EXECUTIVE SUMMARY

By Professor Stéphane Garelli

	The World Competitiveness Landscape in 2002?
I	**High flyers pay the price of volatility.**
II	**Some Asian economies may rebound sharply.**
III	**Many emergent economies need to be more self-reliant.**
IV	**Sustained growth, however, can be impaired by low profitability and high debt in enterprises.**
V	**Successful introduction of the Euro challenges the Yen.**
VI	**A succession of mini-rallies can be expected.**
VII	**Corporate figures have lost much credibility.**
VIII	**Oil prices can tip the balance one way or another.**
IX	**Globalization links nations but opinions diverge.**
X	**A sense of vulnerability will prevail throughout 2002.**

2001, a Year to Forget...

The "economic hangover" discussed in the Executive Summary last year was tougher than anticipated. 2001 was expected to be just a year of technical correction after the exuberance and the excesses of 1999 and 2000. Reality painted quite a different picture: the economy rapidly lost steam and the stock market plunged, dragged down by the technology sector. The dramatic events of September 11th accentuated the correction, and an overall sense of vulnerability and uncertainty further deteriorated market confidence.

In terms of world competitiveness, 2001 is a year to forget…

<u>In the WCY 2002</u>: Countries with rapid growth suffer from volatility in this year's overall ranking. High flyers such as Singapore (5th), Hong Kong (9th) and Ireland (10th) lose 3 ranks each and pay the price of a huge turn around in economic performance. To a lesser extent, and after some ecouraging years, Sweden (11th) and Germany (15th) are also affected by the weakening economy. However, more cautious countries like The Netherlands (4th), Switzerland (7th) and Austria (13th) are reaping the benefits of greater stability in a turbulent environment and rise in the overall ranking. The United Kingdom (16th) and Denmark (6th) have better withstood the uncertainties of the global economy.

Recession or slow motion?

Technically, a recession is defined as a decline in GDP over two consecutive quarters. However, a massive slowdown in economic vitality can have the same consequences. For the year 2000, the World Competitiveness Yearbook recorded for the first time 43 national economies growing at 3% or more out of the 49 countries ranked. For 2001, however, we witnessed certain countries entering a recession while others posted very slow growth. Japan, Singapore, Mexico or Argentina, to name a few, are clearly in recession, although for different reasons. In Japan and Argentina, the recession is structural and deeply rooted. Very little good news can be expected from these countries in the short term. It will take time and political courage to fix the situation. Other countries face a more cyclical problem. South East Asian economies, for example, had a very strong year in 2000 and are now undergoing a tough correction. For these countries, recovery is likely to be more rapid and even brisk.
Many other economies, whilst technically not in recession, lost momentum in 2001. This is the case of the European Union where economic activity remained flat and where member countries' growth oscillated around 0%. The US has narrowly avoided the recessionary scenario: the third quarter showed GDP in decline at -1.1%, while at the end of the year growth returned at +1.4%. This should be compared however to 5% GDP growth in 2000 after a long and buoyant period of economic expansion, which started in March 1991.

Some countries still shine: Britain has weathered the economic slump better than its neighbors, as did Australia. China and Russia continue to expand strongly, relying on the development of a huge internal market.

<u>In the WCY 2002</u>: Under Real GDP Growth, Singapore, which was in 2nd position last year falls to 47th. Mexico (43rd) loses 33 ranks compared to last year, just like Taiwan, which is now 46th. Hong Kong, which was the fastest growing economy in 2000 with an astounding 10.5% growth, has now fallen to 42nd position with 0.1%. Japan's problems persist (-0.5% recession) but, not alone anymore, it moves up 4 ranks (44th). China (1st) tops the growth league this year and Russia is 4th.

What is different in 2002 versus 2001?

