Regional Competitiveness: Creating an East African Economic Strategy

Professor Michael E. Porter
Harvard Business School

East African Business Summit
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This presentation draws on ideas from Professor Porter’s books and articles, in particular, “Building the Microeconomic Foundations of Prosperity,” in The Global Competitiveness Report 2005-06 (World Economic Forum, 2005); “Clusters and the New Competitive Agenda for Companies and Governments,” in On Competition (Harvard Business School Press, 1998); Clusters of Innovation Initiative (www.compete.org), a joint effort of the Council on Competitiveness, Monitor Group, and ongoing research. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means—electronic, mechanical, photocopying, recording, or otherwise—without the permission of the author.

Additional information may be found at the website of the Institute for Strategy and Competitiveness, www.isc.hbs.edu
Prosperity Performance
East Africa versus Other Developing Countries

PPP-adjusted GDP per Capita, 2007 ($USD)

Growth of Real GDP per Capita (PPP-adjusted), CAGR, 1998-2007

Note: highlighted countries are part of the East African Community (EAC). Source: EIU (2008), authors calculations.
What is Competitiveness?

- Competitiveness depends on the **productivity** with which a nation uses its human, capital, and natural resources.
  - Productivity **sets the sustainable standard of living** (wages, returns on capital, returns on natural resources) that a country can sustain
  - It is not **what** industries a nation competes in that matters for prosperity, but **how** it competes in those industries
  - Productivity in a national economy arises from a **combination of domestic and foreign firms**
  - The productivity of **“local” or domestic industries** is fundamental to competitiveness, not just that of export industries

- Nations compete to offer the **most productive environment for business**
- The public and private sectors play **different but interrelated roles** in creating a productive economy
• Macroeconomic competitiveness creates the potential for high productivity, but is **not sufficient**

• Productivity ultimately depends on improving the **microeconomic capability** of the economy and the **sophistication of local competition**
# Macroeconomic Competitiveness

<table>
<thead>
<tr>
<th>Social Infrastructure and Political Institutions</th>
<th>Macroeconomic Policies</th>
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<tbody>
<tr>
<td>• Basic human capacity</td>
<td>• Fiscal policy</td>
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<td>• Political institutions</td>
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<td>• Rule of law</td>
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</table>
### Macroeconomic Competitiveness

#### Social Infrastructure and Political Institutions

- **Basic human capacity**
  - Basic education
  - Health system

- **Safety and security**
  - Reliability of police
  - Prevalence and costs of crime

- **Political institutions**
  - Political freedom
  - Voice and accountability
  - Political stability
  - Government effectiveness
  - Centralization of economic policymaking

- **Rule of law**
  - Judicial independence
  - Efficiency of legal framework
  - Business costs of corruption
  - Civil rights

#### Macroeconomic Policies

- **Fiscal policy**
  - Government surplus/deficit
  - Government debt
  - Savings / Investment rates

- **Monetary policy**
  - Inflation
  - Interest rate spread

- **Economic openness**
  - Average tariff rate
  - Exchange rate and capital controls
## Prosperity and Human Development
### Selected Countries

<table>
<thead>
<tr>
<th>Country</th>
<th>GDP per Capita (PPP)</th>
<th>Human Development Index (HDI)</th>
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<th>Education Rank</th>
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Note: Percentages are relative to best country in the world

Source: UNDP (2008)
Political Institutions Indicators

Selected Countries

Note: Sorted left to right by decreasing average value across all indicators. The ‘zero’ horizontal line corresponds to the median country’s average value across all indicators.

