

# The Fundamentals of Competitiveness

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**C**ompetitiveness policies work when they are targeted at very precise objectives. "Blanket" proposals, based on unfocused and vague statements, invariably fail to produce results.

A modern economy is an aggregation of several sub economies. Competitiveness policies need to take into account a diversity of economic models within any single national framework. The research that we have conducted over the past decade throws new light on the structure of competitiveness. Different parts of an economy do not all compete in the same way on world markets. Some do not compete at all. It is therefore important to understand how competitiveness works. In order to increase the efficiency and the relevance of policies aimed at improving competitive performance.

Companies do not operate in a vacuum. Their performance depends heavily on their national environment

## Measuring economic prosperity

The theory holds that world competitiveness, like trade, increases the economic prosperity of people. The best economic indicator of the attainment of this objective – or rather, the least inappropriate – is the Gross Domestic Product per capita, adjusted to Purchasing Power Parity (PPP). The rate of growth in the GDP, adjusted to PPP, indicates whether a nation is moving in the right direction or not.

The GDP is, at best, an imperfect economic indicator of wealth creation. In the case of competitiveness, it does not distinguish between.

- revenues from the depletion of

- non-renewable resources (such as oil);
- revenues from the exploitation of assets accumulated by past generation (as is the case in most "old" industrial nations);

- revenues from true economic value added (such as innovation, technology and transformation processes).

Bearing these shortcomings in mind, GDP nevertheless remains the best statistical approximation of wealth creation.

## The test of World Markets

The term "World Competitiveness" indicates that the real test of competitiveness takes place on international markets. It is conceivable that companies could develop their competitiveness behind closed frontiers, in a purely domestic environment. Some politicians, indeed, advocate a protectionist approach to competitiveness. However, economic theory holds that competitiveness, like trade, is enhanced by operating in open international environment. Ultimately, on the whole, a nation is far better off when following this path. This approach has also prevailed internationally over the past 20 years. Today, an increasing number of countries and industry sectors have been opened up to world competition.

## The two facets of competitiveness: Companies and nations

The theory of World Competitiveness distinguishes between the competitiveness of companies and the competitiveness of nations.

The competitiveness of companies is at the core. Within a nation, the fundamental role of companies is to create economic value added. This process requires capital, technology, labour,

natural resources, etc. and has been widely studied by scholars as early as the classical economists. Modern economists analyze company competitiveness from the angle of strategy formulation, product development, processes or structure. Ultimately, the goal of the company remains unchanged: wealth creation.

In fact, the process of wealth creation is so critical to the prosperity of nations that, in the past, some governments opted to take direct ownership of it by nationalizing companies (state planned economies). Other nations limited their actions to those, which influence the environment. They left the value creation process in private hands (market economies).

## What does the World Competitiveness Yearbook analyze?

It is assumed that competitiveness depends very much upon the ability of a nation to create an environment, which favours sustained value added creation. The term "sustain" is important. It emphasizes the long-term dimension of competitiveness. This is reflected in the importance of such issues as education, value systems, or motivation of individuals, who strongly influence the future prosperity of a nation, even if their impact on quarterly performance indicators is sometimes hard to discern.

## Four forces which shape the competitiveness environment

During the past decade of research, we have noticed that even market economies tend to actively shape their competitive environment. However, in contrast to state planned economies, they do not tamper with industrial policy or ideology. Their influence on the environment is more general, and does not interfere with the ownership of companies. On the contrary, the trend is towards privatization.

We found four forces at work in the competitiveness environment of any given country. Such forces are often

the result of tradition, history or value systems. They are so deeply rooted in the 'modus operandi' of a country that, in most cases, they are not clearly stated or defined. They are "given" and part of the national characteristics of a country.

### **Proximity and Globality**

The economic system of a country is generally not homogeneous. In most cases, nations must deal with two types of co-existing economies:

#### **(a) *The economy of proximity***

Which comprises traditional activities such as crafts, social and personal services such as doctors and teachers, administrative activities such as government and justice, and consumer-support activities such as after-sales service and customization. The economy of proximity provides value added close to the end user. It is generally protectionist and expensive.

#### **(b) *The economy of globality***

Which is composed to companies with international operations. It assumes that products need not necessarily be close to the end-user, and it benefits from the comparative advantages of markets world-wide, especially with regard to operational costs. It is generally competitive and price efficient.

The proportion between these two economies in national prosperity varies with the size and the economic development of a country. On average, it can be assumed that in Western Europe 2/3 of GDP is generated by the economy of proximity, and 1/3 by the economy of globality. Smaller countries are much more dependent on their economy of globality. Larger countries, such as the United States, still very much rely on their huge domestic markets, although the trend towards globalization is increasing.

Over the past 25 years, the economy of globality has grown enormously,

sometimes invading the turf of the economy of proximity (with such measures as opening of trade barriers, trade agreements, regional integration, privatisation, deregulation, etc.) One important consequence of globalization is that it exercises strong pressure on prices, margins and wages. Nations with high domestic standard of living and operating costs, such as Germany and Switzerland, are going through a harsh adaptation process. Other countries, such as Britain or the Netherlands. Have definitely put their bets on the globalization of their economies.

### **Attractiveness and Aggressiveness**

As stated earlier, the concept of competitiveness, like trade, is significant when it can stand the test of international markets. For example Germany, Japan, Singapore, Taiwan, Korea and Hong Kong have all been export led successes. Likewise, every failure since WWII occurred in those nations which refused to accept the verdict of world markets, such as the former communist countries. Therefore, a country or company is now competitive by world standards, or not at all.

Some nations manage their internationalization process by being attractive, i.e. by creating a domestic environment and trade. Examples include Ireland and Thailand. Other nations, such as Korea and Japan, manage the internationalization process by being aggressive. Generally, a nation focuses on one approach by being aggressive. Generally, a nation focuses on one approach or the other. Ireland is not very aggressive in international markets, Korea is not very attractive to foreign investments. Great Britain used to be aggressive and has now become attractive. Switzerland has followed the opposite direction, and has moved from attractiveness to aggressiveness. The United States seems to be the only country that is able to be both very attractive and very aggressive.

The distinction is of particular importance for modern competitiveness policies. Aggressiveness creates revenues in the home country, but not necessarily jobs. Attractiveness creates jobs in the

host countries, but can be short on revenues because of tax incentives, etc. This means that even wealthy nations, some of which are very aggressive on world markets, can not ignore the importance of attractiveness, especially because of its impact on employment and the economy of proximity. Both aspects of competitiveness should therefore be balanced.

### **Assets and Processes**

Nations also manage their competitive environment by relying more heavily on assets or on processes. Some nations can be rich in assets – land, people, natural resources, etc. – but are not necessarily competitive. This may be the case of Brazil, India and Russia. Other nations such as Singapore, Japan and Switzerland are poor in resources and have relied essentially on transformation processes. In general, the latter nations are more competitive than the former.

Sometimes economists refer to "the spell of natural resources" to describe the fate of asset-rich nations that have become complacent. It probably also is a factor of the central importance for "economic value added" in the notion of competitiveness. It should be added that inherited assets are not necessarily only natural resources. It could be considered that infrastructure, industrial power, and even education and skills are assets, which have been accumulated by past generations. They can also generate complacency in "old" nations, which confuse wealth and competitiveness.

### **Individual Risk Taking and Social Cohesiveness**

The fourth force shaping the competitive environment of a country is the distinction between a system that promotes individual risk and one, which aims to preserve social cohesiveness. (The World Competitiveness Year Book 1997).