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AMERICA'S BACK!

THE REMARKABLE TALE OF OUR ECONOMIC TURNAROUND

BY DANIEL GROSS

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The Comeback Country

HOW AMERICA PULLED ITSELF BACK FROM THE BRINK—AND WHY IT'S DESTINED TO STAY ON TOP.

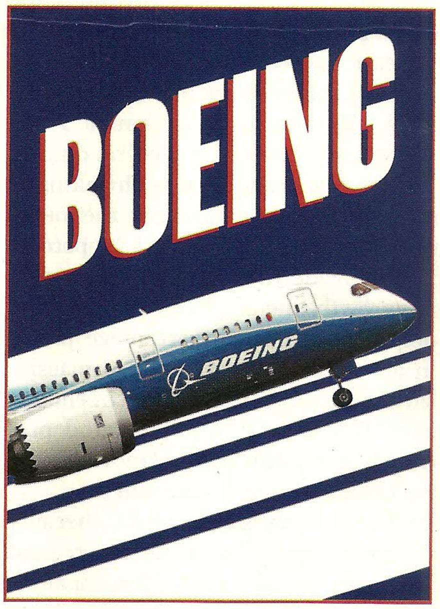
BY DANIEL GROSS

IN THE WAKE OF THE 2008 FINANCIAL meltdown and the deep, long recession that followed, the decline of America has become the preferred intellectual preoccupation of the elite—left, right, and center. Joseph Stiglitz, the Nobel-winning economist, has argued that the Obama administration's tepid response to the recession and the financial meltdown will sandbag the U.S. recovery. Historian Niall Ferguson has made the case that high debt and profligate spending will cause the downfall of a once mighty empire. Harvard economist Ken Rogoff frets that the U.S. could become the next Greece. In January, French President Nicolas Sarkozy, once dubbed *l'Americain,* delivered a blistering speech at the World Economic Forum in Davos that criticized the U.S.-led model of global capitalism.

After the failure of Lehman Brothers in September 2008, industries and institutions tethered to the easy-money era were nearly sliced in half. And so was America's economic self-esteem. Between the end of 2007 and the first quarter of 2009, $9 trillion of wealth evaporated. The relentless boom of China, India, and Brazil, with their cheap labor and abundant natural resources, emerged as a frightening new threat. The collapse coincided with other foreboding omens: $4-a-gallon gas, the rise of the tea partiers, an ungovernable Senate, an oddly blasé White House, unrepentant banks, and stubbornly high unemployment. The broad measure that tallies frustrated part-timers and those who have given up remains at 16.9 percent. If the U.S. doesn't tumble back into recession, the consensus holds, we'll face a Japan-style lost decade. A 2009 NBC/*Wall Street Journal* poll found that only 27 percent were confident their children's standard of living would be better than their own.

Bleak is the new black.

But the long-term decline of the U.S.



KEVIN P. CASEY—BLOOMBERG-GETTY IMAGES

economy has been greatly exaggerated. America is coming back stronger, better, and faster than nearly anyone expected—and faster than most of its international rivals. The Dow Jones industrial average, hovering near 11,000, is up 70 percent in the past 13 months, and auto sales in the first quarter were up 16 percent from 2009. The economy added 162,000 jobs in March, including 17,000 in manufacturing. The dollar has gained strength, and the U.S. is back to its familiar position of lapping Europe and Japan in growth. Among large economies, only China, India, and Brazil are growing more rapidly than the U.S.—and they're doing so off a much smaller base. If the U.S. economy grows at a 3.6 percent rate this year, as Macroeconomic Advisers projects, it'll create $513 billion in new economic activity—equal to the GDP of Indonesia.

So what accounts for the pervasive gloom? Housing and large deficits remain serious problems. But most experts are overlooking America's true competitive advantages. The tale of the economy's remarkable turnaround is largely the story of swift reaction, a willingness to write off bad debts and restructure, and an embrace of efficiency—disciplines largely invented in the U.S. and at which it still excels. America still leads the world at processing failure, at latching on to new innovations and building them to scale quickly and profitably. "We are the most adaptive, inventive nation, and have proven quite resilient," says Richard Florida, sociologist and author of *The Great Reset: How New Ways of Living and Working Drive Post-Crash Prosperity.* If these impulses are embraced more systematically and wholeheartedly, the U.S. can remain an economic superpower well into the current century.

