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MAIN FACTORS OF COMPETITIVENESS AND GROWTH AFTER CREDIT CRUNCH WITH THE FOCUS ON ASIA

Abstract: The article describes key factors for governments and courtiers of competitiveness and growth after credit crunch in USA with the focus on Asia. The crisis has raised some fundamental questions about the sustainability of the export-led approach to growth, given debt and unemployment levels in Asia's traditional export markets, and the increased likelihood of Asian currency appreciation reducing the competitiveness of the region's exports. The Asian economies have performed relatively well during the first global recession since World War II. This performance was partially a result of Asian governments' fiscal and monetary stimulus packages that offset the falloff in Asian exports to markets such as North America and Europe.

Key words: Asia, growth factors, global financial crisis, global capital market.

1. Introduction

As we could learn from the first global recession since World War II, governments and businesses share an overarching aim – to steer their economies toward increasing competitiveness and growth. Many business leaders made a greater role for government in this effort. For instance Intel Corporation's former chairmen Craig Barrett has urged governments to implement policies to grow smart people and smart ideas.[1] Rolls-Royce CEO Sir John Rose has argued for the credit crunch to be a catalyst for a sharper focus on industrial competitiveness.[2] Many governments has made a lot of efforts in trying to boost growth and competitiveness. Given the fragility of the business and economic climate – and strained public coffers – the responsibility to get policy right, and thereby to create a solid foundation for a long term growth, is acute.[3]

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[1] C. Barret, *On the post-crises world*, World Economic Forum, Davos, January 29, 2009, blogs.intel.com/csr/2009/01/.

[2] J. Rose, Made in Britain, *The Economist*, November 19, 2008.

[3] *How to Compete and Grow: A Sector Guide to Policy*, McKinsey Global Institute, Washington 2010, p. 9.

The Asian economies have performed relatively well during the first global recession since World War II. This performance was partially a result of Asian governments' fiscal and monetary stimulus packages that offset the falloff in Asian exports to markets such as North America and Europe. But current account surpluses in China, Germany, and Japan – the countries with the largest such surpluses – have declined as the global recession has dampened trade. Although China's current account surplus reached a record $426 billion in 2008, its trade surplus declined in the first half of 2009 by 31%.[4] The current account surplus in both Germany and Japan declined in 2008 and in the first half of 2009. Outside of China, Asian countries' current account surpluses shrunk dramatically in late 2008 and early 2009 as exports fell.[5]

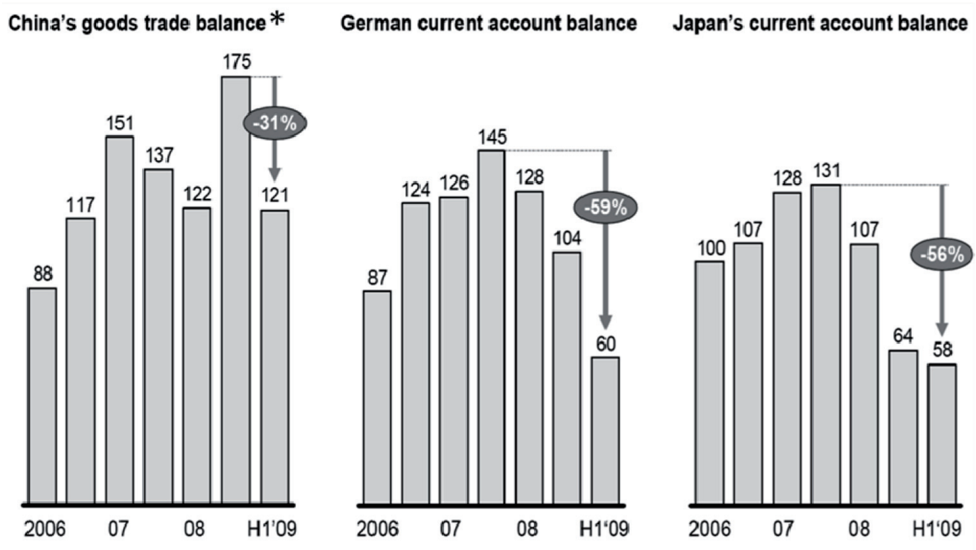

Figure 1. China, Germany, and Japan have experienced sharp declines in their current account surpluses $ billion, half-yearly, using 2008 exchange rates

*China does not publish quarterly current account statistics; however, the monthly goods trade statistics have historically accounted for about 70% of China's current account surplus.

