

# Competitiveness and Economic Development

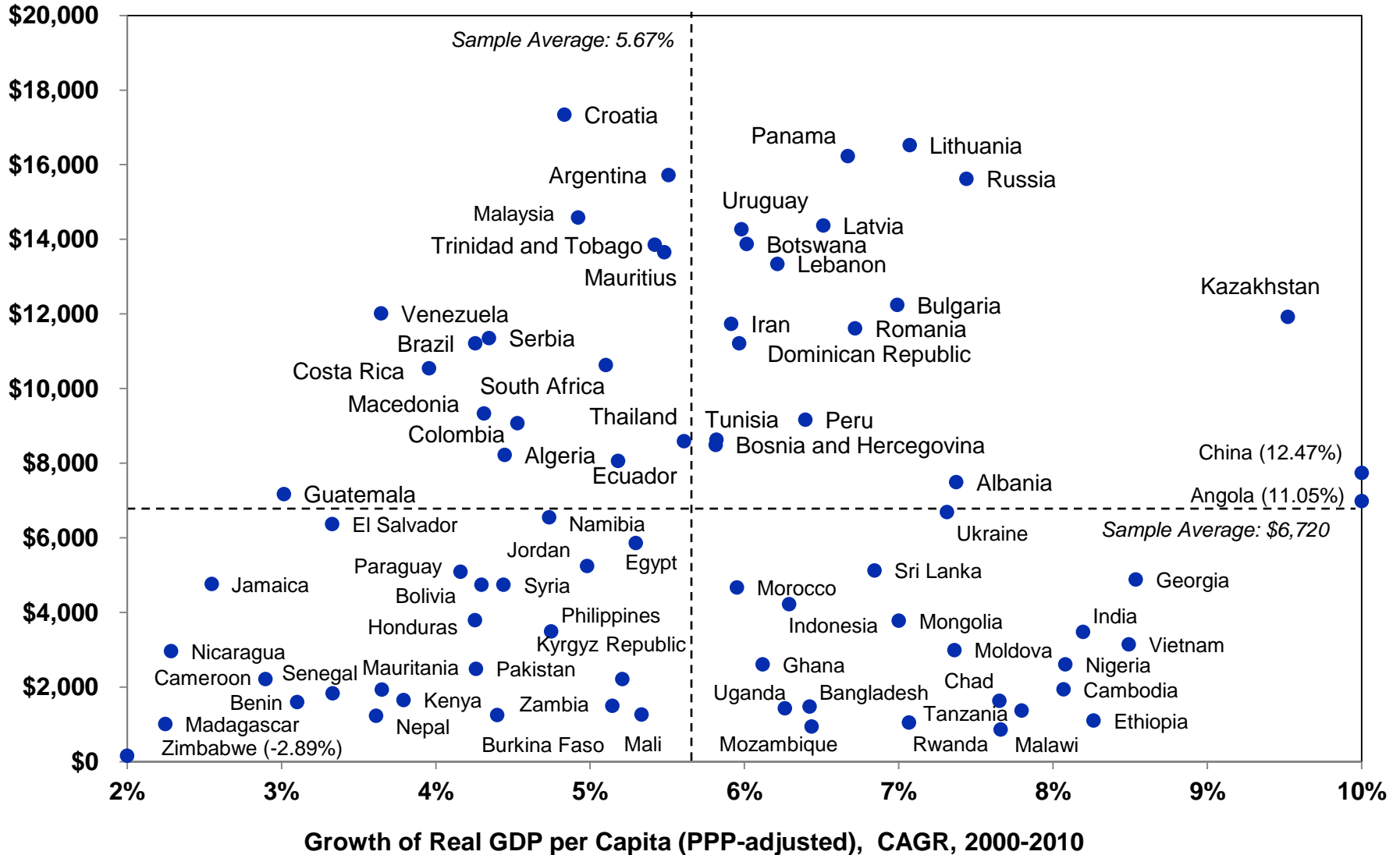
**Briefing for Dr. Jim Kim**  
Professor Michael E. Porter  
Harvard Business School

*Washington, DC*  
*July 19, 2012*

# Prosperity Performance

## Lower and Middle Income Countries

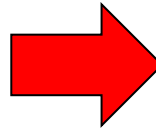
PPP-adjusted GDP per Capita, 2010 (\$USD)



Source: EIU (2011), authors calculations

# Setting the Right Goal for Development

**Poverty reduction**

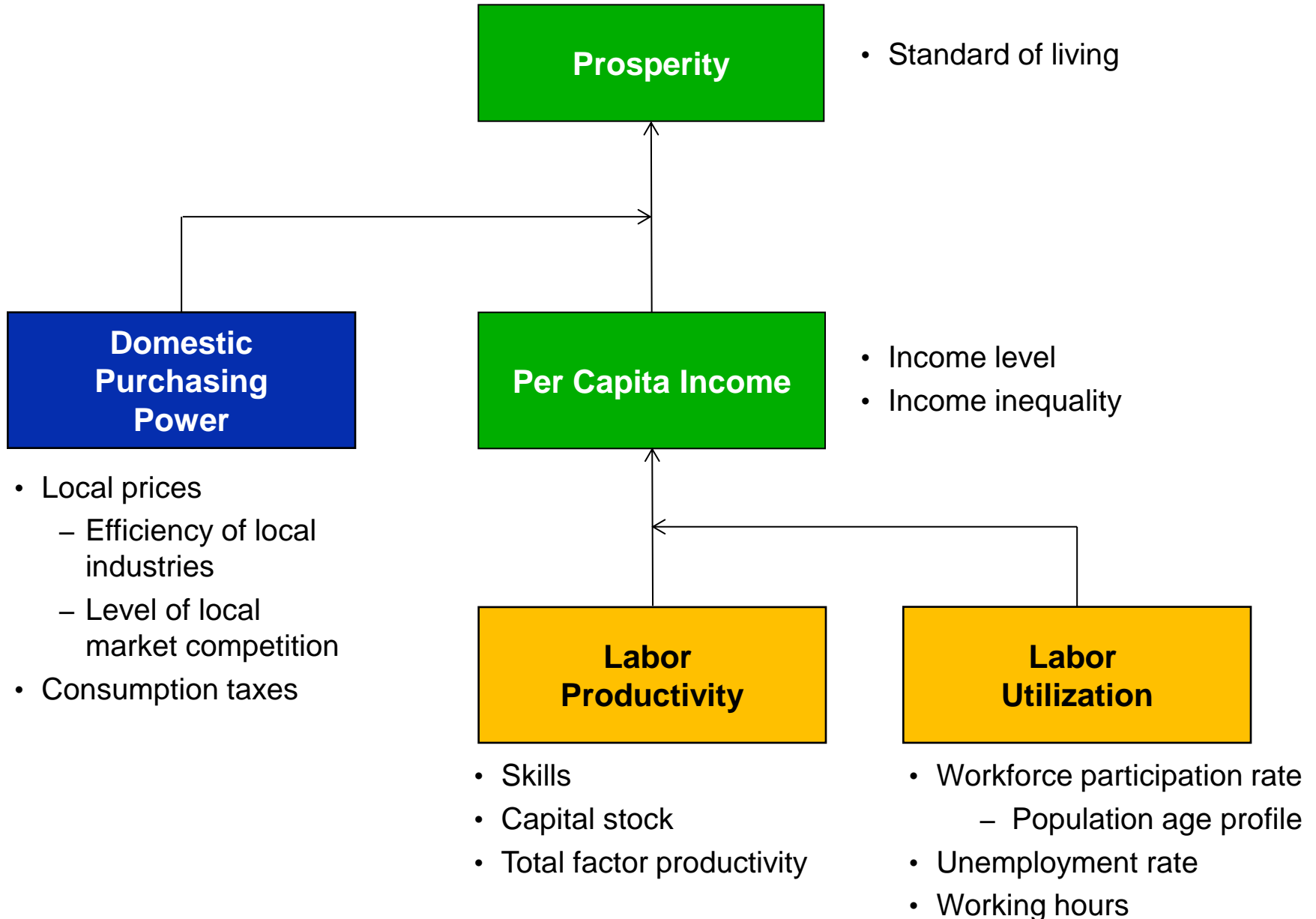


**Increasing jobs,  
income, and wealth  
that is widely shared**

# Agenda

- **Competitiveness and Prosperity**
- A General Framework for Competitiveness
- The Role of Geographic Levels in Competitiveness
- Clusters and Development
- Competitiveness and Economic Development
- Diagnosing Competitiveness
- Economic Strategy
- Organizing for Competitiveness
- The Role of Business: Creating Shared Value
- Implications for the World Bank

# Decomposing Prosperity



# What is Competitiveness?

A nation or region is competitive to the extent that firms operating there are able to **compete successfully** in the global economy while supporting **rising wages and living standards** for the average citizen

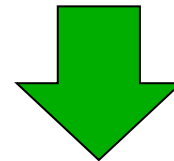
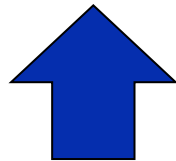
- Competitiveness depends on the **long term productivity** with which a nation or region uses its human, capital, and natural resources
  - Productivity **sets sustainable wages, job growth, and standard of living**
  - It is not **what** industries a nation or region competes in that matters for prosperity, but **how productively** it competes in those industries
  - Productivity in a national or regional economy benefits from a **combination of domestic and foreign firms**



- Nations and regions compete to offer a **more productive environment for business**
- Competitiveness is **not a zero sum game**

# Competitiveness vs. Global Investment Attractiveness

Determines sustainable  
level of prosperity



Determines the attractiveness of a  
location for global investors

# Agenda

- Competitiveness and Prosperity
- **A General Framework for Competitiveness**
- The Role of Geographic Levels in Competitiveness
- Clusters and Development
- Competitiveness and Economic Development
- Diagnosing Competitiveness
- Economic Strategy
- Organizing for Competitiveness
- The Role of Business: Creating Shared Value
- Implications for the World Bank



# A General Framework for Competitiveness



Endowments

- Endowments, i.e. **natural resources**, **geographical location**, and **size**, create a **foundation** for prosperity, but true prosperity is created by **productivity in the use of endowments**

# Underlying Sources of Prosperity

## Inherited Prosperity

- Prosperity derived from **inherited natural resources / endowments**
  - Prosperity is **limited**



- **Dividing** the pie
- **Government** usually becomes the central actor in the economy
- Resource revenues allow **unproductive policies and practices to persist** and fuel **corruption**

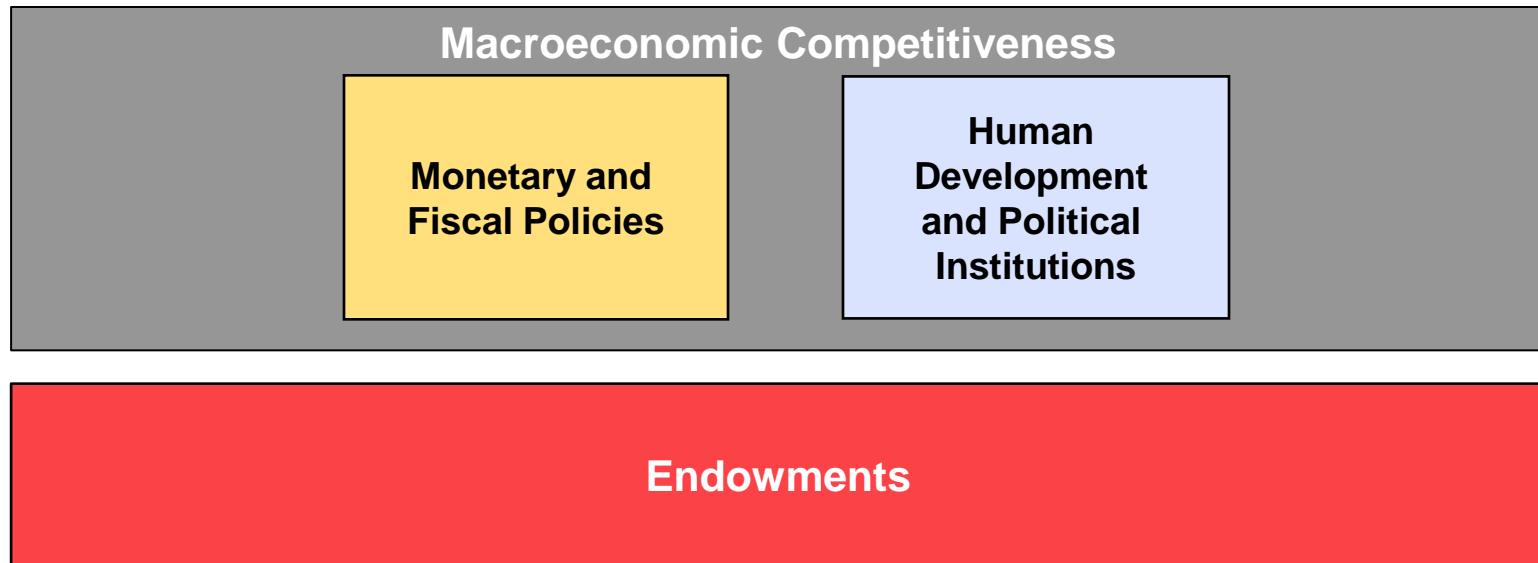
## Created Prosperity

- Prosperity arising from **productivity** in producing goods and services
  - Prosperity is **unlimited**



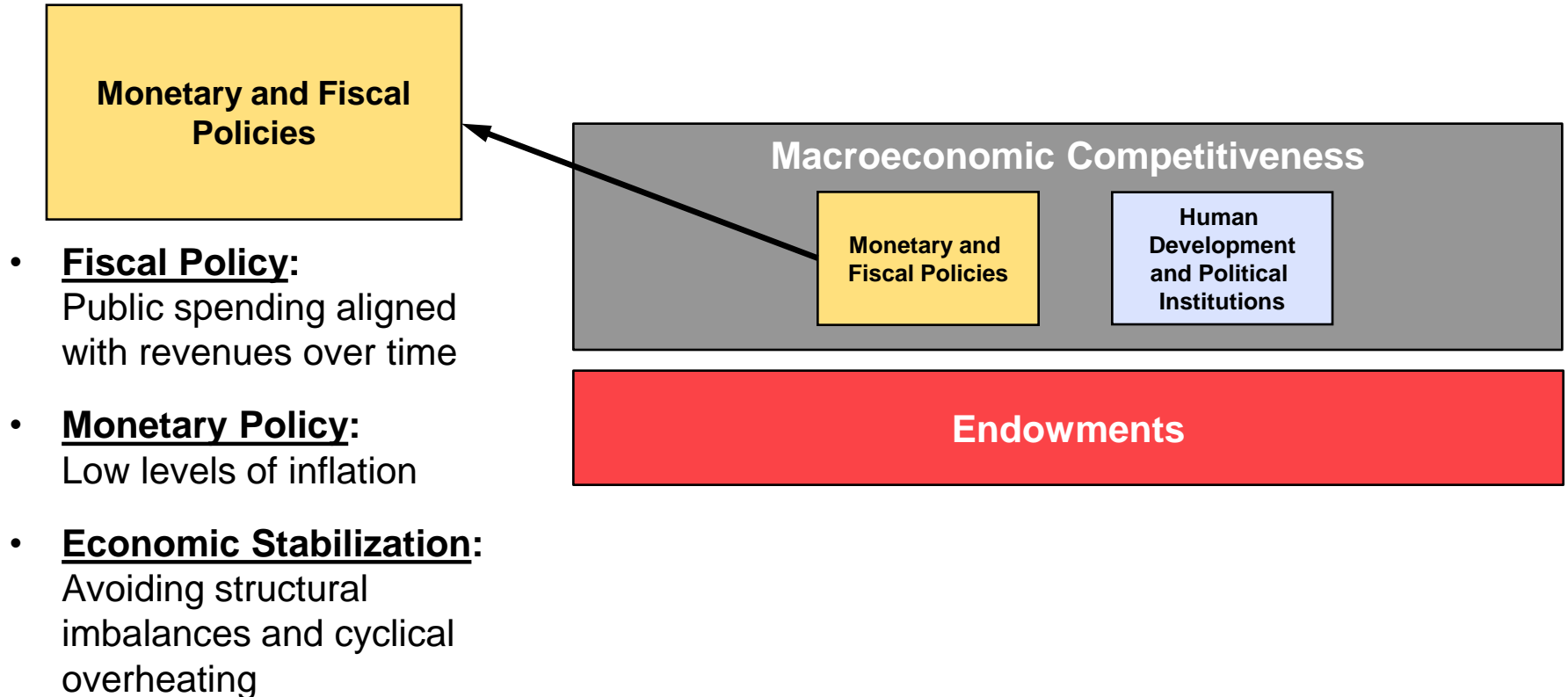
- **Expanding** the pie
- **Companies** are the central actors in the economy
- **Government's role** is to create the **enabling conditions for productivity** and foster private sector development

# A General Framework for Competitiveness

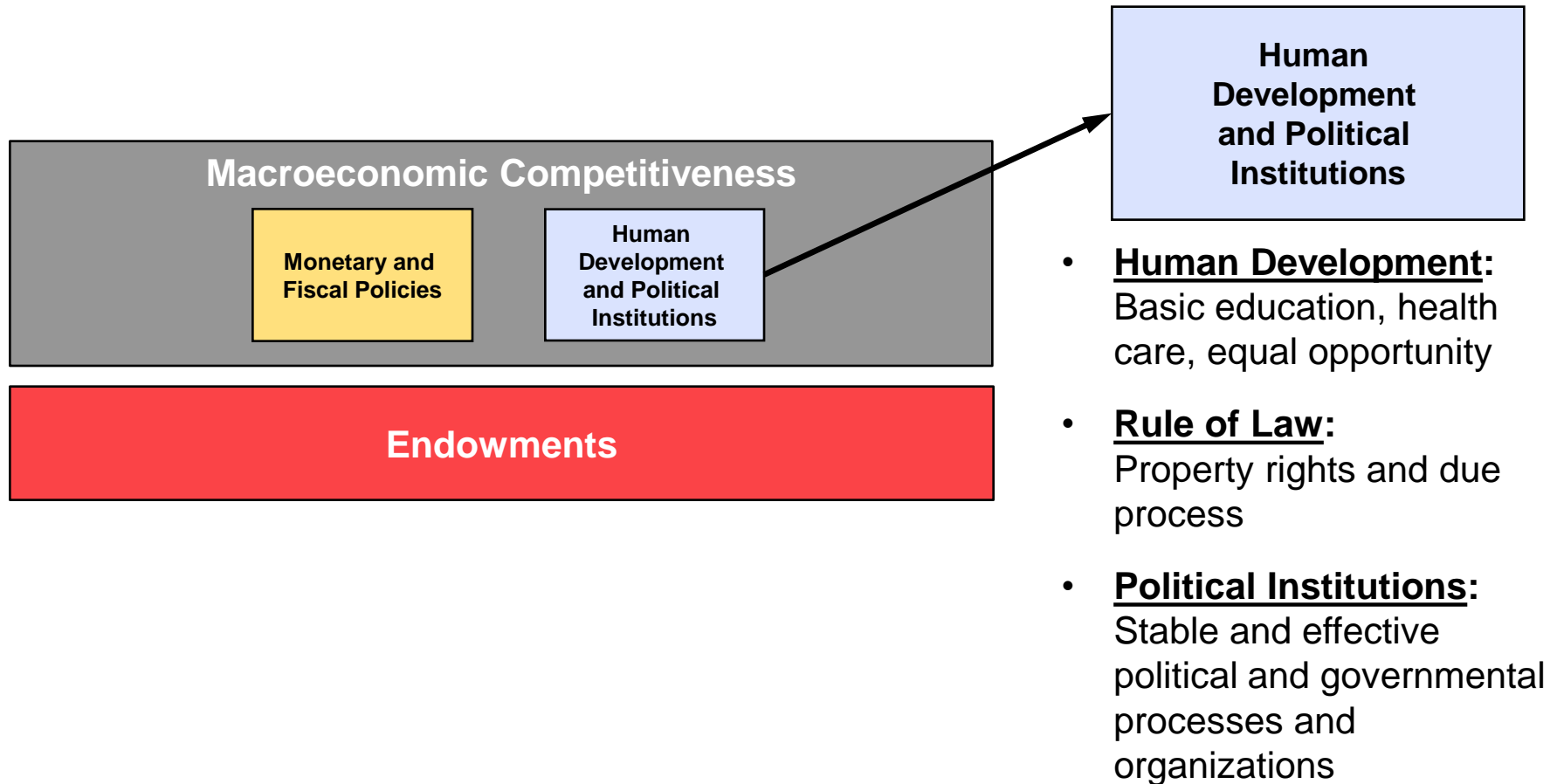


- Macroeconomic competitiveness sets the **economy-wide** context for high productivity to emerge, but is **not sufficient** to achieve this outcome
- Endowments, i.e. **natural resources**, **geographical location**, and **size**, create a **foundation** for prosperity, but true prosperity is created by **productivity in the use of endowments**

