

## How The U.S. Can Gain Its Competitive Power In Today's Global Economy

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### Abstract

The United States does not dominate the world in terms of its economy and power, as it once did. The current U.S. position, according to statistics and quality of life, is lower than it has been since World War II. The most recent trends to affect the United States' position increased international competition, poor U.S. education, and foreign outsourcing. The best angle for the United States to pursue is to excel in innovation and knowledge transfer. The ability to change is one of the most valuable in a fast-moving integrated world economy, which is where all countries are headed.

### Introduction

Before one can address the matter of how the United States can become the leading world power again, one must first consider the United States' current position, how the country arrived at that position, and then what can be done in the future to change that position. From a historical perspective, the United States emerged as a superpower after the fall of the Soviet Union in the early 1990s. According to Yale's Paul Kennedy, "America had more economic, political, military, and cultural power than any nation since ancient Rome some 2,000 years ago" (Gergen, 2005, ¶ 1).

### Current U.S. Position

The current status of the United States' economy is that of recovering from recession. Economists define recessions in terms of declines in real gross domestic product (GDP), the national output valued at constant prices. "By this definition, the U.S. entered a recession in the first quarter of 2001, but statistics other than real GDP indicate that the problems for the economy developed in the summer of 2000. In terms of real GDP, the recession bottomed out in the third quarter of 2001 and the U.S. economy began to grow in the fourth quarter of 2001" (Watkins, 2005, ¶ 3). In today's American economy, investors have cautiously returned to the markets, consumers have a more optimistic outlook, and governments are dealing with long-term reforms like pensions and healthcare (Garelli, 2004, p. 14). An objective way to assess the economy of the United States is to relate it to that of the world's economy.

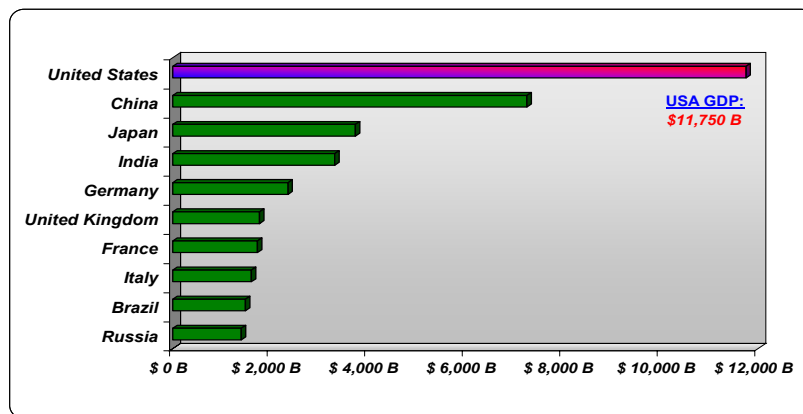


Fig. 1. U.S. GDP in Comparison to Global Economies

The United States currently produces more than 30% of the world's total gross domestic product when measured at market exchange rates, or 21% at purchasing power parity rates. These rates are up slightly over those of the past decade, due to the strong dollar and stock market boom of the mid-1990s (Julius, 2005, p. 14). The per-capita income in the United States is about 30% higher than that of the average of the members of the European Union (p. 14).

