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Export Competitiveness: Reversing the Logic

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1. Introduction

In the wake of the current economic and financial crisis, countries around the globe are looking for ways to reignite economic growth. Traditionally, export-led growth has been perceived as one of the most promising pathways to do so. The experience of several waves of Asian economies that achieved high and sustained growth while pursuing a strong export orientation provided the empirical backdrop for this approach.

Government policy to achieve export-led growth is then essentially about finding ways to increase the ability to sell domestically produced goods and services on global markets. This ability to export is what has often been understood as “export competitiveness”. In this thinking, exports become the target and ultimate goal of economic policy.

While the crisis has increased the demand for growth strategies, it has also raised serious concerns about whether the traditional export-led growth strategies are providing the right answer. This note outlines a number of these concerns, ranging from the practical to the conceptual. It argues that an underlying problem has been the misguided interpretation of export competitiveness as the ability to sell globally, a concern that was voiced about the term competitiveness more broadly already more than 15 years ago (Krugman, 1994). As an alternative, the note outlines a growth approach in which exports are a diagnostic instrument and the associated policies focused on exports one plank in a broader competitiveness and growth strategy. It argues that the focus of debate now needs to be on the actual policies that can increase competitiveness rather than exports per se.

2. Policies to improve export competitiveness: Critical issues

The notion that exports and trade more generally are conducive to economic growth has been a long-standing feature of economics. The theoretical arguments focused traditionally on the ability to exploit gains from trade, essentially leading to higher productivity by exploiting comparative advantages. Over time, arguments related to the exploitation of economies of scale and to different types of externalities became additional features of the debate. The introduction of market imperfection arguments actually introduced significant complications: specialization in the “wrong” activities, i.e. those with lower levels of positive externalities, could hurt growth prospects (Grossman/Helpman, 1991). Exports, then, might not be beneficial per se, but only if they occur in the “right” activities.

The empirical analyses tried to provide insights into the factual linkages between trade and growth. Many researchers have found a stable relationship between openness and prosperity growth (Baldwin, 2003; Dollar/Kraay, 2002; Frankel/Romer, 1999; Sachs/ Warner 1995), or highlighted the role of trade as a means to tap into foreign knowledge and raise productivity (Coe/Helpman, 1995; Alcalá/Ciccone, 2004). But others are more skeptical and attribute these findings to the specific data and econometric approach used (Rodríguez/Rodrik, 2000; Median-Smith, 2001). There are also questions as to whether the relationship between specific trade policy instruments such as tariffs and growth has not been stable over time (Clemens/Williamson, 2004). On a more basic notion, there remains a significant amount of empirical evidence that trade remains much stronger within countries than across borders (Mayer/Zignago, 2005), even when traditional tariff and non-tariff-barriers have been removed like in the EU's Internal Market (Ilzkovitz et al., 2007).

While neither the theoretical nor the empirical work provided unequivocal support for targeting exports, the successful example of the Asian economies with their significant export growth inspired policy makers to look for ways to enhance growth through policies to increase exports. They are faced with critical issues at three different levels: How can export competitiveness be improved, is export competitiveness (still) a feasible policy approach, and is export competitiveness an appropriate policy objective?

- How can the effectiveness of export competitiveness policies be improved?

If one accepts the notion that exports provide positive externalities and thus should be encouraged by government, the policy question is how to do so most effectively.

One large body of thinking is devoted to identifying general barriers to exports that reduce trade below its socially optimal level. Exchange rate (Rodrik, 2009) or other policies to change relative prices can provide a countervailing force by subsidizing exports. But they increase the costs of imports, hurting both domestic consumption and export-oriented industries with high import content. More effective policies would thus target these barriers directly. Some of these barriers are related to inefficiencies in the domestic business environment, for example those captured in the World Bank's Logistical Performance Index (Arvis et al., 2010). Others are related to market access abroad, for example through the tariff and non-tariff barriers captured by the WTO, World Bank, and the OECD. Or they could be related to lagging capabilities of domestic companies, either in understanding foreign markets or in their own products, services, or value chains.

Another large body of thinking is devoted to identifying specific sectors in which exports can be increased more easily or with more value being generated. More prosperous countries tend to be more diversified and present in different product categories than other countries (Hausmann/Hwang/Rodrik; 2005). Most of the new literature focuses on the question of how countries can identify sectors that are not only generically more attractive in terms of the prosperity level they can support – the perspective taken by the traditional strategic industrial policy – but also are within reasonable reach for a country given its existing industry portfolio. There has recently been interesting progress on the analytics of identifying relations between industries that make successful diversification seem more likely (Hausmann/Klinger, 2006; Delgado/Porter/Stern, 2009; Neffke et al., 2009). There is less systematic progress on identifying the policy tools to develop these related industries in ways that avoid the mistakes of industrial policies in the past. Empirical evidence is also mixed with some recent work suggesting that much of the potential for export growth and export diversification into more attractive market segments can happen within existing export industries rather than in industries new to a country (Shaw et al., 2009).

