PROLOGUE

THE CHALLENGE FROM WITHIN

We are treading the edge of a precipice here. Civilizations die of disenchantment. If enough people doubt their society, the whole venture falls apart. We must never let anger, fashionable cynicism, or political partisanship blur our vision on that point. We must not despair of the Republic.

—JOHN W. GARDNER,
cabinet secretary to President Lyndon Johnson

Thus, it is manifest that the best political community is formed by citizens of the middle class, and that those states are likely to be well-administered in which the middle class is large, and stronger if possible than both other classes...

—ARISTOTLE,
Politics

IN HIS MAGISTERIAL WORK A Study of History, British historian Arnold J. Toynbee tells the story of how civilizations rise and fall through the dynamics of challenge and response. After studying twenty-one civilizations across six thousand years, Toynbee found that the fate of each civilization was determined by its response to the challenges it faced.
Ancient Egypt rose to enduring greatness, Toynbee reported, by overcoming the challenge of a hostile climate with a sophisticated system of agriculture. In South America, the Mayan and Andean civilizations overcame similar environmental hardships but perished before the challenge of more powerful invaders. Other civilizations collapsed from within. The city-states of ancient Greece fell into fierce competition among themselves over trade and spiraled into decline from fratricidal warfare. Ancient Rome fell victim to what Toynbee called a “schism in the body social” and a “schism in the soul”—internal divisions that undermined Rome’s unity at the core.

In the twentieth century, America met and overcame the military challenge of mortal enemies—Hitler's Germany and then the protracted global challenge of Soviet communism.

Today we face a more complicated and potentially more dangerous challenge—a challenge from within. Like ancient Rome, we are in danger of causing or contributing to our own downfall by having spawned the schisms that Toynbee talked about—schisms in the body politic and in the soul of our society.

A House Divided: Two Americas

Over the past three decades, we have become Two Americas. We are no longer one large American family with shared prosperity and shared political and economic power, as we were in the decades following World War II. Today, no common enemy unites us as a nation. No common enterprise like settling the West or rocketing to the moon inspires us as a people.

We are today a sharply divided country—divided by power, money, and ideology. Our politics have become rancorous and polarized, our political leaders unable to resolve the most basic problems. Constant conflict has replaced a sense of common purpose and the pursuit of the common welfare. Not just in Washington, but across the nation, the fault lines that divide us run deep, and they are profoundly self-destructive, unless we can find our way to some new unity and consensus.


Americans sense that something is profoundly wrong—that we have gone off track as a nation. Many skilled observers write about this, but it is hard to grasp exactly how we arrived at our present predicament or how to respond—how to go about healing America’s dangerous divide. The causes do not lie in the last election or the one before that. They predate the financial collapse of 2008. The timeline to our modern national quagmire lies embedded in the longer arc of our history, and that history, from 1971 to the present, is the focus of this book.

Hidden Beginnings

History often has hidden beginnings. There is no blinding flash of light in the sky to mark a turning point, no distinctive mushroom cloud signifying an atomic explosion that will forever alter human destiny. Often a watershed is crossed in some gradual and obscure way so that most people do not realize that an unseen shift has moved them into a new era, reshaping their lives, the lives of their generation, and the lives of their children, too. Only decades later do historians, like detectives, sift through the confusing strands of the past and discover a hitherto unknown pregnant beginning.

One such hidden beginning, with powerful impact on our lives today, occurred in 1971 with "the Powell Memorandum." The memo, first unearthed by others many years ago, was written by Lewis Powell, then one of America’s most respected and influential corporate attorneys, two months before he was named to the Supreme Court. But it remains a discovery for many people today to learn that the Powell memo sparked a business and corporate rebellion that would forever change the landscape of power in...
Washington and would influence our policies and economy even now.

The Powell memo was a business manifesto, a call to arms to Corporate America, and it triggered a powerful response. The seismic shift of power that it set in motion marked a fault line in our history. Political revolt had been brewing on the right since the presidential candidacy in 1964 of Senator Barry Goldwater, the anti-union, free-market conservative from Arizona, but it was the Powell memo that lit the spark of change. It ignited a long period of sweeping transformations both in Washington’s policies and in the mind-set and practices of American business leaders—transformations that reversed the politics and policies of the postwar era and the “virtuous circle” philosophy that had created the broad prosperity of America’s middle class.