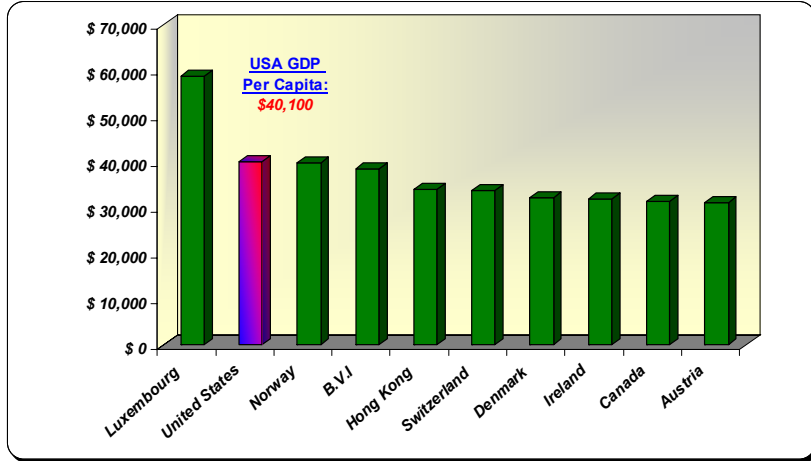


Fig. 2.U.S. GDP per Capita in Comparison to Other Industrialized Nations

Another factor to consider is that of the United States' trade deficit, which is \$569.6 billion, as of April 2005 (U.S. Business & Industry Council, 2005). While the U.S. has run a deficit in the trade balance for a number of years, the reasons may now be different. Because of globalization, American companies (among others) are increasingly manufacturing products and staffing service organizations in other countries, in order to serve domestic markets more cost-effectively. As a result, many imports to the United States are actually developed and created by American companies (Julius, 2005, p. 16).

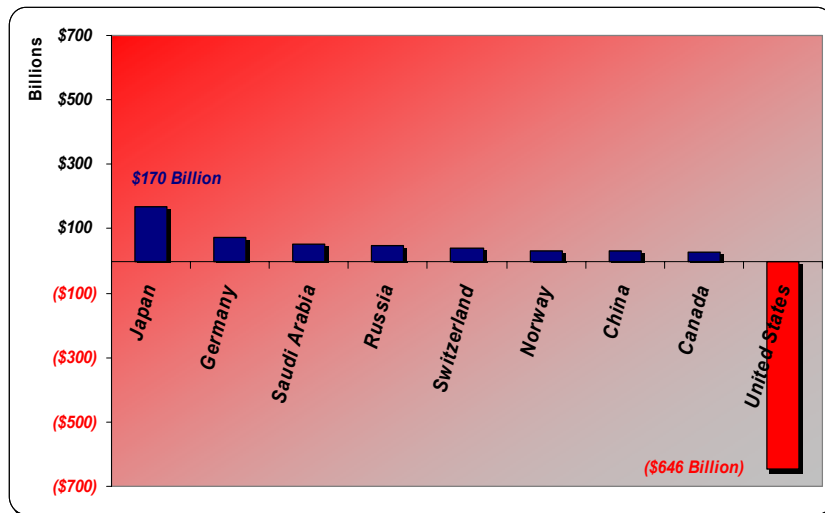


Fig. 3. Current Account Balances in the Global Economy

Finally, the national debt is considered by many to be a significant indicator of a nation's prosperity, or lack thereof. The United States, however, is currently increasing its national debt

daily – a trade-off between economic security and national security – by financing a long-term war on terrorism.

The budget allocations for the war in Iraq already exceed \$150 billion (p. 16). The U.S. national debt is now more than \$7.8 trillion (Hall, 2005).

In addition, the United States borrows nearly \$2 billion per day from foreign nations. Two months ago, Standard & Poor's predicted that the U.S. debt will be downgraded to junk bonds within 25 years (Gergen, 2005, ¶ 3). As these foreign holdings of U.S. treasury and agency bonds have increased, so too will the necessity to reward foreign lenders. Federal, state and local governments are all relying on this financing method and will be confronted with its rising costs (Garelli, 2004, p. 16). As a result of war expenditures, the economic slowdown, and tax rebates, the United States' budget is going further into deficit spending (p. 16). The budget gap expanded to \$412.55 billion in fiscal year 2004, marking the Bush administration's second-straight record deficit, and the largest budget deficit in U.S. history (*U.S. Budget Deficit*, 2004, ¶ 1-2). According to Deanne Julius, chairman of Chatham House, formerly the Royal Institute of International Affairs, "the defining characteristics of the United States' economic model include relatively low taxes, relatively little income redistribution, relatively low provision of health, social security, and public transport, and relatively little regulation" (2005, p. 17).

