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THE 2011 IRPP POLICY HORIZONS ESSAY

REKINDLING THE AMERICAN DREAM

A NORTHERN PERSPECTIVE

Thomas J. Courchene

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Foreword

Since its creation in 1972, the IRPP's mission has been to improve public policy decisions by producing analysis and sparking debate on the emerging issues facing Canadians and their governments. On the eve of our 40th anniversary, we are pleased to launch the IRPP Policy Horizons Essay, whose purpose is to look well beyond day-to-day challenges and consider the larger economic, social and cultural shifts on the horizon that will shape Canadian policy and decision-making in the years to come.

For this inaugural essay, we are pleased to have Thomas J. Courchene, Jarislowsky-Deutsch Professor of Economic and Financial Policy at Queen's University and Senior Scholar at the IRPP, shed light on the uncertain economic prospects of the United States.

Given that the United States is the destination of more than two-thirds of Canada's exports and nearly 20 percent of its total economic production, a flagging American economy has obvious and enormous implications for Canada. But, more broadly, a struggling America could jeopardize the stability of the international geopolitical order it helped build after the Second World War, and the economic growth and support for democratic values and individual rights that accompanied it.

The Policy Horizons Essay is intended to bring a multidimensional perspective to complex issues. To this end, future contributors will, like Thomas Courchene, have long and distinguished careers in analyzing Canadian public policy and an exceptional ability to apply rigorous analysis and contribute fresh thinking and new insights to difficult policy challenges, which is at the heart of the IRPP's mission.

Graham Fox
President
Institute for Research on Public Policy

About the Author

Thomas J. Courchene was educated at the University of Saskatchewan (honours BA, 1962) and Princeton University (PhD, 1967). He is the Jarislowsky-Deutsch Professor of Economic and Financial Policy, and a member of the Department of Economics, the School of Policy Studies and the Faculty of Law at Queen's University. He is senior scholar at the IRPP. He is the editor/author of some 60 books and roughly 300 articles in academic publications on Canadian policy issues, including a four-volume series on Canadian monetary policy published by the C. D. Howe Institute. His 1994 book, *Social Canada in the Millennium*, was awarded the Doug Purvis Prize for the best Canadian economic policy contribution in 1994. His book *From Heartland to North American Region State: The Social, Fiscal and Federal Evolution of Ontario* (1998, with Colin Telmer) won the inaugural Donner Prize for the best book on Canadian public policy. His latest book, *A State of Minds: Toward a Human Capital Future for Canadians*, was published by the IRPP in 2001. Thomas Courchene was chair of the Ontario Economic Council from 1982 to 1985, was a senior fellow of the C.D. Howe Institute (1980-99), was a member of the Economic Council of Canada (1988-91), is a fellow of the Royal Society of Canada (elected 1981) and is a past president of the Canadian Economics Association (1991-92). He received honorary doctorates of laws (LLDs) from the University of Western Ontario (1997), the University of Saskatchewan (1999), and the University of Regina (2007). On the occasion of the 100th anniversary of the University of Saskatchewan, he was included in the 100 Alumni of Influence. Courchene was awarded the 1999 Canada Council Molson Prize for lifetime achievement in the social sciences and humanities. He was invested as an Officer of the Order of Canada in April 1999.

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Rekindling The American Dream: A Northern Perspective

Thomas J. Courchene

American exceptionalism seemed unassailable as the world welcomed the third millennium. With its greenback serving as the world's currency, America was the uncontested global superpower — economically, financially, militarily and, to Americans at least, morally. Among the keys to America's ability to scale what Yergin and Stanislaw (2002) refer to as the "commanding heights" of the global economy were its individualist ethic, its liberal approach to markets, its openness to the best and the brightest from across the globe and, above all, its inherent dynamism and penchant for innovation.

Yet, from the vantage point of 2011, America's status as the sole global superpower seems contestable, and in many circles the notion of America declinism is making headway.[1] The sources of this concern about America's future are partly external, stemming less from a decline in the United States than from the spectacular rise of the emerging (and largely Asian) economies — first Japan, then the tigers (Singapore, Hong Kong, Taiwan and South Korea) and now China, India, Indonesia and Brazil. But much is also internal to America, such as the debt and deficit overhang, the unsustainable Social Security entitlements as the boomers become golden agers, the erosion of the middle class and the growing political polarization.

Since 2007 these concerns have become much more acute: the financial collapse, the mortgage debacle, the recession, near-double-digit unemployment and the advent of trillion-dollar deficits have given rise to broader societal concern over America's future. A recent national telephone poll showed that 47 percent of America's likely voters believed the "nation's best days are in the past" (Friedman 2010). In the context of a *Foreign Affairs* article

[1] Among the many studies and articles that raise concerns about the future of America are Friedman (2008), Zakaria (2008), Steingart (2008), Hedges (2009), Bremmer (2010), Fry (2010), Stiglitz (2010), Kotlikoff (2010) and Rachman (2011). For a more sanguine view, see Fallows (2010).

that offers one of the more optimistic visions of America's future, Joseph Nye nonetheless reminds his readers that there are some storm clouds on the horizon:

> Another cause for concern is the decline of public confidence in government institutions. In 2010, a poll by the Pew Research Center found that 61 percent of respondents thought that the United States was in decline. And only 19 percent trusted the government to do what is right most of the time. In 1964, by contrast, three quarters of the American public said they trusted the federal government to do the right thing most of the time. (2010, 8)

This sharp decline of trust in government amid deep-seated angst about the future of the country suggests America's current predicament is structural in nature and transcends the recent deep recession — indeed a far cry from the commanding heights.

In this essay I will highlight the features and forces that led to the global supremacy of the US in the early post-Second World War period, then assess the constellation of philosophical and policy forces that are now undermining key aspects of American exceptionalism. To conclude I will outline some pathways toward a twenty-first-century version of exceptionalism or, in the words of the title, toward rekindling the American Dream: the enduring belief that individual initiative and hard work will deliver material progress for all.

Why is a Canadian undertaking this exercise? Canada and Canadians obviously have a vested interest in the fate of our southern neighbour. The United States is by far our biggest trading partner and, despite globalization of trade and the increasing thirst of emerging markets for the oil and other natural resources that we are fortunate enough to possess, it will remain a fundamental determinant of Canada's economic prospects. Moreover, American global leadership gives Canada a privileged position in international affairs, allowing us to "punch above our weight" and to advance issues of mutual interest. Beyond these pragmatic reasons, the US has indeed been a "shining city on the hill." Under its economic and political leadership, the postwar period has seen unprecedented income growth across the globe, the creation of international governing institutions, a doubling of the number of democratic governments, the reduction of poverty and the successful management of the Cold War, to name just a few accomplishments. And while America presumably acts in its own strategic interests, within this framework the US has revealed itself to be a most generous nation and a defender of rights and freedoms. For these and other reasons, what underlies the often critical assessment of US policies in this essay is an earnest desire for the US to regain its stature.

The essay begins by taking a step back to explore some features of the evolution of nations and societies, highlighting key differences between civil-law and common-law regimes, as reflected in continental European communitarian capitalism and Anglo-American individualist capitalism. The analysis then focuses on postwar America's "Fordism" and the heyday of the American Dream, which held sway for the better part of half a century. What followed during the 1980s was a transition to a new model of capitalism with its liberalized markets, and the emergence of a new technology centred on the Internet and related networks in the informatics era. The conclusion derived from this analysis is that the US has carried individualist capitalism very far in the direction of winner-take-all capitalism, a consequence of which is a drift toward greater societal inequality. While inequality is traditionally not a concern of the American ethos, I argue that it has reached a point where it is threatening equality of opportunity and the middle class, the core pillars of the American Dream.

Life, Liberty and the Pursuit of Happiness: The American Model

From the Declaration of Independence: "We hold these truths to be self-evident, that all men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are Life, Liberty and the Pursuit of Happiness." Just as "Liberté, égalité, fraternité" is France's societal maxim, "Life, liberty and the pursuit of happiness" has always been America's defining national rhetoric. However, in their cultural and socio-economic implications, the two could not be further apart. In particular, underpinning "Life, liberty and the pursuit of happiness" is the uniquely American interpretation of the individualism of English common law, while "Liberté, égalité, fraternité" flows from the collective nature of continental European civil law (the Napoleonic Code and, before that, Roman law). Indeed, these roots and characteristics distinguish Anglo-American individualist capitalism from continental European communitarian capitalism,[2] although the latter is also found in non-European countries such as Japan, and in the province of Quebec.

One critical difference between these regimes has to do with the conception of the state (Fleiner, forthcoming). Under common law, from the Magna Carta forward, the main role of a constitution is to limit the powers of government and, in the US case, to guarantee citizens their "unalienable" rights. Indeed, the function of the branches of government under common law is to moderate among competing powers and interests. In contrast, in the civil-law tradition, the unity of the state is uppermost and is the main legitimizer of a constitution. As such, the civil-law state's function is to steer society; in the case of France, for example, the role of the constitution is to organize society for the purpose of achieving equality and justice. Note that this civil-law conception of the state as sovereign, central, unitary and indivisible makes it difficult for civil-law societies to embrace federalism. In the German and Austrian federations, for example, the subnational governments are administrative, not legislative, entities, thereby preserving the civil-law vision of the (legislative) unity of the state.

Individualist capitalism vs. communitarian capitalism

Lester Thurow reflects as follows on the role of labour and capital in the two systems:

> In the Anglo-Saxon variant of capitalism...firms must be profit maximizers. For profit-maximizing firms, customer and employee relations are merely a means to the end of higher

[2] In the language of political science and international relations, the corresponding terms are "liberal market economies" and "coordinated market economies."

> profits for the shareholders. Wages are to be beaten down where possible and, when not needed, employees are to be laid off...Job switching, voluntary or involuntary, is almost a synonym for efficiency.
>
> The communitarian business firm has a very different set of stakeholders who must be consulted when its strategies are being set. In Japanese business firms employees are seen as the number one stakeholder, customers number two, and the shareholders a distant number three. Since the employee is the prime stakeholder, higher employee wages are a central goal of the firm in Japan. Profits will be sacrificed to maintain either wages or employment. Dividend payouts to shareholders are low.
>
> Communitarian societies expect companies to invest in the skills of their work forces. In the United States and Great Britain, skills are an individual responsibility...Labor is not a member of the team. It is just another factor of production to be rented when it is needed, and laid off when it is not. (1992, 32-3)

Michel Albert in *Capitalism vs. Capitalism* elaborates that in the "Rhine model" (his term for communitarian capitalism as practised in Germany), "all parties are invited to participate in company decision-making: shareholders, employees, executives and trade unions alike cooperate in a variety of ways to achieve a unique form of joint management [or corporatism] and...a 1976 law makes it compulsory for all firms of 2,000 or more employees to implement this system of shared decision-making at virtually every level" (1993, 110-11).[3]

The two models of capitalism also differ in their approaches to financial markets and industrial ownership. Although the differences are diminishing over time, in Anglo-American capitalism the dominant source of long-term corporate finance is equity, provided competitively by capital markets, whereas in communitarian capitalism the source of long-term finance tends to be credit, provided by universal banks.[4] Arguably, the rising role of equity finance is one of the principal reasons why Frankfurt has not been able to overtake London as the financial capital of the European Union (EU), even though the United Kingdom is not in the eurozone.

Moreover, because corporate America is financed by impersonal capital markets, Americans are less concerned about preserving particular enterprises. As Thurow notes, "Since the group is not important, preserving any firm is not important" (1992, 142). Closely related is the difference in the approaches to industrial ownership. In Anglo-American capitalism, corporate assets are more or less continuously on the auction block. This is simply not the case in Germany, for example, where commercial bank cross-ownership of industry means that to get control of a firm such as Volkswagen, a buyer would have to get several of the German universal banks on side, plus the government. The same challenge would be found in civil-law Japan, where the *keiretsu* create a complex web of overlapping ownership of

[3] Quebec is also a civil-law jurisdiction, and "Quebec Inc." refers to the tendency of the Quebec government to play a role in the economy along communitarian-capitalism lines. In addition, the third (or voluntary) sector in Quebec is integrated into overall societal governance in ways that differ markedly from the pattern in the (common law) rest of Canada. See Laforest (2007).

[4] Universal banks are financial institutions that can operate across all financial pillars: banking, trusts, insurance and securities. It should not be surprising that civil-law Quebec led the way in developing universal banking in Canada when it allowed its insurance companies and its credit unions to expand across all pillars.

the country's industrial sector. Markets and institutions in such communitarian societies are organic in nature and are an integral part of the societal fabric.

One further area of significant difference between individualist capitalism and communitarian capitalism merits highlighting: immigration. Almost by definition, individualist capitalism will be much more open to immigrants. Labour markets especially are welcoming, since, in principle at least, immigrants are on an equal footing with nationals because it is a worker's skills rather than other personal characteristics that are rewarded. Hence, one celebrates the American "melting pot" and the "multiculturalism" successes of Canada and Australia — all common-law countries. Moreover, while these three countries have different approaches to immigrant accommodation, what they have in common is that the labour market is the key instrument of societal integration. Indeed, part of the inherent economic dynamism of the US stems from the fact that it has succeeded in attracting "the best and the brightest" to its shores.

In stark contrast, communitarian-capitalist societies appear to have considerable problems with immigration. Some are opposed to immigration (Japan), some tend to invite immigrants to enter primarily as "guest workers" (Switzerland), and some accept them but then are unable or unwilling to integrate them geographically or societally (Germany, France). Not only are these countries denied the rejuvenation from which immigrant-integrating societies benefit, but many of them have further rigidified their labour markets by adopting some version of the "insider-outsider" model of the labour market. Spain is a good example of these rigidities:

> One of [every] two euros spent next year by the Spanish government will go on pensions, welfare payments or unemployment benefits. Yet the same government is unwilling to tackle one of the biggest barriers to growth; its unjust, two-tier labour market, in which some workers are nearly unsackable but others (the young, immigrants and others on temporary contracts) take the pain. (*The Economist* 2009, 61)

Arguably, what makes these insider-outsider models possible is the presence of a generous social safety net to placate the outsiders.[5]

Canada captured top place in the annual United Nations Human Development Index for much of the 1990s, due to both high material living standards and the superior health and educational outcomes that broad access to good-quality public services allows. It appears that Canada skilfully blended both versions of capitalism by combining the dy-

[5] Another interesting contrast has to do with the quite different access to tax sources available to cities. Cities in individualist-capitalism countries tend to have their taxing powers limited to taxing property. For example, as a proportion of total local tax revenues, property taxes represent 100 percent in Australia; 99.5 percent in the UK, Ireland and New Zealand; 92.7 percent in Canada; and 72.8 percent in the US. In sharp contrast, communitarian-capitalism cities typically have access to broad-based taxation. For example, income taxes account for 100 percent of local taxes in Sweden, 93.5 percent in Denmark, 84.3 percent in Switzerland and 69 percent in Germany (Chernick and Reschovsky 2006). Because broad-based taxes such as income taxes, unlike property taxes, automatically grow with the economy, they can provide cities with the necessary financial resources to flourish in the informatics era. Since cities are arguably the new dynamic motors today, individualist-capitalism cities would appear to be disadvantaged in this regard.

namism of the Anglo-American economic model with the inclusiveness of the continental European social model in striving for a society that pursued both efficiency and equity. And, of course, a major reason for this is that our federation likewise embraces both common-law and civil-law traditions.[6]

Reflections on the American Dream

Most Canadians are puzzled if not astonished that a country as rich as the US lacks an effective social safety net. To be sure, American individuals and families with ample resources can access excellent health and education services that arguably define the "state of the art" for the rest of the world. However, for a significant and growing number of Americans this is not the case: tens of millions have no health care coverage (though the number will almost certainly decline if President Obama's health care reform is fully implemented), and the US public school system is recognized as wholly inadequate for a developed country. A major part of this puzzle relates to the manner in which the US approach to individualist capitalism has evolved. In particular, and again incomprehensibly to most citizens of the developed world, the US reality is that while increasing incomes over time is a societal priority, the distribution of this income at any point in time tends not to be. Rather, what has come to be called the American Dream is a temporal dream — the belief of Americans that individual initiative and hard work will eventually deliver material progress for themselves and their children (Cooper 1997, 52). Thus, the American Dream is all about a better tomorrow.

