Governance Is the New Competitiveness Imperative

by Gail D. Fosler

National competitiveness is no longer defined solely by measures of international trade or relative cost competitiveness. The recent trends toward open economies, global supply chains, and the migration of people and intellectual and financial capital all combine to undermine the concepts of comparative advantage that have traditionally served as the underpinning of what we understand as competitiveness.

For example, the design and production of a Ford Taurus or a Toyota Nissan can occur simultaneously in 40 locations around the world with a mix of geographic centers of excellence for components—some different but many the same. Based on these developments, the following questions arise:

- Who is competing with whom?
- How distinct are the relative advantages of different countries?
- How unique is the value that countries can command in terms of growth and jobs from the international marketplace?

In today's world, external competitive forces, largely operating through global supply chains, can reshape national economies and, most important politically, determine how economic opportunities, benefits, and costs are distributed. To respond to these radically changed global dynamics, a new framework is needed for understanding the nature of national competitiveness.

Redefining National Competitiveness

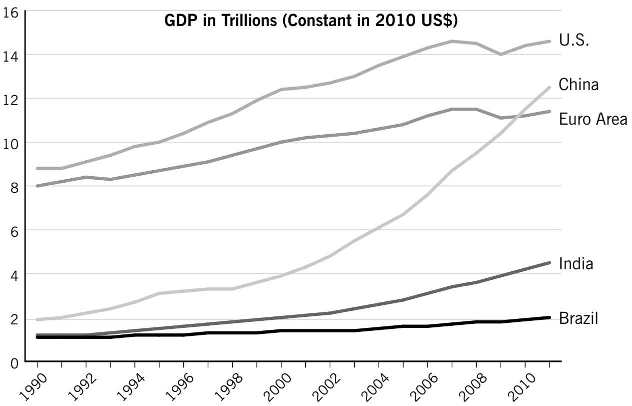
In this new, more integrated global operating model, markets reward innovation and efficiency regardless of their geographic source. These rewards may be recorded in international trade accounts, but are more likely to be reflected directly in a country's ability to raise living standards in a balanced way.

In this new paradigm, the performance measures of competitive success become much more aligned with the measures by which a country judges its own economic performance and is judged by the general public. National competitiveness under these terms is defined by the capability of a country to provide the operating and governance context for growth, economic opportunity, employment, and balanced income growth for its citizens.

It is against these more powerful measures of economic welfare that the United States is clearly falling behind. The United States is failing to provide the improvements in living standards and economic opportunity that lie at the heart of the American dream.

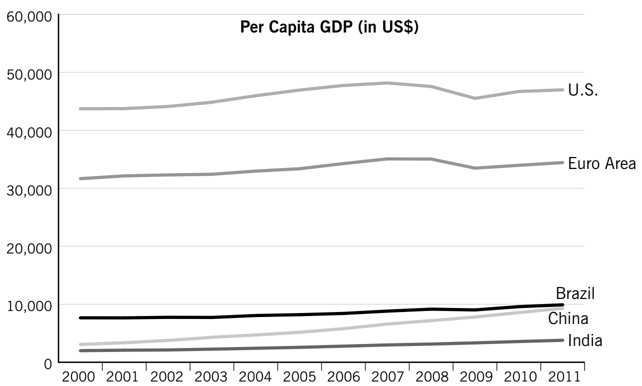
Throughout the 1990s and most of the past decade, the U.S. GDP grew faster than that of most industrialized countries, as can be seen in Figure 1. However, as is now painfully clear, growth in recent years was fueled by unsustainable amounts of borrowing. Over the past five years, U.S. growth has come to track more closely with Europe's, long recognized as a slow growth rate. The U.S. slowdown is particularly striking in the face of continued progress in emerging markets such as Brazil, China, and India.

Figure 1: U.S. Growth Pattern Resembles Europe's



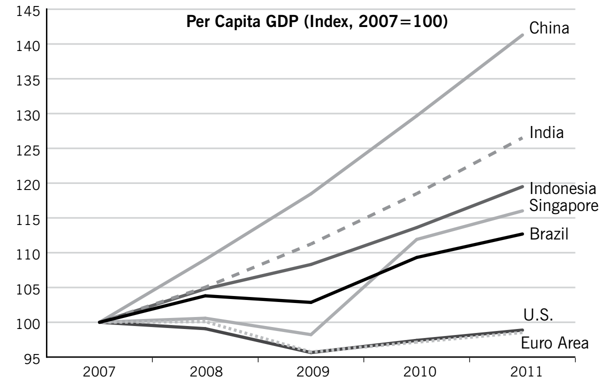
Sources: *The Conference Board Total Economy Database, The GailFosler Group, LLC*

