# Level-Up Economics: Beyond the Wealth of Nations

*Reconstituting capitalism and revitalizing the liberal international order will require revisiting first principles of Western political economy, rebalancing the emphasis it places on broad living standards as opposed to national income. The 2020 US presidential campaign has begun to do just that.*

by Richard Samans*

Three times since the late 19th century, the United States has made a course correction in its political economy – its economic "growth model" and social contract. Most Americans sense that we are overdue for the next one.

Our social fabric is tearing, with friction building between younger and older generations, the heartland and coasts, working class people and educated professionals, and Democrats and Republicans. Both parties are deeply fractured. All of this portends continued political paralysis on the great challenges of our time.

Abroad, illiberal populism and authoritarian, state-directed capitalism are ascendant. These are the main competitors to the liberal international order the US created in its image after World War II. American soft power – the gravitational force of our political ideals and economic strength – is waning at an accelerating pace, with US leadership in the world and quite possibly global peace and stability during the 21st century hanging in the balance.

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Many Americans and citizens of other countries sense that a central part of the problem is the way our economies are run. Indeed, there was an international political consensus on this point a decade ago. During the heat of the financial crisis in 2008 and 2009, leaders of the G20 countries, led by the US and UK, publicly committed to learn from the economic imbalances and policy mistakes that contributed to the crisis and reconstruct a more balanced, inclusive and sustainable model of economic growth.[1]

But no such fundamental shift has occurred or even been charted since then. The enormous task of stabilizing the world economy through extraordinary macroeconomic measures preoccupied governments during the first half of this period. And the past five years have been consumed by the social fallout of the economic crisis and controversy over migration related to the humanitarian debacle in the Middle East and ongoing economic desperation and physical insecurity of people in other poor countries.

This continuing drift and distraction has left many Americans and foreign friends deeply concerned about the future of the United States and the world order it has underwritten for the past 75 years. As the social cohesion and global influence of the leader of the free world seemingly deteriorate before our eyes, we squirm in our seats and wonder: how is this increasingly dystopic movie going to end for our children and their children?

The good news is that many American citizens and particularly millennials have awakened to the need for a major course correction in our ship of state. Most sense that the country requires not just periodic changes in management but a new strategy. Nowhere was this more evident than in the 2016 US presidential primary campaign when an earth-shaking near-majority of those who went to the polls registered a clear vote of no confidence in the economic and foreign policy of both party establishments by voting for Mr. Trump and Senator Sanders.

Europe's conservative and social democratic political establishments have been jolted by their own political earthquakes. These include the Gilets Jaunes phenomenon in France, election of the Five Star Movement and Northern League government in Italy, polarization and fracturing of both major British parties over Brexit, entry of Germany's extreme right AFD party into the Bundestag with 94 seats and similarly unprecedented rise of the far right Sweden Democrats party, which attracted 17.5% of the national vote earlier this year and in so doing precipitated a hung parliament and fragile minority government. As major Western democracies dissemble and cease to serve as a beacon of strength and leadership in the world, many in the transatlantic periphery have taken a decidedly illiberal turn, including Poland, Brazil, Hungary, Romania, Turkey, Czech Republic and Bulgaria. Russian President Vladimir Putin has gone so far as to proclaim the liberal idea obsolete.[2]

But while the leadership establishments in the US and other Western countries have failed to muster a change agenda commensurate with the depth of their electorates' discontent, the same can be said of their illiberal populist tormentors, whose programs appear far more opportunistic than strategic. The crisis confronting the US and other democratic countries in the early 21st century remains an opportunity for the liberal tradition, not unlike the serious economic and political challenges it faced in the early 20th century. The devastation of World War I, Bolshevik Revolution, industrial strikes and Great Depression of that era eventually triggered major reforms that gave it a new lease on life.

The fate of the Western Enlightenment and American Experiment in the 21st century is far from preordained. But more than a decade after the paeans to fundamental reform expressed by our leaders during the financial crisis, the question remains: what is a more consequential response to the socioeconomic frustrations that have accumulated over decades and recently reached a fever pitch in many countries? This challenge is poised to grow even more urgent over the next several years as a new wave of automation related to artificial intelligence and machine learning ripples across the economy and the 2030 window set by the scientific community for decisive climate action[3] closes.

Secretary Clinton's 2016 campaign failed to answer these questions partly by default (the *policy* complacency that candidate Trump criticized so effectively in such areas as trade, immigration, dislocation, etc.) and partly by design (the *political* cautiousness and complacency that led her to evoke continuity with the Obama Administration's record rather than a leap beyond it). In fact, her program contained many significant proposals directly related to this challenge, but it amounted neither in overall policy content nor narrative framing to a clear response to the growing inequality and related misalignment of incentives in the economy. It was not a *structural response* to the challenge people perceive in 21st century globalization, technological disruption and climate change.[4]

The 2020 political cycle is shaping up to be more promising in this respect. A veritable policy renaissance has broken out among Democratic hopefuls, and signs of intellectual ferment and departure from orthodoxy are appearing among Republicans.[5] Democratic candidates have issued ambitious proposals on matters ranging from the environment to education and training to housing to taxation to health insurance and beyond. But their top-line message – their theory of the case regarding how these new policy ideas add up to a fundamental rebalancing of the economy and path forward for liberal democratic governance in the 21st century – has yet to crystallize. This is important because the struggle by liberals of various political hues to reassemble governing majorities in the US and other democracies around the world is likely to be determined not by new policies alone but by a larger narrative in which these form a whole that is greater than the sum of its parts – in which they are practical manifestations of a new governing philosophy that contrasts sharply with the thinking and attitudes that have led liberal governance to go off the rails during the past generation.

Thus far, the candidates have been mainly talking about the trees – the relative merits of individual policy proposals – rather than this forest. But decisive victory in the general election – a genuine mandate – is likely to hinge on whether the eventual nominee is able to interpret this profusion of policy innovation in a way that establishes a new high ground of American politics, a new brand of political change that confounds the right vs. left, moderate vs. progressive, capitalism vs. socialism logic of the past 50 years by leapfrogging it.

How can the 2020 Democrats and other social democrats and classical liberals around the world translate their policy ideas into a narrative that frames a new political economy – a new growth model and social contract that delivers the course correction in liberal economic governance promised after the financial crisis?

