EVALUATION OF INTERNATIONAL COMPETITIVENESS

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Competitiveness can be defined in a number of ways. We can think of it as of a successful performance of a company or organization; or we may talk about competitiveness in a macro context such as a favourable exchange rate of a national currency. Can we also talk about competitiveness of a nation? What is it and how can it be evaluated?

There does not seem to be a common definition of what the international competitiveness of nations is. Some feel that the very notion of international competitiveness of nations is unfair and unacceptable. They argue that the nations themselves do not compete, their enterprises do. For others the notion of international competitiveness of nations is fair. They believe that creating appropriate measures of international competitiveness is central for tracking and understanding the sources of competitiveness of countries.

In this paper I classify and compare the measures developed by various authors. I suggest that the studies on the measurement of competitiveness can be classified into five groups:

1. *Particular sector studies.*
2. *Competitiveness studies at the regional / country level.*
3. *Particular competitiveness indicator studies.*
4. *Competitiveness studies at an international level.*
5. *Cross-country economic policy studies.*

Since the competitiveness studies serve a different audience and purpose, we cannot discuss which is best without first asking: best at what?

Keywords: *international competitiveness, competitive advantage*

1. Introduction

The notion of the competitiveness of nations is controversial and complex. Some scholars deny the importance of this concept, others emphasize its impracticality in economic policy analysis. Even if it is considered important, the concept of competitiveness lacks a universally accepted definition as well as a broad consensus on the appropriate empirical measures.

Analysis of the development of the concept revealed that until early 1980s the concept of national competitiveness had usually been applied in a narrow sense, capturing the countries' ability to sell their products in world mar-

kets. The indicators of cost-price competitiveness reflected a conventional understanding of international competitiveness for economists. In this context, competitiveness was usually discussed in terms of cost, price and productivity differentials. This perception changed when, threatened by the competition from Japan, the United States became concerned with the issues of competitiveness. At that time the ways of increasing international competitiveness became an important topic of discussions in American industrial, political and academic circles. The acute national economic development concerns were reflected in competitiveness proposals that emphasized:

1. Industrial infrastructure development.
2. Support for critical industries.
3. Changes in laws and regulations to encourage cooperative business ventures and alliances.
4. Changes in economic and tax policies to encourage personal savings and so free money for investment in research and development and capital equipment.
5. Product development and production concerns through technology commercialisation.
6. Government sponsorship of generic research.
7. The use of national laboratories and research universities to advance technology.
8. Total quality management.
9. Worker training.

Various institutions such as President's Commission on Industrial Competitiveness and Council of Competitiveness were established on the governmental level to evaluate, analyse and monitor the state of international competitiveness of the U.S. In 1985 US President's Council on Industrial Competitiveness proposed the following definition of international competitiveness: "competitiveness for a nation is the degree to which it can, under free and fair market conditions, produce goods and services that meet the test of international markets while simultaneously maintaining and expanding the real incomes of its citizens".[1] One of the elements of the definition – the real income of people – broadened the perception of what the countries are competing in. For OECD, international competitiveness became "the ability to produce goods and services that meet the test of foreign competition while simultaneously maintaining and expanding domestic real income".[2]

Influenced by this thinking the World Economic Forum (WEF) defined national competitiveness as the ability of a country to achieve sustained high rates of growth in GDP per capita.

International Institute for Management Development (IMD) went even further by suggesting that national competitiveness cannot be reduced to the mere notions of GDP, because firms must cope with the political, cultural, and educational dimensions of countries, as well as their economies. Therefore, according to IMD, it is in providing firms with an environment that has the most efficient structure, institutions and policies that nations compete with each other.

The above definitions were coined in 1980s and 90s, and in fact they made no breakthroughs in economic thinking, but only rein-

[1] President's Commision on Industrial Competitiveness (1985) The publication is often called "Young Report", because it was prepared by a group of people led by the Chairman of Hewlett-Packard Co. J.A. Young.

[2] See OECD/TEP (1992), p. 237.

terpreted the findings produced by a debate on economic growth, which has a long history. The term of "economic growth" was simply replaced with "economic competitiveness".

An example of different emphasis in the debate on national competitiveness is a work by Solow (1988). He saw technological innovations and increased know-how as being crucial to national competitiveness. He also stressed the importance of the intangible factors, which drive a modern economy. Such factors include how competitiveness is perceived and the important role that the perception plays in assessing a nation's performance. It is based on an unquestionable fact that ultimately economic decisions are made by human beings whose individual perceptions crucially influence the final decision.[3]

Even though supporters of the validity of the concept suggest that "we can talk about the competitiveness of a nation, in the sense of its aggregate competitive success in all markets",[4] some prominent scholars argue that such a notion of competitiveness is unfair and unacceptable. The most famous criticism has been expressed by Krugman (1994) who argued that the doctrine of competitiveness is flatly wrong, because the world's leading nations are not, to any important degree, in economic competition with each other. According to Krugman, the nations themselves do not compete, their enterprises do and competitiveness is a seductive idea promising easy answers to complex problems. The result of this obsession, according to Krugman, is misallocated resources, trade frictions and bad domestic economic policies. He finally suggests that "competitiveness is a meaningless word when applied to national economies and the obsession with competitiveness is both wrong and dangerous."[5]

Porter (1991) also comes close to the position that the term competitiveness of a nation makes no sense, stressing that it cannot be that a country is competitive in all industries. Porter arrives at this view after dismissing different concepts of competitiveness: [6]

- a macroeconomic phenomenon, driven by variables such as exchange rates, interest rates, and governmental deficits;
- a function of cheap and abundant labour, connected with bountiful natural resources;
- a phenomenon driven by government policy: targeting, protection, import promotion, and subsidies;
- a phenomenon determined by differences in management practices.

Porter stresses that the whole notion of a "competitive nation" should be abandoned as a term having much meaning for economic prosperity. According to Porter, the principle goal of a nation is to produce a high and rising standard of living for its citizens. The ability to do so depends not on the amorphous notion of competitiveness but on the productivity with which the nation's resources (labour and capital) are employed. Porter suggests that "the rate of productivity is the only meaningful concept of competitiveness at the national level".[7]

[3] These ideas of Solow are related to the behavioral theory of economic decision-making, which stresses the central importance of the individual and is based on a psychoanalytical approach to competitiveness (e.g., some countries or regions offer the most comprehensive investment incentive schemes in the world, but they receive little investment because of negative perceptions about them).

