

ECONOMIC COMPETITIVENESS - AN INSTITUTIONAL PERSPECTIVE -

PhD student Iulian Oneasca¹
European Institute of Romania

Abstract: The article addresses competitiveness with an innovative institutional perspective. The analysis of EU competitiveness in the global space, according to the requirements of sustainable development, identifies weaknesses. These are addressed through recommendations regarding institutional change.

A brief theoretical analysis, with empirical support, reveals the close link between national competitiveness, institutional action and sustainable development. The latter is strained by gaps and threatened by irreversible, social and ecological transformation. Their countermeasure requires additional costs to those traditionally considered by economic competitiveness.

The institutional perspective of competitiveness highlights a close link between the cost of society, its efficiency and institutions. Reducing costs and increasing labor productivity improves market efficiency and boosts competitiveness. Similar processes, associated with interactions and transactions, take place in all areas of activity. The level of societal costs and the measure of their effectiveness are decisive for the overall performance of society, programmed by institutional design and materialized by governance.

The analysis of EU competitiveness in the global space highlights a diverse structure of its long-term evolution, in economic and social terms. Its wealth and corresponding competitiveness and growth potential, are institutionally limited by systemic weaknesses. The fundamental dilemma of an economic system is revealed and discussed. In conclusion, promoting progress requires a comprehensive, unitary foundation that motivates institutional construction, fostering greater overall efficiency, improving programmatic coherence and raising social transformation on a high-level ambition.

1. Understanding competitiveness

Competitiveness is defined in various ways. While the concept evolved significantly over the years, various institutions and persons maintain a diverse perspective on what competitiveness really means. Some definitions are result oriented: i) ability to succeed in international competition (Ketels, 2016); others include the determinants of competition: ii) set of institutions, policies and factors that determine the level of productivity and prosperity of an economy (WEF, 2016); or favor the process: iii) ability of a country to create and maintain a competitive environment for enterprises (IMD, 2016); and finally, there are constructs of competitiveness approaches, adapted to new perspectives of prosperity: iv) "institutional and macroeconomic conditions allow productive firms to thrive; in turn, the development of these firms supports the expansion of employment, investment and trade" (Mario Draghi, 2012); v) "ability of a country (region, location) to deliver the beyond-GDP goals for its citizens today and tomorrow" (Aiginger et al., 2013); vi) ability to create wealth, to drive and adapt to change through innovation and to favor an enabling environment (EIB, 2016).

The concept has multiple levels. Historically, the microeconomic level was the first considered: firms compete on various markets, internal or external to national borders. Their profitability, in terms of costs, and their market share, based on the size of production, are traditional measures of competitiveness (CESifo, 2016). Consequently, measures of

¹ Article published as a result of cooperation between The National Institute for Economic Research (Moldova) and Center for Financial and Monetary Research "Victor Slavesco" (Romania)

competitiveness are largely relying on factor price adjustments (Huemer et al., 2013). Porter (1990), with his seminal work, *The Competitive Advantage of Nations*, approached the dynamics of competition and the importance of regional or national various circumstances in which a company is embedded, raising the competition up to the level of nations.

The approach of competitiveness on international grounds is meant to:

- set the framework for the comparative advantages of firms (Porter 2000),
- analyze the consequences of increasing complexities, driven by the number of players, extended institutional levels and policy arenas (Pedersen, 2008).

The well known Global Competitiveness Index (WEF, 2016), or the newest approaches of competitiveness, such as the index under the new perspectives (Aiginger et al., 2013), or the Institutional Competitiveness Index (Huemer et al., 2013) add more and more variables, with a view to:

- enrich the goals of competitiveness and corresponding prosperity pursued, by considering a social pillar and an environmental one (Aiginger et al., 2013),
- capture the political and institutional factors that determine a country's competitive position (Huemer et al., 2013).

Getting prices right is no longer sufficient to turn the wealth of the society into individual prosperity. It is undeniable that both, countries' goals and their related competitive positions, represent key benchmarks for progress. They complement each other. Setting generous goals and monitoring their achievement, as the WWW for Europe proposed (Aiginger et al., 2013), could benefit of an institutional approach to reflect the policy adjustments.

2. Competition and institutions

Institutions form a pillar of society, fundamental for its evolution. The literature highlights the actions of the institutions and the role they play. Thus, institutions are:

- Incentives that structure human interaction and activity, consisting of formal rules, informal norms of behavior and codes of conduct, and the enforcement characteristics of both (North, 1992);
- Coordination mechanisms in society (Myerson, 2006);
- Creations of men and women, which order social, political, economic and even cultural relations (Immergut, 2010).

