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Does the South of Europe have a competitiveness problem?

Lorenzo Codogno

Economic and Financial Analysis Department of the Treasury, Italy's Ministry of Economy and Finance

"International Price and Cost Competitiveness", Bruegel, Brussels, April 29, 2011



What is Competitiveness?

- The elephant and the blinds
- Krugman's denial: "a dangerous obsession"
- Competitiveness = Productivity?
- No agreed definition, is it a useful concept?
- We don't know but we know when we see it



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No shortcut for a more comprehensive analysis

- Can we exclude imbalances from the concept of competitiveness?
- Measurement issues: a broader perspective
- Policy responses: Competitiveness Councils/Reforms?
- The case of Ireland

Assessing competitiveness (and imbalances) in practice

- GDP per capita/Productivity vs Export Performance
- G20: Mutual Assessment Process (MAP)
- The European approach: more in depth, formal and strict
- Euro Plus Pact
- Symmetric or asymmetric approach?
- How can we best perform macroeconomic surveillance?

EU Scoreboard (tentative): external imbalances

- Current account balance (as a % of GDP)
- Net International Investment Position (as a % of GDP)
- REER with HICP deflators relative to 35 other industrial countries
- Export market shares (% change 5 years)
- Nominal Unit Labour Cost (% change 3 years)

EU Scoreboard (tentative): internal imbalances

- Deflated House Prices (yoy % change)
- Private Sector Credit Flow (as % of GDP)
- Private Sector Debt (as % of GDP)
- General Government Debt (as % of GDP)



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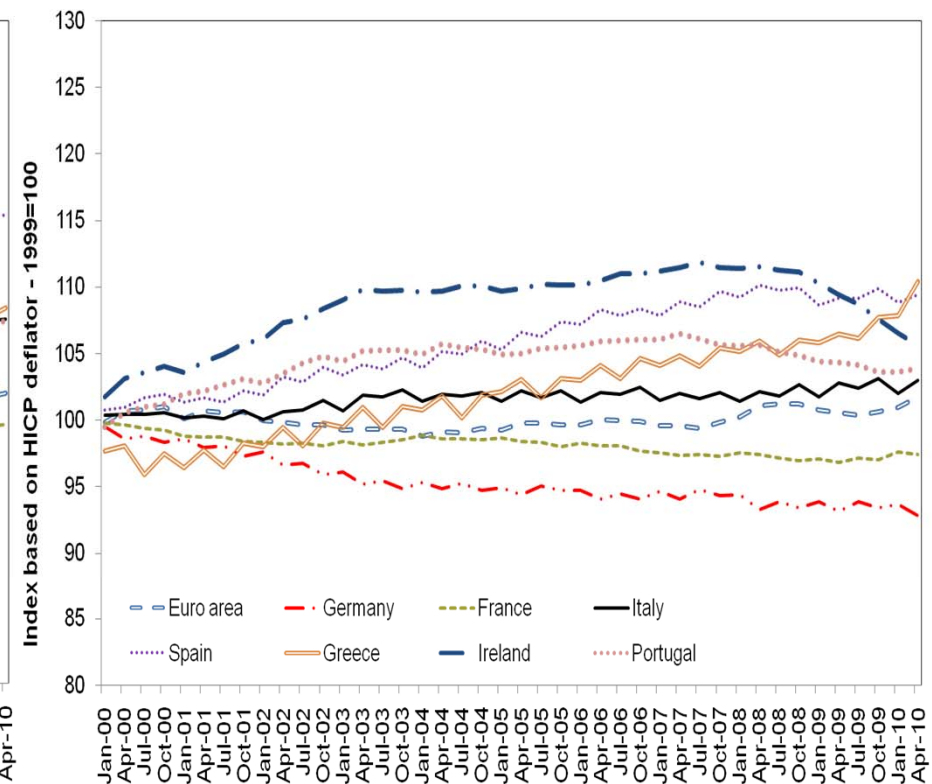
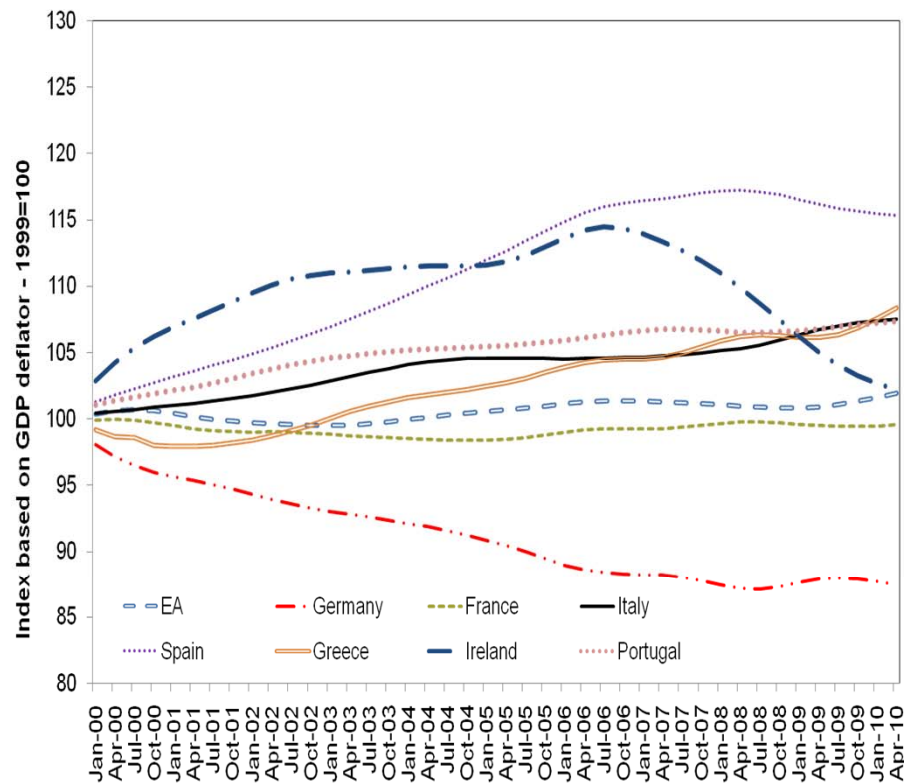


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Price Competitiveness: REER

- Nominal exchange rate (numerator): less controversial
- Numerous candidates for the denominator: consumer prices, producer prices, GDP deflator, unit labour costs, export prices
- Price of capital? Price of service inputs?
- Which sectors? Which inputs? What about outsourcing?
- What weights for exchange rates?
- Data disaggregation: firm-level datasets