So what will our new economy look

17,000 THE NUMBER OF U.S. MANUFACTURING JOBS ADDED IN MARCH—THE THIRD CONSECUTIVE MONTHLY GAIN.

★ 11,000 THE LEVEL THE DOW JONES INDUSTRIAL AVERAGE HAS FLIRTED WITH FOR THE PAST FEW WEEKS—UP 70 PERCENT IN THE PAST 13 MONTHS.

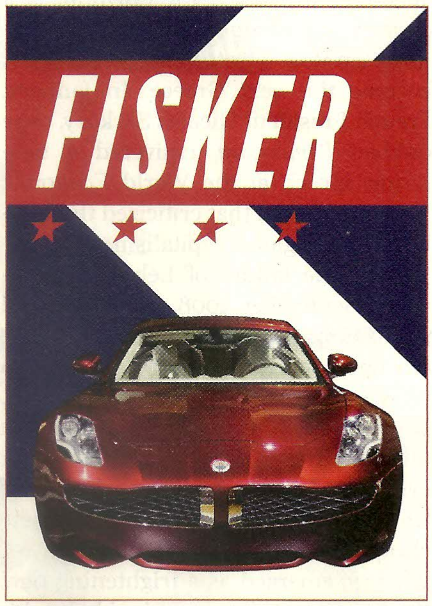
like once the smoke finally clears? There will likely be fewer McMansions with four-car garages and more well-insulated homes, fewer Hummers and more Chevy Volts, less proprietary trading and more productivity-enhancing software, less debt and more capital, more exported goods and less imported energy. Most significant, there will be new commercial infrastructures and industrial ecosystems that incubate and propel growth—much as the Internet did in the 1990s.

The current pessimism is part of a historical economic inferiority complex. To hear some critics tell it, things have been going south in this country since the cruel winter in Jamestown, Va., in 1609, when most of the settlers died. And for most of the 19th century, America was the immature, uncouth cousin that required huge infusions of European capital to build its railroads. The U.S. emerged from World War II as the globe's industrial, financial, and technological leader by default—the rest of the developed world had destroyed much of its industrial capacity. Yet Americans were insecure about their rising status. In the 1920s, many Progressives returned from Mussolini's Italy convinced that Il Duce had a superior economic model. During the New Deal, bankers and industrialists earnestly fretted that Franklin Roosevelt would ruin the nation's prospects for growth by establishing a new safety net. The U.S.S.R.'s launch of the sputnik satellite in 1957 inspired fears that the Soviet Union's presumed technological lead would allow it to triumph in the Cold War. And in the 1980s, Japan threatened the U.S. with exports of electronics and cars and by buying trophy properties like Rockefeller Center and the Pebble Beach golf resort. "The Cold War is over, and Japan won," as Sen. Paul Tsongas put it in 1992.

Of course, the declinists were often wrong—Rockefeller Center and Pebble Beach returned to U.S. ownership within a decade. Just as exuberant projections are generally made precisely at the top (remember Dow 36,000?), prophecies of long-term decline usually gain traction after we've suffered a catastrophic fall. This time around, the chorus of naysayers reached its climax in March 2009, when Federal Reserve chairman Ben Bernanke was widely mocked for his identification of "green shoots" of recovery. In the first quarter of 2009, the economy was shrinking at a 6.4 percent annual rate. By the fourth quarter it was growing at a 5.9 percent rate. Consider the scope of that swing: the growth rate of a $14.5 trillion economy shifted by 12.3 percentage points in about nine months. Like a massive sailboat pivoting 180 degrees in choppy seas, this wrenching turnaround produced a massive wake, and induced nausea among many of its passengers.

The recovery came quickly because the public and private sectors reacted with great speed. In the 1990s, Japanese policymakers deliberated and delayed before embarking on a program that included interest-rate cuts, a huge stimulus program, expanded bank insurance, and the nationalization of failed institutions. In 2008 and 2009 it took the U.S. just 18 months to conduct the aggressive fiscal and monetary actions that Japan waited for 12 years to carry out. And the patient responded to the shock therapy, as the credit markets and financial sector bounced back. Since the announcements of the Treasury-imposed stress tests in May 2009, banks have raised more than $140 billion in new equity capital. In August 2009, not even the most cockeyed optimists could have projected that within four months, Bank of America, Citi, and Wells Fargo would return $100 billion in borrowed funds to the taxpayers. But they did.