Balancing Budgets
Selected African Countries

Budget balance (as % of GDP, 2007)

Source: EIU (2008)
Openness to Trade
Selected African Countries, 2008

Source: Index of Economic Freedom (2008), Heritage Foundation
Inbound Foreign Investment Performance
Selected Countries

Inward FDI Stocks as % of GDP, Average 2002 - 2006

FDI Inflows as % of Gross Fixed Capital Formation, Average 2002 - 2006

Microeconomic Competitiveness: Quality of the Business Environment

- Access to high quality business inputs
  - Natural endowments
  - Human resources
  - Capital availability
  - Physical infrastructure
  - Administrative infrastructure (e.g. registration, permitting)
  - Information infrastructure (e.g., transparency)
  - Scientific and technological infrastructure

- Local rules and incentives that encourage investment and productivity
  - e.g. salaries, incentives for capital investments, intellectual property protection

- Vigorous local competition
  - Openness to foreign and local competition

- Availability of suppliers and supporting industries

- Sophistication of local customers and needs
  - Strict quality, safety, and environmental standards

• Many things matter for competitiveness
• Successful economic development is a process of successive upgrading, in which the business environment improves to enable increasingly sophisticated ways of competing
# Doing Business

## Selected African Countries

<table>
<thead>
<tr>
<th>Ease of Doing Business</th>
<th>Starting a Business</th>
<th>Dealing with Licenses</th>
<th>Employing Workers</th>
<th>Registering Property</th>
<th>Getting Credit</th>
<th>Protecting Investors</th>
<th>Paying Taxes</th>
<th>Trading Across Borders</th>
<th>Enforcing Contracts</th>
<th>Closing a Business</th>
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Rank out of 178 countries. East African countries highlighted.

Microeconomic Competitiveness: State of Cluster Development
Tourism Cluster in Cairns, Australia

Sources: HBS student team research (2003) - Peter Tynan, Chai McConnell, Alexandra West, Jean Hayden

Public Relations & Market Research Services
Food Suppliers
Property Services
Maintenance Services
Travel agents
Tour operators
Restaurants
Attractions and Activities e.g., theme parks, casinos, sports
Hotels
Airlines, Cruise Ships
Local retail, health care, and other services
Local Transportation
Souvenirs, Duty Free
Banks, Foreign Exchange
Government agencies e.g. Australian Tourism Commission, Great Barrier Reef Authority
Educational Institutions e.g. James Cook University, Cairns College of TAFE
Industry Groups e.g. Queensland Tourism Industry Council

Local retail, health care, and other services

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Educational Institutions e.g. James Cook University, Cairns College of TAFE

Industry Groups e.g. Queensland Tourism Industry Council
Kenya’s Cut Flower Cluster

Government Agencies, NGOs & Industry Associations

- Horticultural Crops Development Authority (HCDA)
- Government Export Policies targeting Horticulture
- Government Policy for Revitalizing Agriculture: National Export Strategy; Export Promotion Council (EPC)

Non-Governmental Organizations
- The Rural Enterprise Agri-Business Promotion Project (USAID, CARE, IFAD)
- Horticultural Produce Handling Facilities Project (JBIC)

Trade & Industry Associations
- Kenya Flower Council (KFC)
- Fresh Produce Exporters Association of Kenya (FPEAK)
- Regional Growers Associations e.g., North & South Kinangop; Lake Naivasha, etc

Post-Harvest
Cooling Technology

Grading / Packaging Sheds

Packaging & Labeling Materials

Refrigerated Trucks

Freight Forwarders

Clearing and Forwarding Agents

Air Carriers (Commercial / Charters)

Tourism Cluster

Sources: Student team research by Kusi Hornberger, Nick Ndiritu, Lalo Ponce-Britto, Melesse Tashu, and Tijan Watt,
Microeconomics of Competitiveness Course, 2007
The Kenyan Cut Flower Cluster
Trade Performance

Kenyan Cut Flower Exports in thousand US $

Value
Market Share

Kenyan Cut Flower World Export Market Share

Underlying data drawn from the UN Commodity Trade Statistics Database.
# East African Community