Source: Haver Analytics, McKinsey Global Institute, [in:] Ch. Roxburgh, S. Lund, Ch. Atkins, S. Belot, W.W. Hu, M.S. Pierce, *Global Capital Markets: Entering a New Era*, McKinsey Global Institute, San Francisco 2009, p. 19.

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4 See: Ch. Roxburgh, S. Lund, M. Lippert, O. White, Y. Zhao, *The New Power Brokers: How Oil, Asia, Hedge Funds, and Private Equity are Faring in the Financial Crisis*, McKinsey Global Institute, Washington 2009.

5 Haver Analytics, McKinsey Global Institute, [in:] Ch. Roxburgh, S. Lund, Ch. Atkins, S. Belot, W.W. Hu, M.S. Pierce, *Global Capital Markets: Entering a New Era*, McKinsey Global Institute, San Francisco 2009, p. 19.

2. Key factors for competitiveness and growth

The crisis has raised some fundamental questions about the sustainability of the export-led approach to growth, given debt and unemployment levels in Asia's traditional export markets, and the increased likelihood of Asian currency appreciation reducing the competitiveness of the region's exports. In this environment, sustaining Asia's past growth rates will require broadening the sources of that growth. Asia and the rest of the world would use following key insights, which should be an answer for a time after first global recession:

– **The competitiveness of sectors matters more than the mix.** Some governments worry about the mix of their economies but McKinsey[6] research shows that countries that outperform their peers do not have a more favourable sector mix that propels them to higher growth.
– **To generate jobs, service-sector competitiveness is the key.** Many governments are looking to manufacturing sectors as a new source for growth and jobs in the aftermath of the financial and real – estate sector bust. That services will continue[7] to be critical for a job creation. Productivity improvements are a key role in all sectors but most growth has come from services.
– **Policy impacts non-tradable sectors competitiveness directly – in tradable sectors, getting policy right is more complicated.** Policy makers should take into account the fact that their influence on largely non-tradable domestic sectors is more direct than it is in those sectors that compete globally.[8]
– **Competitiveness in new innovative sectors is not enough to boost economy-wide employment and growth.** Many policy makers are pinning their hopes today on innovative new sectors such as cleantech as the answer to challenges of competitiveness, growth, and jobs. Currently the innovative emerging sectors themselves are too small to make a difference to economy-wide growth.[9]

3. Post-crises key changes in the global environment landscape

There are following key changes in the post-crisis global economy impacting Asia according to the Asia Development Bank. Table 1 outlines how the drivers of economic growth will change in the post-crisis global economy.

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[6] See: *How to Compete*…

[7] See: R. Dobbs, J. Manyika, J. Remes, How Asia economies can compete and grow, *Forbes*, March 5, 2010.

[8] See: W. Lewis, *The Power of Productivity: Wealth, Poverty, and the Threat to Global Stability*, Chicago University Press, 2005.

[9] *How to Compete*…, p. 10.

Table 1. Changing drivers of global economic growth

Factor	Determinants	Impact on global economy	Outlook
1	2	3	4
Commodity-related costs fell in the past, now likely to rise			
Oil prices	• OPEC production rises relative to non-OPEC, raising former's pricing power. • Demand set to rise relative to supply.	• Permanently higher cost of transportation and power.	• Higher business costs reduce profitability of investment. • Some existing production capacity made redundant, forcing painful restructuring. • Supply chains need to be rethought as costs of transport rise.
Other non-food commodities	• Strong demand growth as the People's Republic of China (PRC), India, Brazil, etc. enter resource intensive phase of economic development. • Long lags before supply catches up. Unlike in past when supply-demand balance depressed real prices.	• Increase some input costs in manufacturing sector.	• A period of rising prices in basic metals, rubber and other economically sensitive commodities is likely.
Food	• Strong demand growth in rapidly growing emerging economies. • Scramble by Middle Eastern and East Asian countries to gain access to farmland in low income countries.	• Higher prices trigger inflationary expectations unless monetary conditions tighten.	• Opportunities for growth in land-abundant, water-rich low-income economies, particularly those that are close to rapidly growing economies such as the PRC and Middle Eastern sheikdoms.
Ageing trends turn more negative even in Asia			
Demographics	• Lower population growth, actual fall in number of working age in Japan, the PRC, and many European countries.	• Unless there is a sharp rise in productivity, potential growth will fall.	• Slowing impact becomes more pronounced starting middle of next decade. • Could generate major changes in immigration policy, producing far larger flows of migrant workers.

