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TIME

How to Restore the American Dream

BY FAREED ZAKARIA

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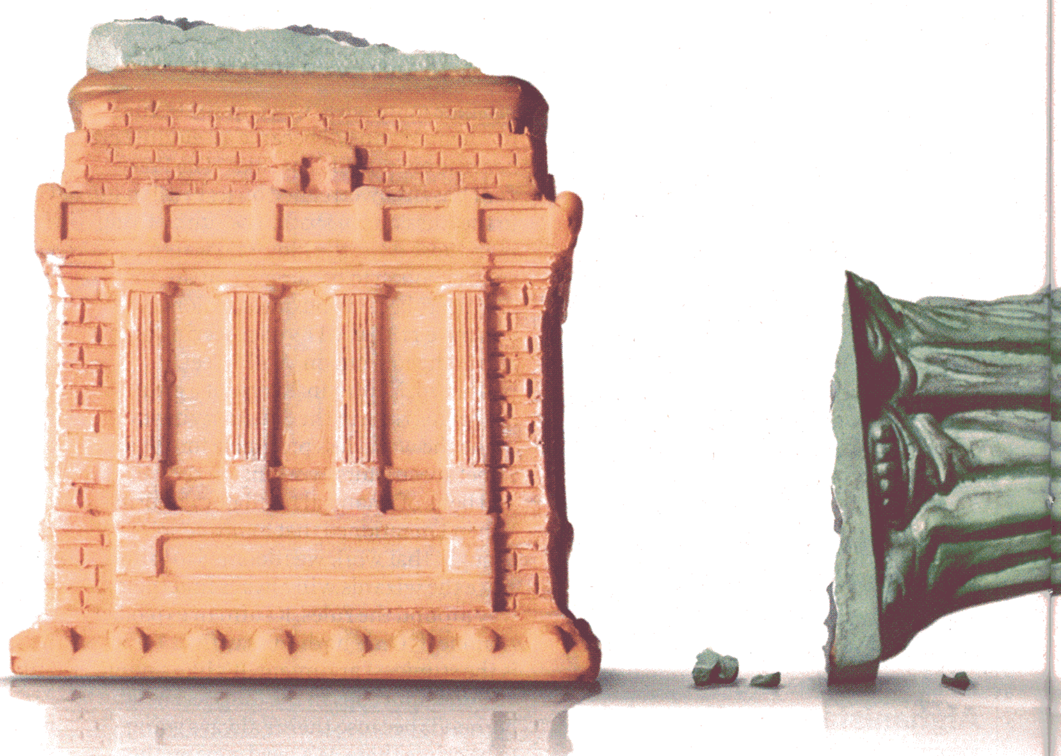
NATION

Restoring The American Dream

The grim reality is that technology and globalization are shattering the middle class. With the midterms around the corner, the good news is that a bipartisan policy agenda can return the country to prosperity. But no one says it will be easy

By Fareed Zakaria



THE AMERICAN DREAM FOR ME, GROWING UP in India in the 1970s, looked something like the opening credits of *Dallas*. The blockbuster TV series began with a kaleidoscope of big, brassy, sexy images—tracts of open land, shiny skyscrapers, fancy cars, cowboy businessmen and the very dreamy Victoria Principal. We watched bootlegged copies of the show, passed around on old Betamax cassettes. America (certainly the CBS soap-opera version of America) seemed dazzling and larger than life, especially set against the stagnant backdrop of India in the 1970s. Everyone I knew was fascinated by the U.S., whether they admitted it or not. Politicians who denounced the country by day would go home in the evenings and plot to send their kids to college in "the States."

Of course, the 1970s were actually tough times in America—stagflation, malaise, the aftermath of Vietnam and Watergate—but they were brutal in the rest of the world. Hyperinflation racked most third-world countries; coups and martial law were familiar occurrences, even affecting staunchly democratic India, where emergency rule was enforced from 1975 to 1977. Set against this atmosphere of despair, the U.S. looked like a shining city on a hill.

A few years later, when I got to America on a college scholarship, I realized that the real American Dream was somewhat different from *Dallas*. I visited college friends in their hometowns and was struck by the spacious suburban houses and the gleaming appliances—even when their parents had simple, modest jobs. The modern American Dream, for me, was this general prosperity and well-being for the average person. European civilization had produced the great cathedrals of the world. America had the two-car garage. And this middle-class contentment created a country of optimists. Compared with the fatalism and socialist lethargy that was pervasive in India those days, Americans had a sunny attitude toward life that was utterly refreshing.

