

## Why the US Will Continue to Lead the 21st Century?\*

**Guy Sorman**

Good morning ladies and gentleman. I am not a neo-conservative because I think neo-conservatism is rooted deeply in US tradition. It is so connected with American history, values and also religion. I have nothing against it, I have tried in many of my books to analyze what neo-conservatism is also about. I am a French scholar and we don't have this tradition in France, for one thing religion is not so much of strong influence on the political and intellectual of France. So I just see myself as a classical liberal which has a long economic intellectual and political tradition starting in the 18th century which I modestly try to pursue, illustrated by remarkable scholars like Tocqueville in 19th Century. So neo-conservatism is for us something a bit exotic.

If we shift now to the subject, what I will not demonstrate but illustrate this morning is the reason why the US economy is the leading economy for more than one century now. These reasons are still there and strongly there and I don't see these reasons as being threatened in the coming years. To explain why I will quote nine items to make things more simple and clear, also in the second part more rapidly and I hope we can discuss about it, I will compare the advantages of the US vis-à-vis the emerging advantages of new continents like Brazil, China, India and the situation of the European Union.

I want to say at the beginning of the discussion, that my hypothesis for the discussion is that the US still had and I don't see why they would lose their place in the coming decades. The strength of the United States, you know this country as well as I do so there will be no surprise in my conference but maybe I will give you a different view on things you already know.

First item and the fundamental reason why the US is a booming and dynamic economy is that the United States is the land of what the economist Schumpeter called a "destructive creation". What do I mean by "destructive creation"? When a company doesn't work, is not profitable anymore, is not promising, it is destroyed to be replaced.

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This is an attitude towards innovation that you do not find in Europe. When a company is threatened by innovation or competition the spontaneous reaction in Europe will be to protect and subsidize the company and try to keep it going for as long as possible. The American attitude is the reverse, first you try to destroy the company then you build a new one. And the argument of Schumpeter was that the US was a very creative economy because it was a destructive economy. From the outside foreigners will say, look their companies they are going bankrupt, Pan-Americanism has disappeared, and major companies have disappeared, other companies are taken over by foreigners in the automobile industry. From an American perspective that is good, if they are bankrupt it's because they deserve to go bankrupt, there is no nostalgia, neither any political or economic investment in keeping, at any price, through protection and subsidies companies which are always perceived as being temporary and not part of the landscape forever.

Of course I won't go into details, this notion of this "creative destruction" has legal and political consequences. Among the legal consequences, the US insists on the importance of bankruptcy laws, because it must be easy to get into business and it must be easy to get out of business. If you compare the US to other countries, many comparisons have been made with Europe for instance, it is much more easier legally and financially to build a company and it also easy to get out of this company. So in this destructive creation process, the bankruptcy laws are a key element of flexibility in the US economy. And I think it is the only economy where bankruptcy laws are considered the major instrument of economic dynamism. Bankruptcy is viewed not as a failure but as a moment, as an instrument in economic dynamism.

The second point, which is more common, that in the United State there is a strong division, a wall in everything being related between economics and politics. It is non-politicized economy that means the major economic decisions are usually, there are exceptions of course, made without political interference. You have lobbying and these things but mostly, if we look at the global picture, it is a non-politicized economy. The strategy of the enterprises are taken into consideration without any connection to politics and the major institutions which impact the economy in the US, legal, financial institutions, judicial institutions are independent from politics. The best illustration of this independence is the Federal Reserve Board, the fact that the state overall has very few influences in terms of economic policy. It is very significant that there is no economic minister. And if there is no economic minister why? Because the US does not consider

that in a free-market it's duty is to intervene in the economy as such. And even if there were an economic minister, there would not be any major instruments for the minister to influence the economy. Therefore in the institutions you see this clear distinction between economic decisions and political decisions.