Figure 2: Per Capita Income Stalled in the U.S. and Europe



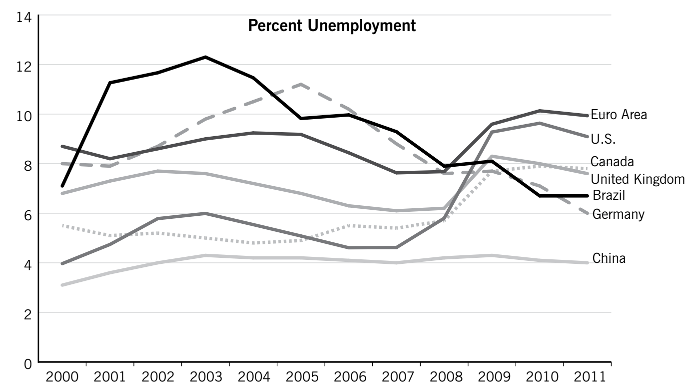
Sources: *The Conference Board Total Economy Database, The GailFosler Group LLC*

Figure 3: Growth in U.S. Per Capita Income Remains Below 2007 Levels



Sources: *The Conference Board Total Economy Database, The GailFosler Group LLC*

Figure 4: U.S. Unemployment Higher Than in Most Other Advanced or Emerging Economies



Sources: *IMF, World Factbook, Statistics Canada, UK Office for National Statistics, BLS, Statistics Bundesamt, The GailFosler Group LLC*

Relative growth differences between the United States and other countries are reflected in relative per capita incomes, as can be seen in Figure 2. Emerging markets have been able to advance their citizens' economic welfare even during and after the financial crisis, whereas incomes in both the United States and Europe have stalled.

It is important to note that because emerging markets are developing from such low income levels and have higher population growth, it is to be expected that they will grow faster than advanced economies do. What is unique and worrying in the present environment is not the high growth rate of emerging markets, but the inability of advanced economies, particularly the United States, to grow at even modest rates.

If the levels of per capita income today are benchmarked to 2007's, the comparisons are even more striking. The U.S. and Europe are still well below the pre-financial crisis peak, as can be seen in Figure 3. What the figure shows, however, is that for the same time period, the growth of per capita incomes in emerging market nations is much higher—in the case of China, almost 50 percent.

At the same time, the power of the U.S. jobs machine has diminished. Figure 4 shows that the United States has a higher unemployment rate than Germany, Canada, and even the United Kingdom do. The U.S. rate is currently about the same as the European Union's, which is plagued by high double-digit rates in the countries facing fiscal crisis, such as Spain and Greece. Large emerging markets like Brazil and China have unemployment rates well below that in the United States.

Equally disturbing is the decline in the share of Americans with jobs. The U.S. has always prided itself in putting its people to work. However, today, the U.S. employs less than half of its population—about the same as the troubled E.U. and significantly less than Brazil and China.

Rethinking the Role of Governance in the National Competitiveness Agenda

In a world of intense mobility of value and resources, one element remains unique to the national character: a nation's governing structures. These structures include the formal institutions of government, the processes by which legal, economic, and social decisions are made. They also include the processes for regulating important elements of the economy, and the goals and performance of key economic and social institutions (including corporations and private businesses, education, health care systems, and the family). It is through these institutions, processes, and practices that a nation can take control of the sources of economic success and find resolutions to barriers that stand in the way of balanced prosperity for the broad population.

This new view of competitiveness is underscored in a recent Business Council survey of national competitiveness. When leading CEOs of global corporations were asked to prioritize a list of key elements of national competitiveness, 90 percent of the respondents agreed on the following top four elements:

- Has the best educated labor force
- Has the leadership and resources to achieve domestic and international goals
- Has the best legal/regulatory/general operating environment for business
- Is politically and economically stable

Being a low-cost producer in leading globally competitive markets and having the fastest growth rates were ranked at the bottom of the list by survey respondents.

Similarly, the broad role of governance ranked high among the effective actions for improving the United States' competitive edge. The competitiveness agenda was remarkably far-reaching.

On the question of what America should do to restore its competitive edge, three-quarters or more of the survey respondents identified the following actions as the most effective:

- The importance of developing a coherent, pro-growth economic policy
- The ability to make hard economic decisions
- The need to reduce the federal deficit
- Tax reform

Of the 16 options on the list, however, 12 were identified as "most effective" or "very effective" by over half of the respondents. These actions include improving education, reducing government regulation, reforming health care entitlements, and a national energy policy. The national competitiveness debate, which in years past was defined in narrow terms of relative productivity performance and market innovation, has now broadened to include almost every aspect of economic and social policy action.

The survey results show a striking alignment between competitiveness and global economic leadership, as measured by perceptions of which countries are likely to lead the world in the future in terms of growth, innovation, and an ability to provide growing living standards for their citizens. China ranked number one in competitiveness, chosen by 56 percent; China also had a striking performance in global leadership, with 70 percent of the respondents expecting China to be either number one or number two in global economic leadership five years from today.