## Top 5 Export Clusters by Value, 2006

<table>
<thead>
<tr>
<th>Cluster</th>
<th>Export Value (in $thousands)</th>
<th>Export Growth (CAGR), 2001-2006</th>
<th>Top 5 Clusters Share of Total Exports</th>
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</thead>
<tbody>
<tr>
<td><strong>Burundi</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jewelry, Precious Metals and Collectibles</td>
<td>$85,550</td>
<td>92.02%</td>
<td>96.8%</td>
</tr>
<tr>
<td>Agricultural Products</td>
<td>$41,938</td>
<td>9.20%</td>
<td></td>
</tr>
<tr>
<td>Business Services</td>
<td>$3,398</td>
<td>51.97%</td>
<td></td>
</tr>
<tr>
<td>Metal Mining and Manufacturing</td>
<td>$2,851</td>
<td>-6.25%</td>
<td></td>
</tr>
<tr>
<td>Hospitality and Tourism</td>
<td>$1,311</td>
<td>29.24%</td>
<td></td>
</tr>
<tr>
<td><strong>Kenya</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agricultural Products</td>
<td>$1,564,199</td>
<td>13.20%</td>
<td>73.3%</td>
</tr>
<tr>
<td>Transportation and Logistics</td>
<td>$1,021,590</td>
<td>22.04%</td>
<td></td>
</tr>
<tr>
<td>Hospitality and Tourism</td>
<td>$688,223</td>
<td>22.18%</td>
<td></td>
</tr>
<tr>
<td>Communications Services</td>
<td>$283,885</td>
<td>57.76%</td>
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</tr>
<tr>
<td>Apparel</td>
<td>$229,614</td>
<td>141.55%</td>
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<tr>
<td><strong>Rwanda</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agricultural Products</td>
<td>$77,361</td>
<td>24.31%</td>
<td>94.6%</td>
</tr>
<tr>
<td>Metal Mining and Manufacturing</td>
<td>$38,958</td>
<td>16.70%</td>
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<tr>
<td>Hospitality and Tourism</td>
<td>$31,702</td>
<td>6.42%</td>
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<tr>
<td>Transportation and Logistics</td>
<td>$30,160</td>
<td>16.71%</td>
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<tr>
<td>Business Services</td>
<td>$8,467</td>
<td>19.60%</td>
<td></td>
</tr>
<tr>
<td><strong>Tanzania</strong></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Jewelry, Precious Metals and Collectibles</td>
<td>$807,812</td>
<td>28.29%</td>
<td>90.2%</td>
</tr>
<tr>
<td>Agricultural Products</td>
<td>$307,431</td>
<td>7.23%</td>
<td></td>
</tr>
<tr>
<td>Fishing and Fishing Products</td>
<td>$188,628</td>
<td>17.84%</td>
<td></td>
</tr>
<tr>
<td>Textiles</td>
<td>$112,680</td>
<td>20.44%</td>
<td></td>
</tr>
<tr>
<td>Tobacco</td>
<td>$106,700</td>
<td>31.66%</td>
<td></td>
</tr>
<tr>
<td><strong>Uganda</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agricultural Products</td>
<td>$375,402</td>
<td>16.53%</td>
<td>73.1%</td>
</tr>
<tr>
<td>Hospitality and Tourism</td>
<td>$354,854</td>
<td>21.02%</td>
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<tr>
<td>Fishing and Fishing Products</td>
<td>$140,705</td>
<td>16.87%</td>
<td></td>
</tr>
<tr>
<td>Jewelry, Precious Metals and Collectibles</td>
<td>$124,215</td>
<td>25.01%</td>
<td></td>
</tr>
<tr>
<td>Communications Equipment</td>
<td>$54,464</td>
<td>140.27%</td>
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</tr>
</tbody>
</table>

Geographic Levels and Competitiveness

- The business environment at a given location is the cumulative outcome of policy at all levels of geography.
- Many microeconomic competitiveness drivers occur at lower levels of geography.
- The allocation of competitiveness responsibilities across levels of geography is a crucial policy challenge.
The Process of Economic Development
Shifting Roles and Responsibilities

**Old Model**

- **Government** drives economic development through policy decisions and incentives