The third item, which explains the competitive nature of the United States, is that the United States is globally a land of low taxation. If we compare once again with Europe for example, Europe between 1950 until today, the percentage of public expenses, state expenses mostly has doubled in less than fifty years. We went from less than 30% to more than 50% of public expenses in our GDP. If you look at the same figure in the United States, the public budget is relatively the same as it was in 1950, it's less than 25% of the GDP. If you go into the details, if you look at the composition of the budget you don't find the same items, for example military expenses has gone down tremendously. In the 1950s, military expenses were almost half of the budget during the Korean War for example. Today with the Iraq War, military expenses represents 3% of GDP. So military expenses went down but welfare expenses went up. So welfare expenses which nearly did not exist in 1950, today is a major expenditure. Which is a risk for the future of the budget and the future of the American economy. There are more political requirement and pressures to increase the welfare and also the baby boomers now entering into retirement are asking for pensions and retirement that we have in Europe and do not have in the United States. Therefore in the US this very low budget and taxation are still there but in the future could be threatened by different demographics and different political requirements, it is a major threat for the balance of public finance in the United States.

Number four. Always in terms of comparative advantage. The US has, as we all know, a very flexible labor market. It is very flexible for two reasons, the first reason is that you have a labor supply that is nearly infinite because of immigration, legally or illegally several million people join the workforce every year in the United States, half of them legal, half of them illegal, the illegal ones stay. So this is a constant labor supply, because of this constant labor supply wages are relatively low in the United States, much lower than in Western Europe for example. And because social security being very small in the United States, the taxes on labor are also very small, so this may explain that many industries that are not so modern, not so hi-tech or many services are not hi-tech at all are doing very well in the US. In textiles or in electronics, you know that many companies have the choice between producing in the US or exporting to the

rest of the world. It may seem very strange, in Southern California you have very low-tech textile industries and you just wonder why they are not in China. But that is because the labor is so cheap and the flexibility of the labor laws as such there is no reason to de-industrialize the United States. And there were a lot of talks 20 years ago to de-industrialize the United States, but this in reality did not occur, the US is still an industrial country.

Another favorable aspect of the labor market from an economic perspective is that the workers are very low production. So that they get in and out of the market very easily, it is the name of the game, very different from Europe. It's also a country of very low conflicts, you have very few strikes, strikes are very short and strikes are usually limited to specific sectors like the transport sector or as everyone knows, the automobile sector which is why the automobile sector has some of the largest wages in America and they are not very competitive. But if we take out this very peculiar sector for historical reasons, a relative flexible labor market with relatively low wages and low conflict.

Number five, in spite of all that is written on the energy dependence of the United States and the rising price of oil, the United States is not that much energy dependent and it will be less and less so. What do I mean by that? By productivity gain the United States like any modern country is consuming less and less energy relative to what they produce. The new industries, the new facilities, the new real estates that are being built in the United States are less and less energy consuming. One consequence is that the raise in oil prices had no impact on American growth. If you remember what happened in 1973 and if you compare with today, the oil price raises in 1973 disrupted Western economies. Today? No. It practically has no impact. On top of it, moreover, if prices were rising even more, the United States has many possibilities for substitutions, they have oil, they have gas, which they don't use because it is relatively costly or because of environmental groups opposing this, they have a very much under-equipped nuclear energy but there are more and more debates about the construction of new nuclear facilities to produce energy. So there is a lot of flexibility as far as energy is concerned. And they are not so energy dependent, neither for the prices nor for the production.

