

# “The Decline of America” Revisited

WASHINGTON – Remember Yale historian Paul Kennedy and his 1987 tome on “The Rise and Fall of the Great Powers”? At that time there was a lot of interest in this fairly comprehensive narrative focusing on how all major western powers, primarily because of the huge cost of maintaining their Empires, suffered progressive economic decline and eventual decay. Thus Spain –in Kennedy’s argument– thus Great Britain and thus –inevitably– the US. The book sparked a spirited debate about the future of the US as the leading power of the century. The combination of a sputtering economy, strong Japanese competition and raising security expenditures necessary to maintain the American Empire would lead to bankruptcy and thus to the inevitable –if sad–retreat from global ambitions. Kennedy’s work contributed to a new self-reflective atmosphere that gave rise, among other things, to efforts aimed at investigating the soundness of the main pillars that sustain the edifice of America’s might. Think tanks, the Congress, and the Federal Government launched studies, initiatives and task forces on “US Competitiveness” –or lack thereof. The newly formed bipartisan Concord Coalition started warning Americans as to the structural damage caused by runaway deficits due in large part to the unstoppable growth of spending on entitlement programs.

So, according to the conventional wisdom of the late 1980s, we were overstretched militarily because of the Cold War security commitments highlighted by the 300,000 troops permanently stationed in Europe, as our most visible contribution to NATO and by the questionable idea of spending billions of dollars on the Star Wars program, that is space based ballistic missile defenses. We had lost our edge in economic innovation. We were assaulted by the Japanese bulldozer from the East.

This was the time, we should remember, in which the trade deficit was about Japan; while Japanese concerns had started a buying spree in America that, according to many, even serious, observers, had all the markings of a progressive take over of our economy. Meanwhile the "Europe 1992" agenda, the solemn commitment on the part of the then European Community to pull down residual internal barriers and create a brand new, vibrant market, seemed to foretell a new era of economic primacy for the Old Continent, engineered behind the walls of a "Fortress Europe" that –it was feared– would exclude Americans. Here at home, because of misguided fiscal policies and unhealthy personal spending habits, we –the Government and the individual citizens– were slowly but surely drowning in debt. That was the picture then. It was the widely shared notion that the economy was on the verge of collapse, especially after the mild recession of 1991 that propelled technocratic Bill Clinton and his panoply of new, original economic ideas (never really implemented, by the way) to the White House.

But, in the meantime, the unexpected happened –on many fronts. 1989 did not give us just the promise of German reunification. It was the first shock wave that signaled the collapse of the Soviet Empire and thus the end of the major threat to US security. The final demise of the biggest existential threat was the justification to significantly cut defense spending and international commitments in the 1990s. This dramatic change, combined with a resurgent faith in small government, especially after the republican revolution of 1994 masterminded by Newt Gingrich, meant that runaway federal spending could be contained.

At the same time, without the support of any particular blueprint devised in Washington, the information revolution was unfolding. Rather than creating a new economy, the massive adoption of IT by all businesses meant a massive leap forward in the competitiveness of the US economy. We had spectacular

growth year after year, record low unemployment and high tax receipts that gave us for the first time in decades a federal budget surplus. At the same time, without the US lifting a finger, Japan, because of its internal social, rather than economic, contradictions, fizzled, while the predictions of the rise of a robust, innovative and economically powerful Europe proved to be quite wrong. And so, we had the roaring '90s: a prolonged period of American unchallenged economic primacy. The US was first in everything: innovation in high tech, creation of new employment, record productivity increases.

But it all seemed to have ended somewhat ignominiously with the beginning of the new millennium. We have had the dot.com bust, accompanied by the Enron, WorldCom, Adelphia and other well known corporate scandals which ushered the Wall Street contraction and the ensuing long bear market. The 9/11 attacks, occurring during this downward spiral certainly did not help.

And now, where are we now? There are disturbing signs that would indicate that Paul Kennedy and other were after all right in predicting decline. Only they were incorrect as to how close it was and what would cause it. The root cause is not "Imperial Overstretch", but the erosion of US competitiveness due to lack of investments in both human capital and needed infrastructure, accompanied by the unstoppable growth of entitlement programs. Sure enough, at this time we also have a war. The prolonged Iraqi campaign has become stupendously expensive. But, regardless as to one's own political opinion about the war, this commitment, in an as of itself, is economically affordable.