For starters, progressive and moderate Democrats need to recognize that they are both right and wrong. Progressives are surely right that in order to prevail over illiberal populism, US Democrats and their left and center-right counterparts overseas will need to offer their own formula for systemic disruption and renewal. A frank reckoning with and rupture from the past is the price of admission for a politician wishing to energize the party's base of progressives and democratic socialists as well as be taken more seriously by disaffected voters who are skeptical of either party's capacity to do anything meaningful about the hollowing out of the middle class in today's economy.[6]

But moderates are surely right that the narrative explaining this deep reform will need to be politically additive in a way that angry, demonizing rhetoric is not, however valid its charges of greed, corruption and deliberate disenfranchisement. A profound misalignment of incentives exists within the US and many other economies. Indicting these rather than angrily objectifying and alienating entire groups of fellow citizens is the path to strategic rather than tactical and transient victory.

A policy revolution is indeed required to revive the American Dream, but to succeed it will need to evoke a political welcome mat for voters who do not self-identify as progressive Democrats. These include small entrepreneurs aspiring to build bigger businesses; socially conservative working-class households; white collar suburban and exurban voters not attached to any ideology; and senior citizens cautious about change and skeptical of fiery, finger-pointing rhetoric --- in short, the bulk of the electorate. In our non-parliamentary, bicameral constitutional system in which a plurality of nearly 40% of Americans call themselves Independents, any such revolution is likely to remain on the drawing board without a bigger coalition than progressive Democrats firmly behind it.

The last two policy revolutions that spawned political realignments in the US were achieved by revisiting first principles of American political economy and reformulating them in a way that recast the role of government in the economy. This in turn changed the terms of political debate in the country – and the world – for a generation. FDR's New Deal was constructed on the fly in the midst of crisis, but it drew from the insights and initiatives of George Warren, John Maynard Keynes, Harry Hopkins, Frances Perkins, Henry Wallace, Robert Wagner and others that together upended conventional wisdom regarding the purpose and practice of economic policy in multiple domains. The Reagan Administration's supply side revolution was built on the back of conservative libertarian principles honed and propagated over many years by the so-called Mont Pelerin society of economists and related organizations. This, too, produced a shift in conventional wisdom regarding government's role in the economy that endures to this day as evidenced by the dominant polemic in the current campaign regarding capitalism and "socialism."

It is time once again to revisit and reformulate first principles of American and Western liberal political economy – to adapt our understanding of government's role in the economy to contemporary conditions and policy challenges. History suggests that this is liberalism best hope for outflanking illiberal populism in the 21st century.

*The Great Disconnect of Modern Liberal Governance*

People all over the world evaluate the economic performance of their national governments based on the social quality of economic growth – its effect on the standard of living of their household and community. By contrast, economists and the politicians they advise have focused for decades primarily on the quantity of growth – the volume of goods and services produced at a national level as measured by GDP. This is the great disconnect of liberal governance in its classical, international sense and the original sin and abiding failure of modern economic science.

Over the past generation, the US and other countries have focused heavily on increasing the quantity of growth through measures that improve the efficiency of resource allocation within the economy: fiscal and monetary discipline, including cuts in social safety net programs; flexibility of labor and product markets; financial deregulation; trade liberalization; international capital mobility and exchange rate flexibility; and privatization. These are all tools for improving allocative efficiency as a means to expand the overall size of the economy.

The major if implicit assumption of this economic doctrine --- now referred to as neoliberalism --- is that broad progress in living standards flows naturally from greater economic efficiency and flexibility and the larger national and world economy they create. The social benefits of expanded GDP inevitably trickle down and out to the populace at large. This assumption is reflected in the use of GDP as the standard basis for measuring a country's economic performance and overall level of development even though neither of these concepts is synonymous with what GDP measures: the market value of goods and services produced within the economy during the most recent period.

In effect, Western and other liberal economists and policymakers have come to assume implicitly that Adam Smith's Invisible Hand of market-based resource allocation optimizes not only the wealth of nations (its core function as stated by Smith) but also the well-being of their populations at large. A rising tide of GDP, as it were, will lift all boats. In fact, Smith himself assumed no such thing.[7]

Nevertheless, this was the philosophy of the last major course correction in US political economy in the form of President Ronald Reagan's so-called supply-side program. It also has been the organizing principle for international economic cooperation since World War II and particularly the 1980s. Countries have integrated product, capital and labor markets regionally and globally. They have done so through coordinated domestic regulatory reform and international trade and investment liberalization on the assumption that that the resulting boost in growth would have a positive downstream effect on the living standards of their populations as a whole. This was the economic rationale for European integration and the proliferation of free trade agreements around the world even though many of these initiatives were motivated first and foremost by foreign policy objectives.

As has been well documented, over the past twenty years this cornerstone assumption of modern Economics has crumbled in the face of two social realities in the US and many other countries. First, although economies have indeed responded to this policy mix and expanded significantly in size, inequality has also grown and median living standards have stagnated as the distribution of national income has shifted appreciably from labor to capital in many of them.[8] Second, this same policy mix emphasizing efficiency and flexibility has brewed a triple cocktail of human dislocation and insecurity in the form of accelerated industrial restructuring driven by technological disruption, increased trade and investment flows propelled in part by labor and tax arbitrage, and domestic deregulation and privatization. The result has been a discrepancy between national economic performance in statistical economic and financial terms (GDP and asset prices), on the one hand, and human terms (median income, economic security and social mobility), on the other.[9]

This disconnect between GDP growth statistics and the lived experience of most people risks growing even wider as a disruptive new wave of automation cascades across multiple manufacturing and services industries in the years to come. Estimates of likely dislocation vary, but one of the most cited and nuanced studies projects that in advanced economies with relatively high wage levels, such as France, Japan, and the United States, automation could displace 20 to 25 percent of the workforce by 2030 -- and that is a midpoint scenario! So is the estimate that 15 percent of the global workforce, or about 400 million workers, could be displaced by automation during this period. And many other jobs that are not outright displaced will change dramatically, with 30 percent of the activities in 60 percent of all occupations susceptible to being automated and therefore requiring major worker retraining and adjustment.[10]

Politicians of both parties in the US and their center-left and center-right counterparts in other countries have been flat-footed in the face of this challenge. Doubling down on trickle-down economics, such as the Trump and George W. Bush administrations' fiscal policies or tinkering around the edges of it (which for the most part describes Democratic economic policy over the past twenty-five years) increasingly resembles feet-of-clay economics to the public. These are perceived as weak tea at best and cynical distraction at worst relative to the depth of change most people sense is required to deal with the disruption and dislocation that has already occurred, let alone what is fast approaching.