1	2	3	4
Easy credit: no longer promoting growth, now a constraint: Bad for US consumption			
Monetary and credit conditions	• Easy US, Japan, etc. monetary policy 2001-2005. • Financial innovations created a shadow banking system, now largely defunct. • Asians' purchase of G3 bonds, depressed long term rates.	• Created asset price boom, wealth effect • Boosted personal consumption in major economies. • Supported housing booms. • All these are reversing and acting as drags on global growth.	• Credit conditions will improve as the financial crisis ends but as companies and non-bank financial units focus on balance sheets and as they reduce risk and leverage, credit demand will remain weaker than pre-crisis. • More of available savings will be used to fund fiscal deficits than during pre-crisis
Housing: Developed economies' booms turn into busts: Bad for US consumption			
Housing – US, EU, Japan	• Loose money (as above) now reversing.	• Consumption was boosted by wealth effect, mortgage equity withdrawal. • Real estate, services/ construction boomed.	• Down cycle across the world in real estate values will bottom by 2010 but overhang of excess supply and detritus of the crisis in the US, UK, Spain, and Ireland in particular will constrain revival of sector as a source of growth, at least in the immediate future.
Housing: Developing economies will see a boost			
Housing – rapidly growing developing economies	• Rapid income growth, supportive monetary and other policies, urbanisation, improved connectivity in large developing economies such as the PRC, India, etc.	• Purchase of new homes usually leads to purchases of home appliances etc. • Expansion of real estate related services including mortgage industry. • High growth usually boosts real estate prices, wealth effect on consumption.	• Positive for most developing economies in Asia.

Table 1, cont.

1	2	3	4
Chinese fixed asset investment less of a driver, Chinese consumption demand could figure more in global growth			
Chinese demand	Factors that used to drive fixed investment in the PRC are changing: • Below-normal costs of land, labour and capital induced by policy. • Under-valued currency • Easy lending by banks and illegal lending networks.	• Drove up demand for capital goods, commodities.	Post-crisis, the PRC will emphasise quality over quantity in growth: shift to higher value activities. Currency appreciation, imposition of more rigorous labour codes, reduced subsidies over the longer term and tighter enforcement of environmental regulations will all raise costs. Renewed currency appreciation will help boost demand for imports.
Supply side gains in developing economies replace those in developed economies as a source of global growth			
Efficiency improvements in developed economies	Supply side factors that drove US and other OECD growth weakening or reversing: • End of Cold War released resources for productive purposes in developed economies. • Corporate restructuring in 1980s/1990s. • New technologies. • Economic integration – Single European Market, NAFTA, etc.	• Raised potential growth in developed economies: lower sustainable unemployment. • Monetary policy could be easier.	• Negative: Most gains from end of Cold War, IT revolution, economic integration have been reaped. • Positive: New technologies are coming on stream in medical technology, bio-tech, nanotechnology, alternative fuels, etc.
Efficiency gains in developing economies	Powerful supply side factors kicking in/strengthening: • Lagged effects of reforms. • Improved connectivity through transport rollout. • Increased regional integration.	• Increasing returns on investment will spur rising capital spending – virtuous cycle.	• Reduced positive impact from supply side improvements in developed nations (e.g., outsourcing, lengthening of production supply chains) can be offset by domestic supply-fed growth.

1	2	3	4
New technologies	• Rising oil prices prompt development of new sources of energy. • Technological advances open new opportunities in other areas such as bio-technology, nanotechnology, etc.	• New opportunities for growth. • Can help improve productivity.	• Newer technologies – alternative energy, nanotechnology, etc – are evolving and will produce more discernible effects in the coming decade.
Production sharing which drove FDI in manufacturing into Asia losing steam			
Consolidation of production networks	• Costs of labour and other inputs. • Tax and other incentives by host nations. • Relatively low transport costs. • Liberalisation of trade.	• Slicing production and allocating each slice to different locations produced higher profits, spurring FDI into low-cost developing economies.	Argument for production sharing remains but with less vigour: • Increased transport costs. • Rising developing economy currencies (e.g., the PRC's RMB). • Rising labour costs (PRC). • Customer needs becoming more complex pushing some producers to locate production closer to end user market*. • Businesses more aware of the risks of offshoring production – cultural, language, unexpected delays, etc.