But when I travel from America to India these days, as I did recently, it's as if the world has been turned upside down. Indians are brimming with hope and faith in the future. After centuries of stagnation, their economy is on the move, fueling animal spirits and ambition. The whole country feels as if it has been unlocked. Meanwhile, in the U.S., the mood is sour. Americans are glum, dispirited and angry. The middle class, in particular, feels under assault. In a *Newsweek* poll in September, 63% of Americans said they did not think they would be able to maintain their current standard of living. Perhaps most troubling, Americans are strikingly fatalistic about their prospects. The can-do country is convinced that it can't.

Americans have good reasons to worry. We have just gone through the worst recession since the Great Depression. The light at the end of the tunnel is dim at best. Sixteen months into the recovery, the unemployment rate is higher than it was in the depths of all but one of the postwar recessions. And as government spending is being pared back, the economy is showing new signs of weakness.

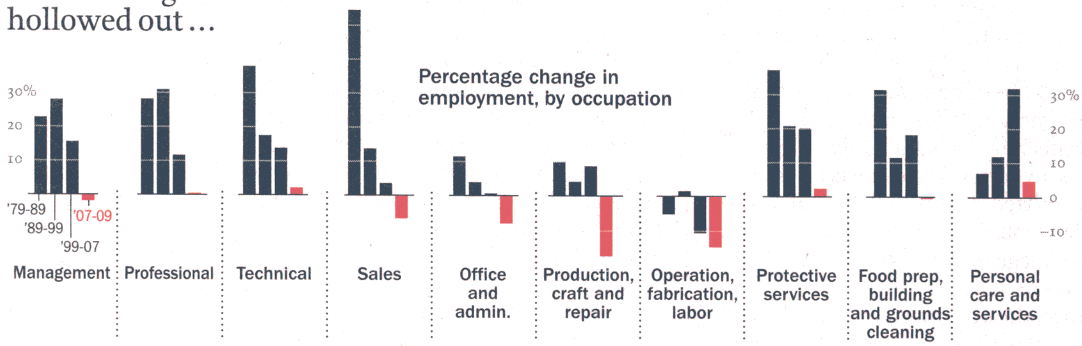
Some experts say that in every recession Americans get gloomy and then recover with the economy. This slump is worse than most; so is the mood. Once demand returns, they say, jobs will come back and, with them, optimism. But Americans are far more apprehensive than usual, and their worries seem to go beyond the short-term debate over stimulus vs. deficit reduction. They fear that we are in the midst of not a cyclical downturn but a structural shift, one that poses huge new challenges to the average American job, pressures the average American

PHOTO-ILLUSTRATION BY LON TWEETEN FOR TIME; PHOTOGRAPH BY DANNY KIM FOR TIME

In September, 63% of Americans said they did not think they would be able to maintain their current standard of living. The can-do country is convinced that it can't

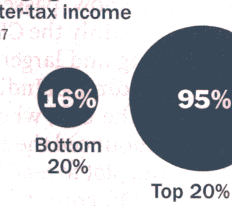
Charting the Decline

1 The middle class is being hollowed out ...



2 As inequality becomes more entrenched ...

Percentage growth in real after-tax income
1979-2007



Sources: May/ORG CPS; David Autor, Center for American Progress, the Hamilton Project; Pew Economic Mobility Project; Centers for Medicare & Medicaid Services; Pew Center on the States

wage and endangers the average American Dream. The middle class, many Americans have come to believe, is being hollowed out. I think they are right.

Going Global

FOR A PICTURE OF THE GLOBAL ECONOMY, LOOK AT AMERICA'S great corporations, which are thriving. IBM, Coca-Cola, PepsiCo, Google, Microsoft, Apple, Intel and Caterpillar are all doing well. And they share a strategy that is becoming standard for success. First, technology has produced massive efficiencies over the past decade. Jack Welch explained the process succinctly on CNBC last September. "Technology has changed the game in jobs," he said. "We had technology bumping around for years in the '80s and '90s, and [we were] trying to make it work. And now it's working ... You couple the habits [of efficiency] from a deep recession [with] an exponential increase in technology, and you're not going to see jobs for a long, long time." Welch gave as an example a company owned by the private-equity firm with which he is affiliated. In 2007 the business had 26,000 employees and generated $12 billion in revenue. It will return to those revenue numbers by 2013 but with only 14,000 employees. "Companies have learned to do more with less," Welch said.