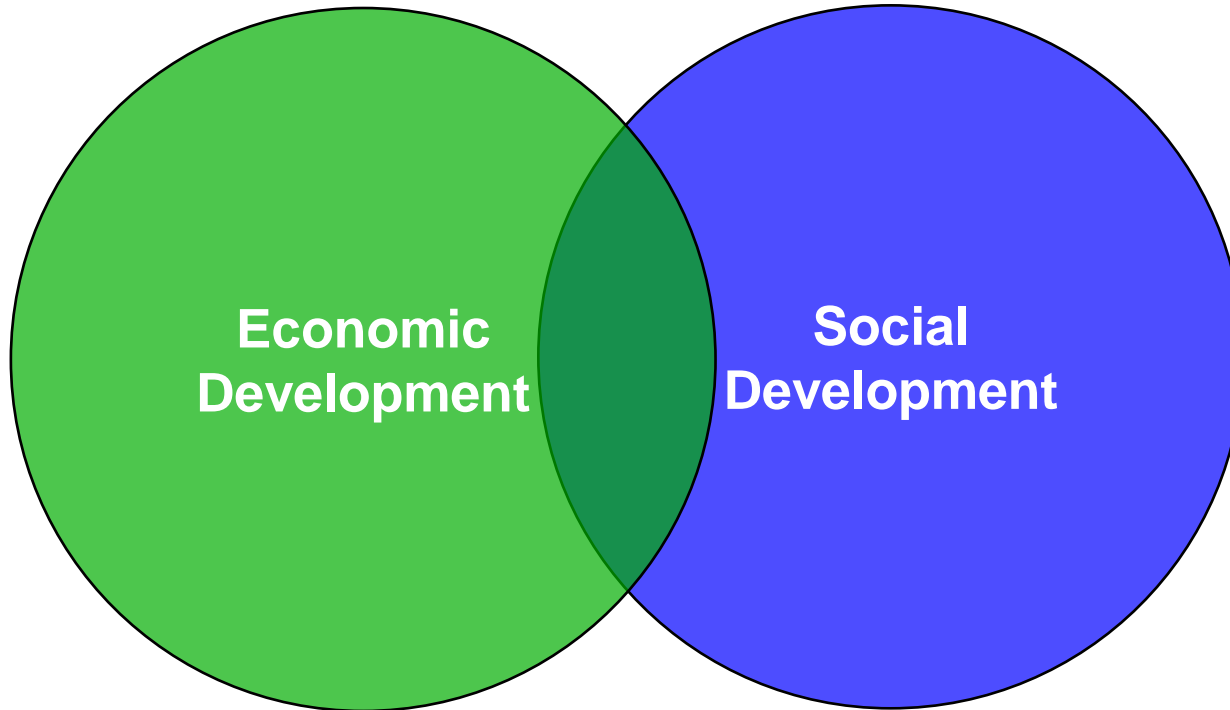
# A General Framework for Competitiveness



# A General Framework for Competitiveness

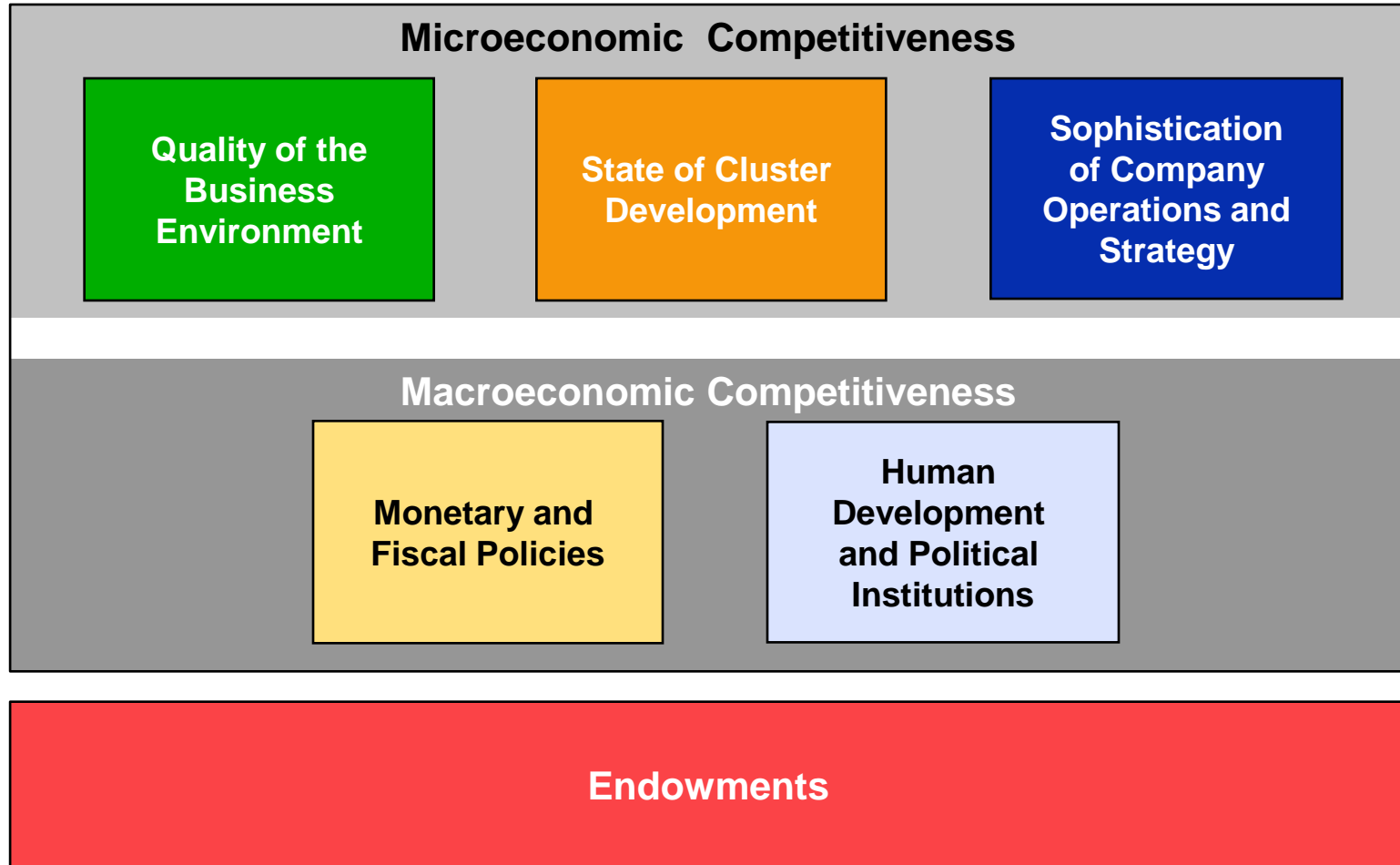


# Competitiveness and Poverty Reduction



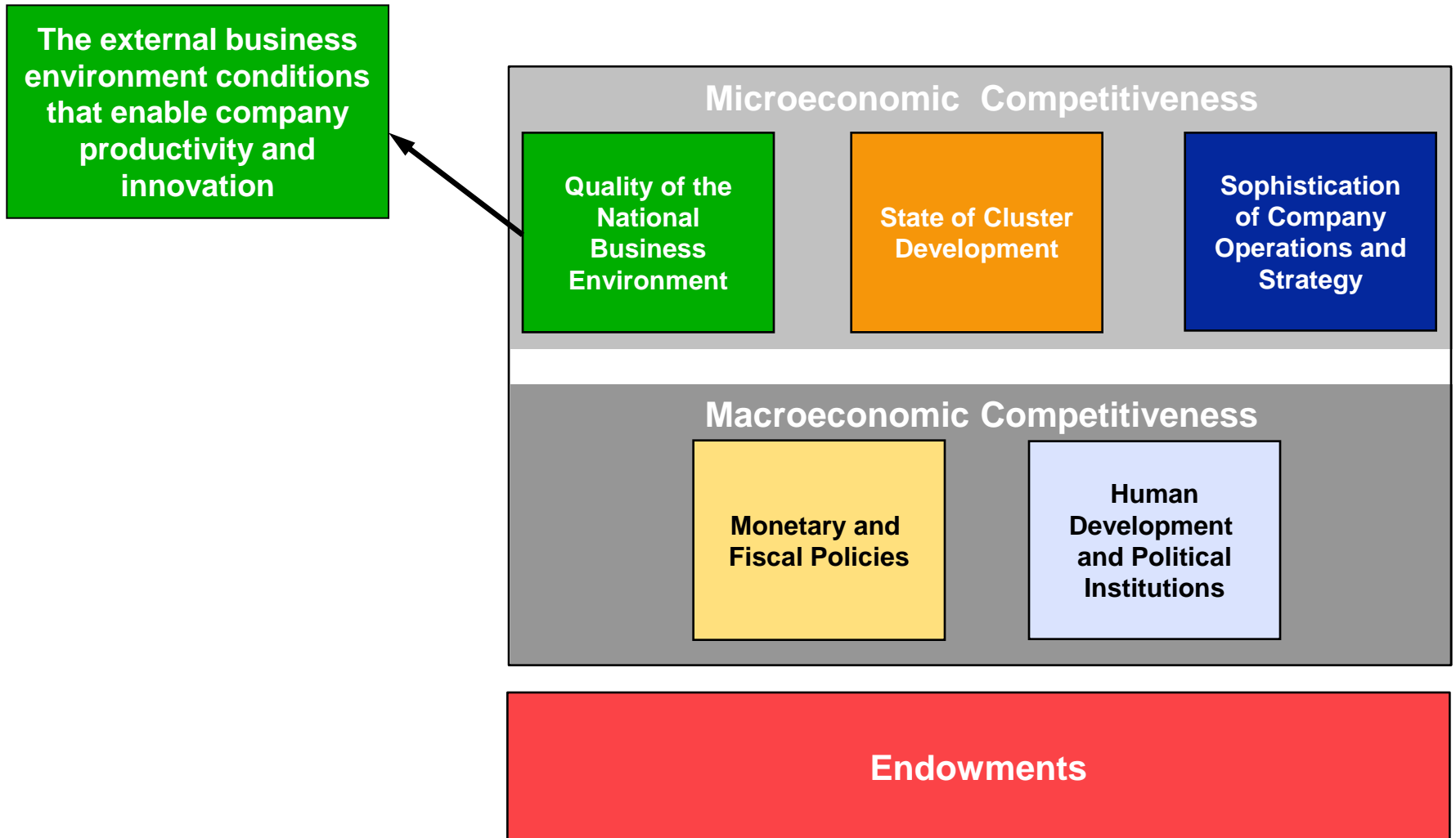
- There is a strong connection between **economic** and **social** development
- Improving competitiveness requires improving the economic and social context **simultaneously**

# A General Framework for Competitiveness



- Productivity ultimately depends on improving the **microeconomic capability** of the economy and the **sophistication of local competition** revealed at the level of regions and clusters
- Macroeconomic competitiveness sets the **economy-wide** context for high productivity to emerge, but is **not sufficient** to achieve this outcome
- Endowments, i.e. **natural resources**, **geographical location**, and **size**, create a **foundation** for prosperity, but true prosperity is created by **productivity in the use of endowments**

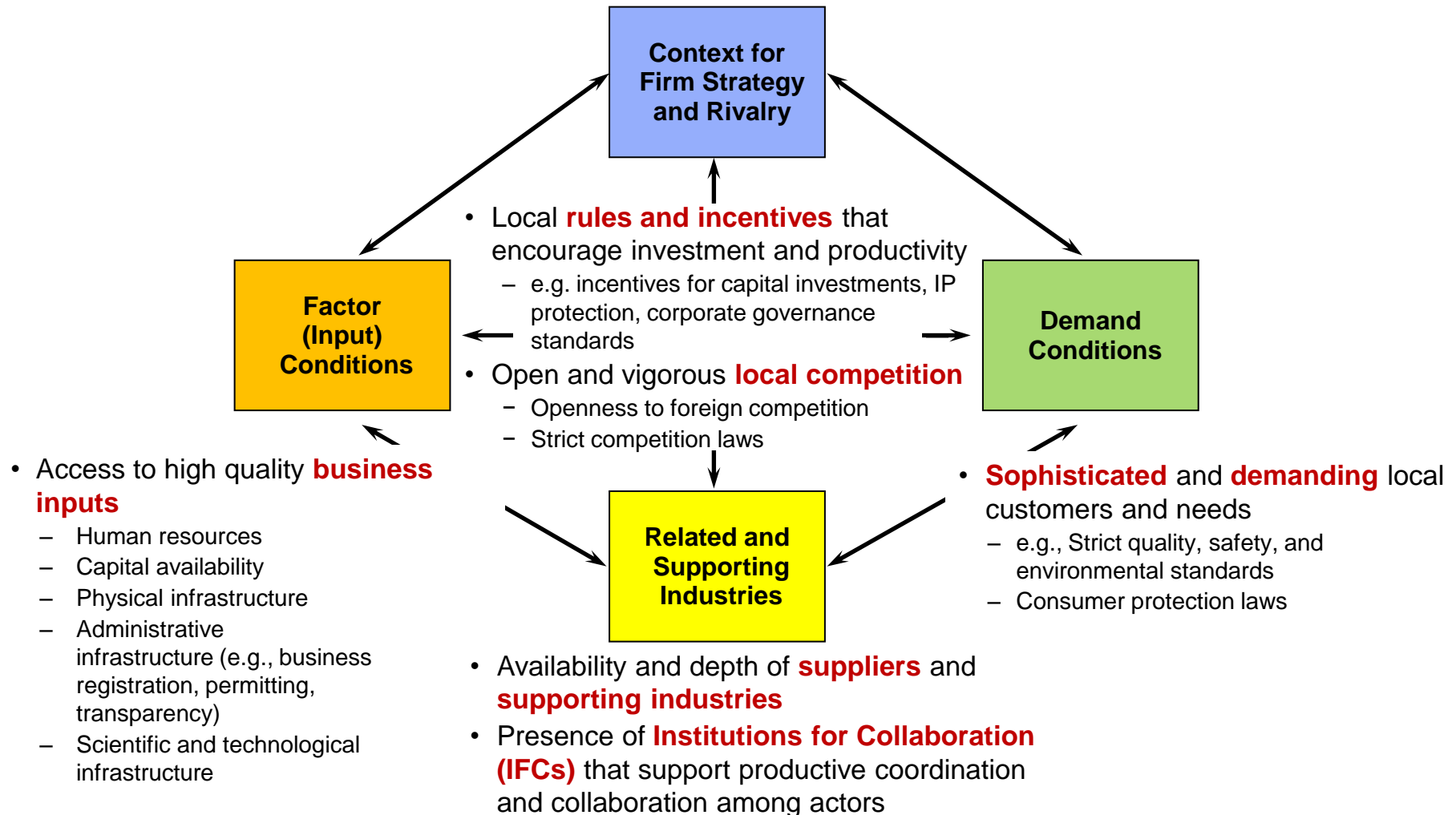
# A General Framework for Competitiveness





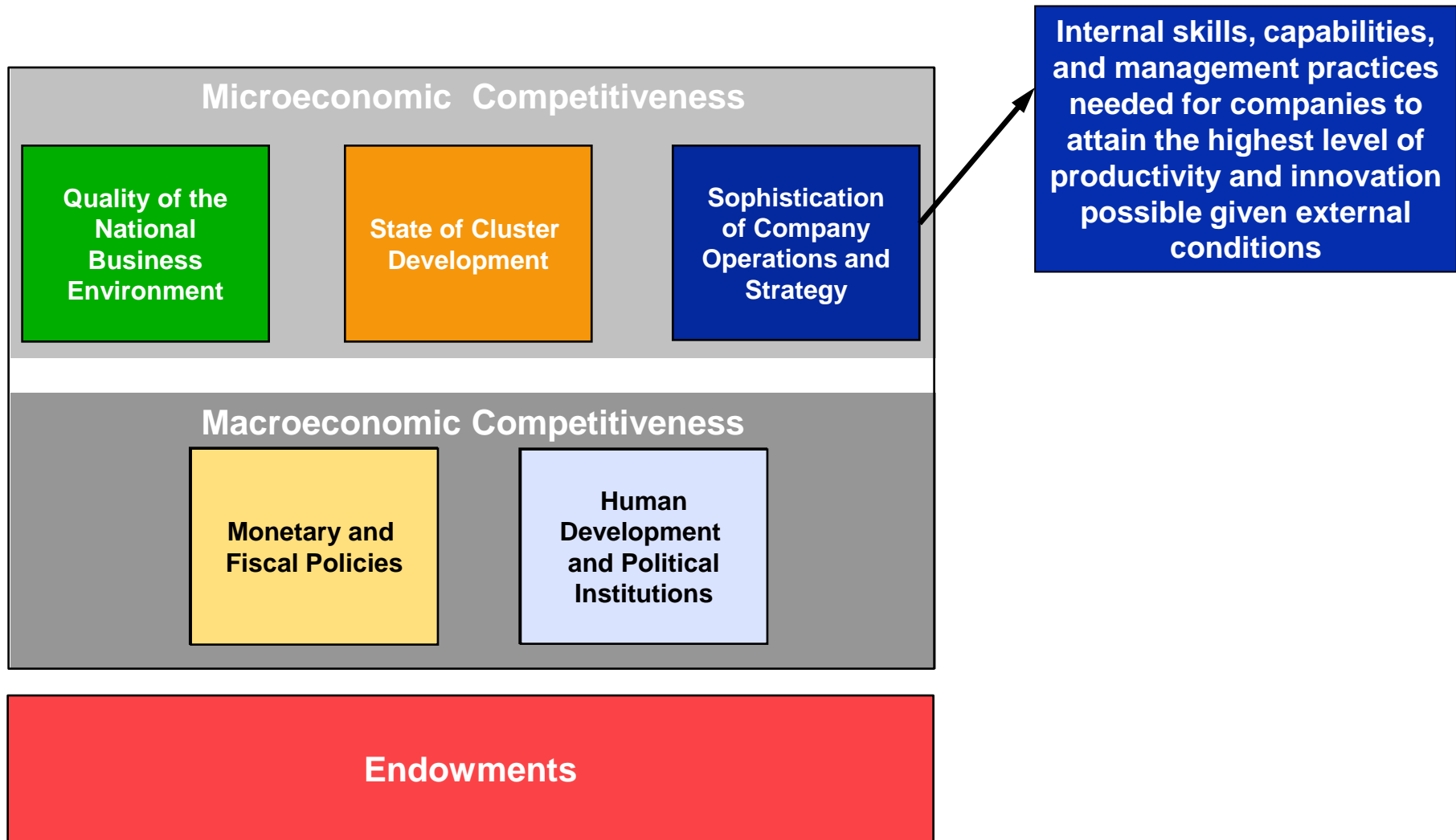
# Improving the Quality of the Business Environment

