Learning to do both simultaneously is one of the moderate democratic arts.

This is not an easy task. It means, among other things, that we regularly have to accommodate our understanding of justice to the habits and ways of life of fellow citizens that we might find at best uncomfortable, and at worst repugnant. But for democracy to work in a pluralistic society, we must learn to be moderate even in our pursuit of what we think to be justice. That is why toleration — a virtue that is far from natural and is under significant strain today — is such an important habit to learn, and to teach one other.

Our distinctive vision represents an attempt to learn from and incorporate what is best in a variety of ideological traditions. With this approach, we hope to model the art of moderation. With hard work and a bit of good luck, we can help move our divided society toward the best version of itself, and away from the toxic tribalism of our current politics.

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