While a war and an increased Pentagon budget are a drain on public finances at the expense of productive investments, the real problems are in the same factors that were identified 20 years ago, at the time of the "competitiveness debate", by most sensible analysts: a more and more expensive welfare

state that cannot sustain itself financially, and the progressive erosion of the education advantage that made America the principal player in the knowledge economy. If we continue to follow the notion that large segments of the American society, mostly the elderly and the retirees, have an inherent right to subsidized benefits that represent an excessive drainage of national resources, the federal government, even assuming the ability to finance these obligations, will have nothing left for productive investments. The secondary public education system, in turn, provides mediocre graduates, while minorities, on balance, do a lot worse than the already low average. It is impossible to sustain this increasingly complex economy without a dramatic improvement in the quality of the labor force.

The fantastic explosion of the trade deficit is the manifestation of eroded competitiveness. The 40 billion dollar deficits that scared us about Japan in the 1980s are pocket change compared to the 220 plus billion that we have nowadays with China alone, (not to mention the increased cost of our energy habits: at 300 billion in 2006, higher than the cost of imports from China).

Unfortunately, the argument on how to best rebalance our trade accounts has been successfully framed by a strange medley of simplistic romantics and demagogues who point the finger at the combined perils of free trade and outsourcing. By opening ourselves to foreign producers –so the refrain goes– we allow cheaper goods to come in. This means that US companies that have much higher costs go out of business or move overseas. Good American jobs go abroad because greedy corporations want to save money by having cheaper foreigners perform jobs previously held by higher paid Americans. The solutions advocated? Essentially close our borders, so that the jobs stay in and the foreign goods out. In this new era of global and irreversible interdependencies, the notion that this way

we shall be able to regain, maintain and for ever keep our supposedly God given infinite prosperity is bizarre; but, nonetheless, it has strong emotional appeal.

However, if it is clearly futile to try and close our borders to keep cheap goods out or to prevent businesses from outsourcing, we still have a huge problem which is indeed caused by globalization. But not the globalization demonized by the protectionists. It is caused by the global spreading of the knowledge economy model developed first in America whose successful exploitation gave the US the edge for a number of years.

We have to come to terms with the fact that the genie of IT innovation has been out of the Silicon Valley bottle for a long, long time. We cannot restrict inventiveness and entrepreneurship –the key components of the American success story– to the American soil. The main ingredients of a knowledge based economy are transferable and so (despite copy cat failures and other clumsy attempts) they are transferred elsewhere today and more so in the intervening years.

True, the 1990s triumph of America's reacquired competitiveness was due to a complex mix of factors that cannot all be easily reproduced. The lively, free wheeling, chaotic mixture of entrepreneurs, academics, venture capitalists and their interactions with established corporate entities that buy, absorb, invest in new ventures, as yet, has no equivalent elsewhere around the world, in terms of depth and scope. But some of its elements can be replicated. No doubt, by trial and error in time others will manage to produce adequately funded innovative clusters that will be able to quickly direct new discoveries to a hungry global marketplace.

The celebrated Bangalore example in India is illustrative. Leaving aside all other considerations, the Indians have managed to create and aggregate in productive clusters world

class human capital (scientists, engineers, software programmers) and to harness it effectively in competitive IT enterprises. To keep things in perspective, we should remind ourselves that Bangalore is still mostly about outsourcing and not about innovation. Moreover, the whole Indian high tech phenomenon is only a small speck within a still primitive Indian economy which is constrained by inefficient administration and crumbling infrastructures. India has an enormous population that is still largely poor or very poor. So, the days of Indian supremacy are still in the distant future.

But Bangalore and other such examples around the world will multiply, as more and more people gain access to higher education, IT literacy and mundane computer and business skills that cannot be kept within the West and America. The very information revolution unleashed by the American genius becomes the vessel that greatly expedites the transfer of knowledge that will create new centers of excellence where none existed before. Furthermore, the Indian example proves that we do not need an economy that is overall highly developed to create islands of modernity that can compete on practically any level with counterparts in advanced economies. Indeed, centers of competitive high tech can be established even without the fertile ground of an already developed economy that has already successfully dealt with macroeconomic issues.