Institutions control the transaction costs in economy. Accordingly, market efficiency basically depends on: its size, the cost of information, enforcement of the contract and ideology (North, 1992). The gap in information (and knowledge) makes a significant difference in development (World Bank, 1999). The size of the market is decided by customs, and adjusted by social order and ideology. Most societies regarded the market as internal to their borders, while expansive and entrepreneurial nations have always considered the world-wide potential. National governments control the rules and protect the exchanges. Outside the internal market, enforcement of rules and provision of information at bearable costs require substantial efforts. Therefore, only organized and powerful states can support exchanges beyond borders. Smaller states may only exploit the larger, trustworthy markets. Generally, markets' inefficiency, due to imperfect information, is common (Greenwald and Stiglitz 1986). Efficiency rejects imperfect competition, externalities (including the environmental ones), and public goods (Stiglitz, 2016).

The role of institutions in promoting competitiveness enjoys recognition. The development of public and private institutions dedicated to the improvement of competitiveness picked up the pace:

- In US, the Executive Order 12428/19832 of Ronald Reagan establishing the President's Commission on Industrial Competitiveness; it was followed by a think tank in 1986, the U.S. Council on Competitiveness³.
- The Irish Government established the National Competitiveness Council (NCC)⁴ in May 1997, releasing annual Competitiveness Reports.
- In EU, as a result of recognized needs to improve coordination and surveillance of competitiveness developments, the European Commission issued a COUNCIL RECOMMENDATION with regard to the establishment of National Competitiveness Boards within the Euro Area (COM(2015) 601 final).

Many other countries followed suit. A rationale for institutional development, with a view to monitor and promote competitiveness, would be to:

- reduce costs of transactions, improve market efficiency and maximize growth,
- promote sustainable equilibria within a multiple goals framework, social (such as education and health), economic (macroeconomic stability) and ecological ones (healthy environment, and preserving natural resources /habitat)
- manage the required societal transformation on a more ambitious path.

The attention given to institutions and competitiveness, led to the creation of a specialized indicator, the Institutional Competitiveness Index (ICI). The new index has an exclusive focus on the policy variables, directly influenced by policy makers. Its public institutions sub-indicator relies on measures of soundness of public finances, democracy, policy quality and law enforcement (Huemer et al., 2013). Empirical data reveal that political and institutional variables are strong drivers of the variation of total competitiveness between country groups (Huemer et al., 2013, p. 23).

3. Competitiveness and wealth

The EU has considerable issues in terms of market performances. 'Europe's competitiveness and long-term, sustainable growth potential suffer from a history of underinvestment in important areas, inefficient and fragmented financial markets, and institutional barriers' (Werner Hoyer⁵, President of the EIB).

Figure 1. GNI, Trade and FDI, in a selection of countries, US dollars per capita, 2005-2014

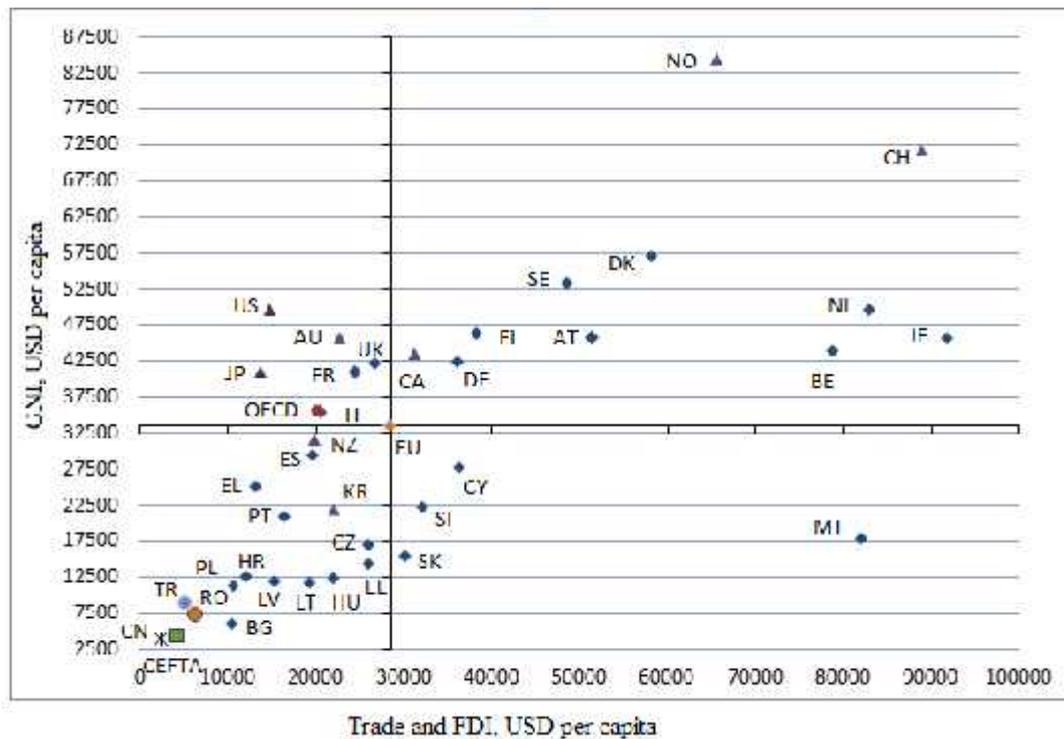
² See the official website for more information, online at <http://www.presidency.ucsb.edu/ws/?pid=41529>.

