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Contents

Competition and competitiveness-drivers for economic growth and better performance of the financial sector

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Abstract

Competition is important for proper functioning of all economic sectors, because it pressures the companies to be more innovative, efficient and effective. With the proper competition, the results show better performance and achievement of the desired outcome. Consequently, well-functioning companies are drivers for economic growth. However, competition in the financial sector is not as easy applicable as in the other economic sectors. High regulations can affect the flexibility and the innovative performance of the financial institutions. Nevertheless, the results of the effect of competition in the financial sector, with an emphasis on the banks, are mixed. Some theories show that competition has positive impact, contrary to some other findings that showed limited effects. In order to have economic success and progress, economic freedom is needed. Hence, in this paper the Business Freedom Index is presented for Albania, Bulgaria, Greece, N. Macedonia and Serbia for 2019-2021. The competitive pressure in the market pressurizes the countries to perform better in the areas that can help them achieve progress.

Key words: *competition, growth, performance*

1. Introduction

The proper functioning of the national economies and their financial systems mostly depends on the stability and the performance of the business entities. Therefore, main driver for growth and prosperity of the companies is the competition among them. Hence, competition is a way to make the companies more disciplined. In other words, it pressures them to be innovative and to become more efficient and effective. Consequently, effective competition among the business entities is beneficial for the customers as well due to the approach to lower prices, higher quality, and bigger choice of products (Stucke, 2013). Moreover, globalization in one way helped and pressured the countries to increase their competitive powers in the global markets. Therefore, the concept of competitive power has started to increase progressively (Akis, 2015). It is worth mentioning that competition is very important for the financial sector as well. Hence, the degree of competition determines the efficiency of production of financial services, the quality of financial products and the financial innovation in the sector. However, theoretically and empirically has been proven that the degree of competition in the financial sector determines the access to the financial services, which consequently directly affects the spending power of the firms and the households and in the end affects the overall level of economic growth (Claessens, 2009). Furthermore, competition and stability can co-exist in the financial sector. On one hand, competition encourages better financial services and on the other, stability is important for creating systematic trust on which the whole financial sector depends (OECD, 2009). Nevertheless, too much competition can destabilize the economy and lead to financial crises (Allen and Gale, 2004). Financial services are continuously evolving and changing as a result of removal of barriers, increased presence of non-bank financial institutions, globalization and technological progress. All these factors, directly or indirectly affect the level and the type of competition in the financial markets. However, the effect of competition in the banking industry has been analyzed extensively, but without reaching ultimate consensus. Some papers show that competition increases bank risk taking (Allen and Gale, 2004; Keeley, 1990), while others show that competition decreases bank risk taking (Boyd and De Nicolo, 2005). Additionally, the research that was conducted for analyzing the effect of a financial crisis shows that increased competition has positive effect on financial stability (Carlson and Mitchener (2009). Therefore, the aim of this paper is to provide theoretical representation of the literature concerning the meaning and importance of competition and competitiveness, with a focus on the financial sector and the economic growth, with a descriptive analysis of Business Freedom and Trade Freedom Index.

2. Competition and competitiveness

Before explaining what competitive power means, it is necessary to explain the term competition. Stigler's (1988) definition is a starting point of explaining what competition means. In his definition competition stands for the rivalry between individuals, between groups or between nations and it arises whenever two or more parties strive for something that all cannot obtain. Furthermore, competitive power can be explained as a superiority of an economic unit (individual, company, industry, country or region) compared to its competitors. Nevertheless, not all economists have agreed upon one single definition of competitive power, because it is defined differently at each level, whether it is a company, sector or country level. In order to determine the competitive power of a country it can be defined through foreign trade and it can also be analyzed from micro or macro level (Akis, 2015). According to Aktan (2004), national competitive power refers to the ability of the country under fair conditions to increase the income of its population and to produce the right amount of goods and services according to the international market standards. According to Akis (2015), competitive power of a country depends on several factors such as the level of development of the country, productivity of R&D activities, foreign trade activities, performance of various sectors, existence of qualified manpower and the ability to manufacture products with high technology. Additionally, competition is very effective mechanism in the process of regulating the various processes in the market, because it provides opportunities for economic freedom and contributes to increased competitiveness. Hence, competition increases the competitiveness, but, the level of competitiveness mostly depends on the levels of growth and development of the economy (Melnyk and Yaskal, 2013). However, competitiveness exists only when there is an effective competition. When it comes to competition, it can be analyzed from two perspectives, competition as a static state and competition as process of rivalry. The static concept of competition is defined as the equilibrium condition, rather than the process of achieving the equilibrium condition. In other words, companies cannot over charge or earn abnormal profits.

