Economic Growth V: Competitiveness

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competitiveness

'Most people who use the term "competitiveness" do so without a second thought. It seems obvious to them that the analogy between a country and a corporation is reasonable and that to ask whether the United States is competitive in the world market is no different in principle from asking whether General Motors is competitive in the North American minivan market. In fact, however, trying to define the competitiveness of a nation is much more problematic than defining that of a corporation...So when we say that a corporation is uncompetitive, we mean that its market position is unsustainable - that unless it improves its performance, it will cease to exist. Countries, on the other hand, do not go out of business. They may be happy or unhappy with their economic performance, but they have no well defined bottom-line. As a result, the concept of national competitiveness is elusive.' Paul Krugman, Pop Internationalism.

competitiveness and the terms of trade

- The nominal exchange rate is $E_{UK} = f/\$$
- The real exchange rate is the relative price of foreign goods in terms of domestic goods, $R_{UK} = E_{UK} * (P_w/P_{UK})$
 - This can be thought of as the nominal exchange rate doubly deflated by foreign and domestic goods prices. As long as goods prices (P_w and P_{UK}) move closely together, the nominal and real exchange rate move together. If foreign prices rise faster than domestic prices, the real exchange rate will depreciate.
- The terms of trade is $T_{UK} = 1/R_{UK} = (P_{UK}/P_w)/E_{UK}$
 - The real exchange rate (and hence the terms of trade) is determined in the long-run by relative inflation rates and by the relative supply and demand for tradeable goods. When relative Purchasing Power Parity holds, the nominal exchange rate will move to cancel out the effect of different inflation rates, leaving the real exchange rate unchanged.

Nominal and real effective exchange rates for the UK (pounds per unit of foreign currency)













Figure **1.1**

Current account balance

£ billion



Figure 1.2

Trade in goods and services





£ billion

Figure 1.4

Current transfers

Credits less debits

£ billion



Figure 1.3

Investment income

Credits less debits



Figure 1.6

International investment position and income

Credits less debits



UK Current Account Components 1970-2002 as % of GDP



Figure **9.2**

Current account by continent, 2002

£ billion



Figure **9.3**

Current account with the European Union Credits less debits

£ billion



Figure **9.4**







Trade in goods Summary table 2.1

continued

continued													£million
			1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Balances		SITC ¹											
Food, beverages and tobacco	BQOS	0+1	-3 936	-4 127	-3 849	-4 369	-6 094	-5 808	-7034	-7 840	-7 752	-8 867	-9 347
Basic materials	BOOR	2+4	-2 666	-2 801	-2 971	-3 508	-3 755	-3 520	-3119	-3 145	-3 704	-3 875	-3 099
Oil Crude oil Oil products Total oil	воня вони вонв	333 334+335 33	857 753 1 610	1 248 1 364 2 612	2 915 1 022 3 937	3 446 877 4 323	3 698 1 112 4 810	3 038 1 522 4 560	2 506 536 3 042	4 042 406 4 448	5 697 839 6 536	5 609 -32 5 577	5 043 444 5 487
	-												
Coal, gas and electricity	BQNH	32+34+35	-1 254	-1 010	-787	-542	-516	-368	-421	53	506	300	671
Semi-manufactured goods Chemicals Precious stones and silver Other Total semi-manufactured goods	воні вонк воні	5 667+681.1 Rest of 6 5+6	3 726 -129 -4 349 -752	4 762 367 -4 304 825	4 650 207 -4 477 380	3 518 -235 -5 066 -1 783	4 071 -21 -5 537 -1 487	4 496 -318 -5 014 -836	4 723 -1 192 -5 260 -1 729	4 452 -1 155 -5 473 -2 176	4 359 -710 -5 849 -2 200	4 771 -552 -6 836 -2 617	4 489 480 -7 356 -2 387
Finished manufactured goods Motor cars Cther consumer goods ² Intermediate goods ² Capital goods ² Ships and aircraft	вонг вони вони воно воно	781 792+793	-2 184 -5 886 -478 703 1 513	-3 583 -6 073 -997 643 1 212	-3 534 -5 208 -1 054 1 248 397	-2703 -4942 -1900 1939 1252	-2 528 -5 271 -3 757 3 108 1 580	-4 465 -6 683 -625 3 573 1 646	-4 908 -9 344 -1 454 3 464 -401	-4 848 -11 065 -4 879 1 068 -363	-4 225 -13 731 -7 325 -775 -144	-8 573 -15 597 -4 000 -746 -1 981	-7 491 -17 823 -4 656 -4 328 -3 103
Total finished manufactured goods	BQOV	7+8	-6 332	-8 798	-8 151	-6354	-6 868	-6 554	-12 643	-20 087	-26 200	-30 897	-37 401
Commodities and transactions not classified according to kind	вдол	9	280	233	315	210	188	184	91	-304	-161	-241	-379
Total	LOCT		-13 050	-13 066	-11126	-12023	-13722	-12342	-21 813	-29 051	-32 976	-40 620	-46 455

