DRIVERS OF COMPETITIVENESS

Biswajit Nag
Indian Institute of Foreign Trade
New Delhi, 110016, INDIA

biswajit@iift.ac.in, biswajit.nag@gmail.com
For the company, competitiveness is the ability to provide products and services as or more effectively and efficiently than the relevant competitors.

In the traded sector, this means sustained success in international markets without protection or subsidies.

Although transportation costs might allow firms from a nation to compete successfully in their home market or in adjacent markets, competitiveness usually refers to advantage obtained through superior productivity.
Measures of competitiveness in the traded sector include firm profitability, firm's export quotient, and regional or global market share.

In the traded sector, performance in the international marketplace provides a direct measure of the firm's competitiveness.
Industry Competitiveness

- At the industry level, competitiveness is the ability of the nation's firms to achieve sustained success against (or compared to) foreign competitors, without protection or subsidies.

- Measures of competitiveness at the industry level include overall profitability of the nation's firms in the industry, the nation's trade balance in the industry, the balance of outbound and inbound foreign direct investment, and direct measures of cost and quality at the industry level.

- The success of a single firm from the nation might be due to company-specific factors that are difficult to reproduce. The success of several firms from the nation in an industry, on the other hand, is often evidence of nation-specific factors that might be extended and improved. Competitiveness of a single firm does not necessarily imply the competitiveness of an industry.
For the nation, competitiveness means the ability of the nation's citizens to achieve a high and rising standard of living. In most nations, the standard of living is determined by the productivity with which the nation's resources are deployed, the output of the economy per unit of labor and/or capital employed. A high and rising standard of living for all the nation's citizens can be sustained only by continual improvements in productivity, either through achieving higher productivity in existing businesses or through successful entry into higher productivity businesses.

Competitiveness at the national level is measured by the level and growth of the nation's standard of living, the level and growth of aggregate productivity, and the ability of the nation's firms to increase their penetration of world markets through exports or foreign direct investment.
Competitiveness is vital if the nation's firms are to take advantage of the opportunities presented by the international economy.

World trade and foreign investment have grown faster in the last several decades than world output. Competitiveness in industries subject to international trade and foreign direct investment can therefore provide substantial leverage for economic growth.

It can allow firms to overcome the limitations of relatively small home markets in order to achieve their maximum potential.
Lower costs for transportation and communication, reduced trade barriers, and the spread of technology have combined to sharpen international competition. This competition has put unprecedented pressure on all a nation's economic actors, including management, labor, and government.

There is a growing realization that nations cannot avoid the rigors of international competition.

The experience of developing nations in the 1980s has indicated that attempts to isolate an economy can have lasting detrimental effects. This is particularly true for small nations, in which the costs generated by economic isolation in terms of rent seeking and losses in efficiency can be substantial, and for developing nations, in which any loss of efficiency often means higher levels of poverty.
Consistently subsidized exports are not evidence that a firm or an industry is "competitive." Although there are infant industry arguments that might support some level of subsidies in an industry's early stages, exports that depend on ongoing subsidies are more evidence of the nation's ability and willingness to subsidize than evidence of firm or industry competitiveness.

Unless the firm or industry is self-sustaining and can compete successfully on its own without subsidies, it is not truly competitive.

Competitiveness for the nation does not mean export success in every industry, or even most industries. Clearly, no nation can sustain a trade surplus in every sector of the economy. Indeed, the very specialization required to achieve international success in some industries in the nation implies that other industries will be less successful in terms of their export performance.
Understanding of Competitiveness

- Competitiveness for the nation does not require the nation to preserve its existing industrial base. Nations progress when their firms improve productivity in industries or segments in which they already compete and when they gradually enter industries or segments that involve higher productivity.

- In this process, some industries are inevitably left behind. Exit from some industries is the natural consequence of the process of economic development. Governments that fight to save every industry can slow down the advance of the economy by trapping resources that would be best deployed elsewhere.

- Even the most advanced and economically successful nations, have substantial portions of the economy in which they are not competitive.
Competitiveness based exclusively on low wages will be to some extent self-limiting in the long run unless productivity is increased through the development of higher skill levels, incorporation of more advanced technology, or the institution of better management techniques.

Similarly it is true that advantage a country is enjoying by devaluing its currency is also not competitive advantage in true sense.