Contrary to this concept, competition as a process of rivalry considers that firms are continuously engaged in a dynamic competitive process (OECD, 2021). Traditionally, competitiveness has been measured by GDP per capita, rates of employment and unemployment, public deficit, debt and current account positions. However, the concept of competitiveness has been evolving through time narrowing it to the “ability of a country to deliver beyond-GDP goals” (Aiginger, et al, 2013). In addition, there are large number of researches that examine competitiveness, such as Fagerberg (1988), Porter (1990), Lall (2001), and others. Fagerberg (1988) points out in his research that in countries with competitive markets, the standard of living of people increases not only by increasing income, but also by opening and creating new jobs. In that context, he claims that competitiveness is a way to achieve the main economic goals that would bring benefits to people. According to Velloso (1991), international competitiveness increases the country's ability to maintain and increase the participation of the national economy in the global market and, at the same time, to reach international standards of efficiency, successful exploitation of natural resources and adequate product quality. He also argued that a country's international competitiveness depends on its ability to export its products, efficiently exploit natural resources and increase productivity, which ultimately affects the improvement of living standards. In 2015, the World Economic Forum concluded that key elements of national competitiveness at the macro level are exports, government, finance, infrastructure, technology, labor and institutions.

3. Competition in the financial sector

Competition in the financial sector is important for having productive and allocative efficiency. Competition varies among the countries and it is not driven by the financial system concentration (Claessens, 2009). However, perfect competition in the financial sector is not possible. For instance, banks are imposed to prudential regulations, which include capital requirements, licensing and proper rules from the management team. All these factors directly affect the level od competition. Furthermore, the financial sector requires large fixed costs, which consequently affect it to become oligopolistic (Yokoi-Arai and Yoshino, 2006). According to Yoshino and Fujita (1996) the level of competition in the financial sector is affected from the efficiency of the public financial institutions. This is due to the fact that these institutions directly affect the private financial institutions. However, theory shows that the domestic financial sector should be open to international competition. During a crisis, international foreign banks that have diversified asset portfolio can have stabilizing effect (Barth, et al, 2001). Besanko and Thakor (1992) in their paper examine how banks can differentiate from the competitors. The results showed that the more banks are added to the market, the loan rate decrease and the deposit rates increase. Guzman (2000) through a simple general-equilibrium model found that monopoly power in the banking industry puts a downward pressure on capital accumulation. Corbae and Levine (2019) in their paper suggest that tightening leverage requirements reduces the bank risk taking. They also found that capital requirements and bank governance are directly linked and monetary policy can have bigger short-run effect on lending in more competitive banking systems. However, contrary to almost every other sector of the economy, where competition is needed to achiever the planned goals, history has shown that for the well-functioning financial systems, regulation is the most necessary ingredient. Over-regulation does impede competition, but, financial systems can become easily unstable if they are not well regulated (OECD, 2011). Banking competition and low barriers to entry can have an important role in improving the access to finance, for instance by lowering the interest rates and providing better terms for loans (Petersen and Rajan, 1995). Zoghlami and Bouchemia

(2021) in their paper used a sample of 197 commercial banks that operate in the MENA region. Their purpose was to analyze the impact of competition on bank profitability and risk-taking for the period 2011-2018. The results showed that competition reduces interest-based income and increases the bank fragility. In other words, the overall banks' profitability is improved as a result of the competition. Additionally, there are also studies that analyze the effect of competition on the insurance industry. Cobbinah et al. (2020) in their paper employed the Generalized Method of Moments style Panel Vector Autoregressive estimation model in order to analyze the relationship between competition and financial stability in ten countries in West Africa for the period 2000-2014. The results showed that competition enhances stability. Kasman et al. (2019) conducted similar study in the paper in which they found that non-life insurers in Turkey for the period 2002-2014 are more stable in less competitive environment. Contrary, life and pension insurers perform better in highly competitive markets. Cummnis et al. (2017) in their paper through a cross-country study and Boone indicator method found that competition contributes to insurer solvency. Contrary to the positive impact that was determines in these papers, in an analysis conducted by Kar and Swain (2014) using the Boone indicator, it was estimated that competition in the micro-finance sector leads to an increase of the loans issued and a decline in financial self-sustainability.