Such policy complacency and immobility are symptoms of a deeper problem: blithe incomprehension. For decades, business, political and academic elites have failed to understand let alone confront weaknesses in the assumption that GDP expansion inevitably diffuses or "trickles down" into broad socioeconomic progress. And they continue to fail to appreciate the extent to which the political fortunes of the liberal international order are tied to the mast of this increasingly flawed assumption.

Whether consciously or not, mainstream business and political leaders and economists have been conditioned to believe that measures to expand GDP are essentially the only intellectually credible way to use public policy to raise broad living standards, safety net programs for the poorest notwithstanding. This cognitive reflex is reflected in not only the use of GDP per capita as the standard measure of success but also the relative lack of theoretical and applied research on the relationship between economic growth and broad progress in living standards as economics developed as a social science over the past century and a half.

This blind spot of Western liberal economic doctrine accounts for the policy stasis in the US and elsewhere in the face of mounting social unease with the performance of their countries' economies in human terms. More than anything other factor, the trickle-down mental model of economic progress at the foundation of modern economics is responsible for the deer-caught-in-the-headlights political character of contemporary liberal governance, whether in its establishment Democratic and Republican forms in the US or social democratic and conservative variants overseas. It is increasingly out of step with the lived human experience and changing political attitudes of the electorate as technological change and globalization reorder the economic landscape.

This indoctrinated obtuseness about the human implications of rapid economic change is fundamentally what has been roiling politics in democracies around the globe in recent years, creating an opening for illiberal populists to gain ground in relatively liberal societies and leaders of illiberal governments to become more assertive on the world stage. A lack of understanding and empathy regarding the impact of technology, liberalization and integration on people has been inculcated in our political, business and academic leadership. This systemic failing – this artifact of late 20th century liberal political economy – is ultimately responsible for creating the parched electoral landscape in which isolated extremist brushfires have spread into the raging political blazes we now witness in the US, Italy UK, Hungary, Poland, Chile and Brazil and may soon see in countries as diverse as Sweden, South Africa, France, Mexico and possibly even Germany. Popular dissatisfaction bordering at times on resentment about the way socioeconomic opportunity and outcomes have been managed fuels each.

To be certain, the current controversy in the West over immigration and national identity is also an important propellant. But here, too, illiberal forces in our societies are aided by the failure of leaders to reconcile high liberal principle with the on-the-ground economic and social insecurities of people. As Karl Polanyi famously observed in analyzing the policy mistakes that contributed to the rise of fascism in Europe in the 1930s (e.g., the moral insistence by World War I victors that Germany pay onerous war reparations),[11] there is always a risk that the social frustrations these mistakes aggravate will be exploited for narrow political gain. Steve Bannon and the Kremlin appear to be working in different ways and for different reasons to connect the extremist blazes burning across the West and whip them into a five-alarm global political inferno that consumes the liberal international order as we know it. But the first step in extinguishing or at least controlling these fires is for friends of the Western liberal tradition to recognize that they started at home – in the faulty wiring within our own mental model of economic governance that has led us for a generation to set policy as if human lives adjust as fluidly to shifts in market conditions as commodity prices.

Not since the Bolshevik Revolution and Great Depression has liberalism faced such an existential social and political threat. At that time, academic and policy elites struggled to understand and overcome the blind spots in the economic doctrine of the day that were preventing an adequate response to those mortal threats to capitalist democracies. The resulting course correction in political economy included a veritable revolution in monetary and fiscal policy; creation of extensive social insurance systems and other anti-poverty programs; and major new regulation of financial and labor markets, including establishment of the International Labor Organization (ILO). The ILO's 1919 charter and 1944 Philadelphia Declaration articulated a tripartite (business-labor-government) consensus behind a new way of combining market economics with broad social progress based expressly on the principle that labor is *not* a commodity. They articulated a universal minimum social contract in which employers committed to respect certain legally-enforceable worker rights, and all three stakeholders committed to engage in ongoing "social dialogue" aimed at surfacing and resolving differences in good faith (i.e., without resorting to political confrontation and violence).

The combined effect of these reforms was to change many of the basic rules and institutional arrangements underpinning the US and other Western economies, fundamentally rebalancing their "growth model" and social contract. This political economy course correction enabled several decades of robust progress in which national income and household living standards progressed in tandem across industrialized democracies.

A similarly fundamental restructuring of rules and institutions is needed today, realigning the growth model and social contract of capitalist democracies with the technological, environmental and social transformations of our time. That is the stark message being sent by the electorate's vanishing confidence in the liberal political and economic establishment.

One can begin to discern the outline of this post-neoliberal social contract and growth model in the various proposals of Democratic presidential candidates that would use government in new ways to improve the social inclusiveness and sustainability of economic growth and prepare people better to navigate the transformation of work. There is a common theme emerging from these proposals. Without altering the market's central role in resource allocation, this new Democratic agenda seeks to improve the diffusion of progress in living standards more directly – through strengthened institutions and policy incentives – as opposed to continuing to rely overwhelmingly on the indirect, trickle-down process at the heart of the standard liberal economic model. In this sense, it is going back to first principles of liberal political economy, beginning the necessary task of re-examining and reformulating them in a 21st century light.

*The Living Standards of Nations: From Trickle-Down to Level-Up Economics*

Current liberal economic doctrine varies considerably from the original framework and underlying assumptions of some of its most influential 18th and 19th century pioneers, including Adam Smith in his 1776 *An Inquiry into the Nature and Causes of the Wealth of Nations.* Specifically, the prevailing growth model, which is almost singularly focused on allocative efficiency as a means to generate aggregate increases in national income (the overall wealth of a nation), is out of sync with the mental model Smith, John Stuart Mill and Alfred Marshall, who is regarded as the father of neoclassical economics, had of economic progress. These men were moral philosophers before they were economists, literally and figuratively. They were quite explicit that well-functioning markets provide a necessary but not sufficient basis for increasing the material well-being of entire societies, and that adequate enabling policies and institutions are needed in a wide variety of domains for the rising wealth of nations to translate into broad improvement in the living standards of their people.[12]

Increasing national income through a more efficient mechanism of resource allocation (markets) was precisely what was needed at the dawn of the industrial age, following a millennium of minimal productivity growth and wealth accumulation in poor, agrarian and feudal societies. However, modern economic science and particularly late 20th century neoliberalism extrapolated these important insights to near-theocratic status, creating an intellectually consistent, mathematically rigorous construct with a growing real-world blind spot, namely a failure to recognize that particularly for advanced industrialized countries the primary challenge was shifting from boosting the overall level of national wealth from abjectly low levels to broadening the base of the growth process in order to extend its manifold benefits to the population as a whole and thereby render it more sustainable.