Another characteristic of the US approach to the welfare state is that individualist capitalism, and especially the American "Life, liberty and the pursuit of happiness" variant, places more responsibility on the individual than does communitarian capitalism. As Sawhill notes, "In the US people believe that where you end up depends on your own effort and skills — that is, US citizens believe they live in a meritocracy" (2010, 5). As a result, the American ethic places more emphasis on opportunity than on poverty or inequality (20). But it is also true that the election of President Obama on a "Yes we can" platform signalled in large measure a desire to rejuvenate America's social safety net. In spite of a confrontational and arguably dysfunctional political system, the passage of the US health care reform bill in 2010 represented "the biggest attack on economic inequality since inequality began rising three decades ago" (Leonhardt 2010, cited in Sawhill 2010).

Indifference to the actual distribution of income also carries over to the manner in which the US federation operates. Specifically, the US is the only developed federation (probably the only federation, developed or not) that does not have a formal revenue equalization program for subnational governments. It could be argued that, while richer states obviously

[6] For an argument that civil-law Quebec played (and still plays) a pivotal role in developing Canada's social programs, see Courchene (1995). Moreover, because central Europeans and Scandinavians (i.e., peoples from civil-law countries) were well represented in the wave of immigrants that populated the Canadian prairies, provinces like Saskatchewan, which spawned producer and consumer cooperatives and Canadian medicare, also played important roles in the evolution of social policy in Canada in a communitarian direction. I am indebted to Mary Janigan for this insight.

have higher per capita incomes and therefore have access to higher per capita revenues, these incomes and revenues will get capitalized in the form of higher wages and rents. And since states' expenditures are correlated with wages and rents, in the final analysis there may be little to equalize. However, the assumption that there is full (100 percent) capitalization is a convenient fiction that allows American individualist capitalism to also ignore point-in-time distribution issues as they relate to fiscal relations between the federal government and states, and to fiscal equity between states.[7]

The US electoral and political system

It should come as no surprise that common-law or individualist-capitalism countries are the last bastions of first-past-the-post (FPTP) electoral systems: the United States; the United Kingdom; Canada; Australia (except for the Upper House); and, until recently, New Zealand. For their part, communitarian-capitalism countries have various forms of proportional representation (PR) systems, which tend to encourage multiple parties and, therefore, coalition or consensus governments, and on occasion even grand coalitions between the two largest parties, as in Angela Merkel's first mandate in Germany. On the other hand, FPTP systems tend to be adversarial in nature (witness Question Period in the parliamentary democracies of the British Commonwealth), typically involve two main parties and are usually characterized by majority governments. The two parties in FPTP systems often find themselves fighting for the electoral centre, whereas PR systems encourage narrowly focused, even single-issue parties. Here, recent experience in the US is very different. There seems to be no desire to occupy the centre; indeed, there seems little in the way of a policy centre to be occupied.

While the US clearly falls into the FPTP camp, its political culture differs significantly from those of the other FPTP systems. Topping the list of differences is the extraordinary amount of money involved in US election campaigns: over $1 billion in the 2008 presidential campaign and election (with Obama outspending McCain two to one), and $2.6 billion for the 2006 "off year" congressional election.[8] In congressional races, a winner of a House of Representatives seat in 2008 spent an average of $1.4 million (compared with $680,000 in 1998), while a Senate victor in 2008 spent an average of $7.5 million (compared with $4.7 million in 1998) (Campaign Finance Institute 2010). In stark contrast, electoral expenditure limits (after the writ is dropped) for aspirants to the Canadian House of Commons in the 2006 election ranged from C$62,000 to C$106,000 (Heard 2011), depending largely on the number of eligible voters in the constituency, with the maximum spending limits for the national political parties set at just over $20 million if they field candidates in all ridings (Elections Canada 2010).

[7] These observations need to be nuanced. Isabel Sawhill of the Brookings Institution reminded me in her comments on an earlier draft that the US does undertake some equalization on the expenditure side: Medicare and food stamps, for example, are based on formulas that take state per capita income and need into account. And, of course, on the defence side of the federal budget the location of military bases and installations plays a role here as well. More speculatively, might Obama's directing funds from his stimulus package to selected states in order to forestall the layoff of teachers and social workers be viewed as a move toward more formally embracing the principle of interstate fiscal equity?

[8] Unless otherwise specified, dollar figures are in US dollars.

In 2010 the US Supreme Court ruled in *Citizens United vs. Federal Election Commission* that governments cannot ban political spending by corporations and by third parties more generally. Specifically, the five-to-four decision granted corporations free speech rights under the First Amendment. The consensus was that this ruling would help the Republicans, most immediately in the 2010 midterm elections. Indeed, data released in early December 2010 indicated that spending in those elections would likely end up in the $4-billion-plus range, over 50 percent more than the $2.6 billion spent in the 2006 midterm elections. Not only is the amount spent astoundingly high, but perhaps even more surprising, under this ruling, corporate America's political donations can remain anonymous. *Citizens United* will buttress the adage that America has the "best government that money can buy," and it may well add a new dimension to the meaning of "corporate governance."

Along somewhat similar lines, US representatives and senators are more likely to be elected as a result of their own strengths, political and financial, than are members of Parliament in the British or Canadian systems, where many gain office on the coattails of their party or leader. Hence, US lawmakers are much freer to break from party positions. Intriguingly, however, the US political parties themselves are arguably more clearly defined than those in Canada or the UK. Specifically, the Democrats tend to be social and moral libertarians and economic protectionists, whereas the Republicans are social and moral conservatives/protectionists and economic libertarians. At the risk of oversimplification, Democrats favour more expansive public goods and infrastructure on the social side and tend, compared with Republicans, to be pro-choice and to support same-sex unions on the moral side. In contrast, the Republicans embrace the religious right on moral issues, and the ethos of rugged individualism inclines them to be rather indifferent to issues of social equity at home. They also favour an aggressive role for the US abroad as the moral policeman and the defender of liberty and democracy. On economic priorities, Republicans favour lower taxes, smaller government (with the exception of military spending) and liberal trading regimes, whereas the Democrats typically support labour's penchant toward protectionism and are (implicitly) in favour of higher taxation to fund their preference for a larger social envelope. Given these party preferences, it is not surprising that it is hard to find any common or middle ground.

Fordism and the American Dream

Unlike Europe and Japan, the US came out of the Second World War with its economy and infrastructure largely intact. In one of their country's finest hours, Americans embarked on the Marshall Plan, among other initiatives, to rebuild the war-ravaged economies, and they played a lead role in creating a new international institutional order: the World Bank, the International Monetary Fund (IMF) and the General Agreement on Tariffs and Trade (GATT) on the economic and trade side; and the United Nations and the North Atlantic Treaty

Organization on the political and security side. Further on trade and economic matters, the US took the lead in terms of a number of initiatives, including the gold-exchange standard anchored to the greenback (and later the dollar standard itself), as well as the move to restore full currency convertibility and capital mobility across the developed nations. To be sure, these measures were also in America's self-interest since an expanding global economy was essential for the US to take full advantage of its privileged position as the uncontested economic superpower. Nonetheless, in the process the US paved the way for the Europeans and the Japanese to eventually achieve rough equality with the US in terms of living standards.

The postwar recovery in economic growth and trade led to the era of US mass production, or Fordism, and to significant increases in incomes. The result was a dramatic expansion of the American middle class. One of the key factors underlying this surge in US economic fortunes was the 1944 GI Bill of Rights, which ensured that the roughly 10 million returning soldiers, many of whom had been unemployed before the war, were eligible for training and scholarships. Gabor Steingart writes that this education program "would prove to be an upgrading of the labour force that was unprecedented in the world...[and] led to great jumps in productivity in the post-war era" (2008, 63). In 1946, almost 50 percent of the roughly two million US college or university students and three-quarters of the males were veterans (Bennett 1999).

Indeed, the privileged position of the US in the early postwar period was such that even relatively unskilled Americans could aspire to middle-class status because they were able to work with quantities of physical and financial capital that were simply not available in other countries. Moreover, the American economy was increasingly dynamic and innovative as a result of creating world-class universities and research institutes and of inviting the best and the brightest from the rest of the world to settle in the US. This innovation drove the productivity of all workers, regardless of skill level. For both of these reasons, American factory workers could command higher wages than similarly qualified workers elsewhere. The rising wages and incomes of these factory workers combined with falling prices for consumer goods arising from mass production meant that a majority of Americans were able to live the American Dream: the middle-class lifestyle. The United States had indeed reached the commanding heights.

Inevitably, however, Europe and Japan began to close the income and technological gap with the US, and in the 1990s many observers began to champion aspects of the European socio-economic model, especially its emphasis on training (e.g., apprenticeships) and on the high societal value placed on skilled trades. Part of the argument advanced, consistent with Thurow's description of labour quoted earlier, was that the individualist-capitalism model's tendency to view employee benefits and training (and social programs in general) more as a cost of production than as an investment in the education and well-being of workers and citizens was leading to the "commodification" of labour and to the attempt to compete with the bottom end of the labour force (Laux 1991, 289). As I noted in my presidential address to the Canadian Economics Association (Courchene 1992, 770), "While competing with the bottom may make sense as a transition strategy, over the longer term it is a mug's game since there will always be somebody, somewhere with a lower bottom." Indeed, I suggested that the resulting inequality of opportunity between skilled and unskilled workers would undermine social cohesion and would likely lead to the kind of societal decoupling consistent with the visions of America articulated by Robert Reich in 1991 and Christopher Lasch in 1994. Not surprisingly, "competing with the bottom" left unskilled labour vulnerable to offshoring.

In contrast, the advocates of communitarian capitalism argued that the better longer-term approach was to compete with the middle and upper parts of the labour market on the one hand and to embrace citizens' upward mobility through skills enhancement on the other, as in the German apprentice/technologist model. This would lead, the argument went, to an industrial system geared to high-value-added production and thus a high-wage and, if one wished, a high-transfer economy and society. Hence, productivity increases within the European system in this era arose via technological change and by utilization of a labour force with a higher skill mix rather than from the commodification of labour under the individualist-capitalism model (Myles 1991, 363).

While Fordism did in this sense sow the seeds of its eventual demise, there were several key features of the US model that ensured that the American Dream would remain alive and well, at least for a time. Prominent among these was the fact that the US still excelled in innovation, while Europe remained largely engaged in economic and technological catch-up, not yet ready to make the transition to technological leadership. To be sure, this is a difficult transition, since the closer a nation gets to the technology frontier, the more "innovation" rather than "replication" becomes the name of the competitive game.

Beyond technological leadership, a second reason why the US trumped Europe and Japan in innovation during, and even beyond, the Fordism era relates to the inherent flexibility and dynamism of the US individualist-capitalism model. As Thurow notes, "America's greatest strength is not its ability to open up the new...[but rather its] ability to shut down the old" (1999, 56). In more detail:

> In contrast to America, where eight of the twenty-five biggest companies in 1998 did not exist or were very small in 1960, all of Western Europe's twenty-five biggest corporations in 1998 were already large corporations in 1960…[Again] in contrast to America, which in less than a decade went from having two to having nine of the world's top ten largest companies, Europe started with one and ended with one — Royal Dutch Shell. Europe has been completely unable to grow new companies into big companies in the last forty years. (93)

Whatever the other benefits of communitarian capitalism may be, the organic nature of its markets and institutions (i.e., its corporatism) is not conducive to the Schumpeterian cycle of creative destruction. Moreover, the inability to shut down the old (or sunset) industries means that labour and capital run the risk of being trapped in lower-productivity activities, whereas creative destruction frees up these factors to engage in newer and higher-productivity ventures. In this context, Canadian economist Sylvia Ostry's oft-repeated dictum merits airing one more time: Governments may be no better or worse than the private sector in picking winners, but losers are incredibly adept at picking governments.

Given that the US has maintained much of the inherent flexibility and dynamism that allowed it to dominate the Fordism era, it would seem rather obvious that these characteristics would stand America in good stead in the informatics era, when Schumpeterian creative destruction holds even more sway. However, while the elites still reap the rewards of this dynamism, the combination of some key features of the informatics era interacting with America's variant of individualist capitalism has served to undermine not only the American Dream and the middle class, but the US economy as well.

The Informatics Era

According to sociologist and information theorist Manuel Castells (1996, 2004), the post-Fordism or post-1980 global economic and financial environment is the product of two developments: a new and transformative technology that led to the emergence of the network as the preeminent and ubiquitous socio-economic organizational form, and a change in the Anglo-American value system in the direction of "unfettered capitalist globalization." In tandem, these gave rise to the informatics era.

Transformative technology: The rise of the network society

Underpinning the informatics era is a new general-purpose technology based on the dramatic enhancement of our capacity for, and the democratization of access to, information processing and communication, a technology that is built upon successive revolutions in microelectronics, software, computation, telecommunications and digital communication. And at the heart of this latest revolution is the Internet, which is the technological basis for the network. Because networks are located not in the "space of places" but rather in the "space of flows," they are by definition unconstrained by national boundaries (Castells 2004). It is this characteristic of networks that underlies the informatics era's conception of globalization — namely, "the ability for an economy to work as a unit in real time on a planetary scale" (Castells 1996, 92). In particular, networks are the key integrating instruments enabling the rapid emergence of global supply chains; indeed, global supply chains are networks.