³ See the official website for more information, online at <http://www.compete.org/about>

⁴ See the official website for more information, online at <http://www.competitiveness.ie/About-Us/>

⁵ EIB, 2016. Restoring EU competitiveness, online at

http://www.eib.org/attachments/efs/restoring_eu_competitiveness_en.pdf, accessed on 4.12.2016



Notes: GDP is used as a proxy for its GNI in the case of CEFTA. EU stands for EU 28.

Source: Author's calculation, based on UNCTAD⁶ and The World Bank⁷.

Figure 1 presents the relative positions of several countries, in a selection, with regard to their economic performances. I have considered two indicators, measures of per capita averages during the 2005-2014 decade: i) Gross National Income (GNI), ii) the value of international economic relationships: trade (imports and exports) and foreign direct investment (inward and outward flows).

The indicators reflect the need for appropriate complementary means to express:

- Intra- and inter-state economic interaction or models;
- National outcomes and institutional efforts, relevant to job creation and utilization of the factors of production.

EU, as OECD and CEFTA, are groups of countries. Their corresponding indicators, per capita averages, include the economic exchanges between the respective member states. It is a remark worth mentioning in comparing the results between EU and its reference, US.

EU 28 is placed at the origin of the axes, to facilitate the comparisons. The four quadrants highlight four categories of countries:

a) NE, composed of top performer Scandinavian states, Belgium, Netherlands and Luxembourg (outside the frame), the German culture states, Austria and Germany, as well as Ireland, Switzerland and Canada;

b) NW, composed of high GNI per capita countries: United Kingdom, France and Italy, the USA and Japan; it is a compact group in which Italy is close to the average of OECD countries;

c) SE, composed of small new member states with trade and investment performance: Malta, Cyprus, Slovenia and Slovakia;

⁶ Goods and services (BPM6): Trade openness indicators, annual; Foreign Direct Investment: Inward and outward flows and stock, annual; Population; averages over the period 2005-2014. Trade and FDI are expressed in US Dollars at current prices and current exchange rates; online at <http://unctadstat.unctad.org/>, accessed on 02.05.2016.

⁷ GNI per capita, Atlas method (current US\$), averages over the period 2005-2014, online at <http://data.worldbank.org/indicator/NY.GNP.PCAP.CD/countries?display=default>, accessed on 02.05.2016.

d) SW, is the largest group of states, below the EU average, consisting of the other nine new member states: the Baltic states, Poland, Hungary and the Czech Republic, Bulgaria, Romania and Croatia; south old member states: Portugal, Spain and Greece; OECD members New Zealand and Korea; CEFTA, Turkey and China; the least performing states in this selection are China, CEFTA countries, Turkey, Bulgaria and Romania.

Economically, the figure indicates the cash flow of trade and FDI, which returns to each monetary unit of GNI. The size of the domestic market and the high costs of transactions, encourage the smaller states to engage in international economic relations as a means to expand the market and improve their economic efficiency. The process generates national income growth by harnessing information and systems of contracts' enforcement in foreign markets, which offer great and varied opportunities.

