The *Myth* of *American Decline . . .*
and the Rise of a New Economy

BETTER, STRONGER, FASTER

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CHAPTER 1

The Rise of Decline

The word came down on a hot, muggy August afternoon. And as frequently happens in the financial world, whether announcing bank closures or bankruptcy filings, the messenger dumped the bad news on Friday after the stock markets had closed. Doing so gives investors sixty hours to process the information before trading on it.

On August 5, 2011, Standard & Poor's, the firm that rated Lehman Brothers an investment-grade A credit on the eve of its implosion, that rented out its ancient and venerable name to any investment bank that wanted to shovel junky assets into a credulous market, stripped the United States of its AAA credit rating. In a terse statement, S&P downgraded the credit of the world's largest economy, the unchallenged military leader, the proprietor of the world's reserve currency and guardian of the globe's stability, to AA–. The United States, which first received an AAA score from the credit ratings agency Moody's in 1917, was suddenly judged to be as likely to make good on its debt as . . . *New Zealand*?

The downgrade was just the latest humiliation to befall the U.S. economy in a three-year run of epically bad news. It came a week after the Commerce Department announced that the economy had expanded at a near-recessionary 1.3 percent annual rate for the second quarter. It came at the beginning of a month in which the economy would create no jobs, and two years after the country had officially emerged from a deep recession. It came at a time when Washington was in complete disarray, when Congress and the president were locked in an absurd standoff over extending the debt ceiling. Through fanaticism on the part of Congress and poor negotiating strategy on the part of the Obama administration, official Washington had managed to turn a once-routine formality into a circular firing squad. It came at a time when 14.2 million people were out of work, and when many more seemed to be out of hope. The fact that it was delivered when the markets were closed for the weekend did nothing to soften the blow.

In the fall of 2008 the failure of Lehman Brothers, a lightly regulated, highly incompetent investment bank that had managed to amass $650 billion in debt, triggered a chain of events that transformed the U.S. credit crisis into a global credit crisis. And it seemed to mark the end of a sixty-three-year American-led global epoch—driven by the mighty American consumer, fueled by American banks. For decades American institutions and individuals had provided the moral, intellectual, and financial underpinnings of the world's financial, consuming, and trading system. But when cheap and easy credit disappeared in the wake of the Lehman debacle, the global engine suddenly conked out: 2009 marked the first year since 1944, the height of World War II, in which global economic output contracted. Though the shrinkage was hard all over, the United States seemed to suffer the most grievous physical, financial, and psychological blows. Ghost towns, ghost malls, and ghost office buildings haunted Las Vegas, Nevada, Phoenix, and Miami. Between the end of 2007 and the first quarter of 2009, $9 trillion of American wealth evaporated, making the United States suddenly poorer than Europe. New car sales fell 35 percent from 2007 to 2009. The United States endured a recession that lasted eighteen months, the longest period of economic contraction since the Great Depression.

Nothing was downsized as much as the national ego. The collapse of September 2008 coincided with other foreboding trends: China's relentless boom, $4-per-gallon gas, a falling dollar, an unfathomably large government budget deficit, the soaring price of gold. The largest financial institutions, once the envy of the world, became wards of the state. No entity seemed capable of making a home mortgage except the government. The hardest-working country in the world became Dropout Nation. The unemployment rate spiked to 10 percent in October 2009; an alternative measure of unemployment, which takes into account frustrated part-timers and those who have given up looking for work, soared above 17 percent. A rampant Tea Party, an ungovernable Senate, a seemingly blasé White House, unrepentant banks, and falling home values contributed to a sour mood. An NBC/*Wall Street Journal* poll conducted in September 2010 found that 61 percent of Americans believed the country was in a state of decline and that only 27 percent were confident their children's future standard of living would be better than their own.

Americans who ventured abroad after the Great Panic of 2008 suffered a series of insults and pokes in the eye. At the World Economic Forum in Davos, Switzerland, in January 2010, amid the panels on climate change, green technology, and the need to reimagine capitalism, American voices were conspicuous by their absence. The United States, which had once dominated the forum, occupied negative space in the multilevel Kongresszentrum. U.S. bankers remained in their Manhattan bunkers, reluctant to be seen jetting off on private planes to attend an elite gathering in the Alps. Most of the Obama administration's economic team remained in Washington, prepping for the State of the Union address. The congressional delegation consisted largely of a rumpled Barney Frank, the Democratic representative from Massachusetts, and a sheepish Lindsey Graham, the Republican senator from South Carolina, who was continually forced to account for the antiglobalization rants of his Republican colleagues. In his keynote address, President Nicolas Sarkozy of France, once dubbed *l'Americain* for his interest in bling, long working hours, and generally harder-edged attitude toward economic policy, proclaimed an end to the U.S.-led version of global capitalism and immodestly proposed himself—and Europe—as an alternative leader. "Finance, free trade, and competition are only means and not ends in themselves," he declared. At *Newsweek*'s big Friday lunch, in the sun-dappled dining room of the Hotel Seehof, the White House economic advisor Lawrence Summers was asked to say a few words about the economy. But he was cut off: the queen of Jordan was about to make her entrance. Rania, a radiant vision in a white pantsuit, blew air kisses and made her way to the head table, where Marie-Josée Kravis, the Canadian economist and third wife of the financier Henry Kravis, was nudged aside to make room. Summers crossed his arms and remained on his feet.

