Evolution of competitiveness theory assignment

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Evolution of Competitiveness theory Chapter 2 Review: What is competitiveness? Before exploring Porter's Diamond Model, Cho and moon invite readers to reflect on the concept of competitiveness. Over the years, the debate has been ongoing about the meaning of this word and most citizens lacking important notions in global trade have stuck with the meaning that was most accessible and comprehensible to them, the same meaning President Clinton gave to it during his time in office: nations are like corporations competing in the global marketplace.

This definition implies many things such as the existence of a bottom line for countries and the impossibility of there being two winners in the equation. Paul Krugman starts the debate by presenting his disapproval of this commonly accepted vision. For him, countries unlike corporations don't have a bottom line in the sense that they don't try to maximise their citizen's wealth in order not to cease existing because there is nothing the least resembling to bankruptcy as an option for countries. He also denies that trade is a zero-sum argument.

All countries have the possibility of being winners in the world market place through the dynamics of comparative advantage. In Krugman's views, nations are not in economic competition with each other and their problems can't be attributed to their lack of success in competing on the global platform. Indeed, since exports are only 10% of GNP, countries are not really dependent on their neighbours for success. Success, in the sense of sustainability and high standards of living, is entirely dependent on a country's domestic productivity growth.

One key point Krugman wants to get through is that because trade balance is so innocuous, there is no need to build domestic polices around it. Doing so would only result in a misallocation of resources and a lack of funding for the service sector, protectionism and bad public policies. He does concede that if purchasing power (real GNP) was to grow slower than the output a country produces, this country's competitiveness could actually end up relying on competition across borders after all.

Although he thinks competitive problems can theoretically arise, he further states that they don't. Krugman finishes by pointing out major arithmetic errors that have been made by economists in literature over the past. He attacks statements of four authors: Thurow, Magaziner, Reich and ex-British Prime Minister John Major. Thurow and others respond to these previous accusations and present their own thesis. Prestowitz Prestowitz's criticizes Krugman's firm belief that trade is not a zero-sum game.

He agrees that two countries can complement each other's needs and both come out as winners if they focus on what they produce best and sell these goods abroad, but only in the case where they didn't both focus on the same industry as it is the case in airplane building between Europe and the US. In his book Trade Deficits and the Loss of Good Jobs, Thurow had blamed the average income loss of 6 % during the Bush and Reagan years on the trade deficit in manufactured goods.

Yet Krugman doing a bit of math had calculated that even if 1 million workers were moved from these high wage jobs into the service sector which is estimated to pay 30% less, this would only explain 0. 3 percent of the

decline in U. S. wage rates. What Pretzowitz now says is that service workers (who he maintains don't compete internationally), are remunerated according what people can pay. If they are paid as much as they are today it is because productive workers in the manufacturing sector can afford to pay as much.

If these people made less, the whole economy would consequently be affected. That is why Pretzowitz encourages productivity in the manufacturing sector. It determines wages throughout the economy. Pretzowitz also points out that Krugman underestimated the part of trade in the economy. Krugman had estimated the effect of trade on the US economy to be 10% but for some reason, he had left imports out of this calculation. If we revised this number 21% of the economy would be indirectly affected by trade.

Thurow: Thurow believes Krugman would be the first to be in favour of protectionist measures to limit the amount of imports coming in to equal the amount of exports going out because this measure would allow for these imports to be created domestically and this would generate jobs in sectors with above average returns. Thurow doesn't think that this would be useful. To him, succeeding domestically is unachievable unless a nation is also successful in the global economy.

Countries that don't compete abroad don't have the advantages of the faster pace of economic change and the new techniques to improve domestic productivity that are learnt from competitors. Thurow, having a few of his arguments demolished by Krugman, blasted back by saying that domestic

investment and innovation had always been at center of his concerns. He believes countries actually have a bottom line of improving the living standards of each citizen and that it depends up to 93 % on rising productivity. In turn, only 7% of the economy depends on competitive and cooperative advantages.

He calls this his 7% solution. This 7 %, although very small, still needs to be accounted for. A country has to keep in mind competition especially in areas where it dominates and has above average wages. Government should organise brain power around these industries to create an economic leadership. COHEN At the center of Cohen’s theory is the belief that competitiveness is constituted of a broad set of indicators and that none of them work alone but together they achieve a dynamic understanding of the problem that is at hand.

Krugman’s use of single numbers to prove his idea is consequently pointless. Given the unreliability of many of the data, a calculation alone doesn’t mean anything. He also adds to the idea of the value added sector. Initially Ira Magaziner and Robert Reich had stated that for living standards to rise, you needed to invest capital and labor into industries with high value added and to maintain an advantageous position in those industries compared to your competitors.

Krugman in response had pointed out that high value added sectors occurred in sectors that where highly capital intensive and therefore investing in these to increase productivity was unlikely to create a lot of extra value added. What Cohen now added was that high value added sectors were also sectors

in which big monopolies were exercised. This got Cohen to put into question what determined productivity. Basically Cohen's main point is simply that although many are starting to agree productivity is at the center of competitiveness, causes for this productivity have yet to be clearly defined.

Conclusion Krugman is given the last word and closes this affair by pointlessly poking at little mistakes in previous arguments. These tiny flaws are in his view good proof that Thurow, Prestowitz and Cohen all have a desire to believe in an erroneous concept. Nonetheless he does make one key point in saying that Thurow might be wrong about the possibility of creating 1, 000, 000 new jobs in the US by producing domestically what was previously produced abroad. He states that the government would intervene or raise interest rates to prevent inflation.

This opens up new avenues of thoughts and places an importance on the urge of governments to define competitiveness and a country's objectives. Reflecting on the debate: The good thing about the debate is that at least all authors concur on the objective of staying competitive whether their definition of this word varies or not. This objective is and should remain to allow a country to sustain a high standard of living. A common agreement what high living standards are would have in my view eliminated a lot of superfluous comments in the debate.

In my naive view, high living standards include a vast array of criterions including the high levels of disposable income, high levels of happiness, the quality of a country's institutions and high levels of technological innovation. This calls of using more than a single number reasoning as Krugman has

done in the past to evaluate competitiveness. I believe a thorough evaluation of competitiveness should at least take into account the level of preparation of a country in the face of the knowledge-based economy of the 21st century, the happiness level of its citizens and a country’s balance in trade.

I have to agree with Krugman in that high living standards depend enormously on the long term prospect for domestic productivity. High productivity, which in my view entails efficiency, would allow a country to get more out of a single output and this in turn would mean that there would be more for all to be redistributed. The problem is that this method of doing things prevents economic growth in the sense that there is less money to invest.

The key here would be finding the right balance between high efficiency and the ploughing back of money into innovation, education and public health. I believe the way of reaching such a balance is specific to each country and that no universal model can be elaborated. Finally, balance would also be of crucial importance in finding the right amount of money governments should invest in every industry. Concentrating resources in the industries where they have a comparative advantage is important but it shouldn’t be done to the detriment of other industries.