Number six, the US dollar. The US dollar has a huge advantage because for the entrepreneurs or for the borrowers, for any American it is easy to borrow money, you have an abundant and unlimited supply of money and the rates are relatively low

because of the abundance of supply. This comes from the fact that the dollar *is* the reserve currency. Now, is the dollar threatened as a reserve currency and this easiness to borrow at a relatively low price, which is a factor in the US economic dynamism, will it disappear or not? It could disappear but which currency would replace the dollar? Nobody knows. Right now, it is impossible to say one currency, neither the Chinese currency nor the Euro are in a position to replace the US dollar. Because to become a reserve currency you must have a long history, the markets look at the history and look at the institutions, which are the ultimate guarantee of your reserve currency. The Federal Reserve Board has a long history, the banking system also has a long history in the United States of safety, the same with the Treasury Bonds. In the case of the Euro, the institutions are still too young, they are still too controversial within Europe itself, so it is not very tempting for an investor to move to shift from the dollar to a currency that is an unknown and still an unpredictable currency and of course this will be much worse in the case of China. So, so far, in spite of all debate on the US dollar that has been going on for so many years, the dollar going up and down and being completely unpredictable it is still not threatened in its role as a global currency. And this gives a tremendous financial advantage to the American entrepreneurs. Some economists in the US consider that 1% every year of US growth can be explained by the privilege of having the dollar as the reserve currency because it gives easy access to the capital markets and a decisive help for investment.

Item number seven. One of the characteristics of the US economy, which I think, is significant today, it was not the case of 25 years ago, monopolies are rather well accepted in the United States. The old judicial movement against big companies and the destruction of monopolies stopped in the early 80s. AT&T was a major monopoly that was destroyed by a major legal decision. But since the early 80s all major companies have not suffered this kind of legal action. The best example being Microsoft. The US system considers that a company can be a monopoly in the United States but is not a monopoly on the global scene. Therefore the definition of a monopoly has changed, very convenient and there is no reason to destroy a monopoly like it was. It is significant that Microsoft has escaped the American justice and is falling vis-à-vis European justice. They have problems with the European Commission and the European legal system, which is forcing Microsoft to pay a huge fine and trying to disassemble their operations. This is a European decision, it is not an American decision.

Number eight, and there are only nine so I am coming to the end. Number eight, maybe it's number eight but it is important, it is the quality of higher education in the United States. You cannot understand the dynamism of the United States if you do not understand that this country is the leading country of producing innovation. Ideas, ideas that can be transformed into economic assets and these ideas don't come out of the blue they come out of the excellent centers of American universities. So if I was to isolate one single factor of the American edge in economic terms and one factor that you don't find in the rest of the world, it is evidently the university system. This university system, the fact that it is very good, the fact that it is very competitive and the fact that it is very expensive is very meaningful. It is very expensive because higher education costs a lot, you need to invest a lot in order to attract the best professors from around the world and to attract the best students from all over the world. It is a heavy investment and it is a private investment, as you know in most of the cases. Why are students ready to pay \$50,000 a year in tuition excluding the rest? Because they know it is the best investment in their life and the return in investment will be very high. And more and more in the case of the American economy, there is a premium on education that is increasing every year. Many social observers say that inequality is increasing in the US. True, people at the top are making more and more money. If you are wondering why they are making lots of money it is because they have invested in their education and they have a huge education premium. So in order to improve equality in the United States, what is necessary to do is not a social policy or a redistribution policy, it is to invest more and more in a better education system, the universities are very good, colleges are not and high schools are a disaster. There is a lot of work to be done and this is a key factor. And I am not sure if this heavy investment in higher education and this connection between high investment in education and the economy is well understood abroad by other countries. It is certainly well understood by the students because Korean students and French students try to reach a US campus as soon as they can.

Number nine and the last one. One of the most remarkable things in the US economy since thirty years is you have business cycles but no depression. You can never be sure, economists don't like to make predictions, but it is very unlikely that you will have a depression in the United States. You have business cycles, which are provoked by objective reasons for example significant change in technology. When you shift from the industrial sector to the innovation sector, you have an objective reason to bring a business cycle. When the financial sector is making mistakes as we recently see, you

have reasons for a business cycle. A business cycle is not a depression. If we look at the long run, I could quote the economist from Minneapolis Edward Prescott, Prescott remarks "the growth of the US economy started at the very end of the 19th Century and in fact it has been the dominant economy in terms of innovation and growth since the end of the 19th Century." And if you calculate the trend not on a yearly basis but on a long run basis, the trend is 2% and 2% each year in one century makes you very rich. The trend is 2% and the return on investment since one century is 4%. Those are the key figures of the US economy. In the long run, no country has been able to produce such sustainable and predictable growth. This is one of the reasons why I do not see any major threat or change in the dynamism of the American economy.

