Edexcel (A) Economics A-level

Theme 4: A Global Perspective

4.1 International Economics

4.1.9 International competitiveness

Notes

Measures of international competitiveness

International competitiveness is the ability of a nation to compete successfully overseas and sustain improvements in real output and living standards.

Countries can compete with price and non-price competitiveness. For example, the quality of goods and services and the rate of innovation can change how competitive a country is.

Relative unit labour costs

The unit labour cost is how much labour costs per unit of output.

Generally, the cheaper the relative unit labour costs, the more competitive the country in manufacturing. For example, countries such as China, India and Bangladesh have lower labour costs than countries such as the UK and US, which means that a lot of production requiring manufacturing, such as textiles, clothes and technology, has moved abroad.

However, higher prices could compete if a niche market is targeted or by using product differentiation. Quality is also important: German cars are famous for their quality, so consumers might be willing to pay more for them.

The more productive a country becomes, the lower its unit labour costs. This makes the country more internationally competitive.

Relative export prices

This is the ratio of one country's export prices relative to another country, and it is expressed as an index. The lower the relative export price, the more competitive the country.

Factors influencing international competiveness

Ability to attract FDI from MNCs

If a country can attract more FDI, it increases their productive capacity. This can help produce long term growth and raise living standards.

Ability to produce or attract entrepreneurs

Entrepreneurs help develop new ideas and stimulate innovation. This keeps a country ahead with technology and gives them an edge in the market, which makes them more competitive.

Ability to attract (skilled) labour from abroad

This might fill a skills gap in, for example, IT or biotechnology, and improves the quality of the labour force. If there is a skills gaps, firms face higher costs. The UK's ability to attract FDI depends on:

- The skills and flexibility of the labour force, which could lower unit labour costs.
- The UK acts as a gateway to Europe, especially with the free trade within the EU. The EU forms 16.5% of world trade and is the world's largest trading bloc.
- The relatively low tax rate.
- Stability in the economy and financial system.

Unit labour costs

Unit labour costs rise when wages increase at a faster rate than productivity. China's large population means wages are generally low, but the rise of the middle class and consumer spending is pushing wages up.

Exchange rate

A depreciation in the real exchange rate makes exports relatively cheaper, so the country becomes more internationally competitive.

If the price of imports increases as a result of a devaluation, then the cost of raw materials would increase, which would be particularly damaging to small firms.

It is important to remember that devaluating the currency is not a policy relevant for countries with floating exchange rates, such as the UK.

Quantity and quality of skills possessed by a nation's workers

This refers to the skills of human capital. If there are limited skills, the economy cannot expand its productive potential. The more skilled the workforce, the more productive it is. It also means goods and services are of a better quality, which improves international competitiveness.

- **Flexibility of labour**

Part time and temporary contracts help limit a firm's costs, which lowers unit labour costs. Additionally, if the labour market is flexible and geographically or occupationally mobile, it can better respond to economic shocks and changes in demand or supply, which can help improve competitiveness.

- **Economic stability**

If inflation is low and stables, firms are more able to plan their investment and spending, because they know what future prices will be. Deflation or high and uncontrollable inflation makes it hard to plan for the future.

For example, the UK government could try and reform the banking sector so it is more resilient to shocks.

- **Tax policies e.g. low income tax**

A lower tax rate provides an incentive to earn more, since consumers and firms know they will keep more of their income. A low income tax might attract more skilled labour, too.

The UK government has tried to increase competitiveness by lowering the corporation tax rate from 21% to 20% in 2015. This is the joint lowest in the G20 and should help increase inward investment.

- **Regulation**

Excessive regulation (red tape) can make it hard for firms to invest, and it could raise their average costs of production. The UK government has established the 'Red Tape Challenge', which aims to simplify regulation for businesses, so it is cheaper and easier to meet environmental targets and create new jobs. It should help to encourage investment and innovation, so domestic firms can become more internationally competitive.

In France, there are excessive employment laws that make it hard for small enterprises to compete.

- **Rate of innovation**

This is calculated by the proportion of GDP invested in new capital. If a country innovates more, they are likely to develop new, more advanced technology that can help them become more competitive. It could increase the quality of the goods and services produced.

It could be argued that non-price factors such as availability, reliability, quality, design and innovation are more important than price factors.

- **Interest rates**

It can be considered whether the UK's low interest rates have helped the international competitiveness of the UK. It has encouraged spending, which increased AD and growth. However, it can be seen as a deterrent for foreign investors, since they get a low return on investment.

The increase in AD might cause demand-pull inflation, which could make UK goods more expensive than elsewhere. This might increase imports, if they are cheaper than domestic goods, which could worsen the current account deficit. However, this means the UK has a capital account surplus.

A depreciation of the pound would result in a lower return on investment for investors, which might reduce demand. The UK gets a lot of investment in the London property market. A lack of investment would result in a lack of research and development.

Competitiveness is limited by exchange rates in other countries. However, it should be considered whether strengthening the domestic economy or becoming more internationally competitive is more important.

Significance of international competitiveness

Benefits of being internationally competitive

Being internationally competitive is vital in the light of the global economy. The UK's vision is quite short-termist and profit driven, whilst Germany has a lot of small and medium-sized enterprises (SMEs), many of which are family run. SMEs tend to focus on supply-side policies for long run growth, rather than MNCs which are profit driven. This is especially the case in machinery, auto parts and electrical equipment.

As of 2015, the UK is the 9th most competitive country in the world. Switzerland is the most competitive, whilst Germany is 5th. Despite being a small country, Switzerland is the most competitive since it is a tax haven, which encourages a lot of inward financial flows.

If a country becomes more competitive, such as Germany, they can gain a reputation for their exports, which might make them more price inelastic. As a result, they might be able to demand higher prices for their goods and services.

By operating in a competitive market, firms can reach out to more consumers. For example, only 32% of McDonald's sales are generated in America, whilst 40% were from Europe and 23% from Asia, Africa and the Middle East.

This can also help firms gain economies of scale, which can help lower its average costs of production.

Problems of being internationally competitive

The economic importance of education and health spending could be considered. It could help improve the skills and productivity of human capital which can make the country more internationally competitive, but the effectiveness of the spending is questionable. Is the investment better spent elsewhere?

Being innovative is not always successful, and it could lead to funds being wasted.

A lower tax rate might mean the government receives fewer tax receipts, which could limit public spending. It depends on how important public services are to each country, however.

If firms are operating in a competitive environment, infant industries might find it hard to compete, so they are forced out of the market. Also, the supernormal profits of large firms might be eroded away, which could limit the amount of investment in R&D.

If jobs are offshored, the domestic country might face job losses and structural unemployment. However, it could benefit the recipient country.