Next, companies have truly gone global. The companies on the S&P 500 generate 46% of their profits outside the U.S., and for many of the biggest American names, the proportion is much higher. You might think of Coca-Cola as the quintessentially American company. In fact it is a vast global enterprise, operating in 206 countries. "We have a factory in Ramallah that employs 2,000 people. We have a factory in Afghanistan. We have factories everywhere," explains Muhtar Kent, the CEO of Coke. Nearly 80% of Coca-Cola's revenue comes from outside the U.S., and an even greater percentage of its employees are in foreign countries. "We are a global company that happens to be headquartered in Atlanta," says Kent.

America's great corporations access global markets, easy credit, new technologies and high-quality labor at a low price. Many have had to cut jobs at home, where demand is weak, and have added them in the emerging markets that are booming. They are not "outsourcing" jobs. That word makes little sense anymore. They simply invest in growth areas and cut back in places where the economy is weak. None of them will ever give up on the American market—it is too large, too profitable and too central to their businesses—but the marginal dollar is more likely to be invested abroad than in the U.S.

While businesses have a way to navigate this new world of technological change and globalization, the ordinary American worker does not. Capital and technology are mobile; labor isn't. American workers are located in America. And this is a country with one of the highest wages in the world, because it is one of the richest countries in the world. That makes it more difficult for the American middle-class worker to benefit from technology and global growth in the same way that companies do.

At this point, economists will protest. Historically, free trade has been beneficial to rich and poor. By forcing you out of industries in which you are inefficient, trade makes you strengthen those industries in which you are world-class. That's right in theory, and it has been right in practice. As countries have traded with one another over the past two centuries, they have prospered, and average living standards in those countries (primarily in the Western world) have soared. Those places that kept themselves protected (mostly communist and third-world nations) found that they had crappy industries, shoddy goods, massive corruption and slow growth.

And yet something feels different this time. Technology and globalization are working together at warp speed, creating a powerful new reality. Many more goods and services can now be produced anywhere on the globe. China and India have added literally hundreds of millions of new workers to the global labor pool, producing the same goods and services as Western workers at a fraction of the price. Far from being basket-case economies and banana republics, many developing economies are now stable and well managed, and companies can do business in them with ease. At some point, all these differences add up to mean that global competition is having quite a new impact on life in the U.S.

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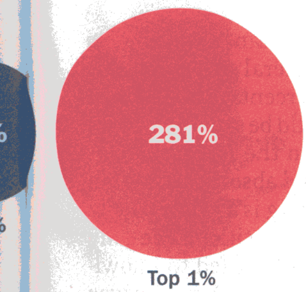
COCA-COLA: CORBIS; CAR: TIME



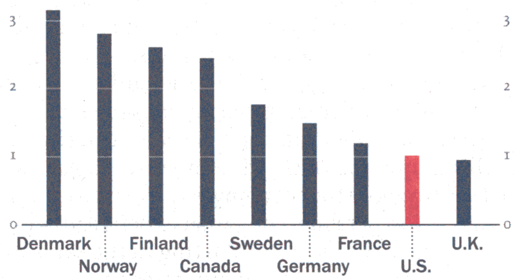
❸ And increased costs limit U.S. competitiveness ...

Private health insurance
Increase per person, 2000-08
59%↑
2008 **$2,270**

Pensions
Increase in payouts by state and local governments, 2000-08
135%↑
2008 **$64 billion**

❹ Which means the U.S. is not the land of opportunity it was

Relative income mobility of a generation over the previous one
U.S. = 1
2006



Two weeks ago, for example, I sat in a Nano, the revolutionary car being produced by Tata Motors in India. It's a nice, comfortable midgetmobile, much like Mercedes-Benz's Smart car, except that rather than costing $22,000, it costs about $2,400. Tata plans to bring it to the U.S. in two to three years. Properly equipped with air bags and other safety features, it will retail at $7,000. Leave aside the car itself, whose price will surely put a downward pressure on U.S. carmakers. Just think about car parts. Every part in the Nano is made to global standards but manufactured in India at about a tenth of what it would cost in America. When Ford orders its next set of car parts, will they be made in Michigan or Mumbai?