Overall there is clear evidence that policies to achieve export competitiveness, understood as the ability to sell on global markets, can be improved.

- Are export competitiveness-oriented policies still feasible?

Even if one accepts the notion that export-led growth strategies can work, policy makers face the question as to whether it is a feasible approach for all countries at all times.

One body of literature, emerging already when Asian economies focused on exports to regain growth after the Asian crisis (Felipe, 2003), questions whether the export-orientation is still feasible if it is being pursued by a large number of countries in parallel. It might have negative terms-of-trade effects if all exports focus on the same industries. It might lead to unsustainable macroeconomic imbalances with countries running large current account surpluses/deficit on a sustained basis if normal adjustments through exchange rate movements work sluggish. This is a possibility that has become very real over the last few years. Export-oriented countries might get trapped in beggar-thy-neighbor policies to capture share in the global market for exports instead of adding to global trade (Atkinson, 2009). There is some evidence of this tension emerging in recent years, for example in Europe as German wage restraint improved its relative cost position on export markets. In importing countries there might be a significant political economy backlash from sectors exposed to increasing foreign competition. Here, too, pressure has been rising but so far there is “no significant intensification of trade or investment restrictions” (WTO/OECD/ UNCTAD, 2010).

Another set of contributions focuses more on the question whether export-orientation is feasible in the current economic climate. On the demand side, the sluggish growth in advanced economy markets and the excess capacity globally might leave insufficient room for countries to achieve export growth (Rodrik, 2009; Blecker/Razmi, 2009). However, increasing trade within the south seems to provide alternative export opportunities (Canuto et al., 2010). On the supply side, the almost unlimited labor supply at low wage levels (Lewis, 1954) in China and countries like Vietnam might make it hard for other countries to compete with them successfully on export markets. The empirical data confirms the presence of this effect but does not indicate that it renders export-driven growth strategies infeasible (Wood/Mayer, 2009).

Overall, the discussion remains far from having reached a consensus. At the minimum, there is a sense that there is a need to reach a more balanced approach where exports are not the central driver of countries' growth strategies.

- Is the focus on export competitiveness as the ability to export appropriate?

The most fundamental question is whether the focus on raising exports is appropriate as a guiding principle for a sustainable economic growth strategy, whether or not it could be improved or remains feasible.

One concern relates back to the empirical evidence presented at the outset, which indicated that the link between exports and prosperity is less robust and the causal relationship from one to the other is less clear than would be necessary to confidentially put exports at the center of growth strategies. An alternative view of the data suggests that export-orientation works if some other fundamental conditions are in place. These fundamental conditions should then be at the core of growth policies, not the exports that are their result or, at best, a multiplier of their impact.

Another concern is that the policy focus on exports very easily leads to insufficient attention to domestically-oriented or more traditional sectors (services, agriculture). This creates economic costs like traditionally in Japan (Porter et al., 2000). But it is also politically harder to sustain then, for example, the Thai "dual track" strategy with growth impulses for both exporting and local activities that turned out to generate broad-based public support (Looney, 2004). An alternative view is to integrate export-orientation in a broader based growth strategy.

Overall, the discussion suggests that there are sufficient grounds to be skeptical that exports are the right foundation to build a growth agenda on. Exports play a role in growth but it is doubtful whether they are a root cause or even the best lever to achieve sustained growth.

3. Reversing the logic: A different way of looking at exports and competitiveness

The competitiveness framework developed by Porter (1990, 1998) suggests that there is an alternative way to look at the relationship between exports, competitiveness, and growth. The remainder of this note will take this perspective to address the last of the three questions raised in the previous section, i.e. is the focus on export competitiveness as the ability to export appropriate?

Conceptual issues

In Porter's competitiveness framework (Porter, 1990; Porter, 1998), competitiveness essentially means productivity. Productivity is at the heart of the framework, because it is seen as the critical driver of long-term sustainable prosperity, the outcome that is seen as the relevant ultimate objective of economic policy. This is an important point because many export-led policies were motivated more by intermediate objectives like generating jobs or creating export revenues to cover import costs or serve foreign debt obligations. There is nothing wrong with these objectives but they are neither necessary nor sufficient for prosperity growth.

More specifically, competitiveness means the level of productivity that companies can achieve in a location given the full breadth of conditions that affect their activities there. It is the structured approach towards organizing these conditions and the systemic relationships between them that is at the heart of the competitiveness framework (Porter et al., 2008). Empirical work has confirmed the high correlation between strong performance on these conditions and prosperity levels across countries (Porter et al., 2008).

