

Chuck BY PHILIP K. VERLEGER, JR.

the Models

*American entrepreneurs are
on a roll. America's future
could not be brighter.*

It happened so quickly. Just two years ago, very good economists wrote of the United States' impending demise. These pessimists saw a country burdened by enormous debt, rising oil prices, and an underperforming and undereducated labor force. It was, in short, unprepared for the twenty-first century. Two years later, the books and papers published by these Cassandras have been relegated to the dark cloud, the modern equivalent of the dustbin.

Today, one expert has even been bold enough to write a book titled *Unleashing the Second American Century*. The author, Joel Kurtzman, is a former *New York Times* business editor and former editor-in-chief of the *Harvard Business Review*. Now a senior fellow at the Milken Institute, Kurtzman sees an almost boundless future for this country. Given recent events in Europe, especially near Russia's borders, he may need to revise his projection upward.

How could the U.S. situation change so dramatically and rapidly? The national debt overhang remains at a staggering 102 percent of GDP. The education deficit continues. American children still lag far behind their counterparts in Europe or Asia. Employment in the United States has not fully recovered from the 2009 recession. As of this writing, 100,000 fewer Americans have jobs than in January 2008, the previous peak. In spite of these obstacles, our future still looks bright. The United States' transformation since 2009 has come about for two reasons. First, things were not as bad at the end of 2011 as pessimists described. Second, entrepreneurs in the United States—the little guys—cracked an important geologic code ignored by the large oil companies. Their success has put the United States on the road to energy independence, surprising almost everyone.

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THE INTERNATIONAL
ECONOMY

THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY

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To take a step back, the pessimistic case of recent years has been put forward best by Jeff Rubin, the former chief economist at CIBC World Markets. In his 2012 book *The Big Flatline*, Rubin eloquently asserts that the United States is facing its sunset years. He contends that high oil prices and trillions of dollars of government debt will constrain U.S. economic growth. In his view, the idea of the United States returning to its days of robust expansion is a “nonstarter.”

From Rubin’s perspective, the United States should now follow Denmark’s lead. The path back to strong growth, he observes, requires aggressive reductions in greenhouse gas emissions. Denmark has already taken that route by cutting hydrocarbon use, embracing conservation, and aggressively investing in renewable energy.

Rubin has picked a less than stellar role model, however, at least for the short run. According to the European Union, Denmark’s economy expanded 1.1 percent in 2012 and 1.4 percent in 2013. Meanwhile, the U.S. Bureau of Economic Analysis reports that our economy grew 2.8 percent in 2012 and 2.3 percent in 2014. Circumstances could change, certainly. Future events could realize Rubin’s gloomy no-growth forecast by 2022, but few people today will join him in betting that the United States is in decline.

Rubin’s mistake was to underestimate the ingenuity of our entrepreneurs. Senator John McCain (R-AZ), without reading *The Big Flatline*, identified this error when he said these words to an audience at Tokyo American Center in August 2013: “In short, no one has ever made money betting against the United States, and I don’t think now is a good time to start.”

Two other researchers, Trevor Houser and Shashank Mohan, attempted to map the future of America’s recent energy renaissance in *Fueling Up: The Economic Implications of America’s Oil and Gas Boom*. Unfortunately, they failed. In this work, the authors examine the implications of the dramatic change in the U.S. energy situation. They focus initially on the oil and gas production surge brought about through the efforts of American entrepreneurs. The word “entrepreneur,” however, never appears in the study. The authors, who

have no training in economics, present page after page of tables and graphs produced by other organizations. For most of their conclusions, they rely on simulations from the giant modeling system developed by the U.S. Department of Energy. After combing the DOE results, they conclude that the energy boom may add 0.6 to 2.1 percentage points to real GDP by 2020 from 2013. In other words, Houser and Mohan suggest U.S. growth could fall between 0.1 and 0.3 percent per year.