[4] See Meredith et al. (1999), p. 34.

[5] See Krugman (1994), p. 44.

[6] He pointed out that "none of these explanations is fully satisfactory...each contains some truth; but a broader, more complex set of forces seems to be at work". See Porter (1991), p. 166.

[7] See Porter (1990), p. 2.

2. Measurement of National Competitivenes

There have been numerous attempts to measure national competitiveness. Various institutions have developed sets of competitiveness indicators, which measure the state of competitiveness on various levels (industry, region, country, international). I suggest that the studies can be classified as follows:

1. Particular Sector Studies:
   - Diamond approach (Michael Porter);
   - Global Capital Access Index (Milken Institute).
2. Competitiveness studies at the regional / country level:
   - Index of the Massachusetts Innovation Economy (Massachusetts Technology Collaborative);
   - Competitiveness Indicators of UK (Department of Trade and Industry of the UK).
3. Particular competitiveness indicator studies:
   - Price competitiveness studies: trade, productivity and exchange rate related indicators (OECD and others);
   - Non-price competitiveness studies: product specification and reliability related indicators (OECD and others).
4. Competitiveness studies at the international level:
   - World Competitiveness Yearbook (International Institute for Management Development);
   - Global competitiveness report (World Economic Forum);
   - Database of competitiveness indicators (World Bank).
5. Cross-country economic policy studies:
   - Economic freedom of the world (Frazer Institute);
   - Index of economic freedom (Heritage Foundation);
   - Freedom in the world (Freedom House).

2.1 Particular Sector Studies

To evaluate competitiveness at the industry level, Porter (1990) offered an approach which takes as its key a "diamond" of factors, which makes industries in some nations more competitive than in others. The four parts of this diamond are:

1. Factor conditions: the nation's position in factors of production necessary to compete in particular industry.
2. Demand conditions: the nature of home demand for the industry's product or service and how discriminating it is.
3. Related and supporting industries: the presence or absence of supplier industries and related industries that are internationally competitive.
4. Company strategy, structure and rivalry: the conditions governing how firms are created, organized and managed, as well as nature of domestic rivalry.

Companies gain competitive advantage outside their home markets, Porter argues, when their countries provide a dynamic competitive environment characterized by an accumulation of specialized assets and skills, and a constant stimulus to upgrade and improve their products and processes. Concerning specific government policies to promote the creation of competitive advantage, Porter suggests that a government should:

1. Focus on specialized factor creation encouraging specialized apprenticeship programs, universities' research connected with specific industry, trade association activities, private investments of companies.

2. Avoid intervening in factor and currency markets.
3. Enforce strict product, safety, and environmental standards (strict standards must be combined with a rapid and streamlined regulatory process that does not absorb resources and cause delays) and encourage improving quality; upgrading technology; responding to consumer and social demands.
4. Sharply limit direct cooperation among industry rivals: cooperative projects should be only in areas of basic product and process research; cooperative research should be only indirect, channelled through independent organizations (universities' laboratories, centres of excellence); a number of industries should be involved in one project and substantial R&D investments must be required.
5. Promote goals that lead to sustained investment encouraging sustained investment in human skills, innovation and physical assets (through various tax incentives).
6. Deregulation and privatisation must be combined with vigorous domestic rivalry.
7. Enforce strong domestic antitrust policies: disallow mergers, acquisitions, alliances that involve industry leaders; the same standards should be applied to both domestic and foreign companies; favour internal entry over acquisition; allow big companies to acquire small companies in related industries since it is not a damaging competition.
8. Reject managed trade: pursue open market access in every foreign nation; imports and exports should not be regulated; utilize compensatory tariffs rather than market quotas.

Attempts to analyse competitiveness of particular industries were continued by Milken Institute.[8] The institute has developed the Global Capital Access Index, which is a quantitative tool measuring how well national financial institutions put resources into the hands of talented and industrious entrepreneurs. The index is based on the premise that the wealth of nations largely depends on entrepreneurs and their ability to bring new ideas to life. The index ranks countries in three categories designed to measure the extent to which capital has been democratised. A country's final rank is determined by its performance across three categories:

1. Quantitative performance (e.g., equity market, taxation, government spending,).
2. Risk performance (e.g., interest rates, currency volatility, stock market volatility).
3. Qualitative performance (e.g., foreign investment protection, banking system, rule of law).

According to the Milken Institute, the index reveals that the countries whose financial systems create best access to finance ideas that generate jobs, income, and wealth show the greatest promise for economic growth. How to do this best is the critical issue in today's global capital markets. The Milken Institute emphasizes "the efficiency of today's markets", suggesting the following:

1. The democratisation of capital – the extent to which capital markets and financial institutions can be mobilized to finance new ideas that generate new jobs and capital – plays a critical role in fuelling economic expansion.

[8] See Yago et al. (1999).

2. Global financial integration leads to more active, liquid, and efficient domestic financial markets. The increased depth and breadth of those markets encourage faster growth and more rapidly rising living standards.
3. The foreign direct investment leads to economic growth. Domestic firms learn from successful foreign investment enterprises. The overall effect is positive for countries with an educated labour force that can take advantage of investment spillovers in export growth and additionally triggered domestic investment.
4. Open-market economies tend to outperform those economies with higher degrees of government intervention and control, giving credence to the efficiency of today's markets.

Results of the evaluation reflect the conviction of the Milken Institute that open-market economies tend to outperform those economies with higher degrees of government intervention and control, giving credence to the efficiency of today's markets.