CIT Group, the small-business lender that lost its way in an ill-timed foray into subprime, is a perfect example of those quick reflexes. It filed for Chapter 11 on Nov. 1, 2009. In five weeks it wiped out $10.4 billion in debt (including $2.3 billion of TARP funds) and emerged from bankruptcy. It has brought in a new



CEO—John Thain, who had run the New York Stock Exchange and Merrill Lynch—and is now focusing on its core business of lending to small and midsize firms. "Restructuring, whether it is done out of court or bankruptcy, is an accepted genre in the U.S., whereas overseas it still carries much more of an onus," says Stephen Cooper, a founder of Zolfo Cooper, which pioneered the business of administering triage to seriously wounded companies.

ANDREW HARRER—BLOOMBERG NEWS-GETTY IMAGES

DANIEL ACKER—BLOOMBERG-GETTY IMAGES

Fixing broken financial structures is only the beginning. In periods of slack demand, the single most important factor that drives profitability is the ability to do more with less. Here again, Americans seem to have an innate competitive advantage. Whether it was Frederick Taylor, the inventor of scientific management, walking around Victorian-era factories with stopwatches, timing workers' motions; or Henry Ford perfecting the assembly line; or W. Edwards Deming developing total quality management; or Walmart's insanely effective supply chains—the pursuit of efficiency is as American as apple pie. In this crisis, companies embraced cost cutting and efficiency. From the fourth quarter of 2008 to the fourth quarter of 2009, productivity rose 5.8 percent. In 2007 and 2008, productivity growth was 1.7 percent and 2.1 percent, respectively.

In the short term, the ruthless pursuit of efficiency translates into the uncomfortable—and unsustainable—dichotomy of rising profits and falling employment. But the focus on efficiency is creating new business opportunities for smart companies. At BigBelly Solar, a Needham, Mass.-based firm whose solar-powered trash compactors reduce the need for both labor and energy, sales doubled in both 2008 and 2009. "Cities and institutions like universities and park systems are eager to do more with less," says CEO Jim Poss. Leasing 500 compacting units has allowed Philadelphia to cut weekly pickups from 17 to five, and will save it $13 million over 10 years. BigBelly employs fewer than 50 people, but like many businesses in fast-growing markets it indirectly supports a much larger number of jobs. At Mack Molding, an Arlington, Vt., contract manufacturer, 35 workers are kept busy on two shifts producing compactors. "When you add the employees at the more than 50 component suppliers, this work is supporting another 180 jobs," says Joan Magrath, vice president of sales and engineering at Mack Molding. BigBelly compactors, which are entirely made in the U.S., have been exported to 25 countries. It's a drop in the bucket. But thousands of startups and small businesses are trying to crack the markets developing at home and abroad.

In fact, since bottoming in April 2009, exports have risen smartly, from $121.7 billion in April 2009 to $142.7 billion in January 2010—an increase of 17.3 percent. Boeing will deliver about 460 commercial planes in 2010, up from 375 in 2008, with the vast majority going to non-U.S. buyers.

All well and good, the skeptics note, but we've got a long way to go. To recoup the 8.2 million jobs lost since December 2007, it'll take four years of growth at 170,000 jobs per month. And by definition, it's hard to identify the next transformative economic force—the next steam engine or interstate-highway system. White House economic adviser Larry Summers tells a story about the economic summit in Little Rock after the 1992 election. In the thousands of pages of briefing papers and policy briefs, one word didn't appear: Internet.

Beyond creating jobs for those who built and maintain it, the Internet functions as a powerful platform on which all sorts of new businesses—and ways of doing business—can be rolled out. And constructing entirely new ecosystems is another discipline at which the U.S. excels. "In a reset, we get great individual innovation," notes Richard Florida. But more important is the rise of systems innovation, like Thomas Edison and George Westinghouse building electrical systems. "That leads to new models of infrastructure and new kinds of consumption."