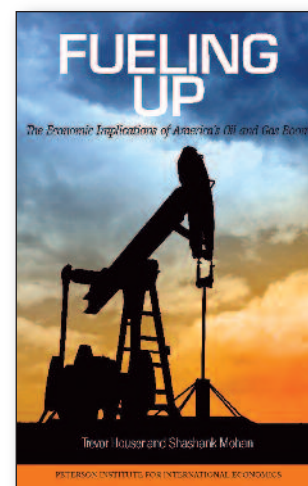
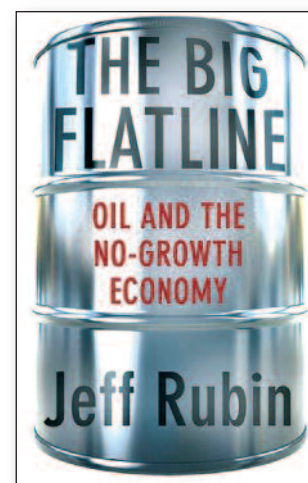
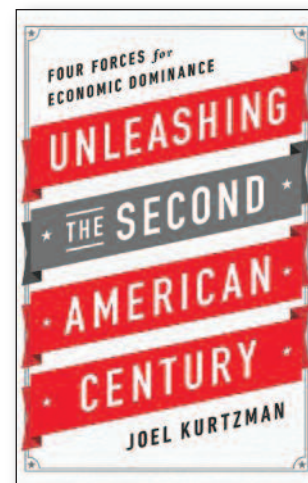
Looking past 2020, the authors become even more dismissive of the benefits produced by the American energy revolution. They view the energy boom as a development that is “not transformative.” They see it as only capable of delivering more of the same energy at lower prices. Ultimately, their work

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does not undermine Rubin’s well-articulated case for a low-growth future. Their findings suggest America’s better energy prospects will contribute little to economic growth.

Ironically, the “model jockeys” Houser and Mohan are researchers at the Peterson Institute for International Economics, an organization that in its short history relative to other economic research groups has produced an extraordinary number of path-breaking studies. Researchers such as John Williams and Gary Hufbauer have conducted studies that carve out new ways of understanding international trade and monetary economics. In the case of America’s energy boom, though, the breakthrough insights on the reversal of U.S. economic circumstances come from Kurtzman, who, as noted, is associated with the “younger” and more dynamic Milken Institute.

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In *Unleashing the Second American Century*, Kurtzman presents four reasons that explain why the United States will “own” the twenty-first century rather than China or any other country. The four “forces”

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The fifth succeeded.

described below, in his view, will help the United States dominate the global economy.

■ **The United States’ soaring levels of creativity.** Kurtzman argues that no other country has so many “scientific, technological, industrial, commercial, and artistic innovations.”

■ **Massive new energy reserves.** U.S. creativity will be enhanced by our impending energy independence, which will provide dependable, low-cost energy to businesses.

■ **Gigantic amounts of capital.** Kurtzman, a long-time business reporter, notes that U.S. firms have accumulated huge stashes of capital that could be mobilized.

■ **Unrivaled manufacturing depth.** Surprisingly, Kurtzman shows that the United States is leading global manufacturing innovation and that “reshoring” is accelerating.

Many will be put off by Kurtzman’s almost jingoistic views, especially since he is not an economist. These doubts are understandable. However, Kurtzman makes a clear case for a positive future by emphasizing the success of American entrepreneurs. The following paragraph, which discusses why the United States has so many more startup firms than other countries, stands out in this regard:

German, Japanese, and French workers are just as smart as their American counterparts. But they don’t storm out of their place of employment to start new companies, confident that sometime in the foreseeable future they will create something bigger, better, and more valuable than the company that employed them. Except for a very small handful of people, researchers in other countries don’t mortgage their homes, max out their credit cards, and beg money from their friends to form companies dedicated to commercializing their idea.

That’s America’s unique form of chutzpah, and it will keep America number one.