Some rapid remarks on competition. Europe. First of all, to talk in terms of competition between Europe and the United States is rather artificial. We are not at war, we share the same civilization and many of our companies are global. This notion of opposing county versus country in the modern global economy does not have much meaning because of the interdependence, especially in the case of Europe. If you wanted to oppose France versus Germany, for example, we are so interdependent. So to oppose two countries as if they were two champions, economically has no meaning. This being said, globally Europe excluding the UK is lacking in terms of growth, in term of innovation and in terms of higher education. I won't elaborate on the deep reasons for this situation, I just want to mention that the reasons are deep, they have to do with demographics, and they have to do with the way people see their future. They also have to do and I think this is the decisive factor, with the very important welfare system that we have all over Europe.

It has been decided collectively after World War II to invest massively in a welfare sector, health care, pension and social security. It is a kind of political and social choice, which the United States decided to avoid. Because of this social choice in Europe, that you can approve or disapprove, it is a trade-off. You have a better welfare you have less growth. Why is there less growth? Because in order to pay for welfare you have to increase taxes and you have to increase the importance of the public sector. And we know that the productivity of the public sector is less that that of the private sector. So once again, it is a trade-off. You can't have the best of both worlds, you can't have a very good welfare system and a high growing economy. And if you have a high growing economy like in the US, you will have a poor welfare sector. So, the collective choices are different and so the consequences are different. European governments are doing

much efforts and it is being done in the UK, it is being done by Schroeder in Germany, by Prodi in Italy, by Sarkozy in France to improve a little bit, to change a bit the balance between the productive sector and non-productive sector. What the government can do is to change the balance, to modify a little bit the line. But with a country that spends more than half of its production and a country like the United States that spends a quarter of its production, the difference, the gap will remain enormous. Therefore in terms of innovation we can do a little bit better than we do, but we still stay much behind because we have a different model.

Some short words on China and India. China is not a competitor for anybody I would say. Neither for United States nor Europe. China is an extremely poor country, it started off from a very low level that they have a very high growth rate. But this growth rate is not very extraordinary, it is comparable to the growth rate of emerging East Asian economies in 40s and 50s. Nothing better than what Korea or Taiwan did in the past, there is nothing fascinating or nothing new about China. The only new aspect is the size, but the method, export-orientated cheap goods, is well know. And this is not, so far, a threat for anybody. In the case of the United States and Europe, because of China's cheap production we live much better, consumer prices are going down not only in textiles and in electronics but everywhere. Because every time you introduce Chinese components in the production process you lower down your production costs. So in a way, the whole world is benefiting from Chinese low labor costs, because the Chinese low labor costs is incorporated into the cost. And one of the reasons we don't have inflation in the West is because China by providing all these cheap goods is keeping prices down. It is not always perceived because people see in their specific sectors, if you are a textile producer in Mexico or Bangladesh, you can be bankrupt because of the China's competition. This is the name of the game, you just try to be more sophisticated than the Chinese. You have an emerging country like Turkey, which is doing very well. Turkey was heavily into textile, they are still in textile, but because China is getting into textile, they are getting into more sophisticated textile. China is not a threat. It is an incentive. Growth for China is good for China and is good for the world. So I don't see China becoming a world leader because of their poverty and their low level where they are right now. And on top of it, China is a very unpredictable country. Institutions are not there, you don't have predictable economic institutions, you don't have property rights, you don't have an independent justice system and you have a political system that does not guarantee the stability of the system itself. Some Chinese say that they are very lucky thus far since Deng Xiaoping to have enlightened leaders.