4. Competition and economic growth

The evidence base regarding competition laws and economic growth vary among countries. However, the common ground is that competition is very important for the proper functioning of the market economies (Gomaa, 2014). According to Don et al. (2008), competition is not the main goal to the politicians and the policymakers, but, it is a way through which they stimulate efficiency in the economy, which later contributes to better productivity, higher economic growth and consumer welfare. Marwa (2014) in his paper analyzed the impact of competition on economic growth for the MENA countries. He used panel data estimation for a sample of 115 countries during the period 1995-2010. He obtained positive results. Hence, competition positively affects the economic growth.

Moreover, in the past several years many countries oriented towards markets liberalization and adoption of competition policies. Theory suggests that competition is an intermediate objective, while the final goal is to achieve economic growth (UNCTAD, 2010). Nevertheless, there are many other factors that affect the process of implementing competition. Rule of law, capacity constraints, business environment, transaction costs are some of those factors that complicate the process of implementing competition policies in the developing countries compared to the developed ones (UNCTAD, 2010). Dutz and Vagliasindi (2000) in their paper based on several factors such as the level of law enforcement, competition advocacy and institution-related activities evaluated the relationship between competition law implication and expansion of private firms. Through cross-sectional study, they found positive relationship in all of the 18 transition economies of Eastern Europe and the former Soviet Union they took as a sample in the study. Acemoglu et al. (2006) in their paper found that high barriers to entry affect the growth level of a country. In the early stages of development, less competitive environments foster growth. Cherif, et al. (2020) in their paper examined the question whether market competition improve the competitiveness and the growth level. They uses country and firm level data for a sample of 39 sub-Saharan countries for the period 2000-2017 and concluded that competition is positively associated with GDP growth rates. Dutz and Hayri (2000) in their paper also confirm strong correlation between competition and long-run economic growth. Furthermore, Reyes and Useche (2019) in their paper through time series data organized at three levels, individual countries, groups of nations, Latin America and Caribbean as a whole, for the period 2006-2015, analyzed the competitiveness, economic growth and human development. They used the index of competitiveness, rates of change in real GDP and Human Development and found that those countries that have better competitiveness have better economic performance and better conditions for human development.

5. Data and analysis

In order to have intensive competition, the barriers to entry have to be easy, because competition is directly related to the strength of the barriers to entry. Following the paper of Marwa (2014) in conducting an analysis for the effect of competition as proxies can be taken the business freedom index and the trade freedom index by the Heritage foundation. The business freedom index ranges between 0 and 100, where 100 refers to the most free business environment. This index is an indicator of the competitive pressure from the internal market. Trade freedom index also ranges from 0-100, where 100 stands for lower barriers. This index measures the competition that comes from the external market. Scopelliti (2009) conducted similar study where he analyzed the relationship between competition and economic growth for 20 OECD countries for the period 1995-2005. As indicators (proxies for competition), he used business freedom and trade freedom index. The results showed that for the countries that are far from the frontier trade liberalizations are more beneficial, while for the countries that are close to the frontier, business liberalizations are better.

Therefore, in this paper a descriptive analysis is provided regarding the Business Freedom Index for 2019, 2020 and 2021 for Albania, Bulgaria, Greece, North Macedonia and Serbia.

5.1 Business Freedom Index

Business Freedom Index measures the economic freedom based on 12 quantitative and qualitative factors, categorized in four groups (Rule of Law, Government Size, Regulatory Efficiency and Open Markets). This index is an indicator of the efficiency of government regulation of business and it measures the property rights, government integrity, judicial effectiveness, tax burden, government spending, fiscal health, business freedom, labor freedom, monetary freedom, trade freedom, investment freedom and financial freedom. More specifically, property rights, judicial effectiveness and government integrity belong in the group Rule of Law, while tax burden, government spending and fiscal health belong in the group Government Size. The group Regulatory Efficiency is composed of business freedom, labor freedom and monetary freedom, while Open Markets is composed of trade freedom, investment freedom and financial freedom (Heritage website, 2022).