Exports have a dual role in this framework; they (and a number of others with the same quality, including imports, FDI, and investment) are intermediate indicators and enablers of competitiveness. They are signs of underlying competitiveness – the more productive you are, the more you will be able to sell, all else equal. But they are also contributors to competitiveness – the more you export, the more you are exposed to foreign competition and ideas which in turn will improve your capabilities and push you to make better use of the capabilities you already have. The observation that exports contribute to competitiveness even though they are not a fundamental driver provides a rational explanation for why export-oriented policies have still fared much better than other policies, for example import substitution, even if they have not been an unqualified success.

Policy implications

What does this mean for economic policy, i.e. how are government policies informed by the competitiveness framework different from those that have been traditionally employed in export-driven growth strategies?

Competitiveness strategies are broadly based, recognizing the need to upgrade performance across the entire economy, not just the export-oriented sectors. Export-oriented sectors are like the engine of an economy. They are critical but without an efficient transmission system of local industries, their value generation does not translate into a high standard of living for the broader population. While both parts of the economy are important, they do face different dynamics. In export-oriented sectors companies compete directly with foreign peers, implicitly pitting different business environments against each other, not just firms. In the local sectors, the competition is only between firms that are all exposed to the same business environment conditions. For policy makers, this implies that a competitiveness strategy needs to cover both export-oriented and local industries. And it needs to take into account that in the export-oriented sector policy choices have to be made with a much stronger view on policies in places in other locations.

Competitiveness strategies are squarely oriented towards reaching higher productivity. Attracting FDI, generating jobs, and growing exports are positive implications of higher productivity. But the ultimate test of whether policies are effective is their impact on prosperity. And here productivity is a much better long-term target than intermediate outcomes like exports that can also be driven up by policies that do not raise productivity or long-term prosperity. For policy makers, this suggests that each individual measure under consideration needs to be tested as to whether it improves productivity or only improves intermediate outcomes by raising the private profitability of activities. This is not only an absolute benchmark to decide whether an individual measure should be introduced but can also be used to compare different policy instruments. Wage-restraint, for example, has mainly an impact on private profitability but could of course also lead to long-term productivity improvements if it leads companies to come and investment in a more advanced capital stock. Government efforts that directly improve productivity through upgrading workforce skills or subsidizing companies more specifically for upgrading technology is, however, likely to provide a much better balance between productivity improvements and private profitability gains. Importantly in the current context, policy interventions that raise productivity do not create macroeconomic imbalances. Policy interventions that interfere in market prices without raising productivity, i.e. artificially low exchange rates, export subsidies, etc., might have that effect if compensating changes in other prices, for example relative wages, do not occur.

Competitiveness strategies are highly country-specific, targeting the specific barriers for growth a country is facing at a given point in time. While the general principles apply across all countries, the key barriers for growth differ dramatically depending on the local circumstances. The competitiveness framework provides an analytical way to identify these key barriers based on an in-depth analysis of country-specific data, including the export profile. While the export-oriented growth model (or frameworks such as the Washington consensus) provides a recipe to be used pretty much the same way across different countries, the competitiveness approach suggests a conceptual algorithm for how each country can find its appropriate policy mix to raise productivity (this is similar to the logic in Rodrik, 2007 and Hausmann/Hwang/Rodrik, 2005). An added complexity is that policy choices are often highly interdependent, i.e. the effectiveness of a program to strengthen workforce skills depends on simultaneous investments in infrastructure and targeted regulatory reforms. Only then will it become profitable for companies to make the investments in activities with higher levels of productivity that leverage that better skills available. For policy-makers, this implies a need for much more own analysis based on country-specific data rather than an adoption of general policy principles from abroad. It implies to identify which policies are truly critical at a given point in time, instead of trying to do everything in parallel. And it implies identifying which packages of policy reforms need to be implemented in an integrated fashion to achieve real impact.

Competitiveness strategies combine efforts to upgrade general conditions in an economy with efforts that are targeted at the specific conditions affecting individual groups of activities. These groups of activities, covering industries related to each other in the value creation process, tend to geographically co-locate in clusters. The competitiveness approach argues that to be effective, measures to upgrade productivity need to be at least in part cluster-specific. If government only addresses challenges affecting all companies, a large part of what matters to companies in a modern company remains left out. This approach is fundamentally different from the old industrial policies that targeted industries by tilting the competitive environment on markets in their favor. Instead, it focuses on upgrading productivity and is principally open to all industries that are willing to engage in collaborative efforts to upgrade competitiveness (Ketels, 2010).