But the process of selection of the leaders does not necessarily lead to a process of delivering an enlightened leader. So you don't know what the next leaders will be. And also in the case of China, the strategy that has been chosen, it has been chosen by the leader, the people have not approved it. We don't know what the people think. So you can't say there is an economic consensus in China, we absolutely don't know.

If I can compare China with India, India has a growth rate, which is now exactly the same as China. China is around 10% and India is 9 and 10%, in terms of economic growth they are the same. Do I see India as a threat for the world and as the next global leader? Also not. Because until they have resolved their domestic problems, it will take at least one century. They are following a different strategy, they are more domestic-orientated, they are less orientated to exports, it is more stable growth, it is less centralized, it is based on more small and medium-sized companies, it is less disruptive for the people and it is based on a political consensus. All political parties have approved the Indian strategy, which has been followed now for ten years. Therefore India is very predictable. China is less predictable. In both cases you have two poor countries that must not be considered a threat to the world in economic terms. One final remark, when I come to this part of the world what strikes me is that the most important nation in this part of the world is never mentioned. Everybody is so focused on China and India that we tend to forget that you have Japan. It's not because Japan has very slow growth in ten years that Japan has become a minor economic force. I think you can expect a Japanese comeback and I think that Japan is more of a major actor economically than China or India. The debate on China is actually based on a cultural fascination for China and because of the size of China. But China for a long time to come will remain a minor player as far as economic forces are concerned.

### **Questions & Answers**

**Q** Will you make a comment on the problem of the current deficits in the US, the trade deficits and budget deficits, many people are saying it is not sustainable but people have been saying that for more than ten or twenty years but there might be some limit.

**A** Yes, you are right. It has been more than ten years that the deficit has been supposedly non-sustainable. Why has it been sustainable? It is sustainable firstly

because the US economy is growing. In a growing economy to finance the public deficit is not a problem, and the relationship between the public deficit and the US economy is very small. So it is not a real economic challenge, it is political challenge. And the deficit is more used as a political instrument to say, "look you are unable to manage resources". But in fact in economic terms, as you know, the public deficit is only a problem if it is financed by inflation. In the US it is not financed by inflation but it is financed by credit and this credit is very reliable. So people would say "yes, but it is financed by credit that is borrowed abroad." What if the Russians, the Chinese, the Korean and the Japanese take their money out of the United States? They could do that theoretically, but they know that if they do that it would be a kind of suicide. Because they know they would be the first victims of a bankruptcy of the US system. We are happily in a period where central bank leaders are quite well enlightened. Everybody now at the head of major countries knows how the economy works. In the case of China and also some of the Arab countries that lend a lot of money to the US, they know what they do. They lend money to the US because it is a safe investment. It is the safest investment on earth, even if it is not a profitable it is safe. And what people are looking for is safety. I see no risk in why the money would suddenly leave the United States and shift to another currency, where would they go? They have nowhere to go. The system is stable and I think it can be predicated as stable.

Now for the exchange deficit, it is a little bit of the same story. The exchange balance deficit is a great advantage for the world, because of this deficit China is booming. It is because US consumers are buying too many Chinese goods, too many Korean goods, and too many Indian goods. This is why these countries are booming. So everybody is happy with this kind of deal, for American consumers life is cheap and for the Chinese producers life is good. Everybody knows how this trade-off works, once again you have people advocating the trouble ahead, what happens if there is a panic? Well, if there is a panic the dollar will go down, which is happening right now and the US will export more and that would be bad for the Chinese. So everybody is interdependent and the twin deficits are only a part of this interdependence. It shows the cycle is closed and how all these nations are dependent on the leading nation. And the leading nation must have a deficit because it is through the deficit that it can act as an engine of export for developing countries.

