ADB

ERD Policy Brief

ECONOMICS AND RESEARCH DEPARTMENT

SERIES

No. 18

Public-Private Partnership for Competitiveness

Jesus Felipe

June 2003

Asian Development Bank
http://www.adb.org/economics

Asian Development Bank
6 ADB Avenue, Mandaluyong City
P.O. Box 789
0980 Manila, Philippines
http://www.adb.org/economics
ISSN: 1655-5260

Printed in the Philippines

ERD POLICY BRIEF NO. 18

Public–Private Partnership for Competitiveness

Jesus Felipe

June 2003

Jesus Felipe is an economist in the Macroeconomics and Finance Research Division, Economics and Research Department, Asian Development Bank. This note is based on the Special Chapter on "Competitiveness in Developing Asia" of the *Asian Development Outlook 2003*.

A key question in development economics has been why some countries grow faster than others. In recent years, the role of the government has come to the center of the discussion, giving rise to the notion of "national competitiveness." The debate about national competitiveness has revolved around two questions: first, whether the notion of a country's competitiveness is meaningful; and second, whether the government should do anything to enhance it. This brief addresses these two issues.

There are several reasons why competitiveness has recently attracted a great deal of attention. First is the increasing importance of international trade in the world economy, leading some to believe that a country's living standards depend on its capacity to export. Second is the greater mobility of capital across countries. Third is the enormous difference in performance of countries in terms of trade and economic growth, with East Asia outperforming all other regions. Fourth is the increasing popularity of indices of national competitiveness, by which countries are ranked and compared with each other. Finally, the forces of globalization and technological progress have accentuated competition among both domestic and foreign firms.[1] For instance, in recent years, the challenge of the People's Republic of China has heightened the need to be competitive in order to survive. In this new environment, the key resource is knowledge, which is changing the nature of comparative advantage (Yusuf 2002).

What is Competitiveness?

Competitiveness is the ability of firms to remain profitable by delivering the products and services that consumers desire. Competitiveness is best understood as a process rather than a one-time event. It is about the comparative performance of individual firms. This means that firms become more competitive by constantly being observant of other firms and by persistently striving to do business better. Consequently, in the process some firms fail and go out of business, while others prosper, and new ones emerge.

---

[1] Globalization is a process of economic integration of the entire world through the removal of barriers to free trade and capital mobility, as well as through the diffusion of knowledge and information.

From this definition it follows that competitiveness is basically a firm-level characteristic and not one that describes countries as such (Krugman 1994). An implication is that the term “national” (or “international”) competitiveness—with reference to, for example, shares in export markets—can be misleading for policy purposes. While nations are typically concerned about status and power, they do not compete for market shares.

This clarification helps in making policy focus on firms as the main generators of growth in a market economy. Competition and the quest for profits are the driving forces of firms in a market economy. Competition forces adoption of the least costly methods of production and improvement in the quality of products. Technological upgrading, in the form of introduction of new machinery and improvement of technological capabilities, provides a firm with the means to be successful in competition. In the process, firms increase labor productivity, i.e., the efficiency with which the firm converts resources into value, and this is how the profit motive that drives them is put into practice.

Productivity growth is the bottom line of competitiveness. Labor productivity grows through the interplay of two complementary mechanisms: increases in efficiency and technical progress. The latter is the result of investment in new capital, and development of entrepreneurial and technological capabilities. These capabilities are defined as the ability to use, generate, change, and add to the pool of the industrial arts. These allow firms to move into new areas, such as services, as well as take risks and engage in trial and error.

The competitiveness debate has had one important outcome: there is now a much greater appreciation of the critical role innovation and technological improvements play in the relative economic performance of countries. Although it is ultimately how individual firms perform in the marketplace that determines a country’s overall economic strength, certain national characteristics?how human capital is used, the technical skills of the labor force, managerial practices, and government policies?do indeed influence firms’ ability to compete. It is from this point of view, especially the role of government policies, that the notion of international competitiveness has a national dimension and, hence, a place in the policy debate.

