



HOW MUCH LONGER WILL THE U.S. REMAIN THE LEADER IN WORLD COMPETITIVENESS?

Towards a re-make of the Japanese tragedy?

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Will the US keep its first place?

Once again, the United States is in first place in the rankings of the 2008 IMD World Competitiveness Yearbook (WCY), a pioneer in competitiveness since 1989. The US pushed Japan out of the top slot in 1994 and has maintained its leading position ever since. But will this continue? In our 20th anniversary edition this year, we may be seeing the US in the number one position for the last time! Singapore has been quickly catching up over the past couple of years and may boot the US out of its top spot next year, closing the gap that has become infinitely smaller. With the US at 100, Singapore is in a close second place at 99.3 in the WCY overall ranking. This year may be the turning point where the US falls from its leadership of top competitors in the world economy. Looking back over the 20-year history of competitiveness, we may learn some lessons from another leading country's experience – Japan. Is this “dèjà vu”?

A re-make of the Japanese tragedy?

In 1989, when we first published our ranking on competitiveness, Japan was firmly in the number one position, while the US was in third place. Japan's competitiveness seemed unassailable, with a strong domination in economic dynamism, industrial efficiency and innovation. Then things went very wrong: the stock market went into reverse in 1989, land prices collapsed in 1992, credit cooperatives and regional banks came under attack in 1994, large banks teetered on the edge of bankruptcy in 1997 and a major credit crunch occurred in 1998. Does this ring a bell?

The past crisis in Japan bears some resemblance with the present turmoil in the US. It followed a period of economic boom, real estate price follies and exuberant assets expansion. In addition, the liberalization of financial instruments took place without the appropriate regulatory environment; corporate governance was inadequate with little accountability and transparency; and the government was quickly overwhelmed by the magnitude of the crisis.

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What was the price that was paid?

The crisis in Japan spread from the stock market to real estate, then developed into a credit crunch and finally into a major crisis of the financial system. Consequently, no bank was too big to fail! The resulting cost of bailing out the financial system was huge: 15% to 20% of GDP over a 10-year period. Deflation spiraled down and interest rates dropped all the way to zero. The Japanese economy stagnated for a decade. Frightening... Will this happen to the US? Once it starts, the logic of a financial crisis seems hardly stoppable.

On the other hand, the differences between the two economic societies are quite large. Apart from a few notable successes (Canon, Toyota, etc.), by the 1990s, much of Japanese industry was in a paralyzed state. The Japanese never practiced "creative destruction." The US, because of its openness, resilience and entrepreneurship, always seems to find the means to reinvent itself in ways that Japan (and much of Europe) often lacks.

Lessons to be learned

But the US has a few trumps in hand. The Japanese breakdown of the 1990s provided some forewarning for the US government. The Federal Reserve and the Treasury were quick to realize the magnitude of the risks and will continue to take drastic action. Central banks are supplying massive liquidities to financial markets and are acting as lenders of last resort (e.g. in swapping mortgage-backed assets). Emerging sovereign wealth funds appear willing to recapitalize financial institutions (such as CITI, Merrill Lynch or UBS) and the global economy is still buoyant (110 countries grew over 5% in 2007).

Will it be enough? The structural deficits in the US (balance of trade, budget and, as a consequence, national debt) will ultimately have to be addressed otherwise the dollar will remain weak. A recession in the US is a strong possibility. Will it last and will it spread? In both cases, the answer is probably yes. The financial sector represents 40% of US corporate profits. In addition, the International Monetary Fund reckons that a 1% fall in US growth cuts European growth by 0.5%. Furthermore, high prices of raw materials and food are triggering imported inflation at a time of low interest rates – pretty nasty... 2008 will be rough.

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The downfall of Japan in competitiveness - ranking 22nd in the IMD World Competitiveness Yearbook 2008 - bears some similarities with the present situation in the US. What are the chances of the United States following the same path?

In the 20 years that we have been researching competitiveness at IMD's World Competitiveness Center, we have learnt one thing: no nation, however competitive, is immune to a collapse, especially when it stems from the financial sector. In the words of Benjamin Franklin: "even a small hole can sink a big ship..."

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