# GLOBALISATION AND EXPORT COMPETITIVENESS: A THEORETICAL APPROACH

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*Over the past two decades, globalisation has given a boost to world trade, has grown one and a half times faster than world output, and the difference has even been considerably higher in recent years as world trade growth accelerated very strongly. More and more goods and services have entered the markets, and domestic companies have increasingly engaged in international trade. So what is the export competitiveness of an economy in the global market? Despite its acknowledged importance, the concept of competitiveness is still misunderstood, and a discussion of its underpinnings remains a central task. Competitiveness is nowadays a central preoccupation of all countries in an increasingly open and integrated world economy. In this paper, we will try to generally define competitiveness and particularly, we will focus on defining the export competitiveness, in order to offer a conceptual framework for a better understanding.*

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## 1. Introduction

Competitiveness is a central preoccupation of all countries in an increasingly open and integrated world economy, characterized by the tendency of freer trade, and even more nowadays, which are very challenging times – for Europe and for the global economy. We take the opportunity to look at Europe's economy and the external and internal dimensions of Europe's competitiveness from a broad perspective and to focus particularly on the growing challenge of globalization, because it is recognised that these two dimensions are closely related, as well as they are also related to the current situation - the economic crisis, its impact on Europe as a whole and on the world economy.

Developments in the international economy had always a particular impact on the EU, reflecting its very open nature and its strong dependence on international trade and financial flows. But it is important that we recognise the global nature of this crisis, in which public authorities everywhere are confronted by the adverse effects of the market turbulence on their own economies and financial systems. And it is important to recognise that despite these difficulties, we have not lost the things that have made the real economies of the EU so successful in recent years, notably our skilled workforces, our dynamic businesses and our openness to trade. That's why we will further discuss how the external performance of the EU relates to key internal dimensions including integration, flexibility and competition, drawing attention to policy changes that are necessary to maintain and improve Europe's competitiveness.

## 2. Defining competitiveness

Despite its acknowledged importance, the concept of competitiveness is still misunderstood, and a discussion of its underpinnings remains a central task. This is the reason why, in this paper, we will try to define competitiveness, focusing on the export competitiveness, and offering a conceptual framework for understanding its causes.

So what do we mean by "competitiveness"? For many people, competitiveness is a disconcerting word, suggestive of pressures to change and constant adjustments. And these pressures can have personal and social costs, as well as very large benefits – we need to stay competitive for the long-term welfare of the people of each economy.

What does the word "competitiveness" mean to economists? In a narrow sense, it is often used to refer to international price competitiveness as measured by various indicators of effective exchange rates.

For Michael E. Porter, Christian Ketels and Mercedes Delgado, "*competitiveness* is a country's share of world markets for its products".[180] According to this definition, the authors further argue that this "makes competitiveness a zero-sum game, because one country's gain comes at the expense of others"[181]. This view of competitiveness is used to justify interventions to skew market outcomes in a so-called strategic industrial policy, including subsidies, artificial restraints on local wages, and intervention to devalue the nation's currency. In fact, the authors agree that "lower wages or devaluation *make a nation more competitive*."[182]

Although widely used in economics and business management, the usefulness of the concept, particularly in the context of national competitiveness, is vigorously disputed by economists, such as Paul Krugman, who argues that "As a practical matter, however, the doctrine of 'competitiveness' is flatly wrong. The world's leading nations are not, to any important degree, in economic competition with each other."[183]

Eurostat's Concepts and Definitions Database (CODED) defines competitiveness as "The ability of companies, industries, regions or supranational regions to generate, while being and remaining exposed to international competition, relatively high factor income and factor employment levels on a sustainable basis."[184]

The European Central Bank analyses developments according to a whole host of such indicators. This concept of competitiveness is linked to the "external performance" of a country, typically measured in terms of export growth, shares of export markets or current account balances. Developments in price competitiveness have always been important drivers of an economy's ability to compete in international markets. But in recent years, other factors have become increasingly important in the face of the structural changes engendered by globalisation. These relate to export specialisation, which includes the range and the quality of the products a country exports, and the particular markets it exports to. In this regard, it is important that a country takes advantage of its high technological advancement and well-educated labour forces, to produce higher quality and more sophisticated goods and to redirect its exports towards strongly growing markets.

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180 Michael E. Porter, Christian Ketels and Mercedes Delgado (2008), *The Microeconomic Foundations of Prosperity: Findings from the Business Competitiveness Index*, The Global Competitiveness Report 2007-2008, p.2, electronically available at the following web address: http://siteresources.worldbank.org/EXTEXPCOMNET/Resources/2463593-1213989126859/03_Porter_GCI_ch1&2.pdf.