The personal saving rate, constructed by formulating a ratio of personal savings to disposable personal income, is also considered an important economic indicator. In recent years, the personal saving rate in the United States has fallen sharply, and it is now at a very low level compared either to U.S. historical experience or to the savings behavior of many other industrialized countries. Since 1994, the U.S. saving rate fell steeply from 8%, and since mid-2000, it has averaged approximately 1% (Federal Reserve Bank of San Francisco, 2002, ¶ 1). In contrast, the personal saving rates from 1980 through 2001 averaged 13% in Japan, 12% in Germany, and 15% in France, with no steep declines after 1994. For the United Kingdom, the personal saving rate was close to the U.S. rate during the 1980 to 1994 period, averaging 9%, but it has since declined only modestly to an average of 7% after 1994. For Canada, the personal saving rate did decline sharply during the latter half of the 1990s, but it is still higher than the U.S. rates, averaging 16% from 1980 through 1994 and 7% since 1994 (¶ 1).

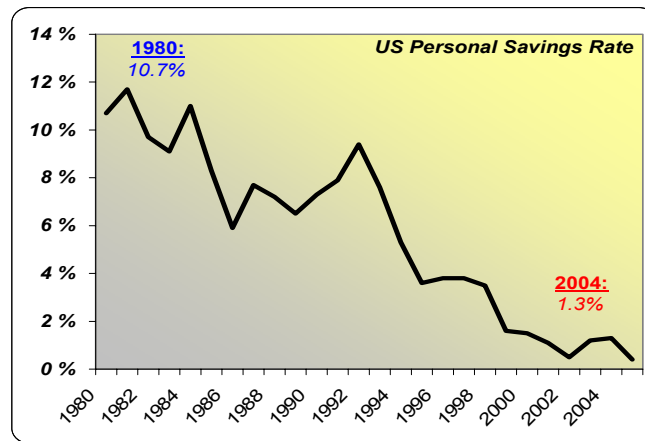


Fig. 4. U.S. Personal Savings Rate, 1980-2004

The United States' personal savings rate for April 2005 was just 0.4% (*Personal savings rate*, 2005). Considering quality of life issues also does not elevate the United States above the world's other large economic bloc, the European Union. While the per-capita GDP was almost 30% higher for the U.S. than for Europe, this is partly due to the longer work-hours of Americans, and the choice of more European mothers to leave the workforce (Julius, 2005, p. 15). When taking into account the fewer dual-income households and longer vacations of Europeans, the United

States does not appear to have a significant economic lead. When measured as output per hour, productivity rates in the United States and Europe are approximately equal (p. 15). “This same factor skews comparisons of economic growth” states Julius. “Over the past ten years, which included the bubble period of the mid-1990s in the United States, GDP growth averaged 3% per year in the United States and only 2.1% in Euroland. However, population growth in the United States averaged 1.2% per year, compared with 0.5% in Euroland. Thus, GDP per capita in the United States grew by 1.8%, only marginally faster than Euroland’s 1.7% per year” (p. 18). Julius also characterized the United States’ economic model as a “strong, but far from dominant, competitor.” The best economic model for a society is dependent upon that society’s valuation of economic risk versus economic security, and leisure time versus labor income (p. 18).

## China’s Economy

Much can be learned from emulating the industrial policies of the economic leaders of Asia. The United States can benefit from incorporating some of the strategies of Japan and China into its own industrial policy. Learning from these successful Asian countries may be necessary for existing U.S. businesses to remain competitive in Asia. “Over the last 50 years, the industrial policy of Japan, Korea, Taiwan, Malaysia and other high-growth Asian countries has been to shelter their infant industries behind some form of trade barriers, invest heavily in manufacturing process research and training institutes, subsidize R&D investment and help domestic firms license and learn the latest innovation in manufacturing processes and technologies” (Dickson & Czinkota, 1996, p. 86).

China’s economy is one of the largest and fastest growing. China has a higher GDP growth rate than Japan or the United States. Figure 5 shows the projected GDP growth rates for the United States, China, and Japan. The country has been in economic reform which has been led by China’s government. The fact that the government continues to play a significant role in economic affairs is fairly uncommon and may lead to increased transactional costs. Despite the increase in costs associated with government dominated systems, China’s economy continues to improve at a fast pace.

