Chilean Competitiveness:
Ready for the Next Stage?

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Prosperity Performance Across Countries
2005 - 2010

PPP-adjusted GDP per Capita, 2010 ($USD)

OECD Average: 3.04%

OECD Average: $31,423

Note: Luxembourg omitted
Source: EIU (2011), authors calculations
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Growth of Real GDP per Capita (PPP-adjusted), CAGR, 2005 to 2010

- Latin American countries
- Other OECD countries
Income Inequality
Selected Countries

Index of Inequality (2006)*

Note: * latest data available used (in some cases earlier years data used)

Source: World Bank, World Development Indicators, 2008, United Nations University (UNU-WIDER)
Chile’s Economic Situation in 2011

- Impressive management of the **global economic crisis**
  - Chile hit by dramatic but short-lived terms-of-trade shock
- Long-term economic performance remains **ahead** of Latin American peers
- Overall prosperity growth remains **respectable** and has driven poverty rates to low levels
- An increase in labor force mobilization has supported growth but remains **low** compared to peers, especially for **women and young workers**
Labor Force Utilization
Participation Rates, Selected Countries

Labor Force Participation Rate, 2010

Change in Labor Force Participation Rate, 2000 to 2010

Note: Luxembourg omitted.
Source: EIU (2011), authors calculations

Legend:
- Latin American countries
- Other OECD countries

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BUT

• There has been a slow-down of growth, both absolute and in comparison to peers
Chilean Real GDP Growth

Decomposition by Growth Contribution

Source: OECD (2011)
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• There has been a slow-down of growth, both absolute and in comparison to peers
• Resilience of high inequality remains a serious problem
• Productivity growth has stagnated
  – Productivity growth is increasingly dependent on capital deepening
  – Sectoral change towards higher productivity industries has slowed
  – Within sector productivity growth remains low
Labor Productivity Level and Growth
Selected Countries

Real GDP per employee (1990 GK$), 2010

OECD average: 1.37%

Note: Luxembourg omitted
Source: Groningen Growth and Development Centre, Total Economy Database (January 2011). GDP calculated using Geary Khamis calculation methodology.

Growth of real GDP per employee, 2000 to 2010

Latin American countries
Other OECD countries
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• Export growth is disappointing, especially if the effects of resource price increases are removed
Export Performance
Selected Countries

Exports of Goods and Services (% of GDP), 2010

OECD Average: 47.70%
OECD Average: -5.15%

Norway
Finland
Estonia
Sweden
Slovenia
Slovakia
Belgium
Belgium
Netherlands
Czech Republic
Slovenia
Austria
Poland
Hungary
Iceland

Canada
New Zealand
Spain
France
Australia
Turkey
USA
Missouri
Argentina
Mexico
Peru

Note: Luxembourg omitted
Source: EIU (2011), authors calculations
Copper Price Effects on Exports

Total Export Revenues (US$M)

Source: EIU (2011), COMTRADE (2011), author analysis
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• Innovation output is weak
Innovative Output
Selected Countries, 1999 to 2009

Average U.S. utility patents per 1 million population, 2007-2009

CAGR of US-registered patents, 1999 to 2009

Source: USPTO (2010), Groningen Growth and Development Centre, Total Economy Database (2010)
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• Resilience of high **inequality** remains a serious problem
• Productivity growth has **stagnated**
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  – **Sectoral change** towards higher productivity industries has **slowed**
  – **Within sector** productivity growth remains **low**
• Export growth is **disappointing**, especially if the effects of resource price increases are removed
• Innovation output is **weak**
• Traditional strengths in macroeconomic policy and openness have been preserved but are **increasingly insufficient**
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- Traditional strengths in macroeconomic policy and openness have been preserved but are **increasingly insufficient**

- Chile is in the midst of a complex but necessary transition towards a **new competitiveness paradigm**
What is Competitiveness?

• Competitiveness is determined by the **productivity** with which a nation uses its human, capital, and natural resources.
  
