71. Competitiveness – Lack of competitiveness

1. Extract 1 – read the extract and answer the questions that follow.

Current real Italian GDP is now lower than it was in 2001. With a debt-to-GDP ratio of over 120%, Italy's fiscal hangover may stretch many years into the future. Most notably, Italy's unit labour costs have increased relative to competitors, leading to the suggestion that falling productivity may lurk behind its current economic malaise.

But curiously, other evidence suggests Italy may not be quite doing as badly as a first glance at the headlines suggests. Most interestingly, Italy's exports have held up surprisingly well during the crisis for a country often seen as having serious competitiveness problems. Exports in high-value sectors, such as fashion, have proved particularly robust. For instance, brands like Gucci have almost never had it so good, even as many of their products are still made in Italy. According to UNCTAD's Trade Performance Index, Italy has remained, during the downturn, the world's top ranking exporter in textiles, clothing, and leather goods. Even for non-electronic machinery and manufactures it is still ranked second in the world, behind only Germany.

The International Monetary Fund, has suggested that traditional cost competitiveness measures may no longer be the best way of calculating how well countries like Italy are doing. The ICT revolution in the 1990s is regarded by many economists to have widened the difference behind the two main ways of measuring competitiveness. An increase in technological or design innovation might boost wages in an economy as high-skilled jobs are created. An increase in unit labour costs can therefore be a sign of more high-level jobs being created in an increasingly innovative and competitive economy.

Overall measures of unit labour costs may have also hidden the resilience of Italy's high value-added and high-margin sectors during the crisis. Its makers of precision machine tools and high-class fashion have built themselves international reputations for innovation and boosted GDP. The solutions to Italy's unemployment problems and flagging output figures may be to try and grow these high-value and high-quality industries further. But this is much easier said than done. More structural reforms are still required. The IMF suggests that reforms are urgently needed to reduce bottlenecks in Italy's snail-pace judicial system and to write-down the bad debts of its dysfunctional banking system. *Source: "Italy's productivity puzzle", The Economist, October 4th 2013*

1.1 Discuss why the IMF may think that "traditional cost competitiveness measures may no longer be the best way of calculating how well countries like Italy are doing"?

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1.2 Discuss why Italy's "exports in high-value sectors… have proved particularly robust"

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1.3 Discuss the possible structural reforms that Italy might be able to use to reduce the level of unemployment.

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2. Evaluate the importance of each of the following policies in aiding competitiveness

Policy	How it works	Evaluation
Capital deepening	Increase in investment to raise the level of **capital per worker**. In turn, labour productivity will rise and unit labour costs will fall.	
Outsource production	In recent years there has been a rising trend in UK firms sending manufacturing and support service elements to the Far East to lower costs.	
Innovation	By investing in R&D and new designs, firms will boost quality and innovation, hence raising the non-price competitiveness of their goods.	
Privatise state-owned industries	This opens firms up **to the profit motive** which ensures that directors will want to cut costs and raise productivity.	
Invest in education & training	This will raise literacy and numeracy standards, boosting the productivity of the workforce.	
Reduce both income taxes and benefits	This increases work incentives by raising the opportunity cost of not being in employment. Hence there will be an increase in labour supply, putting a downward pressure on wages.	