If the planned-economy socialist experiment of the 20th century failed because of its excessive focus on equity and control to the detriment of allocative efficiency and dynamism, the ongoing experiment in neoliberal capitalism is staring its own political failure in the face for the opposite reason --- an unbalanced focus on efficiency and aggregate wealth creation over their social payoff in terms of broad-based progress in living standards.

In fact, production of goods and services (GDP) is just a top-line measure of national economic performance, analogous to the way revenues (sales) are commonly considered the top-line measure of business performance and profits are considered the desired bottom-line result. The bottom-line way societies – people – judge their economy’s success is not GDP growth but rather progress in the living standard of their household and community, i.e., in the lived experience of ordinary families. And yet, like in a business, it is very difficult to grow the bottom-line over time without increasing the top-line. GDP growth remains vitally important to progress in living standards for the simple reason that it is easier for everyone to receive a larger piece of pie if the entire pie, in this case the national economy, is expanding.

The cultivation of strong, sustained and broad-based socioeconomic progress requires policymakers to adopt such an explicit twin focus. This is particularly true when markets are undergoing substantial liberalization, integration or technological disruption, since these impose increased human costs in the form of dislocation, insecurity and income dispersion. Governments in modern market economies need to adopt a dual economic policy anchor – national income growth and median progress in living standards. Each objective requires conscious policy effort and performance measurement in its own right. Moreover, there is an important feedback loop between the two, a circle that can be either vicious or virtuous depending upon circumstance and policy.

Like a person who can only see through one eye, standard liberal economics suffers from limited depth perception and peripheral vision in managing the performance of economies because it is neither conceptualizing, nor pursuing expressly through policy nor measuring national economic performance simultaneously through these two lenses.

Thus, rebalancing capitalism in the 21st century and reclaiming it from the clutches of 20th century neoliberalism begins with reconstituting economics, both scholarship and policy practice, so that it is focused at least as much on cultivating the median *living standards of nations* as the aggregate *wealth of nations*. This includes developing a deeper understanding of the mix of policies and public and private sector institutional features that can best activate the latent synergy between the two.

This new principle – that GDP growth and broad progress in living standards deserve equally explicit and direct policy effort – is also an old one judging from the writings of 18th and 19th century pioneers of market economics. But instrumentalizing it in the 21st century will require capitalist democracies to revise the mental model, policy toolbox and progress metric they have relied upon to develop their economies for the past 70 to 80 years.

An elaborate canon of theory and policy tools for conceptualizing and influencing GDP growth has accumulated over many decades of scholarship and practice. But comparatively little has developed in this respect regarding living standards and their relationship with economic growth. As a result, the tree of accumulated economics knowledge is lopsided and at risk of toppling over and taking the rest of the Enlightenment's precious legacy of individual liberty and empowerment with it. What should have been one of its major branches of inquiry is severely stunted, whether due to lack of imagination, path dependency or the natural tendency of analysts to go where the data is, which happened to be GDP after the establishment of national income accounting in the 1930s and 1940s.

At the center of the prevailing mental model of economic progress, familiar to everyone who has taken college macroeconomics, is the aggregate production function. This is an analytical framework that deconstructs the growth process into its main building blocks or "factors of production". It typically takes the form of an equation in which an economy's overall level of production of goods and services (Y) is represented as a function of factor inputs, typically capital (K), labor (N), and technology (A) but also sometimes breaking out additional factors like human capital (knowledge). For example:

$$Y = f(K, N, A).$$

The production function provides a cognitive roadmap for addressing the challenge of raising the level of production in an economy (GDP). It has been the focus of extensive theoretical and empirical inquiry.[13] Great effort has gone into developing policies aimed at optimizing this equation by strengthening these factor inputs and understanding how they relate to each other.

Policymakers need an analogous mental map for enabling broader improvement in living standards – a *diffusion function* – in order to fully operationalize the principle that an economy's production (GDP) and median living standards deserve equal and parallel emphasis. Inspired by its production function counterpart, this living standards diffusion function should deconstruct the main drivers or channels by which a country's standard of living rises in distributed fashion across society. By modeling such *factors of diffusion,* we can better understand the full range of policy levers that are available to help render the economic development process more socially cohesive and sustainable.

A basic diffusion function can be represented as follows:

$$Z = f(O, I, S, Q)$$

where (Z) is the median household standard of living; (O) is employment opportunity; (I) is disposable income; (S) is economic security; and (Q) is material quality of life. These four "factors of diffusion" are the core components of a household's material standard of living. Like the supply of capital and labor and the pace of technical change represented in the production function, these factors are influenced substantially by policy rules and incentives as well as public and private institutional frameworks. It happens that in the US and most other countries this occurs on an ad hoc and almost idiosyncratic basis rather than as part of a conscious, integrated strategy. That is because this policy and institutional ecosystem lies outside the central focus of top policymakers, who have been trained by standard liberal economic doctrine to concentrate effort on policies (macroeconomic, financial stability, trade) that influence the economy's top-line performance, GDP, rather than its bottom-line socioeconomic outcome – broad progress in its standard of living.