A further transformative feature of the shift from an industrialization or Fordism paradigm to the new informatics paradigm is that it privileges knowledge and human capital (i.e., skills and educational attainment) relative to physical and financial capital or, to draw on my own terminology (2001), it privileges "mortarboards" over "boards and mortar." Moreover, since human capital is distributed across the globe much more equally than is physical or financial capital, and since the full resources of the network society are in principle accessible from anywhere on the globe, these space-of-flows enterprise networks have the obvious potential for dramatically reconfiguring the locus of geographical (space of places) economic power.

Another difference, as Paul Romer notes, is the sharp contrast between the "decreasing returns" nature of the former industrial Fordism economy of resource extraction, commodity production and manufacturing and the "increasing returns" nature of the knowledge-innovation economy characterizing the new era (1997). While competition in the industrial paradigm normally occurs when new firms produce a similar product but at a lower price, this is not the typical pattern in the informatics era. Here, Romer says, competition occurs when new firms enter by developing new and better products: that is, by innovating. This "leapfrogging" or creative-destruction process of innovation is the essence of the ongoing computer and Internet revolution and, more generally, of the informatics era.

Given all this, it is not hard to anticipate part of the ensuing storyline: relatively unskilled workers (especially those operating with abundant physical and financial capital, as was characteristic of US workers in the earlier era) fared much better under "boards and mortar" Fordism than in the "mortarboards" informatics era.

A new ideology: Unfettered capitalist globalization[9]

Accompanying this new technological and knowledge-based era was and is a very significant ideological shift. Castells notes that this shift was essential because the existing industrial model was underperforming. Its organizations, values and policies were unable to achieve the economic potential unleashed by the informatics revolution. In effect, this meant calling into question the Keynesian economic model and more generally the role of government within it. What actually transpired might be referred to as the "Reagan-Thatcher transform." Castells elaborates:

> The decisive shift to a different model of accumulation came from governments, albeit in harmony with corporations. It can be related to the twin victories of Thatcher in the UK in 1979 and Reagan in the USA in 1980...They came to government with a mission: to recapitalize capitalism, thus ushering in the era of economic liberal policies that by successive waves took over the world, in different political-ideological versions, over the next two decades. The crushing of organized labor politically, the cutting of taxes for the rich and the corporations, and widespread deregulation and liberalization of markets...were crucial strategic initiatives that reversed the Keynesian policies that had dominated capitalism in the previous twenty-five years...A new orthodoxy was established throughout the world...unfettered capitalist globalization, spearheaded by the liberalization of financial markets...and enshrined in asymmetrical trade globalization represented by the new managing authority, the World Trade Organization. Under the new conditions, global capitalism recovered its dynamism, and increased profits, investment, and economic growth, at least in its core countries and in the networks that connected areas of prosperity around the world. (2004, 15-16)

[9] "Unfettered capitalist globalization" is the term coined by Castells; here "unfettered globalization" and "unfettered capitalism" will be used interchangeably.

The immediate US action in pursuit of unfettered capitalism was massive income tax cuts. Ronald Reagan cut the top US marginal personal income tax rate from 70 percent to 28 percent during his presidency, a tax cut that in varying degrees was replicated across the developed world. These tax cuts were accompanied by large increases in defence expenditures. This policy package, appropriately termed "military Keynesianism," led to the Reagan boom, described by Martin Anderson: "We don't know whether historians will call it the Great Expansion of the 1980s or Reagan's Great Expansion, but we do know from official economic statistics that the seven year period from 1982 to 1989 was the greatest, consistent burst of economic activity ever seen in the U.S. In fact, it was the greatest economic expansion the world has ever seen — in any country, at any time" (1990).

The downside of military Keynesianism, however, is that it also generated domestic and foreign indebtedness not seen since the Second World War. During the Reagan era the US went, in absolute terms, from being the world's largest net creditor nation to being the world's largest net debtor nation. Specifically, the net international investment position of the US (including direct and portfolio investment) went from a \$360.3-billion surplus in 1980 to a \$246.2-billion deficit in 1989, while the US net federal debt ballooned from \$700 billion to \$2.2 trillion over Reagan's eight years. Although obviously at odds with the traditional Republican principle of limited government, this run-up in debt and deficits did serve to hamstring any and all efforts to introduce major new spending programs in nondefence areas.

Up until the millennium, and even beyond, unfettered capitalism led, as intended, to a dynamic, innovative and growing America. This ideological shift was certainly fully in line with "Life, liberty and the pursuit of happiness" and the individualist-capitalism model. Moreover, it so infused domestic thinking that the US did its very best to export this philosophy to the rest of the world via the Washington Consensus, a set of principles based on liberalization, deregulation, privatization and free markets used by international institutions such as the International Monetary Fund in their programs for economically troubled nations.

Inequality and the Eroding Middle Class

The transition from Fordism to the informatics era also led to a social transformation. The reconciliation of social and economic goals inherent in the Fordism era lay in what John Ruggie has termed the "compromise of embedded liberalism": "Societies were asked to embrace the changes and dislocation attending liberalization. In turn, liberalization and its effects were cushioned by the newly acquired economic and social policy roles of governments" (1995, 508).

As a result, the modern welfare state grew in tandem with increasing international economic openness because the institutional framework embedded this openness within an activist domestic social democracy and an accommodating international regulatory system, most notably the World Bank, the IMF and the GATT. To be sure, the Fordism era was the heyday of the Keynesian revolution, with its attendant growth in the size and scope of governments everywhere, which served to accommodate domestic priorities and aspirations alongside increasing internationalization of trade. In fact, "it [was] in the most open countries, such as Sweden, Denmark and the Netherlands, that spending on income transfers [had] expanded the most" (Rodrik 1997, 6).

But in the informatics era it is much less likely that unfettered globalization will be accompanied by a deepening of the social envelope. Rather, the opposite is likely to be true:

> Far-sighted companies will tend to their own communities as they globalize. But an employer that has an "exit" option is one that is less likely to exercise the "voice" option. It is so much easier to outsource than to enter a debate about how to revitalize the local economy. This means that the owners of internationally mobile factors become disengaged from their local communities and disinterested in their development and prosperity. (Rodrik 1997, 70)

The question, as Rodrik sees it, is how to ensure that international economic integration does not lead to domestic social disintegration.

Unfortunately, but perhaps unsurprisingly, US policy has effectively ensured that international economic integration will indeed lead to domestic social disintegration. Four signs of this development are examined next: first, the outsourcing and offshoring phenomenon; second, the evolution toward "winner take all" capitalism; third, the current mortgage and financial debacle; and fourth, the eroding middle class.

Offshoring

Human capital is to the informatics era what physical and financial capital were to Fordism. In this increasingly knowledge-based era, the market incomes of those with skills and human capital are rising relative to the market incomes of the unskilled. Furthermore, the greater an individual's human capital, the more mobile internationally he or she is likely to be. This means that in addition to garnering higher wages, high-level human capital, or "talent," is now more difficult to tax. This follows from the general proposition that mobile firms and workers can simply move in response to onerous taxation or regulation. No doubt this is part of the reason why Reagan's dramatic personal income tax reductions triggered analogous reductions across the countries of the Organisation for Economic Co-operation and Development (OECD) and beyond. The evidence suggests that it is the immobile factors (land and unskilled labour) that, relatively and even absolutely, are bearing much of the adjustment cost arising from the informatics era (Rodrik 1997). One of the consequences is that the increase in the returns to human capital will inevitably reconstitute the US middle class along the skills and education spectrum and, equally inevitably, will undermine much of Fordism's middle class. Indeed, this is the theme that underlies much of what follows.

In a context of unfettered capitalism and global supply chains, firms can now search the globe for the most cost-effective location from which to source inputs into the production process. The first and foremost implication for unskilled labour arises from the fact that while work becomes mobile, low-wage workers do not. Thus, the earlier model, which gave rise to an American middle class based on unskilled labour working with a relative surfeit of physical and financial capital, has become less and less competitively viable. The new reality is that workers at the relatively unskilled end of the labour force no longer have access to the American Dream through simple hard work: there will always be a lower, economically accessible bottom elsewhere where this work can be outsourced.

Intriguingly, society's long-standing focus on the minimum wage is being turned on its head by the increasing importance of what might be called the "maximum wage." If the domestic wage related to a given activity is above a certain threshold (i.e., the maximum global wage for this activity), then the activity becomes a candidate for offshoring.

Under unfettered capitalist globalization, there are no longer any "national" firms in the sense of enterprises embracing national goals and policies, unless these are consistent with global economic efficiency or are essential to national security.[10] What is possible, however, is for nations to enact policies, or otherwise encourage activities, that generate "positive non-traded externalities" (Storper 1995). By definition, the only way to access these externalities — often found in clusters — is to locate in their midst. Examples would include the depth and breadth of the informatics-literate labour force in Silicon Valley or the expertise associated with golf-club technology and manufacturing in Carlsbad, California. Such untraded externalities also exist at more aggregate levels (America's flexible and dynamic entrepreneurial environment would qualify, as would Canada's publicly funded health care).

Encapsulating the dilemma of unskilled workers in the informatics era, as well as pointing the way toward one obvious solution, Lester Thurow writes: "If unskilled first world workers don't want to be in competition with equally unskilled but lower wage third world workers, they will need much better skills. With globalization and a skill-intensive technological shift, much better skills must be delivered to the bottom two-thirds of the labor force in the developed world if their wages are not to fall" (1999, 132-3). Thurow also offers the following informatics-era truism about the implications of unfettered capitalist globalization: "If capital is borrowable, raw materials are buyable and technology is copyable, what are you left with if you want to run a high wage economy? Only skills, there isn't anything else" (1993). Because this is a key message for all policy-makers in all economies, it may be that success on this front requires not only an absolute, but also a relative upgrading of skills.

[10] To be sure, there is an earlier literature that suggests that multinational enterprises did embrace aspects of the home country's policy preferences. If this is the case, then the message here is that the shift from Fordism to the informatics era has effectively transformed multinationals into transnationals where home country preferences no longer hold sway. However, there is an alternative way to view this — namely, that corporate interests were always transnational, but until the era of unfettered capitalism and global supply chains the opportunity to maximize profits transnationally was constrained. I am indebted to John Allan for this observation.

So far in this discussion of offshoring we have been ignoring the elephant in the room — namely, that much of what passes for offshoring represents, as Steingart (2008) suggests, an abandoning of Western values and an embracing of the values of the emerging nations as they relate to labour practices and environmental policies.

Abandoning Western values via US imports

With an unfathomable 1.5 billion new workers appearing in the world economy over the recent time frame, the global labour market is experiencing a decline in wages that has caught the West by surprise. Brazil, Russia, India and China now have 45 percent of the world's labour supply compared with 19 percent for OECD members (Steingart 2008, 150). In the presence of global supply chains, transnational firms will obviously move to take advantage of the resulting wage differential. And a most substantial advantage it is, as Steingart elaborates:

> Labor costs make up 23 percent of the retail price of a television set made in the West; the cost of labor that goes into the primarily Asian-made parts is low, but the assembling costs in the West are much higher. If the television set is completely made in China, labor costs make up only 4 percent of its retail price. It is precisely this wage gap — all other production costs being nearly equal — that will ultimately shut out ordinary American workers. (150)

In addition, we can choose a domestic GM vehicle with its associated nonwage labour costs (such as health insurance premiums and pension contributions) of $1,600, or we can choose a car from another country that will not include this markup. Likewise, US-made Whirlpool washing machines cannot compete economically with those from China and elsewhere where workers have deplorable working conditions and there are no environmental standards. Phrased differently, "there is no built-in welfare state in a Chinese made household appliance" (Steingart 2008, 152-3).

The ultimate irony here is that while the West has welcomed China into the World Trade Organization (WTO) in order to ensure that the international playing field becomes more level, it is the West that has embraced (via offshoring of production and reimporting the resulting goods) the social and environmental policies of China and other emerging nations, with the result that the playing field has never been so unlevel from an American (and Western) vantage point. This is a collective decision by the West so that individual Western capitalists have no choice except to take advantage of moving production abroad.

Now some have claimed that, in aggregate, the benefits to all consumers from lower prices as a result of offshoring and then reimporting exceed the dollar costs associated with workers whose jobs have been outsourced. First of all, this is probably not the case: the true dollar costs of this outsourcing must include the ratcheting upward of America's twin deficits — the fiscal deficit because of the increased draw on social programs and the current account deficit because of the huge trade imbalance with China — and the resulting increase in US foreign indebtedness. Second, this is a comparison that could be made only in a society where consumerism as a value is put on par with access to employment. Arguably, this consumerism ethic is one of the features that sets the US apart from the typical communitarian society.

Outsourcing is an element of what might be referred to as "winner-take-all capitalism." Writing during the period when the American Dream was secure, economist Kenneth Boulding stressed "the inefficiency of attempting to wrestle $1 away from one's fellow man when for the same effort one can wrestle $10 from nature" (1973, 95). However, in recent years, when nature seems less bountiful, the temptation to wrestle a dollar from one's neighbour becomes correspondingly stronger. Indeed, a case can be made that US individualist capitalism has veered in this very direction in recent years, as a more competitive external environment encourages rent-seeking rather than value-adding activities.

Winner-take-all capitalism

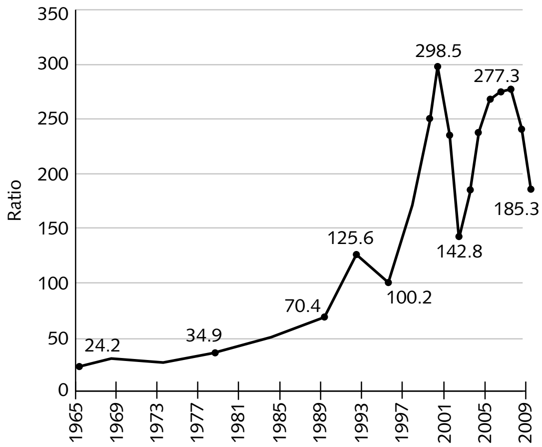
As early as the 1990s, Robert Reich in *The Work of Nations* (1991) argued that the well-being of Americans depended on the value that they add to the global economy through their skills and insights. Obviously, not all Americans are equal in this regard. Reich distinguishes among three types of workers or jobs: routine production workers, in-person services and symbolic analysts. He associates symbolic analysts with problem solving, problem identifying and strategic brokering services. In this era of increasing ease and speed of global communication, the economic star of these symbolic analysts is rising dramatically, while it is falling for the other two groups, particularly for the routine workers as they are replaced by cheaper labour elsewhere. Reich notes that these symbolic analysts tend to congregate geographically (e.g., Silicon Valley and Route 128 near Boston), resulting in not only a widening income gap but also a geographic polarization of rich and poor areas. The symbolic analysts are, in effect, "seceding from America" and linking themselves to the global economy: their social and political bonds to America tend to unravel as their economic bonds unravel.