  – Productivity **sets the 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 in offering 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.
Quality of the National Business Environment

Context for Firm Strategy and Rivalry

- Local **rules and incentives** that encourage investment and productivity
  - e.g., salaries, incentives for capital investments, intellectual property protection, corporate governance standards
- Open and vigorous **local competition**
  - Openness to foreign competition
  - Competition laws

Factor (Input) Conditions

- Access to high quality **business inputs**
  - Human resources
  - Capital availability
  - Physical infrastructure
  - Administrative and information infrastructure (e.g., registration, permitting, transparency)
  - Scientific and technological infrastructure
  - Efficient access to natural endowments

Demand Conditions

- **Sophisticated and demanding** local customers and needs
  - e.g., Strict quality, safety, and environmental standards
  - Consumer protection laws

Related and Supporting Industries

- Availability of **suppliers and supporting industries**

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
Competition

• The Chilean economy is **highly open**

• The presence of foreign companies is relatively **low** and local rivalry **limited**
Intensity of Local Competition
Selected Industries; 2000-2008

Price-Cost Margins

1. Average ratio of operating income to total revenue. The comparator groups includes Australia, Canada and New Zealand.

Source: Thomson Financial, Wordscope Database.

Source: OECD (2011)
Competition

- The Chilean economy is **highly open**

- The presence of foreign companies is relatively **low** and local rivalry **limited**

- Product markets are relatively **heavily regulated**
Policy Environment for Mining Investments

Selected Locations

Fraser Institute Policy Potential Index, 2010 - 2011

Source: Fraser Institute (2011)
1. Overall indicator.

Source: OECD, Product Market Regulation Database.

Product Market Regulation, 2008
Competition

• The Chilean economy is **highly open**

• The presence of foreign companies is relatively **low** and local rivalry **limited**

• Product markets are relatively **heavily regulated**

• **Competition authorities** have only recently been given more power to address the dominant position of conglomerates

• The remote **geographic location** and small absolute **size** of the Chilean market provide limited incentives for foreign companies to enter entrenched local markets
Administrative Infrastructure

- Chile gets high overall marks on government efficiency

- Compared to peers especially outside of Latin America, however, entrepreneurs face significant administrative costs
## Doing Business
### Selected Countries

<table>
<thead>
<tr>
<th>Economy</th>
<th>Ease of Doing Business Rank</th>
<th>Registering Property</th>
<th>Paying Taxes</th>
<th>Starting a Business</th>
<th>Dealing with Construction Permits</th>
<th>Protecting Investors</th>
<th>Trading Across Borders</th>
<th>Getting Credit</th>
<th>Closing a Business</th>
<th>Enforcing Contracts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mexico</td>
<td>35</td>
<td>67</td>
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<td>Peru</td>
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<td>Colombia</td>
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<td>118</td>
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<td>72</td>
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<tr>
<td>Brazil</td>
<td>127</td>
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<td>89</td>
<td>74</td>
<td>152</td>
<td>114</td>
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<td>132</td>
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<tr>
<td>Argentina</td>
<td>115</td>
<td>142</td>
<td>168</td>
<td>118</td>
<td>65</td>
<td>109</td>
<td>143</td>
<td>115</td>
<td>45</td>
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</tr>
</tbody>
</table>

Administrative Infrastructure

• Chile gets high overall marks on government efficiency

• Compared to peers especially outside of Latin America, however, entrepreneurs face significant administrative costs

• Chile is facing a difficult transition from a model with limited government towards a model with more government that needs to be effective

• This challenge will only rise as the country gets more prosperous
Skills and Education

• On many traditional indicators of education Chile ranks **broadly in line** with peers but below its rank on other dimensions of competitiveness
  – Resources available for education
  – Educational achievement of students
  – University rankings
  – *GCR survey responses are much more negative about the education system*

• **Education reform** has been a key issue for Chile; while some progress has been made, more needs to happen
  – Programs to increase availability of finance for students to study in Chile and at leading universities abroad
  – Programs to established standards and raise quality

• Workforce skills are **surprisingly absent** from the education debate
Innovative Capacity