From Table 1, it can be seen that in 2021, Albania, Bulgaria, Greece, N. Macedonia and Serbia have good overall Business Freedom Score. Bulgaria has the best score of 70.4, followed by N. Macedonia, Serbia, Albania and Greece at the end. This means that from these countries Bulgaria had the most free business environment. Nevertheless, if all of the factors are analyzed separately it can be seen that some countries have better score in some of the categories and perform worse in others, although, the general conclusion is drawn from the overall score. For instance, regarding the property rights, Bulgaria has the best score 66.2, while Albania is on the bottom with 46.1. As it was mentioned, out of all these countries, Greece is on the bottom with the overall score of 60.9. However, when analyzing the government integrity factor, it can be seen that Greece has the best score of 53.6, while Albania is on the bottom with 40.6. Regarding the judicial effectiveness, Greece again is on the top, with a score of 53.5, while Albania is on the bottom with 22.8. For the tax burden factor, each of these countries have very good scores (above 90 out of the overall 100). However, Greece shows the worst results, with a score of only 59.9. Interesting results are obtained for the government spending, where Albania has the best score of 74.6, followed by N. Macedonia (71), Bulgaria (64.7), Serbia (49.6) and Greece (34.2). This means that the government in Albania conducts effective and efficient spending that is beneficial for the whole society, contrary to Greece, where the spending of the government does not provide positive results. From the fiscal health results it can be seen that these countries have similar scores. For each of them the score is above 80, where Bulgaria has the best score 99.2 and Greece the worst, 80. For the business freedom, N. Macedonia has the best score of 77.8, followed by Greece 75.8, Serbia 71, Albania 66.1 and Bulgaria 62.9. The lowest overall scores for these countries are for the labor freedom index, where Bulgaria shows the best results of 68.5 score, followed by Serbia 67.3, N. Macedonia 65.2, Albania 51.6 and Greece 49.8. For the monetary freedom, Bulgaria has the best score od 85.2, Albania 82, Serbia 81.1, Greece 80 and N. Macedonia 78.7. Regarding the trade freedom, Bulgaria and Greece show same scores of 84, while N. Macedonia and Serbia are on the bottom with similar scores of 77.4 and 77.2 correspondingly. For the investment freedom they have similar results, Albania, Bulgaria and Serbia having score of 70 and on the bottom is Greece, with score of 55, while N. Macedonia has a score of 65. For the financial freedom, Greece and Serbia are on the bottom with a score of 50, Bulgaria and N. Macedonia with a score of 60 and Albania is performing the best with the score of 70. Hence, it can be concluded that generally these countries have good average scores, but, in the areas where they do not perform at their best level, the policymakers should work on improving their scores.

Table 1: Business Freedom Index 2021

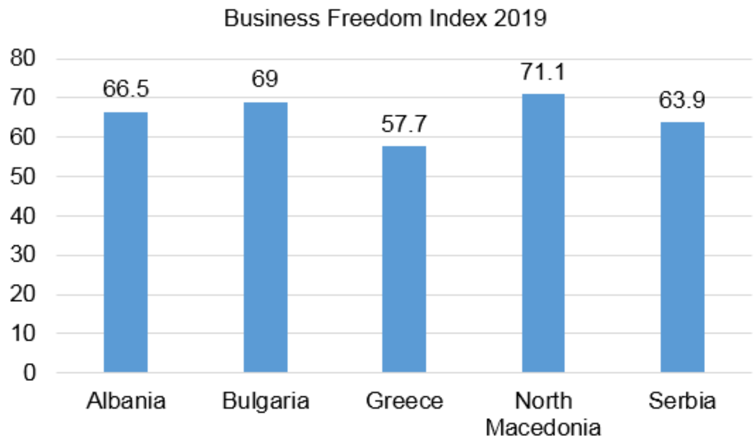
Name	Index Year	Overall Score	Property Rights	Government Integrity	Judicial Effectiveness	Tax Burden	Government Spending	Fiscal Health	Business Freedom	Labor Freedom	Monetary Freedom	Trade Freedom	Investment Freedom	Financial Freedom
Albania	2021	65.2	46.1	40.6	22.8	89	74.6	86.6	66.1	51.6	82	82.8	70	70
Bulgaria	2021	70.4	66.2	46.8	43.6	93.9	64.7	99.2	62.9	68.5	85.2	84	70	60
Greece	2021	60.9	55.5	53.6	53.5	59.9	34.2	80	75.8	49.8	80	84	55	50
North Macedonia	2021	68.6	62.6	41.9	40.4	94.9	71	87.8	77.8	65.2	78.7	77.4	65	60
Serbia	2021	67.2	57.9	45	50.6	92.5	49.6	94.6	71	67.3	81.1	77.2	70	50

Source: Heritage website (2022)