The newly awakened power of business helped propel America into a New Economy and a New Power Game in politics, which largely determine how we live today. Both were strongly tilted in favor of the business, financial, and corporate elites. Trillions were added to the wealth of America’s super-rich at the expense of the middle class, and the country was left with an unhealthy concentration of political and economic power.

This book will take you inside that decades-long story of change and show how we have unwittingly dismantled the political and economic infrastructures that underpinned the great era of middle-class prosperity in the 1950s, ’60s, and ’70s.

The Economic Divide: The 1 Percent and the 99 Percent

Today, the gravest challenge and the most corrosive fault line in our society is the gross inequality of income and wealth in America.

Not only political liberals but conservative thinkers as well emphasize the danger to American democracy of this great divide. “America is coming apart at the seams—not seams of race or ethnic-
more than the economy, our nation itself. A solid majority of Americans say openly that we have reached that point—that our economy is unfairly tilted in favor of the wealthy, that government should take action to make the economy fairer, and that they’re frustrated that Congress continually blocks such action.

What’s more, contrary to political arguments put forward for not taxing the rich, an economy of large personal fortunes does not deliver the best economic performance for the country. In fact, concentrated wealth works against economic growth. Several recent studies have shown that America’s wealth gap is a drag on today’s economy. Harvard economist Philippe Aghion cites an accumulation of “impressively unambiguous” evidence from multiple economic studies documenting that “greater inequality reduces the rate of growth.” A recent International Monetary Fund study came to a similar conclusion—that a high level of income inequality can be “destructive” to sustained growth and that the best condition for long-term growth is “more equality in the income distribution.”

The Unraveling

The opposite has happened in America since the late 1970s. The soaring wealth of the super-rich has brought the unraveling of the American Dream for the middle class—the dream of a steady job with decent pay and health benefits, rising living standards, a home of your own, a secure retirement, and the hope that your children would enjoy a better future.

As a country, we have declined from an era of middle-class prosperity and middle-class power from the 1940s to the 1970s to an era of vast fortunes and mass economic insecurity. We have fallen from being the envy of the world, with the most widely shared economic prosperity and the most affluent middle class of any place on earth, to losing our title as “the land of opportunity.” It is now easier, in fact, to climb the economic and social ladder in several Western European countries than it is in the United States.

Globalization has hit us all, of course, but the way we have responded with our New Economy has put the American middle class in an ever-tightening financial squeeze, raising protests from both left and right.

“The middle class is the key to greatness in this country,” right-wing radio commentator Rush Limbaugh told his audience of millions one sunny fall afternoon in October 2011. “We had the largest middle class in the world, and it’s under assault from practically every direction. Look at the destruction of home values. The family home was the largest asset most people in the middle class have, and it’s being destroyed, and it’s being destroyed after being talked up for generation after generation after generation. The American dream equals owning your own house.”

“It was the middle class that made America great,” AFL-CIO president Rich Trumka said in a television appearance a few weeks earlier. “We were very, very competitive when the unions were at their heydays. We spread the wealth around to everybody so that the main driver of our economy [was] consumer spending, people [had] money in their pockets to spend.” Now, Trumka went on, the question “is whether we’ll restore the middle class, which is the heart and the soul of the American dream.”

When such normally clashing political voices as Limbaugh and Trumka sound a common theme, it is worth listening. They are highlighting a critical national problem.

The Political Divide: Unequal Democracy

In our political life, too, we have left behind one of the most expansive periods of American democracy, the populist era of the 1960s and 1970s, where much of the dynamism and energy that drove sweeping changes in our laws and policies arose from the belly of the nation. Since then, we have moved from a broad populism to a narrow plutocracy. Instead of a high-visibility, outside political power game of mass movements and public participation, we now have a
low-visibility, inside power game dominated by the lobbyists for the American financial and political elite.