## The Diamond

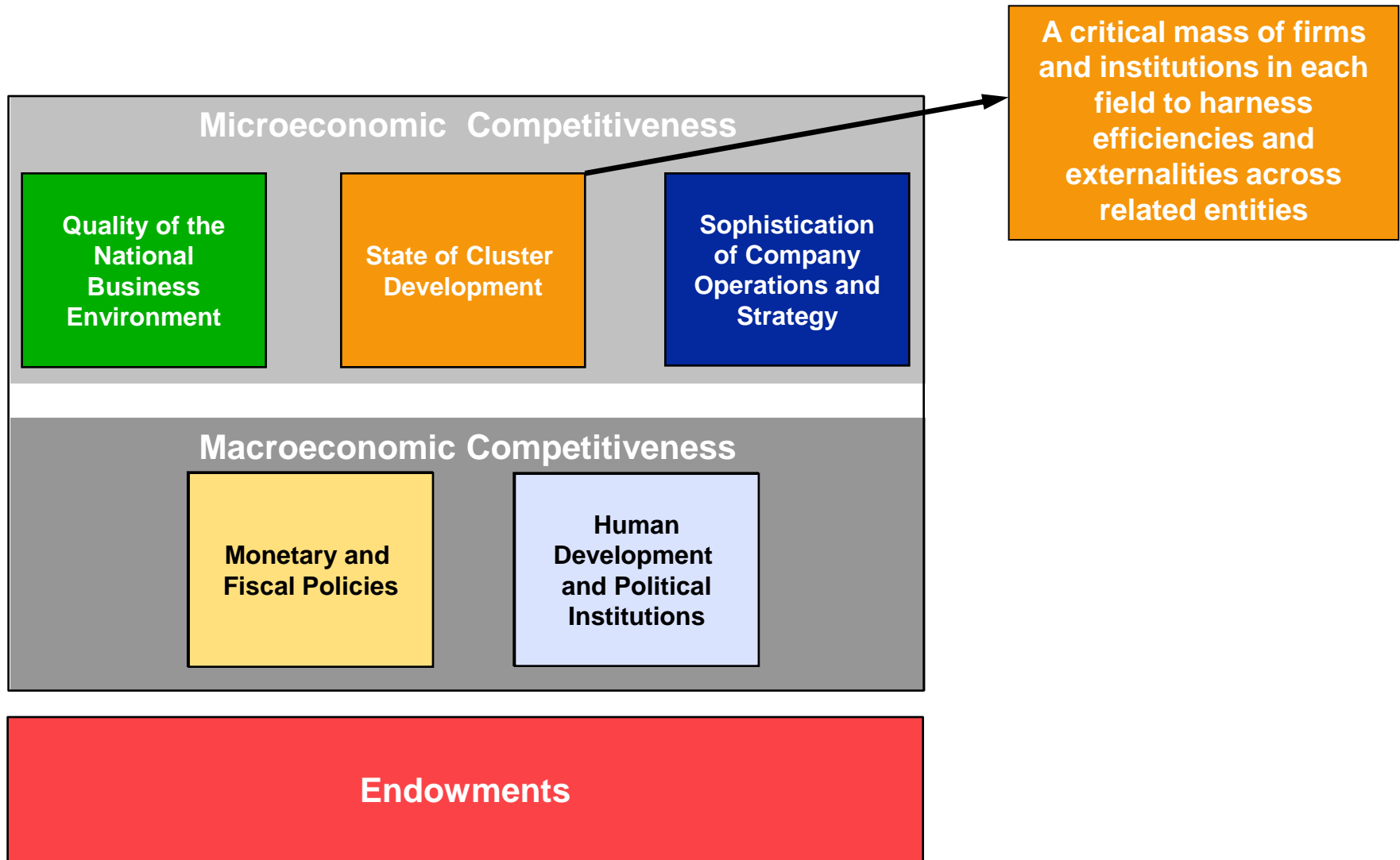


- Many things matter** for competitiveness
- Successful economic development is a process of **successive upgrading**, in which the business environment improves to enable increasingly sophisticated ways of competing

# A General Framework for Competitiveness

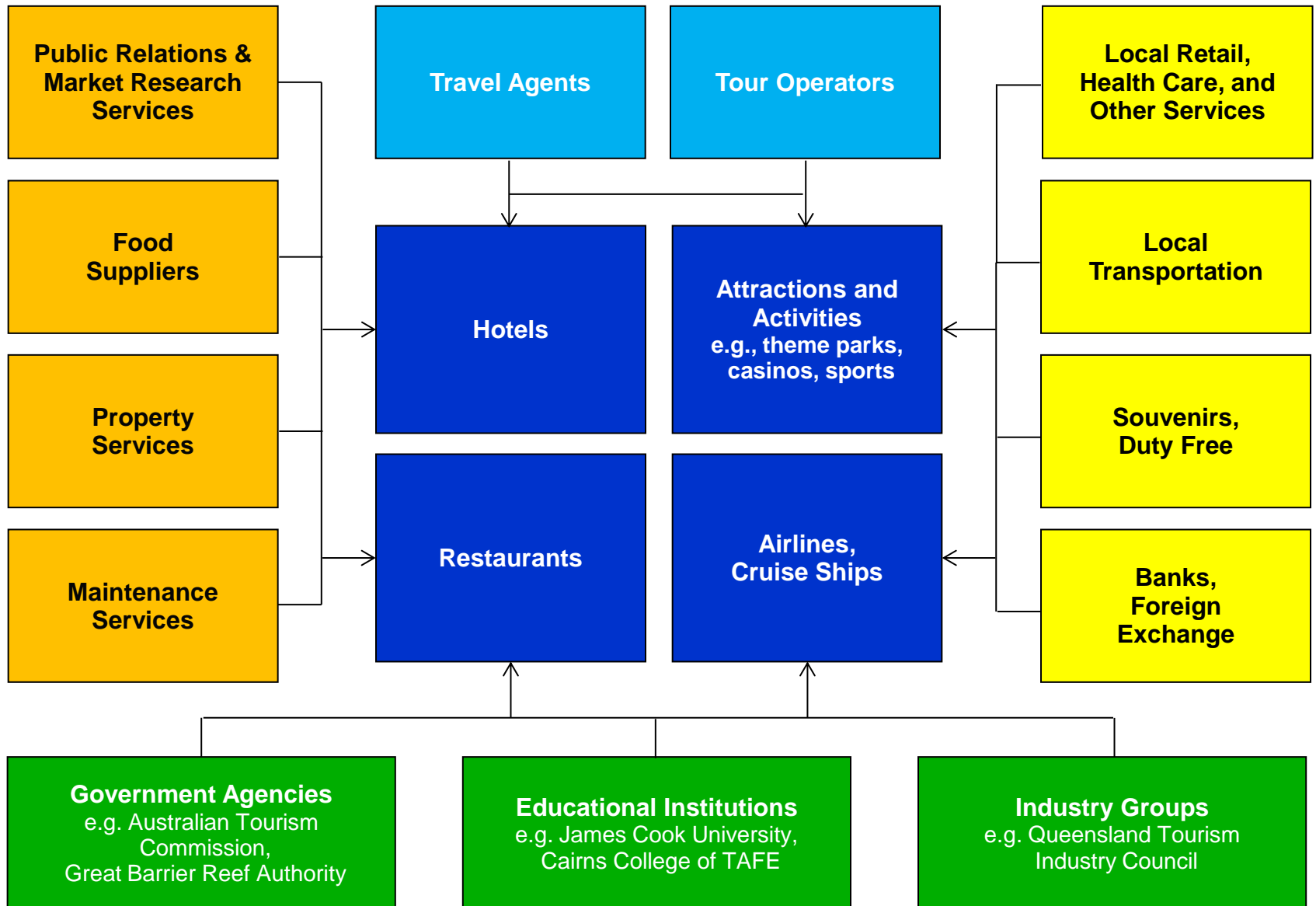


# A General Framework for Competitiveness



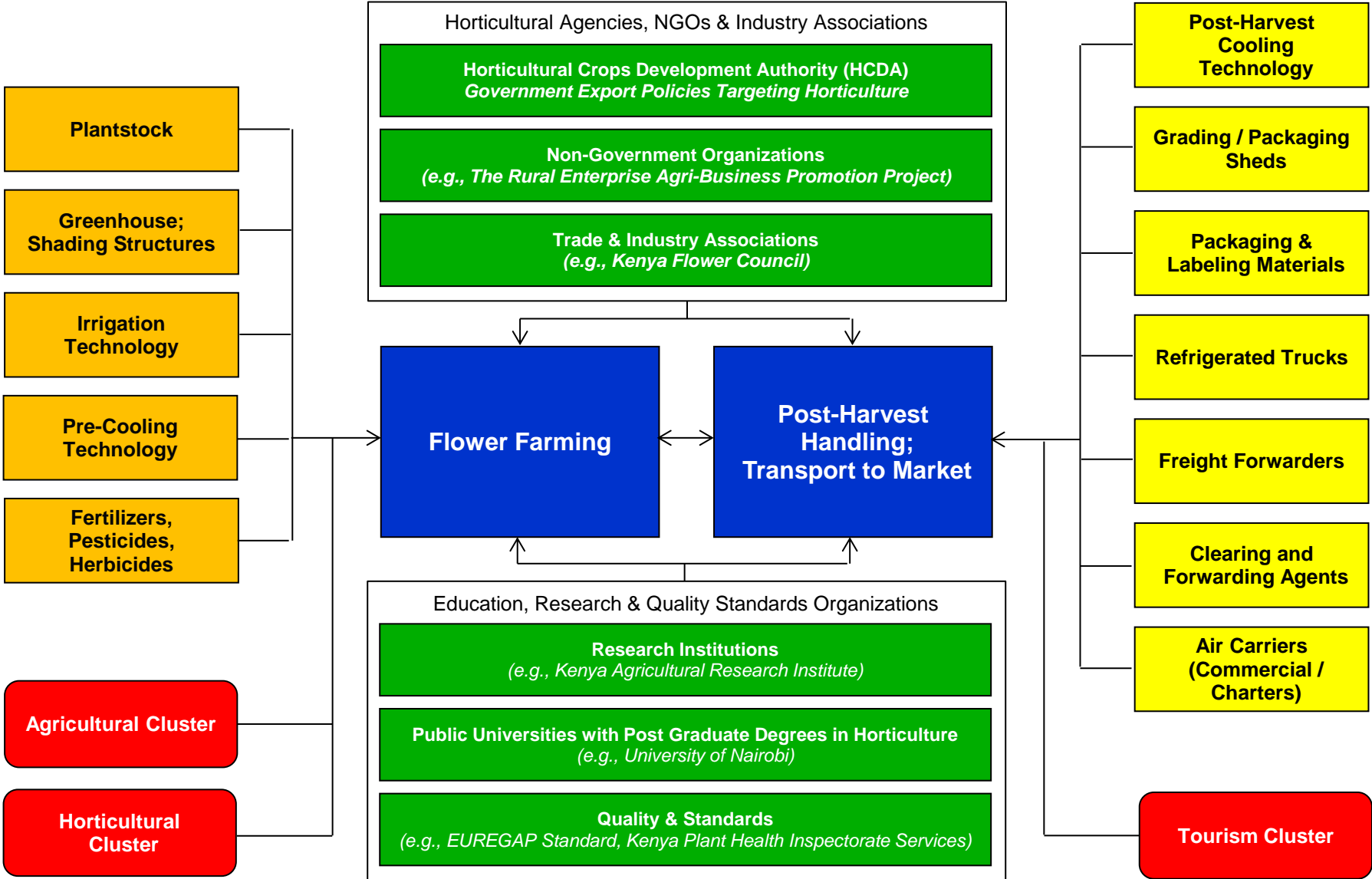
# What is a Cluster?

## Tourism Cluster in Cairns, Australia



# Clusters in Developing Countries

## Cut Flower Cluster in Kenya



Sources: MOC student team research by Kusi Hornberger, Nick Ndiritu, Lalo Ponce-Brito, Melesse Tashu, Tijan Watt, Harvard Business School, 2007

# Clusters and Competitiveness

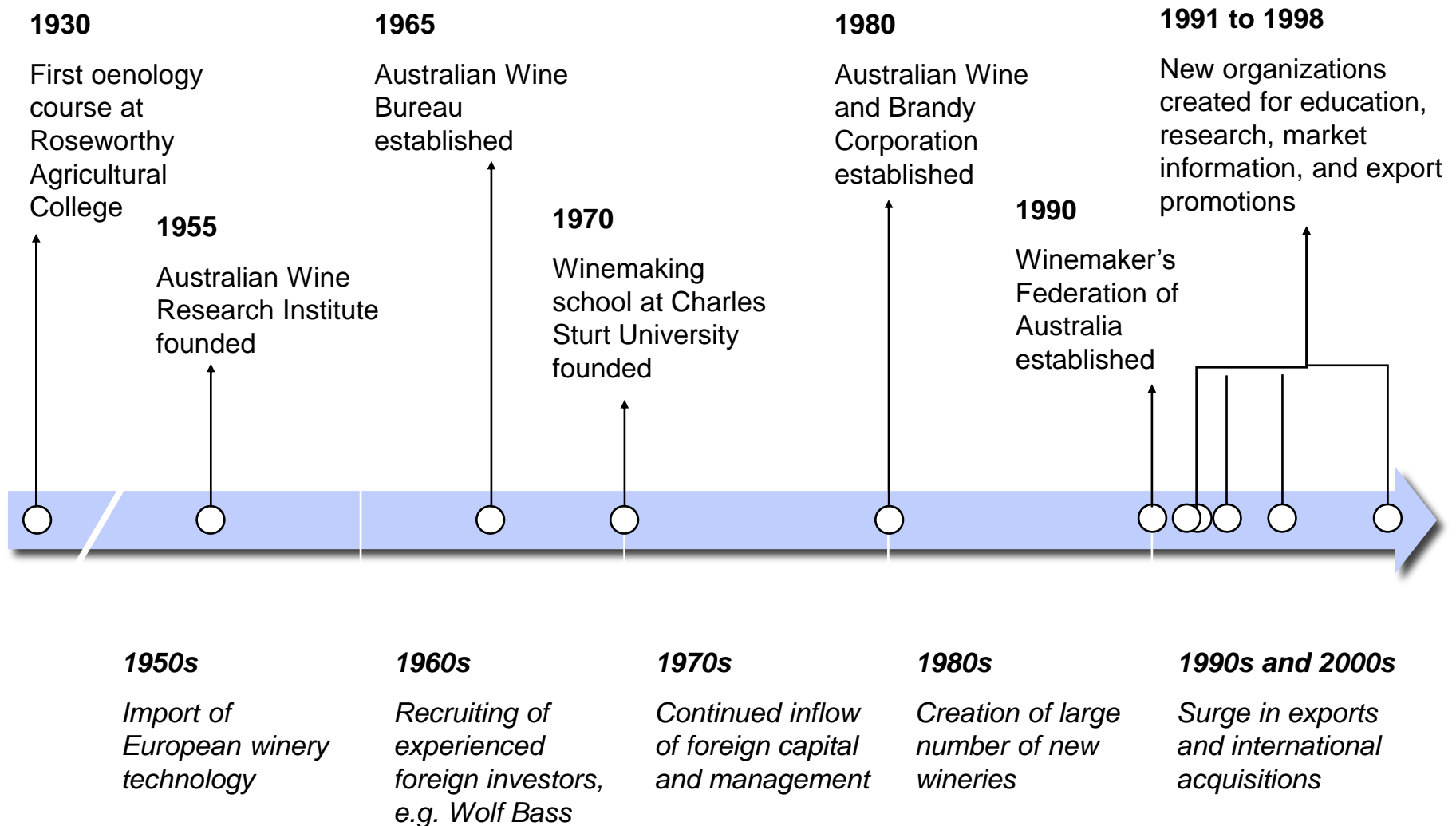
- Clusters **increase productivity** and **operational efficiency**
- Clusters stimulate and enable **innovations**
- Clusters facilitate **commercialization** and **new business formation**



- Clusters reflect the fundamental importance to productivity and innovation of **linkages and spill-overs** across firms and associated institutions

# Cluster Emergence and Development

## The Australian Wine Cluster



# Institutions of Collaboration (IFCs)

## The Australian Wine Cluster

### Winemakers' Federation of Australia

- Established 1990
- Focus: Public policy representation of companies in the wine cluster
- Funding: Member companies

### Cooperative Centre for Viticulture

- Established 1991
- Focus: Coordination of research and education policy in viticulture
- Funding: Cluster organizations

### Australian Wine Export Council

- Established 1992
- Focus: Wine export promotion through international offices in London and San Francisco
- Funding: Government; cluster organizations

### Grape and Wine R&D Corporation

- Established 1991 as statutory body
- Focus: Funding of research and development activities
- Funding: Government; statutory levy

### Wine Industry Information Service

- Established 1998
- Focus: Information collection, organization, and dissemination
- Funding: Cluster organizations

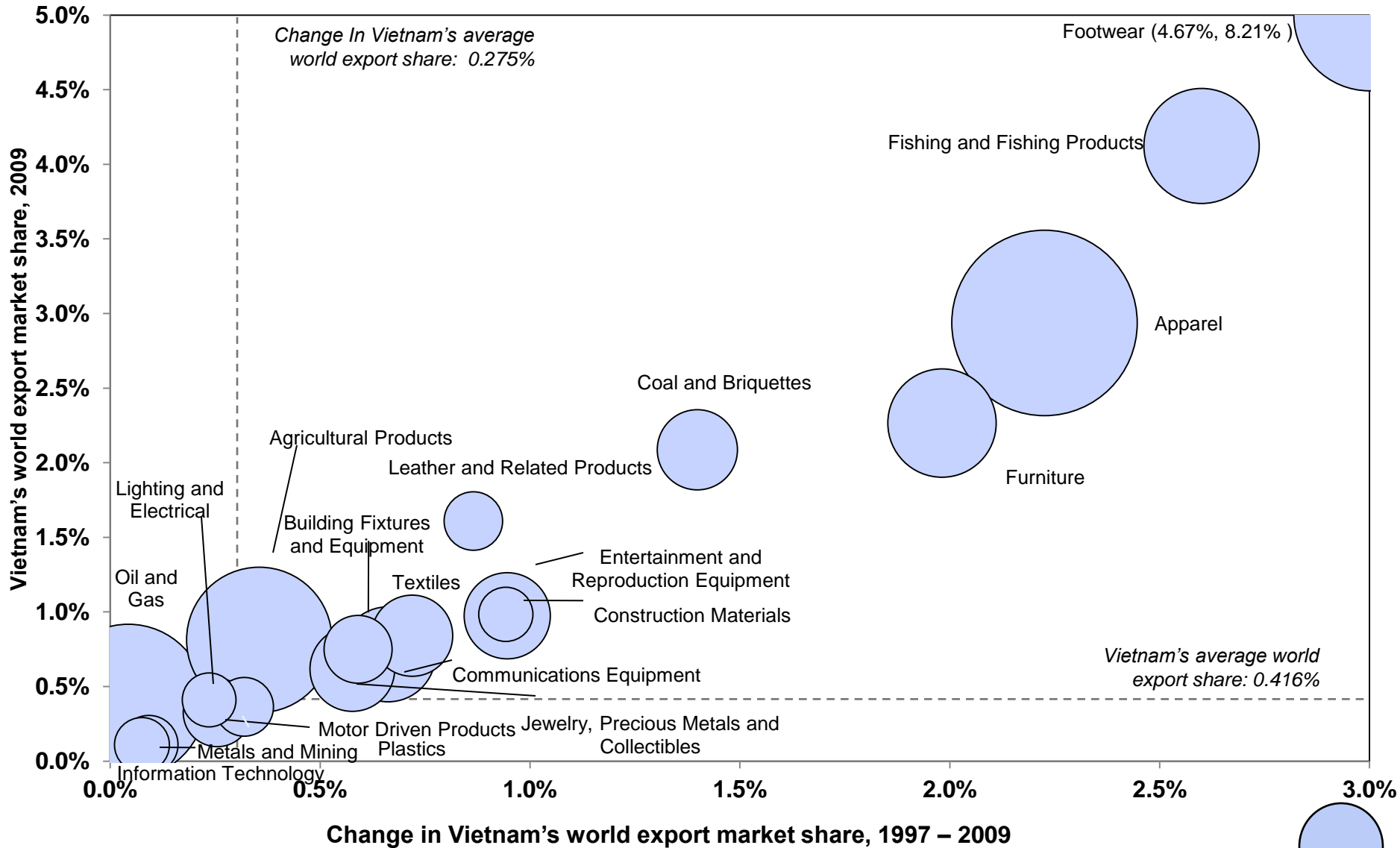
### Wine Industry National Education and Training Council