This is not a hypothetical. Steven Rattner, who helped restructure the automobile industry, tells the story of getting a new General Motors plant online in Michigan by bringing management and unions together. "The unions agreed to allow 40% of the new plant to operate at $14-an-hour wages," he says, "which is half of GM's normal wages. The management agreed to invest in this new plant. But here's the problem: workers at GM's Mexican operations make $7 an hour, and today they are as productive as American workers. And think of this: $14 an hour translates into about $35,000 a year. That's below the median family income. The whole experience left me frightened about the fate of the American worker."

Alan Blinder is also worried. A distinguished economist and Princeton professor, Blinder is a former vice chairman of the board of governors of the Federal Reserve. In a now famous essay in *Foreign Affairs*, he argues that while we recognize the pressures placed on manufacturing jobs by international competition, technology ensures that service jobs are now similarly exposed. Since the service sector is a much larger part of the economy, Blinder estimates that 28 million to 42 million jobs will be "susceptible" to being shipped offshore—jobs such as customer-service representative and stock analyst, which we tend to think of as local. Blinder understands the benefits of free trade but worries that the new wave of offshoring is so big and fast that Western societies will have difficulty adjusting. The crucial distinction for the future, he argues, might be not between highly educated and less educated workers but between those jobs that can be done abroad and those—such as nurse or pilot—that cannot.

You can divide the American workforce in many ways, but

Every part in India's $2,400 Nano midgetmobile is manufactured at about a tenth of what it would cost in the U.S. When Ford orders its next set of car parts, will they be made in Michigan or Mumbai?

any way you slice it, you see the same trend. People who get paid a decent wage for skilled but routine work in manufacturing or services are getting squeezed by a pincer movement of technology and globalization. David Autor, an MIT economist, has done an important study on what he calls "the polarization of job opportunities" in America. Autor finds that job growth divides neatly into three categories. On one side are managerial, professional and technical occupations, held by highly educated workers who are comfortable in the global economy. Jobs have been plentiful in this segment for the past three decades. On the other end are service occupations, those that involve "helping, caring for or assisting others," such as security guard, cook and waiter. Most of these workers have no college education and get hourly wages that are on the low end of the scale. Jobs in this segment too have been growing robustly.

In between are the skilled manual workers and those in white collar operations like sales and office management. These jobs represent the beating heart of the middle class. Those in them make a decent living, usually above the median family income ($49,777), and they mostly did fine in the two decades before 2000. But since then, employment growth has lagged the economy in general. And in the Great Recession, it has been these middle-class folks who have been hammered. Why? Autor is cautious and tentative, but it would seem that technology, followed by global competition, has played the largest role in making less valuable the routine tasks that once epitomized middle-class work.

Recapturing the Dream

SO WHAT IS THE SOLUTION? IT'S EASIER TO IDENTIFY THE WRONG answer than the right one. It would be pointless and damaging to try to go down a protectionist route, though polls show a stunning drop of support for free trade, even among college-educated professionals, its usual cheerleaders. But technology is a much larger driver of the hollowing out than trade. You cannot shut down this new world. How would you stop people from sending one another e-mails, which is what a lot of offshoring comes down to these days? Nor can you help a modern economy by shielding industries from world-class competitors, which just encourages greater inefficiency. I grew up in an economy made up of those kinds of industries, all tightly protected from "foreign exploitation and domination." It added up to stagnation and backwardness.

There are solutions, but they are hard and involve painful changes—in companies, government programs and personal lifestyles. For more than a generation, Americans have been unwilling to make these adjustments. Instead, we found an easier way to goose the economy: expand consumption. During the early 1950s, personal consumer expenditures made up 60% to 65% of the U.S.'s GDP. But starting in the early 1980s, facing slower growth, we increased our personal spending substantially, giving rise to new economic activity in the country. Consumption grew to 70% of GDP by 2001 and has stayed there ever since. Unfortunately, this rise in consumption was not triggered by a rise in income. Wages have been largely stagnant. It was facilitated, rather, by an increase in credit, so that now the average American family has no fewer than 13 credit cards. Household debt rose from $680 billion in 1974 to $14 trillion in 2008. This pattern repeated itself in government, except on a much larger scale. People everywhere—from California to New Jersey—wanted less taxes but more government. Local, state and federal governments obliged, taking on massive debts. A generation's worth of economic growth has been generated by an unsustainable expansion of borrowing.