Following are principal domains of *structural* policy and institutional strength that influence these four factors of diffusion:

**Employment Opportunity**

Competitive/entrepreneurial climate
- Anti-trust and anti-corruption rules and enforcement capacity
- Public and private research and development
- Technology governance rules and practices

Real economy investment in productive capacity
- Corporate governance rules and practices
- Institutional investor governance rules and practices
- Corporate taxation

Equality of opportunity (non-discrimination)
- Gender, racial and other anti-discrimination rules
- Other limits on restrictive business practices (e.g., coercive non-compete clauses)

Skills development (equity of access and quality in education and training)
- Basic (pre-K – 12) education
- School to work, technical and vocational
- Tertiary
- Lifelong

Workforce adjustment

- Public and public-private employment services, skills matching, income maintenance, credentialing

**Disposable Income**

Wage Compensation

- Median and minimum relative to mean (e.g., tax code progressivity)
- Worker rights – e.g., freedom of association and collective bargaining, right to strike, prohibition of forced and child labor, etc.
- Trade union and social dialogue rules and practices

Non-wage compensation

- Profit sharing/employee ownership
- Annual and sick leave
- Health benefits
- Pension benefits
- Dependent care rights and benefits

Purchasing power relative to major expenses (relative cost of necessities)

- Housing
- Health
- Energy
- Education
- Food
- Dependent care

**Economic Security**

Public safety net – coverage and adequacy of benefits

- Health (e.g., Medicare, Medicaid, ACA)
- Pension (Social Security)
- Unemployment insurance

Worker protections

- Occupational safety and health
- Arbitrary dismissal
- Disability

Asset-building/wealth accumulation

- Home ownership
- Private pensions

**Material Quality of Life**

Environmental

- Climate change mitigation and adaptation

- Pollution control infrastructure: coverage, quality, cost
    - Water
    - Air
    - Sanitation
    - Soil

Transport: infrastructure coverage, quality, cost

Digital: infrastructure coverage, quality, cost

Recreation: public infrastructure coverage, quality, cost

Work/life balance
- Time sovereignty
- Maximum work hours

These are the four primary dimensions by which people experience their country's standard of living – the main channels by which the benefits of rising national income manifest at the household level – and the corresponding areas of policy and institutional design that influence the extent to which these channels are activated in a broadly distributed fashion. This structural policy and institutional ecosystem is the *de facto* income distribution system or, more precisely, living standards diffusion mechanism of modern market economies. In the US and many other countries, it remains underdeveloped or has withered in large part because policymakers do not conceive of it *as a system* (a function in economics parlance) that plays a critical role in shaping top- and particularly bottom-line national economic performance and therefore merits deliberate cultivation as a core element of the economic development process.

The diffusion function provides an integrated way of understanding and addressing national economic performance from the bottom up – through the lens of the lived experience of people at the household level as opposed to the production of goods and services measured at the national level. Its vantage point is the kitchen table as opposed to that of the financial trading floor or board room table. This perspective contrasts with that of standard neoclassical and neoliberal doctrine, which focuses on improving the top-line metric of national income (GDP) principally through resource allocation efficiency. And yet the robustness of an economy's diffusion function also has an important feedback effect on GDP growth.

The diffusion function modeled here describes the larger policy "switch" at which liberal democracies have been asleep over the past few decades as inequality and insecurity mounted while digital disruption and economic integration accelerated. Its scope extends well beyond transfer payments and support for college education, the two most commonly proposed responses to technological disruption and globalization. It provides a more comprehensive blueprint for shifting an economy from a socially polarizing trickle-down mode to a leveling-up, lifting-all-boats dynamic.

The next few US administrations have an opportunity to achieve such a shift over the course of the next decade if they work at least as hard to strengthen the diffusion function as production function of our economy, informed by a comparative review of the effectiveness of relevant American policies and institutions with those of other advanced countries.[14] Some countries have managed to forge a more perfect union between individual economic liberty and shared socioeconomic progress than the United States by taking a more direct and systematic approach to managing this side of their economies – the social *quality* of economic growth.[15] They have maintained competitiveness while achieving greater inclusion[16] through a mixture of sharper policy incentives and stronger public and private institutions designed for this purpose, and Americans should not be too proud to learn from them.

These guiding principles and corresponding policy framework, which I call level-up economics, are what is required to fundamentally reform and rebalance capitalism while correcting its neoliberal blind spot regarding the human costs of technological change and policy liberalization. By more directly and systematically activating the broad spectrum of rules, policy incentives and institutional frameworks that can support employment opportunity, household disposable income, economic security and material quality of life, level-up economics provides a roadmap for practicing and not just preaching inclusive and sustainable growth and, in the case of the US economy, shifting it back to American-Dream mode from its present Great-Gatsby footing.

In fact, this doctrinal departure from trickle-down economics is the implicit, thread running through the policy platforms of 2020 Democratic presidential hopefuls, both active and recently suspended. Regardless of whether they self-identify as democratic socialist, progressive or moderate, these candidates have all proposed or endorsed measures to strengthen multiple areas of the US economy's diffusion function. Their various proposals would ultimately need to be prioritized, sequenced and reconciled with the country's finances by a new president and Congress, but differences among these policy platforms are of degree rather than strategic purpose.

For example, proposals by candidates to expand employment opportunity include strengthening market competition through stronger anti-trust enforcement (Warren, Klobuchar); incentivizing long-term real economy investment by levying a financial transaction tax (Sanders and Gillibrand) and rebalancing corporate governance rules to focus on stakeholder rather than only shareholder interests (Warren); strengthening skills development by reducing college costs (Sanders, Warren); increasing K-12 education support for teacher salaries and poorer school districts (Harris, Biden, Buttigieg, Sanders); providing universal pre-school education (various candidates); redressing gender pay disparities and discriminatory employer practices (Warren) and providing a government job guarantee (Sanders, Booker, Gillibrand). Proposals to boost disposable income include raising the minimum wage to $15 (various); increasing tax progressivity through expanded refundable tax credits (Bloomberg, Harris, Bennet) and higher rates for the wealthy and corporations (Warren, Sanders, Harris, Warren); strengthening union representation and bargaining leverage of employees (Warren, Sanders and others); establishing a universal basic income (Yang); providing universal access to affordable child care (Warren); and increasing support for affordable housing (Booker and Harris). Proposals to strengthen economic security include expanding health insurance (various) and Social Security (Sanders, Booker, Harris and more recently Warren) as well as supporting home ownership (Harris). And proposals to enhance material quality of life include combating climate change (Inslee, Biden, Bloomberg, Sanders, Warren, O'Rourke, Harris and Buttigieg); increasing infrastructure investment (Klobuchar); and providing paid family leave (Gillibrand, supported by multiple candidates).

Thus, the philosophy of level-up economics would appear to be the single most important bond uniting Democrats beyond their opposition to the incumbent. This is because it is fundamentally a strategy to increase investment in *people* – their capabilities, purchasing power, fair employment and entrepreneurial opportunity and material wellbeing. Democrats have long striven to be the party that best represents the interests of working and middle class people, whose standard of living overwhelmingly depends on employment-related compensation and publicly-enabled (but not necessarily delivered) education, consumer, asset-building, health, social insurance, infrastructure and other protections and services.