Apple launched the iTunes Music Store in April 2003 with a single product: songs selling for 99 cents. Seven years later, iTunes is a much larger business: hardware like the iPhone, iPod Touch, and iPad; audiobooks, movies, ringtones, apps, and e-books. It's a boon for retailers, movie studios, independent coders, analytics firms, and accessories makers—the market for cases, sleeves, and headphones for i-devices is north of $1.5 billion annually. In late March, the venture-capital firm Kleiner Perkins Caufield & Byers doubled the size of its two-year-old iFund, which backs app makers, to $200 million.

Now consider two interrelated

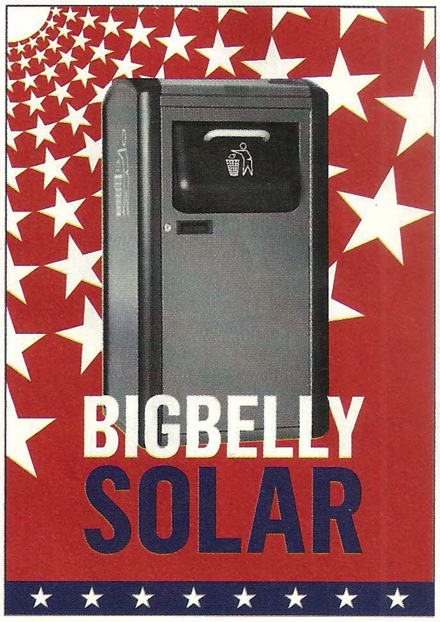
$398 BILLION THE COMBINED STOCK-MARKET VALUE OF APPLE AND GOOGLE—UP FROM A FEW BILLION IN 2002.

$513 BILLION THE AMOUNT OF NEW U.S. ECONOMIC ACTIVITY FORECAST TO BE CREATED THIS YEAR—EQUAL TO THE GDP OF INDONESIA.

systems: energy and auto manufacturing. In the past two years, the old policy of subsidizing housing and Wall Street has been replaced by a new one that seeks to boost national operating income through efficiency. Skepticism about the potential for millions of "green jobs" to materialize overnight is warranted. But in some areas, a process similar to the iTunes experience is developing. The Danish wind-turbine maker Vestas in recent years has announced investments of nearly $1 billion in wind-turbine-manufacturing plants in Colorado, which, when completed, will directly employ about 2,500 people. But Vestas has also attracted a dozen-odd suppliers, including components producers like Aluwind, PMC Technology, Bach Composite, and Hexcel. And it's not just about the hardware. Renewable Energy Systems Americas, the largest manager of wind farms, moved its corporate headquarters to Broomfield, Colo., in 2008. Last month Colorado mandated that 30 percent of the state's energy be produced from renewable sources by 2020.

A similar dynamic is playing out in the wounded auto industry, in which even small gains in efficiency can produce big economic gains. Simply improving the mileage of the U.S. fleet by one mile per gallon would save 6.1 billion gallons of gas per year, or $17 billion at today's prices. To help the industry respond to a new mandate that the U.S. car and light-truck fleet reach average fuel efficiency of 35.5 miles per gallon by 2016, up from 20.5 today, the Energy Department is providing loans and loan guarantees to large companies—Ford has received $5.9 billion in loans to transform several factories—and to startups like Fisker Automotive.

Henrik Fisker, a veteran auto executive born in Denmark, started his eponymous company in August 2007 to produce a premium plug-in hybrid. "The U.S. is traditionally a nation of innovators, but the reason it makes the most sense to be here is because the consumer is also willing to take risks," he says. Fisker raised $250 million in venture capital, snapped up engineering talent on the cheap, and has tapped into the automotive supply chain, which is eager for new business. Last October the company bought a recently shuttered General Motors plant in Wilmington, Dela., for the knockdown price of $18 million. Armed with a $528.7 million



federal loan guarantee, Fisker plans to spend more than $150 million retooling the plant. It's preparing to ship the first Karma (retail price: $87,000) to dealers by the end of this year. But the rollout of electric and plug-in hybrids also has the potential to create its own ecosystem—dealers, charging stations, accessories, software applications. Henrik Fisker says: "The development of this industry will influence how we make electricity in this country."