- Established 1995
- Focus: Coordination, integration, and standard maintenance for vocational training and education
- Funding: Government; cluster organizations

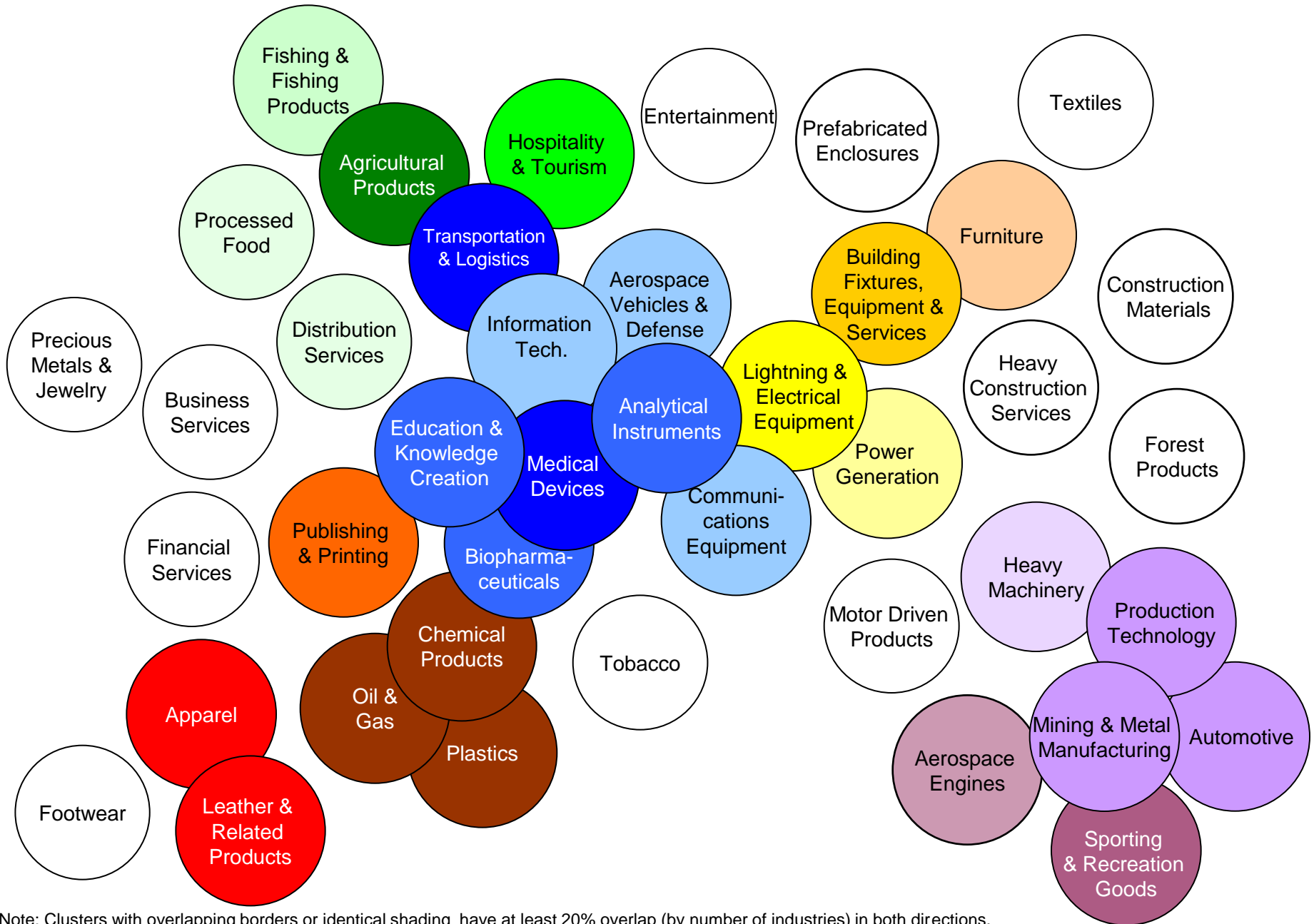


# National Cluster Export Portfolio

## Vietnam, 1997 - 2009



# Clusters and Economic Diversification

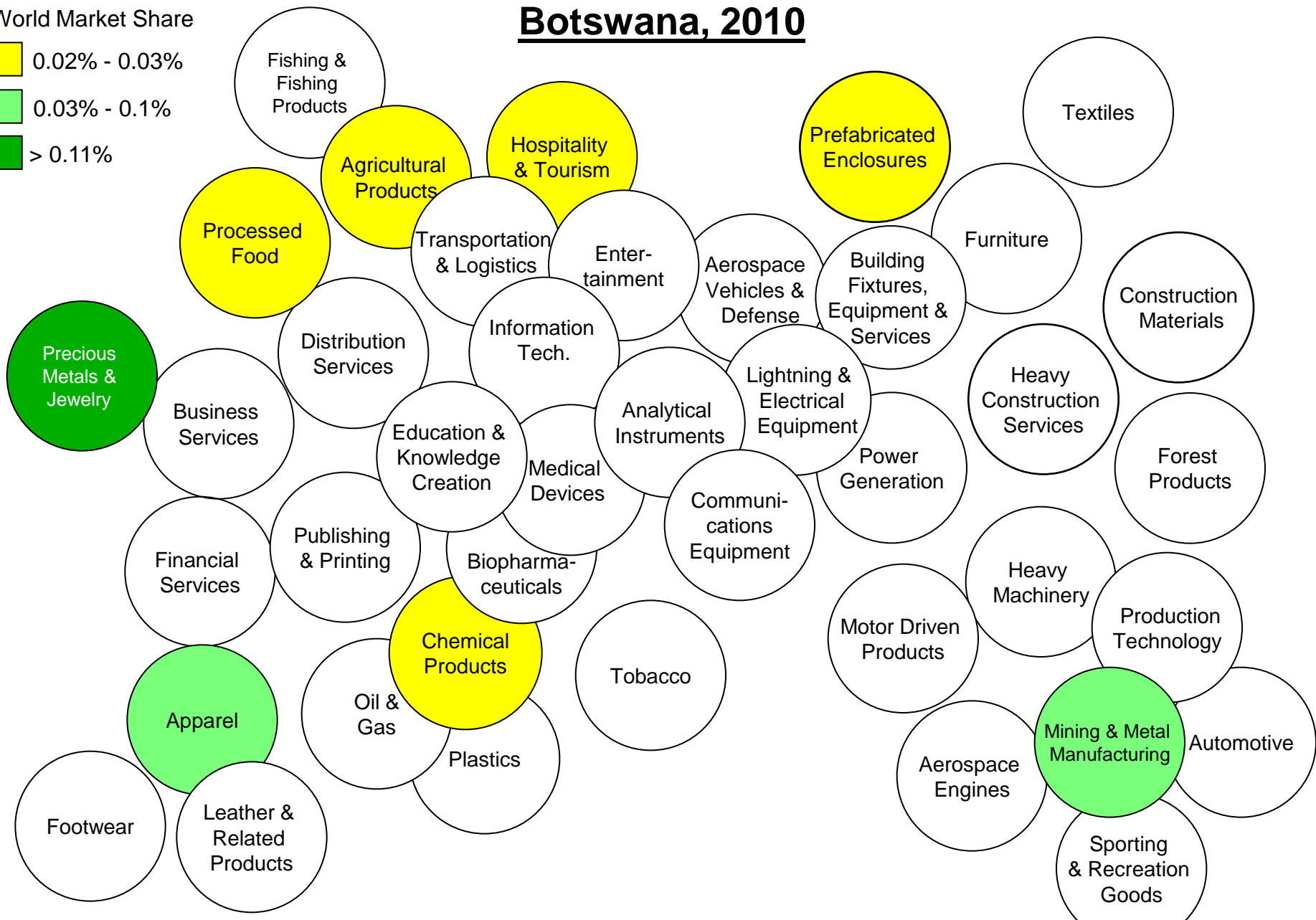


Note: Clusters with overlapping borders or identical shading have at least 20% overlap (by number of industries) in both directions.

# Cluster Linkages and Economic Diversification

## Botswana, 2010

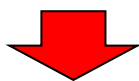
World Market Share



# Determinants of Competitiveness: Implications for Policymaking

## Macroeconomic Competitiveness

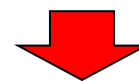
- Largely driven by **central government** decisions
- “Good practice” standards apply **universally**
- **Moderate to low** level of interdependence across policy areas



- Biggest challenge is having the **political will** to implement a generic set of policies

## Microeconomic Competitiveness

- Decisions and actions taken by **many independent actors**
- Action priorities are highly **context dependent**
- High level of **interdependence** across policy areas

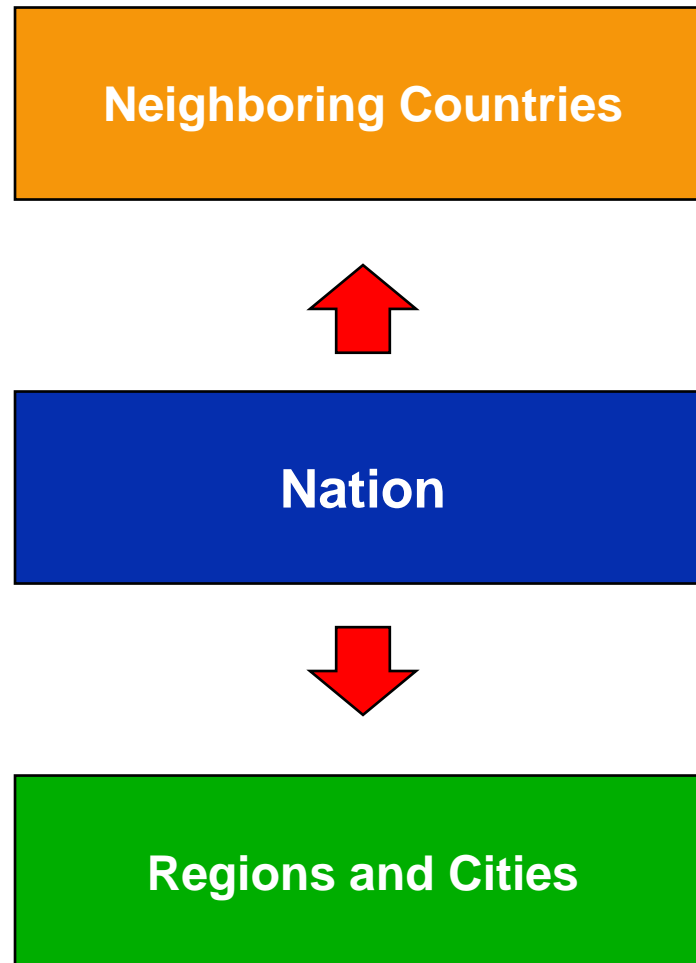


- Central challenge is creating a converging region-specific **strategy** and achieving **consensus** on an **integrated set of actions** to direct limited resources to their highest impact in a given context

# Agenda

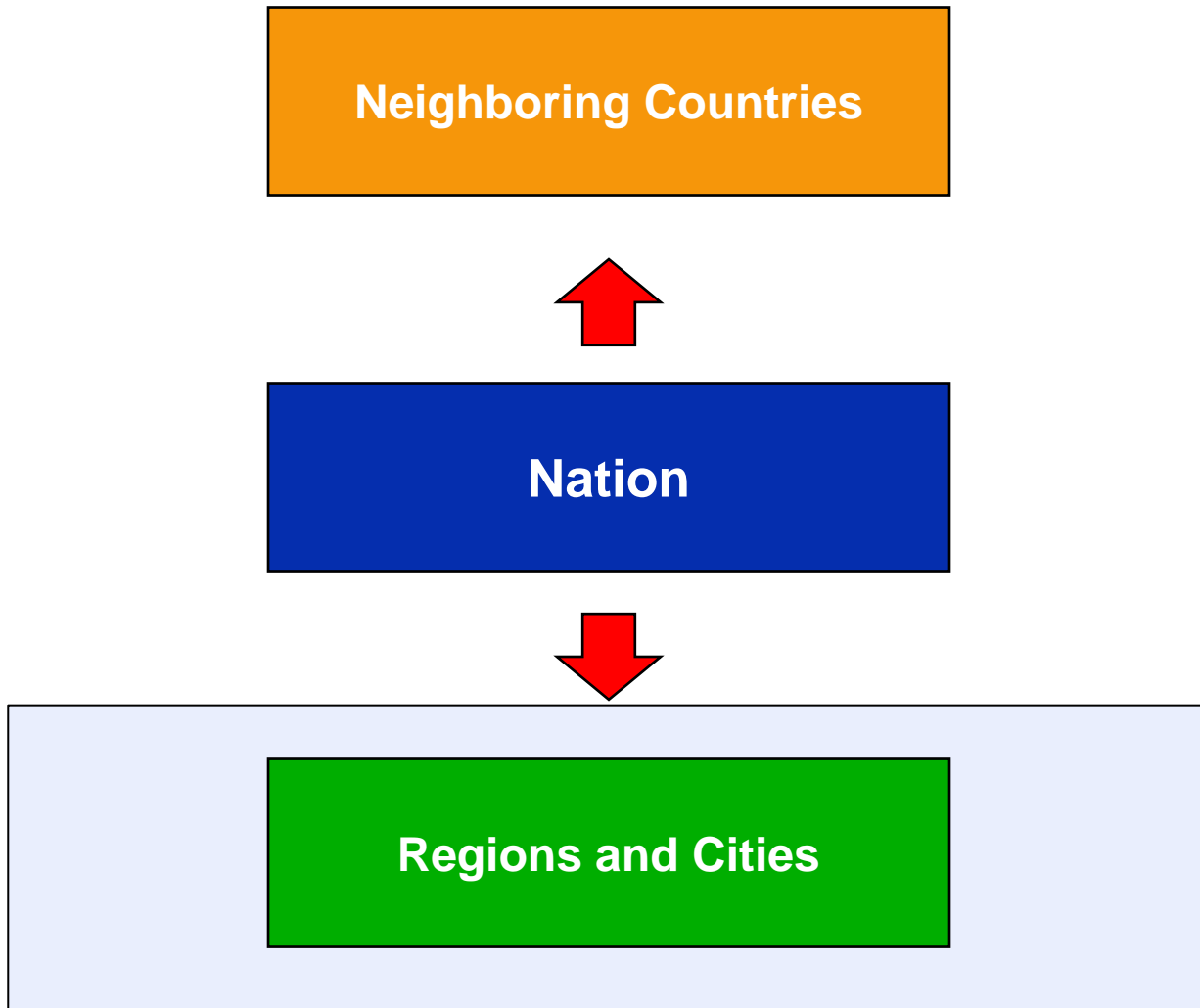
- Competitiveness and Prosperity
- A General Framework for Competitiveness
- **The Role of Geographic Levels in Competitiveness**
- Clusters and Development
- Competitiveness and Economic Development
- Diagnosing Competitiveness
- Economic Strategy
- Organizing for Competitiveness
- The Role of Business: Creating Shared Value
- Implications for the World Bank

# Geographic Influences on Competitiveness



- Regions are the **most important economic unit for competitiveness** in larger countries, especially countries beyond subsistence development

# Geographic Influences on Competitiveness



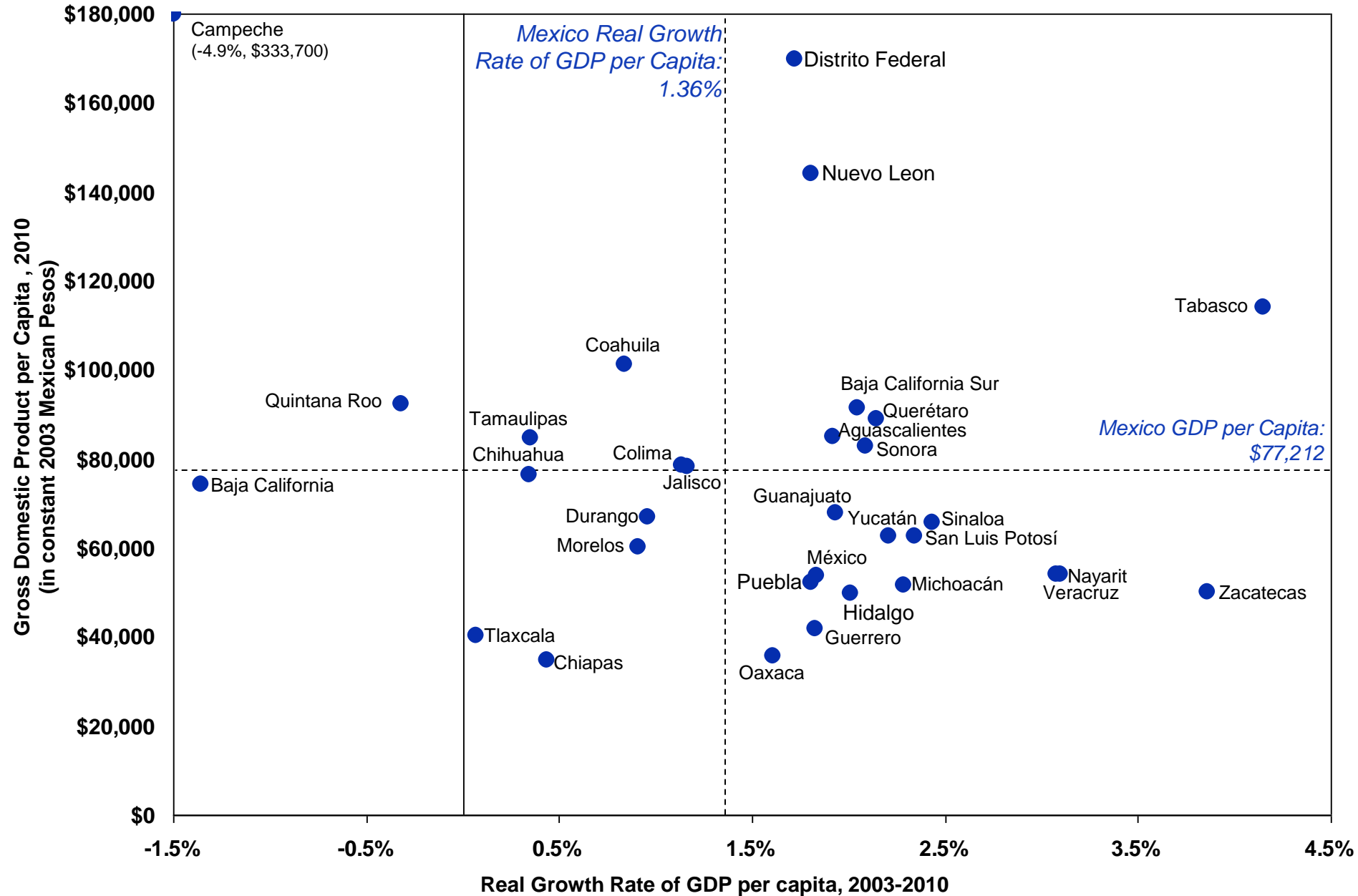
- Regions are the **most important economic unit for competitiveness** in larger countries, especially countries beyond subsistence development