The role of exports in a competitiveness-oriented growth strategy

While the competitiveness-oriented approach provides a fundamental different perspective on how a growth strategy should be designed, it does not ignore the important role that exports play in the growth process. And there is also a significant overlap in terms of the individual policies that are suggested.

Exports are an important diagnostic tool that can help signal whether more fundamental conditions in the economy are right. The overall success on global export markets as well as the particular pattern of industries that successfully export provides valuable “revealed” information on underlying competitiveness conditions. Low levels of exports are an indication that there are weaknesses that either limit the productivity of companies or negatively affect their ability to project their capabilities on global markets. Exports in particular sectors give an indication that the location has a particular set of strengths in its competitiveness fundamentals that are conducive to their success. Together with additional information on these competitiveness fundamentals and ultimate economic outcomes in terms of productivity and prosperity exports are thus an important element to identify the key policy priorities for a particular country or region.

Export-oriented policies also have their place in an overall competitiveness-oriented growth agenda. Many of the policies discussed earlier as instruments to improve the effectiveness of export competitiveness policies remove barriers to exports in ways that directly improve the productivity of companies. They do so either by enhancing companies’ capabilities directly or by removing barriers that limit their abilities to translate these capabilities into valuable products or services for consumers on export markets. But there are other policies like currency undervaluation or export subsidies that do not have this property. Such policies can only be justified, if the rise in exports enhances the effect of other policies that ultimately increase competitiveness. If that happens the initial export subsidies can be eliminated over time. These policies are thus like performance enhancing drugs; potentially useful in the short run but dangerous if they become an addiction. The competitiveness framework can help to better distinguish export-oriented policies that make a contribution to long-term sustainable growth from those that do not.

4. Moving on from here

There is actually quite a lot of emerging consensus on the need to look at the fundamental drivers that lead to higher exports rather than targeting exports directly. In that sense, the call for reversing the logic made in this paper might seem overblown. However, contrasting the export-oriented view with the competitiveness-oriented view as done here does have an important purpose: it is much harder to understand the gaps that do exist between these views, if there is no clarity on the conceptual differences. This is true especially because of the clear overlap in individual policies recommended. The export-oriented approach is clearly not wrong, but it is incomplete and does not provide clear enough guidance to avoid policies that indeed are harmful over time. The competitiveness-oriented approach can provide the additional context and give practical support in evaluating policies.

If the competitiveness-oriented approach is conceptually more robust and the effectiveness of the export-oriented approach not supported by the evidence presented at the outset of the document, why are countries not quickly abandoning the export-oriented approach?

One candidate to answer this question is the short-term effectiveness and relative ease of export-oriented strategies. Export-drives can push growth rates up, at least for a while (Hausmann/Pritchett/Rodrik, 2005). Vietnam is a good example for this dynamic: After opening up its economy following the Doi Moi reforms in 1986, the country embarked on a very successful growth path driven by FDI and exports. Foreign investment introduced capital and provided jobs for people previously occupied in agriculture. At an aggregate level, capital intensity rose, productivity grew, and prosperity improved, and poverty levels dropped dramatically. With close to half of the working age population still in agriculture by 2010, this process can still continue for a number of years. But the downside is that without improvements in competitiveness, Vietnam will ultimately remain stuck at the level of prosperity given by low value-added, labor intensive manufacturing (Ohno, 2009). Nevertheless, in the short term it is much easier for Vietnam to stick to export-orientation than to address the complex barriers to higher competitiveness inherent in, for example, its state-owned enterprises, regulatory framework, and overall policy making architecture.

The more general hypothesis is that policies that foster exports by increasing the private profitability of exporting but do not raise productivity of any individual activities can still raise prosperity as long as they drive structural change biased towards higher (in the context of the country) productivity sectors. Policies that raise the productivity of activities in the export sector can also drive structural change but continue to work even when structural change has slowed down. The attraction of changing relative prices to drive structural change is that this instrument works much faster than the more sustainable, but also slower process of upgrading productivity. This is an area for more conceptual as well as theoretical research.

Another candidate has to do more with the competitiveness-oriented framework itself. While the framework provides conceptual principles and orientation, the specific policy instruments to use have been developed much less in the literature. And there is less practical and documented experience from countries that have followed these recommendations. There are a good number of examples where countries have implicitly followed the advice that a competitiveness-oriented analysis would provide. But there are much less examples where countries have moved through an analytical process as sketched out above, design policy priorities accordingly, and then implemented them as planned. Broader-based adoption of competitiveness-oriented growth policies will to a large degree depend on providing policy makers with more practical examples and tools that can convince them to take the risk that is inherent in adopting any new policy paradigm.

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