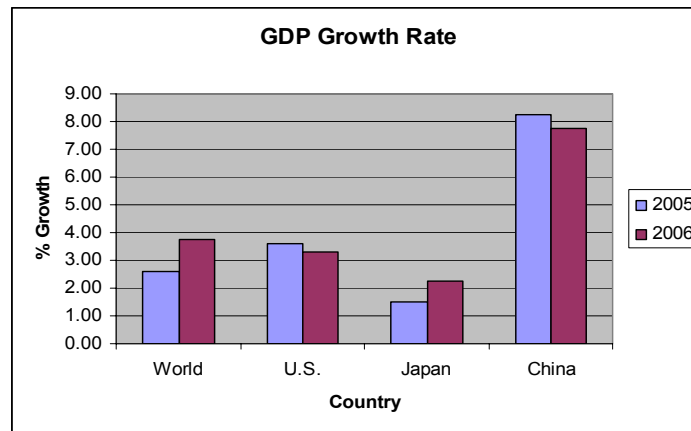


Fig. 5. Projected GDP Growth Rate

An important factor in China’s economic rise is the country’s entrance into the World Trade Organization (WTO). There was much resistance from China’s government and people to joining the WTO. The people of China viewed the rules of the WTO as risky and devastating to local businesses. “China’s entry in the WTO implies that laws of international business will begin to apply” (Overholt, 2004, p. 48). China’s entry into the WTO has benefited consumers, domestic businesses, foreign businesses, importers and exporters. Another key factor contributing to China’s growth is a shift to domestic-led growth. The failure to make this transition combined with a main focus on exports has led many Asian economies to regress (Overholt, 2004, p. 47). Increased

competition is also contributing to China's growth. Before the reform, there were few dominant firms owned by the government with little competition. "State owned enterprises dominated its national economy, producing three-quarters of its industrial output value" and "By 1998, state owned enterprises accounted for only 28 percent of industrial output" (Child & Tse, 2001, p. 8). This shift to privatization and decentralization has been part of the cause of increased competition. The Chinese are hard-working, adaptive, fast-learning and can imitate almost any successful business process.

Entrepreneurship and education have also been encouraged by the government. Students returning from abroad with a post-graduate degree are eligible to receive grants from the government in order to start a small business. "China is sending its youth elite abroad for education primarily in the U.S., to a degree probably unparalleled by any large country since the Romans turned their kids over to the Greeks" (Overholt, 2004, p. 49). China's government has promoted the development of local MBA programs by partnering with foreign universities to offer classes local and by encouraging firms to offer classes to their employees (Child & Tse, 2001, pp. 10-11).

China is also benefiting from advancements in information and communication technology. Multinational companies have been using China for low-cost labor and supply in building technological equipment and networks. The huge market potential of China has led many of these companies to include China in their global expansion. Some firms have even set up research and development centers in China and internet service providers are becoming more common and available to the Chinese. According to Child and Tse, these improvements in education and technology are playing a part in the reduction of dependence, for both domestic and foreign firms, on resources from outside the country (2001, p. 11).

China also has the advantage of its huge size and large population. The country has a vast supply of human resources. China has the benefit of low-cost labor and is a low-cost producer in many areas. This low-cost labor is the reason that many multinational companies set up plants and create jobs in the country. The cost of labor and low production costs also contribute to China being a leader in exports. The Chinese people demand more choices and selection now that the government does not own most businesses. The people of China now have access to more products since the country has become a member of the World Trade Organization. China is a new market to many multinational firms that were prohibited from doing business in the country before.

## How The U.S. Fell

A major reason for the decline of the United States' power in relation to that of other world powers is the increase in competition. The United States did not "fall" so much as other nations were able to "catch up." American capitalism's success or failure has so far been affected by two central turning points, according to Robert Brenner's *The Boom and the Bubble*: the Plaza Accord of September 1985, and the 'reverse Plaza Accord' of 1995 (Callinicos, 2003, p. 422).

In the Plaza Accord, the Group of Five (G-5), made up of Japan, Germany, the United Kingdom, the United States, and France, agreed to force down the overvalued U.S. dollar, as part of an agreement designed, among other things, to coordinate economic policy in the major industrialized nations, and to counteract protectionist forces (Miller, n.d., ¶ 28).