- Innovation policies have been **dramatically revamped** over recent years
  - E.g., creation of the National Innovation Council (CNIC), the Inter-Ministerial Committee on Innovation (ICI), and the National Innovation Fund for Competitiveness (FIC)
  - E.g., launch of the R&D tax credit

- While it will take some more time to fully evaluate the impact of these changes, some **challenges** appear to persist
  - Too much focus on research-driven activities instead of transfer and adaptation of global knowledge
  - Too much bureaucracy around funding programs
  - Too much focus on increasing supply of R&D versus creating demand for innovation-based products and services
Private Sector R&D Activity

Share of foreign companies in total business R&D

Source: OECD (2011)
Houston Oil and Gas Cluster

Upstream

Oil & Natural Gas Exploration & Development

Oil & Natural Gas Completion & Production

Oilfield Services/Engineering & Contracting Firms

Equipment Suppliers
(e.g., Oil Field Chemicals, Drilling Rigs, Drill Tools)

Specialized Technology Services
(e.g., Drilling Consultants, Reservoir Services, Laboratory Analysis)

Subcontractors
(e.g., Surveying, Mud Logging, Maintenance Services)

Specialized Institutions
(e.g., Academic Institutions, Training Centers, Industry Associations)

Downstream

Oil Transportation

Oil Trading

Oil Refining

Oil Distribution

Gas Gathering

Gas Processing

Gas Trading

Gas Transmission

Gas Distribution

Gas Marketing

Oil Wholesale Marketing

Oil Retail Marketing

Oil Trans- portation

Gas Trans- mission

Gas Transportation

Oil Trading

Oil Refining

Oil Distribution

Gas Gathering

Gas Processing

Gas Trading

Gas Transmission

Gas Distribution

Gas Marketing

Oil Wholesale Marketing

Oil Retail Marketing
Strong Clusters Drive Regional Performance

- Specialization in strong clusters
- **Breadth** of industries within each cluster
- Strength in **related clusters**
- Presence of a region’s clusters in **neighboring regions**

- **Job** growth
- Higher **wages**
- Higher **patenting** rates
- Greater **new business** formation, growth and survival

National Cluster Export Portfolio
Chile, 1999-2009

Change in Chile’s World Export Market Share, 1999–2009

Chile’s World Export Market Share, 2009

Chile’s Overall World Export Share: 0.443%

Change In Chile’s Overall World Export Share: 0.144%

Exports of US$850 Million =

Chile Metal Mining and Manufacturing, 1999 - 2009
Specialization by Subcluster

Chile's World Export Market Share, 2009

Copper (33.94%)
Other Metals (0.89%)
Wire and Springs

Increasing exports
Decreasing exports

Absolute value of exports 1999-2009

Exports of US$173 Million =

Change in Chile's World Export Market Share, 1999 – 2009

Change in Chile's World Export Market Share, 1999 – 2009

Specialization by Subcluster

Chile's World Export Market Share, 2009

Change in Chile's Share of World Agricultural Products Exports: 0.23%

Vegetables and Fruits

Wine (1.75%, 5.49%)

Meat and Related Products

Fertilizers

Grains

Oils and Fats

Plants and Flowers

Sugars, Molasses and Honey

Coffee, Tea, Cocoa and Spices

Feeding Materials

Specialty Agricultural Products

Crude Fertilizers

Chile's Share of World Agricultural Products Exports: 1.15%

Exports of US$430 Million =

Increasing exports

Decreasing exports

Current Chilean Approach to Cluster Mobilization

- **Analytical process** to identify the most promising clusters for cluster mobilization; selection of initial five clusters (2007 – 2009)
  - Mining
  - Aquaculture
  - Food products
  - Specialty tourism
  - Offshoring of business services

- Program structure too focused on **government picking clusters** vs. competitive process to mobilize efforts

- Limited success in **broadening efforts** beyond existing strengths

- Solid management capacity and clear impact assessment within cluster efforts **still evolving**
# Improving Company Sophistication