These new enterprises, especially those established in business friendly developing countries where the cost of professional for many years to come will continue to be much lower than America's, are bound to gain world market share, inevitably at our expense. If even a small fraction (as a percentage of the total population) of Indians and Chinese become good scientists, their absolute numbers will be sufficient to tip the balance. Our only hope to stay competitive is in continuing to invest in new technologies and

new ideas so that superior innovative products and services will continue to be created in America.

But here we have a serious problem. Americans are so used to primacy that they do not believe that the ingredients that make this primacy possible need to be nurtured, refined and upgraded, especially now that we are confronted with new, capable competitors that have the added edge of a lower cost structure. (For instance, it has taken 20 years to the slow moving, no pun intended, automobile industry to have just recently what appears to be a collective awakening, with the active participation of the unions representing its thousands of workers. But it seems that only the specter of demise convinced the main players that dramatic cost cutting—be it salaries or health care benefits— is imperative in order to have a chance to compete. But, even if successfully implemented, these strategies are clearly not enough to get Detroit out of the woods. In the next few years we shall see whether the bitter cost cutting medicine will be accompanied by a new wave of creativity that is the real hope for recreating a competitive edge for this ailing sector).

While discussions about the international economy abound, for the time being, we have not framed the debate in a way that will foster real progress. Unfortunately, to the extent that the general public has been brought into the conversation, it is fed gross distortions and oversimplifications pointing at the consequences of lost competitiveness, such as job losses. The conversation is mostly on allegedly bad trade policies and greedy corporations. If we could only change Washington's direction on trade, all will be well. Indeed, the debate is mostly about identifying culprits and quick fixes. So, according to these critics, beyond the international trade policy incompetence (close to treasonous behavior), the enemies are the Asians, (yesterday Japan, today China) who do not play by the rules and the illegal immigrants who steal domestic jobs while depressing wages. This sort of populism

may work with many constituencies in uncertain economic times; but it explains nothing about the causes of our ailments and its remedies would cure nothing.

The reality is that we have structural, systemic problems that need to be addressed now, so that we can begin to change course and hopefully improve our conditions for the long term. While the misbehavior of others is real (think of Chinese disregard for intellectual property rights and the ensuing flood of pirated software and counterfeit goods; think of the Mexican government actively encouraging the emigration to America of the country's surplus labor), there are inherently domestic structural deficiencies that slow down America and that have eroded its ability to compete. To name a few critical ones: a deteriorating education system, the unsustainable cost of the welfare state and the lack of a serious energy strategy.

Clearly the soft underbelly of America is a mediocre to bad education system right at the time when new, world class centers of higher learning are sprouting around the world. America for a long time nurtured domestic talent while, by design or by default, (think about the intellectual migration to America from Nazi occupied Europe), it was able to attract first class minds from around the world. After all, Albert Einstein, Enrico Fermi and Edward Teller were not Americans. But they were welcomed in America and the American intellectual and scientific environment was able to absorb this talent and greatly benefit from it. In more recent years there has been a significant influx of gifted Asians. But now the pull of America is not as compelling as it used to be in the light of the fact that good opportunities exist elsewhere.

At the same time, it is now apparent that the American public education system, the incubator that should nurture the future scientists, engineers and entrepreneurs is at best mediocre, deeply flawed in its worst components and certainly inadequate to create the world class work force that will have to compete

on quality, as costs already work against us. The existence of several world class universities is not sufficient to guarantee that the broader US workforce will be able to compete with increasingly more sophisticated foreigners. A sub par work force will make it difficult to compete, let alone strengthen, our positions in high value added strategic areas.

While it is hard to admit it, a huge chunk of the old manufacturing base of America is either gone or going. We lost a lot of steel, machine tools; we lost footwear, apparel; we have disturbing signs that we cannot keep up in automobiles. We have a battle unfolding in aerospace. Still, American success stories in valuable, technologically complex industries (think of GE, 3M, United Technologies, Boeing among many others) show that, despite higher labor cost, superior quality, when it can be reinforced by constant refinement, still counts.