First glance at REER



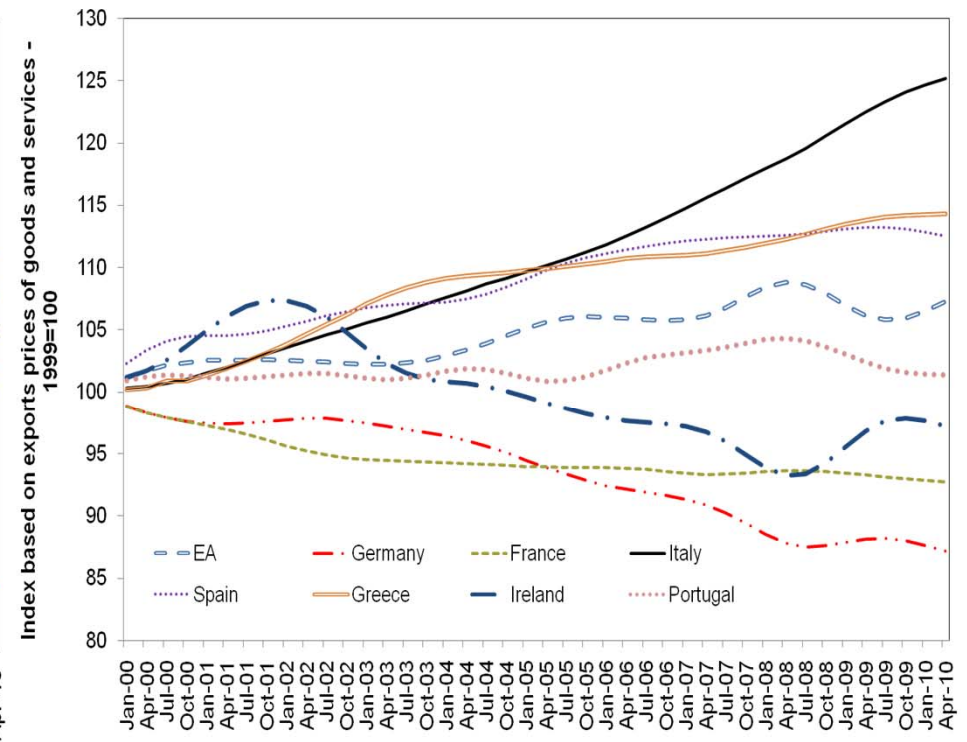
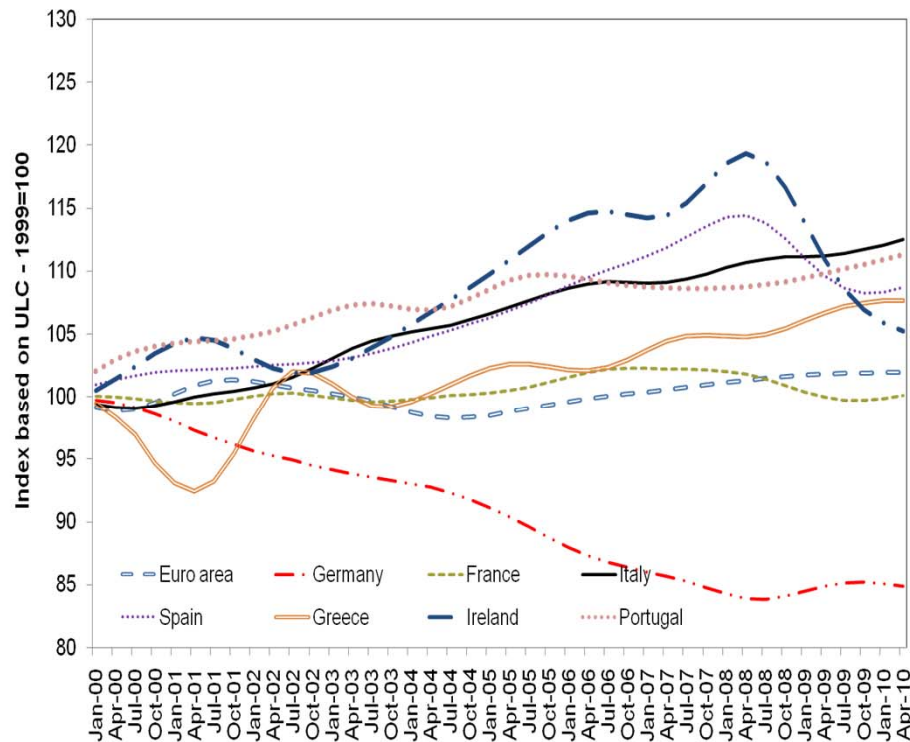
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REER: significant swings depending on the denominator



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Not only a North/South divide

- Largest appreciation of REER (50% in 2000-2008) in countries which most recently joined the EU —Bulgaria, Czech Republic, Estonia, Latvia, Romania, Slovakia
- REER growth for other countries, such as Denmark, Greece, Spain, Hungary, Ireland, Italy, Lithuania, Malta, the Netherlands, Portugal and Slovenia
- Catching-up: the Balassa-Samuelson effect