2.2. Competitiveness Studies at the Regional / Country Level

An attempt to measure competitiveness at the regional level has been made by a public-private economic development organization – the Massachusetts Technology Collaborative, which developed the Index of the Massachusetts Innovation Economy.[9] The index is based on a dynamic conceptual framework that links resources to economic results through an innovation process. The framework measures "Massachusetts' progress in leveraging its resources through innovation to create higher levels of economic performance".[10] It has three interrelated and interactive components and 33 indicators:

1. Results: outcomes for people and business – job growth, rising average wages, and export sales (8 indicators).
2. Innovation process: dynamic interactions that translate resources into results – idea generation, commercialisation, entrepreneurship, and business innovation (9 indicators).
3. Resources: critical public and private inputs to the Innovation Economy – human, technology, and investment resources, plus infrastructure (16 indicators).

According to the Massachusetts Technology Collaborative, economic competitiveness, which is reflected by economic growth" is no longer limited by capital or labour but is sustained by people's ability to generate new ideas and translate them into highly valued, marketable products and services. Innovation – the continuous process of generating and applying new ideas to the creation and upgrading of products, processes, and services – has become the primary source of wealth creation in the information age and continues to be essential for the resilience needed to weather economic cycles".[11]

Department of Trade and Industry of the United Kingdom (UK) proposed to develop a set of competitiveness indicators to measure the UK's progress.[12] It suggested a possible structure of four components, based loosely on

[9] See Preston et al. (1997).

[10] Ibid., p. 3.

[11] Ibid., p. 4.

[12] For an analytical report, see Mandelson (1998).

a model adopted in Massachusetts. The structure includes indicators of:

1. The business environment: measures of macroeconomic stability, progress on supply side reforms and business perceptions of the UK.
2. Resource indicators: measures of human and physical capital, technology and R&D.
3. Innovation process indicators: measures of commercial exploitation of science and technology, entrepreneurship, diffusion of knowledge across borders and among firms.
4. Results: GDP *per capita*, productivity, employment, incomes, and measures of sustainable development.

According to the Department of Trade and Industry of the UK, "knowledge should be seen as the driver of prosperity".[13] The British Cabinet Committee on Productivity and Competitiveness made a commitment to review the UK's performance against the indicators each year and decide what further policies are required to keep the UK on track.

2.3. Particular Competitiveness Indicator Studies

A distinction is often made between price and non-price competitiveness, the first representing a firm's or industry's capacity to succeed in price competition (for a given product quality), while non-price competitiveness encompasses a host of other factors that may account for a firm's or industry's success such as product quality, diversity, novelty or after-sales services. Both dimensions are important, but the cost dimension is easier to measure and it is more often at the centre of policy discussions, as cost competitiveness is directly influenced by macro-economic factors such as exchange rate shifts.

By definition, any measure of cost competitiveness is a relative one, relating one country's costs (or prices) in a particular industry or sector to those of its competitors. A distinction must be drawn between absolute measures of cost differences and the comparison of rates of change over time. Most empirical measures of cost competitiveness are confined to comparisons of movements in relative costs and do not allow absolute comparisons. This is essentially due to measurement problems: the most important impediment is the absence of adequate relative prices to convert measures of industry output or productivity into one common currency. The use of exchange rates or expenditure-related economy-wide purchasing power parities (PPPs) is problematic as these measures reflect neither industry differences nor necessarily relative producer prices.[14] Although some empirical studies have taken on the issue and developed industry-level PPPs, they are still at an early stage and typically cover only a limited set of industries and/or countries.[15]

Given these difficulties, indicators are usually confined to showing relative changes of cost competitiveness.[16] Various publications

[13] Ibid., p.29.

[14] For the presentation of the indicator of trade-weighted unit labour cost disaggregated by detailed manufacturing industry, see Lepron and Schreyer (1998) The indicator constitutes an addition to the OECD set of main industrial indicators.

[15] For estimates for manufacturing and selected service sectors, see Pilat (1996).

[16] While this constitutes a drawback, if the task is to rank countries by their cost competitiveness at a particular point in time, it is not a major disadvantage for other purposes, in particular for the use of these indicators to analyze trade trends.

concentrate on selected sets of indicators, which can be related to productivity, exchange rate and trade.

Table 1. Indicators of international competitiveness

Area	*Indicators of International Competitiveness*
Trade-related	Revealed comparative advantage Exports share Trade balance Revealed international competitiveness Coefficient of international competitiveness Share in world trade of manufactured goods
Productivity-related	Labor productivity Unit labor cost Multi-factor productivity
Exchange rate-related	Equilibrium exchange rate

Measuring price competitiveness the indicators usually draw on the analytical frameworks used by the OECD in its INTERLINK model, by the United States Bureau of Labour Statistics and by the International Monetary Fund. In addition to questions of data availability, there are methodological issues that are still under discussion, including the techniques to apply for multilateral comparisons.

2.4. Competitiveness Studies at the International Level

Two most prominent global competitiveness studies published annually are "The World Competitiveness Yearbook" of International Institute for Management Development (Switzerland) and "The Global Competitiveness Report" of the World Economic Forum (Switzerland). The competitiveness studies are mostly concerned with finding out where market growth is likely to be strongest or where productive facilities might be located most advantageously. They are helpful most to business community. Both studies are based on the data available only for either developed or larger economies.

The Indicators of Competitiveness developed by the World Bank rank the relative standing of a much larger set of countries with an emphasis on less developed countries. These indicators reveal the aspects of particular countries that might be of interest for the potential investors to the economies of developing countries.

2.4.1. International Institute for Management Development

International Institute for Management Development (IMD) has been publishing the World Competitiveness Yearbook (WCY) since 1987.[17] IMD measures how national environments sustain the domestic and global competitiveness of the firms that operate in the countries covered.

The yearbook is based on a belief that a country's competitiveness cannot be reduced to the mere notions of GDP and productivity, and it is in providing firms with an environment that has the most efficient structure, institutions and policies that nations compete with each other.

The WCY is a more than 500-page reference tool. In its analysis of competitiveness IMD has been relying on 2/3 hard data (competitiveness measured – quantifiable informa-

[17] Until 1995, it was published in cooperation with the World Economic Forum (WEF). Then the WEF decided to have a separate report while IMD preserved an initial approach.

tion) and 1/3 survey (competitiveness perceived – qualitative information). Competitiveness is evaluated from eight different perspectives called Competitiveness Input Factors (Input Factors), which are divided into sub-factors to provide the underlying structure of a factor. Each sub-factor has its criteria (a total of 293):

1. Domestic economy (7 sub-factors).
2. Internationalization (8 sub-factors).
3. Government (6 sub-factors).
4. Finance (4 sub-factors).
5. Infrastructure (5 sub-factors).
6. Management (5 sub-factors).
7. Science & technology (5 sub-factors).
8. People (7 sub-factors).