By the same token, we still have an edge in services. But this is entirely dependent on the continuous waves of IT innovation. If we are no longer on the forefront of IT, because we can no longer compete with increasingly more competent but much cheaper Indians and Chinese, we have lost the competitiveness contest.

Much has been said about the increased welfare costs due to the demographic changes that America is experiencing, along with most other developed countries. The question is whether it is smart, in the long run, to have a central government whose main function is to distribute benefits at the cost of everything else. Even now, while immediate solvency is not an issue, the federal government devotes relatively smaller portions of its resources to productive investments, given the weight of the entitlement obligations. As we all know, in the future this is only going to get worse. It is understood that taking something away from people who believe that they have earned a partially subsidized old age is extremely hard. But there is an opportunity cost in spending most of our revenues

on welfare and little on competitiveness enhancing investments. Unfortunately few people enumerate the thousand of research projects or new infrastructure that could be financed by the federal government, assuming a reduction in entitlement programs.

The energy picture is dismal. We have excessive consumption, little and declining production and increased dependence on imports that is financially burdensome, while it creates a serious strategic vulnerability. What we need is not just the tinkering provided by this or that pork laden energy bill; but a bold new *energy strategy* that would set realistic goals regarding alternatives to hydrocarbons, while actively discouraging consumption through revenue neutral gasoline taxes. In doing so, America would free itself from this straightjacket, while possibly becoming the world leader in all new technologies related to alternative energy.

But in all these areas: education, welfare reform and energy, while there is a debate and many have offered sensible solutions, we are far from having reached the deep understanding that is the prelude to decisive action. While many are worried, most believe that things are more or less fine and that we have enough slack to muddle through.

In hindsight, similar historic circumstances characterized by a passive attitude that in effects allows the sliding into decay (and here we go back to Paul Kennedy) are recognized as due to a state of mind of myopic denial and complacency of people who have lost their way. But usually this is the verdict of historians. And when they pronounce it, it is too late to change anything.

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# A Sound US Plan for Immigration

WASHINGTON – The immigration issue has not been dealt with via comprehensive legislation, as it was hoped for during the summer. But it has not gone away. Unsolved, it is still out there; simmering and enticing more and more emotional reactions. “Do it yourself” measures undertaken by a host of state and local actors aimed at dealing somehow with illegal immigrants in their midst fan the flames of emotions on both sides of the divide, without providing clear and equitable long term solutions.

The US legislators who killed the comprehensive reform plan, flawed as it might have been, are guilty of political cowardice. Those who were against the proposed legislation that did not pass last summer, after rejoicing for their victory against the outrage of “amnesty”, should have proposed something better. The idea, advanced by at least some of them, that we do not need new statutes but only the serious enforcement of existing legislation is disingenuous populism. They know full well that it is materially impossible to round up and deport all the millions of illegal aliens. But it is easy to posture on this issue, claiming that, after all, “this is the law.”

At the federal level, Homeland Security most likely wanted to maintain the pressure on the issue by trying to force employers to check on potentially phony identification credentials provided by their workers. By raising the specter of criminal charges against employers who do not fully investigate potential status fraud in job applications, maybe the federal government thought that the business community would force Congress to take action and provide a comprehensive settlement formula for the millions of illegals who are employed. This move, for the time being, has been

stopped by judicial action.

But there are many other initiatives aimed at “doing something” about the illegals. For instance, a few jurisdictions in Texas and elsewhere have created automatic checks on the immigration status of any person stopped for routine traffic violations who cannot provide proper identification. For the illegals, deportation may very well be the ultimate consequence of not observing a stop sign.

While all these measures and attempted measures are technically correct, as they are aimed at law breakers, they create the worst possible scenario of widespread fears of mean, racist persecution, (with intense resentment among the many legal Latino citizens who feel sympathetic towards the illegals), without really “resolving” the problem. The authorities may very well say that citizens and legal residents have nothing to worry about. But the truth is that occasional, random enforcement of the law is inherently unfair. Most of those who are caught in these dragnets, while technically law breakers, are not real hardened criminals who should be deported as they represent a threat to society. They are the unlucky scapegoats who pay the price of legislative inaction; while the larger issue of a meaningful overhaul of immigration is left unattended. Plucking a few people here and there and deporting them causes tensions, while providing no solution to this vast problem.