181 Idem.

182 Idem.

183 Krugman, Paul (March/April 1994), *Competitiveness: A Dangerous Obsession*, Council on Foreign Relations, Inc., Foreign Affairs, electronically available at the following web address: http://www.foreignaffairs.com/articles/49684/paul-krugman/competitiveness-a-dangerous-obsession.

184 Eurostat's Concepts and Definitions Database (CODED), , electronically available at the following web address:
http://ec.europa.eu/eurostat/ramon/nomenclatures/index.cfm?TargetUrl=DSP_GLOSSARY_NOM_DTL_VIEW&StrNom=CODED2&StrLanguageCode=EN&IntKey=16438235&RdoSearch=BEGIN&TxtSearch=COMPET&CboTheme=&IntCurrentPage=1, last consulted on april 5th, 2009.

Looking even more closely into the domestic structure of an economy we come to the notion of productivity. As Krugman notes, "national economic welfare is determined primarily by productivity in both traded and non-traded sectors of the economy"[185].

Productivity and competitiveness are two different concepts, but there are close links between them. More broadly defined, "competitiveness" includes a notion of relative productivity. Under this definition, the most competitive economy is the one with the best prospects for "generating" highly productive firms, contributing to longer-term economic growth and, ultimately, to the welfare of its citizens.

Wealth is actually created by the productivity with which a nation can utilize its human, capital, and natural resources to produce goods and services. According to Michael E. Porter, Christian Ketels and Mercedes Delgado, "Productivity ultimately depends on the *microeconomic* capability of the economy, rooted in the sophistication of companies (both local and subsidiaries of multinationals), the quality of the national business environment, and the externalities arising from the presence of clusters of related and supporting industries. Unless microeconomic capabilities improve, sustainable improvements in prosperity will not occur".[186]

True competitiveness, then, is measured by productivity. Productivity supports high wages, a strong currency, and attractive returns to capital—and with them a high standard of living. Many nations can improve their prosperity if they can improve productivity.

Recent advances in trade theory have stressed the connections between the external and internal dimensions of competitiveness, which have become increasingly relevant in a globalising economy. Some of the latest economic models of trade[187] see global competition as a selection mechanism, in which only the most productive firms do business outside their national borders.[188]

These new models also stress the importance of countries' institutional framework which may make market access easier and push domestic firms to innovate. According to this body of economic knowledge, continuing efforts to promote stronger competition and further market integration appear to be important tools for supporting and enhancing the global competitiveness of one economy firms.

### 3. Globalisation and export competitiveness - EU as an example

Applying these theoretical concepts of competitiveness to the external dimension of an economy, there arrive two questions: how do we assess the external competitiveness; how are firms performing in globalised markets?

Globalisation has given a boost to world trade over the past two decades, world trade having growing 1.5 times faster than world output, and the difference has even considerably higher in recent years as world trade growth accelerated very strongly. Transport costs have dropped dramatically, as have tariffs, and the surge in information and communication technology has facilitated a global exchange of goods and services as well as globalised supply chains. More and more goods and services have become tradable, and domestic companies have increasingly engaged in international trade.

And as Romania is an EU member state, we have to specify that the EU, and especially, the Euro Area, has actively contributed to this rise in international trade. The EU and its member state have a long history in trading, but the openness of the euro area has increased that business

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[185] Idem.

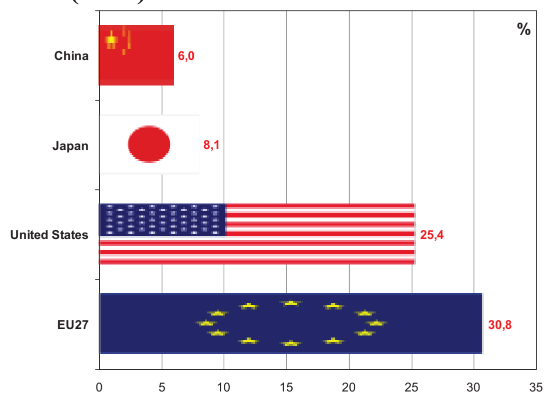
[186] Michael E. Porter, Christian Ketels and Mercedes Delgado (2008), *The Microeconomic Foundations of Prosperity: Findings from the Business Competitiveness Index*, The Global Competitiveness Report 2007-2008, p.2, electronically available at the following web address: http://siteresources.worldbank.org/EXTEXPCOMNET/Resources/2463593-1213989126859/03_Porter_GCI_ch1&2.pdf.

[187] For an overview, see, for instance, Bernard et al (2007).