Recessions are well documented. We have already had 9 recessions since World War II and their pattern is well known. In the US, each lasted between 6 and 16 months. A mix of interest rate cuts and fiscal stimuli traditionally cures them. However, the present situation is slightly different from the past:

- In general, a drop in private consumption and consumer confidence triggers a recession or an economic slowdown. In turn, businesses cut their expenses and investments to adapt to declining demand. Weaker business activity further dampens consumer confidence and the vicious recessionary cycle begins. In 2001 the opposite occurred. A surge in business investment, especially in technological infrastructure, lead to a saturation level in enterprises. A correction in business expenditures and capacities then took place before consumer confidence was affected. This time, customers adapted to the decline in the business cycle and not the contrary.

- A high level of debt weakens the economic system. An unexpected consequence of the 1999 – 2000 boom was the build-up of huge debts in enterprises. This was the result of the massive investments and expenditures, especially in technology, mentioned above. These investments were intended to meet exploding demand and to gain market share in a rapidly expanding market. Companies also took advantage of cheap and abundant capital provided by exuberant stock markets. Consequently, the large European Telecom companies, for example, accumulated a staggering 230 billion Euros of debt, which will take years to be absorbed.

- The impact of the tragic events of September 11th is still difficult to quantify. The strong and brief decline in the stock market was rapidly corrected. However, the damage to the insurance, transport and tourism industries will be more lasting. In addition, a number of enterprises took advantage of the depressed mood after the events to launch drastic restructuring measures to reestablish a more competitive business model.

<u>In the WCY 2002</u>: The US (1st) remain the largest consumer market in the world, with 7,061 Bn$ spent last year. Japan (2nd), Germany (3rd), the UK (4th), France (5th), Italy (6th) and now China (7th) and Mexico (8th) are next. Under Flexibility and Adaptability, Brazil comes first followed by the US (2nd), Iceland (3rd), New Zealand (4th) and Ireland (5th). On the other hand, the less flexible countries appear to be Japan (46th), Germany (47th), France (48th) and Poland (49th). Under Image of your Country Abroad, it seems that South Africa (45th), Indonesia (46th), Columbia (47th), Venezuela (48th) and Argentina (49th) have the most to achieve to reverse the present perceptions.

The World Competitiveness Landscape in 2002?

The famous scientist Niels Bohr once said, "Prediction is extremely difficult, especially about the future". Nevertheless, it is possible to highlight some features that will define the competitiveness environment in 2002:

1. The economy will remain highly volatile, especially in Asia. The difference between the boom (2000) and the doom (2001) years in Europe is a 2-3% decline in economic growth. By contrast, in Singapore, it can mean a variation of between +10.3% and –2.0%. This is a formidable difference of more than 12 points. Comparable swings can be observed in most of the Asian economies.

<u>In the WCY 2002</u>: Under Government Economic Policies, Singapore still ranks 1st in trusting the government to adapt quickly to changes in the economy, followed by Malaysia (2nd), Luxembourg (3rd), Finland (4th) and Ireland (5th). There is more skepticism in China (17th), the United Kingdom (22nd), Italy (28th) and, at the bottom, in Japan (43rd), France (44th) and Germany (46th).

2. Such volatility can have some positive aspects. It is not impossible that some Asian economies will rebound sharply, even during the first semester, ahead of the rest of the world. Korea shows some trends in this direction probably due to the recovery in semiconductor chips, which account for a third of its exports. The major challenge therefore, especially for emerging economies, remains to ensure greater stability in their economic systems.

<u>In the WCY 2002</u>: Under Resilience of the Economy, Korea ranks 11th, in a criterion where Australia (1st) takes the lead, followed by Norway (2nd), the UK (3rd) and the US (4th). Italy is 30th, Germany is 39th while Japan (48th) and Argentina (49th) close the ranking, as expected.

3. The structure of several leading economies is in need of reform. Many Asian and Latin American economies realize the importance of reorienting their economies toward a higher degree of self-reliance. This could be achieved through a revitalization of the domestic economy and a diversification of industries and markets. A very high dependency on the US economy, as well as on exports in the high-tech sector, creates unpredictability. For example, High Tech equipment represents 62% from Singapore manufactured exports, 49% for Malaysia, and 35% for Korea.

