

Improving Competitiveness

Causes	Evaluation	Effects
1. Falling nominal exchange rate e.g. from reduced interest rates or increased domestic spending (more importing)	<ul style="list-style-type: none"> Inelastic demand for exports in short run Rising cost of imports / falling living standards, leading to wage push inflationary pressure 	<ul style="list-style-type: none"> Boost to AD (rising exports, import substitution) Possible fall in AS Likely (net) rise in real GDP & fall in unemployment
2. Falling domestic inflation (relative to abroad)	Requires: <ul style="list-style-type: none"> Wage restraint (but trade union resistance) Successful supply side policies (but can be costly and slow) and / or Deflationary fiscal and monetary policy (slows real growth and incomes; causing unemployment) 	<ul style="list-style-type: none"> Improved Balance of Payments current account Rise in AS: non-inflationary growth
3. Rising productivity (relative to abroad) e.g. from increased investment, skills	Requires: <ul style="list-style-type: none"> More hours worked (less leisure time) Improved skills (after time lag) and / or Higher capital spending (but raises firms' costs) 	<ul style="list-style-type: none"> Rise in AS: non-inflationary growth Rise in AD (higher earnings) Overall rise in real GDP
4. Improved non price competitiveness e.g. strengthen branding, improve product quality	Requires: <ul style="list-style-type: none"> Skilful management Investment in R & D (costly) and / or Better advertising (costly) 	<ul style="list-style-type: none"> Rise in AS: non-inflationary growth Rise in AD (higher earnings) Overall rise in real GDP

Definition:

the ability of domestic firms to sell their output in global markets (domestic + abroad)

Measures:

- i. Real exchange rate
(relates to causes 1 and 2)
- ii. Unit labour costs (ULCs)
(relates to causes 2 and 3)

