

# COMPETITIVENESS

Yuri N. Maltsev

Vilnius, June 11, 2008

- **The existence of enormous differences in the levels of competitiveness, productivity and factor accumulation across the world is probably the most perplexing issue in modern international political economy.**

Competitiveness is the  
set of institutions,  
policies, and factors  
that determine the  
level of productivity of  
a country, - World  
Economic Forum

**Adam Smith argued that economic freedom, specialization and the division of labor lead to dramatic improvements in productivity.**

**Neoclassical development economics emphasized investment in physical capital and infrastructure.**

**Austrian School – major focus on property rights and other institutions /Mises/, as well as information/coordination problem /Hayek/.**

**Ludwig von Mises,**

*Capital Supply And American Prosperity.*

*Lecture at the University Club of Milwaukee on October 13, 1952*

- The average standard of living is in this country higher than in any other country of the world, not because the American statesmen and politicians are superior to the foreign statesmen and politicians, but because the per-head quota of capital invested is in America higher than in other countries.

# LUDWIG VON MISES

- **“Capital is more plentiful in America than it is in other countries because up to now the institutions and laws of the United States put fewer obstacles in the way of big-scale capital accumulation than did foreign countries”**.

# IMD World Competitiveness Yearbook (WCY)

The World Competitiveness Yearbook (WCY) since 1989 analyzes and ranks the ability of nations to create and maintain an environment which sustains the competitiveness of enterprises.

- - Economic Performance
- - Government Efficiency
- - Business Efficiency
- - Infrastructure

# IMD

Each of these factors is divided into 5 sub-factors which highlight every facet of the areas analyzed. Altogether, the WCY features 20 such sub-factors.

- Each sub-factor, independently of the number of criteria it contains, has the same weight in the overall consolidation of results, that is 5% ( $20 \times 5 = 100$ ).
- Criteria can be hard data, which analyze competitiveness as it can be measured (e.g. GDP) or soft data, which analyze competitiveness as it can be perceived (e.g. Availability of competent managers). Hard criteria represent a weight of  $2/3$  in the overall ranking whereas the survey data represent a weight of  $1/3$ .

# **World Economic Forum: The Global Competitiveness Report**

- **Assessment of the comparative strengths and weaknesses of national economies, used by governments, academics and business leaders. The GCR was first published in 1979 and its coverage has expanded each year since, now extending to 131 major and emerging economies.**
- **The Executive Opinion Survey is a major component of The Global Competitiveness Report. The recently launched Global Competitiveness Report 2007-2008 polled over 11,000 business executives worldwide.**

## Old Model

- Government drives economic development through policy decisions and incentives.

# NEW MODEL

- Economic development is a collaborative process involving government at multiple levels, companies, teaching and research institutions.
- Competitiveness must be a bottoms-up process in which many individuals, companies, and institutions take responsibility.

# 12 PILLARS OF COMPETITIVENESS

**Two US economists: Michael Porter and Xavier Sala-I-Martin developed determinants of competitiveness:**

**12 PILLARS OF COMPETITIVENESS –  
COMPREHENSIVE LIST OF DETERMINANTS  
OF NATION'S PRODUCTIVITY.**

# 12 PILLARS OF COMPETITIVENESS

1. INSTITUTIONS
2. INFRASTRUCTURE
3. MACROECONOMY
4. HEALTH AND PRIMARY  
EDUCATION
5. HIGHER EDUCATION AND  
TRAINING
6. GOODS MARKET EFFICIENCY

# 12 PILLARS OF COMPETITIVENESS

- 7. LABOR MARKET EFFICIENCY
- 8. FINANCIAL MARKET  
SOPHISTICATION
- 9. TECHNOLOGICAL READINESS
- 10. MARKET SIZE
- 11. BUSINESS SOPHISTICATION
- 12. INNOVATION

**The concept of competitiveness involves dynamic components: although the productivity determines country's ability to sustain a *level of income*, it is also one of the central determinants of the returns to investment, which is a central factor explaining an economy's level of investments and *growth potential*.**

- **The United States tops the overall ranking in The Global Competitiveness Report 2007-2008. Switzerland is in second position followed by Denmark, Sweden, Germany, Finland and Singapore, respectively.**
- **The rankings are calculated from both publicly available data and the Executive Opinion Survey, a comprehensive annual survey conducted by the World Economic Forum together with its network of Partner Institutes (leading research institutes and business organizations) in the countries covered by the Report. This year, over 11,000 business leaders were polled in a record 131 countries.**

-

**World Economic Forum  
uses Michael Porter's  
definition of stages of  
development:**

**1. Factor Driven**

**2. Efficiency Driven**

**3. Innovation Driven**

**In the first stage, the economy is factor driven and countries compete based on their factor endowments, primarily unskilled labor and natural resources. Companies compete on the basis of price and sell basic products or commodities, with their low productivity reflected in low wages. Maintaining competitiveness at this stage of development hinges primarily on well-functioning public and private institutions (pillar 1), appropriate infrastructure (pillar 2), a stable macroeconomic framework (pillar 3), and a healthy and literate workforce (pillar 4).**

## Second stage

- The *efficiency-driven* stage of development, when countries develop more efficient production processes and increase product quality. At this point competitiveness is increasingly driven by higher education and training (pillar 5), efficient goods markets (pillar 6), well-functioning labor markets (pillar 7), sophisticated financial markets (pillar 8), a large domestic or foreign market (pillar 9), and the ability to harness the benefits of existing technologies (pillar 10).

## Third Stage

The *innovation-driven* stage: countries are able to sustain higher wages and the associated standard of living only if their businesses are able to compete with new and unique products. At this stage, companies must compete through innovation (pillar 12), producing new and different goods using the most sophisticated production processes (pillar 11).

# Stages: Summary

- **The concept of stages of development is integrated into the Index by attributing higher relative weights to those pillars that are relatively more important for a country given its particular stage of development. That is, although all 12 pillars matter to a certain extent for all countries, the importance of each one depends on a country's stage of development.**

# Resource Curse explanation doesn't hold up without broader context

- Resource curse does not happen in the US, Australia, or Norway as natural resources are mostly privately owned
- Factor endowments cannot explain changes over time: many developing countries were rich in earlier ages – ex. Argentina, Cuba, Kenya, Venezuela, Zambia, Zimbabwe – but became poor and decimated societies.
- It is also true in relation to postcommunist societies: all formerly communist countries were well more developed and productive before socialist experiments than after.

# Tatu Vanhanen and Richard Lynn

- IQ argument applied to nations: calculated “national IQs”.
- Does not explain development successes and failures: China’s IQ -121, Botswana – 78, India – 82, etc.
- Unreliable methodology

# IQ Argument

- There is a definite correlation between differences in innate ability, such as intelligence, strength, work ethics and charisma, and an individual's wealth and achievement. These abilities are in high demand in the market economy relative to their supply and hence play a large role in increasing incomes and wealth.
- Static explanation: can not explain, however, long-term deviations in economic conditions within same populations. For ex. Chinese, Russians, Vietnamese with relatively high “national IQs” experienced dramatic changes in productivity and competitiveness.

# Market Freedom

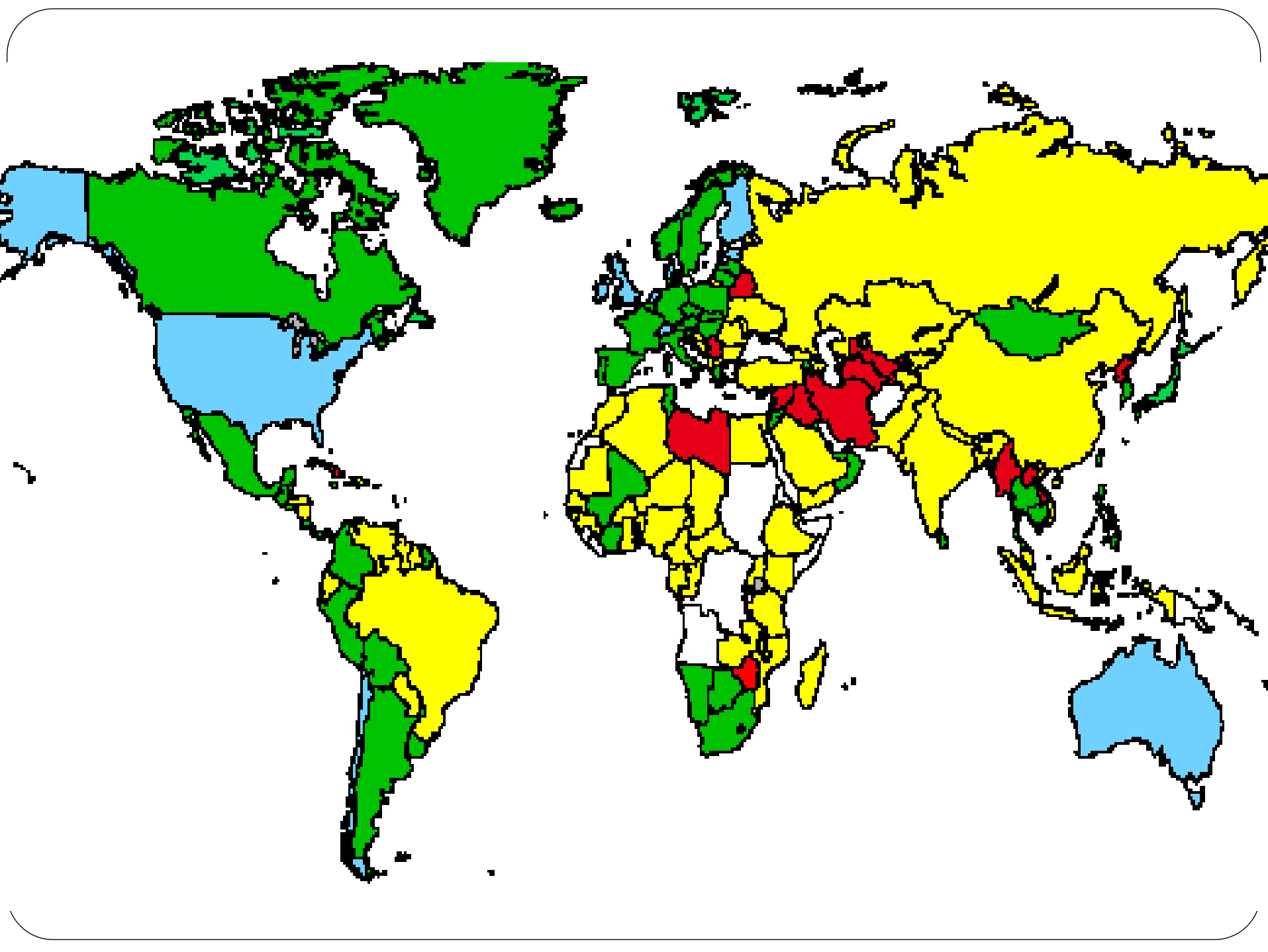
- **Strong correlation between the degree of economic freedom in a country and its productivity and prosperity is The World Index of Economic Freedom compiled by the Fraser Institute in Canada (James Gwartney and Robert Lawson) and published by The Wall Street Journal; similar project is also undertaken by the Heritage Foundation: [www.heritage.org](http://www.heritage.org)**