Analyzing the data displayed, we find that:

- Indicators vary in absolute terms and ratios between them, revealing systemic differences, structural and developmental, between groups of states:
 - EU is slightly below the OECD average with regard to GNI per capita, with 33523 USD as compared to 35410 USD,
 - EU significantly exceeds the OECD in international trade and FDI per capita, achieving 28429 USD, compared to 20338 USD;
 - Candidate or potential candidate countries in CEFTA group (4450/4203 dollars), are far from the average performance of the EU (28429/33523 USD), while the least performing EU Member States are Romania (7327/6387 USD) and Bulgaria (5902 / 10504 USD);
 - Turkey (9008/5017 USD), an EU candidate country, has already a GNI per capita above the ones of Romania and Bulgaria;
- There are wide fluctuations across the EU, from 1 to 9.7 in GNI terms (between Denmark and Bulgaria), and from 1 to 13 (between Netherlands and Romania), in the amount of trade and FDI, signifying per capita differences which are larger in the institutional efforts to engage with the external markets, than between the results highlighting the GNI⁸;
- Matching values of the ratios between the two indicators suggest structural similarities between different countries, even when performance levels are different in absolute terms; the results may be random, provided that the decade 2005-2014 does not properly reflect the respective institutional systems; considering the per capita ratio between, on the one hand, the amount of trade and FDI, and the value of GNI, on the other hand, we find matches between states or their economic models, as follows:
 - Estonia 1.83; Hungary 1.80; Belgium 1.80; and Bulgaria 1.78;
 - Netherlands 1.68; Lithuania and 1.67;
 - Switzerland 1.24 and Iceland 1.22;
 - Denmark 1.02 and Korea 1.0;
 - Serbia 0.98 and Croatia 0.97;
 - Romania 0.87 and Germany 0.85;
 - Portugal 0.79, Israel 0.78 and Norway 0.78;
 - United Kingdom 0.63, Mexico 0.63 and New Zealand 0.63;
 - France 0.6, China 0.59 and Italy 0.58;
 - Greece 0.52 and Australia 0.5;
 - Japan 0.33 and USA 0.3;
- A subunitary ratio means that the country's attention is focused on internal market, while a supraunitary one signifies a relatively high priority given to the international

⁸ The ratios took into consideration the second highest scores; Luxembourg and Ireland, the top performers, have certain economic particularities, requiring a cautious utilization of their results.

economic relations, as an expression of society's experiences, opportunities and choices. A supraunitary ratio is not specific to big countries and numerous societies. Such states display a certain sufficiency with regard to external opportunities, being focused on solving internal matters and valorizing the domestic market.

- The two indicators show a relative autonomy one from the other; thus, the EU most advanced member states in terms of trade and FDI per capita, Ireland, Netherlands and Belgium, exceed by 2.78 times the EU average; simultaneously, the same countries display only 1.31 times the EU average of GNI per capita, which places them behind Scandinavian countries and Austria, as far as this indicator is considered.

International economic relationships come at a cost. Due to unbalanced and nested exchanges, firms need to face a variable demand. In order to face high fluctuations of monetary flows, countries set aside significant reserves of currency and gold. In 2015, the total reserves, expressed in US dollars per capita, ranged from 316 in Estonia and 693 in Cyprus, to 11484 in Denmark, as compared to an average of 2259 in EU 28. US have total reserves of only 1194, much less than China (2483) and Korea (7245) or Japan (9713) and Switzerland (72700)⁹.

Opening the market may lead to the diversification and increase of production, distribution and consumption of goods and services for internal use, according to consolidated needs. The process helps to increase both the demand and supply side of the market, which has positive effects in reducing transaction costs and improving economic efficiency (Coase, 1960; North, 1992). Trade or investment is not an end in itself. Its role is to enhance economic efficiency through market expansion and to better capitalize on domestic resources, increasing revenues. These activities also contribute to better connecting societies to global economic and technological trends and progresses, facilitating economic integration.