The IMD outlines ten golden rules of world competitiveness:

1. Assets and processes are the two main facets of competitiveness.
2. A successful transformation process enhances wealth and therefore creates new assets for future generations (e.g., the Industrial Revolution in Europe).
3. It is possible to be "wealthy" and not competitive, for example, by relying exclusively on existing assets (natural resources, established industries, etc.).
4. A "poor" country, which has few accumulated assets, can become competitive, however, through a very efficient transformation process (e.g., Japan, Singapore, etc.).
5. "Poor" countries can thus be more competitive than "rich" countries.
6. Internationalisation can be based on attractiveness, on aggressiveness, or on both. For example, Ireland is attractive (for foreign investments, etc.) but not very aggressive, Korea is aggressive (in world markets) but not very attractive, and the US is both attractive and aggressive.
7. Competitiveness can be divided into "hard criteria" (generally measurable) such as productivity and growth, and "soft criteria" (generally less measurable) such as education and attitudes.
8. Hard criteria usually have shorter cycles (months, years) than soft data (decades, generations).
9. The more a country becomes economically developed, the more it relies on soft criteria (e.g., moving from cheap labour to educated labour).
10. Competitiveness is sustainable in the long term.

The IMD attitude to the role of government in an economy can be summarized as follows:

1. The state intervention into business activities should be minimized apart from creating competitive conditions for enterprises.
2. Government should, however, provide macroeconomic and social conditions that are predictable and thus minimize the external risks for economic enterprise.
3. Government should be flexible in adapting its economic policies to a changing international environment.

Concerning other sub-factors the IMD suggests the following:

1. Domestic economy:

- Productivity reflects the value-added in a shortterm.
- Long-term competitiveness requires capital formation.
- Prosperity of a country reflects its past economic performance.
- Competition governed by market forces improves the economic performance of a country.

- The more competition there is in the domestic economy, the more competitive the domestic firms are likely to be abroad.

2. Internationalisation:
- A country's success in international trade reflects competitiveness of its domestic economy (provided there are no trade barriers).
- Openness for international economic activities increases a country's economic performance.
- International investment allocates economic resources more efficiently worldwide.
- Export-led competitiveness often is associated with growth-orientation in the domestic economy.
- Maintaining a high living standard requires integration with the international economy.

3. Finance:
- Finance facilitates value-added activity.
- A well-developed, internationally integrated financial sector in a country supports its international competitiveness.

4. Infrastructure:
- A well-developed infrastructure including the availability of natural resources and functional business systems supports economic activity.
- The state must care for infrastructure if no private arrangement exists.

5. Management:
- A competitive price/quality ratio of products reflects managerial ability in a country.
- Long-term orientation of management increases competitiveness over time.
- Efficiency in economic activity together with ability to adapt to changes in the competitive environment are managerial attributes crucial for enterprise competitiveness.
- Entrepreneurship is crucial for economic activity in its start-up phase.
- In more mature business, corporate management requires skill for integration and differentiation of business activities.

6. Science & technology:
- Competitive advantage can be built on an efficient and innovative application of existing technologies.
- Investment in basic research and innovative activity creating new knowledge is crucial for a country in a more mature stage of economic development.
- Long-term investment in R&D is likely to increase the competitiveness of a firm.
- Non-defense private/business investment in R&D is likely to increase the competitiveness of a country more than public investment in defense R&D.

7. People:
- Attitude of the workforce affects the competitiveness of a country.
- Competitiveness tends to increase the level of expectations for the quality of life.

The World Competitiveness Scoreboard is calculated with all the criteria included in the Yearbook.

2.4.2. The World Economic Forum

The World Economic Forum (WEF) developed a methodology for "The Global Competitiveness Report" in 1996.[18] From 1998, M. E. Porter has been contributing to the pub-

[18] It coincided with Jeffrey Sachs of the Harvard Institute for International Development becoming the co-chairman of the Advisory Board.

lication his articles on the microeconomic foundations of economic development and competitiveness.

The rankings of countries in the Global Competitiveness Report are based on a definition of competitiveness as the ability of a country to achieve sustained high rates of growth in GDP per capita. The competitiveness index is designed to assess which countries have the best prospect for economic growth over the next five to ten years – on the basis of each country's current economic conditions and institutions. It is an index of economic indicators that "have proven to be correlated with medium to long term economic growth".[19]

Intuitions of the business community are extremely important in determining the competitiveness of a country by WEF. The World Economic Forum relies extensively (about 2/3) on soft data (the opinion of business community) and on 1/3 of hard data (quantifiable statistical data). The assembled data, both quantitative and survey, are classified and distributed to eight factors[20] determining competitiveness: openness; government; finance; infrastructure; technology; management; labor; institutions.

The WEF suggests that there is strong evidence for a relationship between a country's economic competitiveness and the role of the state in the economy (this includes the overall burden of government expenditures, fiscal deficits, rates of public saving, marginal tax rates and overall competence of the civil service). The WEF argues that national economic competitiveness is also related to the following:

1. Openness: openness to foreign trade and investment, openness to foreign direct investment and financial flows, liberal exchange rate policy and ease of exporting.
2. Finance: how efficiently the financial intermediaries channel savings into productive investment, the level of competition in financial markets, the perceived stability and solvency of key financial institutions, levels of national saving and investment, and credit ratings given by outside observers.
3. Infrastructure: the quality of roads, railways, ports, telecommunications, cost of air transportation and overall infrastructure investment.
4. Technology: computer usage, the spread of new technologies, the ability of the economy to absorb new technologies and the level and quality of research and development.
5. Management: overall management quality, marketing, staff training and motivation practices, efficiency of compensation schemes and the quality of internal financial control systems.
6. Labour: the efficiency and competitiveness of the domestic labour market (this combines a measure of the level of a country's labour costs relative to international norms, together with measures of labour market efficiency (e.g., obstacles to hiring and firing of workers), the level of basic education and skills, and the extent of distortionary labour taxes).
7. Institutions: the extent of business competition, the quality of legal institutions and practices; the extent of corruption and vulnerability to organized crime.