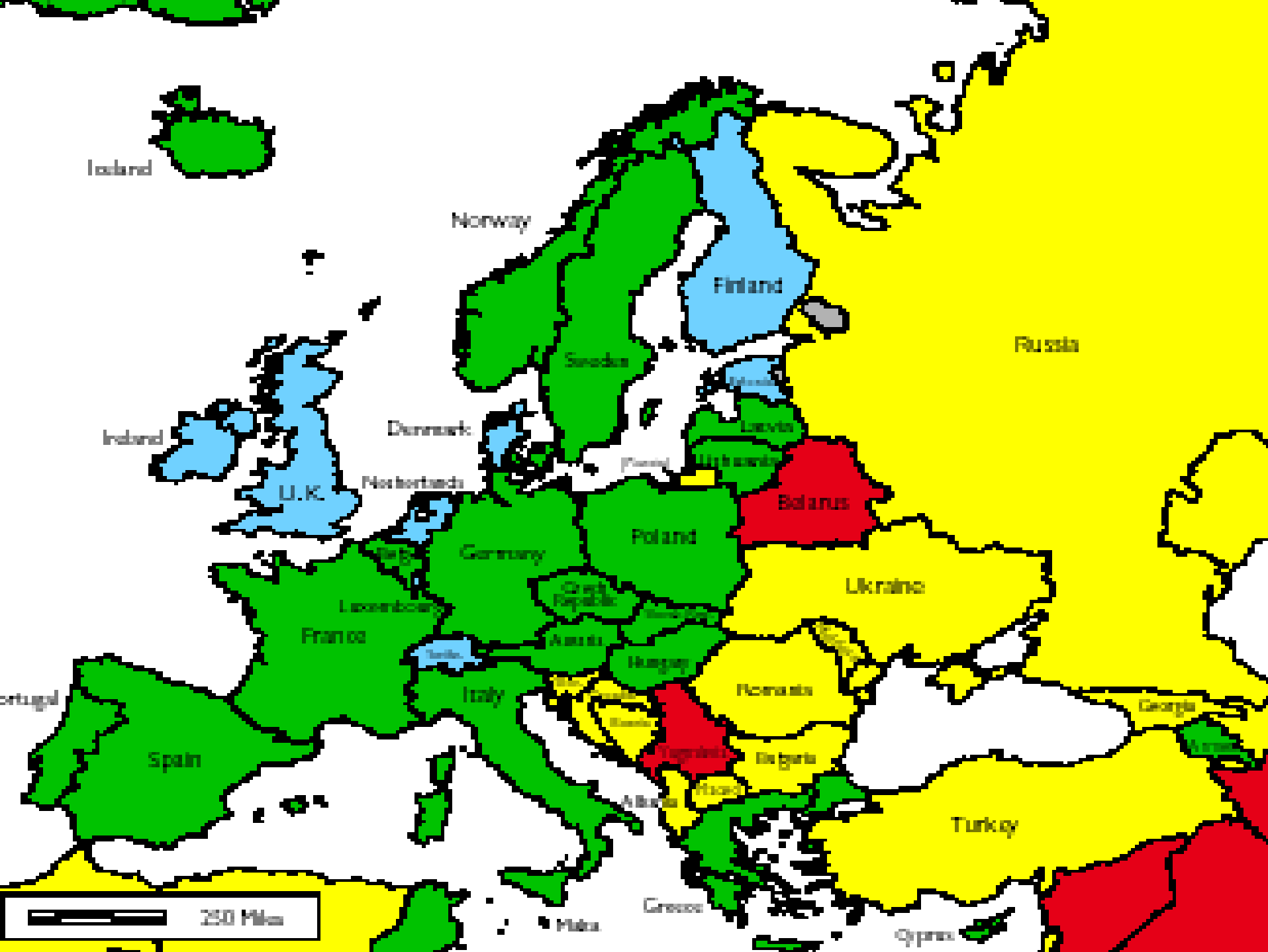
# What is ECONOMIC FREEDOM?

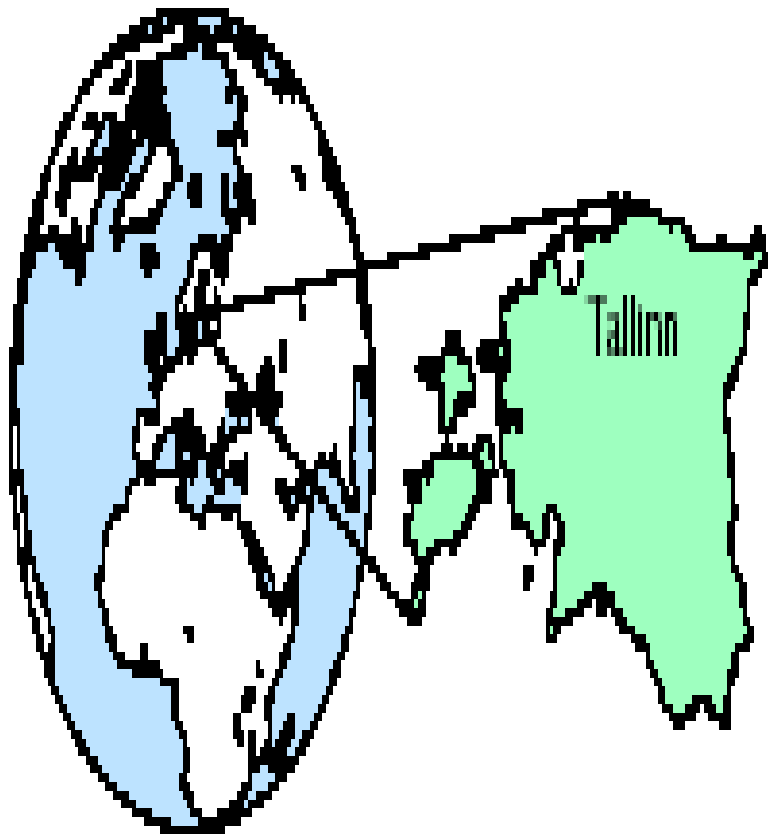
- Personal Choice
  - Individuals are permitted to choose for themselves in economic life (as opposed to having such decisions made for them by others).
- Voluntary Exchange
  - People are permitted to exchange goods at mutually agreeable prices.
- Protection of Persons and Property
  - People are secure from intrusion by others.
- Freedom to Enter and Compete in Markets