"Along with the relatively slow growth of real wages, the falling exchange rate was pivotal to the recovery of competitiveness and profitability in U.S. manufacturing that, in turn, underlay the American boom that gathered pace in the course of the 1990s" (Callinicos, 2003, p. 422). Sharp increases in the Japanese stock and real estate markets took place in the late 1980s, only to have in 1990 an increase in interest rates and destabilization of markets in response to the first Iraq war (Miller, ¶ 45-47). The so-called 'reverse Plaza Accord' took place in spring and summer of 1995, when the Clinton administration adopted a strong dollar policy, promoting the currency's re-evaluation and encouraging a fall in the yen (Callinicos, 2003, p. 422). The resultant rising dollar put pressure on exporters to lower their prices, and subsequently U.S. manufacturing profits dropped, despite productivity growth, by 20% (p. 422). Following the rise of Japan, the current major competitor to the United States became the European Union. As the European Union expands to include more new members, many of them in Central and Eastern Europe, this offers less expensive living

and operational costs to businesses located in Western Europe. Hourly manufacturing costs range from a high of \$30 in Germany to less than \$2 in Slovakia. Many foreign and European businesses will relocate to take advantage of this opportunity (Garelli, 2004, p. 16).

A downside to the European Union is the weak economic growth of the region, and their accumulated budget deficits, which are caused primarily by the aging infrastructure (p. 18). The noteworthy competitor which the United States should monitor for the future is China. While considered a developing country, it will be a serious and formidable competitive challenger (Gergen, 2005, ¶ 6). Due to their huge population, if Chinese GDP per capita reaches just 20% of the United States' level, China's economy will become the largest in the world in absolute terms (Krugman, 2000, p. 169). This growth is not impossible or improbable – China has grown an average of 8% over the past ten years, and is one of the most attractive locations for new business today. China's exports have grown by 17.3% per year, and its tariffs have dropped by 40% during that time (Garelli, 2005, p. 16). "According to the investment bank Goldman Sachs, China will be the largest economy in the world in 2050, with a GDP of \$44,453 billion," states Professor Stephane Garelli of the Institute of Management Development. "Asia is thus becoming a highly attractive place for world investment. Already, more than 60% of the foreign direct investments directed to developing nations are going to Asia" (p. 19). In addition to increased global competition, other factors that contributed to the U.S. decrease in world rankings were trends in education and outsourcing.

A national education commission in 1983 announced that U.S. schools faced a "rising tide of mediocrity." Since then, educational reforms have made taken place across the nation, but the high school drop-out rate has actually increased (Gergen, 2005, ¶ 4-5). According to David Gergen, "Of the kids who now reach ninth grade, 32 percent disappear before high school graduation. Another third finish high school but aren't ready for college or work. Thus, about two-third of our students are being left behind, many of them low-income and minority kids. Only the upper third leave high school ready for college, work, and citizenship (2005, ¶ 5).

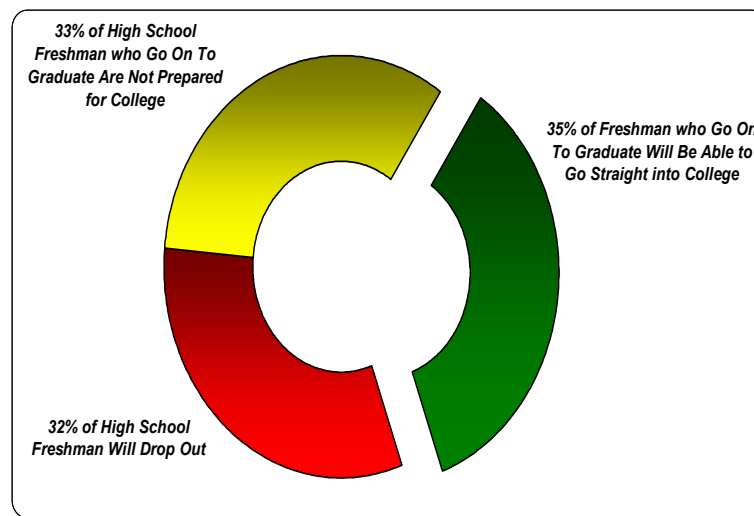


Fig. 6. Cross Section of American 9<sup>th</sup> Grades

Microsoft CEO Bill Gates is more than alarmed by this trend. "When I compare our high schools to what I see when I'm traveling abroad," he said, "I am terrified for our workforce of tomorrow. America's high schools are obsolete" (Gergen, 2005, ¶ 7-8). His observations are not without merit. On a recent list of developed nations, America ranked 16<sup>th</sup> in high school graduation rates and 14<sup>th</sup> in college graduation rates. These rankings, do not, of course, include developing nations like China, previously mentioned as a significant economic competitor (¶ 6). According to Gates, India graduated a million more students from college than the U.S. did in 2001, and China has six times as many engineering majors in college (¶ 7). As the population of developing nations becomes more