<u>In the WCY 2002</u>: Under Balance of Trade, Germany (1st), Japan (2nd) and Russia (3rd) - boosted by oil exports, Canada (4th) and Ireland (5th) remain the leading nations. On the other hand, under High Tech Exports, Singapore is 4th in absolute terms, followed by Korea (7th), China (9th) and Malaysia (10th). As a percentage of manufactured goods exported, Singapore is 1st and Malaysia 2nd.

4. A part of the recovery will be technical. Companies have been highly efficient at reducing their inventories during the second half of 2001. Technology helped them to react more swiftly than in the past. In 2002, inventories will have to be replenished, thereby sustaining a certain level of business activity. In addition, consumer confidence has been surprisingly stronger than anticipated during the recent period of uncertainty.

<u>In the WCY 2002</u>: Under Overall Productivity, Luxembourg (1st) and the US (2nd) lead the ranking with more than $75,000 of GDP created per person employed. They are followed by Norway (3rd), Japan (4th) and Switzerland (5th). Surprisingly, Hong Kong is only 17th with $49,000 and is slightly ahead of Singapore (21st). China (47th), Indonesia (48th) and India (49th) close the ranks with $1,500 or less per person employed, thus underlying the difficulty of extending productivity in a populated country.

5. Japan, the world's second largest economy, continues to suffer from a "mid-life" crisis, which is longer and deeper than expected. Consequently, it will not contribute to a recovery in the world economy to the same extent as in the past. The successful introduction of the Euro will also challenge the Yen's position as an alternative to the dollar.

In the WCY 2002: Under efficient implementation of Government Decisions, Japan ranks 35th. It is 40th under Values of the Society support competitiveness, and it is last (49th) under Budget Balance, showing a staggering deficit of 351 Bn$.

6. The stock market is desperately looking for good news. The "Annus Horribilis" has left some deep wounds. Some 5'000 Bn$ in market capitalization were lost in 2001. Many virtual fortunes created the year before in the E-economy vanished as quickly as they came. The financial markets are eager to recover some of the losses and will scrutinize the faintest sign of optimism. But even if stock markets strive to be bullish, corporate performance continues to be unsure. In many sectors, PE ratios are still high relative to profitability. In addition, the high levels of debt may force companies to divest or restructure. Mini-rallies are possible but may not last.

In the WCY 2002: The US (1st) has obviously the largest Stock Market Capitalization with a value in excess of 15,000 Bn$, followed by Japan (2nd), the UK (3rd), France (4th), Germany (5th), Cananda (6th) and Switzerland (7th). However, under changes in the Stock Market Index, Russia (1st) leads the pack with a remarkable 102% increase last year, followed by Korea (2nd), the Slovak Republic (3rd), Mexico (4th) and Slovenia (5th).

7. People don't trust corporate figures anymore. It is now clear that a lot of fuzzy accounting took place during the golden period of the New Economy. Revenues were inflated and debt evaded through many loopholes or creative accounting techniques. The collapse of Enron and Arthur Andersen has exacerbated the feeling that one may have "lies, damned lies and accounting" (to paraphrase Disraeli's statement on statistics). Restating earnings has recently become very fashionable… A far-reaching overhaul of accounting and auditing practices may be the price to pay for renewed business confidence.

In the WCY 2002: Under Credibility of Managers, Finland is 1st, Singapore (3rd), Denmark (4th) but the UK is only 27th and France 31st. Finland is also 1st for Corporate Boards' performance, but Germany only ranks 26th and, not surprisingly, Switzerland 31st. Japan is only 45th.

8. The price of oil can tip the balance one way or the other. It has been calculated that a $10 drop or increase in the price of a barrel of oil means a 250 Bn$ savings or tax on the world economy. It is important to bear in mind that this calculation does not take into account the psychological impact of such fluctuations.