Business and political leaders commonly describe people as our economy's most important resource, but they have perennially failed to walk this talk by investing adequately in them and their standard of living and economic security. This reflects trickle-down economics' emphasis on boosting investment in physical and financial capital, often through huge, untargeted expenditures of public resources (e.g., across the board personal and corporate tax cuts) having at best an indirect effect on jobs and living standards. Level-up economics, by contrast, focuses on increasing direct public and private investment in multiple aspects of the workforce potential and lived experience of households. It aims to *structurally* (i.e., as part and parcel of the growth process itself) improve the capacity of market economies to diffuse the benefits of growth, thereby bringing more of society along on a nation's upward development journey.

This more comprehensive and direct *human* investment and security agenda also happens to be what is most needed at this juncture to strengthen the US economy's growth prospects, which are far from robust judging from recent results and forecasts. There are three big, vexing challenges in this respect. First, economists having been debating for several years whether the US and other advanced countries are experiencing a chronic deficit of demand – so-called secular stagnation – due to technology, globalization, population aging and other structural factors. The renewed fall of interest rates into negative territory in the Euro area, Japan, Sweden, Switzerland and Denmark and the recent yield curve inversion in US markets have heightened this concern. Second, despite the technological innovation in our midst, productivity growth has been very slow for the past decade – about one percent per year – although it has risen in the last two quarters. And third, with interest rates near or below zero and their balance sheets still bloated from the last crisis, central banks around the world are just about out of ammunition to fight the next downturn even before it has begun. They are beginning to appreciate that they will need to work more closely with fiscal authorities to devise more direct methods of transmitting stimulus into the economy in the event we face such a "liquidity trap" in the next recession.

Level-up economics represents a new and potentially more effective response to each of these growth conundrums. First, it would add a bottom-up, *structural and thus ongoing* dimension to Keynesian demand management, moving beyond its traditional top-down focus on crisis-related monetary and fiscal stimulus in a way that may be particularly suited to the income- and opportunity-dispersing effects of the Fourth Industrial Revolution. A full-court-press of structural policy and institutional reforms that increase direct support to disposable income, purchasing power, economic security, and labor market participation and transition at the household level would support aggregate demand and consumer and investor confidence from the bottom up, potentially helping economies to escape the grip of the secular forces weighing them down. Second, it would frontally attack slow productivity growth by prioritizing investment in skills development, research and development, sustainable infrastructure and anti-trust market surveillance, placing these at the center of national economic policy rather than at the periphery, where they too often have languished insofar as they fall outside the purview of finance and trade ministries. Finally, the diffusion function can also be viewed as a menu of channels available to *transmit stimulus more directly* into the economy in the event central bankers find themselves in the monetary black hole of a liquidity-trap recession. During such a crisis, an extraordinary increase in financing of several of them (such as those in the diffusion function's Disposable Income or Material Quality of Life pillars) through either conventional government borrowing or direct central bank financing would help stabilize the economy in the near term while advancing the structural rebalancing and reform of it over the longer term.

Thus, strengthening an economy's diffusion function represents a *growth strategy* as well as social cohesion agenda – a way to render its growth model more dynamic, resilient and sustainable by making it more inclusive. Finding a way to add a sustained bottom-up impetus to growth could scarcely come at a better time for many economies around the world that are struggling to wean themselves from a decade of unsustainable and decreasingly effective monetary and fiscal stimulus. While crucial to stabilizing their economies in the aftermath of the financial crisis, that global growth engine has run its course. So has the other strategy on which many economies have relied for the past generation – trade surpluses. Merchandise trade among major economies has been contracting due in part to trade disputes.

The world economy also requires a new growth paradigm because of the very real prospect that artificial intelligence and machine learning will hollow out employment, purchasing power and aggregate demand over the next ten to twenty years as much or more than digitization and globalization did over the previous two decades. If projections about the speed of this disruption are anywhere near accurate, then shifting our economic strategy from pushing-on-a-string, trickle-down mode to a lifting-all-boats, level-up footing becomes a long-term macroeconomic imperative as much as sociopolitical one. Direct, systematic action to strengthen the living-standards diffusion mechanism of economies may prove to be an indispensable tool in countervailing a technology-driven erosion or even collapse of demand within them as automation spreads.

*Liberalism 2.0: From Policy Revolution to Political Comeback*

Thus, a country can improve not only the inclusiveness of its economy but also its dynamism and resilience by systematically strengthening its diffusion function. That is the larger significance of the recent Democratic policy renaissance, which is shaping a new type of structural economic reform that is pro-growth as well as pro-equity and pro-sustainability. Indeed, it is pro-growth *because* it is pro-equity and pro-sustainability. As such, if enunciated properly it could reframe the terms of political debate for a generation to come, recasting our conception of government's role in the economy in line with the demands of the digital age and finally carrying us beyond the stale capitalism-versus-socialism and big-versus-small-government polemics which have dominated political discourse for over a generation.

While unabashedly progressive in the Roosevelt (both TR and FDR) tradition,[17] level-up economics' kitchen-table framing and people-centered, human-investment focus have the potential to galvanize a much larger political coalition than either Party or any faction thereof currently commands. This is because they lend themselves to being articulated in the universal vernacular of the typical household's purchasing power, employment opportunity and economic security rather than the divisive language of ideology or identity, and in the aspirational vocabulary of businesspeople and entrepreneurs: economic growth and opportunity.

Chronic underinvestment in the productivity of people when talent and other intangible assets are more important to value creation than ever underlies the slowdown in productivity and economic growth in the US and other economies. And weak domestic demand stemming from a financially-stretched, hollowed-out middle class is a primary reason for our economy's high indebtedness, low investment and suppressed growth potential. Since corporate profits are highly correlated with economic growth over time, white-collar managers and small business entrepreneurs have just as much at stake in addressing these fundamental, longstanding economic weaknesses as workers and poor communities. Many instinctively understand this and would be receptive to such an agenda if it were articulated in this fashion – as a growth as much as fairness agenda. The recent Business Roundtable restatement of corporate purpose is an illustration of how business attitudes may be changing (and could be made to change further and faster) in this regard.[18]

Framed in such pragmatic terms, a far-reaching effort to modernize the economy and social contract has the potential to resonate with workers and businesspeople, younger and older generations, rich and poor, and progressives and moderates alike. It could defrock and then defang illiberal populism by drawing a sharper contrast with its continuing reliance on the trickle-down, trading-floor economics of across-the-board tax cuts and deregulation. These primarily generate windfall gains to existing stocks of financial capital rather than strengthen the productivity and purchasing power of the nation's workers and consumers.