Public-Private Partnership for Competitiveness

What is the appropriate role of government policy in enhancing firm competitiveness, and how can governments remove barriers to competitiveness? The key role of the government is to create a *well-functioning market economy*, which is synonymous with a competitive economy. A well-functioning market economy is the result of a partnership between the government and firms (Stern and Stiglitz 1997).

In this sense, "national competitiveness" can be used as shorthand for a well-functioning market economy in the context of the policy debate.[2] The ultimate objective of the partnership between the government and the private sector is to raise living standards and, hence, catch up with countries at the technological and income frontier. Likewise, increases in labor productivity are key to achieving sustained long-run growth in living standards.

The other component of a well-functioning market economy is the development of institutions that enhance competition among firms and domestic technological capabilities. Institutions, including issues of corporate governance, corruption, etc., are determined by historical and cultural factors as well as by government actions that are necessary for growth. It is of utmost importance that the government itself does not resist the reforms needed to create market-friendly institutions. For example, corporate governance is about how business corporations are directed and controlled, and refers to the specification of the rights and responsibilities of the board members, managers, creditors, and shareholders, as well as to the specification of the rules and procedures for making decisions on corporate affairs. This has direct consequences for firm-level productivity and, hence, for national productivity.

The key issue regarding institutions is that they are an internationally immobile factor of production and, consequently, each country has to experiment and set up the institutions that work in its particular context.

---

[2] Notice that this idea of national competitiveness radically differs from that of competitiveness at the firm level, whose main message is that firms compete against each other.

The process of moving toward the achievement of a well-functioning market economy must be undertaken in a synchronized fashion. For example, it will be futile to dedicate substantial resources toward improving the physical infrastructure if there is corruption in the sectors involved in the contracts. The system works because all its pieces are in place and at work.

While the role of firms in the partnership to achieve a competitive economy is very clear, that of governments is, perhaps, more controversial. Governments have to provide the institutional infrastructure and services that facilitate competition among firms by leveling the "playing field." Governments should: (i) provide macroeconomic stability: (ii) establish the necessary legal system, including competition policy and entry and exit laws; and (iii) address market failures. Likewise, there are three major areas where there is room for the state and the market to share responsibilities: (i) education; (ii) technology and innovation; and (iii) physical infrastructure. There is consensus among economists about the importance of these policies and that, if governments perform these tasks well, they will be laying the foundations for rapid development.

Some governments may believe that they also have an important role in identifying areas or sectors of growth, with a view to promoting competitiveness. Interventions typically include (i) the provision of financial incentives to attract FDI; (ii) the creation of export processing zones (EPZ); and (iii) the creation of clusters and industrial parks.[3] The empirical evidence, however, indicates that government intervention in these areas may not yield significant benefits and it is very difficult to show empirically that industrial policies have been a major source of growth. For example, financial incentives to attract foreign direct investment work, at best, only at the margin, that is, in the final stage of the multinational corporation's decision regarding the location of the subsidiary. Moreover, technology transfer mandates and specific local content requirements on foreign direct investment, or mandatory joint ventures, are discouraged. Also, a problem with these measures is that they are liable to result in retaliatory actions by other countries (and thus cancel each other), which could end up causing a great deal of harm to the global economy (Moran 2002).

[3] These may include the development of special economic zones, where the government selects not a list of industries but a list of areas for economic preferences.

These types of direct interventions often mask failures in achieving the essential functions of government to help foster and sustain firm-level competitiveness and run the risk of “picking the losers” for promotion. It is extremely difficult for a government agency (i.e., government officials) to effectively search for industrial projects that will make major contributions to national productivity, which, in any case, would not be undertaken by the private sector.

Conclusion

In an environment where globalization and technological progress have made competition among rival firms harder than before, the key to success is for the government and firms to devise strategies and policies to take full advantage of the *potential* benefits such an environment offers. Governments and firms in Asia are well positioned to face these challenges due to their demonstrated pragmatism and flexibility in facing challenges and in undertaking policy reforms.