In the middle-class democracy of the 1950s, '60s, and '70s, ordinary Americans felt confident of their political power and its impact. They believed that by engaging personally in civic activism, they could help set the nation's agenda—and they succeeded. They forced action by Congress and the White House. Through grassroots power—the civil rights movement, the environmental movement, the peace movement, the consumer movement, the labor movement, and the women's movement—citizen power won important political victories that altered the face of our society and enlarged the American Dream. Seeing their own impact on public policy, people felt connected to government instead of feeling powerless and alienated as they do today.

In the last three decades, except for the organized activism of the Tea Party and the inchoate protests of Occupy Wall Street, Americans at the grass roots have largely retreated from direct citizen action. Our idealism has given way to a sense of futility. That has prompted Ernie Cortes, one of America’s most effective grassroots organizers, to amend Lord Acton’s famous dictum that power corrupts. Cortes notes: “Powerlessness also corrupts.”

Powerlessness breeds cynicism and passivism, especially between elections, which is the crucial time when policies are forged, the time when the organized money of special interests exerts commanding influence. As Senator John McCain, the conservative Republican presidential nominee in 2008, put it, the flow of money into lobbying and into election campaigns is “nothing less than an elaborate influence-peddling scheme in which both parties conspire to stay in office by selling the country to the highest bidder.”

Political insiders have always had extra power—more at some times in our history, less at other times. Since the late 1970s, the insiders’ advantage has grown exponentially. Today, the New Power Game in Washington is dominated by well-financed professional lobbyists, many of them former members of Congress and government officials with an inside track, working for special interests like Wall Street banks; the oil, defense, and pharmaceutical industries; and business trade associations.

Our once healthy clash of interests has become precariously one-sided. In the past decade, business has employed thirty times as many Washington lobbyists as trade unions and sixteen times as many lobbyists as labor, consumer, and public interest lobbyists combined. Spending has been even more lopsided in favor of Corporate America. From 1998 through 2010, business interests and trade groups spent $28.6 billion on lobbying compared with $492 million for labor, nearly a 60-to-1 business advantage.

Today, no countervailing power matches the political clout of business. Our democracy has become starkly unequal.

The Interaction of Politics and Economics

This book sets out to describe how, over the past four decades, we came to this point—how we became two such polarized and dissimilar Americas, how the great economic and political divide affects the lives of individual Americans, and how we might, through changed policies and a revival of citizen action, restore our unity and reclaim the American Dream for average people.

In my first book, The Russians, I sought to give American readers an intimate human picture of what Russians were like beneath the veneer of Soviet communism and why they behaved the way they did. In The Power Game: How Washington Works, I went inside the American political system and the games politicians played in the era of Ronald Reagan and Jimmy Carter to describe how power really works in Washington and why some leaders succeed and others fail.

In this book, I provide a reporter's CAT scan of the Two Americas today, examining the interplay of economics and politics to disclose how the shifts of power and of wealth have led to the unraveling of the American Dream for the middle class. I tell the story, too, of how we evolved into such an unequal democracy—how we lost the mod-
erate political middle and how today’s polarized politics reinforce economic inequality and a pervasive sense of economic insecurity.

This is a reporter’s book full of stories of Americans high and low. It portrays the impact of the New Economy and the New Power Game on the rich and the middle—on jobs, incomes, homes, retirement—and on people’s hopes and dreams. Among these people are many Americans I came to know reporting for The New York Times, for PBS investigative documentaries, and for this book—leaders like Bill Clinton, Newt Gingrich, and Martin Luther King, Jr.; CEOs like Al Dunlap, Bob Galvin, or Andy Grove; and middle-class people like jet airline mechanic Steve O’Neill, loan officer Bre Heller, computer plant technician Winson Crabb, contractor Eliseo Guardado, and small-business owner John Terbous.

Most still voice a plucky personal confidence. Yet their faith in the American Dream has been sorely shaken. Like others, they want to know what happened to them and to America—what changed the way our economy and our politics work.

Technology and Globalization

The standard explanation offered by business leaders and political and economic conservatives is that these harsh realities of the New Economy are the unavoidable product of impersonal and irresistible market forces.