[19] See Schwab et al. (1999), p. 78.

[20] There are also two supplementary data sets: major economic indicators and supplementary questions.

The WEF believes that the four factors representing openness, government, finance and labor should be "given greater weight than the other factors."[21] The factor indices are given the following weights to create the overall competitiveness index (see Table 2):

*Table 2. **Weights of factor indexes***

Factor index	***Weight***[1]
Openness	1/6
Government	1/6
Finance	1/6
Infrastructure	1/9
Technology	1/9
Management	1/18
Labour	1/6
Institutions	1/18

Source: Schwab et al. (1998), p. 80.

The WEF suggests that the factors of management and institutions are least important for international competitiveness. "This is because the effects of...management and civil society on growth are harder to measure, and perhaps operate with longer lags".[23]

The Competitiveness Index is every year constructed on the same general principles. The guiding principle is to construct an index that is correlated with economic growth. Countries that score high on the competitiveness measure should show a higher rate of economic growth than countries that score low on the measure. Competitiveness rankings by the WEF's Competitiveness Index are intended to show that competitive countries are those that have the highest capacity for medium-term economic growth.

Sachs, Zinnes, and Eilat (1999) constructed a measure of competitiveness of transition economies[24] based on the methodology of the WEF. The indicator contains seven sub-indicators. These are (with their weights in parentheses) openness (3/17), good government (3/17), financial sector (3/17), infrastructure (2/17), technology (1/17), management and labour quality (2/17), and rule-of-law institutions (3/17). To construct the competitiveness indicator, the authors first standardize each sub-indicator, multiply it by its weight, add them all up, and then standardize again. They stress that it is the synergies among firms and between firms, markets, and government that are the key to economic competitiveness. The authors relate competitiveness to the cumulative growth in per capita GDP over the transition period. They show that the more competitive the country by the indicator, the higher was its growth in per capita GDP. Turning to foreign direct investment reveals a similar picture, this time from the point of view of the investor. More competitive countries attract more foreign direct investment.

2.4.3. The World Bank

The Database of Competitiveness Indicators developed by the World Bank is a collection of 49 indicators to assess economic performance and the environment for competitive business development in a large number of countries.[25] These indicators reveal the aspects of competitiveness or the conditions for achieving competitiveness for firms and industries in va-

[21] Ibid., p. 78

[22] The weights' sum is equal to 1.

[23] Ibid., p. 81.

[24] The authors developed a heuristic framework to help understand the current level of international competitiveness of countries in transition as a result of their first decade of what Sachs (1996) calls systemic transformation.

[25] The number of countries varies depending on the availability of data for an indicator.

rious countries.[26] The purpose of the database was to identify constraints to competitiveness and to map the steps for policy reform and institutional strengthening. The indicators are organized in five broad categories:

1. Overall performance.
2. Macro and market dynamism.
3. Financial dynamism.
4. Infrastructure and investment climate.
5. Human resources.

According to the World Bank, the foundations of a competitive economy are built on four pillars:

1. Developing competitive markets with sound macro incentives in place, an appropriate competition policy and efficient markets in products, labour, and capital.
2. Developing efficient transactions with well-defined property rights, effective and clear enforcement of contractual obligations, and an efficient system in place for the resolution of disputes.
3. Establishing effective public administrations focusing on mechanisms and processes for ensuring good governance, efficient institutions and processes for customs and taxation, and transparent and effective privatisations.
4. Building the efficient and sustainable infrastructure in terms of the social sectors (health, education, pensions, etc.), physical infrastructure such as transport, energy, telecommunications, etc. and developing the critical technological and informational base on which much of the globalisation phenomenon is based.

[26] They have been compiled by the Business Environment Group in the Private Sector Development Department of the World Bank.

Most indicators are ranked in ascending or descending order to allow for a quick comparison of relative performance across countries. But for some indicators, performance cannot be easily assessed by a simple ranking. In such instances, countries are listed alphabetically.

The World Bank does not provide a competitiveness scoreboard. However, there are rankings of countries by most of the indicators.

2.5. Economic Policy Studies

While in the competitiveness studies the emphasis is on an economy as a whole, in the economic policy studies it is on government policies. According to the economic policy studies, economic competitiveness is the direct outcome of the government policymaking.

Freedom (economic policy) studies by Frazer Institute, Heritage Foundation and Freedom House are intended for the government leaders and scholars. They provide information on the necessary preconditions for economic growth and the ways to enhance the economic welfare of people. The three studies of freedom rank more than 100 countries. Thus, they have the advantage of providing an information about the economies of smaller and less developed countries. The studies are based on variables thought to be necessary conditions for economic growth. They suggest that in devising an economic development strategy the emphasis should be put on creation of right institutions rather than on resource inputs.

2.5.1. Frazer Institute

The Fraser Institute (Canada) has developed the Index of Economic Freedom. According to the institute, the central elements of economic freedom are personal choice, freedom of

exchange, and protection of private property. When economic freedom is present, individuals are free to make economic choices such as how to use their time and other resources, what goods to consume, and what business and investment alternatives to pursue.

The Index of Economic Freedom comprises 23 components designed to identify the consistency of institutional arrangements and policies with economic freedom in seven major areas:

1. Size of government: consumption, transfers, and subsidies.
2. Economic structure and use of markets: production and allocation via government and political mandates rather than private enterprises and markets.
3. Monetary policy and price stability: protection of money as a store of value and medium of exchange.
4. Freedom to use alternative currencies: freedom of access to alternative currencies.
5. Legal structure and property rights: security of property rights and viability of contracts.
6. International exchange: freedom to trade with foreigners.
7. Freedom of exchange in capital and financial markets.