Yes, in ways big and small, it was hard to avoid signs of the decline in America's economic status. The data, the trends, and the zeitgeist all began to run away from the country. And that darkened the mood considerably. In 2007 Americans may have invested, lent, and behaved as if nothing could go wrong, but starting in 2009 they began to behave as if nothing could go right. In a nation known for its congenital optimism, declinism quickly emerged as the chic intellectual pose for the new decade. Left, right, center, highbrow, lowbrow, ideological, and pragmatic—you name it. Like Walt Whitman, the American decline caucus contained multitudes.

The vindicated bears, the small group of analysts, economists, and journalists who accurately predicted the financial apocalypse of 2008, roamed the denuded terrain with confidence. Frequently scorned in 2006 and 2007, these prognosticators remained suspicious of the turnaround efforts, believing that the excesses that caused the problems in the first place had yet to be worked off. Peter Schiff, the libertarian money manager who warned of a debt apocalypse in frequent media appearances, proclaimed that the cure was aggravating the sickness. An adherent of the Austrian school of monetary theory, he believed the rescue—cheap money provided by the world's central banks and higher levels of government spending—was a vain effort to reinflate the original bubble. Nouriel Roubini, the bon vivant New York University economist dubbed Dr. Doom, whose blog posts accurately predicted the housing and credit debacle, remained bearish through 2009 and 2010. So long as housing remained an issue, he believed there could be no recovery. "I see one percent growth in the economy in the next few years," he told CNBC in July 2009. "It's going to feel like a recession, even when it ends."

Those who looked backward found ample reason to expect decline. From his perch at Harvard, the historian Niall Ferguson, a nostalgist for the faded British Empire, repeated his case that the once mighty American dreadnought was dead in the water. The weight of history suggested that the United States, overextended and debt-ridden, was likely to suffer the same fate in the early twenty-first century that befell the British Empire in the mid-twentieth. "It's not a thousand years that separates imperial zenith from imperial oblivion," he said in a May 2010 speech. "It's really a very, very short ride from the top to the bottom." [1] Kenneth Rogoff and Carmen Reinhart, economists who data-mined history in *This Time Is Different,* a comprehensive look at financial debacles going back to the 1300s, arrived at a similar conclusion. Centuries worth of data on finance-induced crises suggest the United States won't be bouncing back any time soon, they concluded.

The moment Barack Obama was sworn in as president, a wave of economic declinism swamped the political right. A surprising number of analysts, including op-ed page contributors to the *Wall Street Journal*, George Will, and adherents to supply-side economics, insist on viewing economic and market performance mostly through the lens of politics. Democrats, they are convinced, are bad for markets and the economy, while Republicans are good for both—evidence be damned. "Obama's Radicalism Is Killing the Dow," screamed a *Wall Street Journal* op-ed by George W. Bush's economic advisor Michael Boskin on March 6, 2009, as the Dow touched 6,600—the same level at which it stood in January 1997. As President Obama began to enact his agenda—passing a stimulus package and an ambitious health care plan, appointing officials—Republicans warned darkly against creeping socialism and trillion-dollar deficits. House Minority Leader John Boehner famously shouted in March 2010 that the passage of health care reform would presage Armageddon. Everyone on the right, from Tea Party activists to the Republican economic establishment, regards President Obama as a job-killing, market-wrecking, socialist disaster. When the Federal Reserve chairman, a mild-mannered Republican first appointed by President George W. Bush, tried to do his job, Governor Rick Perry of Texas suggested he was engaging in behavior that right-thinking folks might regard as treasonous. Having voted en masse against the 2009 stimulus package on the grounds that it couldn't work, the right went all out on economic failure, intellectually and politically. Until one of its own is back in the White House, the party of economic sunshine is in the strange position of praying for rain.