# Regions and Competitiveness

- Economic performance **varies significantly** across sub-national regions (e.g., provinces, states, metropolitan areas)



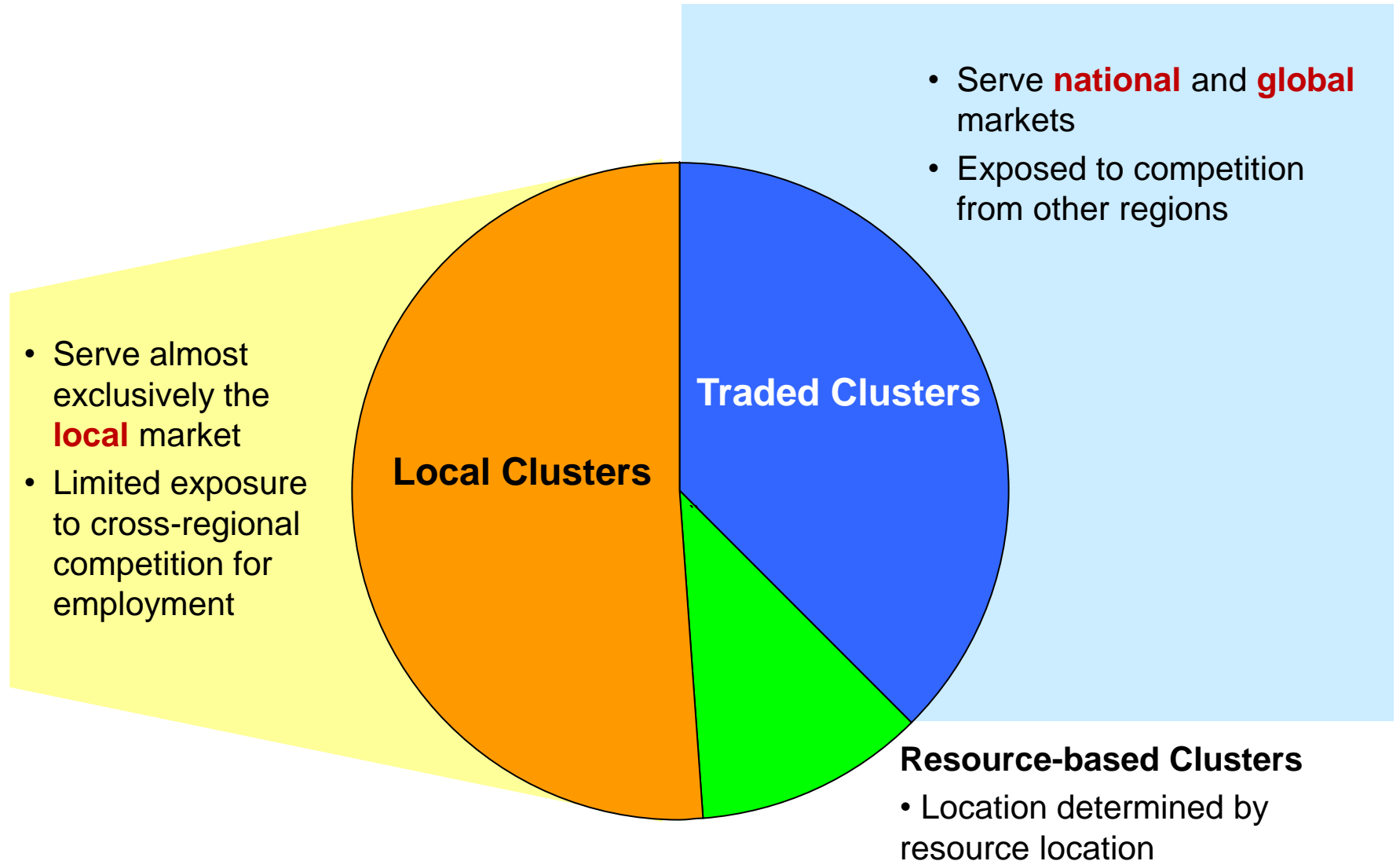
# Prosperity Performance in Mexican States



# Regions and Competitiveness

- Economic performance **varies significantly** across sub-national regions (e.g., provinces, states, metropolitan areas)
- Many of the most important levers of competitiveness actually reside at the **regional level**
- Regions **specialize** in different sets of clusters

# Composition of Regional Economies

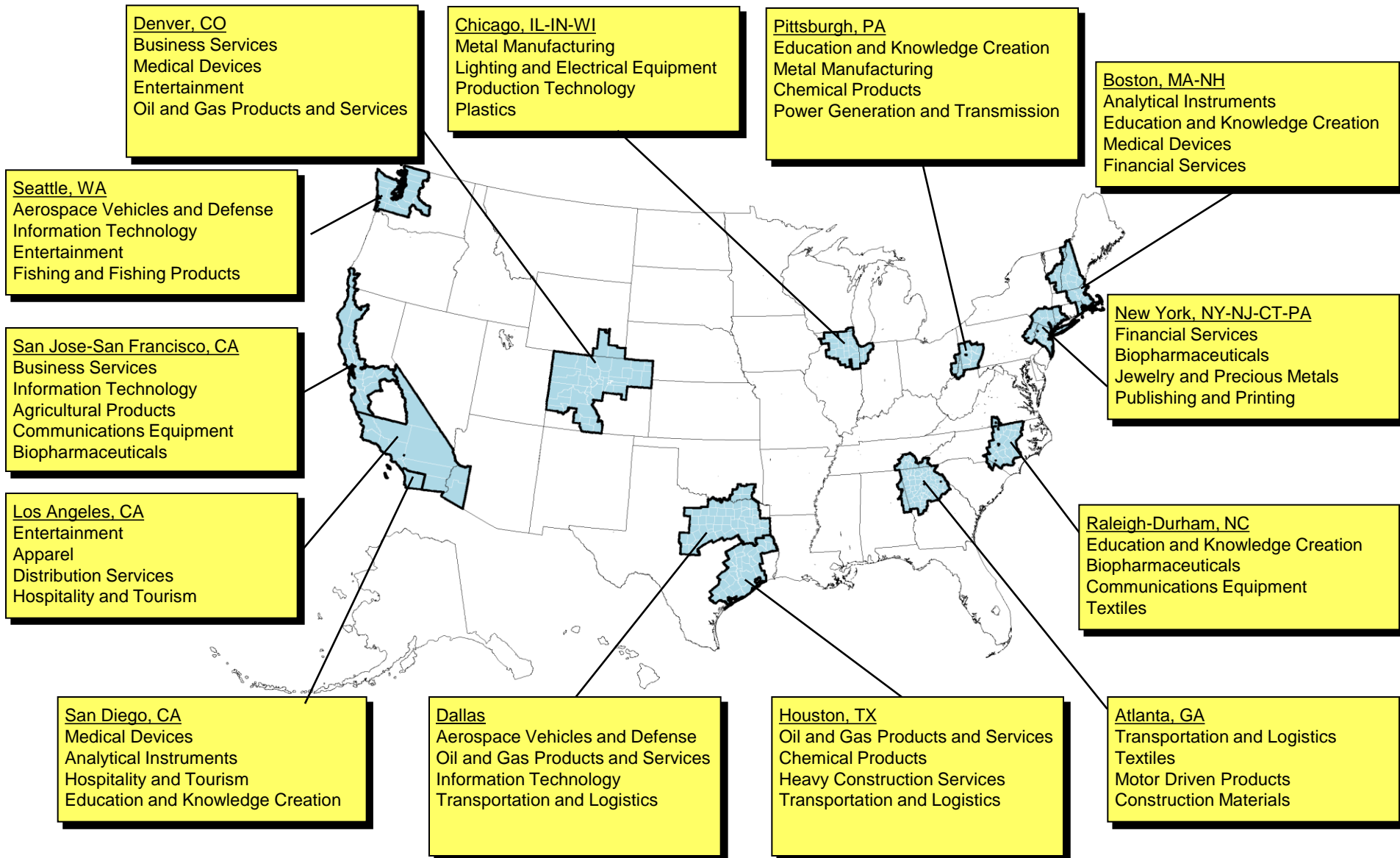


Note: Cluster data includes all private, non-agricultural employment.

Source: Michael E. Porter, Economic Performance of Regions, Regional Studies (2003); Updated via Cluster Mapping Project, Institute for Strategy and Competitiveness, Harvard Business School (2008)

# Specialization of Regional Economies

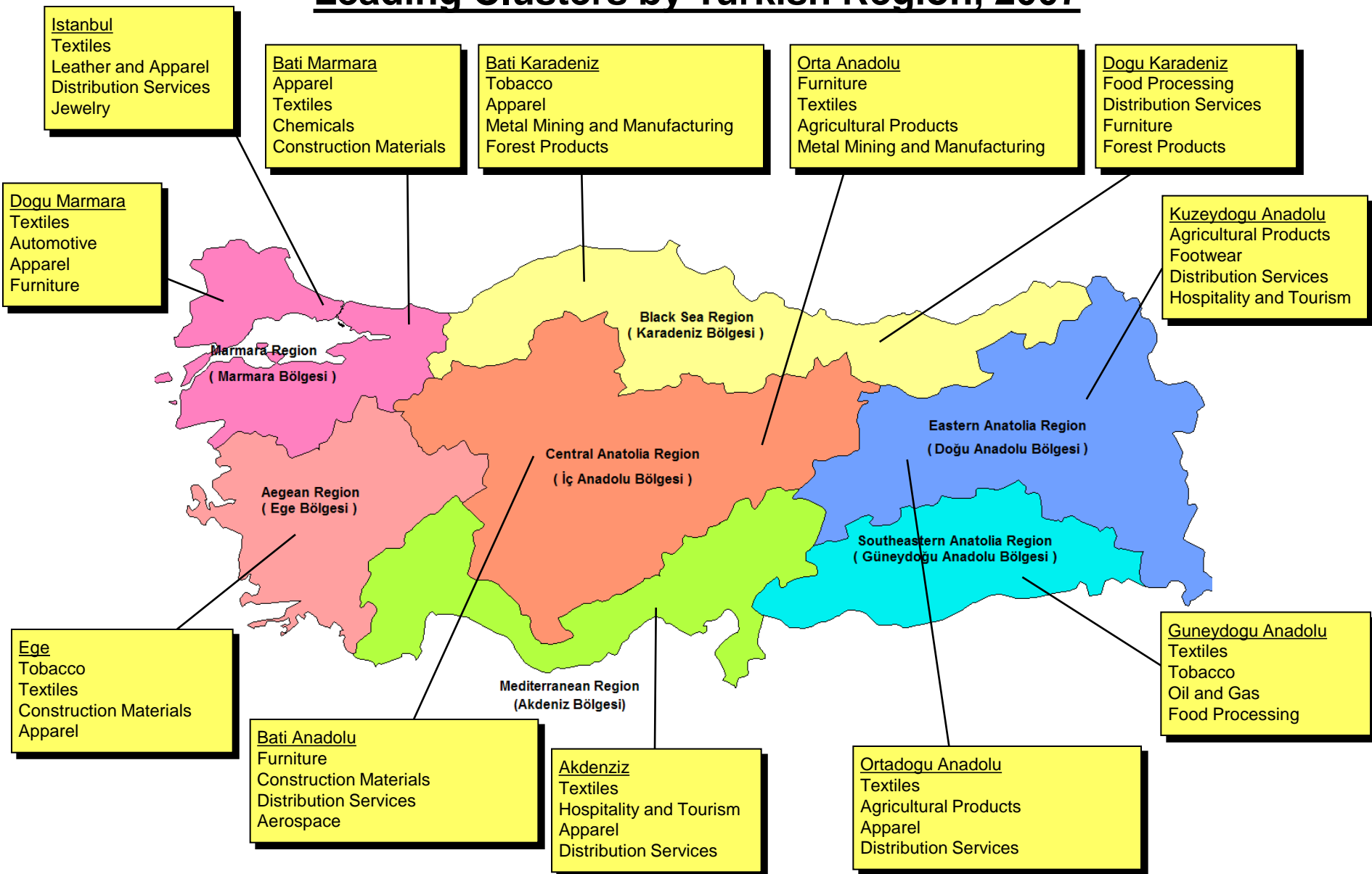
## Leading Clusters by U.S. Economic Area, 2010



Source: Prof. Michael E. Porter, Cluster Mapping Project, Institute for Strategy and Competitiveness, Harvard Business School; Richard Bryden, Project Director.

# Specialization of Regional Economies

## Leading Clusters by Turkish Region, 2007

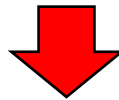


# Regions and Competitiveness

- Economic performance **varies significantly** across sub-national regions (e.g., provinces, states, metropolitan areas)
- Many of the most important levers of competitiveness actually reside at the **regional level**
- Regions **specialize** in different sets of clusters
- **Cluster strength** directly impacts regional performance

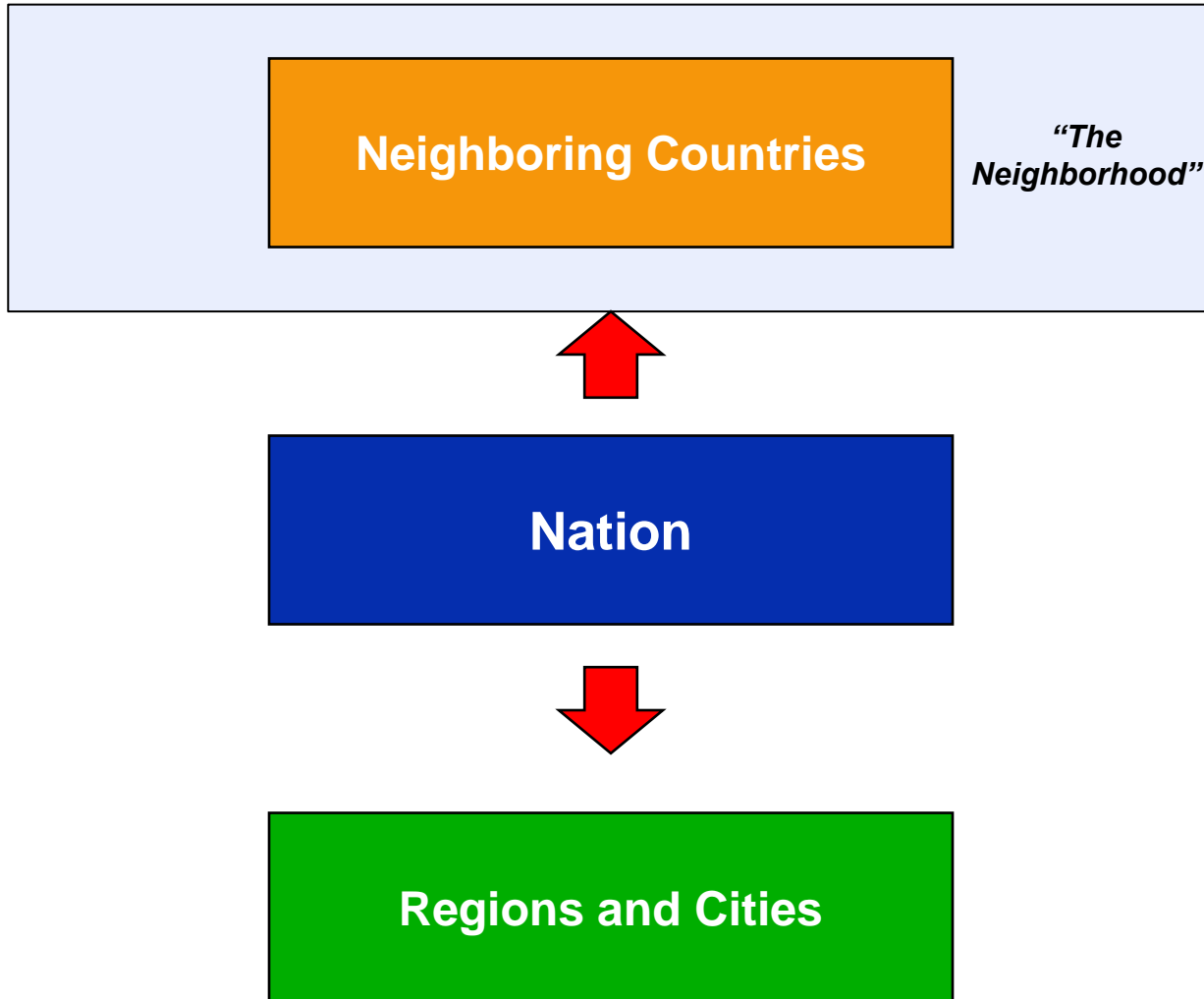
# Regions and Competitiveness

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



- **Decentralization** of economic policy is important to foster regional specialization, internal competition, and greater government accountability
- Effective decentralization requires clarity on Federal versus regional roles and responsibilities, and sufficient **administrative capacity** at local and regional levels

# Geographic Influences on Competitiveness



- Regions are the **most important economic unit for competitiveness** in larger countries, especially countries beyond subsistence development



# Competitiveness and Integration with Neighboring Countries

## Turkey's Neighborhood



- Turkey sits at the crossroad between Europe and the Middle East
- Economic coordination among neighboring countries can significantly enhance competitiveness
- Integration offers greater opportunities than participation in broader economic forums (e.g., EU)

# Competitiveness and the Neighborhood

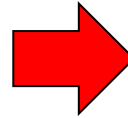
- Opens **trade** and **investment** among neighbors
  - Expands the **available** market for each country
    - A nation's **neighbors** are its most natural trading and investment partners
  - The natural **path of internationalization** for local firms is the neighborhood
  - Open trade and investment make each **country** a more attractive location for investment
- Drives **improvements in the business environment**
  - Captures **synergies** in policy and infrastructure
- Harnesses improvements in **clusters** that cross borders
- Gains greater clout in **international negotiations**
- Helps **overcome domestic political and economic barriers** to reform

# Models of Regional Economic Cooperation

## Traditional model

**Market  
Opening**

- Countries create **free trade areas, customs unions** or **common markets**



## Broader model

**Competitiveness  
Upgrading**

- Opening trade and investment is accomplished by regional cooperation on **multiple dimensions of competitiveness**