Visit  
**FreeTheWorld**

<http://www.freetheworld.com>





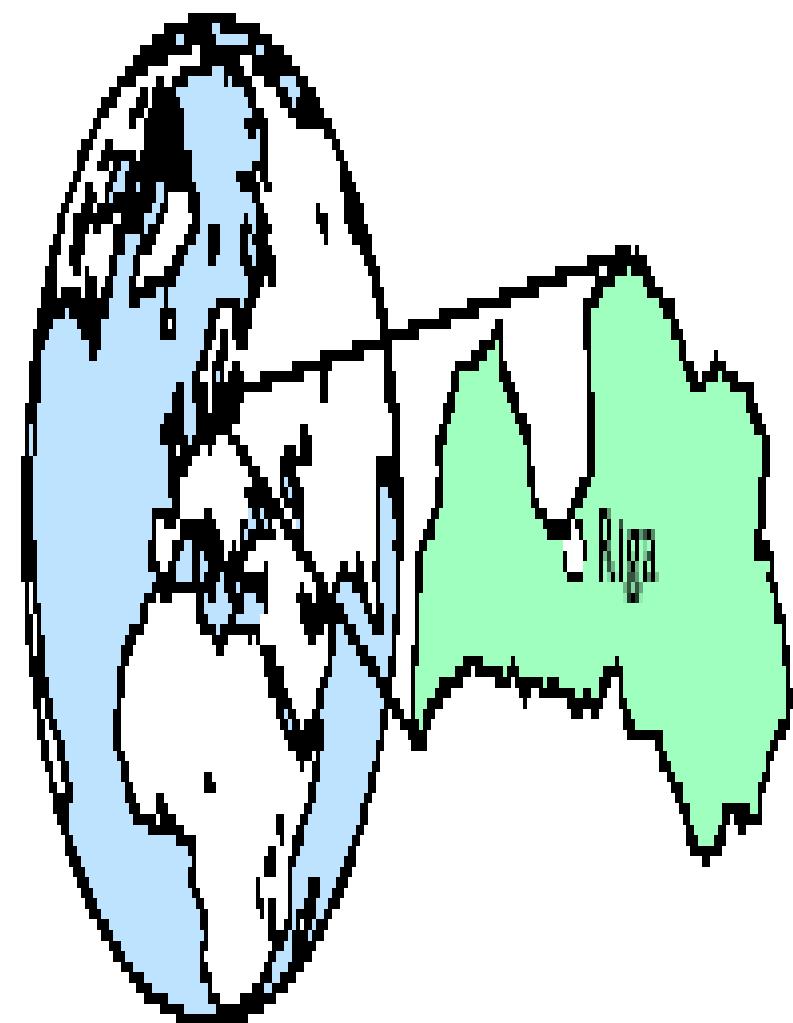


# ESTONIA

Rank: 4

Score: 1.80

Category: *Free*

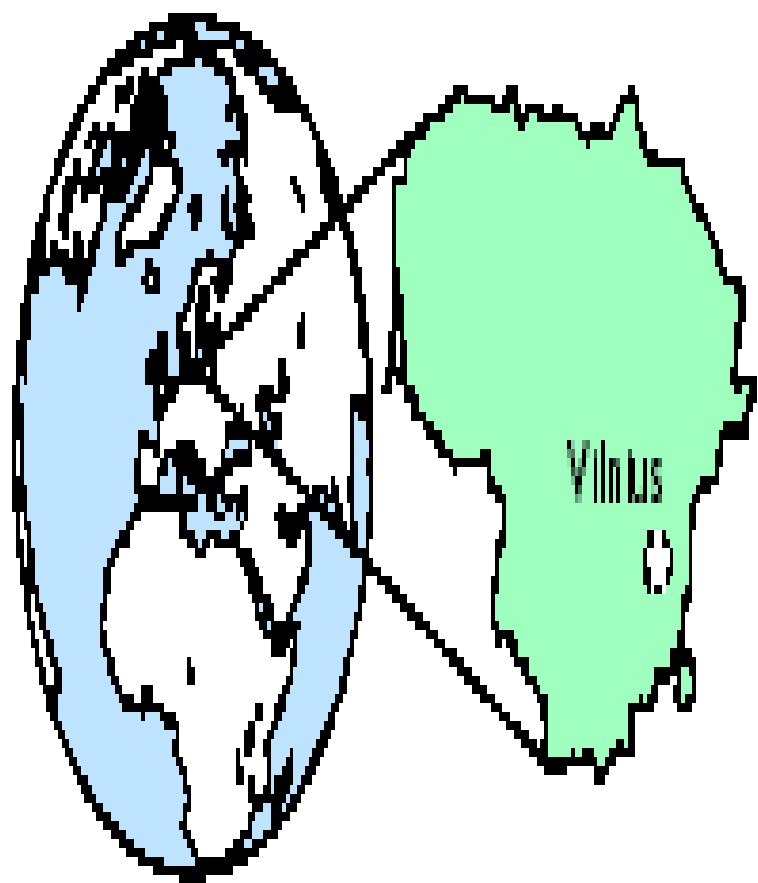


# LATVIA

Rank: 38

Score: 2.50

Category: *Mostly Free*



# LITHUANIA

Rank: 29

Score: 2.35

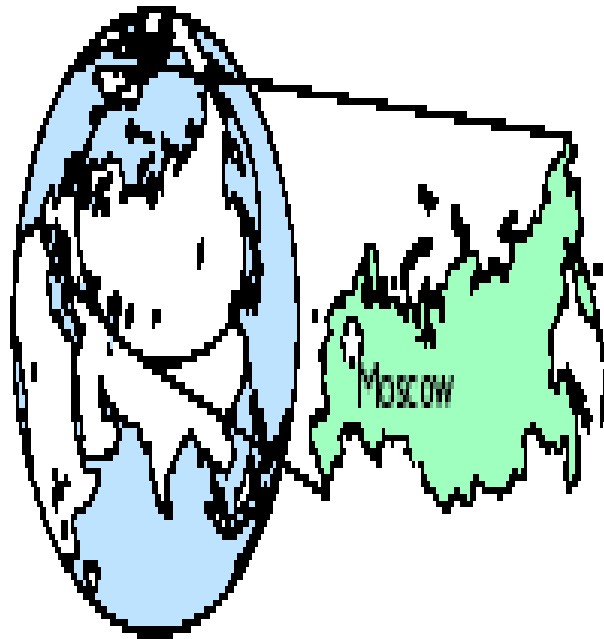
Category: *Mostly Free*

**Who benefits from business regulation  
(as reported by Lithuanian and Swedish  
entrepreneurs)**

	<b>Lithuania</b>	<b>Sweden</b>
<b>Government Bureaucrats</b>	90.9	29.3
<b>Government Monopolies</b>	4.6	16.4
<b>Nobody</b>	4.2	9.3
<b>Customers</b>	2.5	45.0
<b>Competitors</b>	1.4	0.0

# Poverty and Underdevelopment

1. Underinvestment due to harassment or destruction of the rich
2. Resource curse propping up egalitarian regimes and
3. Government economic policies and consequent...
4. Lack of technological innovation
5. Lack of education

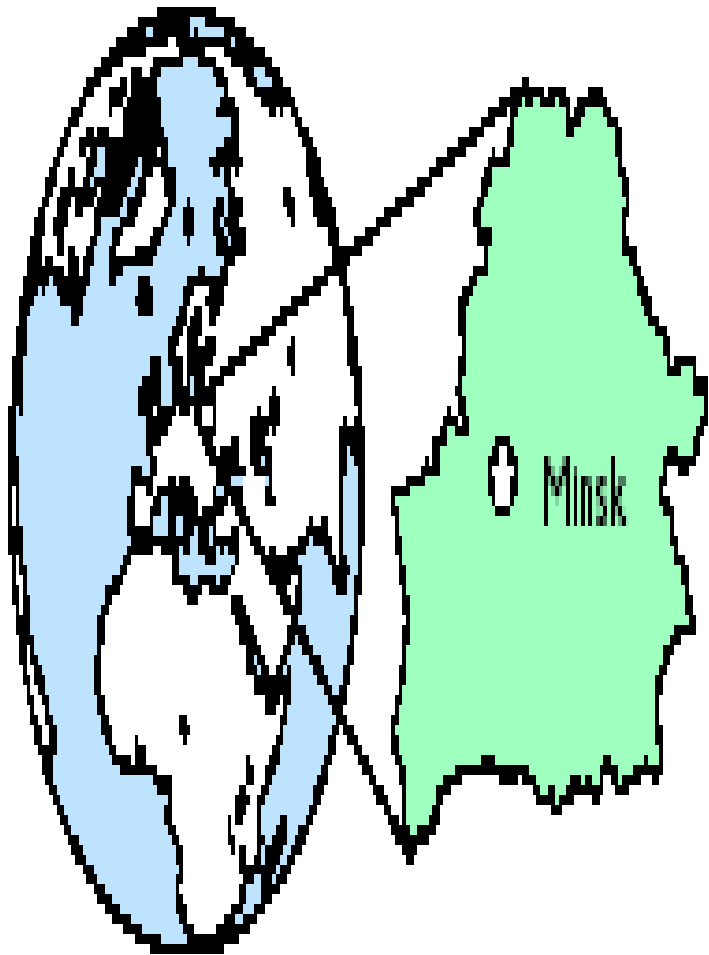


# RUSSIA

Rank: 131

Score: 3.70

Category: *Mostly Unfree*



# BELARUS

Rank: 148

Score: 4.35

Category: *Repressed*

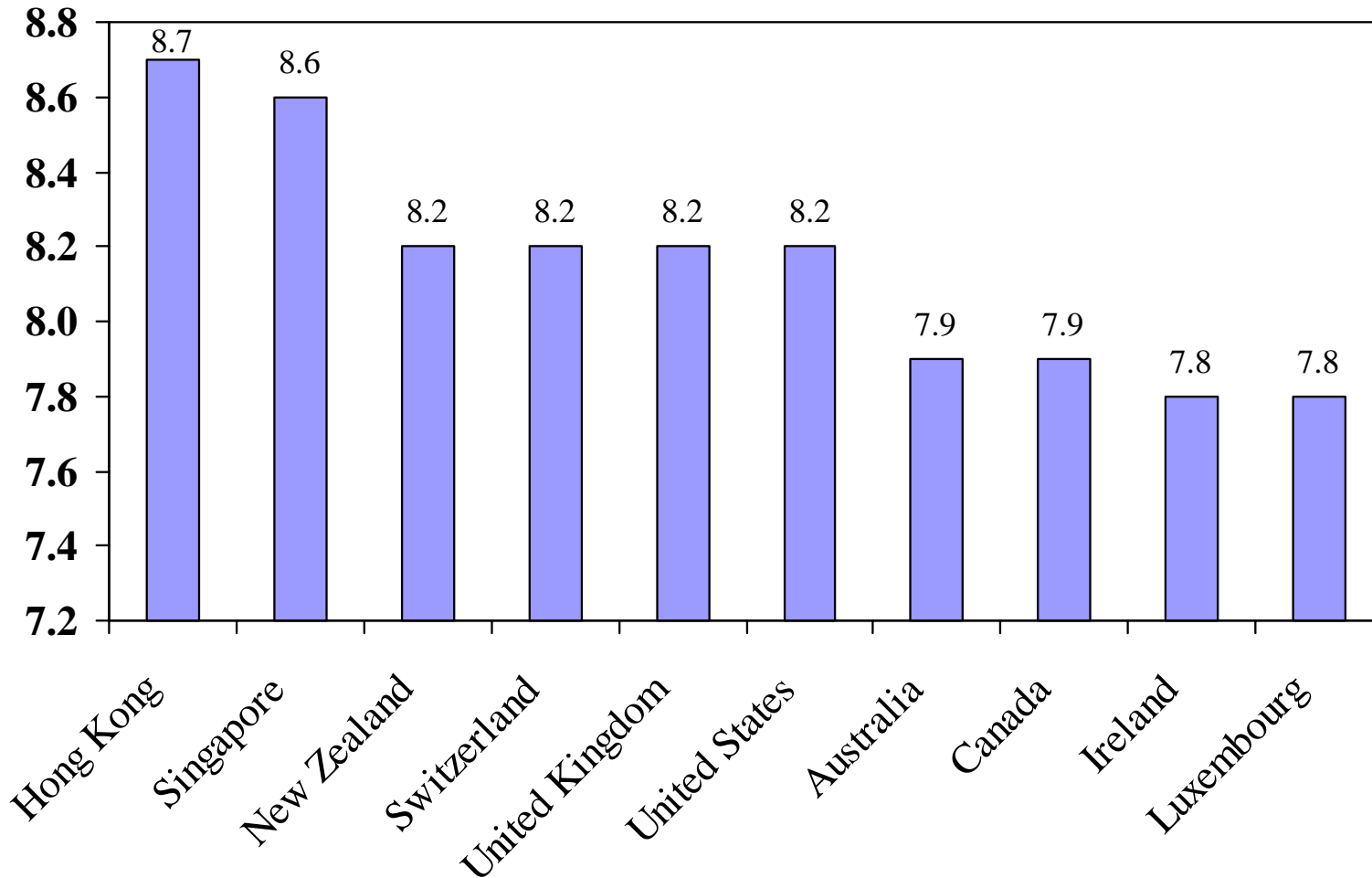
# 5 Areas of EFW Index

1. Size of Government: Expenditures, Taxes, and Enterprises (4 Components)
2. Legal Structure and Security of Property Rights (5 Components)
3. Access to Sound Money (4 Components)
4. Freedom to Exchange with Foreigners (5 Components)
5. Regulation of Credit, Labor, and Business (3 Components)