In "The Revolt of the Elites: Have They Cancelled Their Allegiance to America?" Christopher Lasch expands on this phenomenon: "The elites possess most of the wealth. They are becoming increasingly independent from crumbling industrial cities and crumbling public services because they have their own private schools, private health care, private security etc. Their market is international and their loyalties are international rather than...national or local" (1994, 47).

Direct evidence on the extent to which the American elites have in fact "seceded from America" would obviously be hard to come by. However, recent data based on two different approaches to assessing the relative and absolute incomes of the wealthiest Americans reveal that they certainly have the means to do so. The first set of data measures the ratio of US chief executive officers' earnings to those of the average production worker from 1965

FIGURE 1

Ratio of CEOs' earnings to those of average production workers, United States, 1965 to 2009



Source: Economic Policy Institute (2011).
Note: Point markers denote where ratio is known.

to 2009 (figure 1). In 1965, CEOs earned an average of 24 times more than the average production worker earned. By 1978 the ratio had increased to 35 times. But the big increases came in the informatics era, culminating with an interim high of 298 in 2000. The temporary fall to 143 in 2002 reflects the impact of the high-tech bust. By 2005 the ratio had rebounded to 277, before falling in the wake of the recent recession.

Is America unique here? Or do other capitalist countries, particularly individualist-capitalism countries, have similar patterns? Table 1 comes at this question using different data than in figure 1 — namely, the ratio in 2005 of CEOs' total pay (rather than salaries and bonuses) to average workers' pay (rather than production workers' earnings). The civil-law nations in the table have ratios ranging from 11:1 in Japan to 20:1 in Italy, with Germany and France in between. In individualist-capitalism countries, Canada and Britain have ratios of 20:1 and 22:1, respectively, with common-law Hong Kong coming in with a ratio of 41:1. While these rankings are largely consistent with the two forms of capitalism, the real story is how the US compares with all other countries. With a ratio of 475, it appears that the US has taken the individualist-capitalism model to rather unimaginable heights,[11] the latest indication that the US is becoming a winner-take-all (or in the case of bailed-out CEOs, loser-take-all) society.

Figure 2 contains further evidence along similar lines: the share of overall nominal market income (including capital income) accruing to the top decile of income earners over the period 1917-2007, based on data compiled by Piketty and Saez (2003) and Saez (2009). For 1917 to 1945 they trace the rapid rise in the top-decile income share from 1917 through to the market crash in 1929 and then the dramatic fall from the crash through to the Second World War.[12]

The period from the 1950s to about 1980, which was the heyday of the American Dream, is characterized by a top-decile share averaging just under 35 percent. From 1980 onward, the share rises dramatically, touching 50 percent in 2007. More startling evidence of the widening

[11] It is passing strange that there is not more of an international market in CEOs' pay. One likely explanation is that corporate governance (e.g., the nature and composition of the board of directors) differs markedly between the US models and the "corporatist" governance models of continental Europe and Japan, which typically have labour representatives on the boards of directors who would never tolerate these wage discrepancies.

[12] Piketty and Saez (2003) note that these fluctuations were driven largely by movements in capital income rather than in labour income. In particular, the wartime drop is explained by the rise in corporate income taxes (and the corresponding fall in dividends) related to war financing. Moreover, during this period the share of capital income as a share of total earnings was higher than in more recent periods.

TABLE 1

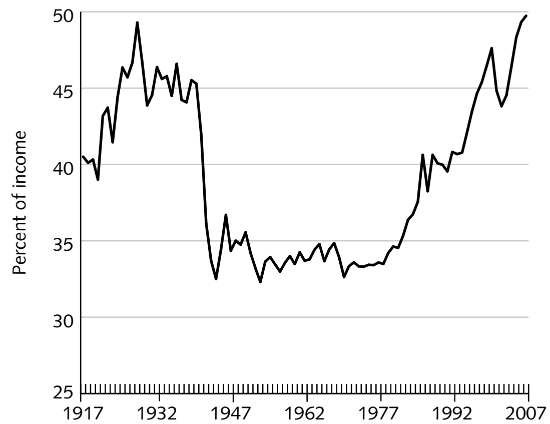
Ratio of CEOs' pay to that of average workers, selected countries

Country	Ratio
Japan	11
Germany	12
France	15
Italy	20
Canada	20
South Africa	21
Britain	22
Hong Kong	41
Mexico	47
Venezuela	50
United States	475

Source: Kroll (2005).

FIGURE 2

Share of income accruing to the top 10 percent of families, United States, 1917 to 2007



Source: Piketty and Saez (2003); Saez (2009).
Note: Income includes labour earnings and realized capital gains. To illustrate, in 2007, the top 10 percent consisted of all families with an annual income above $109,630.

income gap appears in table 2, which presents the growth of real annual incomes for the top 1 percent of Americans and for the remaining 99 percent, for both the Clinton and the Bush expansions. From 2002 to 2007 (during the George W. Bush era), the top 1 percent captured 65 percent of the total income growth, compared with 45 percent under the Clinton expansion. That the remaining 99 percent of Americans garnered only 35 percent of total income growth over the Bush years is further confirmation of winner-take-all capitalism. While the Clinton period was more benign, the 55 percent share of income growth accruing to 99 percent of Americans from 1993 to 2000 obviously also qualifies for the winner-take-all label. Not only do the data show a dramatically eroding middle class, but the income disparities raise concerns about social stability and democracy. Suffice it to say that as eminent a free-market proponent as Federal Reserve Chairman Alan Greenspan, appearing before a Senate committee in June 2005, commented as follows on the diverging fortunes of different groups in the labour market: "As I've often said, this is not the type of thing which a democratic society — a capitalist democratic society — can really accept without addressing" (Grier 2005).

The evidence of the impact of offshoring on low-skilled workers and of the income performance of the richest Americans leads to the conclusion that America is fast becoming the most unequal society in the OECD. For the middle class, prospects are worsening and the promise of the American Dream is fading. Enter the subprime mortgage debacle.

The mortgage debacle and the vanishing American Dream

Since China seems omnipresent in any analysis of recent events and future prospects for the US, it should not come as a surprise that China also played an oft-overlooked triggering role in the still-ongoing mortgage collapse in the US. Specifically, the combination of China's role as the world's workshop, its surplus labour supply (which has kept its domestic wages relatively low) and the currency peg between the yuan and the greenback effectively meant that US goods and services inflation was also low and stable before the collapse. Even though the US Federal Reserve has not formally embraced inflation targeting, it nonetheless tends to calibrate interest rates with reference to what is happening on the inflation front, so interest rates remained low in the mid-2000s in spite of the fact that the economy and expectations were spiralling upward. In the event, monetary policy was far too easy. (If the inflation rate chosen for assessing the appropriate monetary stance had included asset prices in addition to goods and services prices, interest rates would have increased much earlier than they actually did, thus providing some early dampening to what Greenspan had earlier labelled "irrational exuberance.")

It was in this environment that "financial engineering" by the largely unregulated investment banking industry found a foothold. The search was on for some relatively high-yielding financial instrument that could be successfully and successively leveraged via collateralized debt instruments and could, therefore, satisfy the excess demand for credit. The fateful choice was mortgages, and specifically subprime mortgages. (Note that "subprime" actually refers to mortgagors, not the instruments: it is the borrowers who did not qualify as "prime.") In the euphoria of rising home prices in the mid-2000s, the mortgage interest rate for an initial period was set appealingly low, with the renewal rate a couple of years later typically set several percentage points higher. The selling pitch presumably included the likelihood of a substantial appreciation of the value of the property, so that the future interest rate increases could be downplayed. This is one way in which financial engineering morphed into financial subterfuge. Another was that the collateralized debt based on mortgages of subprime borrowers was sliced into tranches, the upper echelons of which were, astoundingly, endowed with triple-A status by the rating agencies.

That regulators could allow the collateralization of these mortgages to balloon into an enormous inverted pyramid and in the process risk the viability of the entire financial sector seems unfathomable, even under the most extreme winner-take-all version of individualist capitalism. And as if the subprime mortgages and the collateralized debt weren't bad enough, the infamous credit default swaps (which Warren Buffett called "financial instruments of mass destruction") rounded out the risk-laden

TABLE 2

Average annual real growth in the incomes of the top 1 percent and bottom 99 percent of families under President Bill Clinton and President George W. Bush (percent)

	Average	Top 1%	Bottom 99%	Proportion of total growth captured by the top 1%
1993-2007	2.2	5.9	1.3	50
Clinton 1993-2000	4.0	10.3	2.7	45
Bush 2002-07	3.0	10.1	1.3	65

Source: Piketty and Saez (2003); Saez (2009).
Note: Computations are based on family income including realized capital gains (before individual taxes). Incomes are deflated using the Consumer Price Index.

picture. These were market instruments that allowed third (unrelated) parties to speculate on the success or failure of specific financial instruments and institutions.

The jump in oil prices to nearly $150 per barrel in mid-2008 put a real damper on expectations of future growth. As the shock of the oil spike spread through the economy, discretionary income fell sharply. Then the built-in interest increases in subprime mortgages kicked in, and a steep increase in foreclosures began: they rose from under 2 percent of mortgages in the second quarter of 2006 to nearly 7 percent in the second quarter of 2008 (Liebowitz 2009). And as these foreclosures spread to the overall financial system, the massive inverted financial pyramid collapsed and triggered the most severe recession since the Great Depression. Not surprisingly, this turned out to be devastating for many low- and middle-income Americans. The unemployment rate approached 10 percent, and the proportion of US homeowners who were "under water" (i.e., who owed more on their mortgages than their properties were worth) soared to about 25 percent (Simon and Hagerty 2009, 24) and remains near that level as of early 2011. This translates to over 11 million households with negative home equity. This is certain to be a further blow to those individuals who had earlier viewed themselves as middle-class, home-owning Americans but had been enticed into remortgaging their homes.

A final indignity visited upon the victims of the mortgage debacle can be described only as a display of unrestrained greed: namely, the multimillion-dollar bonuses paid out to executives of financial institutions, some of whom were among the key players in creating this dangerously leveraged financial situation. Indeed, some of these bonus recipients were from firms that exist today only thanks to last-resort bailout efforts by the US Treasury and the Federal Reserve. The defence offered by these institutions is that these bonuses (and more generally the sky-high pay packages) are necessary to retain valued talent and prevent them from moving to competing firms. However, from table 1 and figure 1, it is clear that this market for top-end talent is largely an American-driven market, not a global market. Where else could these people go? Alternatively, given what they have wrought, why are they still so valued today?

It is important to note that the blame for the subprime fiasco should not fall only on the financial market players. For example, as noted earlier, had the Federal Reserve been targeting asset prices in addition to goods and services prices, it would have raised interest rates much sooner and alleviated some of the excess demand for credit. In the event, the financial institutions engaged in increasingly risky loans and mortgages in order to meet this demand. Influencing them in this direction was the earlier government pressure on banks to make home loans in low- and moderate-income neighbourhoods. Moreover, the regulatory bodies were surely aware of the typical modus operandi of the financial lenders in carrying out this mandate of increasing home ownership: offering a combination of no down payment, no verification of income, interest-only payment plans, weak credit history searches and adjustable-rate mortgages. The unfortunate irony here is that this pressure was presumably premised on the notion that home ownership is an integral part of the American Dream. Given that roughly a quarter of existing mortgages are still under water, the devastation of the subprime mortgage debacle may not yet have run its course. This is regulatory failure on a grand scale. An appropriate concluding comment on this shocking episode is from Michael Lewis' *The Big Short*: "The leveraging of middle-class America was a corrupt and corrupting event, and the subprime mortgage market in particular was an engine of exploitation and, ultimately, destruction" (2010, 107). Well phrased.

Middle class in America: The White House view

The implications of America's version of unfettered capitalist globalism for the middle class and for the American Dream can be seen in *Middle Class in America* (US Department of Commerce 2010), a document prepared for the Office of the Vice President of the United States. For two-parent, two-child families in the 50th income percentile, real income was \$67,600 in 1990; in 2008, a 50th-percentile family's income was \$80,000, 20 percent higher.[13] However, the inflation-adjusted prices for some major-expenditure items associated with a middle-class lifestyle had increased by much more than 20 percent since 1990 — housing (56 percent), health care (155 percent), public college (60 percent) and private college (43 percent). This, too, is a key feature of the erosion of the American Dream.

While it seems clear that middle-income Americans are worse off today than in past years because they are less able to afford the basket of goods and services that define a middle-class lifestyle, something more worrying has emerged — namely, the polarization of incomes and the resulting increase in inequality in the US.

Inequality and the American Dream

In *The Spirit Level: Why Equality Is Better for Everyone* (2010), Richard Wilkinson and Kate Pickett bring what they refer to as "evidence-based politics" to the role that income inequality, as distinct from income level itself, plays in the incidence and severity of health and social problems. The measure of inequality that they use to examine a sample of rich countries is UN data on the ratio of income received by the top 20 percent of the population relative to the income of the bottom 20 percent of the population; income is measured as household income after taxes and benefits, adjusted for the number of people in each household. A second data set comprises the 50 US states, with the familiar Gini coefficient used as the inequality measure.

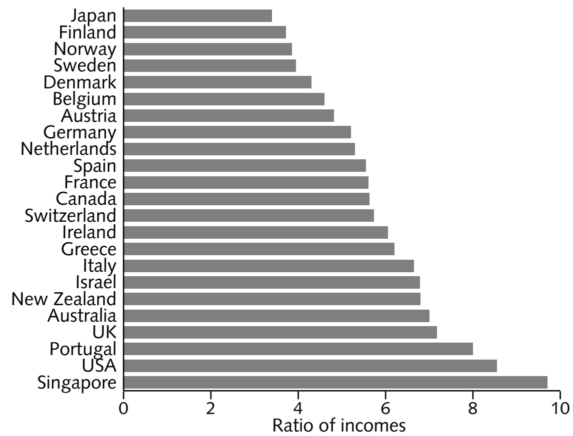
Among 23 rich countries (figure 3), Japan and the Nordic countries have the least inequality and the US is the most unequal, except for Singapore. In the US, the top 20 percent have an income level about 8.5 times that of the bottom 20 percent. Excluding Portugal

[13] The 2008 median-income or 50th-percentile families worked more hours than their 1990 counterparts, were older and were better educated, so that one would expect that their incomes would be higher.

(because its income per capita is several thousand dollars less than the next-richest country's, and lower-income countries tend to have more unequal income distribution), something quite surprising is apparent in figure 3: the 6 most unequal countries are all common-law or individualist-capitalism countries, whereas the 11 most equal countries are communitarian-capitalism countries. Canada ranks higher in the equality hierarchy than any common-law country, presumably because it is a hybrid of the two models.

