Microeconomic Aspects of Competitiveness: Lessons for Post-Crisis Growth Policies

Prof. Christian Ketels
Institute for Strategy and Competitiveness
Harvard Business School
and
Center for Strategy and Competitiveness
Stockholm School of Economics
Policy Priorities after the Crisis

Acute crisis response

Exit from emergency measures

The quest for growth
Empirical Observations

- Many countries have achieved high growth for some periods of time.
- Few countries have been able to sustain high levels of growth; high growth episodes are often followed by dramatic slow-downs.
- Episodes of high growth are often preceded by macroeconomic stabilization and (international) market opening.

- What policies can support sustained growth?
Growth Spurts and Competitiveness

Productive capacity $\Rightarrow$ Competitiveness

- Temporary capital inflows
- Excessive government spending
- Domestic credit bubble
- Positive, temporary terms-of-trade shock

Macroeconomic Adjustment

Consumption

- Productive capacity $\Rightarrow$
- Competitiveness

GDP vs. Time
## Perspectives on Economic Growth Strategies

<table>
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<tr>
<th>Framework Conditions</th>
<th>Pro-competition policies</th>
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- Necessary but often not sufficient, at least in the short- to medium-term
Perspectives on Economic Growth Strategies

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| Industrial Policy    | No                       | Yes                      | No                       |

- Impact often short-lived and almost always negative in the long-term
## Perspectives on Economic Growth Strategies

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Dimensions of Competitiveness

Microeconomic Competitiveness (MICRO)
- Sophistication of Company Operations and Strategy
- State of Cluster Development
- Quality of the National Business Environment

Macroeconomic Competitiveness
- Social Infrastructure and Political Institutions (SIPI)
- Quality of Macroeconomic Policy (MP)

Endowments
- Natural Resources
- Geographic Location
- Size
An Empirical Approach

\[ \log GDPpc_{c,t} = \alpha_0 + \beta_{\text{MICRO}}^{\text{STAGE} c,t-1} + \beta_{\text{SIPI}}^{\text{STAGE} c,t-1} + \beta_{\text{MP}}^{\text{STAGE} c,t-1} + \alpha_{\text{END} c,t-1}^{\text{STAGE ENDOWMENTS}} + \alpha_{\text{year}_t}^{\text{STAGE} c} + \delta_{\text{STAGE} c} + \epsilon_{c,t}. \]

• Data
  – Broad set of data sources covering all dimensions of the framework
  – Unit of observation is the average response per indicator, country, and year
  – Data set is a panel across more than 130 countries and up to 8 years, using the World Economic Forum’s Global Executive Survey

• Approach
  – Step 1: Conduct separate principal components analyses for MICRO, SIPI, to derive their averages per country-year (Simple average for MP)
  – Step 2: Comprehensive regression of MICRO, SIPI and MP on log GDP per capita with endowment controls and year dummies.
    • The model allows the coefficients to vary by the stage of development:
Selected Findings

• The linear model explains **83% of the variation of GDP per capita** across countries

• The linear model reveals that **each broad competitiveness category matters**, even when controlling for the others and for endowments
  – In contrast, past literature has tended to focus on one dimension and on very long time frames

• **Weights change** by stage of development

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<tr>
<th>Linear model</th>
<th>High Stage</th>
<th>Middle/Low Stage</th>
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<tr>
<td>All Economies</td>
<td></td>
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</tr>
<tr>
<td>MICRO</td>
<td>0.35</td>
<td>0.51</td>
</tr>
<tr>
<td>SIPI</td>
<td>0.53</td>
<td>0.47</td>
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<tr>
<td>Macro Policy</td>
<td>0.12</td>
<td>0.02</td>
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<tr>
<td>1.00</td>
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The Baltic Countries in the Global Crisis

Failure of macroeconomic management

Scenario 1
- High Openness
- Additional Challenge
- Policy implication
  - Return to pre-crisis policy

Scenario 2
- Failure to Upgrade
- Additional Challenge
- Policy implication
  - Shift to new policy approach

Common Policy Failure
Overheating
Unit Labor Costs, Baltic Countries and Poland, 2000 – 2010e

Estonia
Latvia
Lithuania
Poland

Baltic Sea Region

2000 = 100%
Reversal
Current Account Balance, Baltic Countries and Poland, 2000 – 2010e
Impact

Unemployment, Baltic Countries and Poland, 2000 – 2010e

Recorded unemployment rate, %

- Latvia
- Lithuania
- Estonia
- Poland
- Baltic Sea Region
Putting the Current Crisis in Perspective

• A decade of **significant achievements**, even taking the painful current losses into account

• Clear **policy mistakes** made in the run-up to the crisis in not avoiding the overheating

• Remarkably **solid policy response** to the crisis
The Profile of Past Policy Reforms

**Micro**

- Business Environment Quality
  - Related and Supporting Industries
- Company Sophistication
- Demand Conditions
- Context for Strategy and Rivalry
- Factor Input Conditions
  - Admin
  - Logistic.
  - Capital
  - Comm.
  - Innov.

**Macro**

- Social Infrastructure and Pol. Institutions
  - Political Institutions
- Macroeconomic Policy
  - Rule of Law
  - Human Development
The Role of the EU

Macroeconomic policy
- Euro zone conditions
- Stability and Growth Pact

Microeconomic policy
- Acquis Communitaire
- Common Trade, Competition, and Agricultural Policy
- Structural Funds, Framework Programs, CIP
- Lisbon Agenda

**PROVIDED**
- Minimum standards
- Reducing weaknesses
- Generic policy targets

**LACKED**
- Strategic priorities
- Creating strengths
- Unique objectives
**Implications**

- Sustainable growth depends on a **solid mix** of micro- and macroeconomic policies
- Growth-oriented policies need to contribute to the emergence of **competitive advantages** and engage the **private sector**

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**Positioning**

*Developing a national economic strategy*
- What unique advantages does the location offer as a place to do business; for what activities?
- How do policy priorities support the strategy?

**Private Sector Development**

*Developing the capacity of local companies*
- How do policies facilitate the spreading of best practices across companies?
- How do policies support the upgrading of companies’ competitive advantages?