# COMPETITIVENESS

## Definition:

Competitiveness is the ability of a nation to compete successfully internationally and sustain improvements in real output and wealth for its citizens. Competitiveness is vital in raising real incomes, and if a country cannot compete it will suffer from unemployment and something will have to be done to increase competitiveness. It is also characterized by increasing export market shares. Competitiveness, therefore, is demonstrated by the ability to meet the test of free international markets while expanding real income. It is based on generating more value through improved productivity, quality, service and innovation. Effective business strategies are the generators of competitiveness. International competitiveness mostly depends on the competitiveness of firms.

## How is Competitiveness Measured and Why:

There is no single measure of competitiveness, and it is measured on price or non-price factors.

**'Price' Competitiveness –** measures the relative costs of production and the final price levels between international businesses:

- Unit Labour Costs:

  This is the standard measure and it represents the total labour costs per output and for the purpose of cross country comparison they are converted into a common currency, which is usually the US dollar. Changes in ULC will thus be caused by changes in wage rates or productivity levels. A rise in relative Unit Labour Costs indicated that a country is becoming less competitive on the international market. UK's position: Change in UK's ULC's can be seen in Fig.1:

  *Figure 1: IMF Index of Relative Unit Labour Costs – Normalised: Index (1990=100)*

Since 1996 Relative Unit Labour Costs have risen sharply; this implies that competitiveness has worsened by 40%. This is due to the continued strength of the pound, slower productivity growth and faster growth of wages and earnings (leading to rising unit wage costs).

- Exchange Rate

A depreciation (fall in value) in an economy's exchange rate makes its exports cheaper and imports more expensive. Hence an appreciation (rise in value) of the exchange rate in an economy will make its exports more expensive, and will make their exports cheaper. Hence a depreciation of the exchange rate artificially boosts country's competitiveness. UK's position: In the UK the pound has been strong recently which has brought its worldwide competitiveness rating down significantly. Exchange rates, however, do not apply to competitiveness ratings of the Euro zone, as the currency is the same. (The UK has dropped form 9$^{th}$ place in the world in 1997 to 19$^{th}$ in 2001)

- Relative Inflation

With increasing prices in any country, its exports become less competitive abroad. UK's position: if the prices are rising in the UK, like they were during the recession in the early 90's when inflation reached its peak at 10 percent in 1991, then the UK products become less competitive abroad. In the recent future, however, UK has experienced low inflation at around 2-3 percent, which would theoretically make it more competitive internationally. On the other hand the Purchasing Power Parity theory suggests that an increase in domestic prices will be offset by a proportionate decrease in the exchange rate, leaving international competitiveness unchanged.

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**'Non- Price' Competitiveness** – Measures that affect international competitiveness by not affecting the price of products, but other factors such as product performance, product design, advertising, business investment, entrepreneurship and many others.

- Productivity

Higher productivity provides a platform for an economy to achieve sustained growth without rising inflationary pressure. Not only does productivity increase aggregate supply, but it also helps to control the growth of unit labour costs and labour costs can have a significant effect on the rate of inflation and hence a country's competitiveness on international markets. UK's position: There has been a long standing productivity gap between the UK and other leading countries. This is the cause because the amount of capital per worker available for British employees is much lower than that of USA, Germany and many other developed countries. This is due to under-investment in physical capital by both the private and the public sector over many years. There also exists the so-called 'skills gap' which represents the difference between qualifications of British and overseas employees. UK has a small share of workforce with high or medium level qualifications, which is exceedingly important in the increasingly knowledge-driven economy. Gains in productivity are important in determining the long run aggregate supply for a country – to do this UK needs to increase productivity of existing factor resources (labour and capital) whilst at the same time seek to extend the available labour supply and increase the stock of physical, natural and human capital available to produce goods and services. In recent years supply side reforms have been introduced in the UK to close the productivity gap, however the evidence presented by the Office of National Statistics suggests that the reforms have not helped to reverse the productivity gap. This can be seen in Figure 2.

*Figure 2: GDP per Worker (Index UK=100)*

| **Year** | **France** | **Germany** | **Japan** | **USA** | **G7** |
|---|---|---|---|---|---|
| **1992** | 128 | 108 | 103 | 136 | 120 |
| **1996** | 120 | 109 | 106 | 135 | 121 |
| **2000** | 118 | 109 | 97 | 138 | 120 |

As it can be seen in Fig.2 there has been no significant improvement in the UK productivity gap, and it stayed almost the same compared to the average of G7 over the period of eight years.

- Labour Market Performance and Regulations

Modern, fast changing economies need flexible efficient labour markets in order to respond to changing circumstances and to make the best of new opportunities. They also need to offer appropriate worker protection. Moreover, labour market regulation is a necessary and important component of the institutional framework. It affects the ability of employers to offer a diverse range of employment opportunities to meet their needs and those of their employees. It also influences the ability of the unemployed or inactive to find suitable unemployment. UK's position: The UK labour market has a regulatory environment perceived a significantly better than other major European countries, and only slightly behind the US (Fig: 3)

*Figure 3: Business Executive perceptions of Labour Regulation. G7 comparison. Survey score: 1-10 scale.*

- Capital Investment

Capital investment plays a key role in generating economic growth. If a country's capital investment is high, then this will increase its competitiveness. It needs to be encouraged by the government. UK's position: Data on business investment per worker shows that the UK has historically invested less per worker than most of the G7 (Figure 4). This is also reflected in the UK's lower capital stock when compared with other developed countries.

*Figure 4: Business investment per worker. G7 comparison: 1974-2001. USD averages at 1995 prices*.

- Entrepreneurship

Entrepreneurship is vital in building the knowledge driven economy, which is becoming more and more significant in the world. Developing entrepreneurship skills can be done by strengthening of capabilities, knowledge, skills and creativity. UK's position: In the UK the government understands the significance of entrepreneurship in international competitiveness and wants to develop entrepreneurs and is spending 15 million pounds to support education and business partnerships. The government has also subsidized Regional Development Agencies to identify key skills gaps and set out plans to address them.

**Other factors affecting competitiveness in terms of export levels and import penetration:**

A key determinant in the level of UK exports is the level of income and hence consumers demand in the rest of the world. The more income the consumers have overseas, the more the demand for UK products, which will therefore increase exports and rise UK competitiveness. On the other hand, higher incomes in the UK will generate greater demand and therefore attract foreign imports. In this case it is crucial for the rest of the world to import more from the UK not to create a balance of payments deficit, which will make the UK less competitive on the international market.
Other relevant factors include the levels of any barriers to trade that exist. These barriers include currency conversion costs, transport costs and barriers imposed through protectionist policies. In many cases these barriers have declined, however they still do exist. Within Europe the creation of a single market has reduced barriers to trade substantially.

**Conclusion:**

Competitiveness is the key to business prosperity, and in a fast-changing global economy it is increasingly recognised that competitiveness depends on how we generate, diffuse and apply knowledge. Globalisation will intensify the need for the British economy to become more competitive in both 'price' and 'non-price' terms. In the last five years the Labour Government has published several in-depth reports on competitiveness and the links with long-term economic performance. The Government has an important role to play including use of tax credits for investment, supply the necessary finance for new businesses and create incentives for more spending in research and development. In the long term, Government policy needs to focus on encouraging the conditions for higher productivity, possibly through education and labour market reforms, a strategy to encourage entrepreneurship and best practice in each industry, or in driving through important changes to competition policy to increase the contestability of markets and stimulate improvements in management and working practices. These improvements in the supply side need to take change over long term. Therefore it will take a tremendous amount of time for supply side improvements to work their way through.