FIGURE 3

Average ratio of the incomes of the richest 20 percent and the poorest 20 percent, selected countries, 2003-06



Source: Wilkinson and Pickett (2010), figure 2.1.

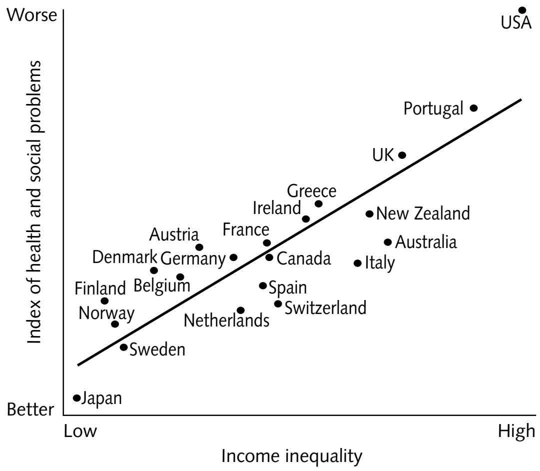
Wilkinson and Pickett find that the greater the degree of income inequality, the worse are the health and social problems; the US is a clear outlier, with the greatest inequality and the worst outcomes. Of the 21 countries in figure 4, the communitarian-capitalism countries tend to do much better than the individualist-capitalism countries. Figure 5 establishes that there is no obvious correlation between the level of per capita income in these countries and the index of health and social problems, so inequality has an impact on social pathologies that is independent of income itself.

When this exercise is repeated for the individual American states, the results show that, like countries, states with greater inequality (i.e., higher Gini coefficients) have worse health and social problems (figure 6). The authors also show that there is no general relationship between US states' social pathologies and the level of their per capita incomes, so again inequality appears to have an impact independent of income levels (not shown here).

Similar patterns appear in the data Wilkinson and Pickett analyze for several of the individual social and health problems listed in their index (see figures A1 to A3 in the appendix of this study). Not only are teenage birth rates positively correlated with inequality but, again setting aside Portugal, all six individualist-capitalism countries have higher rates than any of the 14 communitarian-capitalism countries. Furthermore, all individualist-capitalism countries except Ireland experience more drug use than any of the 16 communitarian-capitalism countries in the sample. Another facet of US society that merits attention is that the incarceration rate easily surpasses that of any other country. With 5 percent of the world's population, the US has 23.4 percent of the world's prisoners (2.3 million inmates in 2009). An astounding 1 in 20 men is either behind bars or being monitored (Glaze 2010). Incarceration is another social pathology that is closely related to inequality. Wilkinson and Pickett

FIGURE 4

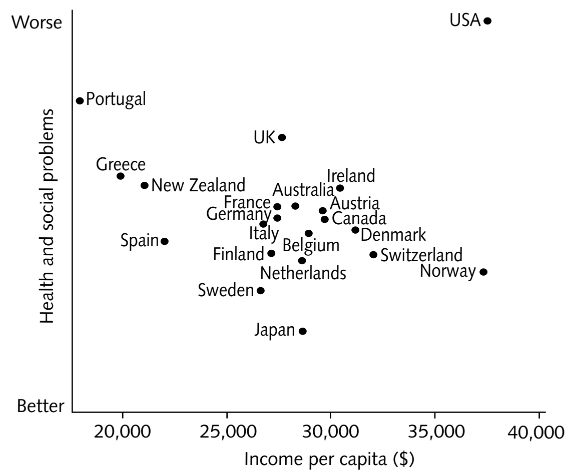
Relationship between health and social problems and income inequality in the late 1990s and early 2000s, selected countries



Source: Wilkinson and Pickett (2010), figure 2.4.
Note: Health and social problems are measured by an index of life expectancy; numeracy and literacy; infant mortality; homicide rates; rates of imprisonment; teenage births; trust; obesity; mental illness, including drug and alcohol addiction; and socio-economic mobility.

FIGURE 5

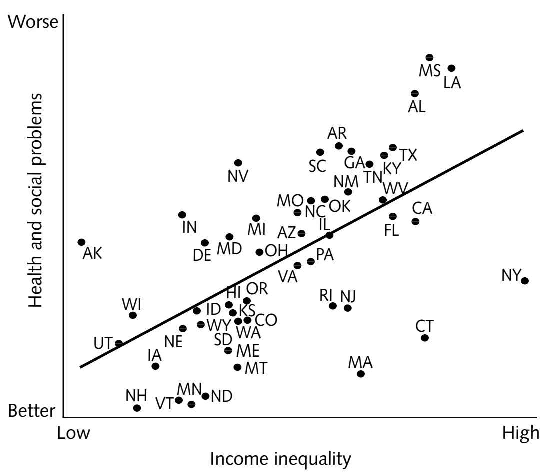
Relationship between health and social problems and income per capita in the late 1990s and early 2000s, selected countries



Source: Wilkinson and Pickett (2010), figure 2.5.
Note: Health and social problems are measured by an index of life expectancy; numeracy and literacy; infant mortality; homicide rates; rates of imprisonment; teenage births; trust; obesity; mental illness, including drug and alcohol addiction; and socio-economic mobility.

FIGURE 6

Relationship between health and social problems and income inequality, US states



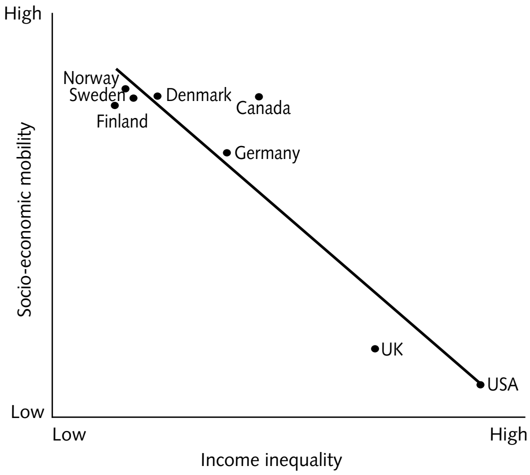
Source: Wilkinson and Pickett (2010), figure 2.5.
Note: Health and social problems are measured by an index of life expectancy; numeracy and literacy; infant mortality; homicide rates; rates of imprisonment; teenage births; trust; obesity; mental illness, including drug and alcohol addiction; and socio-economic mobility.

also point out that the national risk of being imprisoned if you are black is 6 times greater than if you are white, rising to 13 times greater for New Jersey (2010, 150).

I noted earlier that the American Dream has more to do with material progress over time than with income distribution at any given time. But how much upward mobility is there in the US? Research by Michael Weinstein showed that in the 1970s almost nine of ten American children in the lowest of five income groups remained in the bottom two groups ten years later (2000). He noted that this also applied in the 1980s, implying that upward mobility for the least-well-off Americans has not materialized over this 20-year period. Wilkinson and Pickett also weigh in on this issue (2010, chap.

FIGURE 7

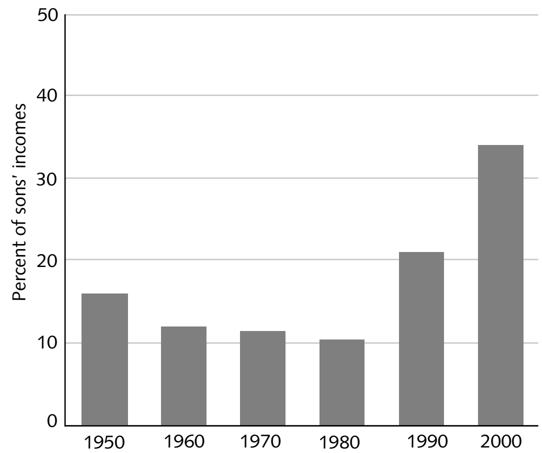
Relationship between socio-economic mobility and income inequality, selected countries



Source: Wilkinson and Pickett (2010), figure 12.1.
Note: Socio-economic mobility is measured by the correlation between fathers' and sons' incomes from 1950 to 2000: the higher the correlation, the lower the mobility.

FIGURE 8

Share of sons' incomes that can be explained by their fathers' incomes, United States, 1950 to 2000



Source: Wilkinson and Pickett (2010), figure 12.2.

12). They define "low social mobility" as a situation where rich parents have children who end up rich and poor parents have children who stay poor. "Like father, like son," as they put it. Although there are few countries with relevant data, figure 7 reveals that the US (along with individualist-capitalism UK) is the most socio-economically immobile nation, suggesting that the American Dream may be giving way to a degree of inequality that is becoming entrenched. Figure 8 reveals that while overall US social mobility was increasing until 1980, it decreased markedly in the 1980s as the Reagan-Thatcher shift to unfettered global capitalism took hold, and this continued through 2000.

While the preceding figures suggest that inequality is related to a wide range of social pathologies, a few caveats are in order. First, these are one-on-one comparisons, whereas it would be preferable to undertake such analyses in a multivariate context. For example, variables such as indigenousness, ethnicity, age and immigrant ratios (among other factors) may be driving both the inequality measures and some of the pathologies. Moreover, while these correlations appear robust, the causation could well be in the other direction: the pathologies could be driving the inequalities.[14] Nonetheless, it seems clear that the contrasting legal and philosophical underpinnings of individualist- and communitarian-capitalism nations are reflected in equality and social outcomes and that the US, with its common-law heritage, has adopted a winner-take-all approach to capitalism, the outcomes of which are starkly evident in Wilkinson and Pickett's work.

[14] For critiques of the Wilkinson and Pickett analysis, see Corcoran (2010) and *The Economist* (2011).

Where Has All the Greatness Gone?

America's economic and fiscal situation is in a shambles. On the fiscal front the US government is running the largest deficit-to-GDP ratio in the rich nations' club and is anticipated to increase its debt by something like $10 trillion over the next decade. On the economic front the titanic economic, trade and fiscal interplay between the US and China entails huge challenges for an indebted America. As *The Economist* recently put it: "Where has all the greatness gone?" (2010e).

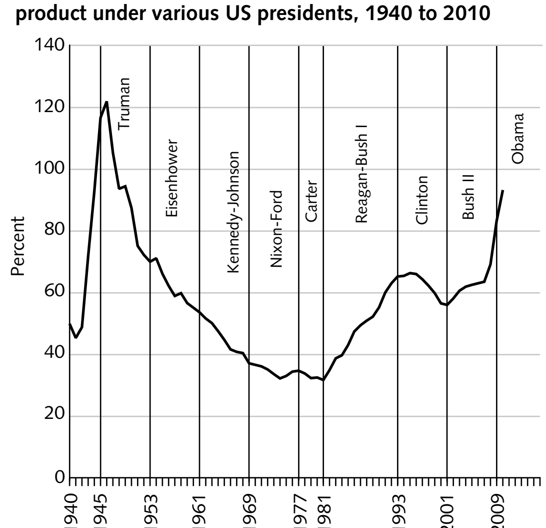
Drifting into fiscalamity: Living off future generations

The story of America's descent into deficits begins with an overview of the performance of the Reagan, Bush I, Clinton, Bush II and Obama administrations, the legacy of which is the increase of the gross federal debt-to-GDP ratio from just over 30 percent at the end of the Carter administration to nearly 100 percent in the Obama era (figure 9).

Although Reagan's military Keynesianism (1981-89) played well to some key Republican principles — the huge military buildup and the massive tax cuts resonated fully with moral conservatism and economic libertarianism, respectively — it nonetheless dramatically escalated America's debt. And Bush I (1989-93) continued the military spending (the first Iraq War). However, while the economy performed extremely well after the early 1980s recession, this did not offset the impact of military Keynesianism on the budget, with the result that the debt-to-GDP ratio doubled over the Reagan and Bush I administrations. The gross federal debt went from roughly $900 billion to $2.6 trillion under Reagan, and further to $4 trillion under Bush I.

FIGURE 9

Gross federal debt as a share of gross domestic product under various US presidents, 1940 to 2010



Source: US Office of Management and Budget (2011).

Indeed, this mounting debt and deficit overhang became a major societal concern and, therefore, a major political constraint on the policy flexibility of the Clinton administration (1993-2001), in large measure because the Republicans campaigned on the fear that a victory by the Clinton Democrats would move the nation in the direction of greater spending or increasing taxes or, worst of all, the double sin of tax-and-spend policies. But in his 1996 State of the Union address President Clinton proclaimed that "the era of big government is over." And he delivered on this message, aided by three favourable developments. First, unlike Reagan, Clinton did not begin his term facing a major recession; second, he inherited the "peace dividend" associated with the cessation of the war in Iraq and, more importantly, the end of the Cold War; and third, he rode the revenue escalator associated with the high-tech boom. As a result, the US was the first G7 country to return to a budget surplus in the wake of the near-universal deficits associated with the early 1990s recession. And although the gross federal debt rose under Clinton to $5.6 trillion by 2000 (an increase of 40 percent), its share of GDP headed downward.

In terms of the Democratic principles articulated earlier, Clinton's major achievement was the introduction of the earned-income tax credit (EITC), a work-income supplement that was and remains an important step in addressing the income shortfall of low-skilled working Americans and facilitating the transition from welfare to work. However, Clinton is likely to be remembered more for his 1996 welfare reform bill, which with its "tough love" approach was more in line with Republican principles than with Democratic ones. A decade later the number of people on welfare had fallen from 12.2 million to 4.5 million, and 60 percent of mothers who left welfare had obtained employment and seen their incomes generally rise, in part because they could take advantage of the EITC (Haskins 2007).

Bush II (2001-09) followed in Reagan's footsteps in embracing Republican principles: on the moral front, a (temporary) victory in Afghanistan and then an aggressive regime-change mission in Iraq designed to enhance homeland security and to pursue democracy and freedom abroad; and on the economic front, a tax cut disproportionally favouring the upper-income classes. As defence spending ramped up with the second Iraq War, the deficit began to balloon again, since Bush II opted for deficit and debt financing rather than tax financing. This, among other reasons, led the gross debt to mushroom to just under $10 trillion, a 75 percent increase over his tenure. It was also under Bush II that the offshoring of routine production to China rose dramatically, as did US imports from China — a more than threefold increase from $100 billion in 2000 to $338 billion in 2008, with obvious and rather dramatic negative effects on the US manufacturing sector. Since American exports to China grew very slowly, this offshoring of jobs and purchasing of the resulting product led to a huge current account deficit with China.

Greeting President Obama in 2009 was an almost vertical spike in the debt-to-GDP ratio, with the federal deficit for 2010 running just under $1.5 trillion in the context of a financial meltdown, a collapsed economy, double-digit unemployment and a seemingly never-ending housing crisis requiring huge and continuing bailouts for Fannie Mae and Freddie Mac as well as for cash-strapped subnational governments. Beyond this, Obama's "Yes we can" approach to government involved a surge (in all but name) in Afghanistan, a massive stimulus package and the controversial comprehensive health care legislation, which has the potential for significant expenditure overruns in spite of the official administration line that it will lead eventually to cost savings. All in all, federal government spending seems headed ever skyward, with debt escalation averaging over a trillion dollars per year and with gross borrowing requirements (including rollover refinancing) much higher still. These trends suggest that US aggregate government indebtedness as a ratio of GDP will soon be surpassing the greater-than-100-percent levels reached during the Second World War.