In this way, level-up economics is potential political jujitsu. It could turn an apparent strength of incumbency – solid GDP growth and employment – into a weakness and form the basis of a different and more effective form of populism: *liberal populism* that genuinely places people and their lived experience at the center of national economic policy.

A large majority of Americans is likely to agree, whether openly or grudgingly, with the following line of argument:

- Trickle-down, supply-side economics is a 1980s strategy that is continuing to make the economy less rather than more inclusive and borrow from our children's future.

- The recent corporate and investor tax cuts and indiscriminate deregulation have been overwhelmingly used by companies to boost profits and shareholder payouts rather than invest in productive capacity and capability. This has been an enormous diversion of resources from what the economy most needs, which is increased investment in people and the real economy, including its low-carbon transition.

- The chickens are coming home to roost from this inefficient, backward-looking strategy in the form of decelerating growth, ballooning budget deficits and increasingly nervous financial markets. It is time to turn away from this old economic model in which we firehose public money at corporations and investors that are already flush with cash and underinvest in our economy's most important asset: people and their everyday standard of living.

- A new kind of economics – level-up economics – aimed more directly at easing family budget constraints (housing, health, education, jobs, benefits, cost of necessities) and strengthening the foundations of the real economy (labor productivity, long-term investment in productive capacity, reduced concentration of rents and market power, R & D and sustainable infrastructure) would not only make the economy more inclusive. This new type of structural reform would also strengthen the economy's fundamentals rather than paper over weaknesses in them, which is literally and figuratively what the US has been doing for the past twenty years through fiscal and monetary policy. Diffusing progress in living standards in this fashion would make the economy fairer and more productive at the same time. This rather than short-term tactics to inflate corporate profits and asset prices is the key to shared, sustainable prosperity in the new digital, globalized economy and to a rebalancing of our economy away from its dangerous dependence on excess liquidity, debt accumulation and carbon-intensive energy.

This narrative would engage businesspeople where they live by making a serious, new argument about what is needed to grow the economy just as warning signs about a slowdown are flashing. It would connect with grandparents and parents by emphasizing investment in the success of younger generations rather than nostalgia about a bygone era. Most of all, it would resonate with working- and middle-class families by speaking directly to their kitchen-table concerns and pledging to turn forty years of economic policy on its head by placing these rather than the comparatively abstract and indirect tools of macroeconomic policy, financial regulation and trade liberalization at the heart of the country's strategy.

In short, this new intellectual construct also translates well into political discourse, reframing the age-old debate about the role of government in the economy in language that cuts across traditional political fault lines and casts the capitalism versus socialism debate as a false-choice legacy of the previous century. It lays the foundation for a bigger political tent, a governing as opposed to one-time electoral majority, at precisely the moment when so many Americans and citizens of other democracies have become unmoored from their prior political assumptions and allegiances.

Both major factions of the Republican Party will struggle to capture this prize as long as they retain their deeply entrenched trickle-down mental model of economic progress and instinctive tendency to frame the choice regarding government's role in the economy simplistically between "big" and "limited" government. Democrats have a better opportunity because they carry less of this intellectual baggage. But Democrats have baggage of their own: first, a tendency toward identity politics that segments the electorate and almost by definition limits their ability to mobilize the broad, philosophically-anchored coalition of which durable governing majorities and political realignments are made; and second, a weakness for silver-bullet, big-bang initiatives that, deservedly or not, risk pulling the debate back into unproductive capitalism-versus-socialism terrain by inserting government dominantly and expensively into resource allocation processes currently performed by markets.

Rebalancing the US economy and liberal governance more generally is a generational project that cannot be accomplished in a single election or with one or two big new programs. It requires a more sustained and iterative effort that brings the electorate along, enlarging and shifting the political center of gravity over several years. History suggests that such a political realignment is much more likely to be set in motion by a principles-based or *philosophical argument for a watershed change in strategic direction* of the kind made by level-up economics regarding the overall purpose and specific nature of government's role in the economy in the 21st century than any single marquis policy initiative.

Each of the three course corrections in US political economy since the 19th century – the early 20th century progressive reforms, the New Deal and the Reagan supply-side revolution – was articulated and organized in this fashion. FDR exemplified this approach. In his famous "forgotten man" speech during the 1932 campaign, he "lambasted 'trickle down' proposals and demanded a recovery program 'that builds from the bottom up and not from the top down, that puts faith once more in the forgotten man at the bottom of the economic pyramid'."[19] He later added to this directional principle his call for "bold, persistent experimentation" in policy, which became a watchword for the New Deal's wide-spectrum, sustained approach to reform, the cumulative effect of which shifted both the country's economic growth model and political center of gravity for a generation.

Proposals such as the Green New Deal, Medicare for All, universal basic income funded by Modern Monetary Theory, and comprehensive student debt forgiveness all point in the right direction. But none of these amounts to replacement for the prevailing GDP-centric, trickle-down paradigm of economics. None by itself offers a new political vocabulary that transcends traditional political boundaries of ideology and identity. And none in its most ambitious form is fiscally feasible in the next four years, let alone all.

The Green New Deal (GND) comes closest to representing a new organizing principle of economic policy. But it is more of a big-picture aspiration rather than an actionable program, and some of its original language plays into Republican caricatures of Democrats as advocates of centrally planned and fiscally unrealistic government intervention in markets, thereby threatening to deepen rather than transcend conventional political fault lines. Recent efforts to translate a high degree of climate ambition like the GND into a practical policy agenda, such as Governor Inslee's climate plan, are helping to overcome this problem.