The road towards achieving competitiveness is also partly unique for every nation. The knowledge of what makes a firm, industry, or nation competitive provides a direction for improving firms and upgrading national economies. The challenge of improving productivity across industries is one faced by every nation. Some simply have farther to go than others.
Drivers of Competitiveness

- Comparative advantage: Technology driven or endowment driven?
- FDI driven or domestic investment driven?
- External and internal economies of scale (external: industrial clusters, SEZ, QIZ etc.) (internal: technology, value chain, management system)
- Input-output relations: Innovation system
- Human Capital improvement
- Trade and Institutions driven
- International production Network
- Distribution and marketing channels
Stages of Economic Development and Drivers of Competitiveness

- Resource Driven Stage
- Efficiency Driven Stage (through increasing investment)
- Innovation Driven Stage
At the most basic level of economic development, competitive advantage is determined by resources, such as low-cost labour and access to natural resources.

Many developing countries, and most least developed countries, are mired in this stage. The export mix is extremely narrow and typically limited to low value-added products. Dependence on international business intermediaries is high, and margins are low and susceptible to swings in prices and terms of trade. Technology is assimilated through imports, imitation and foreign direct investment (FDI).

In this stage, strategy-makers should design strategies to attract capital investment and to invest the proceeds of economic growth into the wider determinants of national competitiveness, specifically health, education and infrastructure.
One level up is the investment-driven stage, where countries begin to develop competitive advantage by improving their efficiencies and developing increasingly sophisticated products. Improvements are made to imported technologies; there is extensive joint venturing and heavy investment in trade-related infrastructure (roads, telecommunications and ports).

The focus of the national export strategy at this second stage should be on further improving the business environment through revisions in regulatory arrangements (customs, taxation and company law). Strategy should assist prospective exporting firms to extend their capabilities within the international value chain. As production shifts from commodities towards manufacturing, sector-level strategy should seek to support greater value-addition nationally within the value chain. While promotion of FDI should, of course, continue to be a strategic priority, strategy-makers should focus increasingly on encouraging in-country business alliances.
INNOVATION-DRIVEN STAGE

- At the final stage in the competitiveness process, the innovation-driven stage, the country’s competitive advantage lies in its ability to innovate and produce products and services at the frontier of global technology.

- Strategy should focus on technological diffusion and on establishing an increasingly efficient national environment for innovation. The emphasis should be on supporting institutions and extending incentives that reinforce innovation within the business sector. Companies should be encouraged to compete on the basis of unique strategies. The development of service export capacities should be a priority objective.

- However, strategy-makers should not take progress from one stage to the next for granted. As Peter Cornelius of the World Economic Forum pointed out at the Executive Forum 2002: “The transition through the different stages is not necessarily linear or gradual. Nor does it happen automatically.”
THE 12 PILLARS OF COMPETITIVENESS

**Basic requirements**
- Institutions
- Infrastructure
- Macroeconomic stability
- Health and primary education

**Efficiency enhancers**
- Higher education and training
- Goods market efficiency
- Labor market efficiency
- Financial market sophistication
- Technological readiness
- Market size

**Innovation and sophistication factors**
- Business sophistication
- Innovation

Key for factor-driven economies
Key for efficiency-driven economies
Key for innovation-driven economies
### Classification of Countries into Stages of Development

<table>
<thead>
<tr>
<th>Stage of Development</th>
<th>Countries in This Stage (Example)</th>
<th>Important Areas of Competitiveness</th>
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<tbody>
<tr>
<td>Stage 1 (Factor Driven)</td>
<td>India, China, Egypt, Syria, Morocco</td>
<td>Basic Requirements (Critical) and Efficiency Enhancers (Very Important)</td>
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<tr>
<td>Transition from 1 to 2</td>
<td>Colombia, Algeria, Libya, Thailand, Jordan, Oman</td>
<td>Basic Requirements (Critical) and Efficiency Enhancers (Increasingly Important)</td>
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<tr>
<td>Stage 2 (Efficiency Driven)</td>
<td>Turkey, Russian Federation</td>
<td>Basic Requirements (Very Important) and Efficiency Enhancers (Critical)</td>
</tr>
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<td>Transition from 2 to 3</td>
<td>Bahrain, Barbados, Korea, Czech Republic</td>
<td>Same as above but Innovation Factors become Increasingly Important</td>
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<tr>
<td>Stage 3 (Innovation Driven)</td>
<td>United States, United Kingdom, UAE, Japan</td>
<td>All three areas important: Basic Requirements, Efficiency Enhancers and Innovation Factors</td>
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Why does FDI improve Competitiveness?

