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Is the United States Really One of the Most Competitive Economies in the World? No.

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The United States has consistently ranked near the top of international competitiveness rankings. But these reports are largely meaningless in measuring actual international competitiveness, providing policymakers a false sense of optimism about America's position.

KEY TAKEAWAYS

- Economic indexes from the World Economic Forum, IMD, and others attempt to measure international competitiveness, and the United States consistently ranks well in them.
- Yet these indexes don't really measure international competitiveness—and for a variety of reasons they are biased toward the United States.
- The positive U.S. rankings in these misleading reports act as a drug, leading to dangerous complacency among U.S. business and government leaders: Why take significant action if the United States is at or near the top?
- More appropriate measures of competitiveness suggest that the United State is in quite a weak position—and falling. This requires bold federal action.

INTRODUCTION

For a sports team to know whether it is competitive, it simply needs to look at its win-loss record. A record that is wanting sends a valuable message to the owners, coaches, and players that things need to change.

It's more difficult for a country to know whether it is competitive globally. There is no win-loss record. Rather, most policymakers turn to popular competitiveness indexes that, unfortunately, uniformly mismeasure competitiveness, resulting in a U.S. ranking much higher than it should be. It would be as if a sports team were measured by factors such as the average speed of its players, size of its stadium, and the opinion of sports writers. Those might be closely correlated to actual performance, or they might not be. In the case of popular competitiveness indexes, they are not.

When these pollyannish reports come out, the media trumpet the findings, as when CNBC proclaimed, "US named the world's most competitive economy."[1] That is misleading at best, and at worst it acts as a drug, leading to a dangerous complacency among U.S. business and government leaders. After all, as the old Avis car rental commercial famously said, "We're No. 2: We try harder." But why try harder when you are already number one? Why take drastic action that will cost money, require institutional change, and potentially alienate key political constituencies if, after all, the United States is at or near the top?

This report examines a number of commonly referenced competitiveness indexes and explains why they are largely meaningless in measuring actual international competitive positions. It then lays out data suggesting that the real U.S. position is much worse than these studies would suggest.

COMPETITIVENESS INDEXES

There are a number of indexes that attempt to measure international competitiveness. Perhaps the most widely cited is the World Economic Forum's annual "Global Competitiveness Index," which ranks 141 countries. The United States does extremely well, ranking first in 2018 and second in 2019. Others also rank the United States highly. The International Institute for Management Development's (IMD's) 2018 "World Competitiveness Rankings" report includes 63 countries and ranks the United States number one.[2] The 2016 "Global Manufacturing Competitiveness Index" conducted by Deloitte and sponsored by the Council on Competitiveness reports that the United States ranked second to China, but was predicted to be ranked number one by 2021.[3] INSEAD reported that the United States ranks third on "talent competitiveness."[4] And UNIDO's "Country Industrial Competitiveness Report" ranks the United States fourth.[5] In other words, all is fine with U.S. international economic and industrial competitiveness. Policy makers can focus on other issues.

At first glance, these studies appear on the mark. After all, U.S. gross domestic product (GDP) is highest in the world, per capita income is near the top, and America is strong in factors such as venture capital and research universities. But a closer look suggests something is not quite right. The U.S. economy runs the largest trade deficit in world history, nearing $110 billion in March 2022.[6] Between 2000 and 2012, the United States lost a larger share of its manufacturing employment than almost any major nation did.[7] Among major nations, the U.S. share of workers employed in manufacturing and share of GDP from manufacturing were among the lowest.[8]

Finally, as the Information Technology and Innovation Foundation (ITIF) recently reported, America's performance in advanced industries has declined and is now below the global average.[9] So what's going on?

LIMITATIONS OF THE STUDIES

In drilling down into the methodology of these studies, it's clear that they suffer from a number of major flaws that lead to a disjuncture between the U.S. scores and actual competitive position and performance.

Inaccurate Definition of Competitiveness

One foundational reason for the disjuncture between rankings and actual performance is many of the studies employ an inaccurate definition of "competitiveness." According to World Economic Forum (WEF) President Klaus Schwab, their study is to help policymakers "assess their progress against the full set of factors that determine productivity."[10] The index "aims to measure the drivers of 'total factor productivity.'"[11] If that is indeed the case, WEF should retitle the report "The World Economic Forum Index of Productivity Input Indicators" because competitiveness and productivity are two very distinct things. The report appears to recognize this disjuncture but waves it away with this statement, backed up by neither logic nor analysis, but rather the simple assertion, "Enhancing competitiveness is still key for improving living standards."[12]

While not providing as clear a definition of competitiveness, IMD uses a similar definition, stating that its report, "analyzes and ranks countries according to how they manage their competencies to achieve long-term value creation."[13] They don't define "long-term value creation," but it presumably also means "productivity."