America, they point out, was an unchallenged economic colossus at the end of World War II. It was easier then for the United States to generate middle-class prosperity. But as Europe, Japan, and Russia recovered, America’s share of world trade shrank from nearly 20 percent in 1950 to less than 10 percent in 1980. In the early 1970s, we began running trade deficits, and as Asia boomed, we imported much more than we sold abroad. As historian Charles Maier put it, the United States morphed from the “empire of production” into the “empire of consumption.” Today, we benefit as consumers, but we pay a heavy price in lost jobs, American jobs lost to foreign imports or because U.S. companies have moved them overseas.

Business leaders and free market economists tell us that this economic hemorrhaging is an unavoidable cost of progress. It is the price of the inexorable march of technology and free trade. But that seductive half-truth doesn’t fully square with the facts. It ignores the political and economic story that this book tells—the impact of public policy and corporate strategy on how we became Two Americas. It fails to explain why such an overwhelming share of the fruits of technological change and globalization went to a privileged few while the majority of ordinary Americans got left out.

Few would dispute that technological change and the digital age have shaken up the U.S. economy, forcing change, creating new winners and losers, and disrupting many industries and millions of lives. But if technological change and globalization were the primary causes of America’s problems today, then we would see the same yawning income inequalities and middle-class losses in other advanced countries. But we don’t.

A Comparison—and a Fork in the Road

Germany took a different fork in the road in the 1980s and it has fared far better than America in the global marketplace. While the United States piled up multitrillion-dollar trade deficits in the 2000s, Germany had large export surpluses. In the midst of Western Europe’s economic turmoil, Germany is a bastion of strength. Its economy grew faster than the U.S. economy from 1995 to 2010, with the gains more widely shared. Since 1985, the hourly pay of middle-class workers in Germany has risen five times as fast as in the United States, with the result that the German middle class is now paid better on average than Americans.

German leaders worked hard to keep their high-wage, high-skilled jobs at home. While U.S. multinational corporations aggressively
moved production offshore, Germany, too, lost some of its production workforce, but it retained a larger share of its manufacturing base at home than America did. Today, 21 percent of Germans work in production; in the United States, it's 9 percent.

The difference is not in technology but in our government policies and our corporate strategies. Germany has maintained strong trade unions and a strong social contract between business and labor, even reducing unemployment during the Great Recession, while America's jobless rate shot up.

**America Chose a Different Fork**

America chose a different path, driven by the pro-business power shift in politics and a new corporate mind-set, both of which lie at the root of the economic rift in America today. The New Economy laissez-faire philosophy of the past three decades promised that deregulation, lower taxes, and free trade would lift all boats. It argued that sharply reduced taxes for the rich would generate the capital for America's economic growth. Its disciples asserted that the free market would spread the wealth.

But that is not what has happened. The middle class was left behind—the 150 million people whose family incomes range from nearly $30,000 to $100,000 a year—as well as 90 million more low-income Americans living in poverty or just above. Even the 60 million upper-middle-class Americans and the nation's wealthiest 5 percent have been falling steadily further behind America's financial elite, the super-rich 1 percent.

The New Economy mind-set marked a sharp break with the corporate philosophy of the postwar era. Then, the mantra of business leaders was to share the wealth—to distribute to their employees a sizable share of the profits from growth and from gains in productivity. Since the 1970s, business leaders have largely abandoned that share-the-wealth ethic. With some exceptions, CEOs have practiced "wedge economics"—splitting apart the pay of rank-and-file em-
ployees from company revenues and profits. In fact, according to the Census Bureau, the pay of a typical male worker was lower in 2010 than in 1978, adjusted for inflation. Three decades of getting nowhere or slipping backward.

Such a dichotomy has developed in America's New Economy that last April, while more than twenty-five million Americans were unemployed, were working part-time against their will, or had dropped out of the labor force and the economy was still struggling to recover, The Wall Street Journal ran a front-page story trumpeting that major U.S. companies "have emerged from the deepest recession since World War II more productive, more profitable, flush with cash and less burdened by debt" than in 2007, before the U.S. economy collapsed. Many of the 11 million jobs added by American multinationals since 2007 and much of the $1.2 trillion cash added to their corporate treasuries came from overseas. At home, the Journal noted, "the performance hasn't translated into significant gains in U.S. employment."

