The Triggers of Competitiveness

EFIGE Conference organised by Bruegel jointly with the National Bank of Belgium (NBB)

Auditorium of the National Bank of Belgium, 06 December 2011

"Countries do not compete, produce and trade. Firms do."

Luc Coene, Governor of the National Bank of Belgium - Welcome Address

Competitiveness is a subject of most importance. Competitiveness is of capital importance for the growth of an economy. As such it regards all economic stakeholders including National Central Banks. For them it is a question of building a balanced and stable macroeconomic framework in order to boost the employment rate and incentivise entrepreneurship and innovation. Measures taken to achieve this objective should improve inflation control and a moderate growth in wage costs. Competitiveness is fundamental for Belgium whose trade openness is now as high as 80%. Given such an open economy, growth in both economic activities and employment depends on global demand and companies' capacity to adapt to the new challenges and new opportunities in the coming years. It is not just Belgium that is affected by the link between economic growth and companies' performance in the common market. The economic and financial crisis has effectively shown to what extent the economies of the Member States of the European Union are interconnected. Via contagion effects, the consequences of an imbalance can spillover across national borders and affect other countries. Since in a monetary union, like the European Monetary Union, exchange rate rates can no longer be used, the policies that can be implemented in order to smooth out imbalances between the partners of the Union are primarily of a structural nature. In this sense, they take some time to have an effect so it is of the utmost importance to put the necessary adjustment measures into place as rapidly as possible.

European policy has drawn its lessons from the crisis and has developed a number of instruments for detecting imbalances in good times, as well as working out the mechanisms for correcting them, and even implementing sanctions if appropriate action is not taken. The development of the European Commission scoreboard in the framework of the European Semester and more specifically the excessive imbalance procedure falls into this context. The objective of this initiative is to detect in real time the emergence of any structural imbalance. The scorecard comprises very different indicators for assessing competitiveness, such as current account imbalances, changes in the export market share, wage costs or real exchange rates. Globalisation related challenges are in fact quite considerable for all the governments. The rapid emergence of new economic centres has led to an expansion of international trade. The expansion of trade flows from emerging economies has been quite spectacular. Availability of cheap labour and adoption of the new technologies made their economies able to compete at the global level. Their effect is evident not just in the domestic but also in the export market. Facing these major changes is not only a question of adapting with a purely defensive aptitude. The challenge is not just to recover, as much as possible, national market shares, but also to equally benefit from the exceptional opportunities that the growth in demand of emerging economies offers in terms of outlets of firms' products. To tackle this growth it is essential to develop firms' own capacity to adapt and innovate. Specialising in research and development enables firms to remain dynamic on the export markets (it's not clear what kind of products you are trying to develop). This specialisation in high value added products also gives firms a chance to pass-on increases on input costs and raw material costs, in particular, to the sale prices. Conversely, this capacity to sail off on foreign markets at high prices is limited for standardised products which are in abundance. Moreover, this difficulty for standardised products tends to be exacerbated in times of crises when the global demand for such products is already feeble. Responding to competition therefore requires a particular effort in terms of quality, product differentiation and productivity. At the same time, fear of competition on the global market encourages countries and firms to stay on the products and production processes where they have a comparative advantage.

Another feature of today's globalisation is the emergence of globalised value added production chains. The economic policy challenge here is to encourage high value added and job creating productions. To these ends, new initiatives aim to set up new indicators seeking to measure the value added of exports. Developed economies are those facing a major challenge. Of course, exports are not the channel for generating economic development, but presence on foreign markets helps to safeguard and consolidate nations' prosperity. Moreover, exports act as catalysts for productivity increases in the domestic markets. Firms must be as widely involved as possible in the development of international trade. An economy's ability to increase its steady and balanced standard of living will depend on its capacity to adapt in order to take advantage of globalisation and technological progress.