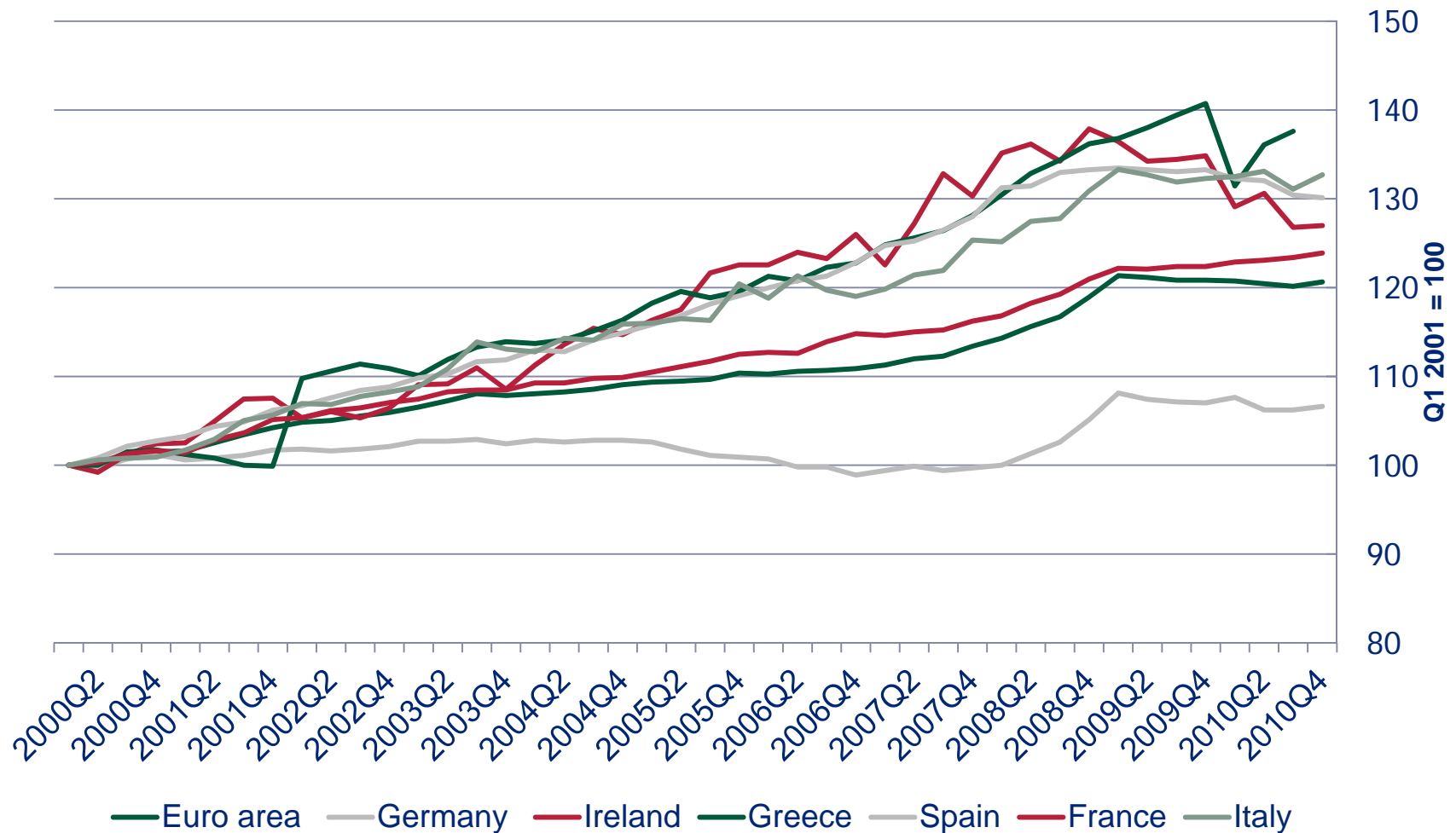
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Divergence in unit labour costs are important but



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... there are other factors not strictly related to labour costs

- Sectoral specialization
- Geographical destination
- Technological content
- Offshoring/outourcing
- Attractiveness for foreign direct investments
- Imports as inputs to exports
- Increasing return from clusters and trade agreements
- etc....

And the real challenge are non-price factors

- Branding
- Product quality
- Product differentiation
- After-sale service
- Financing packages
- Other product and distribution features



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Focus on the service sector

- 2/3 of global GDP but only 1/4 of global trade
- Data limitations
- Difficulties in measuring productivity
- Role of economic integration



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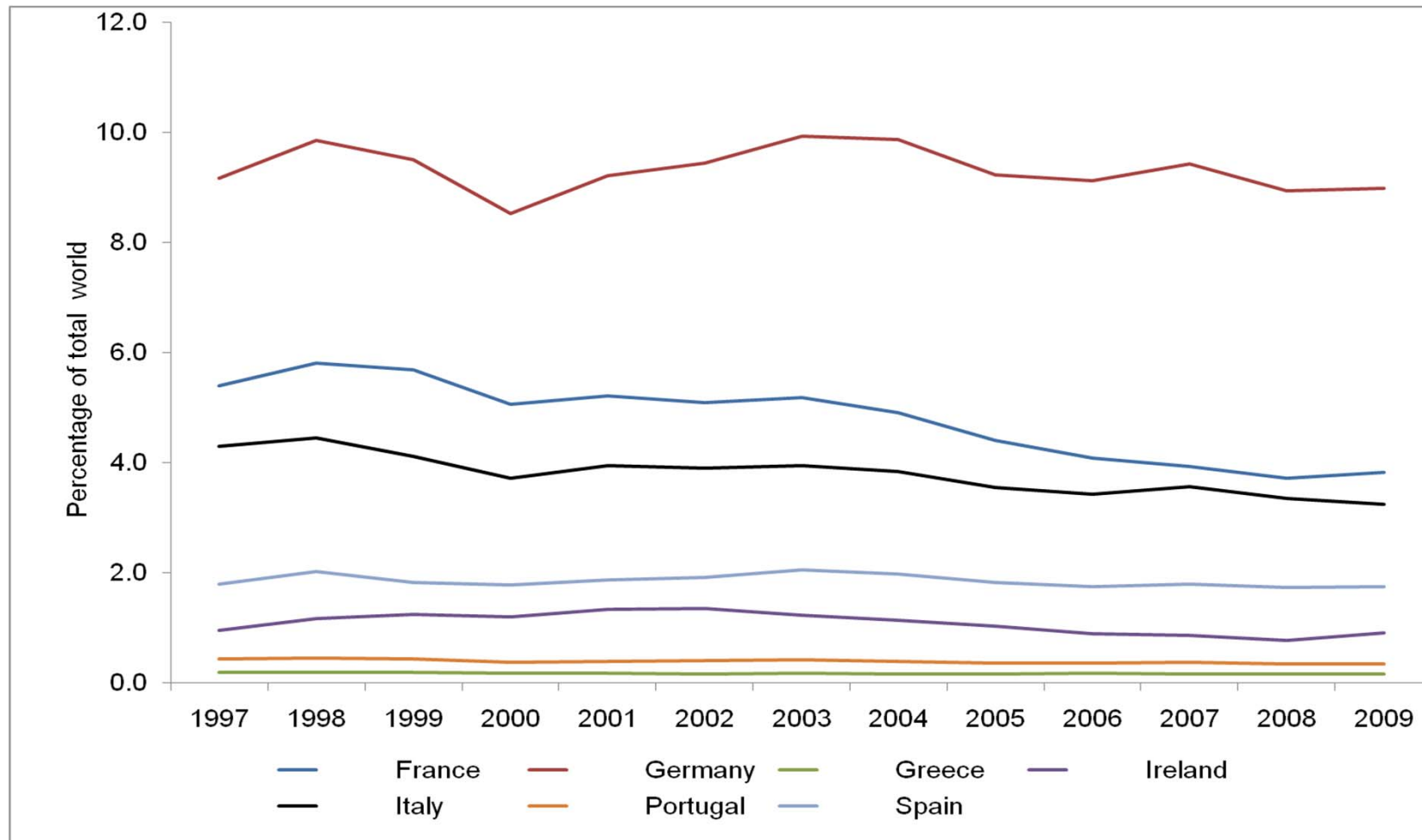