Through a different way of thinking the left reached a similar conclusion about the nation's short-term economic prospects. The bailouts of 2008 were conceived in sin, because they provided unjust and unwarranted rewards to the highly paid, malign idiots (i.e., bankers) who nearly destroyed the economy. More broadly, Obama, under the sway of advisors too close to Wall Street banks, was overly concerned with appeasing discredited economic interests. Joseph Stiglitz, the Columbia economist and 2001 Nobel laureate, argued that the collapse and tepid response to the financial crisis and economic downturn had rendered the United States irrelevant. "The point now is that no one has respect for that kind of model anymore," he told the *Washington Post* in October 2008. Obama's repeated and fruitless attempts to reach across the aisle in 2009 and 2010 only deepened the angst. The price of three Republican votes for the stimulus bill in the Senate was reducing its size by $300 billion. And that, argued the Nobel laureate and *New York Times* columnist Paul Krugman, made it too small to be effective, given the steep decline in economic activity. In essence, the government was left with "$600 billion trying to fill a $2.9 trillion hole," Krugman said in February 2009.[2] For Keynesian economists, President Obama was excessively passive. He outsourced the design of vital health care legislation to Congress, failed to fill open positions at the Federal Reserve, tolerated Republican holds on crucial nominees and filibusters of legislation, and focused on deficit reduction at precisely the wrong time in a fruitless effort to garner Republican support. By generally failing to aggressively press his economic agenda and command the legislative stage, he let disputes fester into confidence-sucking faux crises surrounding the debt. Yes we can? No we can't.

Instead of pointing out internal sources of rot and decay, many declinists looked abroad to bolster their case. Take the China Bulls, a group of analysts and journalists awed and impressed by China's rapid growth, such as Thomas Friedman of the *New York Times*. It's hard not to be overwhelmed by the enormousness of

China. Every year of 8 percent growth, each high-speed rail track laid down and solar panel erected, and the steady agglomeration of impressive economic data seem to signal China's rise and America's fall. In the summer of 2008, when America was melting down, China staged the Summer Olympics in impressive fashion. In the fall of 2009, when I visited China for the first time, I traveled to Chongqing, which had been the country's national capital during World War II. In the middle of town stands the Liberation Tower, which was erected to memorialize the war effort. Thirty years ago this ninety-foot-tall structure was the highest in town. Now it sits in the middle of the Jiefangbei shopping district, dwarfed by the office towers, hotels, and apartment blocks that march along the foggy banks of the Yangtze River. Oh, and there's a Rolex ad embedded in the top of the tower.

Massive cities, rampant growth, and stunning scale confront visitors to China at every turn. On a six-hour boat ride through the Three Gorges area, I counted fifteen new bridges that had recently been built over the Yangtze River at the high-water mark. After debarking I toured the immense power plant built into the dam. The world's largest renewable energy generator, the Three Gorges plant has the capacity to produce 18,200 megawatts of energy—about nine times the capacity of a large nuclear power plant. I rode the Maglev train that shuttles passengers from downtown Shanghai to the immaculate Pudong Airport at 250 miles per hour, without subjecting them to bumps. Returning to John F. Kennedy Airport's glum arrivals hall and resuming my commute on Metro North, whose Eisenhower-era cars jostle passengers along at Eisenhower-era speeds, it was hard to avoid the conclusion that the future is happening somewhere else.

The shift in economic energy to the Far East is obvious. In 2010 stock exchanges in Hong Kong and China combined raised three times as much in initial public offerings as was raised in the United States: $119 billion to $42 billion; in 2011 greater China's exchanges staged forty-six IPOs worth $47.9 billion, while the New York Stock Exchange and NASDAQ between them floated forty-seven IPOs worth a combined $20.8 billion.[3] The fearful American reaction to dynamism in China and elsewhere was very similar to the trepidation Europeans felt when visiting the United States during our industrial revolution of the late nineteenth century: *We are sooooo screwed.* Think what visitors from Old Europe encountered when they saw Pittsburgh, or New York, or Chicago—cities that were dirty, bustling, crowded, booming, difficult to understand, and self-confident. The latest technology being put to ambitious use. A sense of purpose and striving. People who just seemed to work harder and want it more. As the economist Arvind Subramanian argued in his 2011 book, *Eclipse: Living in the Shadow of China's Economic Dominance,* Americans had better get used to this feeling of inferiority.