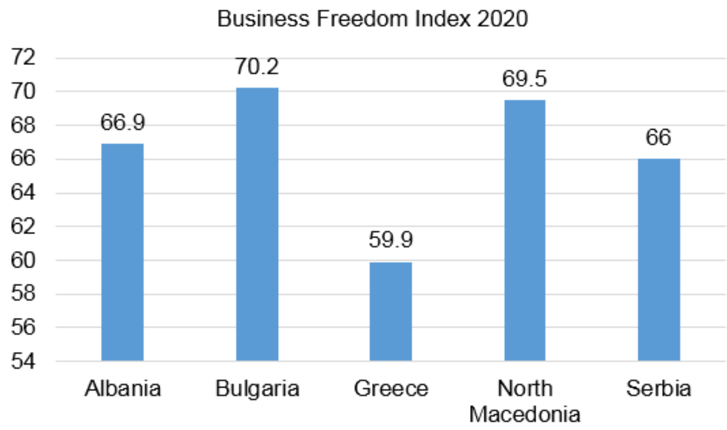
In the graphs below are presented the Business Freedom Indices for 2019, 2020 and 2021. In these three years, Albania managed to maintain similar score, 66.5 in 2019, 66.9 in 2020 and 65.2 in 2022. Bulgaria had an overall score of 69 in 2019, with a slight increase of total 70.2 in 2020 and 70.4 in 2021. Greece performed the worse in 2019, with an overall score of 57.7, followed by an increase in 2020 and 2021, with 59.9 and 60.9 correspondingly. From 2019-

2021, N. Macedonia had a decrease in the overall score, from 71.1 in 2019, 69.5 in 2020 and 68.6 in 2021. Contrary to N. Macedonia, Serbia had an increase in its overall scores from 2019-2021. It had a score of 63.9 in 2019, 66 in 2020 and 67.2 in 2021. Nevertheless, the best overall score for the Business Freedom Index in 2019 had N. Macedonia. In 2020 and 2021, Bulgaria had the highest scores, while Greece had the lowest scores for the three years. Therefore, Greece is showing the worst performance and this country should work on strategies and policies to improve its situation in the upcoming years.

Graph 1: Business Freedom Index 2019

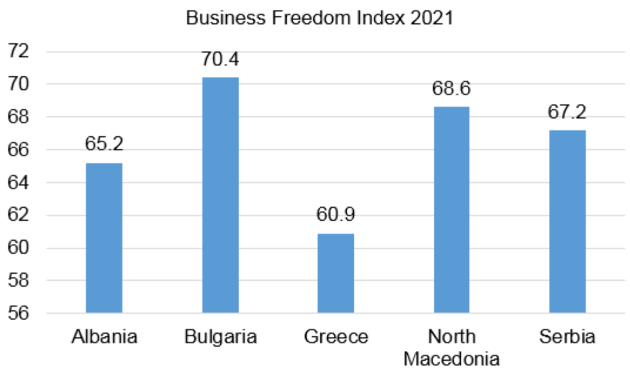


Graph 2: Business Freedom Index 2020



Source: Heritage website (2022)

Graph 3: Business Freedom Index 2021



Source: Heritage website (2022)

6. Conclusion

Theory shows that competition is a driver for growth and prosperity. However, the level of competition has to be adequate, efficient and effective and it should be intensified in areas that show potential for progress. In this paper, the main purpose was to provide theoretical representation of the meaning of the concepts of competition and competitiveness and to show

how they affect the financial sector and the economic growth. Some of the papers show that they have positive results, while others show that sometimes the effect can be negative. Therefore, the Business Freedom Index for five Balkan countries was presented in order to see more specifically how they perform in different segments. This is of huge importance because economic freedom is a formula for economic progress and success. Perfect freedom does not exist, which is why understanding the areas that are weak can help the policy makers make better decisions. In order to promote competition, there should be policies that will enhance the economic freedom. Only then, the competitive market place can create more high-quality jobs, consumers can have access to better products and services and opportunities for entrepreneurs and innovators can be created. The analysis showed that Greece has the lowest Business Freedom Index, which means that this country should work on enhancing its economic freedom and create opportunities for prosperity for its citizens. Bulgaria has the best overall score, but it underscores in government integrity. This suggests that the Bulgarian government should commit better to the public, stay on its word and reinforce the credibility of the policy decision makers. Additionally, out of all factors, N. Macedonia underscores in judicial effectiveness, which suggests that this country should improve the process of serving justice for all of its citizens. Finally yet importantly, every country should work towards creating the perfect business environment for the companies and for its citizens. Only then, competition can show positive results and good outcome for every party involved in the business.

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