On the other side of the divide there are those who would like not just leniency regarding the millions of illegals, but who create a new fantastic picture whereby there is really no offense, criminal or otherwise to be concerned with. These are just “undocumented”, “indocumentados” workers. They are here because there is a need for their labor. What’s wrong with that? Being “undocumented” is looked at as a mere technicality that could be easily dealt with. But this approach is wrong. The term “undocumented” to describe an individual who entered the country illegally is an absurd euphemism that

would like to do away with the problem by denying its existence. Furthermore, the fact that the term "indocumentado" is the only one used by the Spanish language US television networks when discussing these matters misleads their mostly immigrant audience and it is ultimately dangerous. As being "indocumentado" sounds like a minor bureaucratic issue, if people are rounded up, arrested or deported, then it must be about racism and disregard for basic human rights.

This scenario is bad and it could become worse because of the tension heightened by selective enforcement. Getting rid of all the illegals is impossible. Likewise, to claim that coming to the US illegally is no big deal and it should not have consequences is preposterous. It is time to get serious. Let's stop populist demands to enforce the law as is (thus deporting millions of people); and let's stop asking for open borders for all, as if it were the duty of the United States to make room for anybody who cares to show up.

There are unfortunately many drivers behind this mess. But we can say that there are two fundamental dimensions. First: How to regulate future immigration, so that we create a credible, rational process that serves America's interests; distinguishing carefully, though, between those who are just interested to work in the US and those who are interested in becoming part of the US society. Second: how to deal with the illegals who are already here.

On the first issue, Mexico, the country of origin of most of the illegals, has a huge responsibility. Mexico is a middle income developing nation with significant income disparities and millions in permanent poverty. Lacking the ability to improve the conditions of its poor, Mexico regards the encouragement of illegal emigration to the US as a key component of its social policies. "You are poor? You cannot find employment? Go north to the US and good luck to you. If this means breaking the law of a neighboring country, this is

their problem.” If Mexico were a more mature society, we could expect more cooperation from their end aimed at blocking would be illegal emigrants. But, as long as illegal emigration to the US is viewed as a convenient tool to alleviate the social pressures caused by the vasy army of the very poor, we cannot hope on this, for the time being. So, no serious barrier to stop the outgoing flow.

On the US side, it is quite clear that the flow of illegals is fueled by manpower demand from within America. And here we have an extremely complicated picture. The enemies of immigration accuse cynical US businesses of encouraging the inward flow of illegals so that they can pay them less; or, at the very least, so that, by relying on an inflated labor pool of legal and illegal workers, they can keep wages depressed for all. Businesses reply that this is not so. They need labor. The immigrants, legal or otherwise, are the only ones willing to do certain jobs. The truth must be somewhere in the middle.

It is quite obvious that various social and economic factors, on both sides of the border, tend to feed the pipeline of illegal immigration. One day, assuming a developed Mexico, Mexicans would not try their luck by illegally crossing the border seeking opportunity, as they would have sufficient income at home. But we are not there.

This is why we need new credible policies and actions aimed at creating a secure border, as people without jobs at home have and will continue to have the incentive to cross it illegally. By the same token, The US official posture of stating that illegal immigration is a crime but at the same time relying on an insufficiently guarded, porous border to enforce the law, is an indirect nod to the illegals and to those who push them out and pull them in. “Look, it is illegal, of course. But, since the chances of not being caught are relatively good, you can give it a try”.

The United States, the country that can afford to spend billions of dollars every month for a controversial Iraq war, could spend a few more billions to create a credible border that can be crossed only legally through official checks. I have no idea as to whether a border fence is the best technical means to achieve the goal. But the twin notions that somehow it would be technically impossible to construct a fence or that, if successful, this barrier would be shameful and inhumane since it would prevent interaction between societies, are both ridiculous. Technically it is feasible. And it is certainly politically and morally justifiable for a sovereign country to do its utmost to prevent illegal border crossings.

And let us put an end to the silly comparisons with the Berlin Wall. Once and for all let us remember that until the Berlin Wall existed its only purpose was to keep very unhappy people who wanted to go elsewhere in; not unwelcome invaders out. In East Berlin, the machine guns on the fortified Wall were trained inside the border, to kill if necessary the East Germans who might have tried to escape from their workers paradise. What is at issue regarding the US border with Mexico is something entirely different: how to keep unwanted trespassers out. How can this be bad? Does anybody question the right of any individual to have a door in their home? A door that they will open only to welcome visitors? Is having a door in the house a manifestation of hostility towards outsiders?