In the WCY 2002: Under Total Indigenous Energy Production, Norway is 1st, producing more than seven times as much energy as it consumes (thus a leading exporter), followed by Venezuela (2nd) and Columbia (3rd). Russia is 7th.

9. Globalization remains a fact, even if excesses need to be corrected. Foreign direct investments, even more than trade, have linked the destinies of nations. A cutback in a company in California may mean lay-offs in a factory in Ireland or for a partner in Singapore. The competitive power of a nation cannot solely be assessed in terms of trade. In 1999, the total sales of US companies to non-US entities amounted to 336 Bn$, while purchases by US companies from the rest of the world reached 290 Bn$. In a global world, the origin of an investment is just as important for competitiveness as the location of this investment.

In the WCY 2002: Under Globalization, Finland (1st), the US (2nd), Iceland (3rd), the Netherlands (4th), Denmark (5th), Sweden (6th) and Switzerland (7th) strongly feel that they offer the best opportunities for their economies. The ranking is slightly different regarding Attitudes toward Globalization. Under this criterion, The Netherlands (1st), Singapore (2nd), Taiwan (3rd) and Hong Kong (4th) enjoy the most supportive population. Unexpectedly, Switzerland falls to 26th position and the UK to 33rd showing a significant gap between managers and public perceptions of the issue. It is however less surprising that France ranks 47th followed by Argentina (48th) and Venezuela (49th).

10. Vulnerability is becoming a fact of life. Whether it takes the form of business breakdowns, computer piracy or terrorism, companies and people are learning to live with a sense of feeling permanently exposed and unprotected. This real or perceived vulnerability will not disappear easily. It could take a much smaller event than September 11th or the Afghan war to throw the world economy back into a very depressed mood. Security and reliability are thus becoming key concerns, but at a huge cost…

In the WCY 2002: Under Data Security, Germany is 10th, followed by the US (13th), the UK (18th), France (26th), Spain (29th), China (43rd) and Russia (46th).

To summarize, the 2002 competitiveness environment will be characterized by much nervousness and unpredictability in the market. A series of "W" shape trends are to be expected, in other words a succession of cold and hot showers / bad and good news.

For enterprises, consolidation is the name of the game.

"All industries start with lots of little companies that get consolidated". This statement by Larry Elison, chairman of Oracle, applies today to the technology sector. After a pioneering phase, this sector, which includes computers, peripherals, telecommunications and Internet, exploded at the end of the 90's. Then, development of an advanced technological infrastructure was considered a competitiveness priority for both nations and companies. Internet and E-business did the rest.

The investment craze ceased in early 2000 and the market is now confronted with too many players and too much capacity. Some sectors, such as mobile telephony, are reaching saturation while the next wave of technology (3G, etc.) has not yet been rolled out. As indicated earlier, a considerable amount of debt, often resulting from the purchase of new technology licenses, continues to weaken the performance of large traditional operators.

As a result, the technology sector, which in the past was accustomed to double-digit expansion rates, is no longer the growth engine of the world economy. Advanced and emerging economies suffer alike. This problem will be exacerbated when the market consolidates to get rid of overcapacity.

Other sectors have been consolidated in the past such as transport, energy or automobiles. In the latter, it was recorded that some 3000 start-ups took place in the US between 1900 and 1925. Today only 3 car companies survive in the US! Since 1925, companies have disappeared, merged or bought each other, distribution channels have changed and margins have been under constant pressure.

The World Competitiveness Yearbook has always considered that the sustainability of a competitive position is linked to a certain level of diversification in industry sectors and markets. The formidable success of the technology sector has delayed this adjustment process in many countries, which continue to be overly dependent on one industry or one market. When such a sector consolidates or slows down, the damage to the competitiveness of a country can be significant. On the other hand, the US economy may have been saved, technically, from a recession by the remarkable and unexpected performance of its traditional Construction and Housing market, which benefited from repeated cuts in mortgage rates. Diversification is sometimes a valuable security net…