Along these lines, Boston University economist Laurence Kotlikoff argues that the US is in much more fiscal trouble that anyone is letting on (2010). The IMF's annual review of US policy states that closing the fiscal gap — the present value of the difference between projected spending, including debt servicing, and projected revenue in all future years — requires a permanent annual fiscal adjustment equal to about 14 percent of GDP (2010). Kotlikoff offers the following assessment of what this gap means for policy: "To put 14% of gross domestic product in perspective, current federal revenue totals about 14.9% of GDP. So the IMF is saying that closing the U.S. fiscal gap, from the revenue side, requires, roughly speaking, an immediate and permanent doubling of our personal-income, corporate and federal taxes as well as the payroll levy set down in the Federal Insurance Contribution Act [Social Security]" (2010).[15]

How can the gap be so big? Kotlikoff's answer: The US has 78 million baby boomers who, when fully retired, will each collect benefits from Social Security, Medicare and Medicaid that, on average, exceed per capita GDP. The annual cost in today's dollars of these entitlements will total about $4 trillion. How is it that the preeminent global economy was able to risk its privileged status by acting as if it had no budget constraint?

Original sin, budget constraints and the US debt explosion

In a 1999 article, Barry Eichengreen and Ricardo Hausmann argue that all countries are born with "original sin," defined as the inability of countries to borrow abroad in their own currencies. This means that their ability to sustain debt-financed government spending is limited.[16] Latin American economists are among the major contributors to this literature, presumably because all countries in Central and South America have experienced the inability to borrow abroad. Indeed, some Latin American countries have been subject on occasion to an even stricter version of original sin — namely, not being able to borrow long-term *domestically* in their own currencies due to fear on the part of the lenders of ruinous inflation. Original sin also afflicted most of the countries that are in the eurozone, although they now can borrow in euros. No Asian economy has as yet completely overcome original sin, but China may be on the verge. One of the ways to overcome original sin would be to enact policies that lead to a competitive and high-productivity economy with a strong political constituency that would be harmed by, and would hence oppose, currency devaluation and inflation.

But the US is in a privileged financial position. Not only is America the sole country that has been fully absolved, as it were, from original sin but, in addition, the US dollar has be-

[15] It is important to remember that Kotlikoff's analysis does not take into account any contribution to deficit reduction arising from the economic recovery.

[16] The inability to borrow abroad in one's own currency may stem from lenders' fears that the borrowing country would purposely devalue its currency (directly or by inflating) in order to reduce the real value of its foreign debt to the creditor.

come the global currency. And because the international markets for US dollars are so broad and so deep and, therefore, so liquid, until the advent of the euro almost all countries tended to borrow internationally and to denominate their international transactions in US dollars. Indeed, these countries need and want to hold US dollars and US short-term securities not only as foreign exchange reserves but, more generally, as part of their international finance and trade positioning.

While being able to borrow internationally in its own currency is one of the advantages accruing to the US, the advantages are larger still because the US dollar, as the global currency, generates seigniorage,[17] the value of which is far from trivial. However, there is a flip side to this privilege — namely, that America, in its dealings with the rest of the world, is facing a "soft" budget constraint, in the sense that its ability to borrow is essentially without limit. This is most obvious in the context of China fixing its currency (the yuan) to the dollar. Since the Chinese want to maintain the currency peg and since there is upward pressure on the yuan because of China's current account surpluses, China effectively dons the role of creditor of last resort for US government borrowing. In turn, this essentially means that there is no budget constraint at all for the US, at least until American international indebtedness reaches a tipping point.

In this context, it is worth noting that proponents of the Washington Consensus regularly railed against any and all soft budget constraints elsewhere in the world. The counterfactual here is that if the US did have a meaningful budget constraint— for instance, if it had to borrow in some other currency — it would never have been able to indebt itself to the extent that it has. I leave it to readers to assess how well this analysis can explain how the US managed to become so indebted that its macro sustainability is now in question. However, I am quite comfortable in asserting that joining the eurozone did allow Greece, Ireland, Portugal and Spain to escape the constraints of original sin and to reduce dramatically their traditional budget constraints, with their resulting indebtedness now threatening the sustainability of the entire eurozone.

China in ascendancy

In addition to these internal factors and forces eroding America's long-standing global economic pre-eminence, there are significant external challenges. Out of nowhere, it seems, China became the workshop of the world and the world's largest exporter. Foremost among the factors that led to this economic miracle was China's recognition that it lacked the internal capital markets that could allocate domestic and foreign investment toward their most productive uses. Accordingly, and in the form of an economically brilliant and unprecedented initiative, China invited global capital markets and global enterprises to do

[17] If it costs one cent to print a US dollar, then each additional dollar in circulation in the global economy provides the Federal Reserve with 99¢ of real purchasing power. This 99¢ is referred to as "seigniorage."

this internal allocation for it. In other words, China's recent surge in production was, at the outset, driven by global prices and by international comparative advantage working in tandem with the inexpensive and inexhaustible Chinese labour force. What was required of these foreign enterprises was to link up with Chinese partners and share technology and industrial secrets with them. From the perspective of the foreign enterprises, the advantage of increased competitiveness in exporting to the rest of the world from China, and of gaining access to the world's fastest-growing domestic market, obviously outweighed the costs of China's requirements.[18]

In order to provide these foreign enterprises with economic security and continued open access to foreign markets and, on the domestic side, to hasten the employment of its scores of millions of workers, China pegged its yuan to the US dollar and began to accumulate enormous amounts of US-dollar foreign exchange, both from the growing US trade deficit with China (figure 10) and from financing new and maturing US government debt. As already noted, in order to maintain the yuan-dollar fixed exchange rate in the face of its huge current account surpluses, China had to become the buyer of last resort for US debt. China's mushrooming stocks of US foreign exchange and Treasuries served to provide a guarantee to foreign investors that the currency fix would hold, because otherwise any appreciation of the yuan would saddle China with enormous exchange rate losses.

As a result, by 2008 the world's most populous country, with a per capita GDP of only US$3,500 (compared with $46,000 for the US), became the world's largest exporter, surpassing Germany. More recently, China passed Japan to become the second-largest economy in terms of GDP. And as more of its labour force is brought into the market economy, it is just a matter of time before China becomes the largest global economy and the world's largest importer, too.

In 1978 China adopted a one-child policy, which by good luck or foresight has ended up ensuring that its recent economic takeoff has led to rapidly rising per capita incomes, in contrast to India, where per capita income growth has run into a version of the Malthusian population trap. However, as Chinese economic development proceeds, one can reasonably assume that China will consider abandoning this one-child policy in order to counter the aging of its society and the policy-induced increase in the male/female birth ratio. All in all, China has embarked on a unique socio-economic development strategy, embodying as it does a commingling of economic freedom and socio-political authoritarianism.

The clash of the Titans

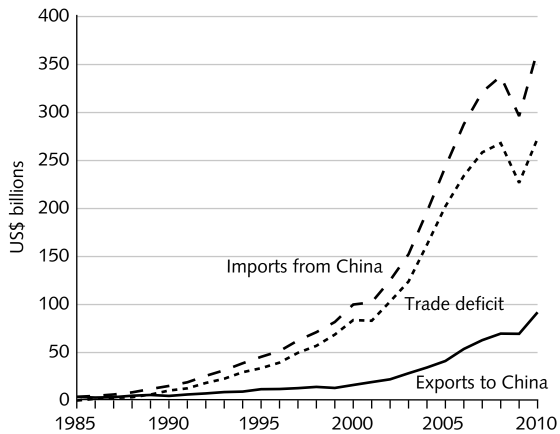
The interplay of Chinese ascendancy on the one hand and America's ongoing struggle with its Great Recession and its increasing indebtedness to China on the other is visible in many in-

[18] More recently, corporations have become increasingly concerned with the required sharing of technology, industrial design and innovation with their Chinese partners.

dicators. An appropriate starting point is the evolution of US-China trade (figure 10). From a 1985 export/import balance in the $3.5-billion range, US exports to China grew to $92 billion in 2010. In contrast, US imports from China have grown four times faster, reaching $365 billion in 2010. As a result, except in the recession years 2001 and 2009, the US trade deficit with China has deteriorated every year since 1985, reaching $273 billion in 2010. All told, the sum of the US current account deficits with China over 2000-10 is in excess of $2 trillion.

FIGURE 10

US trade with China, 1985 to 2010



Source: US Census Bureau (2010).

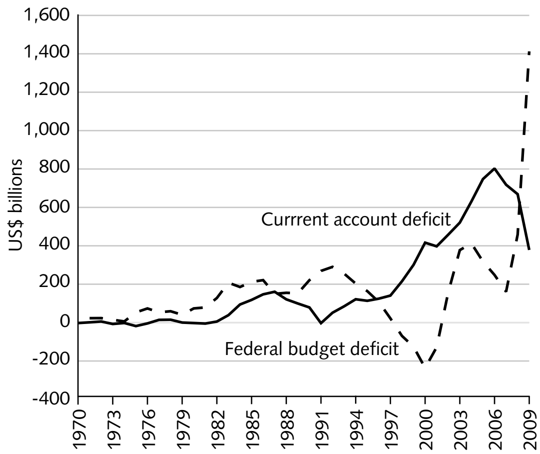
A key issue for America's future is that much of the increase in imports from China arises from American firms offshoring production to China and then importing the resulting products. Walmart is the clear leader here. In 2004, more than 80 percent of its six thousand suppliers were located in China, accounting for 70 percent of the products sold at Walmart. Indeed, Walmart was China's fifth-largest "export market," ahead of Germany and Britain, and it then accounted for 11 percent of US imports from China (AFL-CIO 2011). Overall, the cumulative US factory job losses since China joined the WTO in 2001 run into the millions.

The point here is not so much that the US should embark on countervailing protectionist measures. Rather, it is that China is actively pursuing a highly protectionist exchange rate policy, one that would not have been tolerated in the earlier era when fixed exchange rates were the norm. Arguably, the stakes of the US-China economic "cold war" have advanced to the point where each country possesses its own doomsday button. Specifically, were the Americans to attempt to close their market to Chinese goods, China would likely respond by dumping US reserves on world markets, thereby sending the dollar into a tailspin with economic losses all around. Presumably, this would also be the result if the Chinese initiated the collapse by ceasing to be the buyer of last resort for US Treasuries, since the US would then respond by mounting barriers to Chinese access to the US market.

The implications for America's prospects are most troubling. The US has been progressively living beyond its means (that is, consuming more than it produces). This extra consumption comes from an excess of imports over exports, which is reflected in figure 11 by the rising current account deficits. These deficits are caused in part by government deficits, which have been spiralling ever upward since 2000. China, as the requisite buyer of last resort of US debt, already has $2.85 trillion in US foreign exchange reserves, equal to over

FIGURE 11

Federal budget and current account deficits, United States, 1970 to 2009



Source: US Bureau of Economic Analysis (2011); US Congressional Budget Office (2011).

40 percent of its GDP. This relationship is an accident waiting to happen.

In the interim, while the US remains overextended fiscally, financially and militarily, the emerging nations and sovereign-wealth-fund countries have been rapidly accumulating foreign exchange reserves and financial assets. For example, three of the world's four largest banks are now state-owned Chinese firms (Industrial and Commercial Bank of China [ICBC], China Construction and the Bank of China), and ICBC, China Mobile and Petro China are among the world's five largest companies by market size. On the resource side, three-quarters of global crude oil reserves are owned by national oil companies (Bremmer 2010, 21, 56). And the Chinese are now deeply involved in developing the current and future resource potential in much of Africa and in many other countries, including Canada. It is patently clear that global markets are not "free" in the traditional sense but, rather, are progressively more "political." Indeed, Ian Bremmer's book focusing on the trade and economic war between corporations and state companies is appropriately titled *The End of the Free Market* (2010). It is simply not credible that the political/state mega-corporations of China or other BRIC (Brazil, Russia, India and China) nations will conduct their affairs in line with, say, WTO principles when these principles are not aligned with their own political/national interests.

With America vulnerable on the fiscal and economic fronts and failing on societal and inequality measures, what are its prospects for a return to "sustainable prosperity"? In this context, it would be defined as a prosperous economy, manageable government and current account balances, a low-inflation environment, a more equal distribution of income and a shift toward equality of opportunity for all Americans.

Toward Sustainable Prosperity

Can the US inflate its way into sustainability?

One strategy for a return to prosperity is frequently raised in international circles, but it is likely to result at best in a "hard landing." This is the proposition that since the American government debt is denominated in dollars, the US could attempt to gradually inflate its way out of its indebtedness. Inflation would erode the real value of the US outstanding debt and at the same time depreciate the dollar relative to other currencies so that the US would become more competitive internationally.

This would be a most dangerous venture even at the best of times because the inflation and depreciation could get out of hand. Moreover, to embark on an inflation strategy when the US is already the most indebted nation and one with much of its debt short-term in nature is to risk a dramatic rise in the cost of debt servicing from new issues and rollovers. Beyond this, the principal holders of US debt (China, South Korea, Japan and others) would likely view an inflating US economy as a violation of the implicit contract associated with the dollar's role as the world's currency, an understanding that led them to hold large quantities of US debt in the first place. In response, these countries would probably begin to dump US dollars on global markets, or at least cease buying new issues, the effect of which would precipitate a dollar crisis.

At this point, almost anything could happen: the US Federal Reserve might have to increase interest rates in order to control the inflation, which would risk an economic downturn; the US could be forced to finance further deficits and debt rollovers by denominating them in foreign currencies; the depreciating dollar could significantly further reduce Americans' purchasing power and their standard of living. In short, an inflation strategy will certainly not be included in the Federal Reserve's choice set.

Why, then, even mention it? Because maintaining the current US policy of "drift" — that is, spend and borrow — is likely to lead global capital markets to question US financial sustainability. If Greece's fiscal overextension can nearly bring down the euro, it should surprise no one that America's fiscal overhang will hasten the international financial community's ongoing search for a new global currency. Continuing drift will eventually trigger the dumping of US bonds on global markets with implications similar to those associated with an inflation strategy. In other words, America's current policy framework is inviting an economic future that could spin out of its own control.

Is a Chinese currency appreciation the solution?