*See A.T. Kearney Procurement & Analytic Solutions, March 2009.

Source: M. Bhaskaran, R. Ghosh, H. Kohli, *Lessons of the Crisis and Global Imbalances: Should and Can Asia Reduce its Reliance on Exports to US and Europe and Focus More on Internal (Regional) Markets?*, Centennial Group International, Asian Development Bank, Manila 2010, pp. 3-5.

The implications of these structural changes are assessed below.

3.1. Slower growth in G3 economies and retrenchment of US consumers for several years

Fiscal cost of the crisis includes both the stimulus packages as well as the cost of rescuing the financial sector. These fiscal costs are raising public sector debt to GDP ratios in the US, United Kingdom and some parts of the Eurozone well beyond the

100% level considered safe. Once economic growth resumes and financial institutions have stabilized, governments of major economies will have to cut back sharply on fiscal deficits in order to begin reducing the public sector debt ratios. This means several years during which fiscal policy will essentially act as a drag on economic growth.

Other government intervention in developed economy growth also likely to be negative. There is a considerable backlash that is unfolding against the excesses of the free market. Two dimensions of this increased government intervention in economic matters in rich countries will detract from economic growth.

– First, political leaders will have to assuage voters' real anger with the worsening of income inequality. Increased taxation of corporate profits will be one response.
– Second, there will be more intrusive and rigorous regulation of economic affairs, especially in the financial sector. By reducing the room for innovation in financial products, growth in the financial sector is likely to be slow compared to pre-crisis days.

Oil prices will tend to rise, translating into higher costs of transport and power. There are powerful forces at work pushing up oil prices over the next 20 years. Figure 2 shows the International Energy Agency's forecast of oil prices until 2030. Other agencies are similarly predicting significantly higher oil prices in real, inflation-adjusted terms.[10]

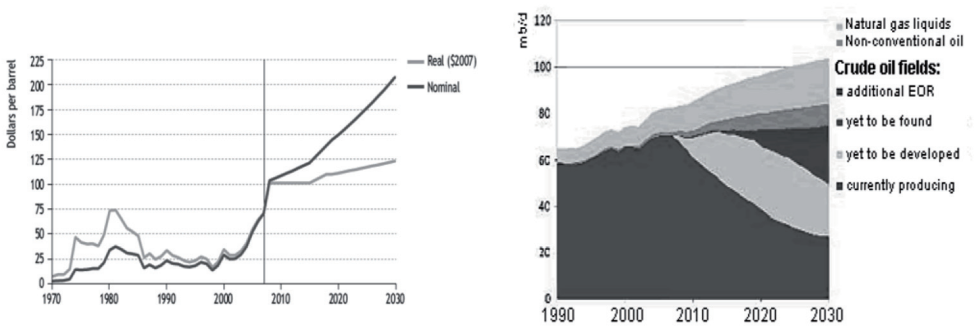

Figure 2. Average IEA crude oil import price (annual data)

Source: collated by Centennial Group from International Energy Agency, [in:] M. Bhaskaran, R. Ghosh, H. Kohli, *op. cit*., p. 9.

The US consumer will be retrenching. The household savings rate in the US is set to reverse its long-term decline. Household wealth is now falling with declining real estate prices, and it will take many years of recovery before households have

[10] M. Bhaskaran, R. Ghosh, H. Kohli, *op. cit*, p. 10.

the same level of wealth as they did during pre-crisis.[11] Mortgage refinancing with equity withdrawal is no longer the force it used to be and with financial institutions set to be far less adventurous in lending practices post-crisis, this factor is unlikely to influence household savings as it did pre-crisis.[12]

This change in the behaviour of the US consumer – combined with the expected drop in the value of dollar – is though necessary to raise US savings rate and reduce the country's large trade deficit and thus resolve, these in turn are key to resolving the issue of global imbalances. These developments in the US would though need to be complemented by efforts in the major surplus countries the PRC, Germany, Japan, and the Gulf states.