[188] See, for example, Melitz and Ottaviano (2008) and Ottaviano, Taglioni and di Mauro (2009).

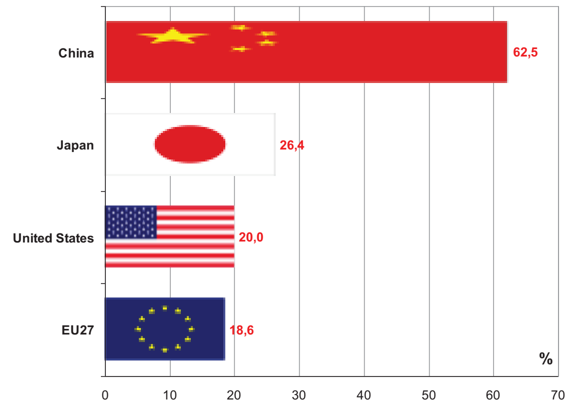
markedly. In the mid-1990s, exports of goods and services from the euro area were equivalent to around 30% of GDP; now they are equivalent to around 34,05% of GDP, and even 44% of GDP, if we consider the founding members of the euro area, only[189]. Earlier observers who said that European integration could lead to a closing vis-à-vis the outside world have proved to be utterly wrong, because quite the opposite has happened.

***Tabel 1:*** **Share of (current) GDP in World GDP (2008)**




*Data Source: World Bank; Share = GDPi / GDPw*

***Table 2:*** **The EU in the World Trade. Degree of Insertion in World Economy (2008)**




*Data Source: Eurostat (Comext, Statistical regime 4), IMF, World Bank; Ratio = (Imports+Exports, excluding Energy) / GDP*

Obviously, Europe's trade has grown not only because of Asia's, and particularly China's emergence as a fully-fledged trading partner, but also by the growing role of the central and eastern European countries. But even though EU is roughly comparable in size to the United States, the euro area is about ten percentage points more open, and is much more open than Japan, despite its larger size. This is an indication, if there was more necessarily, of why Europe has a key stake in global economic developments. [190]

Europe's openness is also remarkable in international finance: over the past decade, the stock of outward and inward foreign direct investment has virtually doubled as a percentage of GDP. And even more strikingly, the euro area is more open financially than other advanced countries, like the United States and Japan. In 2007, international financial assets and liabilities of the euro area, as a percentage of GDP[191], reached almost 160%, compared with about 135% for the United States and 90% for Japan.[192] And this explains why Europe is largely exposed to the current global financial crisis and it underscores to which extent Europe has an important stake in global financial stability. Greater openness in trade and finance has of course, created new challenges, which have rarely been as visible as today.

And just as with the global financial crisis, global trade integration calls for constant adjustment. As low-cost competitors have emerged, the advanced economies have recorded some losses in

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[189] Based on own computation relaying on data posted by EUROSTAT at the following web address: http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/search_database.

[190] See Trichet, Jean-Claude (26 February 2009), *The external and internal dimensions of Europe's competitiveness*, Institute of International and European Affairs, Dublin.

***[191] ECB (6 November 2008),*** **Euro area international investment position and its geographical breakdown (as at end-2007)*****, electronically available at the following web address: http://www.ecb.int/press/pr/stats/bop/2008/html/ba081106.en.html.***

[192] Trichet, Jean-Claude (26 February 2009), *The external and internal dimensions of Europe's competitiveness*, Institute of International and European Affairs, Dublin.

world export market shares. These losses partly reflect the mechanical effect of the increasing shares of the new entrants, but the challenge for advanced economies remains: to adjust their export portfolios according to their technological comparative advantages, towards higher quality products, and towards products that are more skill-intensive and capital-intensive.

So what is the comparative advantage an economy, and especially, of the EU and of the euro area in the global economy? Recent ECB analysis[193] has looked at so-called *Balassa indices of revealed comparative advantage* (RCA). According to these indices, a country specialises in a specific product or sector, if the share of that product or sector in the country's exports is higher than the share of that product or sector in world exports. This analysis suggests, somewhat surprisingly, and in contrast to other advanced economies, that the euro area specialisation overall has not changed much over last 15 years. There has been neither a decline in the specialisation in labour-intensive products, nor the expected shift towards more research-intensive production. This might reflect structural rigidities that constrain the ability of euro area firms to adjust rapidly, but it could also mean that euro area firms have so far not been under significant pressure to make substantial changes in their specialisation - particularly in medium-high-tech exports.