# Economic Integration Among Neighbors

## Capturing Synergies

### Factor (Input) Conditions

- Improving the efficiency of the regional **transportation network**
- Creating an efficient **energy** network
- Enhancing regional **communications** and **connectivity**
- Harmonizing **administrative requirements** for businesses
- Linking **financial markets**
- Facilitating the movement of students for **higher education**

### Context for Strategy and Rivalry

- Eliminating **trade and investment barriers** within the region
- Simplifying and harmonizing **cross-border** regulations and paperwork
- **Opening up rivalry** in each country
- Coordinating **anti-monopoly** and **fair competition policies**
- Harmonizing **IP protection**

### Demand Conditions

- Opening **government procurement** within the region
- Harmonizing **environmental standards**
- Harmonizing product **quality, safety** and **technical standards**
- Establishing reciprocal **consumer protection laws**

### Related and Supporting Industries

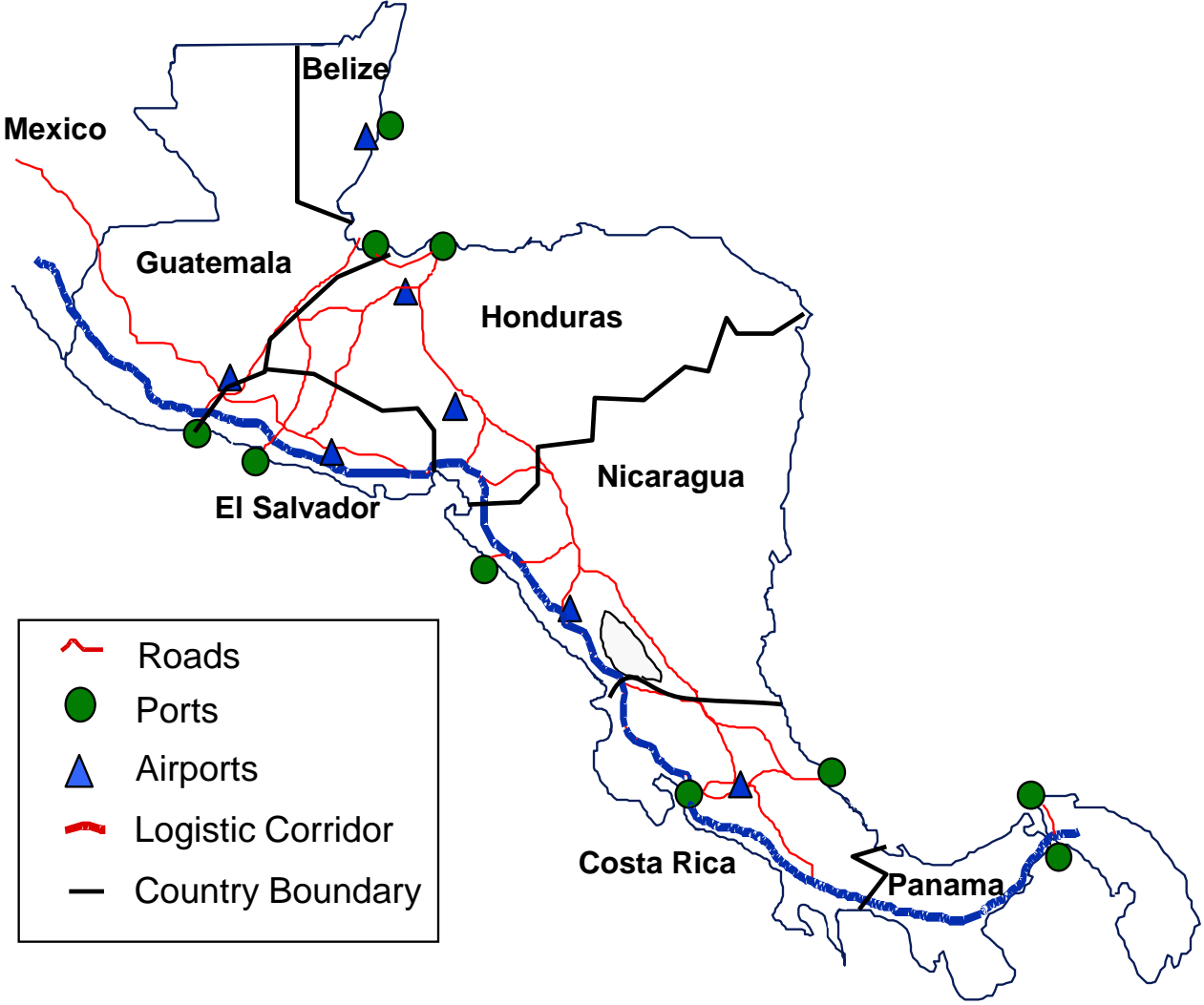
- Facilitating **cross-border cluster development**
  - e.g., Supplier networks
  - Efficient transport and logistics
  - Quality standards

### Macroeconomic Competitiveness

- Coordinating **macroeconomic** policies
- Coordinating programs to improve **security** and **public safety**

# Competitiveness and Integration with Neighboring Countries

## Central American Logistical Corridor



# Pitfalls in Regional Coordination

- An overly broad **set of countries**
- An overly broad **agenda**
- Focus on **politics** versus economics; **form** versus substance
- **Bureaucratization** and complexity
- Lack of a concrete **legal, funding, decision-making, and implementation** structure
- Lack of involvement by **top national leaders**
- Weak political institutions at the **national level**
- **Foreign aid** is traditionally organized by recipient country, creating challenges for cross-national programs
- History of **conflicts**, in part because of the colonial legacy that defined borders cutting across ethnic and economic regions

# Agenda

- Competitiveness and Prosperity
- A General Framework for Competitiveness
- The Role of Geographic Levels in Competitiveness

- **Clusters and Development**

- Competitiveness and Economic Development
- Diagnosing Competitiveness
- Economic Strategy
- Organizing for Competitiveness
- The Role of Business: Creating Shared Value
- Implications for the World Bank

# Sectorial Influences on Competitiveness

## Impact on Productivity

### Narrow Industry

- Industry-level economies of scale

### Cluster

- Cluster-specific business environment conditions
- Agglomeration of related and supporting industries

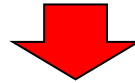
### Economy-Wide

- Cross-cutting business-environment condition



# Microeconomic Competitiveness: General Business Environment vs. Clusters

- Traditional approaches towards improving microeconomic competitiveness have focused on conditions cutting **across the entire economy**
  - Sectorial action has been seen as tantamount to industrial policy intervention in markets process that reduces productivity



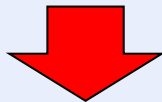
- Recent research has challenged this view
  - Externalities across geographically proximate related firms and institutions are **numerous** and **profoundly important** for productivity and productivity impact
  - Many aspects of the **business environment** that drive performance are cluster-specific
  - Cluster composition and strength is **critical for economic outcomes**
- The new cluster-based policy approach is radically different from old style industrial policy
  - Focus on clusters of **co-located groups of related industries**, not on individual firms or narrow industries
  - All existing or emerging clusters are **good** and can contribute to productivity impact
  - Focus on efforts to **raise productivity** through enhancing the business environment, not on increasing scale or profitability through barriers to competition

# Sectorial Policies: Contrasting Views

## *“What you do”*

***“Structural Transformation”***  
*(Lin)*

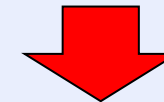
***“Economic Complexity”***  
*(Hausmann, Rodrik)*



- To get rich, do what rich countries do

## *“How you do it”*

***Clusters***



- To get rich, do what you do best

# Clusters and Economic Outcomes: Prosperity

## The Evidence

### Determinants of Regional Job Growth, Wages, and Patenting

- Specialization in **strong clusters**
- **Breadth** of position within each cluster
- Positions in **related clusters**
- Presence of a region's clusters in **neighboring regions**

*And...*

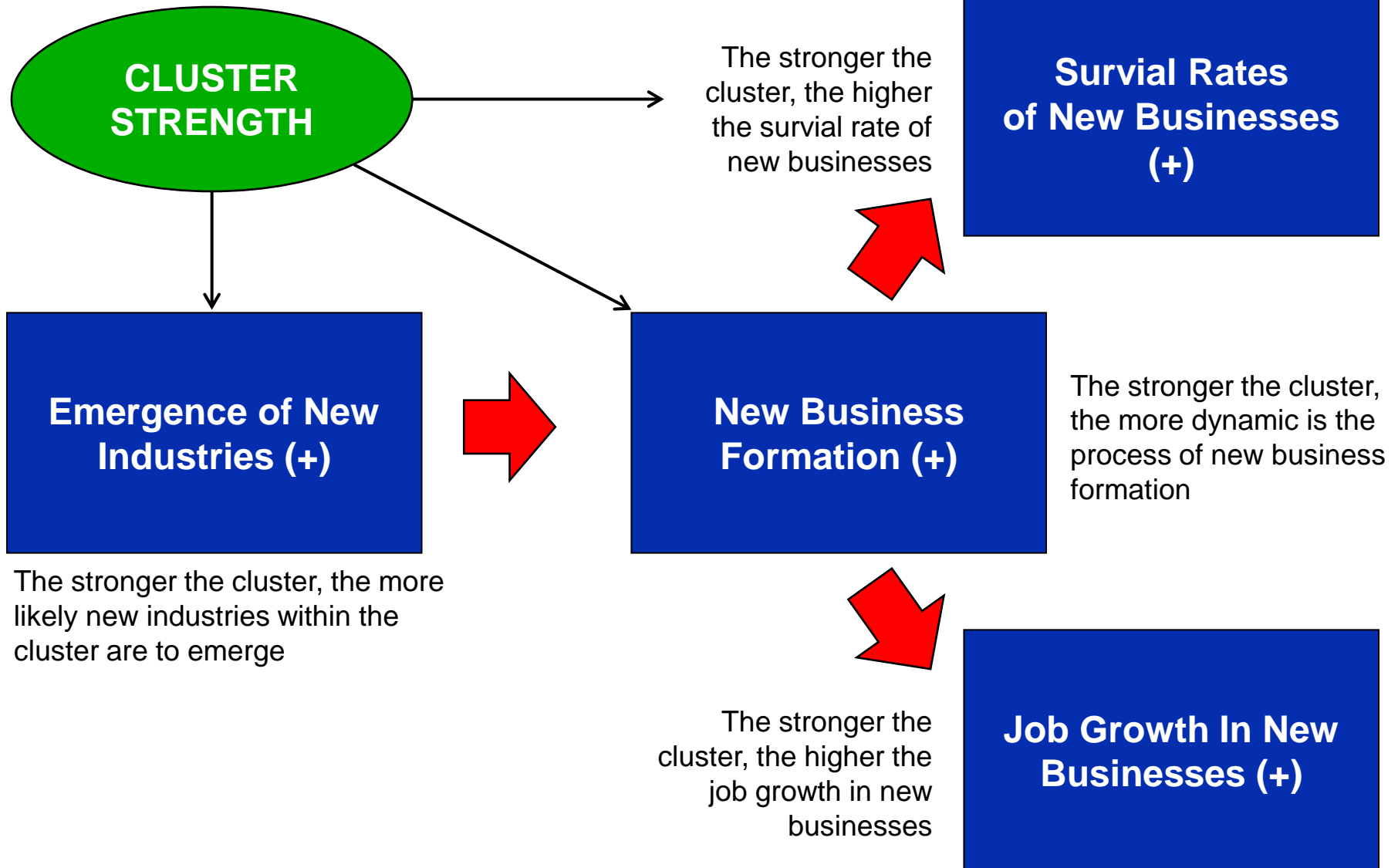
- Cluster mix is significantly **less important** than cluster strength

### Quantifying the effects

- Regional cluster portfolio strength explains close to 40% of variation in regional wages/GDP per capita (Porter, 2003; EU, 2008)
- Doubling regional cluster strength increases the regional average wage by 40% (Porter, 2003)
- One standard deviation increase in cluster strength raises the annual employment growth rate at the **industry** level by 3% (Delgado/Porter/ Stern, 2011)
- The entry of large plants into a cluster raises TFP in other companies by 20% over five years (Greenstone, 2008)

# Clusters and Economic Outcomes: Entrepreneurship

## The Evidence

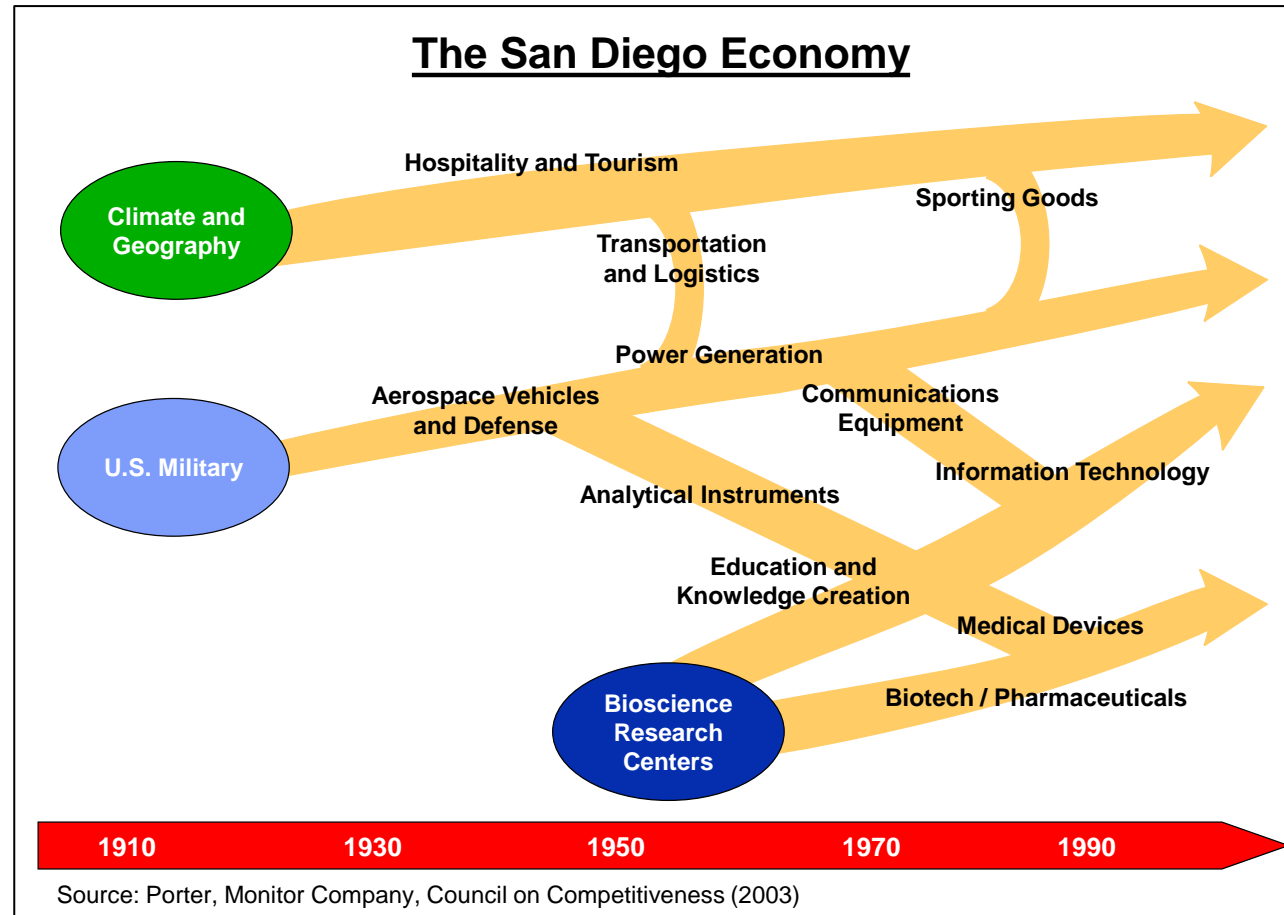


Source: Porter, The Economic Performance of Regions, Regional Studies, 2003; Delgado/Porter/Stern, Clusters and Entrepreneurship, Journal of Economic Geography, 2010; Delgado/bPorter/Stern, Clusters, Convergence, and Economic Performance, mimeo., 2010.

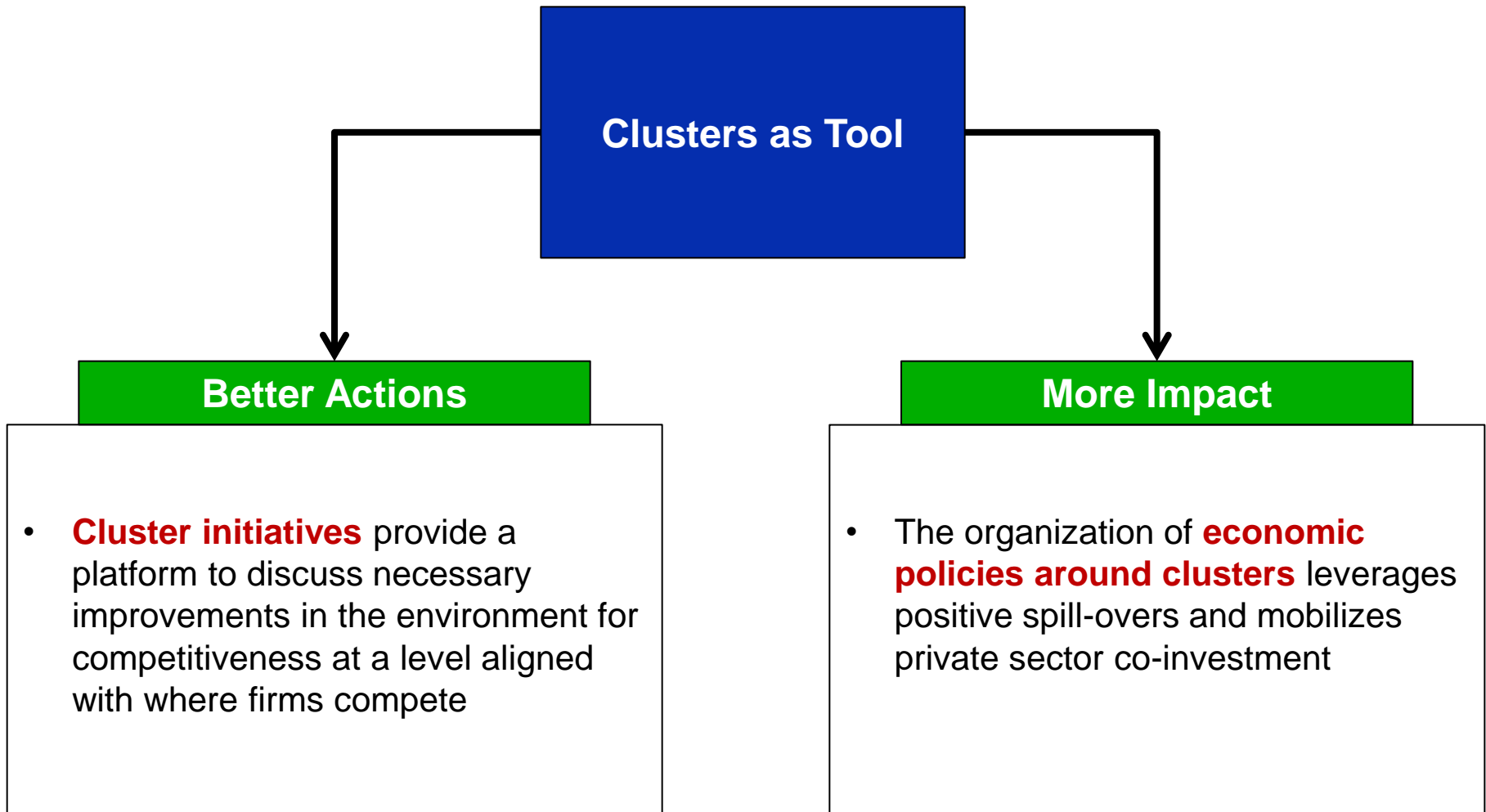
# Clusters and Economic Outcomes: Diversification