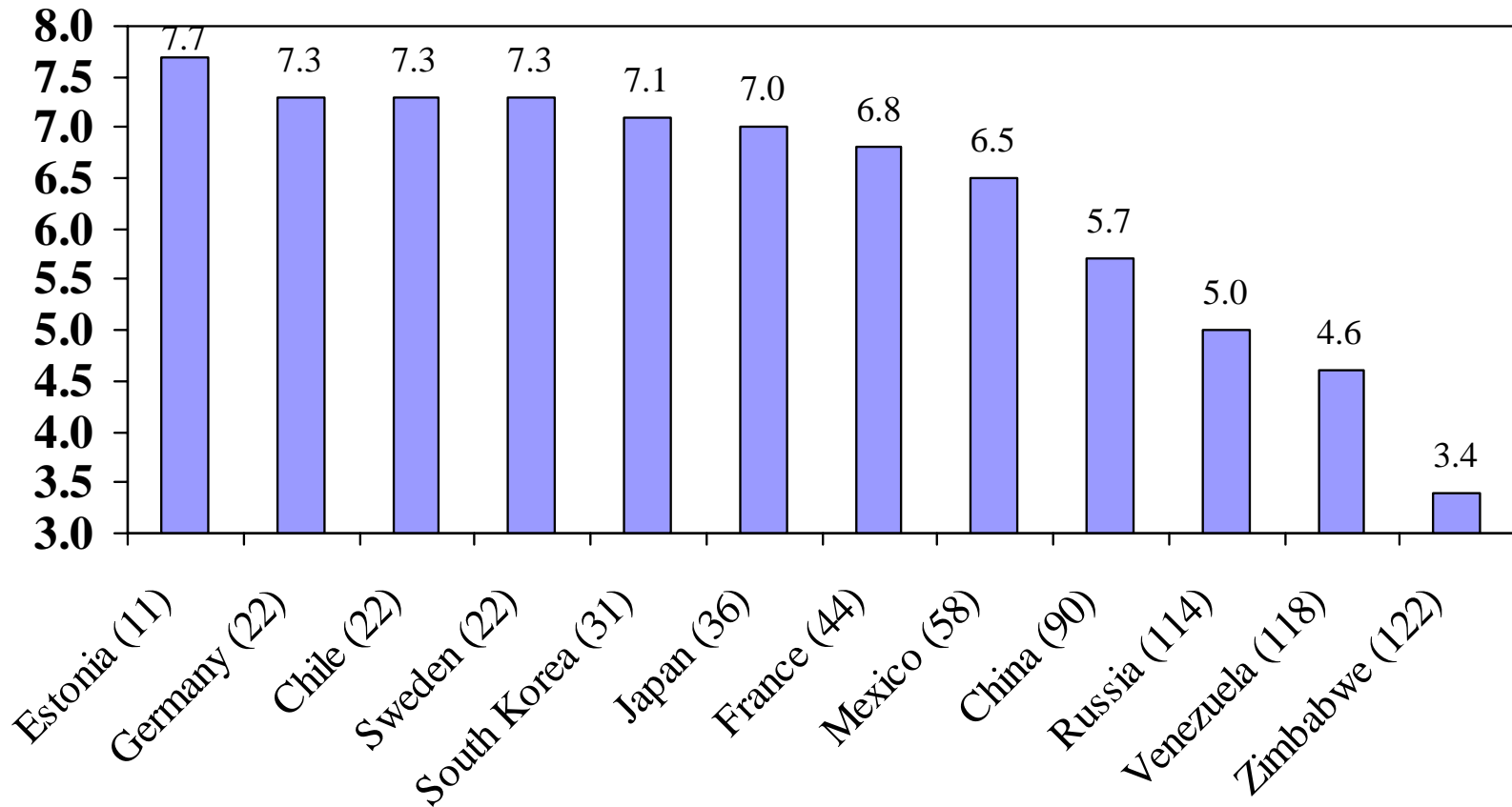
# Methodology

- uses quantitative/objective and third party data (WB, IMF, GCR, ICRG, PWC)
- large number of countries
- long time period
- Zero to 10 ratings (10 means more free/less intrusion).
- 5 Areas, 38 Components and/or Sub-Components
- 60+ institutes around the world

# Which are the freest economies in the world?

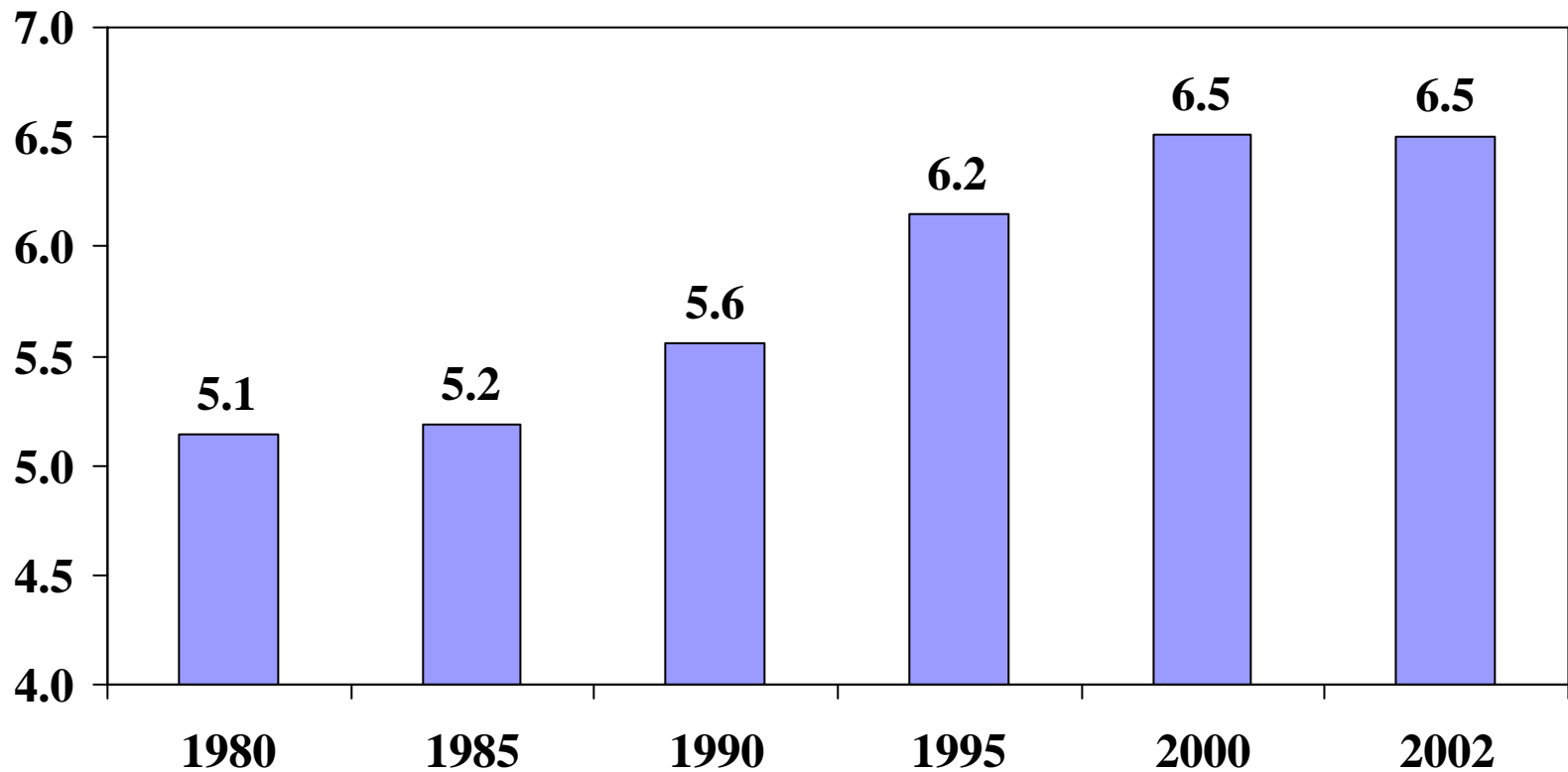


# Economic Freedom Ratings of Selected Countries



# Economic Freedom Is Increasing

(Mean Summary Rating, 1980-2002\*)



Source: Exhibit 1.5

\*chain-linked index

# A look at selected components...

- Monetary policy is more stable.
  - In 2002, only 15 of the 104 countries with complete data since 1980 had inflation rates greater than 10%. In 1980, 76 did.
- Marginal tax rates are lower.
  - In 2002, no country imposed a top rate greater than 60%. In 1980, 49 did.
- Exchange rate controls have been lifted.
  - In 2002, only 4 countries had significant black markets in foreign exchange compared with 36 in 1980.
- Tariffs are lower.
  - The average tariff rate has fallen to 10.4% in 2002 from 26.1% in 1980