- **Foreign direct investment (FDI)** in its classic form is defined as a company from one country making a physical investment into building a factory in another country. It is the establishment of an enterprise by a foreigner. Its definition can be extended to include investments made to acquire lasting interest in enterprises operating outside of the economy of the investor.

- **ADVANTAGES OF FDI**
  
  Foreign direct investment permits the transfer of technologies. This is done basically in the way of provision of capital inputs. The importance of this factor lies in the fact that this transfer of technologies cannot be accomplished by way of trading of goods and services as well as investment of financial resources.

  It also assists in the promotion of the competition within the local input market of a country.
EXTERNAL ECONOMIES OF SCALE

- External economies of scale occur outside of a firm, within an industry. Thus, when an industry's scope of operations expands due to, for example, the creation of a better transportation network, resulting in a subsequent decrease in cost for a company working within that industry, external economies of scale are said to have been achieved. With external ES, all firms within the industry will benefit.

- SMEs are generally deprived of external economies due to their small size. Hence to improve competitiveness clusters, EPZ etc are formed with several common facilities (such as common leather effluent plant). This may be done through public or private or public-private initiatives.
A Special Economic Zone (SEZ) is a geographical region that has economic laws that are more liberal than a country's typical economic laws. The category 'SEZ' covers a broad range of more specific zone types, including Free Trade Zones (FTZ), Export Processing Zones (EPZ), Free Zones (FZ), Industrial Estates (IE), Free Ports, Urban Enterprise Zones and others. Usually the goal of a structure is to increase foreign investment.

Qualifying Industrial Zones (QIZ) are industrial parks that house manufacturing operations in Jordan and Egypt. They are a special free trade zones established in collaboration with Israel to take advantage of the free trade agreements between the United States and Israel. Under the agreements goods produced in QIZ-notified areas can directly access US markets without tariffs or quota restrictions, subject to certain conditions.
INTERNAL ECONOMIES OF SCALE

- As firms become larger and their scale of operations increase they are able to experience reductions in their average costs of production. The firm is said to be experiencing increasing returns to scale. Increasing returns to scale results in the firm's output increasing at a greater proportion than its inputs and hence its total costs. As a consequence its average costs fall.

  1. Technical economies. They are found mostly in plants and arise mostly because neither the capital cost nor the running cost of plants increase in proportion to their size. The main idea is to spread the fixed costs over as large output as possible, so AFC decreases.

  2. Managerial or administrative economies arise because the same people can usually manage with bigger output, so average administrative cost decreases when production increases. Large firms can employ specialists, which leads to the increase in efficiency.
Human capital refers to the stock of skills and knowledge embodied in the ability to perform labor so as to produce economic value. It is the skills and knowledge gained by a worker through education and experience. Many early economic theories refer to it simply as labor, one of three factors of production, and consider it to be a fungible resource – homogeneous and easily interchangeable.

The economic crisis engulfing many Less Developed Countries (LDC’s) has focused attention on the fragility of their financial sector. But longer-term need of many LDC’s economies is to boost technological capability. While the physical capital is no longer the main problem for most of them, they need to improve their human capital by giving them appropriate skill and knowledge through educational improvement policy.
DIVERSE LITERATURE AND EVOLVING CONCEPTS AND ASSOCIATED PRACTICE

- Recent and not-so-recent schools – examples
  + Micro-foundation of competitiveness (Porter)
  + Industry-specific approach (Mc Kinsey)
  + Institutions (Rodrik and Sabel)

- Pervasive in the more “generalist” literature (Lucas, Romer, Krueger, Bhagwati, etc.)
Sound macroeconomic policies and stable political and legal institutions are necessary but not sufficient conditions to ensure a prosperous economy.

Competitiveness, based on the productivity with which nations produce goods and services, is rooted in a nation’s microeconomic fundamentals.
Methodology to examine the binding constraints in factor markets in specific export industries of interest to developing countries (garments, agriculture, metals and minerals, tourism, light manufacturing)

It is not about ‘picking winners’, especially in low-income countries with obvious revealed comparative advantages and limited institutional capacity

It is about informing macro-policy making (e.g., exchange rate policy, fiscal policy, labor policy, land policy, competition policy, etc.) so that constraints can be taken care of.

Source: Palmade (2005)
Market failures contribute to slow growth and demand proactive policies

New approach to ‘Industrial policy’ to speed up the process of structural change towards higher productivity activities

- Emphasis on getting right the strategic collaboration with the private sector
- Emphasis on processes and procedures as opposed to specific policy instruments or sectors (old industrial policy)
- Gradual, cumulatively transformative change through identification of bottlenecks and self-correction