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Revisiting an Evasive Concept: Introduction to the Special Issue on Competitiveness

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Abstract The term competitiveness stems from the analysis of firms and is usually thought to be well defined at the firm level. Today, however, the notion competitiveness has become a prominent concept in the assessment of countries, regions and locations. The competitive advantage of nations and the competitiveness of locations have become important topics in economic policy. Interest in this field has been notably stimulated by the work of Michael Porter. Although the diversity of approaches presented in this issue may appear large to the reader, it is in reality dwarfed by the multiplicity of concepts, articles and books which have been written in reference to the term competitiveness. The vagueness of the general term, the lack of theoretical background, implicit preferences and prejudices, and finally the scope of policy recommendations made in reference to this term have induced outstanding researchers to warn that the term *competitiveness of a nation* could be dangerous, obsessive, elusive or meaningless.[1] The articles presented in this volume share some elements of this critique, but also demonstrate that research is being continued, and that it is indeed relevant to the design and evaluation of economic policy, most notably, the so-called Lisbon Strategy of the European Union.

Keywords competitiveness · welfare evaluation · innovation · Lisbon Strategy

JEL Classifications F10 · F15 · F43 · O31 · O40 · O57

[1] All four adjectives are found in articles by Krugman (1994A, B, 1996): Krugman asserts that the concept of competitiveness is elusive or meaningless when applied to national economies (since there is no well-defined bottom line, like going out of business); for economies with little international trade, competitiveness is specifically maintained to be a funny way of saying "productivity." Thinking and speaking in terms of competitiveness is claimed to be dangerous because it may lead to the wasteful spending of government money, as well as to trade wars and protectionism, and to the support of bad policy on a wide spectrum of important issues.

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This special issue brings together different ways in which the concept of economic competitiveness can be approached. The volume opens with a paper by *Grilo and Koopman*, who argue that standards of living are a meaningful measure of competitiveness and that improving competitiveness could be equated with enhancing welfare. This is in line with the definition used in the European Competitiveness Reports published annually by the European Commission. More precisely, "competitiveness is understood to mean high and rising standards of living in a nation (or group of nations) with the lowest possible level of involuntary unemployment, on a sustainable basis." The background behind the Grilo–Koopman analysis is the Lisbon Strategy, which intended to make Europe the most competitive economic region in the world. The starting point of the analysis is the large difference between the US and the EU in productivity per person employed and in labour participation rates. Specifically, low productivity in five sectors is found to be responsible for the US lead, which has been increasing since the mid nineties. In line with the chosen definition of competitiveness, the authors do not claim that the positive overall trade balance was actual proof of European competitiveness (as the negative trade balance of the US is not an indicator of poor US competitiveness). The paper uses relative trade balances at the sector level[2] to assess competitive performance. The re-launch of the Lisbon Strategy in 2005 could potentially boost growth, employment and competitiveness. Thus while starting from a rather broad concept (standard of living, welfare), this paper then focuses on productivity and trade performance.

Kohler is more sceptical about the Lisbon Strategy. He believes that it lacked precision, and that the targets proclaimed were not self evident. While he is sympathetic to the use of competitiveness as the process of generating sustainable economic well being for citizens, Kohler believes that this might mean implementing the term competitiveness in a way different from that which is usually understood. He cites Krugman's cautions that competitiveness might be a misleading paradigm leading towards wrongheaded policies and mentions the tendency to create national champions by means of industrial policy in France and Germany. Kohler favours the productivity approach. He relates productivity to comparative advantage in trade theory and then to total factor productivity in modern growth theory. "A country's welfare is... determined by its absolute level of productivity and not by some international competitiveness rankings.... In a trading world, productivity is magnified, in terms of its welfare potential by international exchange...adding the terms of trade as a second principle determinant of domestic welfare." According to Kohler, this opens "the distinct possibility of gaining from the other country's productivity improvements" in the two-country model. However, in multi-country models, improvements in the productivity of foreign economies may work also against the domestic economy. As far as the implementation of policy designed to enhance productivity is concerned, Kohler would like policy to be confined to cases where dynamic externalities exist, while industrial targeting should be avoided.