As for the issue of lack of sufficient numbers of US workers in many key sectors, including some characterized by seasonal demand, the simple answer is to create a well crafted and carefully monitored guest workers program. Many Mexicans or other people who come through Mexico do not necessarily want to stay in the US forever. They need income. Assuming the validity of the basic premise: namely not enough US citizens willing to perform certain tasks, then it should be relatively

simple to create guest workers programs aimed at attracting foreigners willing to perform those activities for the same wages offered to US nationals with the same skills. These work permits would not be considered paths to eventual residency and citizenship. This program would be about creating an official, transparent channel aimed at providing the needed labor supply.

As for the other immigrants, aside from political asylum seekers, there are the skilled ones and those who would come on the basis of close family relations with legal immigrants. A solution for both categories does exist. As for skilled people, it is clearly in the US interest to attract more educated, talented people. Individuals willing to come to America in order to engage in research, business and enterprise should be encouraged. However, for them as well as for all other would be new citizens, an induction process should be created whereby they will understand that America is not just a place to do business. America is a country that upholds certain basic values enshrined in the Constitution. Those who do not share them, or, worse, who openly proclaim views that are inimical to the fundamental principles of liberal democracy, regardless of their talent or capital, do not belong.

The immigration of close family relations of newly minted citizens or permanent residents should not be an opportunity to create an endless chain whereby the legalized new immigrant has a right to sponsor relatives who, upon being legalized, sponsor other relatives etc. Restricting this process without causing the break up of basic family units should not be an impossible task.

Assuming a credible solution that would stop the flow of illegals, while regulating in an intelligent way the flow of new legal immigrants, skilled and unskilled, then the hard part of dealing with the millions of illegals settled in the US could begin. We know that the specter of a gigantic amnesty

offered to all created the wave of indignation eventually leading to the defeat of the immigration bill last summer. Yet, it is clear that any serious attempt at resolving the issue of the illegals, many of them having been living in the US for decades, will have to entail some kind of broad legalization process eventually resulting for all practical purposes in amnesty. It is hard to think of any other approach to the illegals that would not cause the painful dislocation of millions, with inordinate injury to them and many others.

However, before legalizing everybody, a choice should be offered to the many who are here only for economic reasons and who aspire to eventually go back to their countries; or who would be perfectly willing to come and go according to the seasonal needs of the economic sectors; assuming that they could do so legally, without fear of being apprehended each time they cross the border. They are the perfect target for a guest worker program that would allow them to do what they are already doing but with full transparency for them and for their employers.

For all the others, a path to ultimate legalization should be created. It is preposterous to think that we are going to send back people who have been living here for a decade or more, in the same fashion in which we would deal with someone caught by the border patrol an hour ago. It would be totally impractical, if not equally preposterous, to mandate that these illegals go back to their country of origin, file an application and wait for a few years at the back of the line. These are people with established lives, homes and jobs here in the US. To deny this fact is absurd.

Having said that, we should recognize that the most compelling argument against any form of legalization is that it would be viewed as a green light for more illegal immigration to come. Amnesty now would encourage others to keep coming illegally, based on the fact that eventually an amnesty will come for them as well. This is a very valid point against

amnesty/legalization. This is why securing the borders and creating a credible process to regulate future legal immigration is an absolutely necessary precondition to any serious plan aimed at settling the problem of the illegals. If we did this right, we would not have to face again this kind of immigration issue ten or twenty years from now.

At a different level, and only with hoped for effects in the long term, it would be in the strategic interest on the United States to strongly support in a meaningful way economic development south of the border. The Mexicans and others encourage people to emigrate because their societies cannot create sufficient opportunity at home. If such opportunity existed, people would stay in their countries and we would not be having this need to create barriers aimed at preventing the unlawful entry of millions driven by economic hardships. After all, we are not talking about a fence on our northern border with Canada, simply because the Canadians are doing well at home and, by and large, intense business and cultural relations with the US notwithstanding, they are happy to stay there.