# A look at selected countries...

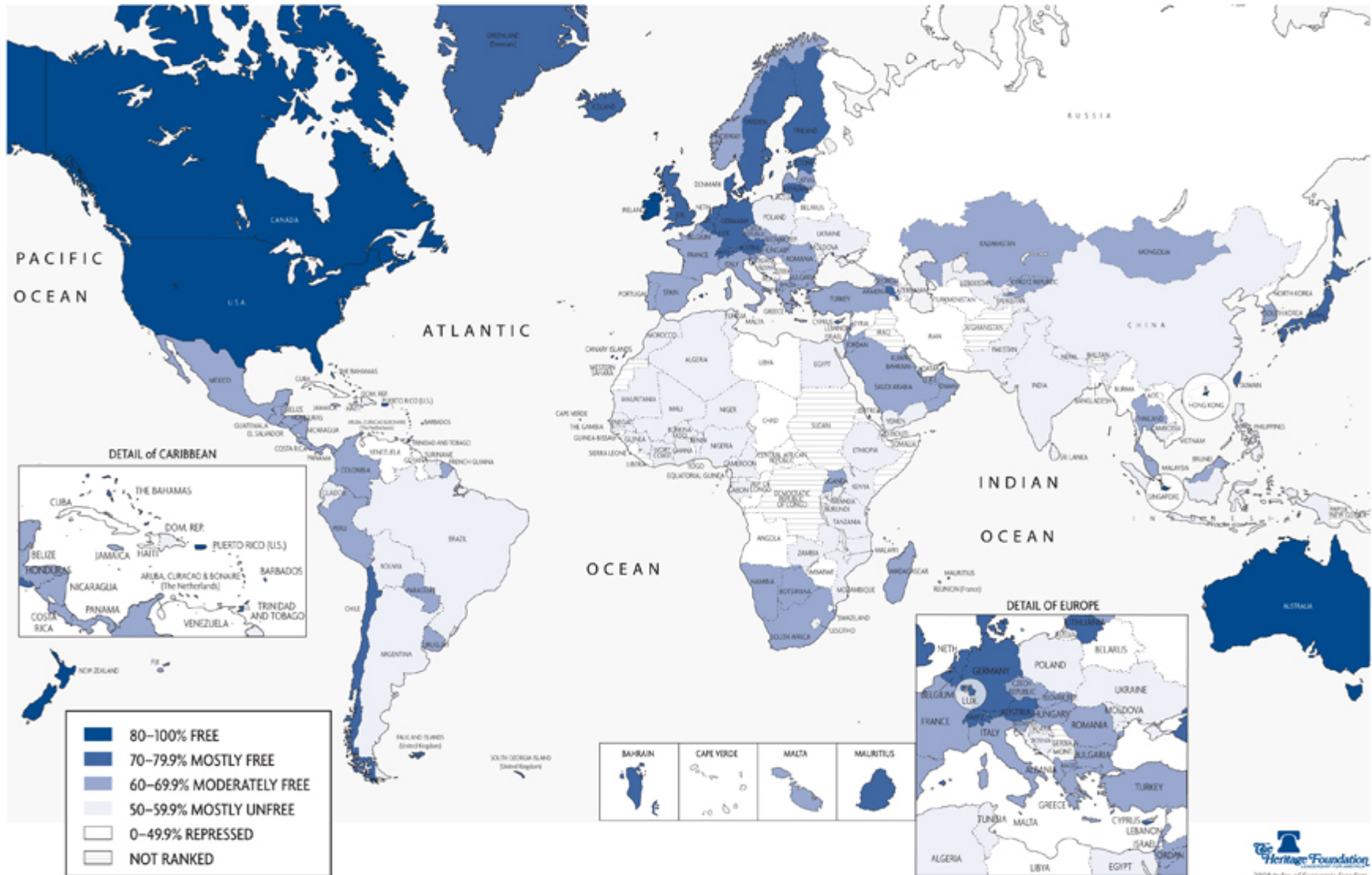
- Botswana
  - Up to 7.4 in 2002 from 5.1 in 1985.
- Chile
  - Up to 7.3 in 2002 from 3.6 in 1975.
- China
  - Up to 5.7 in 2002 from 3.8 in 1980.
- India
  - Up to 6.3 in 2002 from 4.9 in 1990.
- Ireland
  - Up to 7.8 in 2002 from 6.2 in 1985.
- New Zealand
  - Up to 8.2 from 5.9 in 1985.

# A look at selected countries (cont.)

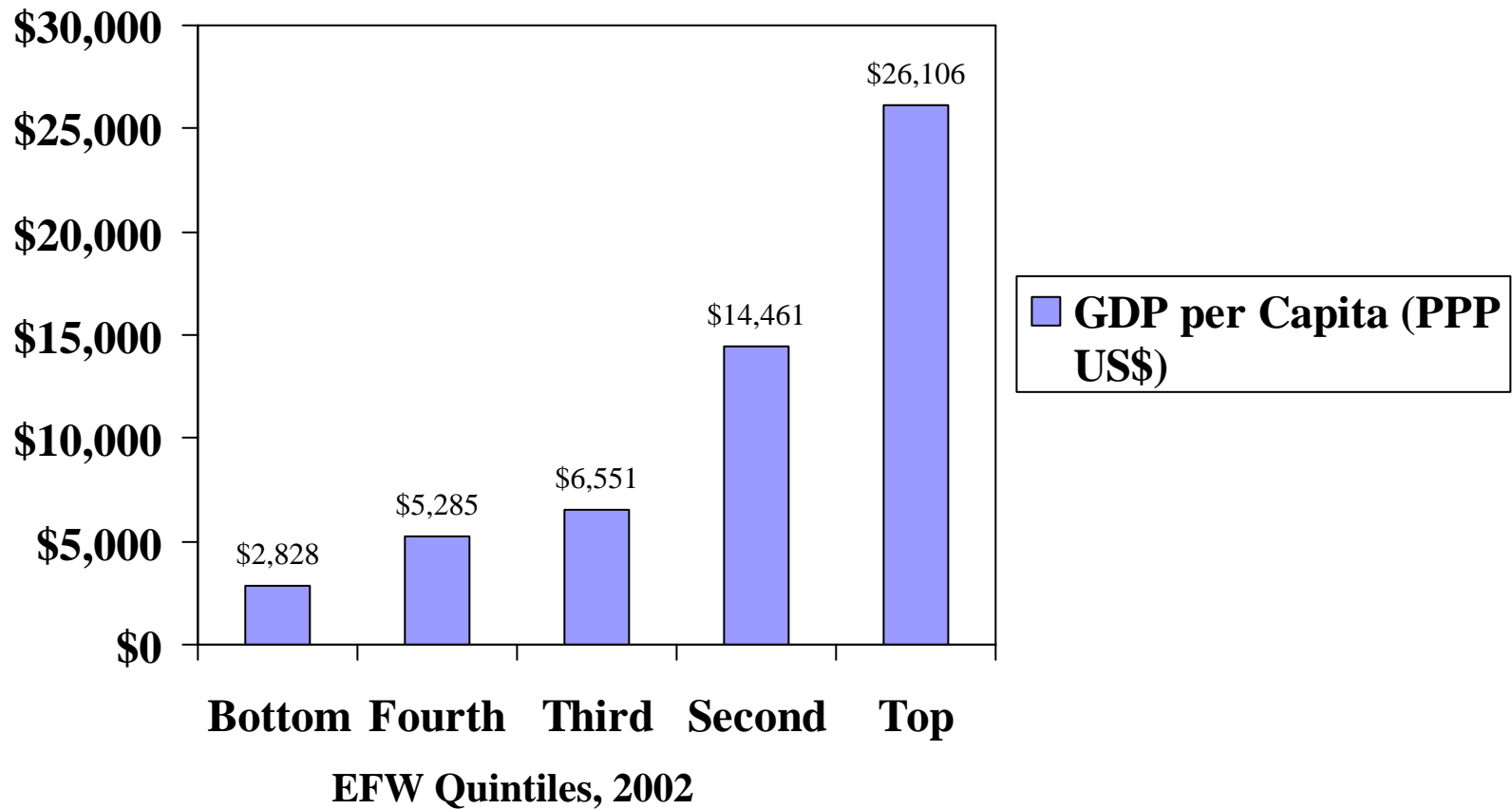
- Estonia
  - Up to 7.7 in 2002 from 5.3 in 1995.
- United Kingdom
  - Up to 8.2 in 2002 from 6.1 in 1980.
- Uganda
  - Up to 6.6 in 2002 from 2.6 in 1990.
- Zimbabwe
  - Down to 3.4 in 2002 from 6.0 in 1995.
- Argentina
  - Down to 5.8 in 2002 from 6.7 in 1995.
- Venezuela
  - Down to 4.6 in 2002 from 6.7 in 1980.