Principal component analysis was used to determine the weight given to each component in the construction of the area index. Areas 1 and 2 contain indicators of reliance on markets rather than the political process to allocate resources and determine the distribution of income. Areas 3 and 4 reflect the availability of sound money. Area 5 focuses on the legal security of property rights and the enforcement of contracts. Area 6 indicates the consistency of policies with free trade. Area 7 is a measure of the degree to which markets are used to allocate capital.

According to the Frazer Institute, the use of government – whether directed by a monarch or a democratic process – to decide what (and how) goods will be produced and who will consume them violates personal economic freedom and has a negative impact on economic competitiveness. In an economically free society, the fundamental function of government is the protection of private property and the provision of a stable infrastructure for a voluntary exchange system. When a government fails to protect private property, takes property itself without full compensation, or establishes restrictions (and follows policies) that limit voluntary exchange, it violates the economic freedom of its citizens and impairs the country's international competitiveness. The Frazer Institute argues that reliance on markets, sound money, legal protection of property rights, free trade, and market allocation of capital are important elements of international competitiveness.

Economic policy suggestions of the Frazer Institute can be summarized as follows:

1. Size of Government: Consumption, Transfers, and Subsidies

- As government consumption increases relative to total consumption (private plus government), politics supplants personal choice and voluntary exchange. Larger government consumption means less private consumption and less economic freedom. When governments focus on core functions that involve the protection of persons and property, and the provision of public goods (things like national defense that are difficult to provide via markets), they may enhance economic freedom. Frazer's research

on this topic indicates that the core functions, defined very liberally, can be provided with approximately 10% of GDP.[27] Regardless of whether financed by taxes or borrowing, government spending beyond the minimal core level reduces economic freedom and the security of property rights is eroded.

- Transfers and subsidies violate the freedom of individuals to keep the value of their productivity. When governments tax income from one person in order to transfer it to another, usually in an effort to "buy" votes, they are violating the property rights of individuals. Such taking of property (including labour services) without compensation conflicts with economic freedom. The ratio of transfers and subsidies to GDP is a measure of the degree to which governments engage in such activities. The higher the ratio the less economic freedom.

2. Structure of the Economy and Use of Markets:

- State-operated enterprises (SOEs) involve the substitution of political for market decision-making. They are fundamentally different from private businesses. The investment choices of SOEs need not pass the market test. Subsidies, favourable tax treatment, and regulations are often used to protect them from private competitors. Thus, SOEs often continue to survive even when they are inefficient and produce little of value. By way of contrast, bankruptcy would bring such activities to a halt in the market sector. Countries with relatively few SOEs and small government investment as a share of the total are considered more economically free.
- Price controls interfere with the freedom of buyers and sellers to undertake exchanges. In addition, they often reduce the value of assets and thereby take property from rightful owners. Both restraints on exchange and the taking of property are violations of economic freedom. Countries that use price controls more extensively are considered less free.
- High marginal tax rates discriminate against productive citizens and deny them income that they have rightfully earned. Countries are decreasing their economic freedom as they impose higher marginal tax rates that take effect at lower income thresholds.
- Conscription denies draftees the property right to their labour services. Countries should rely on market forces to obtain military personnel.

3. Monetary Policy and Price Stability:

- Slow growth of the money supply (relative to the economy's long-run real growth) is indicative of monetary policy consistent with price stability. In contrast, rapid monetary expansion will lead to high rates of inflation and uncertainty with regard to the future value of the monetary unit. Thus, countries with low rates of monetary growth relative to real GDP are considered more economically free.
- Instability in the general level of prices also generates uncertainty. When the in-

[27] However, there is no assurance that governments spending a small amount will focus their expenditures on core functions that are, at least potentially, consistent with economic freedom. For the discussion, see Gwartney et al. (1999).

flation rate changes in an unpredictable manner (for example, when it is 10% one year, 40% the next, and 20% the year after that), it is extremely difficult for individuals and businesses to plan for the future. Unpredictable changes in the rate of inflation undermine the efficacy of money. Countries with the more stable and, therefore, more easily predictable rates of inflation are freer.

4. Freedom to Use Alternative Currencies:

- Money offered by other monetary authorities is a substitute for money issued by the government of a given country.[28] When residents are free to maintain bank accounts in foreign currencies, it is easier for them to avoid the uncertainties accompanying an unstable domestic monetary regime. Each of the three components in this area is binary, indicating that the condition is either present or absent (either legal or illegal). Countries should permit their citizens to maintain domestic bank accounts in other currencies freely.
- Ownership of a bank account abroad provides another alternative method of storing the purchasing power for future use. From a security standpoint, this option may be preferable to the domestic ownership of a foreign currency account, because an account abroad is less vulnerable to confiscation by one's own government. Thus, countries should permit their citizens to maintain bank accounts abroad.
- A citizen's ability to use alternative currencies in exchange and as a store of value is reduced substantially if the domestic currency is not freely convertible to other currencies. A currency is considered to be freely convertible if citizens are allowed to conduct both current and capital account foreign exchange transactions without having to obtain special permission from government authorities. Countries should have freely convertible currencies.

5. Legal Structure and Property Rights:

- Property rights are crucial to the workings of a market economy and the protection of personal freedom. Without well-defined and secure property rights[29] and the rule of law, both the efficiency of markets and the incentive for productive behaviour are severely eroded. The absence of these factors undermines economic freedom. The rule of law reflects the degree to which the citizens of a country are willing to accept the established institutions to ma-

[28] If the purchasing power of the domestic currency is relatively stable and people have confidence that this will continue in the future, the freedom to use other currencies is generally less significant. However, when these conditions are absent, the freedom to use other currencies, maintain foreign currency bank accounts, and convert the domestic currency to other forms of money is extremely important. For further information, see Gwartney et al. (1999).

[29] How can the security of property rights and the presence of rule of law be measured? The International Country Risk Guide has tracked the political, financial, and economic risks accompanying business and investment activities in various countries since 1982. Their ratings are published monthly and marketed to businesses, investors, and financial analysts. While the ratings cover several areas, three of them – risk of expropriation, risk of contact violation, and presence of rule of law – are particularly pertinent to legal structure. The risk of confiscation variable indicates the likelihood that one's property might be expropriated. The component for risk of contracts reflects the degree to which "foreign businesses, contractors, and consultants face the risk of a modification in a contract taking the form of repudiation, postponement, or scaling down". For further information, see Gwartney et al. (1999).

ke and implement laws and adjudicate disputes.