1 Standard International Trade Classification, Revision 3.

2 Derived from the Classification by Broad Economic Categories defined in terms of SITC, Revision 3, published by the United Nations.





3.1 Trade in services Summary table

		1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Balances												
Transportation	FJRP	-776	-628	-836	-533	-1 096	-2 062	-2 117	-2 456	-3 357	-3 556	-4720
Travel	FJSR	-2716	-2810	-3846	-2 803	-2 961	-3 638	-5 899	-8 870	-10 939	-13,266	-13 852
Communications	FJST	-76	-204	-272	-319	-283	-185	-293	-141	-3	61	-82
Construction	FJSU	26	20	32	35	53	98	217	177	75	67	65
Insurance	FJSV	745	1 427	1 492	1 849	2 089	2 5 9 7	2 274	3 422	3 073	3 797	6 166
Financial	FJTA	3 642	4014	4 615	4 518	5 897	7 5 1 8	7 629	8 942	10 626	10 778	10 499
Computer and information	FJTB	296	352	517	502	757	952	1 332	1 742	2 027	1 878	1 868
Royalties and icense fees	FJTC	349	503	550	559	211	401	255	807	1 010	1 179	1 336
Other business	FJTD	4 351	4 000	4762	5 061	6 585	8 2 3 2	9 896	10 486	11 097	11 879	13 411
Personal, cultural and recreational	FJTH	231	264	185	197	218	274	392	356	526	634	794
Government	FJUL	-590	-357	-820	-575	-1 208	-769	-377	-1 331	-709	-451	-319
Total	KTNS	5 482	6 581	6 379	8 481	10 272	13 418	13 309	13 134	13 426	13 000	15 166

£million

share of world manufactures trade (%)

	1960	1969	1979	1998
USA	22	19	16	16
Japan	7	11	14	14
France	10	8	10	8
Germany	19	19	21	15
Italy	5	7	8	8
UK	17	11	9	8
Others	21	23	22	31
Source:	OECD			

changing times...

- The country composition of UK trade has moved towards the EU and away from the rest of the OECD since the 1960s.
- The product composition of UK trade has moved away from foodstuffs and raw materials and towards manufactures, especially in terms of imports.
- The UK's comparative advantage now lies in the following areas: oil, chemicals & pharmaceuticals, aerospace and medical technology, insurance, financial services, computer services & software, other business services, and entertainment.
- It does not lie in traditional industries such as coal, steel, textiles, shipbuilding...this has been clear since at least the 1920s.

explanations of poor trade performance

- Trade structure: too reliant upon slow-growing trade partners, slow-growing products.
 - Dumble (1994) found that the UK lost export market share between 1970 and 1985 was only 10% due to slow-growing partners and 5% due to slow-growing products.
- Price competitiveness: Thirlwall (1980) found that price elasticity of export demand is around 2 in the long-run, versus a price elasticity of import demand of less than 1.
- Non-price competitiveness: Thirlwall (1980) found that income elasticity of UK imports is around 2, income elasticity of UK exports is around 1.