In the WCY 2002: In Entrepreneurship, it is not surprising to see the US (1st) in the lead, followed by Hong Kong (2nd),

Israel (3rd), Canada (4th) and Italy (5th). At the bottom, Japan is 49th. A quite similar ranking appears for Creation of Firms, but in this criterion, Switzerland ranks 25th, Denmark (41st), Germany (42nd), France (47th) and Japan (48th). It is not surprising either that the most Competent Senior Managers are to be found in the US (1st) while some shortage could be highlighted in the UK (30th), Italy (35th), Russia (42nd), Japan (46th) and China (49th). Regarding International Experience, the most seasoned managers are to be found in The Netherlands (1st), Hong Kong (2nd), Sweden (3rd) and Switzerland (4th).

Nevertheless the World expands…

Despite two negative trends influencing competitiveness in 2002, namely an economic slowdown and a market consolidation, the continuous growth in the size of world markets remains the most fundamental long-term factor affecting World Competitiveness. The opening of World markets, despite present trade tensions, has provided access to huge potential markets, especially in emerging countries.

Today, it takes only 12 years to increase the world population by 1 billion people, compared to 123 years between 1804 and 1927. By 2050, the population of Europe will have decreased by 100 million people to 628 million. But everywhere else it will continue to grow. In the US, the population will increase from 305 to 392 million, in Latin America from 504 to 809 million, in Africa from 749 to 1766 million, and in Asia from 3585 to 5268 million!

Competitiveness and market access will also affect the balance of power. Today, the US and Europe, with only 11.2% of the world population, account for 63% of world GDP. In 2050, both regions will only represent 7.7% of the world population. By then, the US will be the only advanced economy in the list of the 12 most populous nations. This list will include such countries as Indonesia, Nigeria, Brazil, Bangladesh, Ethiopia, Congo, etc. In 2050, Pakistan will have the same population as the US!

In the WCY 2002: Under Dependency Ratio, that is the population under 15 and above 64, divided by the active population, Hong Kong (1st), Korea (2nd) and Singapore (3rd) enjoy the best balance, while France (32nd), the UK (35th) and Sweden (38th) suffer from a higher burden on their active population. The consequence of an ageing population is that investments have to be made for the Health Infrastructure. Under this criterion, Austria (1st), Switzerland (2nd) and Iceland (3rd) top the ranking. Healthy Life Expectancy is at its best in Japan (1st) with over 73 years, followed by Italy (2nd), Switzerland (3rd), Australia (4th), Sweden (5th) and Iceland (6th). Surprisingly, Greece is 7th, France (9th) and Spain (10th).

Conclusion

In this context, nations will compete fiercely to attract the best enterprises, or at least those most likely to contribute to their development. Forrester Research estimates that by 2007, 70% of the world's computer programming will be done in developing countries. On the other hand, companies will carefully select the best investment location, especially since an open and global economy provides a considerable array of choices and opportunities. There is also a positive argument for the country where the investment originates. By investing abroad, companies contribute to the diversification of their own economy and, at the same time, show aggressiveness in world markets. In both cases, the World Competitiveness Yearbook continues to show, without interruption since 1989, the most accurate picture of these major shifts and provides the best benchmark of the progress achieved by all players.

In the WCY 2002: Under Direct Investment Flows Abroad, the United Kingdom displays remarkable aggressiveness and is the leader ahead of France (2nd) and the US (3rd). On the other hand, under Direct Investment Flows Inward, the US (1st) is the most attractive country in the world, followed by Germany (2nd), the UK (3rd) and Belgium (4th). Sustainable Development is a priority in Singapore (1st), Finland (2nd), Austria (3rd) and Denmark (4th), less so in Japan (20th) or the US (23rd), even less in the UK (39th) and Italy (45th), and not at all in Slovenia (47th), Argentina (48th) or Venezuela (49th). Finally, under Quality of Life, Austria (1st), Luxembourg (2nd), Australia (3rd), Switzerland (4th) and Canada (5th) seem to be the best places to enjoy competitiveness...