# HERITAGE FOUNDATION

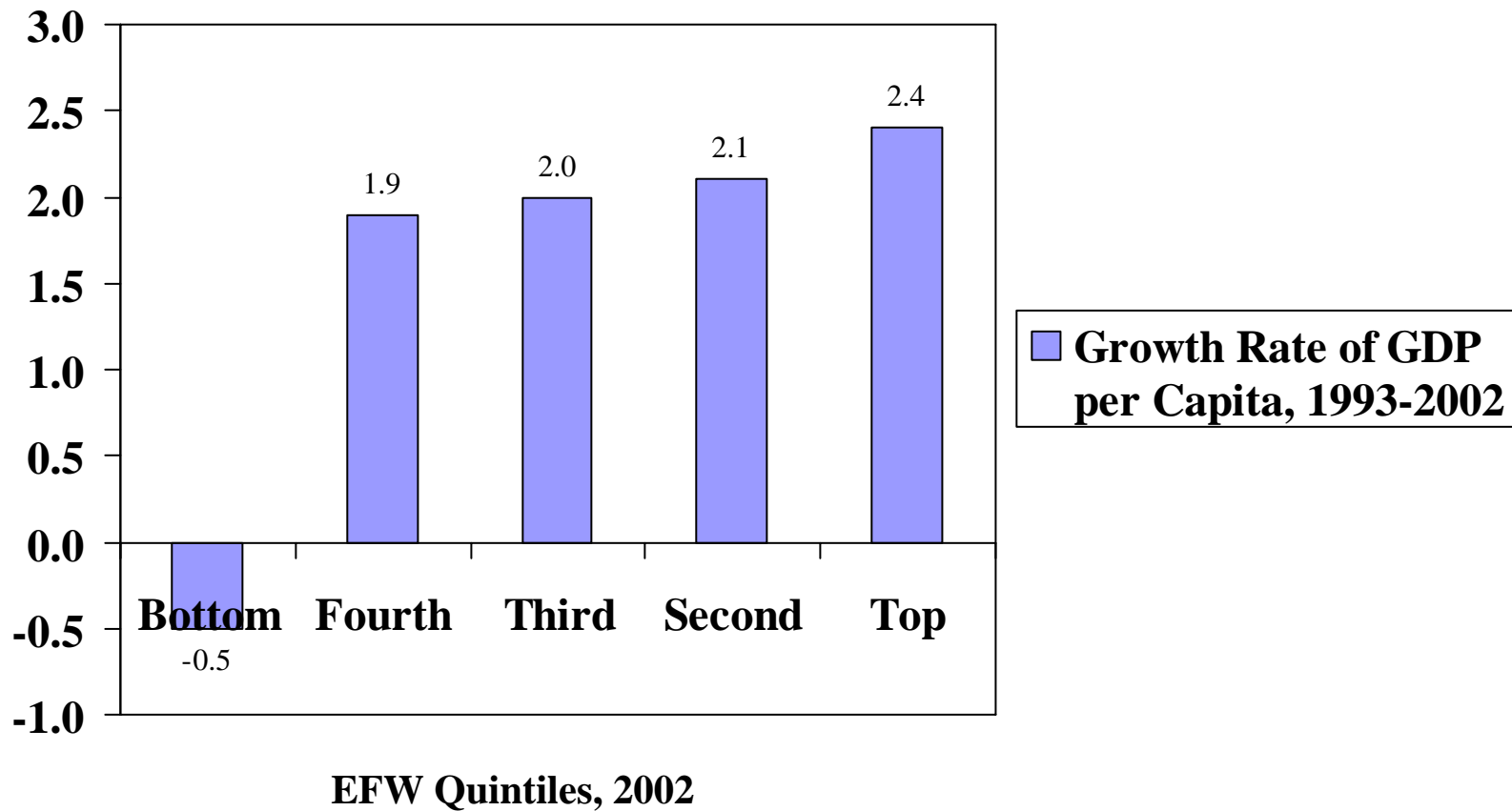
## DISTRIBUTION OF ECONOMIC FREEDOM



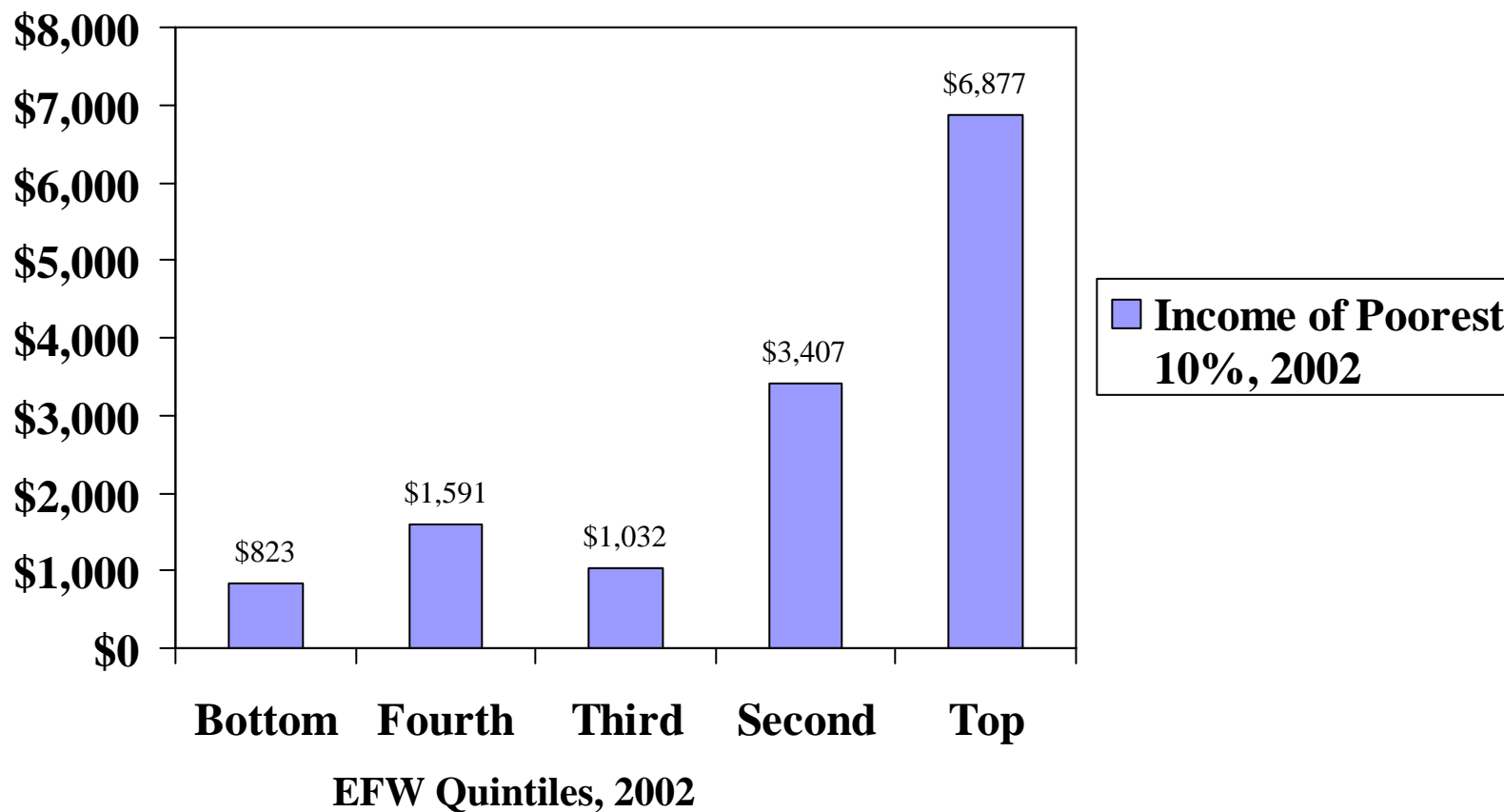
# Economic Freedom and Per Capita Income