A correct understanding of what competitiveness means—that it refers to firms and entails a functional partnership between government and the private sector—can help focus on ways to improve the climate for investment. It can also guide policymakers in linking competitiveness as a firm-level concept with growth at the national level. These are important issues because in a globalized economy, government mistakes in terms of implementing wrong macroeconomic policies and in terms of pursuing ill-advised industrial policy carry a heavy price. Likewise, firms that are not flexible and do not understand the essence of being competitive will perish.

References

Asian Development Bank, 2003. *Asian Development Outlook 2003*. Hong Kong, China: Oxford University Press for the Asian Development Bank.

Krugman, P., 1994. "Competitiveness: A Dangerous Obsession." *Foreign Affairs* 73(2):28-44.

Moran, T. H., 2002. "Strategy and Tactics for the Doha Round. Capturing the Benefits of Foreign Direct Investment." Asian Development Bank, Manila. Processed.

Stern, N., and J. Stiglitz, 1997. A Framework for a Development Strategy in a Market Economy: Objectives, Scope, Institutions and Instruments. Working Paper 20, European Bank for Reconstruction and Development, London, UK.

Yusuf, S., and S. J. Evenett, 2002. *Can East Asia Compete? Innovation for Global Markets*. New York: Oxford University Press for the World Bank.

ERD POLICY BRIEF SERIES

No. 1 Is Growth Good Enough for the Poor?
Ernesto M. Pernia
October 2001

2 India's Economic Reforms
What Has Been Accomplished?
What Remains to Be Done?
Arvind Panagariya
November 2001

3 Unequal Benefits of Growth in Viet Nam
Indu Bhushan, Erik Bloom, and *Nguyen Minh Thang*
January 2002

4 Is Volatility Built into Today's World Economy?
J. Malcolm Dowling and *J.P. Verbiest*
February 2002

5 What Else Besides Growth Matters to Poverty Reduction? Philippines
Arsenio M. Balisacan and *Ernesto M. Pernia*
February 2002

6 Achieving the Twin Objectives of Efficiency and Equity: Contracting Health Services in Cambodia
Indu Bhushan, Sheryl Keller, and Brad Schwartz
March 2002

7 Causes of the 1997 Asian Financial Crisis:
What Can an Early Warning System Model Tell Us?
Juzhong Zhuang and Malcolm Dowling
June 2002

8 The Role of Preferential Trading Arrangements in Asia
Christopher Edmonds and Jean-Pierre Verbiest
July 2002

9 The Doha Round: A Development Perspective
Jean-Pierre Verbiest, Jeffrey Liang, and Lea Sumulong
July 2002

10 Is Economic Openness Good for Regional Development and Poverty Reduction?
The Philippines
Ernesto M. Pernia and Pilipinas F. Quising
October 2002

11 Implications of US Dollar Depreciation for Asian Developing Countries
Emma Xiaoqin Fan
November 2002

12 Dangers of Deflation
Douglas H. Brooks and Pilipinas F. Quising
December 2002

13 Infrastructure and Poverty Reduction—What is the Connection?
Ifzal Ali and Ernesto Pernia
January 2003

14 Infrastructure and Poverty Reduction—Making Markets Work for the Poor
Xianbin Yao
May 2003

15 SARS: Economic Impacts and Implications
Emma Xiaoqin Fan
May 2003

16 Emerging Tax Issues: Implications of Globalization and Technology
Kanokpan Lao-Araya
May 2003

17 Pro-Poor Growth—What is It and How is It Important?
Ernesto M. Pernia
June 2003

18 Public–Private Partnership for Competitiveness
Jesus Felipe
June 2003

For information and to order, write to
Office of External Relations, Asian Development Bank
P.O. Box 789, 0980 Manila, Philippines
or e-mail adbpub@adb.org