- Nations should have sound political institutions, a strong courts system, and provisions for an orderly succession of power.

6. International Exchange: Freedom to Trade with Foreigners:

- Tariffs and taxes on exports drive a wedge between what the seller receives and what the buyer pays, and thereby limit both trade and economic freedom. Large revenue (from taxes on international trade) relative to the volume of trade is indicative of high tariff rates.[30] Tariffs, if any, should be low and uniform. Widely dispersed tariff rates restrain trade.
- Nations should not restrain trade through the use of quotas, monopoly grants, and various other types of non-tariff trade barriers. The share of international trade covered by non-tariff barriers and the actual size of the trade sector relative to what would be expected (given the country's geographic size, population, and location) identify nations imposing such restrictions.
- Exchange rate controls can be a major obstacle to trade. If people are going to trade with outsiders, they must be able to convert their domestic currency to foreign exchange (other currencies). The black market exchange rate indicates the degree to which exchange rate controls limit trade with foreigners. The larger the black market premium, the less economic freedom.

7. Freedom of Exchange in Capital and Financial Markets:

- Countries should use market forces rather than political considerations to allocate capital. When banks are owned and operated by the government, political considerations are likely to play a larger role in the allocation of capital. When market forces are used to allocate capital, most of the credit will be extended to private investors. The larger the share of total domestic credit allocated to the private sector, the higher a country's economic freedom.
- Governments should not affect the allocation of credit through the imposition of interest rate controls. Interest rate controls coupled with inflationary monetary policy are particularly damaging. When the inflation rate exceeds the fixed interest rate, negative real interest rates occur. Capital should be allocated by a private banking sector to private investors at interest rates determined by market forces (including global financial markets). Countries that follow policies resulting in negative real interest rates (and/or wide gaps between the borrowing and lending rates) lack economic freedom.
- Countries should not place limitations on domestic investments by foreigners and limit the freedom of their citizens to make investments abroad, or both. There should be no restrictions on the mobility of capital.

A higher rating of the Index of Economic Freedom for a country is indicative of institutions and policies more consistent with economic freedom.

[30] However, sometimes this figure can be misleading. Prohibitive tariffs – that is, exceedingly high tariffs that effectively prohibit trade – will raise little or no revenue. See Gwartney et al. (1999).

2.5.2. Heritage Foundation

In 1995, the Heritage Foundation (the USA) developed the Index of Economic Freedom (IEF). The IEF reflects the factors that contribute to the institutional setting for economic growth. It measures the impact of tax laws, tariffs, business regulations, government intervention in the economy, corruption in the government, the judiciary, and the customs service along with a host of other economic factors in most of the world's countries.

The IEF ranks the relative degree to which countries achieve economic freedom; in other words, it indicates the best context (or set of institutional inputs) for economic growth. It measures how well countries score on a list of 50 independent criteria (variables) divided into 10 broad economic factors.[31] These 50 variables were grouped into 10 economic factors:

1. Trade policy.
2. Taxation.
3. Government intervention in the economy.
4. Monetary policy.
5. Capital flows and foreign investment.
6. Banking.
7. Wage and price controls.
8. Property rights.
9. Regulation.
10. Black market.

The economic policy recommendations of the Heritage Foundation can be summarized as follows:

1. Trade policy

Non-tariff barriers represent decreased economic freedom. Corruption also constitutes a barrier to trade.

[31] The higher the score on a factor, the greater the level of government interference in the economy and the less economic freedom. See O'Driscol et al. (1999).

2. Income and corporate tax

The higher the tax rate and a more cumbersome progressive tax system, the less economically free a country is. Other taxes, such as value-added taxes, sales taxes, payroll taxes, and state and local taxes represent the negative impact on individual economic freedom.

3. Government intervention

The larger government consumption and the bigger the size of the state-owned sector, the larger is government intervention in the economy. If a country has many state-owned enterprises, or if the state-owned sector produces a large portion of its GDP, it signifies decreased economic freedom.

4. Monetary policy

It is considered that high rates of inflation reflect a loose monetary policy: the currency loses its value and individuals are less free to engage in productive and profitable economic activities. This means less economic freedom than in countries with lower inflation rates (a tighter monetary policy).

5. Capital flows and foreign investment

Restrictions on foreign investment limit the inflow of capital and thus hamper economic freedom. By contrast, little or no restriction of foreign investment maximizes economic freedom and thus increases the flow of investments. The more restrictions a country imposes on foreign investment, the lower the level of economic freedom.

6. Banking

The more government controls banks, the less free they are to engage in their activities. The consequence of heavy regulation of banks is restricted economic freedom.

7. Wage and price controls

It is considered that when governments impose wage and price controls, they restrict economic activity and curtail economic freedom. Therefore, the more a government intervenes and controls prices and wages, the lower its level of economic freedom. Government should not have prices set for any products and by the government; should not control such things as utilities; and should not have a minimum wage policy or set other wages.

8. Property rights

The government should protect private property and keep it safe from expropriation. The less protection private property receives, the lower the level of economic freedom.

9. Regulation

It should be easy to open and operate a business. The more regulations on business, the harder it is to open one – the less economic freedom. There should be no corruption and regulations should be applied uniformly to all businesses. A country should not have any state planning agencies that set production limits and quotas.

10. Black market evaluation

The larger the black market is in a particular country, the lower the country's level of economic freedom.

The IEF treats the 10 factors as equally important to the level of economic freedom in any country. With its Index of Economic Freedom the Heritage Foundation seeks to prove that countries that have more economic freedom also tend to have higher rates of long-term economic growth and have the higher standards of living than those that have less economic freedom.

2.5.3. Freedom house

The Freedom House was founded in 1941 by Eleanor Roosevelt, Wendell Willkie and other Americans. Non-partisan and broad-based, Freedom House is led by a Board of Trustees composed of leading Democrats, Republicans, and independents; business and labor leaders; former senior government officials; scholars; writers; and journalists. All are united in the view that American leadership in international affairs is essential to the cause of human rights and freedom.