## Chile's Relative Position 2010

### Competitive Advantages

<table>
<thead>
<tr>
<th>Competitive Advantage</th>
<th>Rank</th>
<th>Change since 2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Breadth of international markets</td>
<td>9</td>
<td>↑3</td>
</tr>
<tr>
<td>Extent of incentive compensation</td>
<td>16</td>
<td>↑11</td>
</tr>
<tr>
<td>Extent of marketing</td>
<td>27</td>
<td>↓3</td>
</tr>
<tr>
<td>Reliance on professional management</td>
<td>28</td>
<td>↓2</td>
</tr>
</tbody>
</table>

### Competitive Disadvantages

<table>
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<tr>
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<th>Rank</th>
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</tr>
</thead>
<tbody>
<tr>
<td>Nature of competitive advantage</td>
<td>64</td>
<td>↑4</td>
</tr>
<tr>
<td>Willingness to delegate authority</td>
<td>56</td>
<td>↓23</td>
</tr>
<tr>
<td>Capacity for innovation</td>
<td>55</td>
<td>↓16</td>
</tr>
<tr>
<td>Company spending on R&amp;D</td>
<td>52</td>
<td>↓9</td>
</tr>
<tr>
<td>Degree of customer orientation</td>
<td>45</td>
<td>↓7</td>
</tr>
<tr>
<td>Extent of regional sales</td>
<td>45</td>
<td>↑5</td>
</tr>
<tr>
<td>Extent of staff training</td>
<td>42</td>
<td>↓11</td>
</tr>
<tr>
<td>Value chain breadth</td>
<td>40</td>
<td>↑25</td>
</tr>
<tr>
<td>Prevalence of foreign technology licensing</td>
<td>38</td>
<td>↑11</td>
</tr>
<tr>
<td>Firm-level technology absorption</td>
<td>36</td>
<td>↑4</td>
</tr>
<tr>
<td>Production process sophistication</td>
<td>35</td>
<td>↓7</td>
</tr>
<tr>
<td>Control of international distribution</td>
<td>34</td>
<td>↑8</td>
</tr>
</tbody>
</table>

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Note: Rank versus 117 countries; overall, Chile ranks 48th in 2010 PPP adjusted GDP per capita and 28th in Overall Competitiveness.

Firm Innovation


Source: OECD (2009a); Ministry of Economy, Fifth Innovation Survey Indicators.

Source: OECD (2011)
Chile’s Competitiveness Profile
2010

Country Competitiveness (Rank: 29)

Macroeconomic Competitiveness (25)
- Political Institutions (21)
  - Rule of Law (24)
  - Human Development (52)
- Macroeconomic Policy (33)

Microeconomic Competitiveness (30)
- National Business Environment (30)
- Company Operations and Strategy (36)
- Demand Conditions (33)
- Context for Strategy and Rivalry (19)
- Related and Supporting Industries (35)
- Factor Conditions (39)

Note: Rank versus 139 countries; overall, Chile ranks 50th in 2010 PPP adjusted GDP per capita and 29th in Overall Competitiveness.

Towards an Action Agenda for Chile

• Reduce **administrative and regulatory** costs

• Set robust policies to enhance **intensity of rivalry** on Chilean markets
  – FTAs, regional integration, approach to FDI attraction, competition policy
  – Remove unnecessary costs of doing business and entry

• Tackle labor market **inflexibility**

• Mount a comprehensive **workforce skills development program**

• Better align **innovation policies** with the current needs of the Chilean economy
Innovation Policy

Policy priorities

DEVELOPING ECONOMIES

- Inward FDI
- Vocational training
- Technology transfer institutions

ADVANCED ECONOMIES

- Inward FDI
- University education
- Applied research organizations
- Cluster development
- Advanced university education, especially in science and technology
- Scientific research organizations
- Cluster deepening
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• Develop a comprehensive strategy for **regional development**
Regions and Competitiveness