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Bottom line: the proof of the pudding is in the eating

- Success in export markets over the long run is only partially driven by changes in foreign demand and relative prices, that is by developments in the real effective exchange rate
- A large component of export growth can be put down to non-price competitiveness – factors that make the exports more attractive but which are not related to price
- How can we measure it? Let's look at the bottom line

Export market share (value): declining due to globalisation



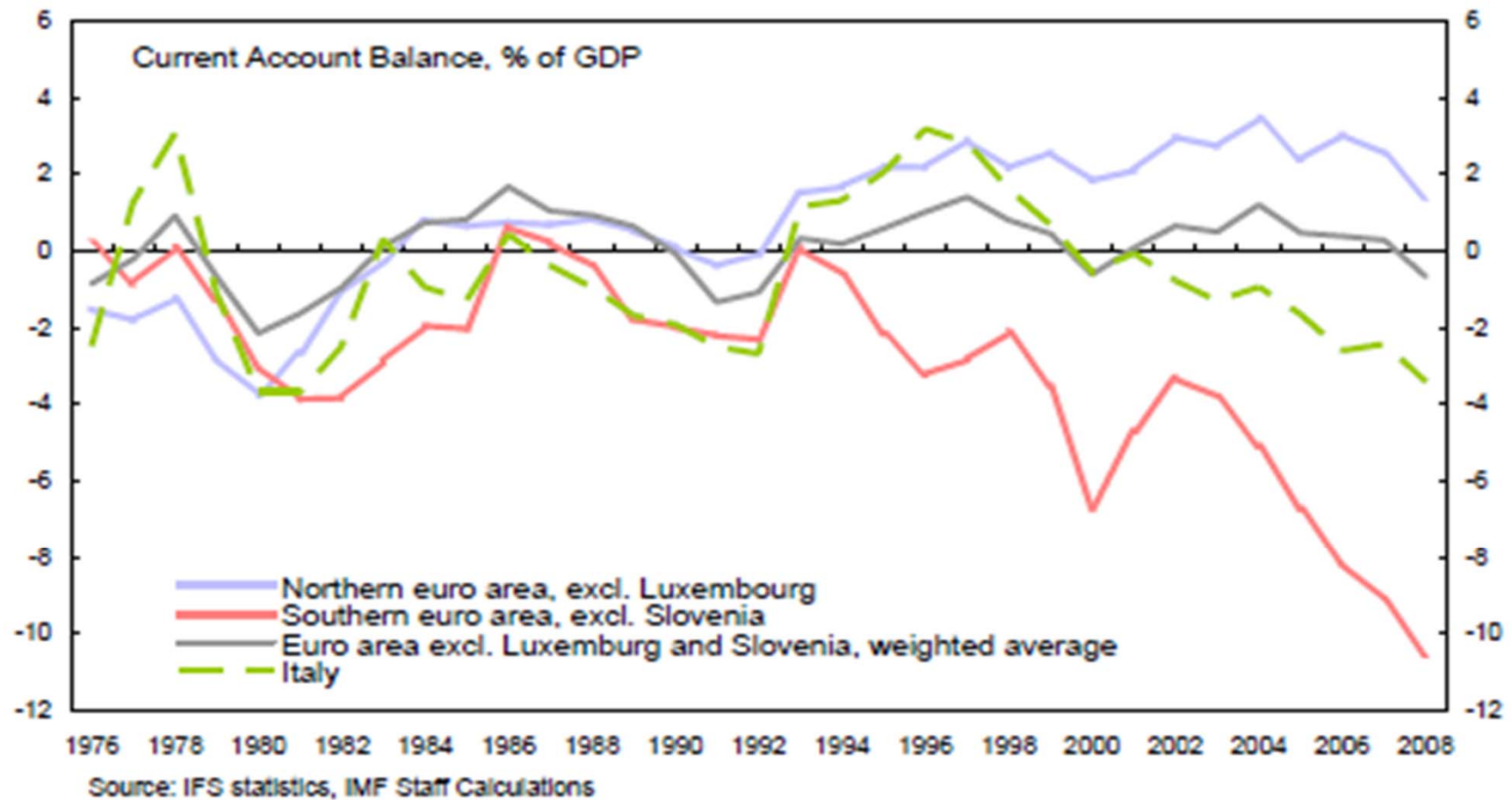
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Current account balance: South vs North?