## The Evidence

- The existing cluster portfolio in a region has a significant impact on the **evolutionary path of the regional economy** (Neffke et al, 2009; Boschma et al. 2011)
- Clusters provide a powerful analytical tool to understand economic **diversification** and the **emergence of new economic activities**



# Cluster Initiatives as a Tool for Competitiveness



# Cluster Initiatives

## The Role of Government

### Government should

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

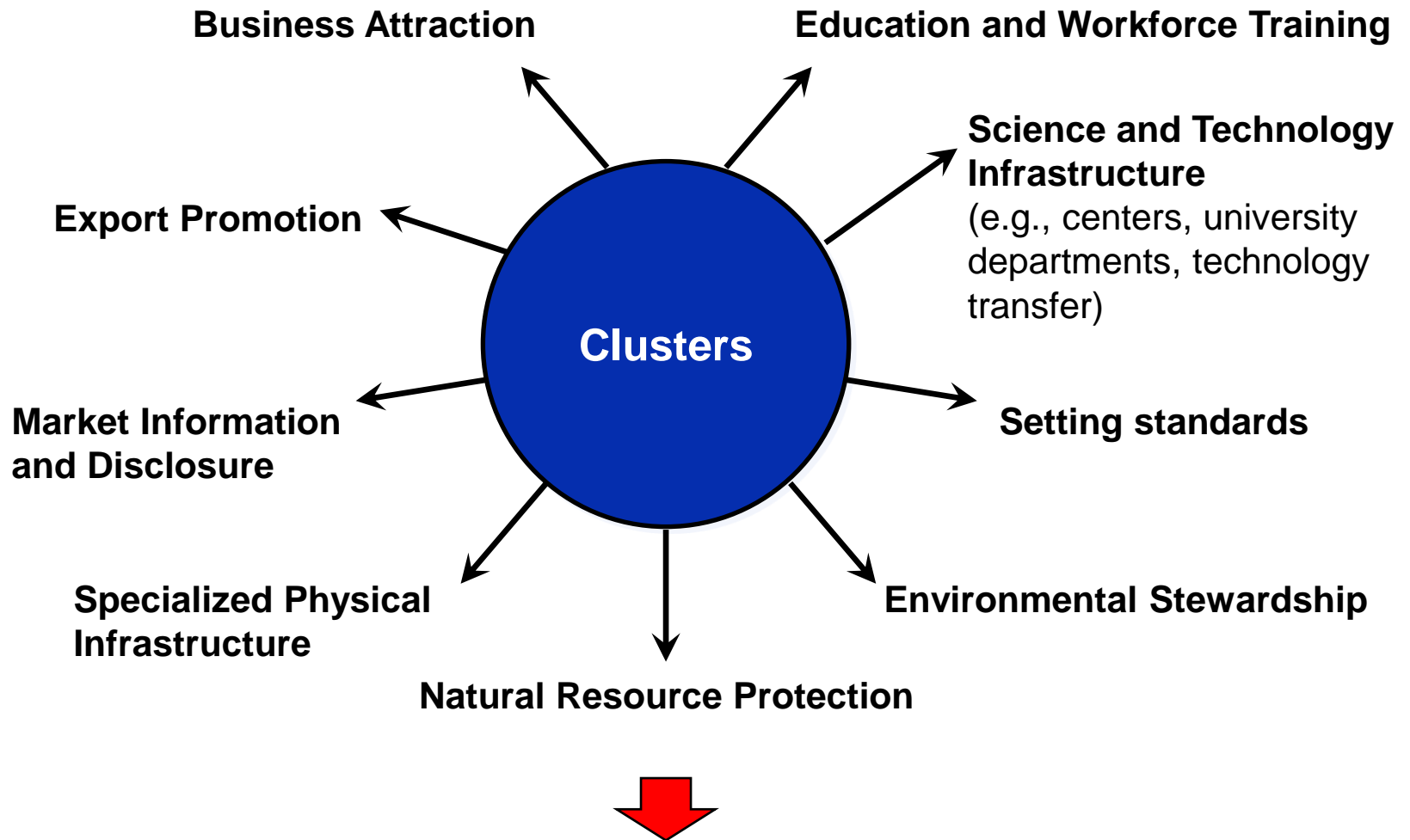
### Government may

- Initiate/ Convene
- Co-Finance

### Government should not

- Pick favored clusters
- Pick favored companies
- Subsidize or distort competition
- Define cluster action priorities

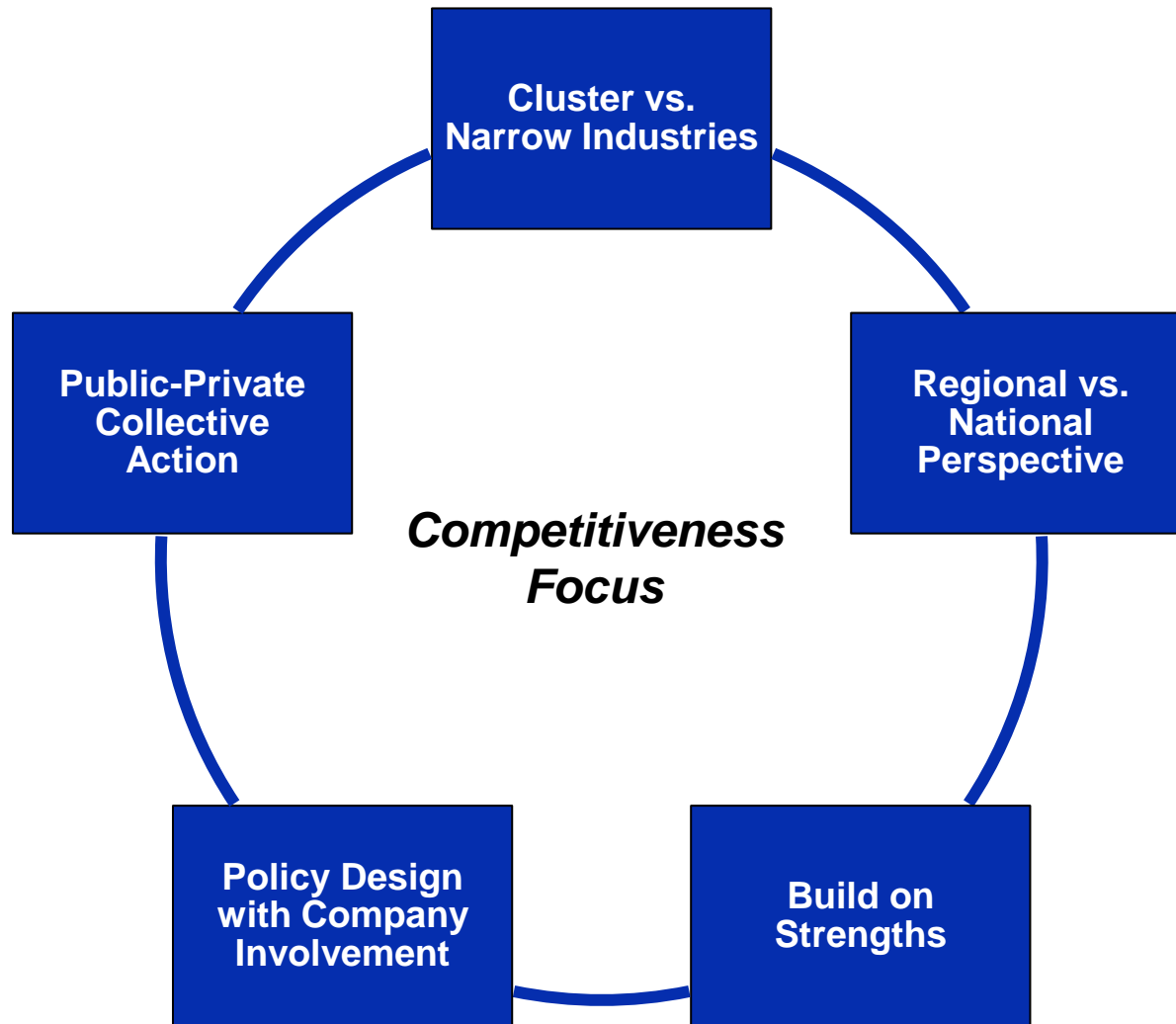
# Organize Public Policy around Clusters



- Clusters provide a framework for **organizing the implementation** of many public policies and public investments directed at economic development



# What is Different about Cluster-Based Policy?



# Agenda

- Competitiveness and Prosperity
- A General Framework for Competitiveness
- The Role of Geographic Levels in Competitiveness
- Clusters and Development

- **Competitiveness and Economic Development**

- Diagnosing Competitiveness
- Economic Strategy
- Organizing for Competitiveness
- The Role of Business: Creating Shared Value
- Implications for the World Bank

# Stages of National Competitive Development

## Shifting Policy Imperatives



### Low Cost Inputs

- Monetary and fiscal, political, and legal stability
- Improving basic human capital
- Efficient basic infrastructure
- Lowering the regulatory costs of doing business

### Productivity

- Increasing local rivalry
- Market opening
- Advanced infrastructure
- Incentives and rules encouraging productivity
- Cluster formation and activation

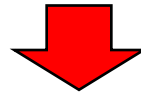
### Unique Value

- Advanced skills
- Scientific and technological institutions
- Incentives and rules encouraging innovation
- Cluster upgrading

# The Diamond Model in Developing Countries

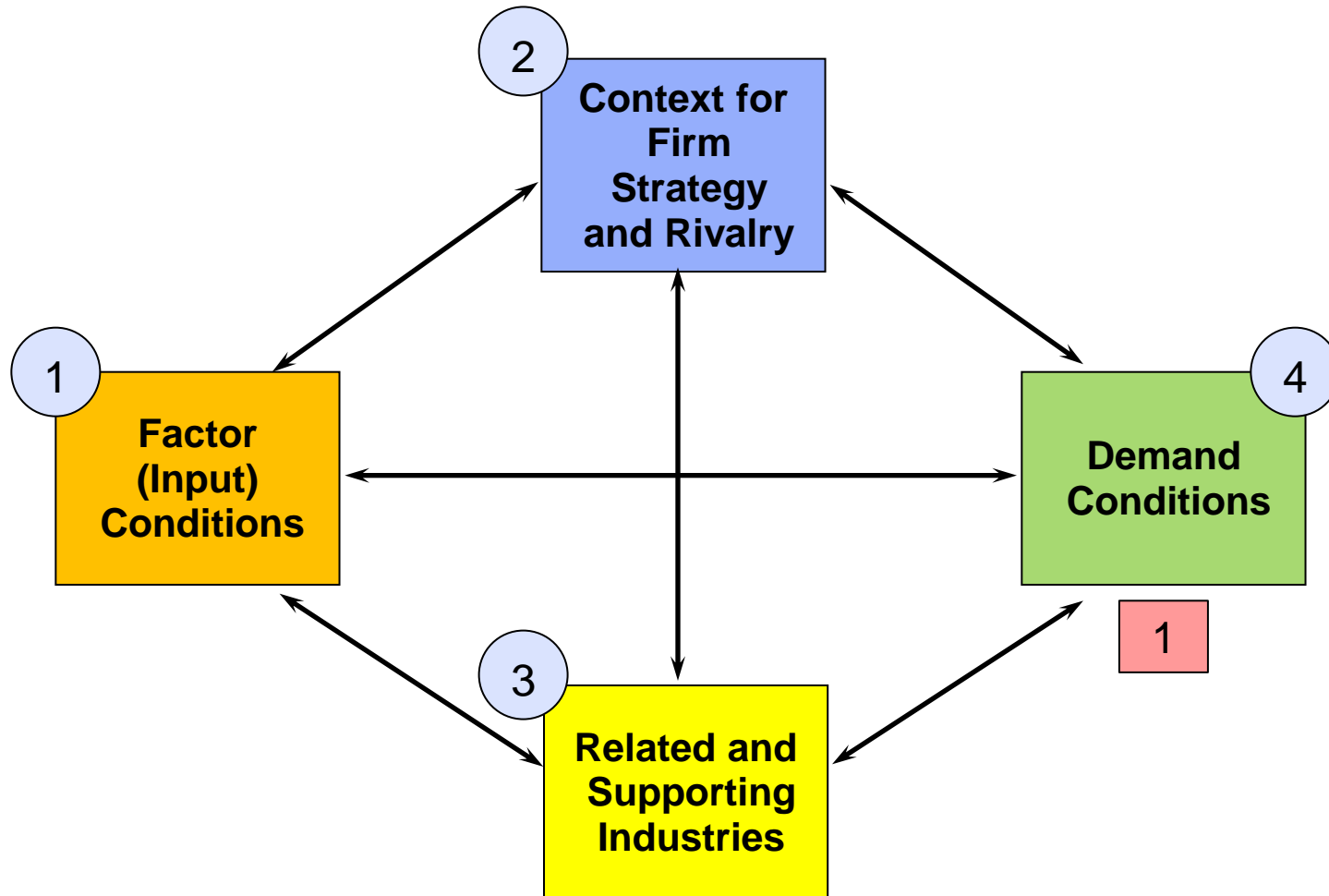
## Summary

- The diamond framework applies to economies at **all stages** of economic development
- The **specific conditions** and **action priorities** differ dramatically across countries and stages of development



- Developing countries must raise the **macroeconomic competitiveness** to a minimum level to have a chance for sustained development
- Developing countries have weaknesses across **many diamond dimensions**
- Strategies that address only one element of the diamond are of **limited effectiveness** in producing growth and improving prosperity
  - A focus on macroeconomic reform or trade liberalization alone is ultimately **unsustainable** if not supported by broader upgrading of the microeconomic fundamentals
  - Reliance on microeconomic upgrading alone can be severely **compromised** by significant challenges in macroeconomic competitiveness
- Diamond improvements should be **sequenced** to address the constraints to productivity at each income and development level

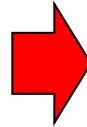
# The Diamond and the Typical Path of Economic Development



# Building the Diamond in an Emerging Economy

## Typical Starting Point for Developing Countries

- High reliance on the availability of **low wage, unskilled labor** and **natural resources**
- Lack of **capital**
  - Low savings
  - Capital flight
- **Inefficient** public administration and regulatory processes which are subject to **corruption**
- **Underdeveloped** infrastructure, capital markets, and educational
- Most technology is **externally** supplied and controlled
- **Low** productivity



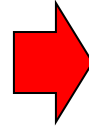
## Successful Economic Development

- Create functioning **administrative infrastructure** for registration and regulation
- Expand business-related **information**
- Upgrade the **quality** and **efficiency of existing factor inputs**
  - Natural resource pricing and conservation
  - Quality and reach of public education
  - Physical infrastructure efficiency
  - Efficiency of labor markets
  - Depth of financial markets
- **Widen** the array of locally available factor inputs
- Improve factor **specialization**
- Build scientific and research **institutions** and the capacity to **assimilate** foreign technology


# Building the Diamond in an Emerging Economy

## Typical Starting Point for Developing Countries

- High **capital costs** and **short** time horizons
- **Opportunistic** practices by firms
- **Competition blunted** by monopoly concessions, state-owned companies, corruption, and heavy government intervention
- Companies **protected** from foreign competitors
- **Monopolistic** companies are dominant or cartels divide the market
- Any local rivalry occurs largely on **price**



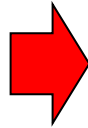
## Successful Economic Development

- Reduce internal **governmental impediments to competition**
    - End monopoly government licenses and concessions
    - Phase out government price controls, entry controls, and locational restrictions
    - Open state monopolies to competition
    - Improve governance of SOEs and government-linked companies
    - Privatize SOEs
  - Begin an irreversible process of **opening the economy** to foreign competition, including FDI
  - Create and implement an effective **competition policy**
  - Develop an effective legal structure and enforcement mechanisms for **intellectual property**
- 
- Reduce **investment hurdle rates** and **lengthen time horizons**
  - Move beyond price cutting and product imitation to **specialization** and **differentiation**

# Building the Diamond in an Emerging Economy

## Typical Starting Point for Developing Countries

- Local suppliers are **scarce** and uncompetitive
- Most sophisticated machinery, components, and more advanced equipment and services must be **imported**
- Inefficient **vertical integration** reflects the lack of local suppliers and barriers to imported inputs



## Successful Economic Development

- Open market access to **foreign** suppliers of sophisticated components, machinery, and services
- Seek FDI that attracts world class suppliers to **support and deepen emerging local clusters**
- Establish programs to support improvements in the **local** supplier base



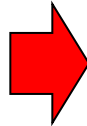
- Early export successes often occur in industries with **weak** inter-industry linkages



# Building the Diamond in an Emerging Economy

## Typical Starting Point for Developing Countries

- **Unsophisticated** local demand
  - Low average income levels
  - Little information
  - Limited selection
  - Overwhelming focus on price
- Product and service designs are **imitated or licensed** from abroad
- **Lax** product, health, safety and environmental **standards**
- The home market **distracts** attention from developing internationally competitive products



## Successful Economic Development

- Improve local demand **quality**:
  - Expand buyer information and increase consumer protection against poor-quality products
  - Open the market to foreign products
  - Phase out restrictions and tax biases against sophisticated products
- Raise product, safety, health, energy and environmental **standards** towards international levels
- Use **government procurement** to stimulate the supply of higher quality products
- Facilitate exports to **neighboring countries** or other countries where **needs are similar**
- Set policies that foster **early demand** for more advanced products and services

# Agenda

- Competitiveness and Prosperity
- A General Framework for Competitiveness
- The Role of Geographic Levels in Competitiveness
- Clusters and Development
- Competitiveness and Economic Development

- **Diagnosing Competitiveness**

- Economic Strategy
- Organizing for Competitiveness
- The Role of Business: Creating Shared Value
- Implications for the World Bank

# Testing the Competitiveness Framework

Broad measure of **productivity**.