**New Model**

- Economic development is a collaborative process involving government at multiple levels, companies, teaching and research institutions, and private sector organizations

- Competitiveness must become a **bottom-up process** in which many individuals, companies, and institutions take responsibility
- **Every** community and cluster can take steps to enhance competitiveness
- The **private sector** must become more engaged in competitiveness to improve rapidly
Role of the Private Sector in Economic Development

- A company’s competitive advantage depends partly on the quality of the business environment
- A company gains advantages from being part of a cluster
- Companies have a strong role to play in upgrading their business environment
- Take an active role in upgrading the local infrastructure
- Nurture local suppliers and attract foreign suppliers
- Work closely with local educational and research institutions, to upgrade their quality and create specialized programs addressing the cluster’s needs
- Inform government on regulatory issues and constraints bearing on cluster development
- Focus corporate philanthropy on enhancing the local business environment
- An important role for trade associations
  - Greater influence if many companies are united
  - Cost sharing between members
• Economic coordination among neighboring countries can significantly enhance competitiveness
• Integration with neighbors offers greater opportunities than participation in broader economic forums
Why the Neighborhood Matters

• A nation’s most natural trading and investment partners are its **neighbors**
  – Trade and investment allow **specialization** that enhances productivity
  – **Proximity** and **similarity of needs** supports trade and investment in more parts of the economy

• A nation’s economic growth and prosperity can be **greatly enhanced by a healthy neighborhood**
  – Larger, growing, and accessible **markets** for local firms (exports and foreign investment)
  – More opportunities for **specialization of the value chain**
  – Each nation becomes **more attractive as a place to invest** because investments can serve the region
## Comparative Statistics
### East African Community, 2006

<table>
<thead>
<tr>
<th></th>
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<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Burundi</td>
<td>8.2</td>
<td>$903</td>
<td>$415</td>
<td>$0.01</td>
<td>$0.03</td>
<td>$99</td>
<td>$432</td>
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<tr>
<td>Kenya</td>
<td>36.6</td>
<td>$22,779</td>
<td>$943</td>
<td>$570.5</td>
<td>$51</td>
<td>$5,963</td>
<td>$8,200</td>
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<tr>
<td>Rwanda</td>
<td>9.5</td>
<td>$2,494</td>
<td>$585</td>
<td>$17.2</td>
<td>$11</td>
<td>$291</td>
<td>$786</td>
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<tr>
<td>Tanzania</td>
<td>39.5</td>
<td>$12,784</td>
<td>$1,825</td>
<td>$8.5</td>
<td>$474</td>
<td>$3,106</td>
<td>$3,941</td>
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<tr>
<td>Uganda</td>
<td>29.9</td>
<td>$9,419</td>
<td>$1,551</td>
<td>$814.3</td>
<td>$392</td>
<td>$1,404</td>
<td>$2,775</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>123.5</strong></td>
<td><strong>$48,379</strong></td>
<td><strong>$5,319</strong></td>
<td><strong>$1,410</strong></td>
<td><strong>$928</strong></td>
<td><strong>$10,864</strong></td>
<td><strong>$16,132</strong></td>
</tr>
</tbody>
</table>

Trade within the Region
East Africa vs. Central America

Source: UN Comtrade (2008)
Regional Economic Strategy

- Regional collaboration and competitiveness
- Defining a strategic role for the region in the continent and the world economy
- Opening internal trade and investment
- Achieving synergies in enhancing the business environment
- Facilitating cross-border cluster development
- Enhancing company capabilities and non-traditional exports

But

- Cross-national collaboration is not a substitute for national microeconomic reforms
- Increasing the attractiveness of the region as a whole for foreign investment
- Winning greater support from the international community
- Spreading economic policy at the national level
### Economic Coordination Among Neighbors
#### Harnessing Spillovers