While competitiveness is related to productivity, it is by no means equivalent.

One advantage of defining competitiveness as productivity is it takes the "competition" out of "competitiveness," as WEF did when it stated that "competitiveness … does not imply zero-sum competition among nations. Our concept of competitiveness is about productivity, and all countries can become more productive at the same time."[14] This way, when WEF members meet in Davos, everything can be amicable.

But as ITIF has written, productivity is not the same as competitiveness.[15] Productivity is simply economic output per unit of input. The unit of input can be labor hours (labor productivity) or all production factors including labor, machines, and energy (total factor of productivity). Competitiveness, on the other hand, is the ability of a region to export more in value-added terms than it imports. This calculation includes accounting for "terms of trade" to reflect all government "discounts," including an artificially low currency, suppressed wages in export sectors, artificially low taxes on traded sector firms, and direct subsidies to exports. It also controls for both tariff and nontariff barriers to imports. Unlike productivity, competitiveness is mostly win-lose. If China gains global market share in semiconductors, countries such as the United States will usually lose output and jobs.

So how does productivity fit into competitiveness? Productivity growth can enable competitiveness, especially if it is concentrated in traded sectors, which lowers costs and enables firms to sell more in global markets without having to rely on government-provided

discounts. But productivity growth can also be unrelated to competitiveness if it is concentrated in nontraded sectors. Imagine a nation with strong productivity growth but almost all of it in nontraded sectors such as grocery stores, electric utilities, and nursing homes. Certainly incomes would go up as relative prices in these sectors fell, but firms in traded sectors would only see minimal reductions in their costs based on the extent of purchased inputs from nontraded firms. So while competitiveness is related to productivity, it is by no means equivalent.

Reliance on Indicators That Have Little Impact on Competitiveness

Perhaps the single biggest limitation of the IMD and WEF reports is they include a vast laundry list of indicators that have little connection to inputs that enable competitiveness—and even less to actual competitiveness performance. It's as if they include any possible indicator that is collected for all the countries they want to include.

For example, WEF includes indicators such as organized crime, homicide rates, budget transparency, energy efficiency regulation, quality of land administration, environment-related treaties, trade tariffs (low is good), labor tax rate, and many more. Most of these appear to have little real effect on how well a nation's firms are able to compete in international markets. For example, it ranks the United States second in electricity access for people, but that has little effect on U.S. companies' performance.

The United States ranks first (lowest) in costs associated with laying off workers. But is this a good thing or a bad thing?

Likewise, most of IMD's 338 indicators have little to do with competitiveness.[16] IMD's report measures homicide rates, females in parliament, differences in gender by unemployment rate, aging of the population, percentage of people living in urban areas, household savings rates, health expenditures as a share of GDP, carbon dioxide emissions, average number of working hours a year, remuneration of management, number of credit cards, gender ratio in access to banking, number of mergers and acquisitions, and the degree to which executive pay is aligned with environmental goals.[17] It's unclear what any of these have to do with competitiveness.

Moreover, for many indicators, it's unclear whether a higher or lower score is better for competitiveness. Are higher health expenditures good or bad for competitiveness? One could make either case. The United States ranks first (lowest) in costs associated with laying off workers. But is this a good thing or a bad thing? IMD includes international investment as an indicator, but this appears to reward countries whose firms invest more in other countries. WEF ranks the United States first on road connectivity, which measures the difference between actual driving distances and as the crow flies. This presumably marginally reduces the cost of shipping, which could boost manufacturing competitiveness, but it also reduces import costs. Likewise, the United States ranks first in airport connectivity, which could very well boost offshoring and imports, as well as exports and competitiveness.

Some studies reward the United States for simply being large, as when the IMD report includes GDP as a metric. The UN report includes some measures that are more closely connected to competitiveness, such as high-tech exports and total research and development (R&D), but they don't appear to control for GDP size and therefore favor large nations such as the United States.

The measures also show the share of world manufacturing value added and manufacturing export per capita, which rewards the United States simply for having the largest economy. Other factors are even less related to competitiveness, such as total energy consumption and number of airline flights, but are also measured in total.

We see this in terms of the United States ranking 2nd in share of world manufacturing output and 3rd in overall manufacturing exports, but 77th in manufacturing as a share of GDP and 24th in share of medium- and high-tech output in overall manufacturing exports.[18]

Moreover, both the IMD and UN studies focus mostly on input indicators, such as infrastructure and research capabilities, which are not output factors. WEF ranks the United States first on business dynamism, which is an input factor. WEF does not include measures of productivity or competitiveness, such as trade deficit, advanced manufacturing output, or other factors. While IMD includes some of these, they are overshadowed by many more unrelated indicators.