evidence on price competitiveness

- Fawcett and Kitson (2004) show that a 10% appreciation will lead to a modest 2.2% fall in UK exports.
- This does not work in reverse a 10% depreciation will raise exports by only 1%.
- When sterling is appreciating, many exporters reduce exports and withdraw from overseas markets sometimes forever as the cost of re-entering foreign markets is so high.
- On the other hand when sterling is depreciating, many exporters take advantage of this to help restore profit margins rather than increase export volumes and market share. The consequence is that a 20% depreciation will be required to adjust for the adverse impact on export volumes of a 10% appreciation.

evidence on non-price competitiveness

- Fawcett and Kitson (2004) also show that a 1% increase in income we buy 2.3% more imports, whereas a 1% increase in world income only increases UK exports by just under 1%.
- This imbalance means that the UK must either grow at a slower rate than the rest of the world or have a balance of payments deficit.
- Would a slowdown in the UK economy alleviate the problem by reducing the growth of imports? Yes, but not to the same extent that rising incomes increase imports. There is another similar and potentially more devastating asymmetry, since a 1% fall in income only reduces imports by 1.5%, or 0.8% points lower than the impact of a 1% rise in income.

income elasticities and growth

Income Elasticities and Growth Rates, 1955-1965

	Income El	asticity		Growth
	Imports	Exports	Ratio	Rate
UK	1.66	0.86	0.52	2.82
USA	1.51	0.99	0.66	3.46
Belgium	1.94	1.83	0.94	3.77
Sweden	1.42	1.76	1.24	4.18
Norway	1.40	1.59	1.36	4.41
Switzerland	1.81	1.47	0.81	4.66
Canada	1.20	1.41	1.18	4.66
Netherlands	1.89	1.88	0.99	4.67
Denmark	1.31	1.69	1.29	4.74
Italy	2.19	2.95	1.35	5.40
France	1.66	1.53	0.92	5.62
Germany	1.80	2.08	1.56	6.21
Japan	1.23	3.55	2.89	9.40

Source:

Krugman (1989) and Houthakker and Magee (1969).

conventional wisdom

- In general, fast-growing countries seem to face a high income elasticity of demand for their exports, and a low income elasticity for their imports (Houthakker and Magee, 1969). This leads to a stable real exchange rate (a 45 degree relationship between elasticity and growth).
- This has led to a conventional wisdom that the UK has a competitiveness problem that the balance of payments is a constraint on domestic expansion.
- "Although the UK has surpluses on oil, services and investment income, it would be a hazardous strategy to rely on these to 'subsidize' a progressive deterioration in trade in non-oil goods", Griffiths and Wall, 2001.
- But, in the early 1960s many Japanese policymakers advocated importsubstitution policies because export markets seemed too tight (q.v. 'export pessimism'). It is also the case that the current account is the counterpart of the capital account, as part of the national budget constraint.

productivity matters

- It would be wrong to think that it is the income elasticity that is driving fast-growth (i.e. that countries with unfavourable elasticities keep running into balance of payments crises and therefore have low growth), see Krugman, 1989.
- Instead, causation runs from fast growth to favourable elasticities.
- For example, as European countries grew in the 1950s and 1960s they were actually becoming *more similar* to their trading partners, and therefore growth was actually biased against the kinds of goods that Europe was originally producing.
- Europe may have grown by expanding its share of world markets not by reducing relative prices of its goods but by expanding its range of goods. Therefore growth in the scale of the economy led to rising trade.

summary

- In the short-run, changes in aggregate demand are reflected in changes in the exchange rate and the balance of payments, as well as in output and inflation.
- In the long-run, when relative Purchasing Power Parity holds, movements in prices (at home and abroad) affect the nominal exchange rate but not the real exchange rate.
- In the long-run, the real exchange rate (and the terms of trade) are determined by relative supply and demand for tradeable goods and services.
- Changes in the relative supply and demand for tradeables is an outcome of changing comparative advantage... on this interpretation, if the UK has a problem it is because of productivity not because of competitiveness.
- Given the likely future growth of China and India, it is likely that the terms of world trade will move against the goods which China and India can produce and in favour of those goods which Chinese and Indian consumers want to buy.