The financial cleavage created by wedge economics has provoked popular discontent. Today, two-thirds of Americans—far more than just a couple of years earlier—say they see "strong" conflicts between rich and poor, and they see economics as more divisive than race, age, or ethnic grouping.

**"The Virtuous Circle" of the 1950s–1970s vs. the New Economy of the 1980s–2000s**

The New Economy is not smart. It hurts our capacity to grow, as we have seen from America's painfully slow recovery from the financial collapse of 2008. The job losses and stagnant pay of the New Economy have broken what economists call "the virtuous circle of growth"—long the engine of America's economic growth and middle-class prosperity.

In the heyday of the middle class, for thirty years after World War II, America's great companies paid high wages and good benefits.
Tens of millions of families had steady income, and they spent it, generating high consumer demand. Robust consumer demand is the main driving force of the U.S. economy. It propels businesses to invest in new technology, new plants and equipment, and more employees. Corporate expansion contributes to full employment, fueling "the virtuous circle of growth" to another round of expansion and higher living standards.

But in our New Economy, the dynamic thrust of "the virtuous circle" has been disrupted by job losses and the lid on average pay scales. Flat pay is bad not only for individuals, but for the whole economy. Weak pay leads to weak consumer demand. Companies don't expand and hire, and as a country, we bog down in long, painful "jobless recoveries." That has happened several times in the past two decades.

In short, downsizing, offshoring, and wedge economics have backfired. For the economy, they don't work. For the nation, they don't work. Individual corporations may profit, especially multinationals that have moved production overseas. But by sharing so little of their gains with their U.S. employees, they have put a crimp on middle-class spending, and without big consumer demand, the nation's economy can't move well.

**Crisis Politics**

Washington can't move either—because it is frozen in dysfunctional partisan gridlock.

Certainly, genuine differences divide us as a people. That has always been true. America's political pendulum has swung back and forth as parties battled over policy. But there was an accepted center of gravity. Work got done. Political rivals like Democrat Lyndon Johnson and Republican Richard Nixon would differ, but there was some consensus. Both expanded Social Security; neither tried to privatize it. Republicans might cut specific government programs or trim the budget more than Democrats, but they were not out to dismantle government and shut down entire cabinet departments.

Today, everything is in dispute. Political Washington has lost the habit of compromise and belief in compromise. No issue is ever settled. One Congress passes a law, the next tries to repeal it. The hallmark of the New Power Game is crisis politics—political ultimatums and a partisan blame game. But the stakes are too high for perpetual brinksmanship. It is time to heed Lincoln: "A house divided . . . cannot stand."

**Challenge and Response:**

*a New Mind-Set, a Domestic Marshall Plan*

It will take a political metamorphosis, a populist renaissance, in America to reverse the political and economic tides of the past three decades and to make our country strong and whole again. The Toynbeean challenge we face requires a response from all of us, a rebirth of civic activism from average people at the grass roots as well as from America's political and economic leaders. Millions of Americans will have to come off the sidelines and reengage in direct citizen action in order to reestablish "government of the people, by the people, for the people" and to achieve a genuine people's agenda in Washington.

It is not hard to conceive of the measures needed to restore a fairer, more level economic playing field—action on jobs, homes, taxes, and fairness, plus a reset in long-term economic thinking. It took decades for us to get into our current national predicament; it will take time—and tenacity—to build our way back to a more just, secure, and vibrant society.

To regenerate widely shared prosperity over the long term, we must get "the virtuous circle" working again. That challenge requires our business leadership to share more of their companies' profits with workers. It requires our political leaders to do more of what past presidents such as Washington, Lincoln, Theodore Roosevelt, and Dwight Eisenhower have done: Use government resources to modernize our aging highways, ports, and airports, to stimulate research and development, to retrain workers who have fallen behind,
and to provide incentives to the private sector in order to make America—and Americans—more globally competitive in the years ahead.