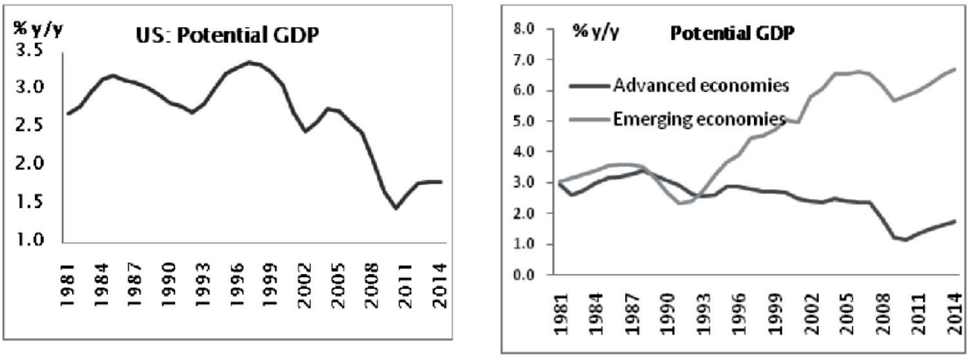

Figure 3. Potential growth of GDP

Source: collated by Centennial Group from IMF World Economic Outlook, April 2009, [in:] M. Bhaskaran, R. Ghosh, H. Kohli, *op. cit*., p. 10.

Potential growth in the US and major developed economies will slow. The IMF estimates that potential growth in the United States and other developed countries will fall noticeably in post-crisis countries. They also estimate that potential growth in the emerging economies will edge down as a result (Figure 3). This is supported by analyses of the supply side of the United States economy as well. The Congressional Budget Office expects a 0.6% annual increase over the next decade compared to labour supply growth of 1.1% on average in 1991-2007. Other studies, such as by

[11] About $13 trillion of wealth or almost 100% of the US GDP has been destroyed by the current crisis. Within this is a massive fall in the value of pension assets: this means that American households have to raise their savings rate substantially just to make up for the erosion of their pension funds. Americans lost a fifth of the value of their retirement accounts – some $603 billion – last year, according to the Employee Benefit Research Institute in Washington.

[12] The surge in household debt allowed consumer spending to rise 3.5% a year in the decade to the peak of the boom in 2007 despite a decline in the personal savings rate to a low of –0.7%, in 2007 see: M. Bhaskaran, R. Ghosh, H. Kohli, *op. cit*.

Robert Gordon of Northwestern University, project the potential growth rate of the American economy to fall to 2.35% over the coming years, roughly in line with the IMF projection.

3.2. Consolidation of production sharing networks

The emergence of production sharing networks was an important driver of economic growth in both developed and developing economies. Carving manufacturing production processes into tinier slices that were each allocated to the location which best improved profitability drove a wave of foreign direct investment (FDI) into developing economies, accelerating growth in the latter. Developed economies also benefited through the higher profitability of their companies and because resources released by such restructuring of production could be re-allocated to higher value activities. They also gained from improved environmental effects as polluting manufacturing activities were sent abroad. This production restructuring will remain a source of growth for lower income countries in Asia.[13]

Credit crunch has shown that all countries have to worry about their own economy, even countries in EMU. All governments and countries are focusing on growth and competitiveness. Currently according to IMF information the US and PRC have around 33% of global GDP and EU around 14%. In outlook for 2015, the US and PRC will have 34% of global GDP but the US will have less than PRC around 1%. Interesting is that India will rich a 6% of global GDP, which is impressive. All governments will have to take a decision how to grow in forthcoming years in point of view of lessens after the credit crunch, which impacted on global economy.

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GŁÓWNE CZYNNIKI KONKURENCYJNOŚCI I WZROSTU PO KRYZYSIE KREDYTOWYM NA RYNKU AZJATYCKIM

Streszczenie: Artykuł opisuje kluczowe czynniki wzrostu i konkurencji dla rządów i państw po kryzysie kredytowym. Kryzys kredytowy stawia pytanie w zakresie zrównoważonego rozwoju eksportu z uwzględnieniem wzrostu gospodarczego, biorąc pod uwagę poziom zadłużenia i bezrobocia na tradycyjnych rynkach eksportowych w Azji, a zwiększone prawdopodobieństwo aprecjacji waluty azjatyckiej i zmniejszenie konkurencyjności eksportu w regionie. Gospodarki azjatyckie stosunkowo dobrze obroniły się w pierwszej globalnej recesji od II wojny światowej. Było to możliwe częściowo w wyniku pakietów pomocowych krajów azjatyckich w zakresie polityki fiskalnej i pieniężnej, które neutralizują obniżenie azjatyckiego eksportu na takie rynki, jak Ameryka Północna i Europa.