• Economic performance varies significantly across sub-national regions (e.g., provinces, states, metropolitan areas)
• Many essential levers of competitiveness reside at the regional level
• Regions specialize in different sets of clusters
• Cluster strength directly impacts regional performance
• Each region needs its own distinctive competitiveness strategy and action agenda
• Improving competitiveness requires effective policy collaboration between regions and the national government

• Decentralization is important to foster regional specialization, internal competition, and greater government accountability
• Effective decentralization requires clarity on roles and responsibilities, and sufficient administrative capacity at local and regional level
Regional Prosperity Differences
Chilean Regions

Real GDP per capita, PPP-adjusted, 2007

Chilean Average: $8,604

Source: OECD
Specialization of Regional Economies
Leading Clusters by U.S. Economic Area, 2008

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- Broaden the approach to **cluster mobilization**
Clusters as a Tool For Economic Policy

• A forum for **collaboration** between the private sector, trade associations, government, educational, and research institutions

• Brings together **firms of all sizes**, including SME’s

• Creates a **mechanism** for **constructive** business-government dialog

• A tool to identify **problems** and **action recommendations**

• A vehicle for investments that strengthen **multiple firms/institutions** simultaneously

• Fosters **greater competition** rather than distorting the market
Clusters provide a framework for *organizing the implementation* of many public policies and public investments to achieve greater effectiveness.
Cluster Linkages and Economic Diversification

Note: Clusters with overlapping borders or identical shading have at least 20% overlap (by number of industries) in both directions.
LQ, or Location Quotient, measures the country's share in cluster exports relative to its overall share of world exports. An LQ > 1 indicates an above average export share in a cluster.
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Clusters and Economic Diversification

Upgrade the sophistication of existing export products and services

Attract multinationals to anchor new clusters

Grow new industries within existing clusters

Grow related clusters
The Role of Government in Cluster Initiatives

**Government should**
- Support *all* existing and emerging clusters
- Participate
- Enable data collection and dissemination at the cluster level
- Be ready to implement recommendations

**Government may**
- Initiate/Convene
- Co-Finance

**Government should not**
- Pick favored clusters
- Pick favored companies
- Subsidize or distort competition
- Define cluster action priorities
Towards an Action Agenda for Chile

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- Better align **innovation policies** with the current needs of the Chilean economy

- Develop a comprehensive strategy for **regional development**

- Broaden the approach to **cluster mobilization**

- Deepen integration with **neighboring countries**
Geographic Influences on Competitiveness

- World Economy
- Broad Economic Areas
- Groups of Neighboring Nations
- Nation
- States, Provinces
- Cities and Metropolitan Areas
Competitiveness and the Neighborhood

• Opening trade and investment among neighbors
  – Expands the available market
  – A nation’s neighbors are its most natural trading and investment partners
  – The natural path of internationalization for local firms is the neighborhood
  – Open trade and investment make each country a more attractive location for investment

• Economic coordination to drive improvements in the business environment
  – Capture synergies in policy and infrastructure
  – Gain greater clout in international negotiations

• External agreements to help overcome domestic political and economic barriers to reform
## Competitiveness Upgrading Among Neighbors

### Capturing Synergies

#### Business Environment

- **Factor Conditions**
  - Improving the efficiency and interconnectivity of transportation infrastructure
  - Enhancing regional communications
  - Creating an efficient energy network
  - Linking financial markets
  - Opening the movement of students for training or higher education

- **Context for Strategy and Rivalry**
  - Eliminating trade and investment barriers within the region
  - Simplifying and harmonizing cross-border regulations, paperwork and visas
  - Coordinating antitrust and competition policies

#### Macroeconomic Policy

- Coordinating macroeconomic policies
- Coordinated financial market rules
- Strong regional development bank

#### Political Institutions and Governance

- Sharing best practices in government operations
- Creating regional institutions
  - e.g., disaster relief
  - Dispute resolution mechanisms
  - Economic statistics
- Developing a regional approach with international organizations

#### Factor Conditions

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#### Context for Strategy and Rivalry

- Eliminating trade and investment barriers within the region
- Simplifying and harmonizing cross-border regulations, paperwork and visas
- Coordinating antitrust and competition policies