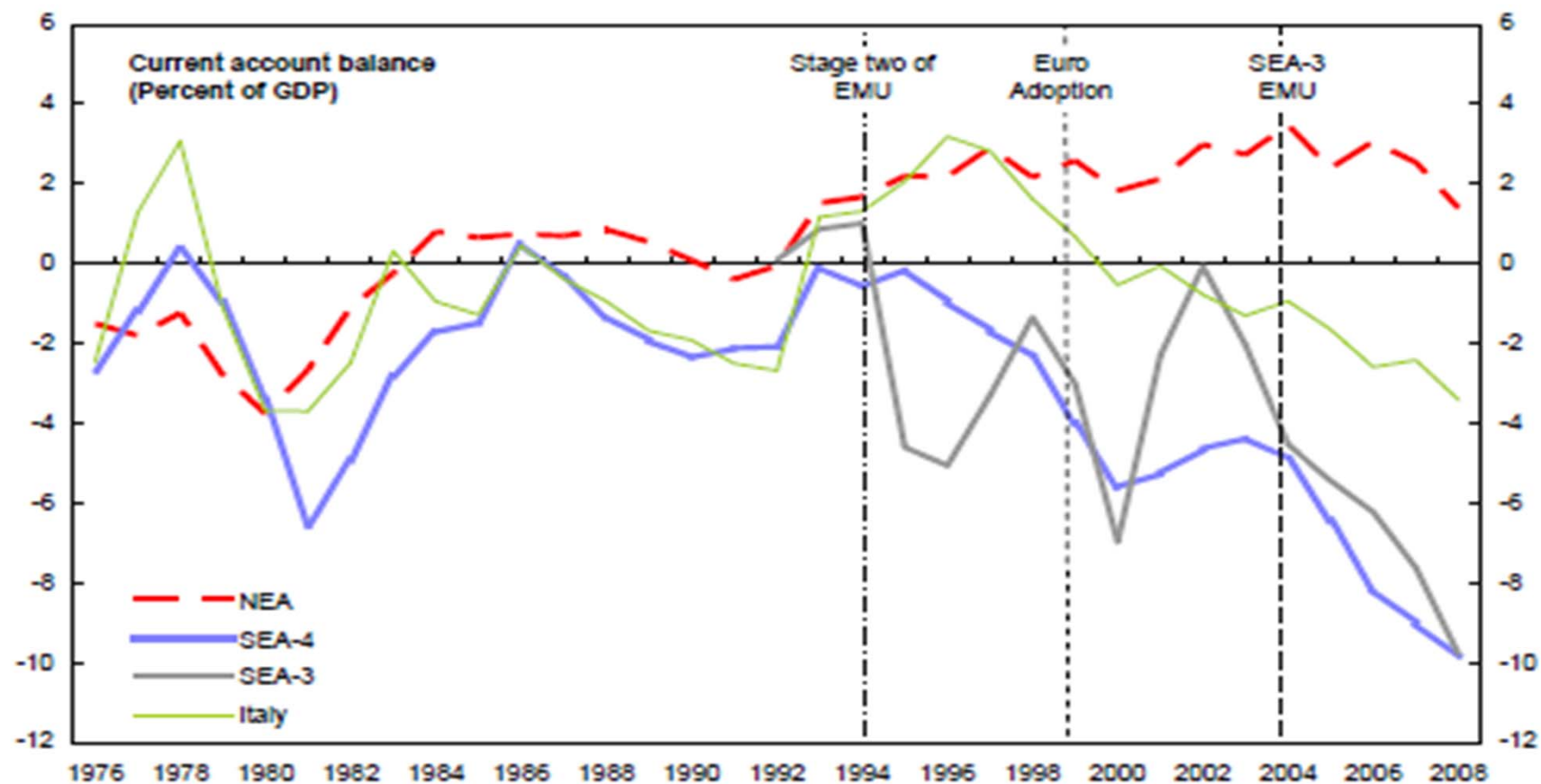
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Are financial accounts driving current accounts?



Source: IFS statistics, IMF Staff Calculations



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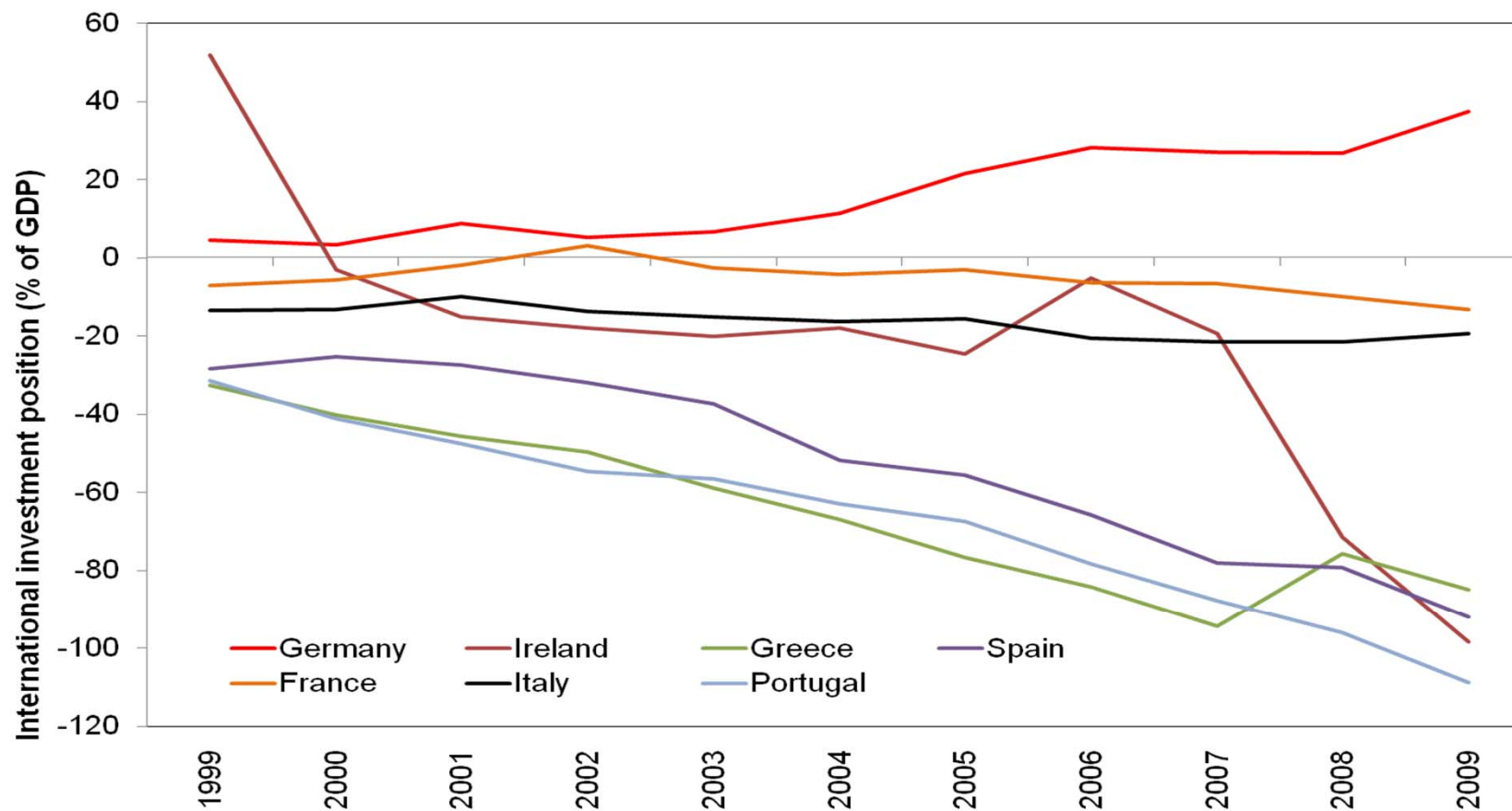
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As a result, net investment position deteriorating sharply