But this general picture for the euro area does however not necessarily hold for all euro area countries, and obviously, not for all other advanced economies in the world. Overall, there have been substantial differences in the export performance across individual countries. And euro area countries have witnessed significant differences in cost competitiveness since the launch of the euro. This explains why the ECB has always said that an appropriate peer surveillance of the evolution of competitiveness indicators, including cost competitiveness and unit labour costs was of the essence.[194]

**4. Competitiveness, the crisis and the challenges for policy**

Turning to the current difficulties in the international economy, which are having such a strongly negative impact on all advanced economies, we should retain the fact that for many years, the most developed countries in the world have been a great success story: openness to trade and a high degree of flexibility have allowed these countries to benefit substantially from globalisation during the last decades. They now have a very high income per capita, and are characterised by a skilled workforce, a flexible labour market, moderate taxation and a business-friendly regulatory environment.

None of these advantages have been lost as a result of the global financial crisis. But crucially for them, this unprecedented international shock has come at the same time as their economies have been undergoing a necessary rebalancing in the composition of their growth, intensifying the challenges they face. In particular the construction and the banking sectors need to adjust.

The governments are acting resolutely to redress the situation. With the public finances, important action is being taken to make immediate savings, and plans are being drawn up for a return to compliance with their Recovery Strategies. A fiscal policy that convincingly reduces future public deficits is indeed absolutely essential for all of them. In addition, measures have been taken or are under way to recover lost competitiveness and to exploit the countries' comparative advantages in their high-tech, high-skills industries.

What is crucial at this moment for all economic policy actors, is to take measures that are both supportive in the current environment and in the longer-term interests of the economy. Many developed countries, despite some progress, still exhibit structural impediments triggered by a

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[193] For more details, see di Mauro and Forster (2008), providing an update of the earlier analysis by Baumann and di Mauro (2007).

[194] ECB (2008), Monitoring labour cost developments across euro area countries, Monthly Bulletin, November 2008, pages 69-85.

rigid legal and regulatory environment. Unemployment is a clear concern right now in many advanced economies, and we surely do not want to lose human capital or scar a large proportion of the people of working age. Wage restraint would help a lot in this respect. More generally, in order to minimise job and output losses related to the current downturn, it is vital that governments and social partners pursue four objectives:

- First, wage setting needs to take account of the competitiveness and labour market conditions in a responsible and timely manner.[195]
- Second, national authorities should pursue straight and courageous policies of spending restraint especially in the case of public wages. A prudent fiscal stance should be always in place.
- Third, a deeper integration of markets is crucial to foster competition and open product and labour markets. Measures that hinder free competition and cross-border trade must be avoided. In this context, it is of the utmost importance to resist protectionist measures.
- Fourth, the necessary reforms that enhance competition and improve long-term growth prospects must be implemented.

Especially in these difficult times such reforms are very important in all developing and developed countries to counteract the economic downturn and limit its negative impact on employment. The price of delaying reforms is particularly high at the current stage. For many years, we have been saying that we need structural reforms – more openness, more competition. The crisis offers us the opportunity and the obligation to seize the moment and implement the right reforms. These would help the economy overcome the crisis and be stronger afterwards.

As a lesson from the current crisis, we should consider ways how to strengthen the surveillance of competitiveness within our economies and regions. This should help countries to build stronger buffers in good times, to avoid excessive increases in unit labour costs, and in other words, this would prevent from again extending public and private spending beyond sustainable levels and experiencing difficulties similar to the current ones.

## 5. Conclusion

Globalization has increased the importance of local conditions in the competitiveness of companies and countries, consequently requiring that every country to compete based on its productivity as a strategic development platform for a widening array of activities, and is driving rapid improvement in the business environments of more and more countries.

But in these very challenging times, it is not easy for all economic policy-makers to reach agreement on the way forward. There are numerous policy areas that must be addressed, and it is difficult to make progress on all aspects of competitiveness simultaneously. Every country must pursue best practices in terms of policy choices and infrastructure development across all aspects of the business environment, while resolutely addressing the challenges of the global financial turbulence, the global imbalances and the resulting global slowdown. Countries need to offer advantages as business locations, not just minimize weaknesses. A unique development path for each country is often needed, which reflects its natural resources, location, unique historical and cultural assets, and state of competitive advantages in an array of fields. Looking forward, all these will continue its efforts to make the economy stronger, more flexible, more resilient and more prosperous. In many ways, the EU is an excellent example of some of the characteristics that foster global competitiveness – in its openness, its flexibility and its high levels of education. Some things will of course have to change. But none of the positive characteristics are lost nor should they be lost in the crisis. The open nature of an economy, associated with its flexibility and adaptability means that it will be well placed to benefit greatly from the eventual recovery and to compete effectively in the global economy in the future.

[195] DuCaju et al. (2008).

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