Reliance on Opinion Surveys

The IMD, WEF, and Deloitte studies rely on opinion surveys, in large part because it is difficult to get hard data on many of the most important competitiveness factors. Opinion survey questions make up all the Deloitte factors, one-third of the IMD indicators, and 30 percent of WEF indicators.

There are many problems with opinion surveys. First is survivorship bias. The executives of companies that shrank or went out of business because of a lack of national competitiveness are not included. Second is the problem of comparability. Two countries may have the same performance on an indicator, but executives in one country may be more demanding and therefore rank their country lower than in the second. Third, it's not clear that executives have adequate and accurate knowledge of many of the factors. For example, notwithstanding the fact that the single biggest complaint from U.S. executives is lack of access to skilled workers, the WEF survey finds that the United States ranks first in ease of finding skilled workers.

WHAT WOULD A REAL COMPETITIVENESS INDEX MEASURE?

A true competitiveness index should measure competitiveness performance: the performance of a nation's traded enterprises, especially those in advanced industries, in global competition.

Two key indicators are the value and trends in currency and trade balance, especially in non-resource industry goods (e.g., exporting a lot of oil is not a sign of competitiveness, it is sign that a country is endowed with a lot of oil).

In trade balance as share of GDP, the United States performs poorly, ranking 83rd out of 158 countries, with a massive deficit.[19] Moreover, the value of the dollar in 2020 was about the same as it was in 1997, but the U.S. trade deficit as a share of GDP was larger in 2020.[20] When a nation's trade deficit increases while its currency remains constant, this suggests a competitiveness challenge.

Perhaps the most accurate indicator of a country's competitiveness is a measure used in ITIF's Hamilton Index, which examines nations' and regions' global shares of advanced-industry output relative to their changing shares of global GDP.[21] This ratio, known as a location quotient (LQ), also can be calculated as an industry's share of national GDP divided by its share of global GDP.

It provides a global benchmark measure of a country or region's industrial concentration, and therefore its competitive position, by expressing its market share as a multiple of the size-adjusted global average. An LQ of 1 means the nation's advanced industry output share of its GDP is equal to the world's advanced industry output as a share of world GDP.

The report looks at eight advanced industries: pharmaceuticals; medicinal, chemical, and botanical products; electrical equipment; machinery and equipment; motor vehicle equipment; other transport equipment; computer, electronic, and optical products; and information technology and information services. Of the 63 nations for which there is data from the Organization for Economic Cooperation and Development (OECD) on advanced industry value added, the United States ranks 23rd with an LQ of just 0.94, below the global average of 1. In terms of percentage change in LQ from 1995 to 2018, the United States ranked 43, with a decline of 3.4 percent.

Comparing the Hamilton Index LQ scores with the final scores of the same nations in the WEF report shows that the correlation is quite weak at 0.39. In other words, there is some correlation between a nation's score on the WEF report and the Hamilton Index location quotient, but it is relatively weak.

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There are a number of reasons for the divergence between the scores of the major competitiveness indexes and the real-world performance of U.S. traded sectors. First, because of the period of unchallenged U.S. economic leadership from the 1940s to the 1980s, and its recent leadership in information technology (IT) industries in particular, many executives presumably believe that this performance has continued, thus overstating America's true position. Second, most of the indicators included in these rankings have little to do with traded-sector firm performance.

Indicators that might have more relevance would be factors such as long-term orientation of firms and capital markets; background of CEOs in production and engineering as opposed to marketing and finance; intensity of capital investment; effective tax rates of traded sector firms; extent and sophistication of a nation's industrial policies; and extent of alignment between large firms and state interests. These are all areas where it looks as if the United States would score relatively low, at least behind many advanced nations. But these are not measured in the major studies, in part because it is difficult to do so and in part because the authors of the studies don't consider them important.

In summary, notwithstanding the acclamatory results of major competitiveness indexes, the real position of the United States appears to be much weaker than reported. Fixing that position requires a coherent national advanced industry strategy, starting with passing and fully funding current competitiveness legislation in Congress.

About the Author

Robert D. Atkinson (@RobAtkinsonITIF) is the founder and president of ITIF. Atkinson's books include *Big Is Beautiful: Debunking the Myth of Small Business* (MIT, 2018), *Innovation Economics: The Race for Global Advantage* (Yale, 2012), *Supply-Side Follies: Why Conservative Economics Fails, Liberal Economics Falters, and Innovation Economics Is the Answer* (Rowman Littlefield, 2007), and *The Past and Future of America's Economy: Long Waves of Innovation That Power Cycles of Growth* (Edward Elgar, 2005). Atkinson holds a Ph.D. in city and regional planning from the University of North Carolina, Chapel Hill.

About ITIF

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ENDNOTES

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