That is why the current economic debate between another stimulus and deficit reduction is frustrating. Right now, there is a strong case for government stimulus, since no one else is doing much spending. But then what? What happens after another year of federal spending? Consumers still might be cautious; do we really want them to spend like they did in the old days? Is the strategy simply to reinflate the housing bubble? In recent years, the left and the right in America have conspired in feeding consumption spending. The left expands government, much of which means more consumption (pensions, health care). The right focuses obsessively on tax cuts, which have a similar effect. The political system, pandering to today's constituents, encourages both tendencies. But when will we invest for our children's economy?

What We Need to Do Now

ULTIMATELY AMERICAN JOBS ARE CREATED FROM THE BOTTOM up by companies, not from the top down by government fiat. But there are measures we can take that will encourage the process. Here are the key ones:

America needs to shift its economy away from consumption and toward investment. Today the average American family has 13 credit cards, and household debt rose from $680 billion in 1974 to $14 trillion in 2008

Shift from consumption to investment. Fundamentally, America needs to move from consumption to investment. Everyone agrees that the best way to create good jobs in the U.S. is to create new industries and companies and to innovate within old ones. This means large investments in research, technology and development. As a society, this needs to become our strongest focus.

Despite substantial increases and important new projects under the Obama Administration, the federal government is still not spending as much on R&D as a percentage of GDP as it did in the 1950s. I would argue that it should be spending twice that level, which would be 6% of GDP. In the 1950s, the U.S. had a huge manufacturing base that could absorb millions of semiskilled workers. Today, manufacturing is a small part of the economy and faces intense global competition. The only good jobs that will stay in the U.S. are jobs related to knowledge and innovation. Additionally, in the 1950s, America was the only research lab in town, accounting for the vast majority of global scientific spending. Today, countries around the world are entering the arena. Two weeks ago, South Korea—a country of just 50 million people!—announced plans to invest $35 billion in renewable-energy projects. We should pay for this with a 5% national sales tax—call it an American innovation tax—which would be partly offset by a small reduction in income taxes. This would have the twin benefits of tamping down consumption and yielding some additional funds. All the proceeds from the tax should be focused on future generations, because we need to invest massively in growth.

The often overlooked aspect of investment is investment in people. America has been able to create the future in large measure because it has tapped into the energies and work of immigrants. It has managed to invest in human capital by taking smart, motivated people from around the globe, educating them in the planet's best higher-education system and then unleashing them in a dynamic economy. In this crucial realm, the U.S. is now disinvesting. After training the world's best and brightest—often at public expense—we don't find ways to make sure they stay here by giving them a green card but rather insist that they leave and take their knowledge to another country, where they will invent, inspire, build and pay taxes. Every year, we send tens of thousands of the smartest Indians and Chinese back home, which is a great investment—in the future of those countries.

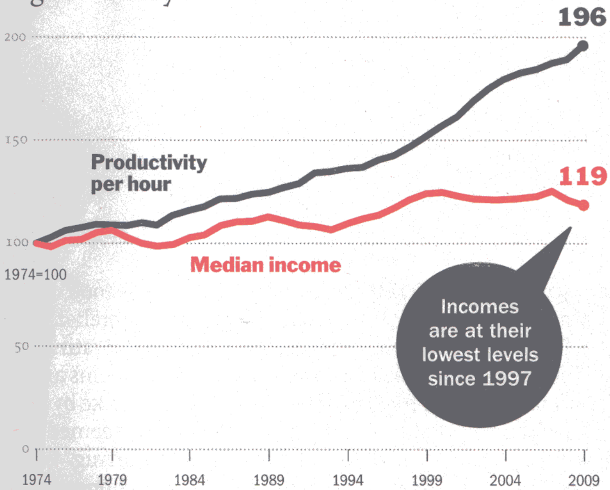
Training and education. "Most jobs that will have good prospects in the future will be complicated," says Louis Gerstner, the former CEO of American Express and IBM. "They will involve being able to juggle data, symbols, computer programs in some way or the other, no matter what the task. To do this, workers will need to be educated and often retrained." We need more and better education at every level, especially job retraining. So far, most retraining efforts in the U.S. have not worked very well. But they have worked in countries that have been able to retain a manufacturing base, like Germany and parts of Northern Europe. There, some of the most successful programs are apprenticeships—which cover only 0.3% of the total U.S. workforce.

