

## Why the Economist gets it wrong?

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Regular readers of the highly respected Economist Magazine do not fail to spot a recurring theme. Japan is going from bad to worse. (See the recent cover story 'The sadness of Japan,' Economist, February 16-22, 2002). The US economy is not as strong as it is made out to be. The Eurozone is faring much better than what it is made out to be. (Read the article, "Farewell euroclerosis," Economist Year Book, "The World in 2002"). The Economist typically carries forward this argument to predict an appreciation of the Euro vis a vis the US Dollar.

In "The World in 2002," The Economist's economics editor, Pam Woodall has written: "The truth is that America's superior economic performance during the past decade has been exaggerated. And thanks to recent reforms, there is good reason to expect growth in the euro area to perk up... Not only has Europe's past economic performance not been as dire as popularly presented, but there is also reason to expect its productivity growth to spurt over the next decade... Unlike America, the euro economies are relatively free of economic imbalances, such as excessive private-sector debt and over-investment, that have dragged America into recession."

Notwithstanding all these arguments, the fact remains that the US is the unchallenged economic superpower of the world. Despite the September 11 attack on the World Trade Centre, the US Dollar continues to do well on the forex markets against both the Yen and the Euro. As the Economist itself argued a few years back, the markets have no ego. If they make a mistake which results in undershooting or overshooting vis a vis the intrinsic value of the currency, they correct the situation, though in some cases with a lag. It is now three years since the Euro was launched. If the dollar continues to do well against the Euro, it means the markets perceive some fundamental strengths in the US economy. After all the strength of a country's currency is a reflection of its economic performance.

When it comes to the yen, the situation is a little different. Though the dollar has appreciated against the yen, the Japanese currency has staged smart recoveries from time to time. And for all the problems in Japan, as reported by The Economist from time to time, the yen has not gone into a tailspin. If all the concerns expressed by the Economist about Japan had been discounted by the markets, the yen would have hit some 170-180 to the dollar by now. And that certainly has not happened.

The main problem with the logic of the Economist is that the competitiveness of a country is not determined as much by macro economic parameters as by micro economic factors. After all, it is companies which compete in the global market place but not countries. So, the long term outlook of an economy critically depends on the speed at which companies are restructuring and adapting to the changing environment. Only then will they be able to provide value to customers in innovative ways. And if they do that on a sustained basis, the economy will go from strength to strength. So will the currency.

The strengths of the US economy need to be understood in terms of its innovative companies in technology driven industries like micro processors, computer software, pharmaceuticals, medical equipment and biotech. These companies are helped in their endeavours by America's deep capital markets which channel venture capital into promising investments. True, there has been some over-investment in information technology, which is probably why we are finding a slowdown in the US. But the adjustment in the form of cut backs in capital spending and inventory liquidation has also been rapid. Moreover, bankruptcy procedures in the US are incredibly fast compared to those in Europe. In short, the ability of US companies to restructure, cut flab and keep innovating remains unquestioned.

Compared to the US, many of the Eurozone countries seem to be muddling their way through. France's anti globalisation rhetoric and strong support to the public sector are eroding its long term competitiveness in an

irreversible way. Labour market rigidities in France and Germany, the two key members of the Eurozone, have created unwanted irritants. Unemployment in most Eurozone countries at the peak of the business cycle is higher than that in the US at the trough.

As for Japan, whatever the macro economic parameters may convey, at a firm level, exciting things are happening. Many Japanese corporations are quietly but surely restructuring themselves and shedding flab. Companies like Sony continue to be innovative. Toyota is as formidable as ever in the global automobile market. Firms like NTT-DoCoMo are demonstrating the ability of Japanese companies to offer innovative Internet based applications. In mobile phone internet access, the Japanese with their established competencies in miniaturisation will be strong competitors. There is also evidence to indicate that Japan's notoriously complicated distribution system is being revamped.

It is time the Economist stopped its pro Euro rhetoric. The Euro is weak because the Eurozone economies have structural problems and will remain so during the foreseeable future. More radical reforms are necessary. Only then may we see a revival in the Euro.

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