An essential prerequisite for a soft landing is for the US to rein in its fiscal profligacy. Equally essential is that the US grow its economy. Given the domestic reality, increasing GDP over the near term requires increasing exports, which, in turn, requires a growing global economy. Most attractive to the US (and to the EU as well) would be a decision by China to begin revaluing the yuan relative to the dollar. To be sure, this move would mean that China not only would be taking a capital loss on its holdings of US foreign exchange and Treasury bills but would be slowing its own economic growth as well. Nonetheless, appreciation may have some appeal to China because inflationary tendencies are developing in the form of both asset bubbles in selected sectors and wage and working-conditions issues on the employee front. China might find it preferable to counter these emerging tensions externally via an appreciation of the yuan, rather than internally via rising prices. With the majority of China's labour force still not integrated into the market economy, and with unemployment figures in the scores of millions, allowing prices to rise may be too much of a gamble for China's leadership.

A second reason why a yuan appreciation is a real possibility is that while the US market was absolutely critical to the Chinese earlier on, the percentage of Chinese exports going to the US has fallen from over 21 percent to roughly 17 percent over the last five years, and this trend is likely to continue. Add in the rapid growth of China's domestic market, and easing up on the dollar-yuan fix is becoming more feasible economically. On the strategic front, as the Copenhagen climate summit demonstrated, China is beginning to take its place as a leader in global political and economic management. The more China desires this role, the more it has to accept a level of responsibility commensurate with this leadership. China will be increasingly reminded, by the Europeans as well as the Americans, that its exchange rate policy is highly protectionist and that it should expect, sooner rather than later, retaliation from other nations in addition to the US if it does not alter its policy. Finally, China is moving toward allowing Hong Kong to settle its trades in yuan and allowing Hong Kong companies to borrow in yuan. These are clearly steps toward making the yuan convertible. All in all, the number of factors (domestic and international, economic and strategic) pointing to a rethinking and reworking of China's currency arrangements is mounting.

It is important to emphasize the fundamental shift in the Sino-American balance of economic power: the US is becoming more and more beholden to China for financing its fiscal profligacy at the same time that China is becoming less and less dependent on the US market for its economic well-being. This economic "decoupling" increases the vulnerability of the US, and it brings to mind former US Treasury secretary Larry Summers' famous question: "How long can the world's biggest borrower remain the world's biggest power?"

Levelling the global playing field

The notion of a level playing field has entered the preceding analysis a number of times, but its full implications need to be considered. Specifically, Steingart broaches the question as follows: "The fundamental idea of trade policy is a worldwide, peaceful balancing of interests designed to smooth out an uneven world and create a level playing field for workers and their bosses, consumers, and producers, a field in which global competition can take place in a free and fair manner" (2008, 241-5). He goes to say that "those who want to secure free and fair trade must be willing to defend it" (244).

But Steingart points out that America and Europe are *not* defending the levelling of the global playing field. Rather, because of its consumerism ethic and winner-take-all capitalism, the US (and to a lesser degree the EU as well) is eager to import products made abroad under working conditions and health and safety standards that it would not tolerate from producers operating domestically. This attitude provides an obvious invitation to domestic firms to move production offshore, thereby undermining decades of hard-won gains for workers' rights.

Already alluded to in this context is the "forced" sharing of foreign corporations' industrial secrets with their Chinese partners. Ford and Toyota have been told that they will have to share the technology associated with electric vehicle development in order to be allowed access to the Chinese domestic market (Shirouzu 2010). But innovation and industrial design are among the economic drivers of the informatics era and they remain areas where US dominance still prevails — not for long, however, if Western companies accept the Chinese offer, which obviously runs counter to the WTO trade and investment provisions. There is a domino effect at play here. If one major international enterprise agrees to the Chinese dictates, then all must follow in order to remain competitive internationally. It is in this sense that the China challenge is a collective challenge for the West.

Steingart offers another relevant example:

> In the summer of 2006, the...WTO was confronted with a new Chinese customs law that pressures the Western auto industry to outsource all of its production to China. Under the law, manufacturers who assemble more than 60 percent of a vehicle outside China are slapped with a 25 percent punitive tariff on parts they import to China. The Chinese leadership hopes to use this strategy to force foreign automakers to shift their entire production to China or purchase their parts from local suppliers. This sort of punitive tariff is strictly prohibited under the rules of the World Trade Organization, as is any regulation stipulating that a certain percentage of value be produced domestically...China is aware of this, but it also knows that Western democracies are slow to make decisions. It can take a number of years before this sort of violation of the rules turns into an official complaint proceeding before the committees of the WTO...The West seems spellbound as it observes the goings on in Southeast Asia. (2008, 244-5)

This resonates well with Ian Bremmer's contention that Chinese trade is driven by political forces rather than by free-market principles. In effect, what is emerging is that American trade policy and practices vis-à-vis China are driven by US and Western corporations whereas China's trade policy and practices are crafted in and by Beijing. Steingart observes: "The West believes it is selling machinery, automobiles, and airplanes. But it also happens to be selling a piece of itself" (2008, 244-5).

Climate change, the WTO and the level playing field

The climate change agenda also has major implications for the trading system. China, India and Russia rank first, third and fourth, respectively, in carbon dioxide (CO_2) emissions, with Brazil in eighteenth place (United Nations 2010).[19] In total, these four account for just over a third of global CO_2 emissions. Yet Kyoto effectively exempted them from any emissions reduction requirements, while the developed countries not only were required to meet the

[19] In terms of overall greenhouse gas emissions, as distinct from CO_2 emissions alone, Brazil would rank fifth in the world.

2008-12 emissions targets (roughly a 6 percent reduction in annual emissions from a 1990 base) but were expected as well to make substantial transfers to the developing nations via the Clean Development Mechanism.[20] Thus the Kyoto Protocol represented a further dramatic un-levelling of the international playing field. Explicit in the Protocol was the requirement that the developed countries put a price on carbon to control emissions — possibly putting their economies at risk — even though the unconstrained emissions of the emerging economies meant that the global environmental tipping point would eventually be reached. Implicit in the agreement was that the WTO would continue to operate in ways that would preclude carbon-tax-related border adjustments on imports from exempt countries.

An additional problem with Kyoto was the absence of a tax on the carbon footprint arising from transportation. For example, ignoring the carbon footprint from (bunker-fuel polluting) ocean shipping means that all countries are, geo-environmentally, as close to, say, New York or to California as the nearest US port of entry. In a world of carbon pricing, the inability to put border taxes on the carbon emissions associated with imports and the failure to tax the carbon footprint of transportation are yet further incentives to offshore. Not only do these gaps in the Kyoto framework contribute to the unacceptable unlevelling of the trading field, but they obviously fail as an approach to curtailing carbon emissions since they will trigger “carbon leakage,” the transfer of carbon-intensive activities to carbon havens. The WTO has to come onside to ensure that the global efforts to address the climate change challenge do not follow the Kyoto Protocol approach of dramatically undermining the competitiveness of the developed countries with no guarantee of successfully controlling emissions.

While the US did not ratify Kyoto (appropriately, in light of the above), it should nonetheless take a lead role in searching for more appropriate approaches to addressing climate change that are at the same time acceptable economically and effective environmentally. The need is especially acute since the greening of the economy is one of the new frontiers where technology, innovation and entrepreneurship — traditional strengths of the US model — will be at the fore. The US has to don the mantle of leadership here if it wishes to regain its competitive edge and maintain its dominance in this sector.

Maintaining the US innovation edge

As China and India (and the emerging markets generally) continue their dramatic growth, they are moving beyond the industrial replication stage and are becoming innovation and technology leaders. *The Economist* reported in 2010: “The emerging world, long a source of cheap labour, now rivals the rich countries for business innovation” (2010a, 3).

[20] Although Russia ratified the Kyoto Protocol, its earlier industrial collapse caused a marked reduction in greenhouse gas emissions, meaning that its CO_2 targets were nowhere near binding. Its signing had more to do with the likelihood that it would emerge as a major beneficiary of the Clean Development Mechanism.

> Emerging countries in general, and China and India in particular, boast a huge number of relatively cheap brainworkers. Between them these two countries produce twice as many people with advanced degrees in engineering or computer science as the United States every year (more if you allow for the fact that 50% of American engineering degrees are awarded to foreigners, most of them Indians or Chinese). This is one of the main reasons why Western companies have started to move their R&D activities to the emerging world. (2010a, 12)

The move by the US after 9/11 to reduce its foreign student intake left the door open for others to benefit from this pool of human capital. Arguably, the most aggressive was Australia. As of 2008, Australia had 543,000 international students enrolled in education programs, including 182,770 in higher education and 175,461 in vocational training. The numbers of students from India and China were 97,000 and 127,000, respectively. Since Australia has also made it easier for international students to remain in the country, this policy provides a big boost to GDP in this progressively knowledge-based economy and society; in addition, the possibility of acquiring Australian citizenship serves to entice global talent to consider Australia as a destination of choice.

Might we be entering a time when some of the best and the brightest may not be attracted to America as their first choice? The US has historically been a desirable and welcoming location for immigrants to fulfill their economic potential. This might be viewed as the international version of the American Dream. While this version played a critical role in the rise to dominance of the American model during the Fordism era, it too is facing challenges as potential international migrants increasingly have other attractive options in the rapidly growing emerging economies. Part of the solution from America's vantage point would be for the US to reopen its doors to foreign students and talent (and perhaps adopt a policy to accept more immigrants generally, as former president Clinton recommended recently). Another part of the solution must be to raise the skill levels of Americans, which brings me back to the role of education as the cornerstone of the American Dream in the informatics era.

Demography, politics and the skills/education challenge

In my 2001 book, *A State of Minds: Toward a Human Capital Future for Canadians*, I offered a "mission statement" for twenty-first-century Canada: "Design a sustainable, socially inclusive and internationally competitive infrastructure that ensures equal opportunity for all Canadians to develop, to enhance, and to employ in Canada their skills and human capital, thereby enabling them to become full citizens in the information-era Canadian and global societies" (154). While this mission statement was intended for Canada, not the US, it is relevant here because the new economic and societal paradigm will require new goals for America, goals that recognize that increasing skills and building up human capital (and the equality of opportunity to do so) are the keys to full citizenship in the informatics era.

While providing greater opportunities for upward mobility is obviously appropriate for all Americans, particular attention needs to be focused on Hispanic Americans. According to the US Census, they are the fastest-growing segment of the population: their share of the population rose from 6.5 percent in 1980 (CensusScope 2011) to 15.8 percent in 2009, and it is forecast to increase to 30.2 percent by 2050. Moreover, of the nation's children 18 and under in 2050, 62 percent are expected to have a minority ethnicity, up from 44 percent in 2008. Hispanics are expected to represent 39 percent of all children in 2050 (up from 22 percent in 2008), more than the 38 percent who are expected to be single-race, non-Hispanic white (down from 56 percent in 2008) (US Census Bureau 2008). What makes this scenario most troubling socio-economically in the context of a knowledge-based economy and society is that Hispanics had high school dropout rates of 18.3 percent, compared with 9.9 percent for blacks and 4.8 percent for whites, as of 2008 (Chapman, Laird and KewalRamani 2010). This should be evidence enough that Lester Thurow's recommendation — that much better education and skills must be delivered to the lower levels of the American labour force — represents a most significant challenge.

The further complication here is that this challenge may become a partisan issue that separates Democrats from Republicans. The Republican Party, having long ago lost the black vote, effectively lost the Hispanic vote in the 2008 election: Hispanics voted for Obama by a margin of more than two to one, enough to tip the scales in key states such as Florida, Colorado, Nevada and New Mexico. While Florida's new Republican senator, Marco Rubio, is an obvious exception, the general pattern in the 2008 presidential election carried over to the 2010 midterm elections. In combination with the demographic trends, this arguably implies the relegation of the Republicans to permanent minority status. According to *The Economist*, the Republicans still have grounds for hope: "If the Republicans want to avoid [this] fearful fate, they need to reconnect with Hispanic voters, and fast. In principle it ought not to be too hard. Culturally conservative, strongly religious, family-oriented and with a long and distinguished tradition of service in America's armed forces, Hispanics are natural Republicans" (2010b, 16). In the same issue, *The Economist* noted: "But the same values also incline them, in contrast to, say, white evangelicals, to *communitarian* economic policies" (2010c, 31; emphasis added).

Were Republicans to reach out to this constituency, Democrats and Republicans would be compelled to engage on a similar range of issues. This would most likely move the US political system in a bipartisan direction, and both parties would, to a much greater degree than now, fight for control over the centre of the political spectrum. This is, of course, the underlying paradox: were the US more communitarian, this would give rise to more bipartisanship, but because the US model and values are individualist in nature, this makes bipartisanship more difficult to achieve.

Addressing Income Inequality and Social Immobility

A vibrant and growing economy is far and away the first-best weapon in the war against unemployment, poverty and inequality. There is a double dividend here: growth moves people from welfare to work (increasing output and decreasing public expenditures), and the increased output adds to government revenues to be employed in the public interest. This is the easy part of the challenge.

A second component is obvious from my analysis, although it may not be easy to achieve: address income inequality and social immobility, both of which are now undermining the very equality of opportunity that is the basic premise of the American Dream. As explained above, more unequal societies have higher incidences of a range of social ills — including drug abuse, crime and teenage pregnancy — and the United States leads the international pack in these rankings. In the Fordism era, when the US had huge financial and infrastructure advantages over its competitors, high skills and educational excellence were not as essential to attaining middle-class status. But in the informatics era, the offshoring phenomenon and winner-take-all capitalism, among other factors, are leaving unskilled Americans with little hope of achieving the social mobility that for so long defined American society.

In addressing income inequality and advancing opportunity, the United States might look to Canada for some useful lessons. In both countries, inequality of market incomes has been rising. However, once taxes and transfers are taken into account, inequality has risen more in the US than in Canada. Arguably, Canada gets much more bang for its social policy buck because so many of the transfers — to the poor, to children, to the elderly, to the unemployed and even to provincial governments — are targeted and subject to income testing (or, in the case of Equalization payments to the provinces, revenue testing).

One illustrative example is government support of child rearing. In Canada, the core program for financial support is the Canada Child Tax Benefit (CCTB), which makes a monthly cash payment on the order of $110 per child, plus a National Child Benefit Supplement (NCBS) for low-income families in the range of $160 per month per child. The CCTB begins to be clawed back at family incomes over $41,000, and the NCBS is subject to income testing at family incomes above $24,000. This permits a much higher level of financial support for lower-income families than would a similar program under a universal system. In effect, the CCTB/NCBS has many characteristics of a negative income tax, which, intriguingly, was the conceptual creation of the University of Chicago free-market economist Milton Friedman.