Climate change is indeed unlike other policy challenges in both the depth and breadth of its implications. It threatens to disrupt the entire production function of the economy, knocking upwards of 10% off of GDP by late in the century according to a recent US government report. But addressing it successfully will require not only decisive mitigation and adaptation measures but also stronger activation of the economy's entire diffusion function in order to address the socioeconomic dimensions, both real and feared, of such a big transition. Time and again – most recently in the Gilets Jaunes protests in France and conservative party victory in Australia based in part on vocal opposition to climate progress – plans for strong climate action have failed to command public support in the absence of a concrete, simultaneous agenda to augment people's livelihoods and living standards. More than vague promises of skills and jobs for everyone when unemployment is less than 4% will be needed to mobilize broad social support for the big increase in climate ambition that Green New Deal advocates rightly say is required to achieve the objectives of the Paris Agreement. The extensive renovation of an economy's diffusion function envisaged by level-up economics and beginning to take shape in the Democrats' overall 2020 platform must be an explicit companion of decisive climate action, going well beyond the enhanced adjustment assistance for fossil fuel industry communities and subsidies for green industry contained in most "climate" plans.

Modern Monetary Theory (MMT) is also sometimes represented as a new economic paradigm. But it is a macroeconomic tool for a problem that is primarily structural in nature. Specifically, it offers a means of mobilizing greater public expenditures on social priorities by having central banks monetize fiscal deficits to a much greater degree than mainstream macroeconomists and policymakers condone. MMT does not, strictly speaking, prescribe how such additional resources should be deployed, although some of its advocates link the proposal to the introduction of a universal basic income or government job guarantee. It is therefore commonly understood to be a financing vehicle for greatly increased fiscal transfers, i.e., for redressing unequal market outcomes after the fact as opposed to changing the structure of labor, capital and product markets to produce more equal outcomes from market activity itself. (Level-up economics encompasses both dimensions with a particular emphasis on the latter, long-neglected one.) But its core argument – governments borrowing in their own currency have more fiscal space than generally acknowledged – is valid and relevant. MMT could enable part of the new approach to structural reform represented by level-up economics, providing a supplemental means of financing investments that have a reasonably direct payoff for productivity growth such as skills and sustainable infrastructure.

And if we find ourselves heading into a recession with conventional monetary policy inoperative, it could and should be used to finance an even wider activation of the economy's diffusion function to transmit monetary stimulus more directly into the economy as discussed above. This is a scenario in which level-up economics, MMT and the infrastructure investment and community adjustment aspects of the Green New Deal come together to create an emergency life preserver for the economy as it navigates uncharted and dangerous macroeconomic waters.

Last but not least, health insurance is arguably the most glaring weakness in the US economy's support structure for middle- and working-class household living standards. But wholesale health system reform is so complicated and politically charged that it would likely consume Washington during the first two years of the next administration just as it did in 1993-4 and 2009-10, foreclosing the opportunity for broader economic reform. Because the weaknesses in the US economy's diffusion function extend well beyond the health insurance system, a staged rather than big bang approach to a Medicare for All-like transformation of that system makes most sense. The next administration should not repeat the mistake of the Obama administration, which was perceived by voters as having put too many eggs in the health insurance basket and not expending enough effort on the broader economy.

*Conclusion*

Rising inequality is not an iron law of capitalism or technological progress, and the choice countries face in confronting it is not between capitalism and socialism. There are multiple policy and institutional levers governments can pull to mobilize a *combined* attack on the problem. The key is to recognize the critical role this structural policy ecosystem plays in shaping the inclusive growth performance of an economy and to place at least as high a priority on it as the traditional focus of economists and policymakers (most of whom are macroeconomists and bankers) on allocative efficiency and the macro-financial context.

In today's digitally disruptive and globally integrated economy, investing more and more directly in people and practical aspects of their standard of living is not only the key to a more equitable society but also a more rapidly growing economy. The talent, purchasing power and fair employment and entrepreneurial opportunity of people are the new keys to national economic success. Ensuring that these are widely distributed across society, rather than pumping more money at owners of capital and hoping that it trickles down through their increased investment activity, is what is most important for the strength of a nation's economy and social fabric going forward.

Big-bang, silver-bullet interventions should be treated with caution and placed in larger and longer term context. Whatever the intellectual merits of universal, government-provided health care, basic income and employment, overemphasis of them in the near term is likely to be counterproductive. The problems of inequality and marginalization are most effectively addressed through a more comprehensive and sustained effort to upgrade a country's growth model and social contract, including in areas in which relatively weak or underdeveloped policy incentives and institutions are behind much of the inequality and exclusion that markets are producing in the first place.

These principles of level-up economics are the point of departure for the course correction required in US economic policy and Western liberal political economy more broadly. They are likely to resonate with the public's sense of why we are off course and can help unite progressive and moderate Democrats behind a game-changing strategy of American economic renewal that over time pulls large, additional segments of the electorate into a durable governing majority. People know instinctively that we have been neglecting our economy's fundamentals, especially the most important one: them.

Strengthening skills, consumer purchasing power and business and public investment in the real economy would lift labor productivity, disposable income and aggregate demand. Adapting power, transport, water and industrial infrastructure to the requirements of the Paris climate agreement would also boost employment and median incomes. When assessed against the bottom-line metric of national economic success – median progress in living standards – these would be far more effective uses of additional public expenditures than the cuts in individual, corporate, estate, and other capital income taxes that are the mainstay of trickle-down economics. A win-win-win – higher growth with greater equity and lower risk – result for the economy becomes possible by viewing it through the bottom-up, people-centered prism of level-up economics rather than the top-down, financial-markets-centered lens of trickle-down economics. Placing our domestic house back in order in this fashion would also rebuild public confidence and Congressional support for a renewal of US global leadership in such soft-power dimensions as trade, aid and sustainable development.

President Trump issued a well-deserved wake-up call to the American leadership establishment when he declared the American Dream dead upon announcing his run for President in 2017.[20] But his program continues the neoliberal error of mistaking growth as the end rather than means of economic policy. It is neither a direct nor durable response to the decoupling of national wealth creation from median improvement in living standards. Over time, it is likely to widen rather than narrow this gap, leaving a bigger public debt and even bigger missed opportunity to strengthen the economy's most valuable resource, its people and their standard of living, in its wake. As currently configured, it is likely to be viewed by history as the last installment of a late 20th century growth model that is out of sync with the technological, environmental, macroeconomic and social challenges of the 21st century.

There are multiple compelling reasons to shift the logic of Western liberal economic governance from a capital-centered, trickle-down to human-centered, level-up approach. This journey begins by taking living standards more seriously in economic theory and policy and by contextualizing the crucial role of markets and economic growth in this wider conception of socioeconomic progress. It continues by recognizing that such progress requires a more active exercise of political economy, just as Adam Smith and several other founding fathers of liberal economics – political economists all and central-planning socialists none – originally intended.

## Endnotes

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