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U.S. Competitiveness and The Chinese Challenge

How does the U.S. economy look from a Chinese perspective? Pretty good, actually.

Yes, the U.S. has its problems, which were laid bare by the financial crisis. But it's still the most innovative economy in the world and retains fundamental strengths that China, for all its recent success, can only envy.

When China tore off the straitjacket of central planning and introduced market-oriented policies, a new class of private entrepreneurs took advantage of ready-to-use technologies and launched the so-called China Miracle. The country has enjoyed a "late mover" advantage for more than three decades, relying on cheap labor, land, and imported innovations and ideas. That game obviously can't go on forever. The rising costs of labor, energy, and raw materials are already undercutting the competitiveness of Chinese companies. Some have responded by trying to raise prices, but with little success. In a buyer's market, customers have refused to pay more, particularly since suppliers have failed to differentiate and upgrade their products and services.

To put it another way, the Made-in-China advantage is quickly fading. In the future, the goal needs to be Created-in-China. That won't be easy to accomplish. Innovation requires far more than cheap

America needs to restore confidence in the country's innovation machine.

labor. For starters, you need imaginative financiers, inspired entrepreneurs, and first-class researchers. Even with all that, you need a culture that permits innovation to flourish.

Some observers, both inside and outside of China, believe that central planning can effectively perform the function of innovation organizer and coordinator. They couldn't be more wrong. The process of searching for new technologies and ideas is a creative one, based on trial and error. Information and experience are crucial to innovation and can be gained only by being engaged in the process. Government officials can't help; they don't have the incentives to acquire information and experience that aren't relevant to their political careers and personal incomes.

What ultimately drives innovation is an invisible yet powerful hand: the market for new ideas. In this market, those who dare to think the unthinkable and bear great risks are rewarded with wealth and fame. In this market, "to get rich is glorious," as China's former leader Deng Xiaoping once put it. But to transform new ideas into productivity and wealth, the market also needs support of institutions such as private property, venture capital, and the stock market—none of which are strong today in China.

China's strategy of copying and imitating helped to narrow the gap with the developed world, but the approach creates long-term problems. Too little value is placed on original research and intellectual property rights. Government policies only reinforce the problem. When firms face IP disputes and litigation, growth-hungry

local authorities too often offer sympathy and support to their pirating constituents. This disregard for intellectual property rights produces short-term gains, but it also effectively kills hope for a flourishing Chinese R&D community and damages the country's long-term growth potential.

It's no surprise, then, that China has had little success fostering innovation. A Chinese version of Nasdaq was created a few years ago to help fund start-ups, but it soon became a channel for insiders to cash out quickly and profitably. Regulators have turned a blind eye to irregularities in pre-IPO investments and trades, which has sapped public confidence. Share prices have fared poorly, especially because senior executives of the newly listed companies dump their holdings as soon as they can. Crony capitalism has triumphed at the expense of entrepreneurship and true innovation. In fact, most of China's top technology firms have been funded by overseas institutions and listed on Nasdaq.

China's enormous economic strides have propelled the country forward. Nonetheless, the U.S., despite its own concerns about the future, remains the world's most competitive economy. It is driven by market forces, not central planning. It rewards innovation. It protects IP. It has trustworthy institutions that minimize corruption and cronyism. What Americans need most is to restore confidence in their innovation machine and to ignore calls for government intervention, which will only suffocate the creativity of the country's most talented people. ▀

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