**Q** I really enjoyed your presentation this morning. My question is simple. You compared

the United States with the EU in terms of economic dynamism and competitiveness. And you also mentioned there is an unavoidable trade-off in terms of welfare and economic growth. My question is, assuming you were born now and you were free to choose your citizenship, which would you choose?

**A** It is a very good question. Young people would prefer the United States system because they are young, but when you are not young anymore you prefer the European system. When you are in your sixties the European system is perfect because your children will pay for you. But my children are not very happy knowing they have to pay for me.

The demography is a very important explanatory factor. When a population grows older, the political balance goes towards the older people, the government looks at where the majority is. The majority being older, the government will give more satisfaction to the older generation, they will have a very good health care and pension system. So the whole of the Western demographic, it is an increase in the number of percentage of older people and this is not very good for younger people. This choice in favor of welfare versus economic dynamism has negative consequences for younger people because it is more and more difficult for them to find a job.

So there again, it is a trade off, that is the problem with economics it is always a trade off, no system is perfect. When people criticize Europe or the United States, they say Europe is not dynamic enough. Ok, we made a trade off in favor of welfare. Other people will criticize the United States, look no welfare, no national insurance for everybody. Ok, but you have economic dynamism. Economic science works that way, you have to choose between the less bad solutions.

**Q** I have one comment to Mr. Sorman. I have been living in the United States for 40 years and I happened to visit my home country this week. And I am very fortunate to be present at you lecture this morning. I cannot agree more with the nine points you just pointed out. And I would just point out one more element based upon my personal experience on living in the United States for 40 years. The economic tolerance of America goes for individual level as well as institutional level. I think that is rarely seen phenomena that we can only see in the United States.

**Q** I understand many French people don't like to speak English, maybe they don't like the United States itself. You said this morning that the US economy would continue to be very good in the 21st Century. Besides this strong economy, is there any other reason for you to speak English and like the country?

**A** I'm afraid to say that I speak French, the Ambassador confirms. But the French people would love that French would be the global language, but it is not. There was a time when French speakers were only invited to speak only in French. Now we understand more and more, even in cultural circles that what is important is not so much the language but the content. It is better to have people understand you because you speak English but do not understand you because you speak French. So many French politicians, intellectuals and academics choose to speak English because it is a global language. English does not belong to any specific nation anymore. When you go to India, people consider English to be their language and they say, "well, these poor British are in a minority now." and "They have this strange British accent." So it is a global language and I think that is very good. I think it is very good in term of human exchanges, we can communicate through the internet, we know that we will be understood anywhere across the country, so I think it is a huge human and economic and cultural advantage in terms of peace and prosperity to communicate. So English is an instrument of communication.

Now the attitude of the French vis-à-vis the United States, it is a very old story. Quickly I will make one distinction, most of the French people like the United States, they are fascinated by American culture, they like to go there for vacation and if they can they like to study there. We were major allies during wars. But there is another phenomenon that is anti-Americanism. Anti-Americanism is kind of an intellectual or political industry, which is producing books, rhetoric, and political behaviors, columns in the newspapers. But this kind of industry is distinct from the United States as a real nation, so we have to make this distinction. You have to look at anti-Americanism as an ideology as such. Sometimes I would say that even if the US did not exist, still you would have anti-Americanism as an ideology.

**Q** Last night over dinner we were talking about French politics. You have now a new French President Mr. Sarkozy who is bidding to have more market reform and labor market flexibility and so on. Which happened under Merkel in Germany. So in a way,

the major European two economies are adopting or at least trying to adopt some of the merits of Anglo-Saxon market-orientated economy. The French and Germans are used to a state-dominated market socialist system and all this very benevolent social welfare and everything else. So how do you see the Sarkozy's probability of success in implementing all these policies?

