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On the concept of 'competitiveness' and its usefulness for policy

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ABSTRACT

This paper examines the coherence and usefulness of the contentious concept of 'national competitiveness'. We undertake an interpretative review of the various uses of the concept in international economics. It is argued (á la Erik Reinert) that the concept of competitiveness is coherent in the presence of dynamic externalities, with a 'winner picking' exercise, by social planners, at its core. However, its usefulness for real-world policymaking can be limited because of practical problems (political and information imperfections) of picking the 'real winners'. These problems are nonetheless not insurmountable. There is ample evidence that competitiveness strategies can work if they are the 'right' kind for a given political configuration.

1. Introduction

There is evidently a widespread interest in the issue of competitiveness at a national level. Many national and supranational bodies now monitor competitiveness of national economies, of which the most prominent is the World Economic Forum, which publishes an annual *Global Competitiveness Report* that includes the *World Competitiveness Index*[1]. The concern for 'competitiveness' (whatever that means) is not limited to poor countries aspiring to revive their stagnant industrial activities, but it is shared by developed countries (keen to maintain their lead in high-tech high-wage industries), and by newly industrialized economies seeking to raise their production and export shares in high-wage sectors (Lall, 2001, p. 1501; see also Vietor, 2007; Schneider, 2013).

The sluggish recovery of the global economy since the recent financial crisis seems to have intensified the competitive – and the associated protectionist – instinct (Georgiadis and Gräb, 2013)[2]. On the conclusion of the London 2012 Olympics voices were heard calling for Britain to replicate the extraordinary success of Team GB (Great

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[1] Examples of national agencies include the US Council on Competitiveness, and UK Department of Trade and Industry which occasional publishes reports on UK competitiveness. See Bristow (2005) and Schneider (2013) for an extended list of white papers and councils.

[2] The resistance within both the major parties in the U.S. against the proposed deals on Transatlantic Trade and Investment Partnership and the Trans-Pacific Partnership is a reflection of the growing anti-trade momentum in the country (The Economist, 2014, p. 72). In September 2012 alone, Argentina lodged a complaint against Spain (over bio-fuels) and against America (over lemons and beef). "Altogether, tit-for-tat actions mean that new restrictions cover 4% of global trade" (The Economist, 2012, p. 12).

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Britain) by picking industrial 'winners'. The reference to picking winners had to do with the highly 'medal-targeted' (rather than indiscriminate) 9 billion £ support and preparation by Britain's Olympics Team[3]. In academia too, specially with applied economists and business theorists, 'competitiveness' is a perennial issue (see Porter, 1990, 2003; Honohan and Walsh, 2002; Salvatore, 2010; Porter and Rivkin, 2012a, 2012b).

However, the concept of competitiveness is highly controversial and often described as "chaotic and ill-defined" (Bristow, 2005, p. 291; see also Lovering, 2001). The concept seems almost alien to neoclassical economics, and is, in some quarters, considered to be "a meaningless word when applied to national economies" (Krugman, 1996a, p. 22; see also Venables, 1996; Friedman and Friedman, 1997). "Not one of the text books on international economics I have on my shelves contains the word in its index" (Krugman, 1996b, p. 24). What do these writers then mean by international competitiveness? Are they using it as what Paul Krugman suspects to be "a poetic way of saying productivity" or are they implying the existence of a potential conflict between countries in international economic relations?

The purpose of this paper is to critically review the various uses of the concept of competitiveness in international economics in order to answer the following two related questions. (1) Is there a coherent meaning of international 'competitiveness' as distinct from the uncontroversial concepts of 'productivity', 'comparative advantage' and 'trade patterns'? (2) Even if international 'competitiveness' had a coherent meaning, would it be a useful concept, in the sense of: is it possible in practice to mount a national competitiveness strategy[4]?

Given the longstanding debate on the issue, one might wonder what else would be left to discuss about international competitiveness. But it can be argued that the extensive discussion in the literature hasn't helped to bring a consensus in the meaning and definition of the concept. Indeed, the various protagonists on the competitiveness debate now appear as if they had agreed to disagree on this 'elusive' concept and have thus ceased to question each other's views. Worse still, the precise points for the disagreement are not quite clear and consequently the twin questions of 'coherence' and 'usefulness' of the concept of competitiveness remain controversial. As pointed out by Porter and Rivkin (2012a) the concept of competitiveness is "widely misunderstood, with dangerous consequences for political discourse, policy, and corporate choices that are all too evident today" (p. 56). The misunderstandings and controversies are perhaps inevitable given the intricacy of competitiveness issues, which Cantwell (2006, p. 560) characterizes as "issues of structural change at an aggregate level".

Our aim is not to provide an unequivocal answer to these two questions but to lay out the debate surrounding international competitiveness in rather informal terms and explore the persuasiveness of the various arguments. In essence this paper can be regarded as complementing Reinert's (1995) grand treatment of the concept of 'competitiveness'—by drawing from more recent literature (including his own) and a discussion of the usefulness of the concept for policy.

We will argue that while the concept of competitiveness is coherent in the presence of dynamic externalities, its usefulness for real world policymaking can be limited because of practical problems of 'picking winners'. These problems are nonetheless not insurmountable. There is ample evidence that competitiveness strategies can work if they are the 'right' kind for a given political configuration. We will begin in the next section with the neoclassical economics' position which essentially dismisses international competitiveness as a concept devoid of a coherent meaning. In Section 3 we discuss what may be called the 'quasi-competitiveness' view. Section 4 presents the view of what we call the 'competitiveness school'. In Section 5 we summarize the discussions to address the questions of 'coherence' and 'usefulness' of the concept of competitiveness. Section 6 presents concluding remarks.

2. Neoclassical economics: Competitiveness as a meaningless concept

Ever since David Ricardo's theory of comparative advantage, neoclassical economics has viewed free trade as mutually advantageous. This view has also been the intellectual basis of the international trading system, as represented earlier by the GATT and now by the WTO.

According to neoclassical economics, a view of trade as conflict or win-lose competition between countries and the consequent call for tampering with free trade or some form of industrial policy is a faulty popular notion that is based on a simple analogy between firms and countries. As argued by neoclassical economists, among others, Jagdish Bhagwati, Milton Friedman and Paul Krugman on several occasions, this popular view appears to be missing the ABC of conventional trade theory and relegates international trade to a type of conflict between corporations competing for market share of a commodity. Firms compete through prices and/or quality of goods and services to increase sales/profit and grow. They design competitiveness strategies to improve their performance; and if they are outperformed and are unable to cover their costs go bankrupt. So the concept of competitiveness, in the sense of what matters for success is relative performance, is not problematic; and thus it is well-defined at the firm level. If this notion is extended to nations, then it suggests that a national economy with relatively more efficient (competitive) firms will have a stronger relative international position in the sense of ability to sell, as reflected in its trade balance.

Neoclassical economists and some of their fierce critics alike find this popular view to be flawed on several counts. To start with, the ability of a nation to sell goods and services is dependent on its cost structure, productivity and

[3] Trades Union Congress leader Brendan Barber said "... the central lessons of this summer [London 2012 Olympics] – that private isn't always best and the market doesn't always deliver – surely need to shape future policy (The Guardian, 2012).

[4] There is a similar debate on 'regional competitiveness' which we don't explicitly get into. We make a brief note about that literature at the end of Section 4.