4. Institutional change

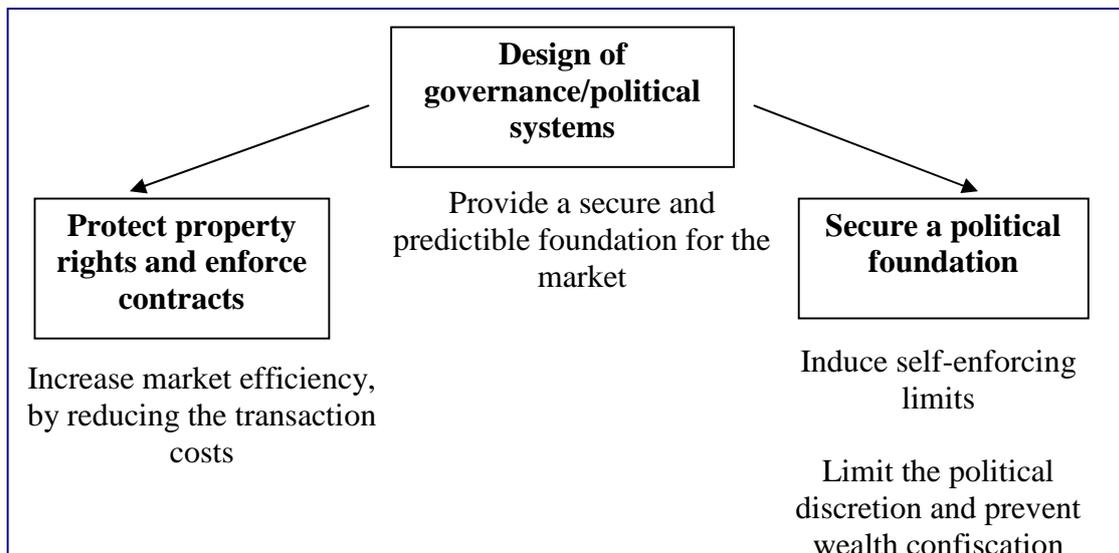
Sustainable development necessarily involves transformation of societies (Stiglitz, 2016). Societies are defined, among other things, by a specific cultural foundation, i.e.: characteristics of communities, such as ethnicity, tribe, caste, clan or class membership and associated norms, customs, and beliefs (Onea c , 2012). These blocks of culture provide important sources for societal change (World Bank, 2015).

The main drivers of change, both for markets and societies, are institutions, which are politically administrated. Institutions organize competition that drives not only market efficiency, but also individuals, „to structure the economy to favor themselves at the expense of others” (North, 1992, p. 7). Capitalizing information, which is asymmetrically available and distributed, helps individuals to take advantage of others in exchanges. The political systems, designing and managing institutions, are known to favor social groups and classes, adding up to market economic shortcomings.

Figure 2 presents a simplified version of the institutional approach to a societal change, which should address the improvement of political systems, and improve the competition.

Figure 2. The fundamental political dilemma of an economic system

⁹ The World Bank, World Development Indicators, (WB API_FI.RES.TOTL.CD_DS2_en_excel_v2), last updated on 10.08.2016.



Source: the Author¹⁰

The main problem of the political system is that „a government strong enough to protect property rights and enforce contracts is also strong enough to confiscate the wealth of its citizens” (Weingast, 1995). The main channels for wealth’s confiscation or its severe diminution are embedded in society:

- a. Long term ideological traits and beliefs, as reflected, for instance, in social order (e.g.: age groups and gender equality, role and place of religion);
- b. Systemic faults, imbalances and biases, revealed by societal institutions and their performances;
- c. Political choices, resulting in distributional effects, which may temporarily
 - favor specific areas (e.g.: urban areas), social groups (e.g.: the rich, employers), or strata (e.g.: elite, middle class) on various time horizons,
 - tolerate unethical practices, such as corruption or political rent seeking;
- d. Inefficiencies or imperfections of multilevel government structures and processes.

Developing an efficient political system is facilitated by an economic perspective, assimilating the political processes with the ones of the market. Promoting politicians with reputations verified repeatedly, from one level to another in a multilevel political system, similar to the federal one, is a way to improve the system’s efficiency (Weingast, 1995; Myerson 2006, 2014).

The way forward is to improve the design of the political system and to compel the state to credibility protect the market, by limiting the political discretion, while keeping it self-enforced (Weingast, 1995). It is a contradiction that only social innovation can overcome. Self-enforced political discretion has various effects on society. For such effects to be mainly positive ones, the politicians must be selected efficiently, in ways similar to the ones the economic market is functioning: based on reduced costs of information, rules of enforcing the contracts and markets, large enough (North, 1992).

¹⁰ According to Weingast, 1995, and North, 1992.