The hardest task is still to identify the economic strategies and policies which are best able to respond to the challenges of globalisation. To this end, micro-economic analysis has proved to be an essential complement to the traditional macro-economic analysis. In order to be able to accurately understand the elements explaining business competitiveness indicators and thus to device the best economic policies, it is essential to look into the situation of individual firms. Over the last few years many findings coming from microeconomic studies, focusing on firms' products and markets, have been able to detect details invisible at the aggregate level. Thanks to these studies it is now a well-known fact that characteristics and performances vary widely across firms within each branch of production, whether in terms of size, productivity or internationalisation. It is therefore essential to single out the most competitive firms. The comparison between these enterprises and other firms in the same sector will enable a better understanding of the key tools to success. Here the economic policy stakes are twice as high. What needs to be done is to pinpoint what measures can help firms to go beyond the crucial threshold of productivity and also to target firms that can contribute the most to growth and employment. Microeconomic analysis has shown that only few firms go international and these are the biggest and the most productive ones. These firms are capable to go over the crucial threshold beyond which internationalising becomes profitable. These superstars account for the vast majority of trade flows and are characterised by product variety and export markets. These factors do hold for the trade of goods as well as for the trade of services, which has been recently growing fast.

Beyond this static comparison between different enterprises at a given moment in time, studying the dynamics of business internationalisation is indispensable for future economic growth. In fact, the microeconomic analysis has revealed that while the superstars account for the lion share of exports, it is new experience in exporting, what is called the extensive margin, that contributes to growth over the medium and long run. This new experience is due to the emergence of new exporters, the development of new products and entry into new markets. It is therefore important to understand which are the factors encouraging a move into foreign markets and to pinpoint the constraints to development in foreign markets. A number of difficulties and uncertainties concern for example consumer preferences, growth opportunities of these markets, potential entry barriers, the choice of the appropriate intermediary or distributor and the profitability of such an investment. There are two types of elements influencing business internationalisation. On the one hand, there is the entrants' performance that is productivity and the quality of variety of their product. On the other hand there are the extra-firm factors such as demand on the product market. Weighting up the importance of each of these elements is crucial for developing efficient economic policies. As for firms' intrinsic performance, basic research and R&D can be promoted in order to develop, for instance, new products and new needs of production. This can encourage old competitors to grow not only on the external market, but in the domestic market too. Moreover, as extra firm factors are concerned, the role of trade fairs economic missions and trade agencies can proved to be quite important for the distributers of exporting goods and help them to go accurately on external markets, above all the most distant ones.

Starting up an export activity is a risky business. Considering the investments involved in setting up into a new market, the role of financing in this process cannot be overlooked. At this point, the impact of the undergoing financial crisis on exports projects and foreign investments is not yet clear. It is known that the rise in prices and the collapse in demand reduced exports by 30% in 2008-2009. According to recent studies, this drop in trade flows doesn't seem to be in firms pulling out of certain markets. Besides, international trade picked up again quite quickly as a result of any protectionist reaction.

As it is usual with scientific research, those findings raise additional questions. For example, the influence of business investments on new trade relations would deserve to be better understood, especially in the case of today's crisis. Earlier research work has shown that firms likely to have difficulties in finding new funding have a lower propensity to go into foreign markets. Business financing may prove to be essential for research and development, a key source for productivity improvements and new product development. It can be absolutely indispensable for establishing subsidiaries abroad. Considerable funds are also necessary for perspective studies and market research carried out with a view of starting a new export business. Among the many questions still needing answers, some include: in what way the financial crisis has affected firms, by reduction in the size of growth grants or by the increase in borrowing costs and guarantees; which firms have been the most hit by the crisis, small enterprises that have started their business on a new market or the big ones; which factors have been particularly affected; which are the projects more risky, but also the most promising in terms of business opportunities, among investments in research and development, internationalisation projects and starting business in the most distant markets; and what impact this had on future productivity and competitiveness of firms.

We cannot overlook the fact that we live in economies that are constantly changing, that have to face up the emergence of new economic stakeholders in the world. In this context, we really have to understand that this competition generates redistribution between firms, between export markets, export products and product ranges. Likewise, identifying strategies put into practice by firms that have been able to appropriately face this competition is evidently vital for establishing an appropriate economic policy. It is only by concentrating on the products where firms are more competitive or by improving the quality of their exports that firms have best resisted this competition from emerging economies on the external market. To sum up, the globalisation phenomenon opens up a vast array of new questions, many of which are essential for future growth and development.