In this regard, Dr Lee asked an interesting question whether you were born to today would you adopt the European model or the Anglo-Saxon model. But when you ask that question, I think you have to be more careful about the current level of per capita income. In the case of Korea, for example, the reason why I say this is that many people will say that the European system is good, but the question is if they are willing to pay that much tax and our per capita higher income is not high enough. We have a long way to go, if you are already over 40,000 per capita income level maybe you can afford to. If we go for that model than our economy will not grow strong enough, so we may never reach the level where European economies are today. I think Koreans have to learn a lot of lessons from the French and German experiences and even they are trying to change the policy of their economic directions. So I am very much interested in the Sarkozy reform package, what's your view on this?

**A** I think what is understood now and is a general consensus between all economists and governments, you have a direct relation between tax and growth. If you have higher tax, you have a lower growth. There is direct relation between public expenditure and the dynamism of an economy. When I say this, it was not so evident 30 years ago, when most of the leading economists thought that you were creating consumer demand. This doesn't work, it doesn't work theoretically, it has been tried, and it has failed. Now it is evident that the level of taxation is the absolute condition of the level of your growth.

So, what Sarkozy is doing and what Schroeder did before Ms Merkel is to reduce the level of taxation in order to increase productivity. The problem is that you cannot go very far because people protect their interests and as France is an old population, demographically, as I said before, the limit is a political limit. You can reduce welfare by reducing taxes to a certain extent but you cannot reduce taxes without reducing welfare, everything is connected. So probably what Sarkozy will do and the German government did is to try to shift the balance, to have a little bit less welfare and bit more economic dynamism. But we will not shift from a European system to an American

system, you cannot just move the line. It is enough sometimes, in the case of Germany before the reforms were implemented, the growth rate was 1.8%, now it is 2.3%, which is half a percent. From a Korean perspective where you are accustomed to very high growth rates it looks ridiculous but from us it makes a big difference because we are already very rich. And if you increase your growth rate by half a percent it means you will reduce unemployment by half in one year, what the Germans are doing. So it is only through this kind of modest reform and shift in within system but not by changing the system, we can make the system more sustainable without revolution.

To summarize all Western governments agree on the diagnosis, that's very important, there is a consensus on what works and what doesn't work. As you say in the case of Korea, if you increase taxes you will destroy growth, in France if you reduce taxes you will destroy the welfare system and the people will revolt. The diagnosis is clear but the solutions are very complicated because we live in a very sophisticated political environment where you have to keep your constituency, the people who voted for you and you must avoid revolt from the rest of the population. But in the case of France we are going in the direction of a modest supply side revolution.

And finally as I mentioned before in the case of the United States, and I do very much insist to France on this and I repeatedly say to President Sarkozy we must invest much more in our higher education system. Our higher education is not at that level. It is free, but there is no such thing as a free lunch, it is not efficient and it is not that competitive. So we have to introduce free-market reforms and privatization within the higher education sector, because this is the only way to remain among one of the leading nations in the future.

**Q** Thank you very much, Dr Sorman for your eye-opening lecture, I have a question about the Chinese economy. The size of Chinese GDP is taking 3rd place in the world. And many economists say that the Chinese economy will become the largest in 2030 or 2040, what do you think will happen to the economic leadership of China and US. And I want to remind you that the Chinese economic size was the largest by the 17th Century. When Chinese economic size will be the largest in the world what will happen to the US superpower status.

**A** Well, just because you are fat does not mean you are fast. So far, of course it is

increasing in volume but I'm not fascinated so far by the innovation capacity of the Chinese economy. And I wait until the day when China will overcome other countries like Korea, Japan, Western Europe and the US in terms of innovation or brand innovations. How many global brands are made in China? None. Much is said about the investment in China in the higher education system. Again it is about size, they have huge universities but the quality of these universities is not yet at a global level and the Chinese are the first to admit it. When they need to build the equipment for the Olympic Games in Beijing they ask architects from UK, Europe and the US and foreign engineers. Because they know, that they confess and you can understand that, their engineers and architects are not yet at the level of global competition. So to put size first in terms of the economy is not very significant and also there are some major problems in China that have yet to be solved.