Such Silicon Valley bravado may ring hollow in a period of diminished expectations. Yet even amid its historic humbling, the U.S. has shown an ability to bring new ideas to global scale rapidly. At Davos, where the world seemed to celebrate the demise of America as a vital economic force, the hottest ticket was the party thrown by Google. Elites elbowed for position at the bar, danced poorly, and tapped out text messages on their iPhones, made by ... Apple. Google and Apple are the nation's third- and ninth-largest companies by market capitalization, respectively, with a combined value of $398 billion. Now consider that in early 2002, in the wake of the last meltdown and the post-Enron crisis in American confidence, their combined value was a few billion, consisting mostly of Apple, which traded for less than the cash available on its balance sheet. Google was a privately held company with about 600 employees. Now both are iconic global brands, major exporters, and spurs to innovation and growth—they represent America the way Chevrolet and McDonald's once did.

The last two expansions have been 120 months and 92 months, respectively. If the U.S. continues to adapt as it has, and if it produces a few more game changers like Google and Apple, there's no reason that the expansion that started in July 2009, against all the odds and predictions, can't last just as long.

With NICK SUMMERS *and* JESSICA RAMIREZ *in New York*

BIGBELLY—MCT-NEWSCOM

The Shape of Things to Come

FOUR LEADING ECONOMISTS PREDICT THE TRAJECTORY OF THE RECOVERY.

NOURIEL ROUBINI
Professor at New York University and chairman of Roubini Global Economics

We expect a decade of growth at or below potential. Policy responses to this crisis have been very aggressive and have steered the economy onto a path toward recovery. But we believe it will be a U-shaped recovery rather than a V. Private demand remains weak and income generation sluggish. Some crucial assets (notably housing, which provided collateral during the credit-fueled but wageless recovery that followed 9/11) will likely continue to deflate throughout 2010. Households are saving more and spending less, and that will last for several years.

Even when private demand comes back and the recovery becomes self-sustaining, Americans will have to deal with the releveraging of the government, which has overextended itself. That will require measures to bring deficits back under control—a politically difficult mix of higher taxes and lower public spending. Like it or not, the high cost of servicing the national debt will put a lid on growth for years to come.

JEREMY SIEGEL
Finance professor at the Wharton School at the University of Pennsylvania

I do not go along with the consensus that the U.S. faces a long period of stagnation in the coming years. In fact, I believe that over the next decade the U.S. economy can grow faster than the 3.2 percent average rate it has achieved over the past half century. That is because in the long run, economic growth is based on advances in productivity, and productivity is based on discovery and innovation. With the communications revolution, there has been an explosion in the number of researchers and entrepreneurs from around the world who are tackling difficult problems in energy, conservation, and medicine, and will make technological breakthroughs that will enhance our standard of living.

LAURA TYSON
Professor at the Haas School of Business at the University of California, Berkeley

There is a wide range of economic-growth forecasts over the next five years, reflecting the fact that the Great Recession of 2008–09 was broad and deep, and that the loss of wealth was substantial. The optimistic forecasts predict an average growth rate of about 3.5 percent for the next five years, while more pessimistic ones predict an average growth rate between 2.5 and 2.8 percent. Unfortunately, for now I find the pessimistic forecasts more convincing. And even the optimists predict that the unemployment rate will remain in excess of 5 percent through the end of 2015—in other words, this recovery will share the "jobless" character of the last two recoveries from recession in the U.S.

MOHAMED EL-ERIAN
CEO of Pimco

After a strong first half of 2010, we expect U.S. growth to average a subdued 2 percent per year over the following four years. As a result, unemployment will decline only slowly, deficit concerns will persist, and the country's social safety nets will come under some pressure. This muted outlook for the U.S. economy is a function of three major post-crisis themes that will play out over the next few years. First, the current strong cyclical tailwinds, driven by the huge government stimulus and the inventory cycle, will confront significant structural headwinds related to overindebtedness, deleveraging, reregulation, and international trade tensions. Second, the globe will experience a continued migration of growth and wealth dynamics to systemically important emerging economies and away from those countries that overrelied on financial engineering as a driver of economic expansion. Third, a post-crisis increase in the risk aversion of both the private and public sector will serve to further lower the speed limit on growth, as a trade-off for a lower probability of another major accident.

NEXT ▶
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A computer model to fight a deadly disease.
BY DANIEL LYONS