#### Demand Conditions

- Harmonizing environmental and energy standards
- Harmonizing product safety standards
- Establishing reciprocal consumer protection laws
- Opening government procurement within the region

#### Related and Supporting Industries

- Facilitating cross-border cluster upgrading
Towards an Action Agenda for Chile

• Reduce administrative and regulatory costs

• Set robust policies to enhance intensity of rivalry on Chilean markets
  – FTAs, regional integration, approach to FDI attraction, competition policy
  – Remove unnecessary costs of doing business and entry

• Tackle labor market inflexibility

• Mount a comprehensive workforce skills development program

• Better align innovation policies with the current needs of the Chilean economy

• Develop a comprehensive strategy for regional development

• Broaden the approach to cluster mobilization

• Deepen integration with neighboring countries

• Create an overarching Chilean economic strategy
The Need for an Economic Strategy

- Implementing best practices in each policy area
- There are a huge number of policy areas that matter
- No country can or should try to make progress in all areas simultaneously

- A prioritized agenda to create a unique competitive position for a country or region
Creating a National Economic Strategy

National Value Proposition

• What is the **distinctive competitive position** of a nation given its location, legacy, existing strengths, and potential strengths?
  – What unique value as a business location?
  – For what types of activities and clusters?
  – And what roles with neighbors, the region, and the broader world?

Developing Unique Strengths

• What **elements of the business environment** can be unique strengths relative to peers/neighbors?
• What **existing and emerging clusters** represent local strengths?

Achieving and Maintaining Parity with Peers

• What **weaknesses** must be addressed to remove key constraints and achieve parity with peer countries?

• **Priorities** and **sequencing** are necessity in economic development
Tests of a National Economic Strategy

• Has the country articulated a *distinctive* position?
  – That will create a positive *identity* for the country?
  – That will *inspire* citizens?

• Does the strategy build on *strengths*?
  – Are the strengths *realistic* versus neighbors and other peer countries?

• Does the strategy *fit with trends* in the region and the world economy?

• Is the strategy realistic given the country’s *weaknesses*. Can weaknesses inconsistent with the strategy be *neutralized*?

• Are *social* and *political* reforms integrated with *economic* reforms and pursued simultaneously?

• Is there the *political will* and the *political consensus* to implement the strategy?
Tests of a National Economic Strategy – Continued

• Do the **policy priorities** fit the strategy?
  – The **choice of special policies** to address, and their design?
  – The **sequence** in which policies are implemented?
• Has the strategy been **communicated clearly** to the stakeholders?
• Is the **private sector** engaged?
• Is **government itself organized** around the strategy?
• Is there an **overall coordinating structure** for economic development?
• Is the **quality** of governmental agencies and other institutions sufficient for effective implementation?
• Are there mechanisms to **measure progress** and **review / modify** the strategy as prosperity improves or conditions change?
Towards an Action Agenda for Chile

• Reduce administrative and regulatory costs

• Set robust policies to enhance intensity of rivalry on Chilean markets
  – FTAs, regional integration, approach to FDI attraction, competition policy
  – Remove unnecessary costs of doing business and entry

• Tackle labor market inflexibility

• Mount a comprehensive workforce skills development program

• Better align innovation policies with the current needs of the Chilean economy

• Develop a comprehensive strategy for regional development

• Broaden the approach to cluster mobilization

• Deepen integration with neighboring countries

• Create an overarching Chilean economic strategy

• Key challenge is transition to a new competitiveness paradigm
Chilean Competitiveness: Ready for the Next Stage

• Chilean policy makers have recognized the need to move to a new competitiveness paradigm

Elements of the new paradigm

• Innovation-driven economy
• Diversification beyond natural resources
• Competitiveness based on more than openness and strong macroeconomic policy

• Success in this new era requires a fundamental shift in roles and responsibilities of the public and the private sector
• Chile has shifted policy priorities and created new institutions
• Now the challenge is to improve their effectiveness and coordination