educated, and globalization increases, outsourcing of service and manufacturing jobs to foreign nations becomes more prevalent. It is projected that more than two million jobs in the financial services industry will be outsourced to India by 2008 (Garelli, 2004, p. 16). China has joined the World Trade Organization and plans to further open its markets, providing an appealing location for new businesses and the manufacturing center of the global economy (p. 16, 19).

### **What Can Be Done**

Much like Bill Gates' concern, the importance of innovation and knowledge cannot be overemphasized. The successful transfer of knowledge has become one of the most important competitive advantages for companies contending in the new global economy (Fink, G. & Holden, N., 2005, p. 5). According to CEO of Siemens Heinrich von Pierer, "Between 60 and 80% of the value-added we generate is linked directly to knowledge – and that proportion is growing" (p. 5). By the same token, total quality management expert Charles Babbage stated in the 1830s that "the application of progressive knowledge and experience (i.e., managerial innovation) is our great power and advantage" (Dickson, P. & Czinkota, M., 1996, p. 77). According to Dickson and Czinkota, the most effective way of increasing the global competitiveness of American firms is for the government to intervene, by making the market for process skill learning more efficient; by creating focused public-private sector education and research initiatives; by encouraging demand through tax incentives; and by designing processes and technology to encourage innovation in learning and training (p. 83).

U.S. firms must also keep in mind Porter's Five Forces model, which indicates success must be market-driven: efforts must be oriented toward buyers, suppliers must be considered, firms must be aware of substitute products and services, and entry and exit barriers, and rivalry among competitors will determine the winners (Dubois, 2004, ¶ 14-19). As Charles Darwin stated, "It's not the strongest of the species that survives, nor the most intelligent that survives; it is the one most adaptable to change" (Darwin, n.d., ¶ 1).

### **Conclusion**

While the United States' economic power may have passed its peak, and may be likely to fall further, this does not necessarily mean that the U.S. economy is in decline. The global economic interdependence that is weakening the United States' power is simultaneously stimulating economic growth throughout the world. A healthy and powerful world economy, where no country or region has supremacy, will be beneficial to all participants (Julius, 2005, p. 18). Paul Krugman said it well: "America will not dominate the world economy the way it used to, not because it is doing something wrong, but because many other countries are also doing something right. And that is good news for everyone" (2000, p. 175).

In order for the United States to strengthen the nation's innovation, trade, public safety, security, and jobs the country needs to implement standards on technology. The National Institute of Standards and Technology (NIST) is the government organization that develops and implements these standards. Innovation is the most important competitive advantage of the U.S. New technologies that are determining the global winners in the early twenty first century – biotechnology, nanotechnology, information technology, and advanced manufacturing. Advanced technology is a key factor in global success. In order for the United States to remain superior, multinational and local firms must utilize the World Wide Web and other advances in communication technology.

One way to create a competitive advantage through use of the internet is by increasing learning and education. American firms must continuously improve all of their processes by becoming superior learning organizations (Dickson & Czinkota, 1996, p. 79). Information and communication technology will bring about greater integration of global markets. This will in turn lead to global trends and more homogeneous consumers (Torre & Moxon, 2001, p. 627). The advances in communication technology increase the potential of advertising and marketing. The

internet can be used to advertise global brand names, inform and educate consumers, and to increase the options and choices available to consumers. All of these factors increase competition.

The United States had solidified its position as a dominate economic power after the Second World War. The British had lost their competitive advantage over the rest of the world through the gain in progressive knowledge the U.S. had attained. The U.S. is currently a technology leader with a strong GDP growth of around 3%. In order for the U.S. to remain number one, they must maintain their advantage in progressive knowledge through many different strategies, increase free trade with foreign markets, and position themselves effectively concerning the growing third world economies including China.

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