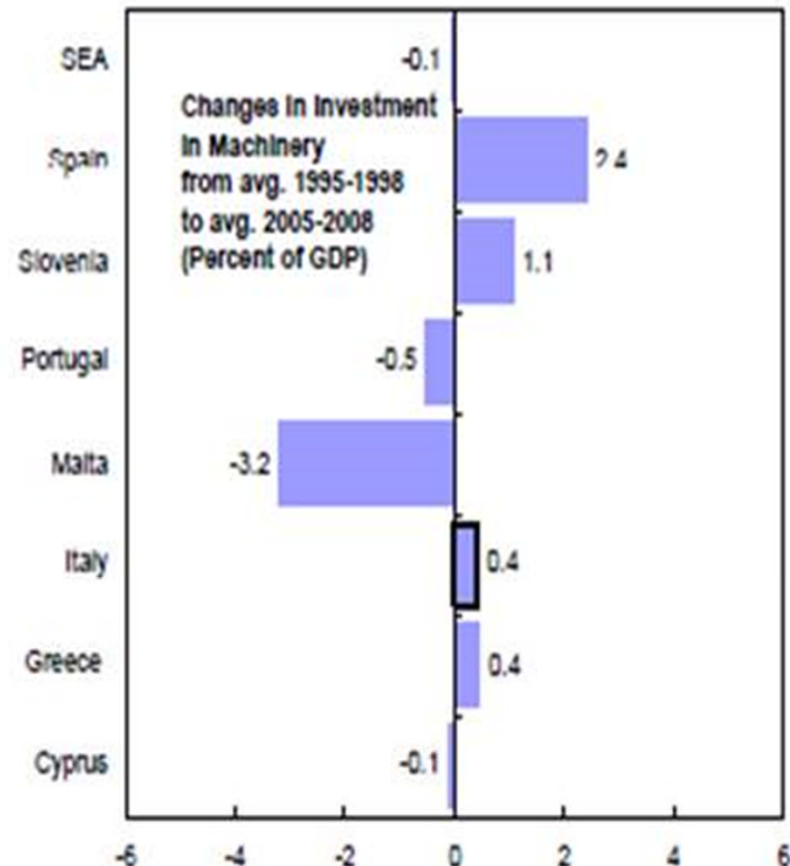
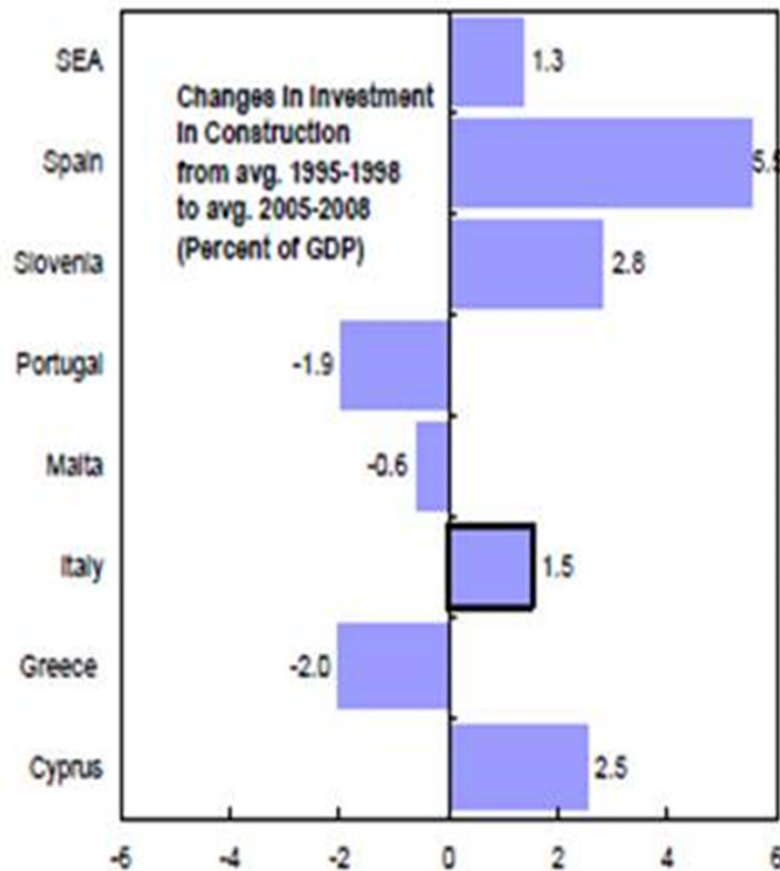
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Where have financial flows gone?



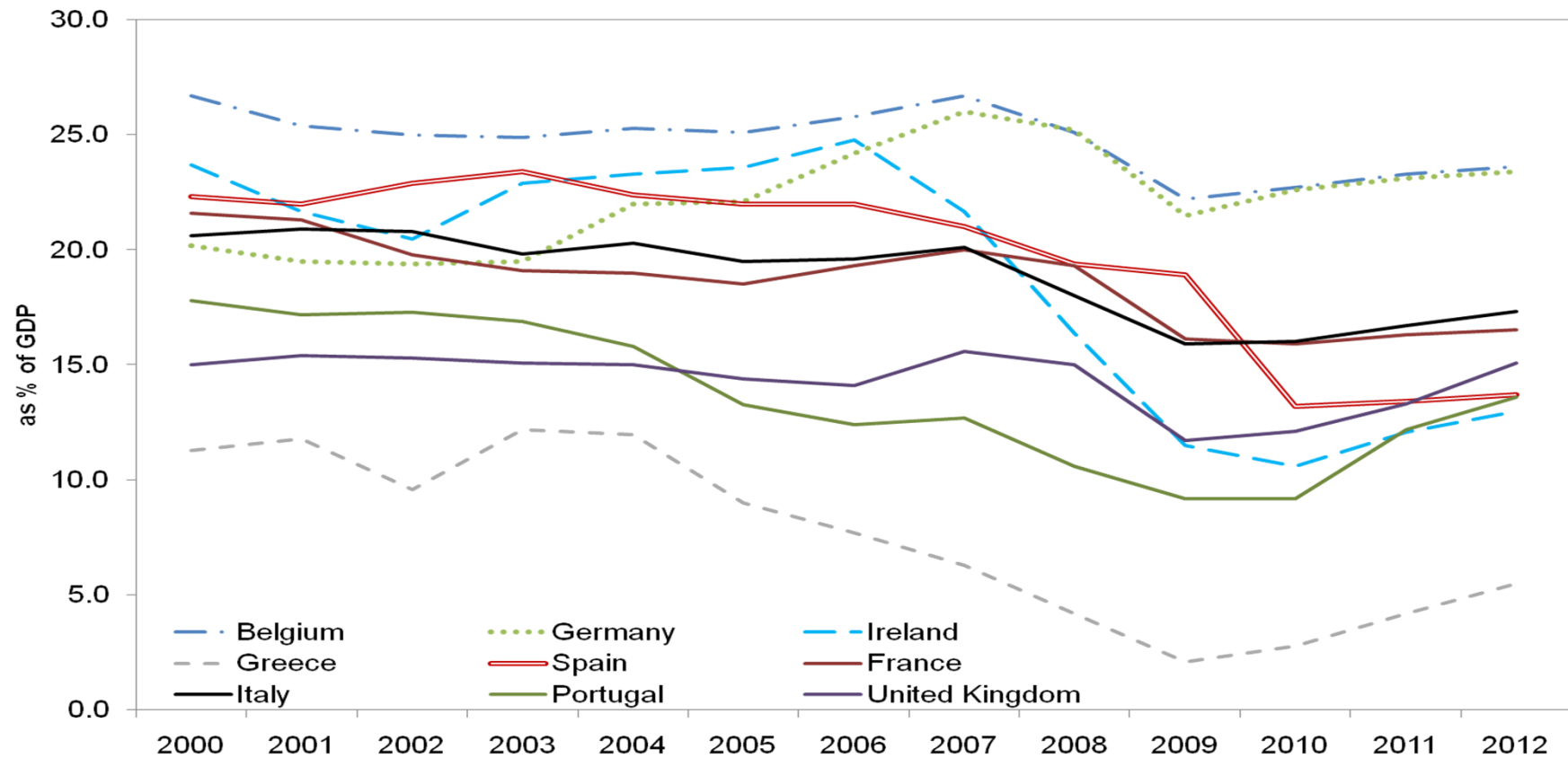
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Household savings has declined