There are some hopeful omens. One problem is that we have become so fearful about our economy and so jaded about government that we overlook the good news in our midst. Business leaders have begun to speak out against the New Economy notion that the United States can survive on a service economy. What we need now, insists General Electric CEO Jeffrey Immelt, is a renaissance in manufacturing and production jobs. Make It in America is the title theme of Dow Chemical CEO Andrew Liveris’s latest book. Other top corporate executives call for a domestic Marshall Plan—a mix of tax incentives, aid for research, public-private investment pools, and a skills alliance to modernize the training of American workers displaced by foreign trade.

General Motors and Chrysler went to the brink of extinction in 2009, but they have come back. The auto industry bailout was brutal, but it signaled some significant changes: business and government working together, management and labor doing give-and-take to save companies and jobs. Both GM’s CEO, Dan Akerson, and the United Auto Workers union scrapped their “us vs. them” rhetoric. The union agreed to keep wages steady. GM and Ford pledged to reopen plants in the United States and not to shift production to Mexico as they had planned. By early 2012, the Big Three carmakers planned to invest several billion dollars to retool multiple plants in the United States.

More broadly, manufacturing employment edged up in both 2010 and 2011, adding more than three hundred thousand jobs, and U.S. manufacturing exports began to rise. And by 2012, the once irresistible cost advantages of China were looking less attractive to some U.S. employers. With labor unrest and wage inflation in China and stagnant or falling wages in America, a few companies such as General Electric, Oris Elevator, and Master Lock of Milwaukee have begun to bring jobs back from China to the United States—and smart government policies could foster that trend. In all, some 25,000 manufacturing jobs have returned to the United States in the past few years, according to Harry Moser, president of the nonprofit Reshoring Initiative.

Personal Involvement

But for the long-term effort to level the economic playing field and to reclaim the American Dream, what is needed is a modern political crusade by average Americans on the model of the civil rights and environmental movements of the 1960s and ’70s.

Inevitably, people ask for leadership: Where is the great new Lincoln to heal the fissures of our divided nation and set our nation on an upward path? In the past, civic leaders such as Martin Luther King, Jr., have emerged from below, from mass movements. The starting point is populist civic action. The vital ingredient is personal involvement.

As Toynbee observed, a grave danger arises when many people living in a mature civilization no longer feel part of that society—that is, no longer feel they matter. Mass alienation and serious schisms emerge when people come to believe that they are not significant participants with a role and a voice in determining the nation’s destiny.

“Americans have reason for negative attitudes,” the late John Gardner, head of the public advocacy group Common Cause, observed a few years ago. “But the sad, hard truth is that at this juncture the American people themselves are part of the problem. Cynicism, alienation and disaffection will not move us forward. We have major tasks ahead.”

The techniques of the Tea Party have shown one way to press a political agenda in Washington. But instead of pushing a middle-class agenda, the Tea Party freshmen in Congress have pushed tax cuts and policies that protect vested corporate and financial interests. Their strategy has been to cut aid to college education for middle class kids, retirement funds and health care for middle-class seniors, and programs designed to keep middle-class families in their homes.
The Tea Party agenda is not a middle-class agenda. Perhaps not a surprise, since more than half of the sixty Tea Party members in the House of Representatives are themselves millionaires, with an average net worth of $1.8 million.

But what can be learned from the Tea Party is that a fresh surge of civic energy at the grass roots can change the political debate in Washington—and the balance of power.

Another fresh surge of energy came last fall from Occupy Wall Street demonstrators in New York City and thousands more from Boston to Portland, Oregon, and St. Louis to Los Angeles. They gave voice to a populist protest against concentrated power and wealth in America, and much of the public responded positively to their message. In a few short weeks, the Occupy movement, inchoate as it was, not only changed the public dialogue on economic issues, but implanted in America’s political lexicon a vivid, Twitter-easy slogan—“We are the 99 percent”—opposing the richest 1 percent—a slogan that frames a central issue for election-year politics and policy makers in Washington.

But lasting change in America will require a broader movement that is more deeply rooted, better organized, and more politically clear about a short list of policy goals. Still, the first shoots of an American political spring have appeared, and our history teaches that, once mobilized, a peaceful but insistent, broad-based grassroots rebellion can regain the power initiative and expand the American Dream.

What’s needed, John Gardner declared, is “a powerful thrust of energy” from grassroots Americans: “We the People” demanding that Washington carry out an authentic middle-class agenda.