Since its inception in the 1970s, Freedom House's Freedom in the World survey has provided an annual evaluation of political rights and civil liberties throughout the world. The Survey attempts to judge all countries and territories by a single standard and to emphasize the importance of democracy and freedom.[32]

The survey's understanding of freedom encompasses two general sets of characteristics grouped under political rights and civil liberties:

1. Political rights:
   - 1.1. Freedom and fairness of elections;
   - 1.2. Freedom to organize in different political units;
   - 1.3. Freedom to be in opposition;
   - 1.4. Freedom from domination by military, foreign powers, totalitarian parties, religious hierarchies, economic oligarchies or any other powerful group;
   - 1.5. Freedom of cultural, ethnic, religious and other minority groups to

[32] At a minimum, democracy is a political system in which people choose their authoritative leaders freely from among competing groups and individuals who were not designated by the government. Freedom represents the opportunity to act spontaneously in a variety of fields outside the control of the government and other centers of potential domination. See Gastil et al. (1999).

achieve self-determination, self-government and autonomy.

2. Civil liberties:
   2.1. Freedom of expression and belief;
   2.2. Association and organizational rights;
   2.3. Rule of law and human rights;
   2.4. Personal autonomy and economic rights.

According to the Freedom House, political rights and civil liberties promote economic competitiveness, growth and prosperity. Political rights enable people to participate freely in the political process, which is the system by which the polity chooses authoritative policy makers and attempts to make binding decisions affecting the national, regional, or local community. In a free society, this represents the right of all adults to vote and compete for public office, and for elected representatives to have a decisive vote on public policies. Civil liberties include the freedoms to develop views, institutions, and personal autonomy apart from the state.

To answer the questions about the routes to economic prosperity, the Freedom House considers the extent to which the political system offers the voter the chance to make a free choice among candidates, and to what extent the candidates are chosen independently of the state. Freedom House recognizes that formal electoral procedures are not the only factors that determine the real distribution of power.[33]

The question of equality of opportunity also implies a free choice of employment and education. Extreme inequality of opportunity prevents disadvantaged individuals from enjoying full exercise of civil liberties. Typically, poor countries lack both opportunities for economic advancement and other liberties. The question on extreme government indifference and corruption is very important, because when governments do not care about the social and economic welfare of large sectors of the population, the human rights of those people suffer. Government corruption can pervert the political process and hamper the development of a free economy.

The Survey rates political rights and civil liberties separately on a seven-category scale, 1 representing the most free and 7 the least free. A country is assigned to a particular numerical category based on responses to the checklist and the judgments of the Survey team at Freedom House.

Conclusion

The above analysis reveals that the concept of national competitiveness is broad, encompassing a large number of both quantitative and qualitative factors. It is difficult to define the international competitiveness of nations by any single definition. Since competitiveness studies serve a different audience and purpose, we cannot reasonably discuss which is best without first asking: best at what?

Particular Sector and Particular Competitiveness Indicator studies focus on the environments of particular sectors, capital access, trade performance, productivity and exchange rates across countries. They can be helpful for a comparative study of some specific industry or an economic indicator. Their major drawback is the failure to reflect the multi-dimensionality of the international competitiveness.

[33] In many Latin American countries, for example, the military retains a significant political role, and in Morocco the king maintains considerable power over the elected politicians. The more that people suffer under such domination by unelected forces, the less chance the country has of receiving credit for self-determination in this survey. See Gastil et al. (1999).

Competitiveness studies on regional, country and international levels as well as cross-country economic policy studies could be useful for the studies on the macro-level, since they aggregate data from various industries and economic indicators, attempting to incorporate all of many facets of national competitiveness. However, they cover the groups of factors, which are often loosely related to each other and are hard to measure. Many questions arise concerning the proper weighing of competitiveness factors, since the importance of various factors may differ across countries. Since the studies are extensively based on soft data (qualitative information), the results of evaluation have a risk of reflecting culture-bound perceptions rather than facts.

Despite the underlying differences in purpose, methodology, and philosophy, the various studies produce rankings that have much in common. Moreover, even though the methods of evaluation of the national economic competitiveness developed by the above studies differ in various aspects, there is an issue on which all of them agree: to increase economic competitiveness, the role of government in economic affairs should be scaled down providing freedom to the market mechanism. In the context of the "state versus market" debate, the competitiveness studies are overwhelmingly supporting the market.

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EKONOMINIO KONKURENCINGUMO VERTINIMAS

Gediminas Ramanauskas

Santrauka

Ekonominį konkurencingumą galima apibrėžti įvairiai. Įmonės ar organizacijos kontekstu jį galima suvokti kaip sėkmingos veiklos prielaidą. Šalies lygmeniu apie jį dažnai kalbama, kai analizuojama nacionalinės valiutos kurso svyravimo įtaka į eksportą/importą orientuotų įmonių verslo sėkmei.

Nors šalies ekonominio konkurencingumo sąvoka dažnai vartojama, sutarimo, ką ji apibrėžia, nėra. Vieni autoriai tvirtina, kad tarpusavyje konkuruoja ne šalys, o įmonės, ir šalies ekonominio konkurencingumo sąvoka yra nesusipratimas. Kiti teigia, kad ši sąvoka yra prasminga, ir kuria šalių ekonominio konkurencingumo vertinimo metodikas.

Straipsnyje autoriaus suklasifikuotos ir lyginamos įvairių autorių metodikos. Suklasifikavus išskirtos penkios metodikų grupės: ekonomikos sektorių konkurencingumo vertinimai; regiono/šalies lygmens konkurencingumo vertinimai; vertinimai pagal konkurencingumo indikatorius; tarptautinio lygmens konkurencingumo vertinimai; ekonominės politikos įtakos konkurencingumui vertinimai.

Nors šios metodikų grupės turi skirtumų, naudojamos valstybių konkurencingumui įvertinti ir palyginti jos duoda panašius rezultatus. Kadangi kiekviena metodika pabrėžia skirtingus dalykus, jos viena kitą praturtina ir papildo.

Įteikta 2004 m. birželio mėn.