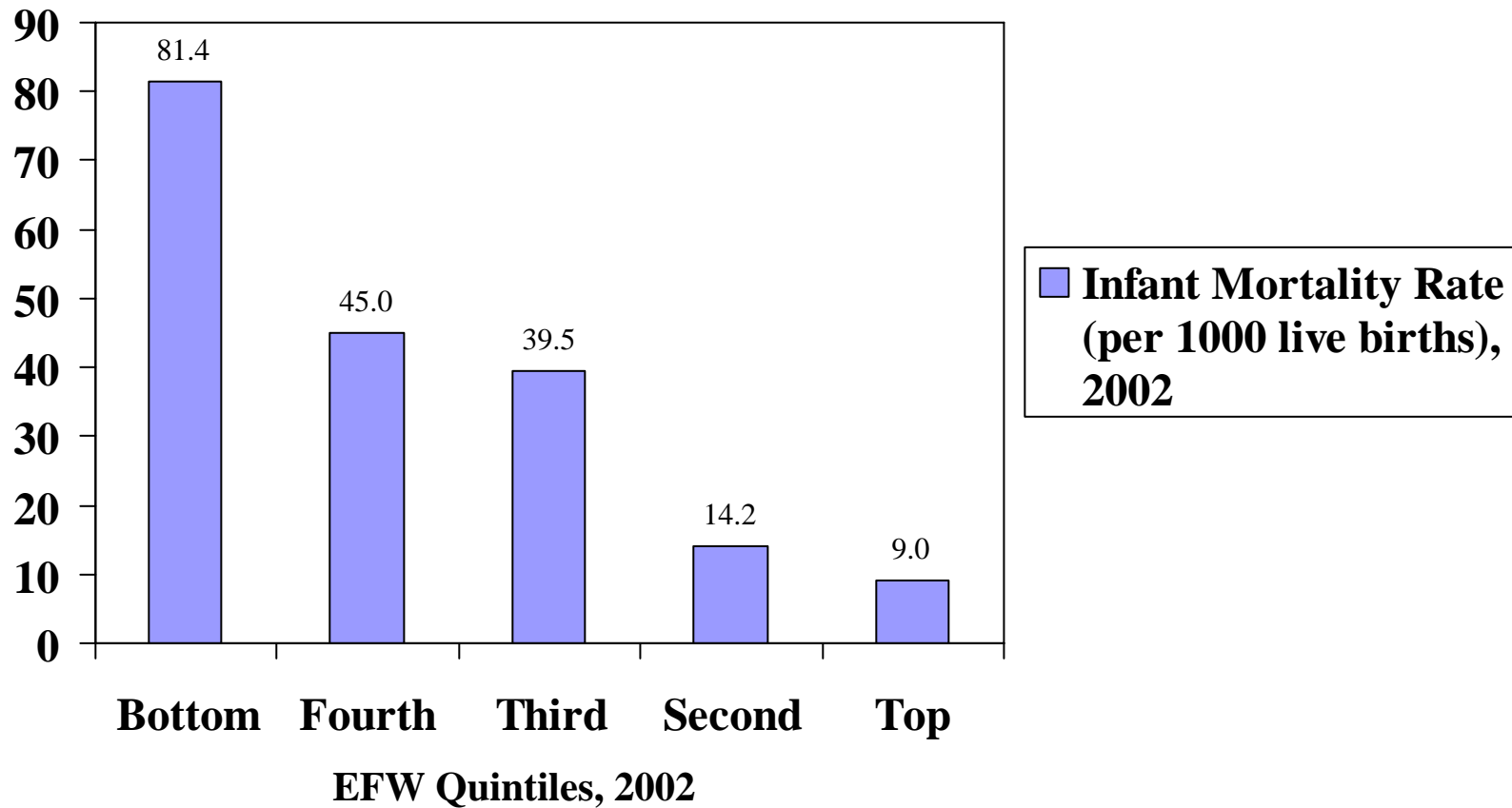
# Economic Freedom and Economic Growth



# Economic Freedom and the Income Level of the Poorest 10% of Population

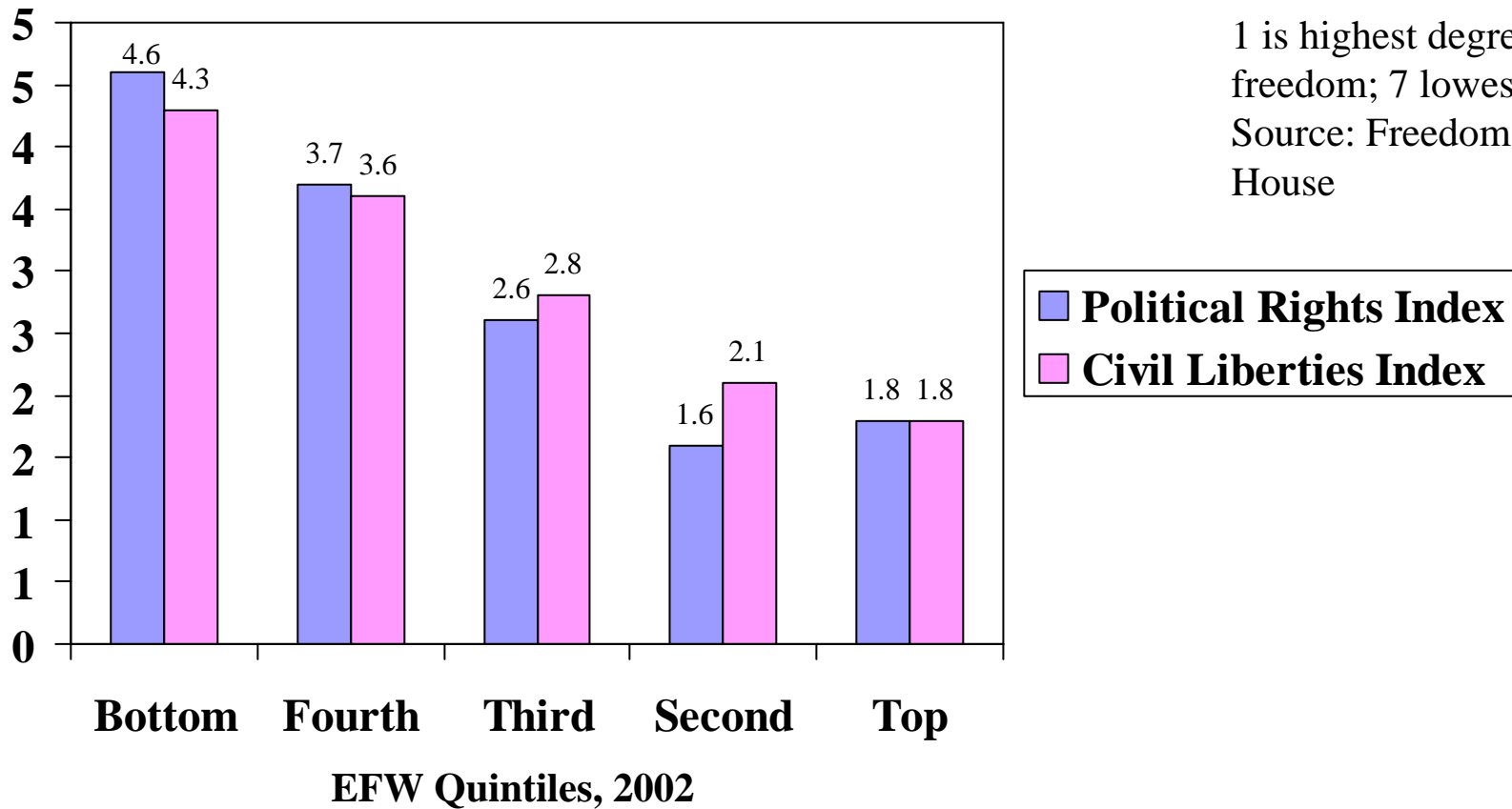


# Economic Freedom and Infant Mortality



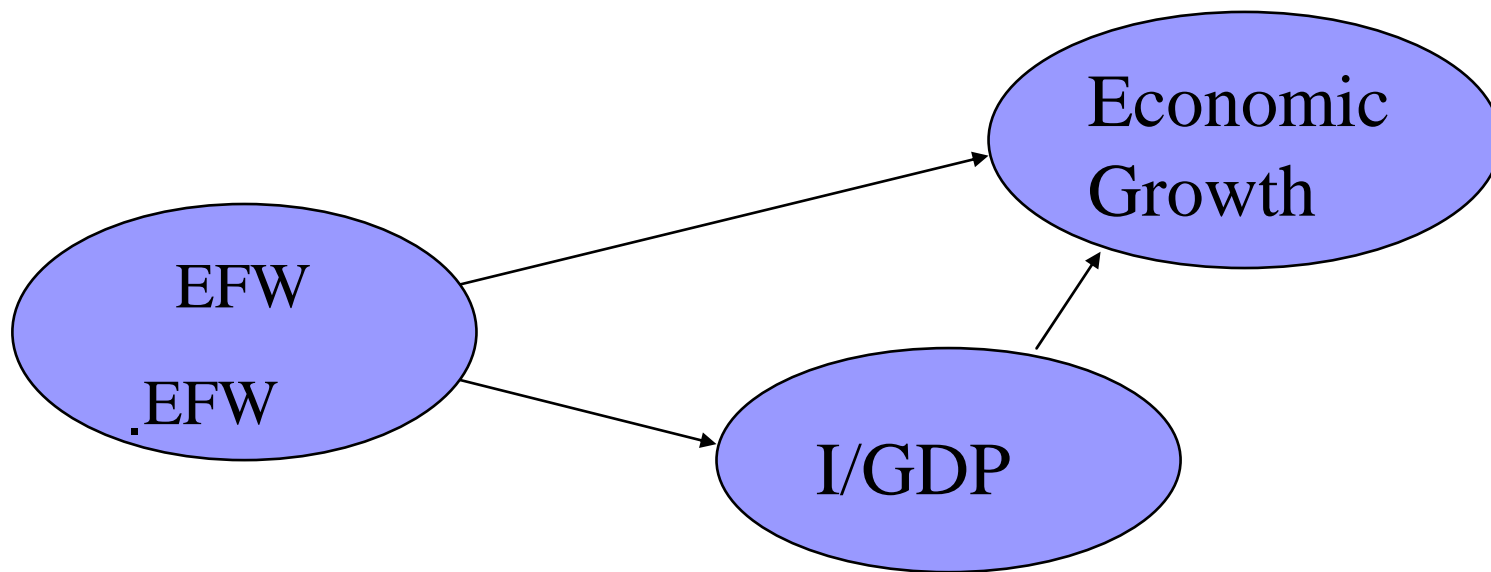
# Economic Freedom and Political Rights and Civil Liberties

Note: Political Rights and Civil Liberties are measured on 1-7 scale: 1 is highest degree of freedom; 7 lowest.  
Source: Freedom House