A different cloud of decline drifted over the Pacific from Asia: the cautionary tale of Japan. Less than twenty-five years ago, Americans believed Japan was something like today's China, only with a smaller population and an even more exotic cuisine. By dint of a superior work ethic, better adaptation of technology, military aggression channeled into commercial ambition, and industrial policy, this Asian power was poised to eat America's lunch. But in the two decades since the collapse of its real estate and stock bubbles of the late 1980s, Japan has sunk into deep decline. The proud nation's citizenry seems to have lost the will to procreate, or even to live. Walking around Tokyo, I frequently felt as if I were in a remake of *Children of Men*, the film about a world in which there are no babies. I was on a Shinkansen train from Kyoto to Osaka that came to a sudden stop. After a few minutes an announcement came over the intercom. Somebody had jumped in front of the train, a fairly common occurrence. Nobody batted an eye. About 100 Japanese commit suicide every day; the annual suicide rate was 24.4 per 100,000 people in 2009, more than twice the rate in the United States.[4]

Japan really can't afford to lose people. I received a tutorial on Japan's demographic problems from Kiyoaki Fujiwara, director of the Japan Business Federation's economic policy bureau. Japan's population peaked at 127.8 million in 2004 and has fallen pretty much every year since, to about 126 million in 2010. The forecast called for the population to shrink to 90 million in 2055. Fujiwara was sweating as he described the situation, and not just because it is so troubling. Japan's Super Cool Biz campaign, aimed at saving energy, urges offices to keep the thermostat set in the mid-80s, even in the middle of Tokyo's tropical summers. (If policymakers listen to Cole Porter's "Too Darn Hot," which describes the many ways in which heat dampens men's sexual ambition, they'll understand the connection between high temperatures and low birthrates.) Well-regarded economic analysts believe that Japan's fate could be ours. "I had said that it would be more of an L-shaped, slow recovery," Joseph Stiglitz told the *New York Times* in August 2011, when the economy seemed to hit stall speed and fears of a second recession were rising. "I think the answer now is a Japan-style malaise."

For many pessimists, decline isn't a matter of ideology or faith. It's a matter of simple numbers. The U.S. economy fell into a very deep ditch in 2008 and 2009. To return the ratio of American household debt to gross domestic product, about 92 percent in late 2011, to its historical average of between 40 and 60 percent, consumers will have to pay down a few trillion dollars of principal. For the price of a typical home to return to its 2006 peak, it must rise 40 percent. The output gap—the difference between what the economy is currently producing and what it could produce without significant inflation—was 6.3 percent, or about $1 trillion, in the summer of 2011. Jobless recoveries have been the norm in recent decades. After the previous recession ended in November 2001, companies slashed payrolls for seventeen of the next twenty-one months. In the past, factories closed down and furloughed workers while inventory was depleted, then recalled workers when new orders came in. These days the shuttered factory is likely to reopen in China, forcing Americans to scramble for lower-paying service jobs. To recoup the 8.75 million jobs lost between January 2008 and February 2010, it will take 6.5 years of growth at 150,000 jobs per month. And that's simply not good enough. Thanks to immigration and natural population growth, the U.S. worker base grows by about 150,000 per month.

Worse, the forces that drove job creation in the recent past—the housing boom, easy money, reckless lenders—are no longer with us. In fact, the great forces that propelled so much growth in the past few decades are poised to act as a brake on growth—at home and globally. For sixty years policymakers relied on a series of simple tools for combating slowdowns and promoting growth: the Federal Reserve cut interest rates, the government slashed taxes, and a deregulated Wall Street provided easy money. All of which spurred debt-fueled consumption and the movement of goods and services around the globe. No more. The Federal Reserve can't lower interest rates any further; the overnight lending rate it controls has been close to zero since December 2008. In coming years interest rates will rise, and taxes and spending will be constrained to deal with the massive deficits that sprouted up in the post-bust years. Meanwhile a dysfunctional government continually sows uncertainty and hinders growth. In the absence of a massive new transformative economic force—the next steam engine, the next electricity, the next Internet—it's difficult to see the path to a brighter future. Until the excesses of the past decade work themselves out, the 2001 Nobel economics laureate Michael Spence told me, "we're just going to have to live with some version of the slow-growth employment problem." For companies dependent on the free-spending American consumer, the days of effortless 15 percent earnings growth and easily accomplished expansion goals are over. "Flat is the new up," William Lauder, chairman of the Estée Lauder Companies, told me in early 2010.

So as the economy muddled through, a kind of fatalism pervaded America, as if we had burned the tools necessary for growth. In many cases, even those most heavily invested in success were skeptical of the nation's capacity for renewal and growth. At a dinner in Washington in 2009 convened by the Aspen Institute and the technology company Intel to discuss innovation, I asked Larry Summers, then the Obama administration's chief economic spokesman, what would happen if we all tried a little harder, if we were more careful with resources. Wouldn't that be worth something? Mustering all the diplomacy he could, Summers responded with a patronizing "Maybe." The weak economy, pundits agree, ended Democrats' control of the House of Representatives in 2010 and will seriously damage or maybe even doom Obama's chance of a two-term presidency.

As negative sentiment bubbled up from a variety of sources