References

- Aiginger, K., Bärenthaler-Sieber, S., Vogel, J. (2013). Competitiveness under New Perspectives, Working Paper no. 44, WWW FOR EUROPE, online at <https://www.oecd.org/eco/Competitiveness-under-New-Perspectives.pdf>.
- Coase, R., H. (1960). 'The Problem of Social Cost', *Journal of Law and Economics*, 3, The University of Chicago Press.
- Draghi, Mario. (2012). *Competitiveness: the key to balanced growth in monetary union*, in Treasury Talks, 'A European strategy for growth and integration with solidarity', conference organised by the Directorate General of the Treasury, Ministry of Economy and Finance – Ministry for Foreign Trade, Paris, 30 November 2012, online at <https://www.ecb.europa.eu/press/key/date/2012/html/sp121130.en.html>, accessed on 4.12.2016.
- Greenwald, B.C., and Stiglitz, J., E. (1986). 'Externalities in Economies with Imperfect Information and Incomplete Markets'. *Quarterly Journal of Economics*, 101(2): 229–64.
- Huemer, S., Scheubel, B., and Walch, F. (2013). Measuring institutional competitiveness in Europe, European Central Bank, Working Paper Series no 1556 / June 2013.
- Immergut, E., M., 2010. INSTITUTION/INSTITUTIONALISM, online la <https://www.sowi.hu-berlin.de/de/lehrbereiche/comppol/pubbl/pdfs/Immergut2011.pdf>,
- Ketels, C., (2016). *Review of Competitiveness Frameworks. An Analysis Conducted for the National Competitiveness Council*, National Competitiveness Council, Dublin, online at <http://www.competitiveness.ie/Publications/2016/Review%20of%20Competitiveness%20Frameworks%20.pdf>
- Myerson, Roger, B. (2006). FUNDAMENTAL THEORY OF INSTITUTIONS: A LECTURE IN HONOR OF LEO HURWICZ, online at <http://home.uchicago.edu/rmyerson/research/hurwicz.pdf>.
- Myerson, Roger, B. (2014). DEMOCRATIC DECENTRALIZATION AND ECONOMIC DEVELOPMENT, online at <http://home.uchicago.edu/~rmyerson/research/decent.pdf>
- North, Douglass C. (1992). Transaction costs, Institutions and Economic Performance, International Center for Economic Growth, online at http://pdf.usaid.gov/pdf_docs/PNABM255.pdf , accessed on 8.12.2016.
- Onea c , I. (2012). Cultural Foundations of Autocracy and Their Amendment: What Can Higher Education Institutions Do? EIR, Romanian Journal of European Affairs, Vol. 12, No. 4, December, pp. 45-58.
- Pedersen, O., K. (2008). Institutional Competitiveness, How Nations came to Compete, International Center for Business and Politics, Working paper no 47, ISBN 87-91690-47-1.
- Porter, Michael E. 1990 (1998 second edition). *The Competitive Advantage of Nations*. London: Palgrave.
- Porter, Michael E. 2000. "Attitudes, values, beliefs, and the microeconomics of prosperity", Lawrence E. Harrison & Samuel P. Huntington, (eds.), *Culture Matters: How Values Shape Human Progress*. New York: Basic Books, pp. 14-28.
- Stiglitz, J., E. (2016). The state, the market, and development, UNU-WIDER Working Paper 2016/1, online at <https://www8.gsb.columbia.edu/faculty/jstiglitz/sites/jstiglitz/files/WIDER%20The%20state.pdf>, accessed on 12.12.2016.
- Weingast, B. (1995). "The economic role of political institutions: market-preserving federalism and economic development", *Journal of Law, Economics and Organization* 11 (1), Spring 1995, pp. 1-31.
- CESIFO, 2016. Wettbewerbsfähigkeit International. CESifo, online <http://www.cesifo-group.de/de/ifoHome/facts/Glossar/11-Deutschland-in-der-Weltwirtschaft/Wettbewerbsfaehigkeit-international.html>.
- European Investment Bank (EIB). (2016). Restoring EU competitiveness.2016 Updated version, online at http://www.eib.org/attachments/efs/restoring_eu_competitiveness_en.pdf

INTERNATIONAL INSTITUTE FOR MANAGEMENT DEVELOPMENT (IMD), 2016. *IMD World Competitiveness, Yearbook 2015*, Lausanne: International Institute for Management Development. ISSN 1026-2628.

World Bank (1999). *World Development Report 1998–99: Knowledge for Development*. Oxford and New York: Oxford University Press.

World Bank (2015). *World Development Report 2015: Mind, Society, and Behavior*. Washington, DC: World Bank.

World Economic Forum (WEF). (2016.). *The Global Competitiveness Report 2016–2017*. Geneva: World Economic Forum. ISBN-13: 978-1-944835-04-0.