Firstly how do you have the whole population involved in the dynamism of the economy, as you know this is not the case today? The economic gap between the rural and urban population is increasing by the day and the gap is frightening. The Chinese government is mostly investing in the industries related to export because this is more productive in terms of currency, they don't invest much in education and health care. It's as if they forgot that 80% of the Chinese people are not part of this dynamism.

So they have this huge social problem and they have as I said this huge political problem, they have no institution, they have no financial institution, they have no legal property right, they have no institutions, so they rely on the legitimacy of the Communist Party and the "enlightened leaders" that they have at the moment.

So there are so many sources of uncertainty that I am cautious about when making any prediction of China. And once again if you consider that innovation is a leading engine of growth, China is once again behind. Now when I say this, I am not China bashing. I know China, forty years ago it was a very poor country, destroyed by civil war, I see China now as a relatively safe and quiet country with hope for the future for the first time in centuries. And this is very good and this is a source of happiness for everybody. No China-bashing, but no exaggeration and no confusion between size and economic dynamism, which is two different factors.

**Q** Thank you very much for your insightful analysis. I would like to invite your view on the US capability to create or change the rule of economic gain. What I mean is, this

was another important factor that contributed to US power. For example, in the 1940s they created the Bretton Woods system and in the 1970s they actually changed the rule of global monetary system by moving from a fixed exchange rate system to a floating exchange rate system. And in the 1980s they globalized international financial system. So each time they could change the rule of the game. Do you think they will still have that ability to change or adjust the rule of the game in this deepening era of globalization?

**A** Yes, it is a very important remark that you make. If you look at the two fundamental rules on the global scene today, the floating exchange rate and the WTO rules, both are favorable for the United States interests. The floating rate system for the US dollar is perfect because whatever the value of the US dollar, they don't have to make any decision, the other will have to pay, its a very good system for them.

If you look at the WTO, it is a very good system for them because they can put pressure on countries that would resist US imports by saying, "look you don't respect the WTO rule" when they are concerned that they do not respect the WTO rule, like the Western European states on agriculture products for instance. The system is very biased in favor of the US, therefore there is no incentive from within the United States to modify these rules. They will do whatever they can in order to sustain the rules that exist now. But the rules can be changed in a more balanced way by pressure from other countries. In the case of the WTO, the WTO rules make many victims. I'm not just talking about agriculture, many countries in the world for instance Africa they cannot industrialize and they cannot export products because it would go against the WTO rules. If a country today wanted to repeat what Korea did in the 1950s and 1960s, Dr SaKong knows a lot about this, subsidizing exports, giving favorable credit to certain companies so that they can penetrate foreign markets, selecting winners, keeping your domestic market protected from domestic competition. All this which has been the successful strategy of Korea, Taiwan, Japan, all this is not possible today because it is forbidden by the WTO. So the WTO is quite a paradox, supposedly it has created a legal system, a field that is equal for all, it's ok if you are already in the field but if you want to get into it you can't. This can only change if the emerging countries reunite and change the rules. And it is the same in the financial system, which is favorable to the US as I said before.

It can only be changed by pressure by other countries and the best pressure is to



create alternatives to the US dollar. If the Euro becomes a credible and predictable currency in the future or if there is a similar currency to the Euro in this part of Asia, then you will have a system that is more balanced and would be less dependent on the US will. So to summarize reforms will not come from the US but it can come from external pressures.

**Q** In the future if any country aspired to be like the US today, which is the dominant power, how could it foster those factors that you mentioned, is it possible for any country to do that?

**A** I would just emphasize the importance of higher learning. Once again, I will stress that in the contemporary world there is definite premium on education and most countries are behind the US in terms of higher education. And many countries do not study why the US is dominant because they have to chose the free competition between the universities, it is because you can open universities, you can compete for students, professors and so on. If you have a centralized and bureaucratic system you cannot go far. And you have to remember, once again, this costs money but this is the best investment you can make now in any emerging country.