Source: Eurostat.



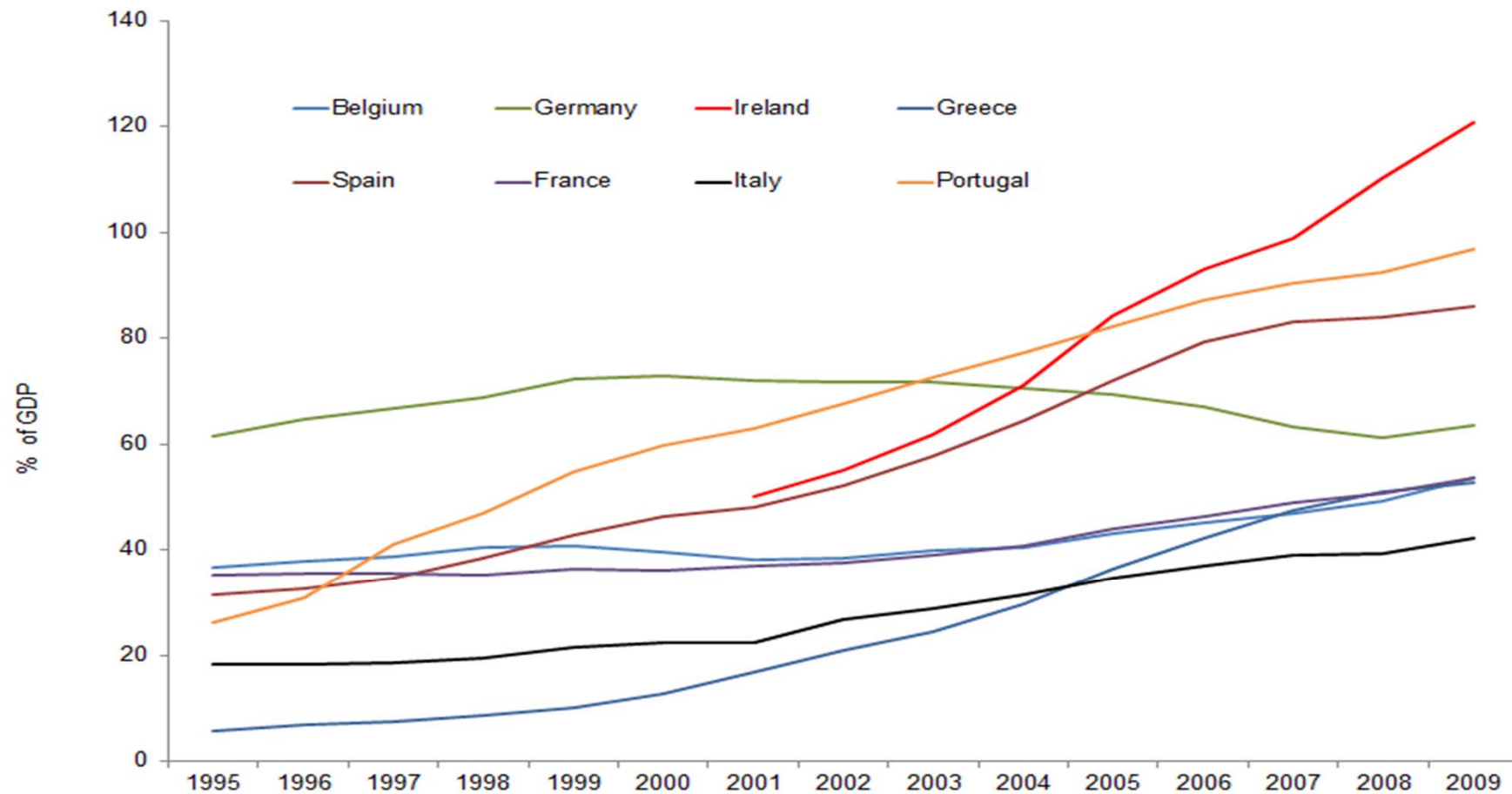
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Household debt has increased