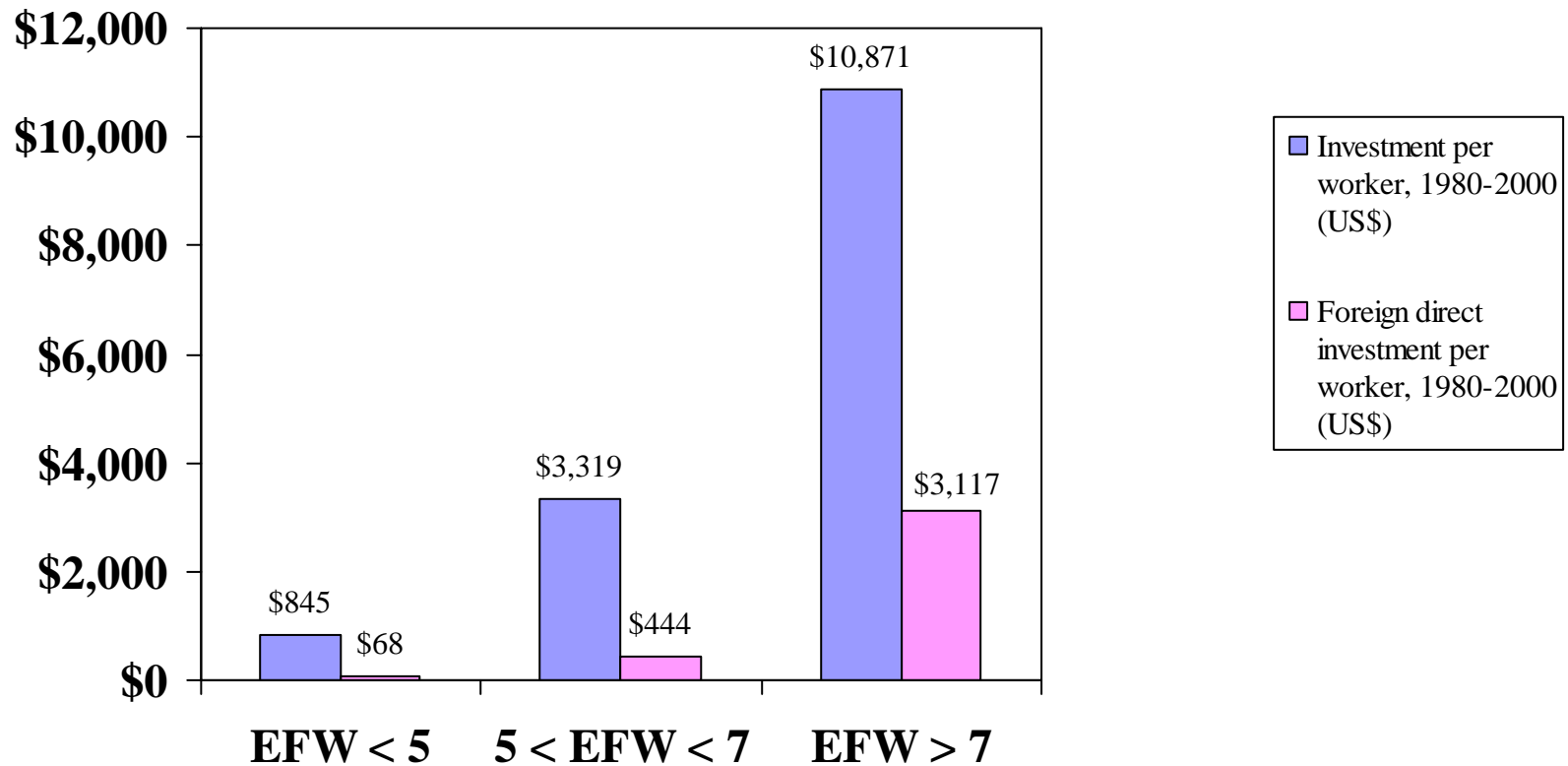


# Chapter 2

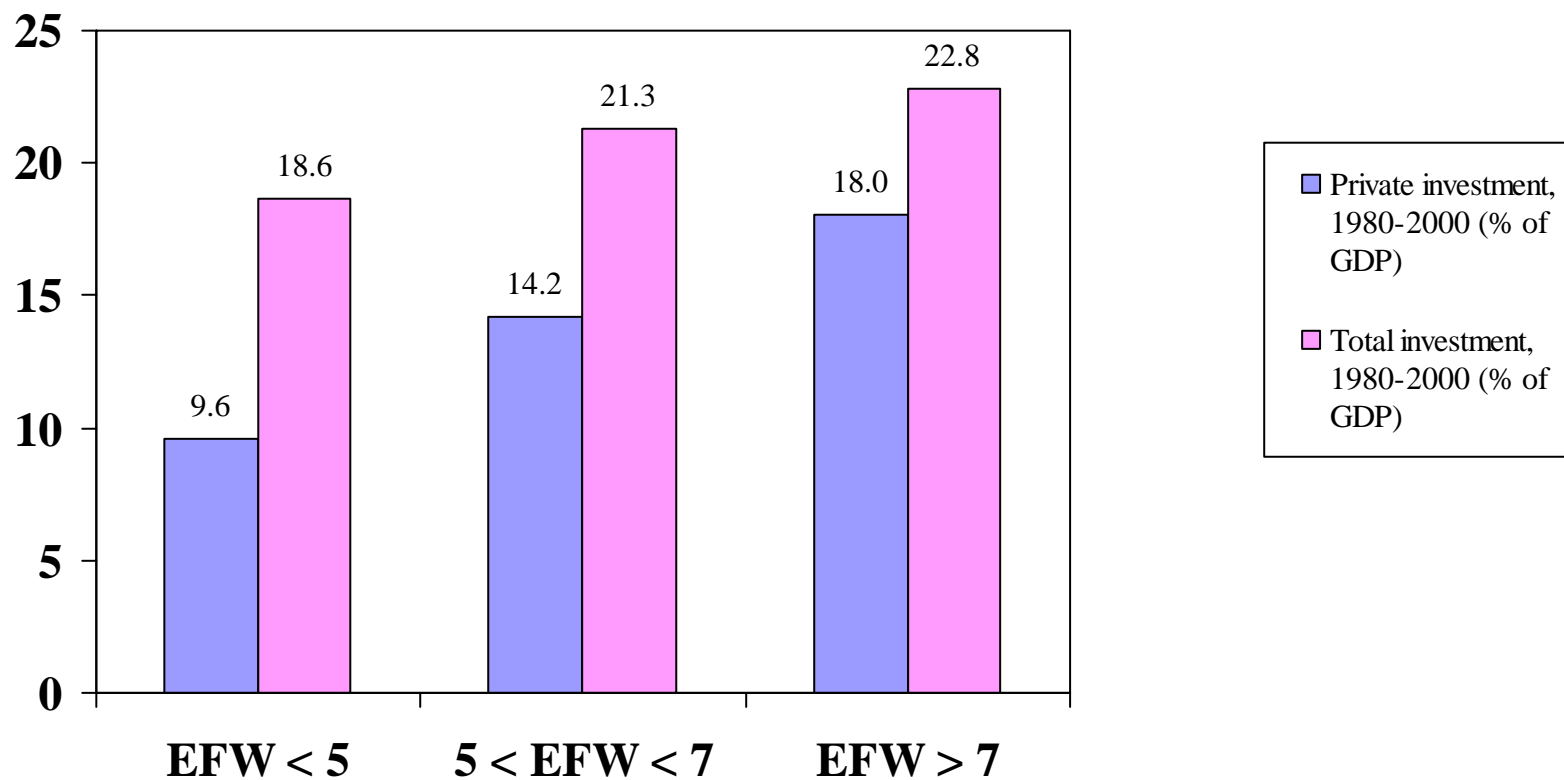
- Study of the empirical relationship between Economic Freedom and Investment and Growth.



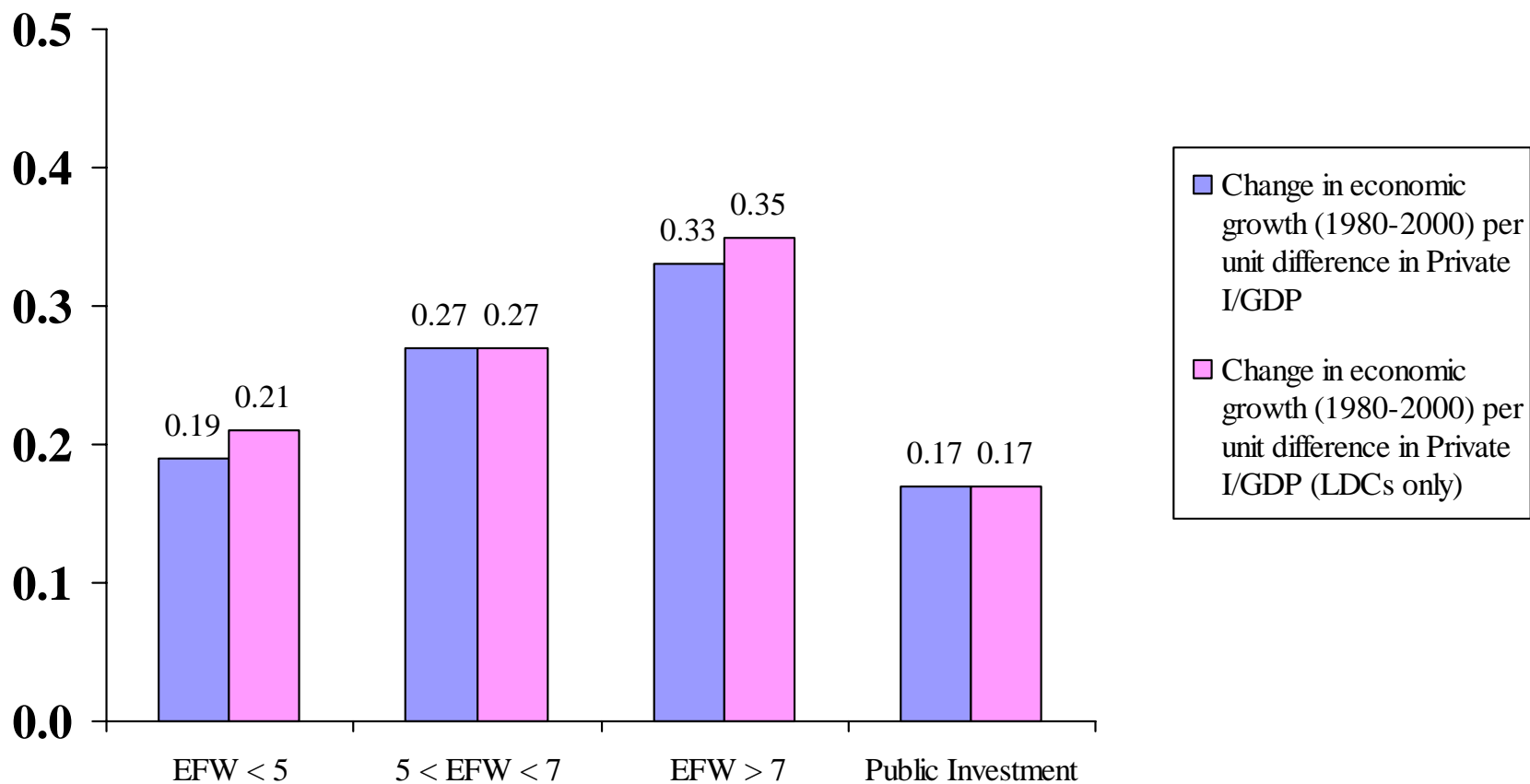
# Economic Freedom and Investment Per Worker, 1980-2000



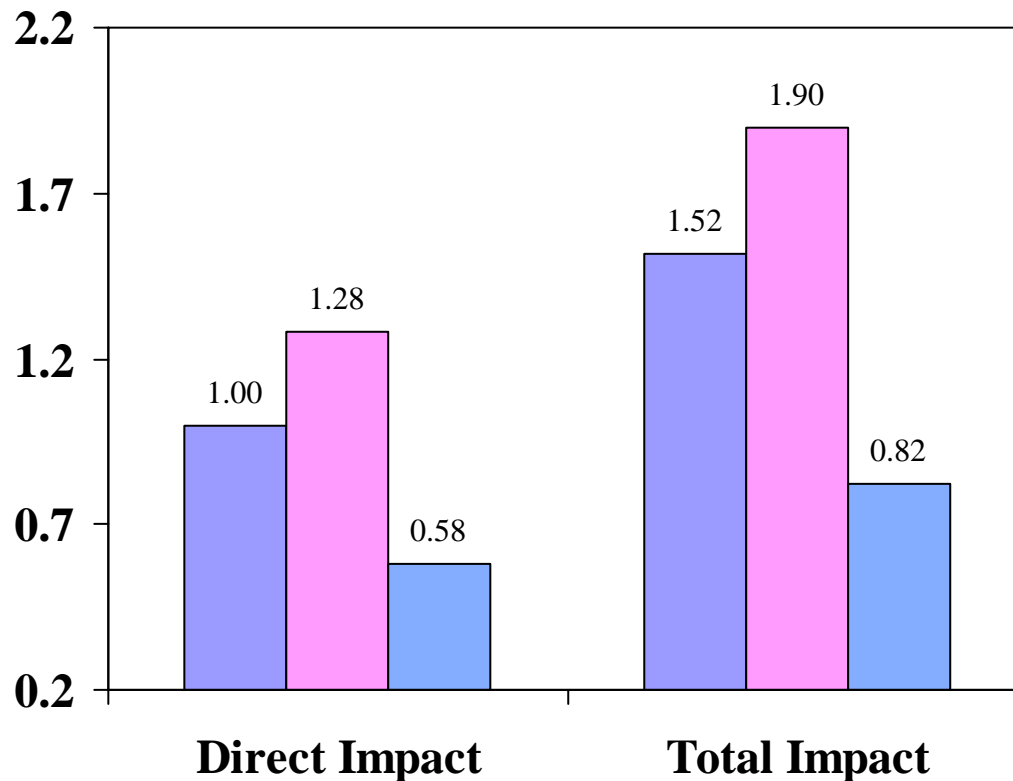
# Economic Freedom and Total and Private Investment as a Share of GDP, 1980-2000



# Economic Freedom and the Productivity of Investment, 1980-2000



# Economic Freedom and Changes in Economic Freedom and Economic Growth, 1980-2000



- Estimated impact of a one-unit difference in the 1980 EFW rating on growth of GDP per capita, 1980-2000.
- Estimated impact of a one-unit change in EFW in the 1980s on growth of GDP per capita, 1980-2000.
- Estimated impact of a one-unit change in EFW in the 1990s on growth of GDP per capita, 1980-2000.

# Ludwig von Mises

- **The more extensive the government's intervention becomes, the greater becomes the gap between the life that people must live and the better life they could have lived had the government not stood in their way. At some point government intervention becomes sufficient to cause people to live not only worse than they might have lived, but worse than they actually did live in the past.**