Ketels discusses Porter's contribution to the analysis of competitiveness, how it developed and how it has been applied to policy. The dominant element of Porter's definition of competitiveness is productivity, much as is argued in *Kohler's* paper:

[2] RCA values, i.e., relative balances of a sector to the total balance of exports and imports (Revealed Comparative Advantage).

the "only meaningful concept of competitiveness at the national level is national productivity" (Porter, 1990, p. 6f). The focus on productivity is driven by its central role in determining the level of prosperity an economy can sustain, thus providing a link to the *Grilo–Koopman* definition. Empirical work since 1990 has helped to develop these concepts further: The analysis of resource-dependent economies called for a differentiation between created, i.e., human-resource-driven, and inherited, i.e., natural resource-driven prosperity. High prosperity is possible in a resource-rich country even when it lacks competitiveness, but it is ultimately limited and not sustainable once the resources are depleted. The analysis of European economies made clear that competitiveness as a driver of prosperity depends on productivity throughout the economy, i.e., the combination of individual per hour productivity and high labour mobilisation rates. High productivity in small segments of an economy is not a sign of true competitiveness. Understanding whether low sectoral productivity or low labour mobilisation is the root of underperformance is critical to devising an appropriate policy response. Ketels points out that Porter develops different measures of prosperity and productivity to design adequate policy advice. His framework goes beyond defining competitiveness as an outcome and focuses much more on why a specific location can reach a given level of competitiveness. Porter (2004) emphasises the social, political, macroeconomic and legal context on the one hand, and the microeconomic foundations on the other hand. The microeconomic foundations are further developed in the famous Porter diamond, ranging from factor conditions, demand conditions, and related and supporting industries to rivalry and government policy. These tools are applied in the context of specific countries (Russia, United Kingdom, Singapore). Ketels then discusses the systematic measurement of the microeconomic foundations of competitiveness in the Business Competitiveness Index developed by Michael Porter, and published annually in the Global Competitiveness Report. The competitiveness index is closely correlated to GDP per capita, giving support to the notion that these microeconomic factors matter to prosperity. But there are also deviations, which can be explained according to (1) the political and legal framework, (2) the geographical position (prosperity of neighbours, access to trading routes, (3) imbalances between competitive conditions (strong firms, business environment) or (4) adjustment processes not yet completed (catching up or deteriorating). Ketels points out two differences between Porter's approach and those of other economists that have sometimes led to misperceptions: Porter uses a language that is much more qualitative than is typical of mainstream economists. This is done to provide advice that is more accessible and can be applied more practically. Additionally, Porter has developed an integrated framework that builds on many concepts and theories. This provides maximum support in identifying specific barriers at a given location, rather then assuming the relevance of a problem independent of time and place.

Siggel provides an overview of the definitions and variations of the term competitiveness used in the literature. He distinguishes between macro concepts and micro concepts, static vs. dynamic, deterministic vs. stochastic, and ex ante vs. ex post concepts. He relates competitiveness to Ricardian comparative advantage and then to domestic resource costs. The latter concept incorporates distortions caused by subsidies and other price deficiencies into total unit costs. He then calculates the extended price competitiveness indicator and its components for Mali, India and Kenya. The concept of price competitiveness, price distortions and

external balances are more important to low income countries than to technological competitiveness or competition in quality.

Finally, *Aiginger* develops a definition of competitiveness which unifies several elements of existing definitions, and circumvents some of the popular critiques of competitiveness. He defines competitiveness as "the ability to create welfare" and suggests that each comprehensive assessment of competitiveness should contain an outcome evaluation and a process evaluation. The outcome competitiveness of an economy should be measured by a set of indicators, similar to those used to evaluate the social welfare of a nation. The strategies and processes which contribute to competitiveness are explained in business research, innovation theory and growth theory; they are often characterised by production functions or explanations of technological progress. However, whether the focus is on the process or the result, whether the focus is static or dynamic, whether absolute levels or relative performance is assessed, will depend on the specific question asked. The proposal of a comprehensive definition and the attempt to make it operational is ventured by a researcher who has been working in this field for two decades (Aiginger, 1987, 1996, 1998, 2000). The discussion regarding the optimal concept may have long reached the point of decreasing returns, while in the globalising world, the policy discussion is as lively and controversial as ever. Aiginger believes that the consensus of the literature may move towards this definition of competitiveness and its two elements. He analyses which other concepts are compatible with this idea and which are nested within it; finally, Aiginger shows that the concept of price competitiveness is not compatible with the new consensus and the definition chosen sidelines the importance of trade balances and market shares.

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