There are advantages to the U.S. system. We don't stream people too early in their lives, and we allow for more creative thinking. But the path to good jobs for the future is surely to expand apprenticeship programs substantially so industry can find the workers it needs. This would require a major initiative, a training triangle in which the government funds,

ISTOCKPHOTO

Stagnant Wages

Increased productivity has not translated into higher family income



Source: Pew Economic Mobility Project

the education system teaches and industry hires—though to have an effect, the program would have to be on the scale of the GI Bill.

Fiscal sanity. To pay for such initiatives, the government needs to get its house in order. The single most important aspect of this is getting health care costs under control, followed by other entitlement programs, especially pensions at the state level. Government today spends vast sums of money on current consumption—health care and pensions being a massive chunk of it—which leaves little money for anything else. We need a radical rebalancing of American government so it can free up resources to fund future growth.

Benchmark, benchmark, benchmark. There is now global competition for growth, which means the U.S. has to constantly ask itself what other countries are doing well and how it might adapt—looking, for example, at what other countries are doing with their corporate tax rates or their health care systems and asking why and where we fall short. Americans have long resisted such an approach, but if someone else is doing tax policy, tort litigation, health care or anything else better, we have to ask why.

There are things the U.S. does well. Most new jobs in America are created by start-ups and small companies, so the ease of doing business is crucial—and there's good news there. The World Bank has a ranking of countries measured by the "ease of doing business," and the U.S. is No. 4. That's very good, but there's a catch. Those rankings are divided into several categories. In most, like "starting a business," the U.S. does well. But in one category it's only 61st in the world, and that is "paying taxes."

The American tax code is a monstrosity, cumbersome and inefficient. It is 16,000 pages long and riddled with exemptions and loopholes, specific favors to special interests. As such, it represents the deep, institutionalized corruption at the heart of the American political process, in which it is now considered routine to buy a member of Congress's support for a particular, narrow provision that will be advantageous for your business.

The Work Ahead

MY PROPOSALS ARE INHERENTLY DIFFICULT BECAUSE THEY ASK the left and right to come together, cut some spending, pare down entitlements, open up immigration for knowledge workers, rationalize the tax code—and then make large investments in education and training, research and technology, innovation and infrastructure. But the fact that it is a solution that crosses political borders should make it more palatable, not less. And time is crucial. The U.S. has considerable advantages, but every day other countries try to find ways to attract growth within their borders. People often note that America's political system is broken. Perhaps the truth is more awkward: America needs radical change, and it has an 18th century system determined to check and balance the absolute power of a monarchy. It is designed for gridlock at a moment when quick and large-scale action is our only hope.

When I left India, the marginal tax rate was 97.5%, corporate taxation was punitive, and business was stifled or went underground. Were I to move from New York City to Mumbai today, my personal tax rate would drop, as would every other rate, from corporate to capital-gains taxes. (The long-term capital-tax rate in India is zero.) Singapore now ranks as the No. 1 country for ease of doing business, with a top tax rate of 20%. I know permanent residents working in the U.S. who are thinking of giving up their green cards to move to Singapore. To an Indian of my generation, this would have been unthinkable. The green card was a passport to the American Dream. But for young Indians, there are many new dreams out there, and new passports.

But there are reasons for optimism. The U.S. faces huge challenges, but it also has enormous advantages. "I've always been bullish on America," says Coke's Kent. "It's the largest, richest market in the world. Look at the demographics alone. North America is the only part of the industrialized world that will be growing in people. It now has a higher birthrate than Mexico, for the first time in history." Or listen to Alcoa's German-born Klaus Kleinfeld, previously the head of Siemens: "I know the things that America has that are unique. The openness, the diversity, the dynamism—you don't have it anywhere else. If you keep all these things, build on them, I still believe in the American Dream."

The term *American Dream* was coined during the Great Depression. The historian James Truslow Adams published *The Epic of America* in 1931, in an atmosphere of even greater despair than today's. He wanted to call his book *The American Dream*, but his publishers objected. No one will pay $3.50 for a book about a "dream," they said. Still, Adams used the phrase so often that it entered the lexicon. The American Dream, he said, was of "a better, richer and happier life for all our citizens of every rank, which is the greatest contribution we have made to the thought and welfare of the world. That dream or hope has been present from the start. Ever since we became an independent nation, each generation has seen an uprising of ordinary Americans to save the American Dream from the forces which appear to be overwhelming it."

Today, those forces really do look overwhelming. But challenges like them have been beaten back before—and can be again. ■