The United States remains number one as the likely future global leader, but confidence in U.S. leadership has slipped compared with a few years ago. At the same time, the United States ranks a clear number two to China in terms of competitiveness. Among other emerging markets, Brazil was seen as making large strides in both national competitiveness and global leadership potential.

In the same survey, Europe ranked near the bottom in both competitiveness and leadership. Despite Europe's strong trade performance, it is seen as neither competitive nor as a candidate for global leadership. Europe should be an object lesson for the United States: competitive drift can turn into economic decline.

Toward a New National Competitiveness Framework

The United States has made remarkable progress competing in the global marketplace on the basis of cost and quality and in bringing the benefits of global supply chains home to consumers and businesses. Nevertheless, it is evident from a range of income and employment measures that the United States cannot cost-compete its way to economic prosperity. Even achieving a trade surplus and a balanced federal budget, while positive steps, are not the Holy Grail of national prosperity and competitiveness.

There needs to be a new competitiveness framework that addresses the nation's progress toward the larger objectives of American prosperity and it should be judged against performance measures that correspond to the modern needs and expectations of the American public. This is not an easy task and goes to the heart of the way the American democratic process works, including the structure of the federal system.

To complicate the challenge further, the United States has developed a number of competitive liabilities as a result of its existing fragmented market and governance structures, which will not be easily overcome. These liabilities include the high and uncontrolled growth and cost of health care; the high cost and deteriorating quality of education; a slowdown in start-ups, innovation, and entrepreneurship; and the level of research and development spending. In addition, it has an infrastructure base that is not only deteriorating, but lacks the funding and the innovation to operate the existing system, as well as to build the next-generation system.

These challenges of overcoming the liabilities discussed above are no greater than the ones America has faced and successfully managed in the past. What has been required

Developing Indicators of Effective Governance

(Adapted from the Website of the World Bank Worldwide Governance Indicators Project)

The World Bank sponsored the creation of a Worldwide Governance Indicators project in 2010. The project identified six dimensions of governance, which were developed for over 200 countries and cover the period from 1996 to 2010. The project defines governance as:

> "the traditions and institutions by which authority in a country is exercised. This includes the process by which governments are selected, monitored and replaced; the capacity of the government to effectively formulate and implement sound policies; and the respect of citizens and the state for the institutions that govern economic and social interactions among them."

The project aggregates individual indicators around each of the following six dimensions:

- Voice and accountability
- Political stability and absence of violence
- Government effectiveness
- Regulatory quality
- Rule of law
- Control of corruption

For example, the government effectiveness dimension draws on data from seven different sources, such as the Economist Intelligence Unit and *The Global Competitiveness Report* of the World Economic Forum. For the U.S., the aggregate indicators are in the low 90s (out of a total of 100), and declined slightly between 1996 and 2009.

Data for the index are drawn from four different types of source data, including surveys of households and firms, commercial business providers, non-governmental organizations, and public sector organizations.

Source: *World Bank, Worldwide Governance Indicators Project, http://info.worldbank.org/ governance/wgi/index.asp*

in each instance during the long history of governance innovations is often a simple but nonetheless revolutionary re-visioning of existing structures with new goals and new standards of performance.

At the core of today's governance challenges is the need for a new framework that includes flexible, dynamic, well-informed, fact-based institutional and decision-making structures with a primary purpose of supporting security and prosperity for the American people. The political process can shape the values that guide the decisions of the governing process, but it cannot define the facts and the analytics by which options emerge.

If we take a dispassionate look around the world, not only at the United States but also at the European Union, China, India, and other emerging markets, past successes did not arise from a superior set of internal endowments—smarter people, more natural resources—nor are they economic consequences of a given stage of national development, such as an unskilled workforce. Successes emerged from tackling the most troublesome challenges of self-governance and forcing breakthrough decisions in areas like free-market adaptation, fiscal structures and prudence, education, and post-retirement security. Changing institutions and the rules by which they operate create winners and losers, to be sure. These actions are, however, predicated on a strong public case that the whole society wins in the long term.

Conclusion

The global competition for talent, knowledge, market, and resources is now determined not only by the quality of a nation's workforce but how that workforce is trained, organized, managed, and led. Governance constitutes the competitive edge. The first country or region to succeed in meeting its governance challenges is likely not only to be rewarded with a new era of prosperity and stability, but recognized as a model state for others. Given its inability to advance a positive national agenda on a range of economic and social welfare issues, the United States faces huge and complex policy challenges without the conceptual framework or the leadership to move ahead. We need leadership but we also need a framework within which leadership can operate and be evaluated. The task is great and time is running out. ◘

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Excerpted from **Governing to Win: Enhancing National Competitiveness Through New Policy and Operating Approaches**
See page 63 for more information on this book made available from the Center.