Source: Eurostat



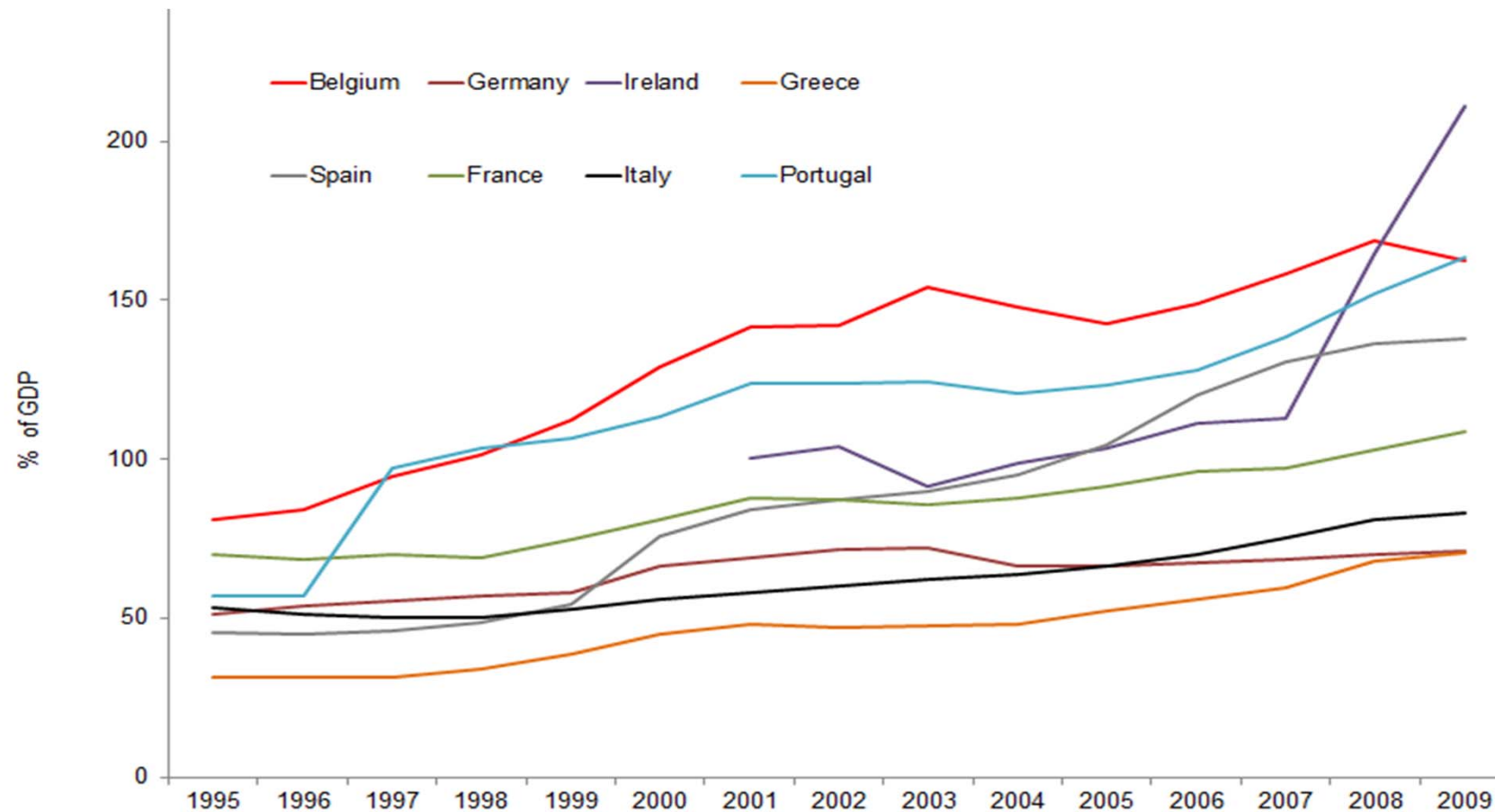
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And debt of non financial institutions



Source: Eurostat



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Back to competitiveness

- A sharp decline in current account deficits (and surpluses) will likely follow the crisis
- Rebalance of demand and reassessment of risks, but what about returns?
- Can the situation be sustainable over the medium term?
- The case of Italy



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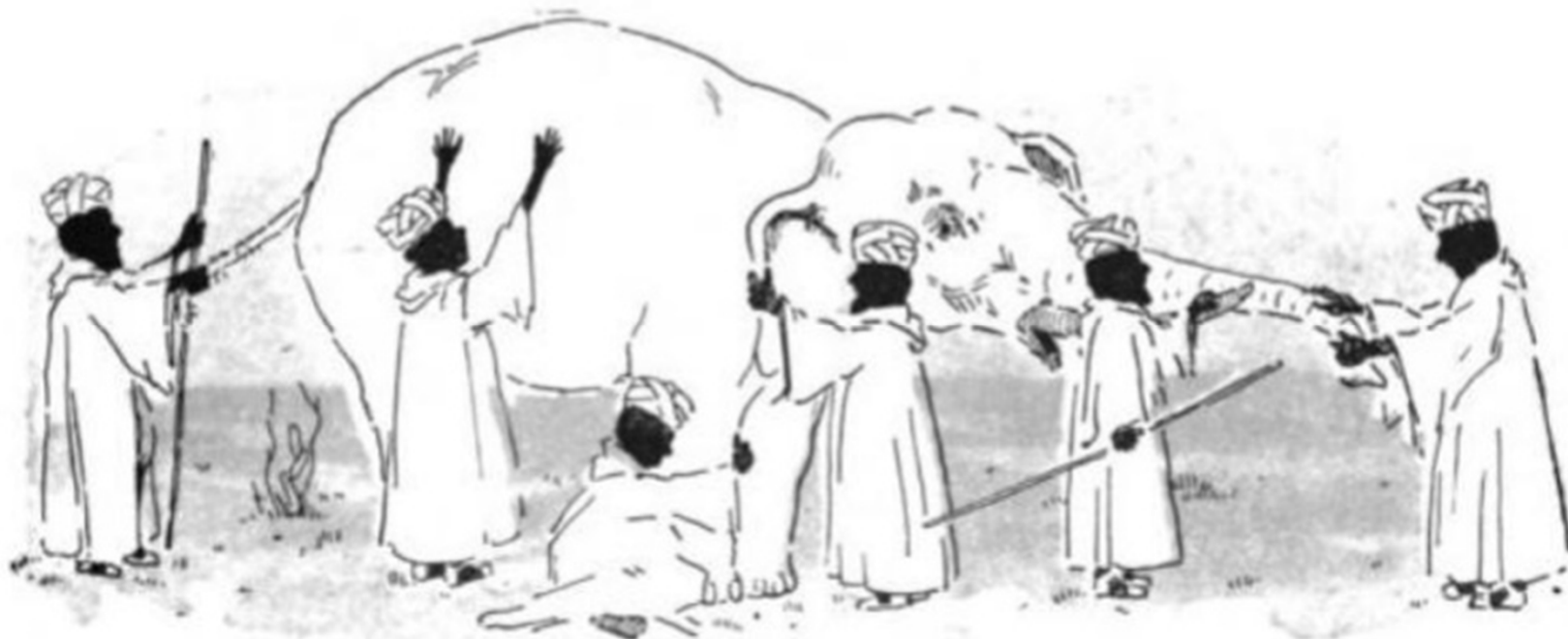


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To sum up: variable geography

- Is Ireland part of the South of Europe?
- Is Italy part of the North?
- Competitiveness: difficult to define and measure, but very exciting word for politicians ...
- Broader-based approach: look at the whole economy and at imbalances, i.e. potential unsustainable trends

And be careful when touching the elephant ...



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