<table>
<thead>
<tr>
<th>Factor (Input) Conditions</th>
<th>Context for Strategy and Rivalry</th>
<th>Demand Conditions</th>
<th>Related and Supporting Industries</th>
<th>Regional &amp; Institutional Governance</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Improving regional transportation infrastructure</td>
<td>- Eliminating trade and investment barriers within the region</td>
<td>- Harmonizing environmental standards</td>
<td>- Coordinating development of cross-border clusters, e.g.</td>
<td></td>
</tr>
<tr>
<td>- Creating an efficient energy network</td>
<td>- Coordinating anti-monopoly and fair competition policies</td>
<td>- Harmonizing product safety standards</td>
<td></td>
<td>- Tourism</td>
</tr>
<tr>
<td>- Interconnecting regional communications</td>
<td>- Simplifying and harmonizing cross-border regulations and paperwork</td>
<td>- Establishing reciprocal consumer protection laws</td>
<td>- Agribusiness</td>
<td></td>
</tr>
<tr>
<td>- Linking financial markets</td>
<td>- Opening government procurement within the region</td>
<td>- Opening the movement of students for higher education</td>
<td>- Transport &amp; Logistics</td>
<td></td>
</tr>
<tr>
<td>- Opening the movement of students for higher education</td>
<td></td>
<td></td>
<td>- Business services</td>
<td></td>
</tr>
<tr>
<td>- Harmonizing regulatory requirements for business</td>
<td></td>
<td></td>
<td></td>
<td>- Sharing best practices in government operations</td>
</tr>
</tbody>
</table>

#### Regional & Institutional Governance
- Creating regional institutions
  - Dispute resolution mechanisms
  - Regional development bank
- Developing a regional marketing strategy
- Coordinating programs to improve public safety
- Coordinating macro-economic policies
Strategy for Cross-National Regions
Central American Logistical Corridor

Roads
Airports
Ports
Logistic Corridor
Country Boundary
Challenges in Regional Coordination

- An overly broad set of countries
- An overly broad agenda
- Focus on politics versus economics
- Lack of a concrete decision-making and implementation structure
- Bureaucracy and complexity
- Neighbors are traditionally seen as competitors
- History of conflicts, in part because of the colonial legacy that defined borders cutting across ethnic and economic regions
- Weak political institutions at the national level pursue ambitious political integration that requires sophisticated governance structures
- Foreign aid traditionally organized by recipient country creating challenges for cross-national programs
Regional Economic Strategy Initiatives
Success Factors

• Common understanding of competitiveness

• Focus on specific projects and initiatives, not just macro

• Emphasis on the microeconomic aspects of competitiveness

• Develop a regional value proposition = a strategy

• Led by the private sector with the participation of all regional actors and representation from the national governments

• Institutionalized through formal enabling structures

• Measure and report progress

• Bottoms up, win-win projects, rather than grand political and macroeconomic declarations
Progress of the East African Community

Institutions
- Summit
- Council of Ministers
- Coordinating and Sectoral Committees, Secretariat
- East African Legislative Assembly
- East African Court of Justice

Achievements
- Customs Union (initiated in 2005)
- Enlargement to Burundi and Rwanda (2007)

Ambitions
- Common Market (2010)
- Common Currency (2012)
- Political Federation (???)
East African Nations
Common Opportunities

• Building exports

• Attracting FDI

• Reducing the costs of doing business

• Human resource development

• Logistical efficiency

• Energy costs and availability
An Agenda for East Africa

• Launch an immediate action program to **simplify and speed up the flow of goods and capital** to improve regional trade
  – e.g., Border crossing hours,
  – customs paperwork

• Create an **East African Business Council** of private sector leaders to organize private sector initiatives and advise government leaders

• Organize **regional networks** in clusters with multiple country presence (i.e., tourism, cut flowers, coffee, IT, etc.) to encourage cross-border investments and projects

• Strengthen **ministerial groups for policy coordination** in key policy areas like infrastructure, logistics, workforce development, energy, etc.

• Encourage collaboration of neighboring **provinces across national borders**

• Jointly approach **foreign donors** to fund for cross-national activities

• Institutionalize the East African Community **governance process**