Nick Steinsberger is one of those American workers. Had Nick worked in Europe or Japan, no one would know who he is because he never would have become an entrepreneur. Russell Gold relates Nick’s story in a new book that buttresses Kurtzman’s view. Gold explains that Steinsberger worked for Mitchell Energy as a field engineer. In 1998, a time when oil prices were collapsing, profits of exploration companies falling, and layoffs increasing, Steinsberger proposed a radical idea: frack wells in North Texas with water rather than the gel customarily used. The first four attempts failed. The fifth succeeded. While this was going on, officials at Mitchell Energy, at the time a relatively small firm, let the experiments continue. The company was well-rewarded. Steinsberger’s technique helped break the code that led to the surge in U.S. oil and gas output.

Kurtzman optimistically predicts a fantastic energy future for the United States, unlike many other writers (including Houser and Mohan). For example, he suggests that the percentage of oil and gas recovered from U.S. oil and gas fields may rise from the current 20 percent to as much as 70 percent. (In some cases today, as little as 5 percent is recovered from shale wells.) In his view, such a success would give the United States a 322-year energy supply rather than a 92-year supply.

I will not quarrel with Kurtzman’s figures. After studying the economy and the energy sector in particular, I have learned the true meaning of this advice: “There are no facts about the future.” However, recent developments in the U.S. energy world, as well as other economic areas, have convinced me that this country is experiencing an amazing transformation, one that cannot be captured by econometric models or perhaps even big data. Moreover, the speed of this change has been astounding.

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Russian President
Vladimir Putin

Why Take a Chance?

Vladimir Putin's aggression in Europe and the passive response of most European countries makes U.S. prospects look even better. What company would want to build new facilities in Europe or expand existing ones, given the prospects for continued unrest there as well as the threat of increasing energy prices, when they could move to the United States instead?

—P. Verleger

The inability to model this future and predict it explains why economists are instinctively critical of the blue-sky thinking of people like Kurtzman. As one trained as an econometrician, I want to run models. This time, though, models do not help. One simple example illustrates the problem. Imbedded in our national income accounts is a line for expenditures on photo finishing. A graph of current dollar expenditures on this service traces an almost perfect bell curve. In 1959, consumers spent \$200 million on it. By 1998, spending on photo finishing peaked at \$6.6 billion and the service had become ubiquitous. At that time, one could get film processed at every corner pharmacy and grocery in the country. Today, photo-finishing services have vanished. We all know people did not stop taking pictures here or anywhere else. Instead, Apple introduced the iPhone and made film cameras and photo finishing obsolete.

Just as no econometric model and no analysis performed with big data could have predicted the quick demise of photo finishing, no modeling effort or simulation can predict the changes that will drive economic growth over the next decades and centuries in the United States. Kurtzman's essential and correct point is

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that the U.S. today provides a better incubator for innovative change than any other place on Earth.

Given recent events, one could argue that Kurtzman is not optimistic enough. Vladimir Putin's aggression in Europe and the passive response of most European countries makes U.S. prospects look even better. What company would want to build new facilities in Europe or expand existing ones, given the prospects for continued unrest there as well as the threat of increasing energy prices, when they could move to the United States instead? Here BMW's recent decision to build a plant in Moses Lake, Washington, is a harbinger.

In 2011, BMW announced it would construct a \$100 million plant in eastern Washington to fabricate carbon-fiber vehicles. BMW picked the Moses Lake location because it adjoins the hydroelectric dams operated by the Bonneville Power Administration and thus has access

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to very low-cost electricity. No doubt other European auto firms will emulate BMW in the near future, especially if the European Union demands ever-lower emissions from autos and trucks.

Companies from Europe, Japan, and other parts of the world will follow BMW's example, as will multinational firms traditionally thought to be American. GE has already restored many activities here, according to Kurtzman.

Intellectual centers such as Silicon Valley in California; Cambridge, Massachusetts; North Carolina's research triangle; and Austin, Texas, will continue to attract individuals and businesses that will foster more innovation and growth. Although it is surprising to say this, America is on a roll. And thanks to Vladimir Putin, our future looks even brighter. It is astounding that so few of us saw this coming. ◆