America's critical deficit is a revenue deficit

In the final analysis, regaining fiscal sustainability has to be about reducing expenditures and/or increasing revenues. There is no question that the US has to roll back the unfunded entitlements associated with aging (health care and Social Security), but some rollbacks might take the form of income testing along the lines of the Canadian child support system. However, even if there were political consensus, the US is unlikely to be able to "expenditure cut" its way to a sustainable fiscal future over the near term, in part because cuts to entitlements for aging boomers are, almost by definition, back-loaded. Jeffrey Sachs provides a cogent description of the dilemma:

> The stimulus tools of standard macroeconomics are spent. Interest rates are near zero, but debt-ridden, unemployed, and frightened households can no longer pick up the pace. Keynesians urge even greater budget deficits, though the $1.4 trillion hole in fiscal year 2009 must give pause. The federal budget gap is now so large that the deficit has itself become a major source of anxiety and uncertainty. Another tax cut would be more likely to frighten than stimulate the economy. Anybody who adds across the budget columns will realize that the federal budget is at the breaking point, and needs higher rather than lower tax revenues. The Federal Government collects a mere 18 percent of GDP in revenues, which are fully swallowed up by spending on health and retirement, the military, and interest payments on the debt. The rest of government, including infrastructure, education, climate, energy, poverty reduction, and public administration is financed by borrowing, with China the largest creditor. (2009, 4)

It is hard to avoid the conclusion that the most important deficit currently facing the US is a revenue deficit. Overall government revenues in the US are about 27 percent of GDP, compared with 32 percent in Canada, 39 percent in the UK, 41 percent in Germany and 45 percent in France (Heritage Foundation 2011). The appropriate way to address this revenue deficit is with a tax on consumption, not on production nor on incomes. The appropriate form of a consumption or sales tax is a value-added tax (VAT), because a VAT is import and export neutral: the tax already collected will be rebated on all exports, and the VAT will be imposed on all imports. The VAT has two positive attributes. First, it would enhance US international competitiveness, because any taxes on inputs entering the production process will be rebated at the time of export, in contrast to the existing US system, in which these taxes remain embedded in the price of US exports. Second, the VAT would apply on the value of all final sales, whether the products were produced in the US or imported. The implications of this are most significant: "A sales [VAT] tax would affect the price of a Korean-made car in exactly the same way as it would a Chrysler or a Ford. Consumers would be the ones paying for the social welfare state, not the American workers" (Steingart 2008, 249).

Along similar lines, it is surprising indeed that the US economy with its emphasis on competitiveness and unfettered capitalism has one of the highest corporate tax rates. For example, the projected federal METR (marginal effective tax rate) in 2012 on new business investment in the US is 34.2 percent,[21] compared with the OECD average of 20.7 percent and Canada's 16.7 percent (Canada 2010, 76). Most OECD countries, including Canada, rely more than the US on consumption taxes (essentially VATs); in fact, the US is almost alone among developed

[21] While the high US corporate tax rate has resulted in a rather dramatic shifting of corporate profits, capital, activities and even head offices to lower-tax countries, a decrease in US corporate tax rates may well reverse many of these trends.

nations in not having a VAT, despite its obsession with competitiveness. In Canada's case, the lower corporate METR is made possible not only because of the competitive advantages of the VAT, but also because Canada has utilized some of the proceeds of its VAT (known as the Goods and Services Tax) to decrease personal and corporate income taxes. In other words, Canada has decreased taxes on production and increased them on consumption.

To be sure, a VAT is a veritable money machine. My guess is that a 5 percent VAT at a time of high employment in the US would generate close to half a trillion dollars. Indeed, one member of Congress famously declared that VAT is "French for big government." But the US does not need or want big government. What America needs is sustainable government for delivering on the potential of the informatics era and, as Sachs notes, to pay for critical public goods that are complementary to an economy led by the private sector. These public expenditures would unleash "trillions of dollars of real demand, not makeshift jobs or last-gasp consumerism, that are bottled up in infrastructure and low-carbon energy projects that can't get off the ground until the government creates a sound policy and financial environment" (2009, 5).

Rekindling the American Dream

Regaining global dominance

So far, I have painted a very bleak overview of America's prospects. Indeed, it is too bleak once one places the US in the evolving global context. Focusing on domestic economic sustainability and international competitiveness, it is clear that some of the US decline is not only relative (rather than absolute) but inevitable: China is already the world's biggest exporter and it is only a matter of time before the economies of India and China will be larger, measured by GDP, than that of the US. Therefore, regaining the commanding heights has to mean something very different in the twenty-first century than it did in the Fordism era and in the early years of the informatics era.

Moreover, in spite of the dire straits in which the US now finds itself, it is nonetheless the case that much remains of what made America preeminent in the first place: a dynamic and innovative economy, an economy open to people from everywhere, its status as the talent capital of the globe, the world's largest economy and market (at least for a while yet), the home offices of the largest number of transnational corporations of any nation, and on and on. Who would doubt that America could rise to this challenge, had it the will to do so?

This more optimistic vision of America's future starts with networks, the ubiquitous organization form of the informatics era. Joseph Nye and Anne-Marie Slaughter both see a resurgent America anchored in a networked and interconnected twenty-first-century world.

> The problem of American power in the twenty-first century...is not one of decline but what to do in light of the realization that even the largest country cannot achieve the outcomes it wants without the help of others. An increasing number of challenges will require the United States to exercise power with others as much as power over others...The country's

> capacity to maintain alliances and create networks will be an important dimension of its hard and soft power. (Nye 2010, 12)

> In this world, the measure of power is connectedness...The emerging networked world of the twenty-first century...exists above the state, below the state, and through the state. In this world, the state with the most connections will be the central player, able to set the global agenda and unlock innovation and sustainable growth. Here the United States has a clear and sustainable advantage. (Slaughter 2009, 94-5)

> In a networked world, the United States has the potential to be the most connected country; it will also be connected to other power centres that are themselves widely connected. If it pursues the right policies, the United States has the capacity and the cultural capital to reinvent itself. It need not see itself as locked in a global struggle with other great powers; rather, it should view itself as a central player in an integrated world. In the twenty-first century, the United States' exceptional capacity for connection, rather than splendid isolation or hegemonic domination, will renew its power and restore its global purpose. (Slaughter 2009, 113)

While this is where America might wish to be headed, the host of challenges articulated earlier relating to domestic and international macroeconomic sustainability must be addressed first. Even if macroeconomic sustainability is in principle achievable, the parallel challenges of dramatic inequality and its accompanying societal dysfunctions remain. Slaughter notes that the United States has never been as egalitarian as it imagines itself to be, which presents an obstacle to the successful America she envisions because a "networked world requires a genuinely networked society which means fostering economic and social equality" (110-11).

The political challenge

Making progress on rekindling the American Dream and the equality of opportunity that underlies it will be much more difficult than regaining macroeconomic sustainability and competitiveness, in part because the latter two can be seen as an international economic imperative whereas reducing inequality is likely to be cast as a domestic political preference. Indeed, such a goal will surely be viewed by many as running counter to aspects of "Life, liberty and the pursuit of happiness," because it could mean increasing citizens' dependence on the state or violating the preference for limited government. There seems to be little support for the view that addressing inequality and equalizing opportunities represent an investment in human capital, which in a knowledge era ranks with investment in physical capital as a driver of economic success.

So can the US can get there from here? *The Economist* (2010d, 11) faults the US political system for being paralyzing, ungovernable, dysfunctional, too subject to filibuster (in principle, 41 senators from 21 states with not much more than a tenth of the country's population can block a bill), too subject to gerrymandering (safe seats mean that the real battles are fought among party activists and lead to candidates pandering to the extremes of the party) and of course too influenced by moneyed interests and lobbyists, especially in the aftermath of the *Citizens United* decision, which threw open the doors to corporate money for electoral financing. Many other observers have claimed that the American political system is the single most important obstacle in the way of America righting its socio-economic ship.

To a considerable degree this appears to ring true. However, some of the dysfunctional aspects of Congress are arguably a reflection of what America itself has become. For example, it was the initial success of the informatics era value system (e.g., unfettered global capitalism interacting with "Life, liberty and the pursuit of happiness") and not the inaction of the political system, per se, that led to America's indifference to the social, economic and educational challenges facing the lower echelons of its labour force. Nor is Congress solely responsible for America's apparent lack of concern for the extent to which it is overextended economically, financially and fiscally, both domestically and internationally. Lax regulators, winner-take-all corporate America and the courts must also accept some blame.

Overall, then, my view on what stands in the way of America attempting to regain its global role accords with Nicolai Ouroussoff's observation that "America is an empire enthralled with its own power and unaware that it is fading" (2005). But I am optimistic that this blinkered view of reality is about to be replaced by a determination to restore America to its former leadership role. As Thomas Friedman puts it, "People intuitively understand that what we need most now is nation-building in America" (2010). Two recent developments merit particular attention: the rise of the Tea Party and the report of President Obama's Debt Reduction Commission.

The Tea Party phenomenon should serve as a Paul Revere type wake-up call to both parties that the informatics era is passing America by. At one level the Tea Party is a tax revolt along the lines of the original Boston Tea Party, from which it draws its name. But it is much more than this: it is a citizen revolt against the tax-and-spend policies of the political classes. It has focused its sights on high taxes, unbridled government spending and the mushrooming budget and trade deficits. In varying degrees the Tea Party is also in favour of privatizing aspects of social policy, overturning the recent health care legislation, transferring more powers to the individual states and increasing military expenditures. Overall, this program is reminiscent of the Reagan revolution but with the addition of a direct attack on social entitlements; if it succeeds, the result would likely be to exacerbate the already problematic degree of inequality. As such, it hardly seems to be an approach that would move America toward a more equal society. Indeed, in key aspects it clearly would not.

But what the Tea Party has effectively accomplished is to place hitherto taboo and even "third rail" issues on the policy agenda, serving to increase the public and congressional space where any and all issues can now be open for debate and discussion. This pending wide-ranging clash of ideas is an essential ingredient, if not a necessary catalyst, of meaningful overall reform and renewal. Moreover, it will bring home to the average American the reality that the nation's problems are indeed far-reaching and daunting.

The report of the bipartisan Debt Reduction Commission proposes a bold combination of short-term stimulus to propel the pace of growth and employment (e.g., a payroll tax holiday) and a series of measures that would at the same time sharply decrease longer-term Social Security and Medicare entitlements on the one hand and introduce greater equity into these programs on the other: increasing the retirement age from 68 to 69, increasing payroll contributions, introducing a slowing of benefit increases or income-testing benefits for high-income Americans, and so on. Overall, the commission recommended raising taxes and fees by $1 trillion over the next nine years, reducing discretionary spending by $1.67 trillion and paring back mandatory spending by $556 billion. Moreover, it boldly proposed cuts of equal percentage for nonsecurity spending and security spending.[22]

These are only proposals — indeed, proposals that did not receive the support of the required 14 of the 18 panel members in order for them to proceed to Congress. Nonetheless, as did the rise of the Tea Party, this report served to alert Americans to the severity of America's fiscal and economic challenges and presented proposals that attack some of the sacred cows of both Republicans and Democrats. Arguably, were it not for the rise of the "new right" in the form of the Tea Party, there would not have been the "old centre" report of the Debt Reduction Commission. The stage is clearly set for a societal debate the likes of which Americans have not recently witnessed.

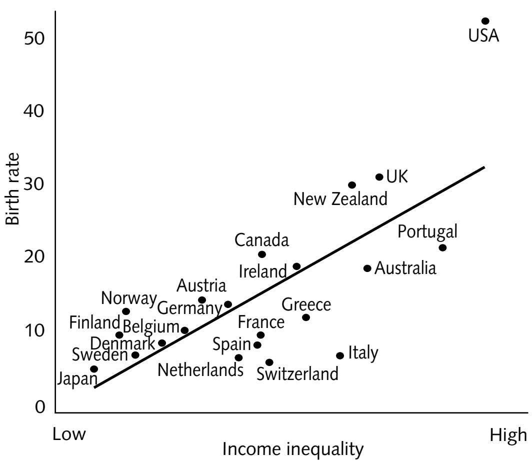
My concern remains that in these debates not only will macroeconomic sustainability trump equality of opportunity but success in the former may come at the expense of the latter. To be sure, the result may well be a prosperous and powerful America. Nonetheless, America needs to aim higher in this knowledge-intensive informatics era. No matter how rich America becomes, it can never achieve its potential in this century unless equality of opportunity comes to be viewed as underpinning "Life, liberty and the pursuit of happiness." Americans must come to recognize that equality of opportunity for all Americans, like macroeconomic sustainability, is also an international economic imperative in the informatics era. The mind of the American state needs to be focused on the state of America's minds.

[22] "Security" covers all defence spending, including homeland security, nuclear weapons, veterans and international affairs, with the exception of war spending. According to Kristof (2011), US defence spending nearly equals the defence spending of all other countries combined and is six times larger than that of China; and there are more personnel in US military marching bands than in the entire Department of State.

Appendix
The Relationship between Inequality and Selected Social and Health Problems

FIGURE A1

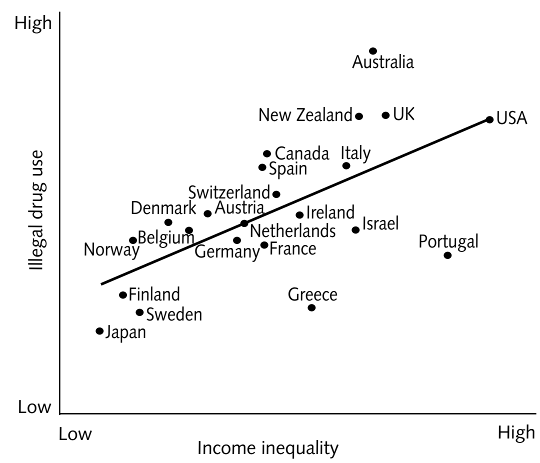
Relationship between teenage birth rates and income inequality, selected countries, 1998



Source: Wilkinson and Pickett (2010), figure 9.2.

FIGURE A2

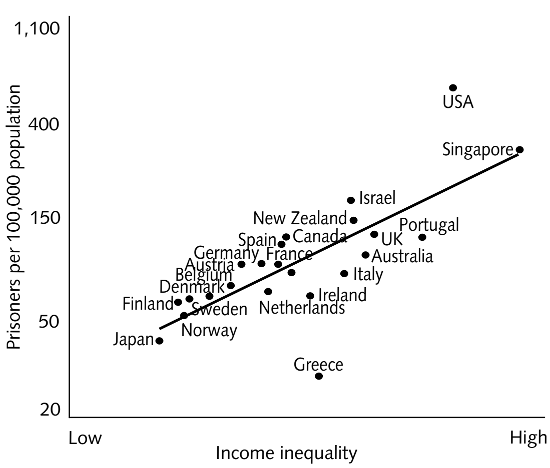
Relationship between illegal drug use and income inequality, selected countries, 2007



Source: Wilkinson and Pickett (2010), figure 5.3.

FIGURE A3

Relationship between rates of imprisonment and income inequality, selected countries, 2000



Source: Wilkinson and Pickett (2010), figure 11.1.

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