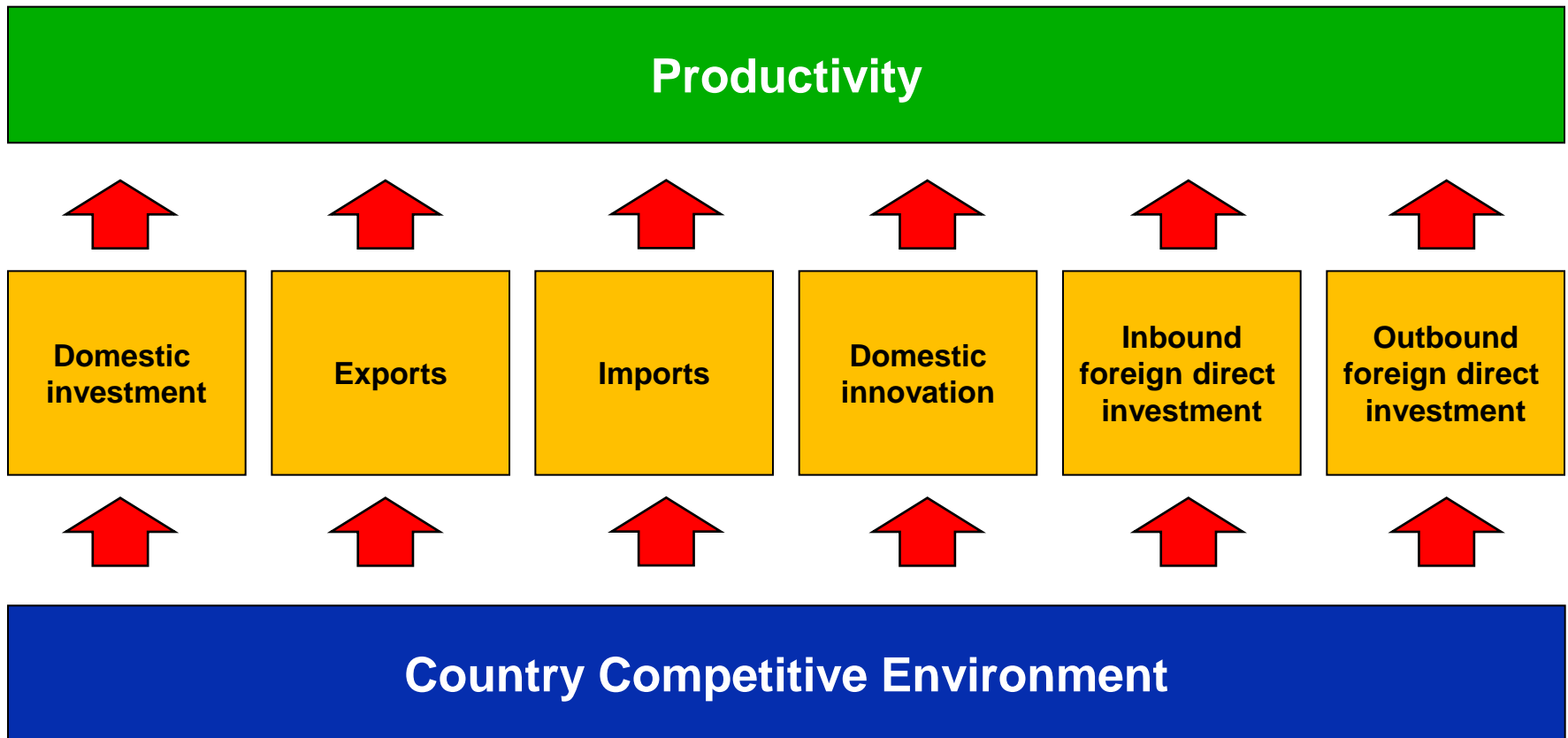
Productivity ultimately drives prosperity, the key outcome policy makers are concerned about

Captures both productivity of **employees** and of **labor market institutions**

*“GDP relative to the available labor force  
given the quality of a location to do business””*

Linked to all ultimate drivers of productivity, in particular those amenable to **policy action**

# Intermediate Indicators and Enablers of Productivity



# Testing the Competitiveness Framework

## An Empirical Approach

- Data

- Broad set of data covering all dimensions of the framework
- Basic unit of data is the average response per indicator, country, and year
- Data set is a panel across more than 130 countries and up to 8 years, using the World Economic Forum's Global Executive Survey and other sources

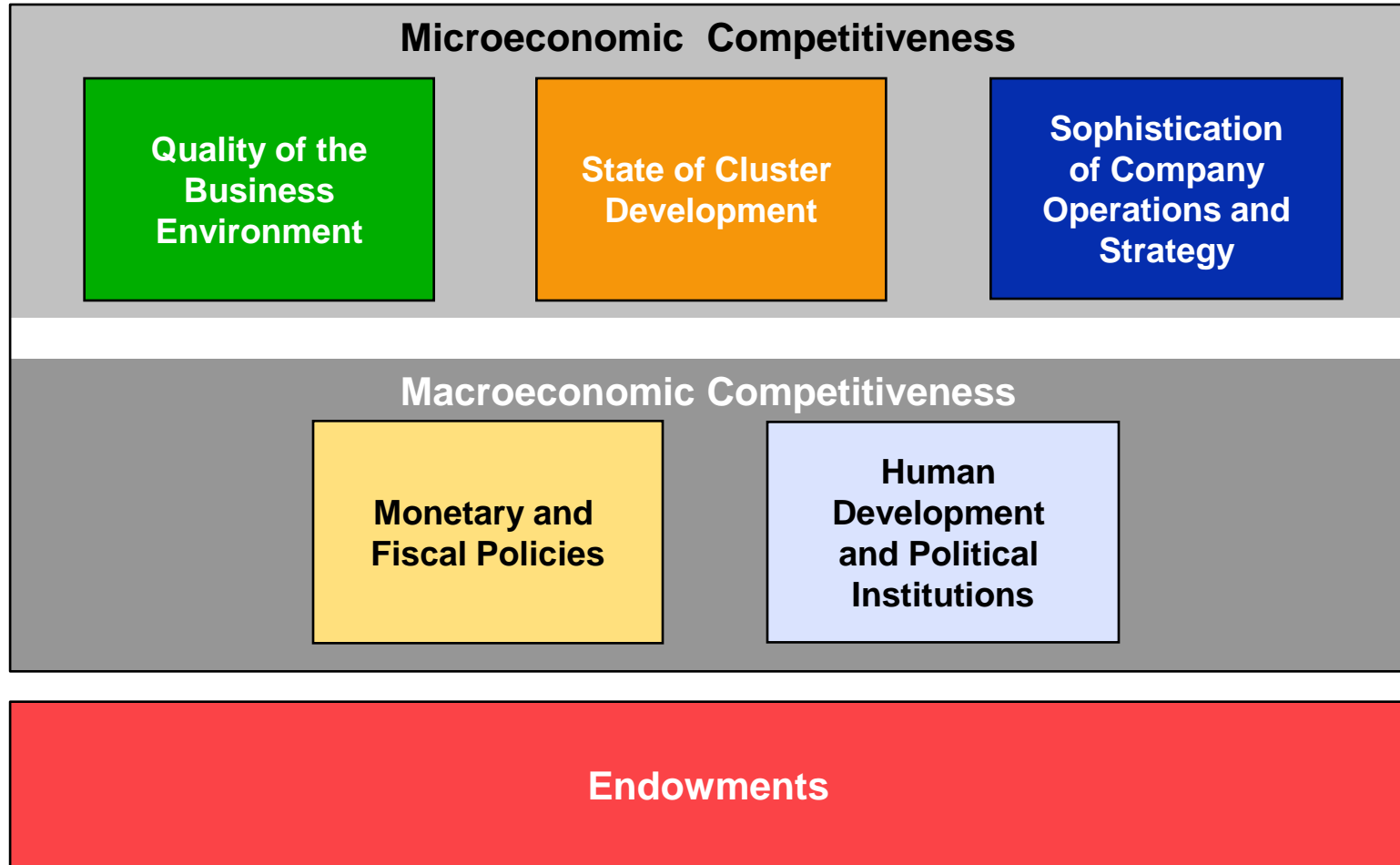
- Approach

- Step 1: Conduct separate, step-wise principal components analyses for MICRO, SIPI, to derive their averages per country-year; simple average for MP
- Step 2: Comprehensive regression of MICRO, SIPI and MP on log GDP per capita with endowment controls and year dummies.

Ln Output per

$$\text{Potential Worker}_{c,t} = \alpha + \beta_{\text{MICRO}} \text{MICRO}_{c,t-1} + \beta_{\text{SIPI}} \text{SIPI}_{c,t-1} + \beta_{\text{MP}} \text{MP}_{c,t-1} + \alpha_{\text{END}} \text{ENDOWMENTS}_{c,t-1} + \alpha_t \text{year}_t + \varepsilon_{c,t} \quad (1)$$

# A General Framework for Competitiveness



- Productivity ultimately depends on improving the **microeconomic capability** of the economy and the **sophistication of local competition** revealed at the level of regions and clusters
- Macroeconomic competitiveness sets the **economy-wide** context for high productivity to emerge, but is **not sufficient** to achieve this outcome
- Endowments, i.e. **natural resources**, **geographical location**, and **size**, create a **foundation** for prosperity, but true prosperity is created by **productivity in the use of endowments**

# Components of Macroeconomic Competitiveness

## ISC Model Indicators

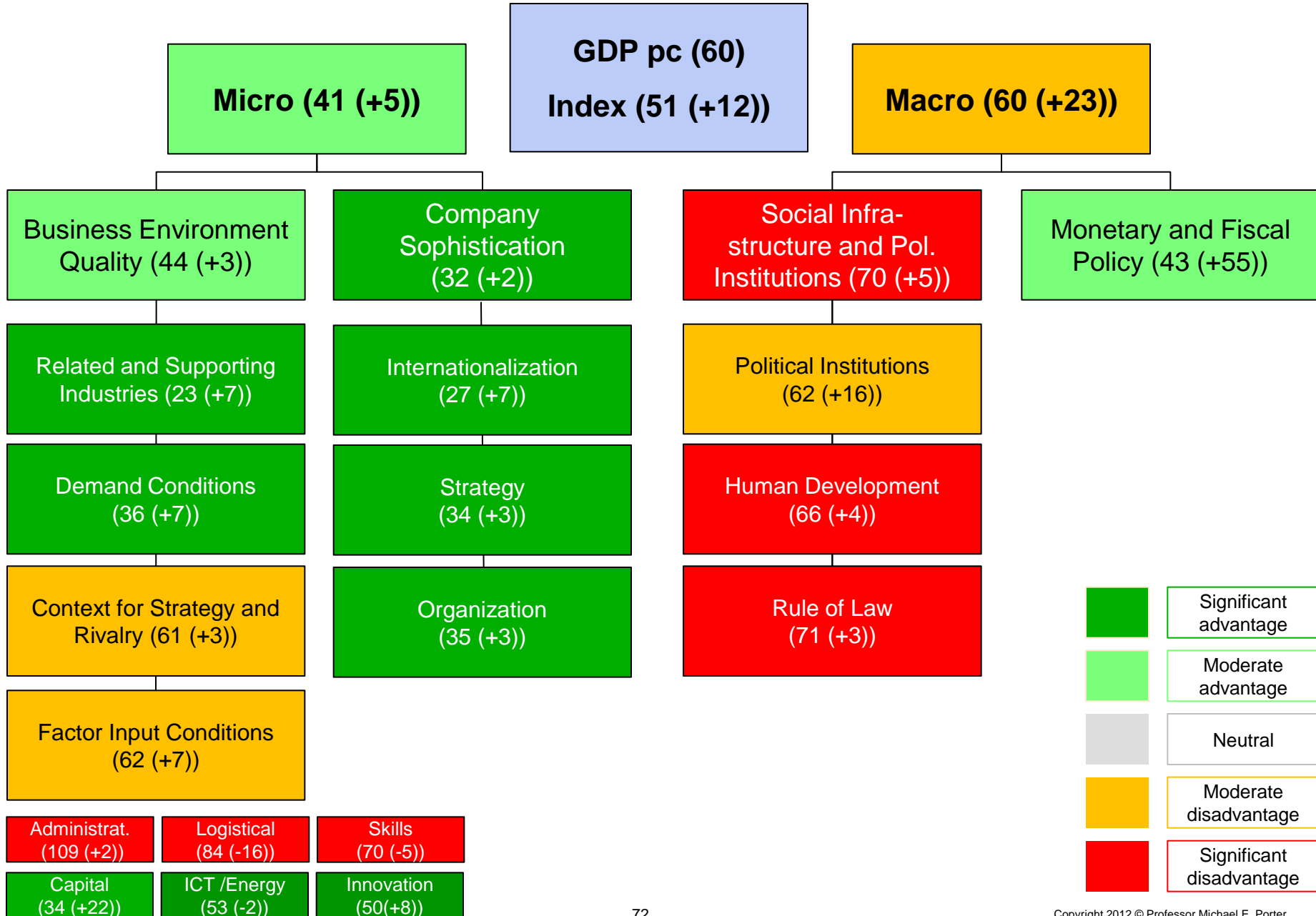
### Monetary and Fiscal Policies

- **Fiscal policy**
  - Government surplus/deficit
  - Government debt
- **Monetary policy**
  - Inflation
  - Business cycle management
  - Savings

### Human Development and Political Institutions

- **Human development**
  - Basic education
  - Health
- **Political institutions**
  - Political freedom
  - Voice and accountability
  - Political stability
  - Government effectiveness
  - Decentralization of economic policymaking
- **Rule of law**
  - Security
  - Civil rights
  - Judicial independence
  - Efficiency of legal framework
  - Freedom from corruption

# Brazil Competitiveness Profile, 2010 (5 year change)



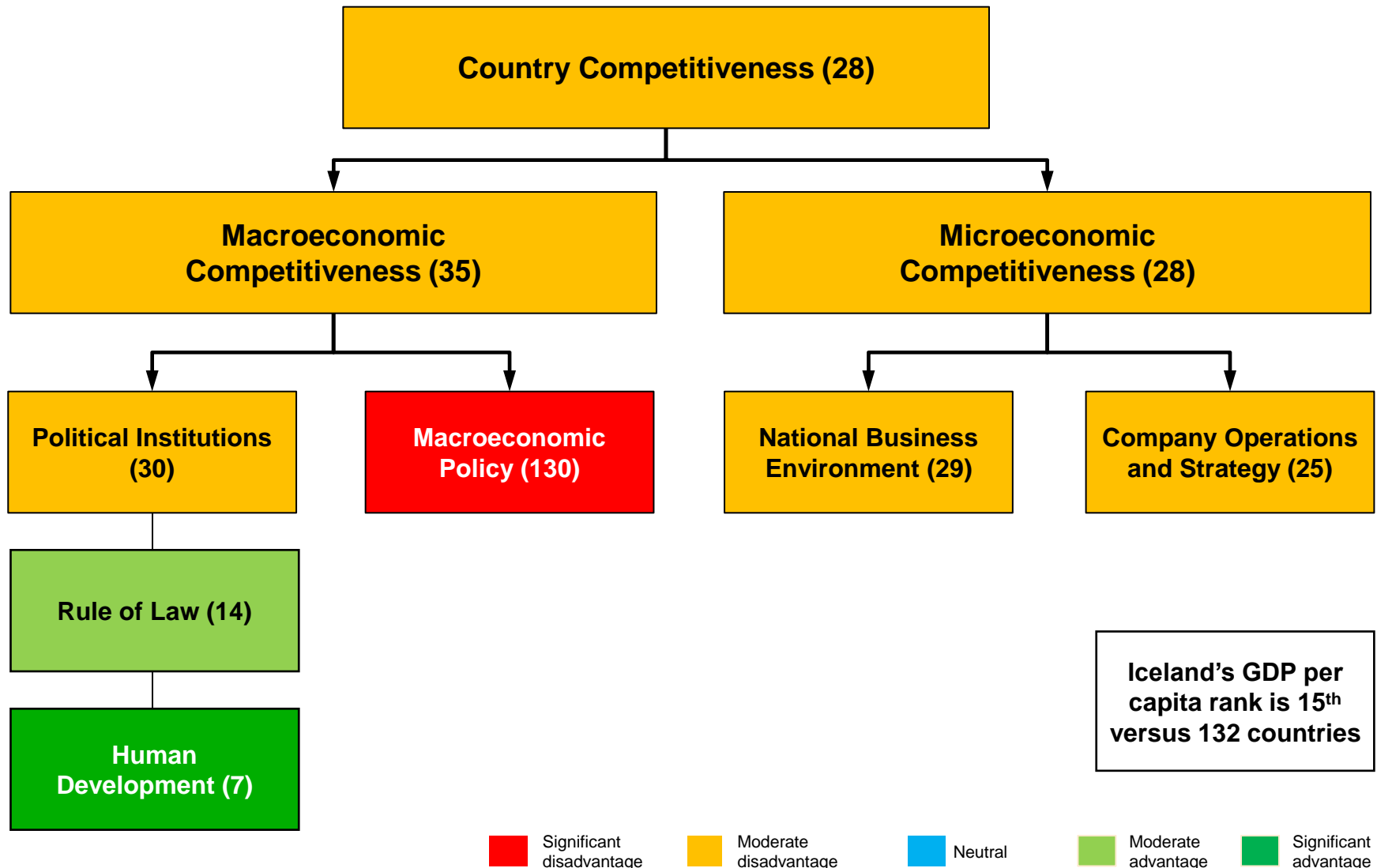
	Significant advantage
	Moderate advantage
	Neutral
	Moderate disadvantage
	Significant disadvantage

Source: Unpublished data from the Global Competitiveness Report (2010), author's analysis.



# Benchmarking Competitiveness

## Iceland's Competitiveness Profile, 2011

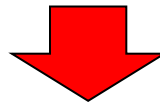


Note: Rank versus 132 countries; overall, Iceland ranks 15<sup>th</sup> in PPP adjusted GDP per capita and 28<sup>th</sup> in Global Competitiveness  
 Source: Institute for Strategy and Competitiveness, Harvard University (2011), based in part on survey data from the World Economic Forum.

# Testing the Competitiveness Framework

## Findings

- The linear model explains **83% of the variation of GDP per potential worker** across countries
- The model reveals that **each broad dimension of competitiveness matters**, even when controlling for the others and for endowments
  - Microeconomic factors are important, independent drivers of prosperity
- **Current circumstances matter**, even when controlling for legacy effects (institutional legacy, country fixed-effects)



- **Extends** the findings of the theory-driven literature
- Integrates the now available data in a **coherent conceptual framework**

# Agenda

- Competitiveness and Prosperity
- A General Framework for Competitiveness
- The Role of Geographic Levels in Competitiveness
- Clusters and Development
- Competitiveness and Economic Development
- Diagnosing Competitiveness
- **Economic Strategy**
- Organizing for Competitiveness
- The Role of Business: Creating Shared Value
- Implications for the World Bank

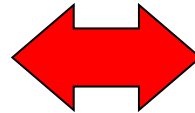
# The Need for an Economic Strategy

## Policy Improvement

- 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



## Economic Strategy

- A prioritized agenda to move towards an **enhanced** and **unique competitive position** for a country or region based on its particular circumstances

- Choices in both areas need to be **fact-driven**

# Creating a National (or Regional) Economic Strategy

## Value Proposition

- What is the **distinctive competitive position** of the nation / region given its location, legacy, existing strengths, and potential strengths?
  - What unique strengths as a business location?
  - For what types of activities and clusters?
  - And what roles with the surrounding nations 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** can be built upon?

## Achieving and Maintaining Parity with Peers

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

- **Priorities** and **sequencing** are essential to economic development

# Role of a National Value Proposition

- The value proposition should be **inspirational** to citizens
  - **Beyond** ideology and incremental changes
- The value proposition is a **signal to companies** at home and abroad about **what assets and conditions can expect to find in the country**
- The value proposition is a **signal to policy makers** about **what types of improvements are most critical** in order to make the economic success a reality

# Tests of an Economic Strategy

- Has the country or region articulated a **distinctive** position?
  - That will create a positive **identity**?
  - That will **inspire** citizens?
- Does the strategy build on existing or potential **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 or region's **weaknesses**? Can weaknesses that retard 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 an Economic Strategy

## Continued

- Do the **policy priorities** fit the strategy?
  - The **choice of policies**, and their design?
  - The **sequence** in which policies are implemented?
- Has the strategy been **communicated clearly** to all 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?



# Agenda

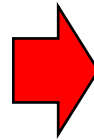
- Competitiveness and Prosperity
- A General Framework for Competitiveness
- The Role of Geographic Levels in Competitiveness
- Clusters and Development
- Competitiveness and Economic Development
- Diagnosing Competitiveness
- Economic Strategy
- **Organizing for Competitiveness**
- The Role of Business: Creating Shared Value
- Implications for the World Bank

# The Process of Economic Development

## Shifting Roles and Responsibilities

### Old Model

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



### New Model

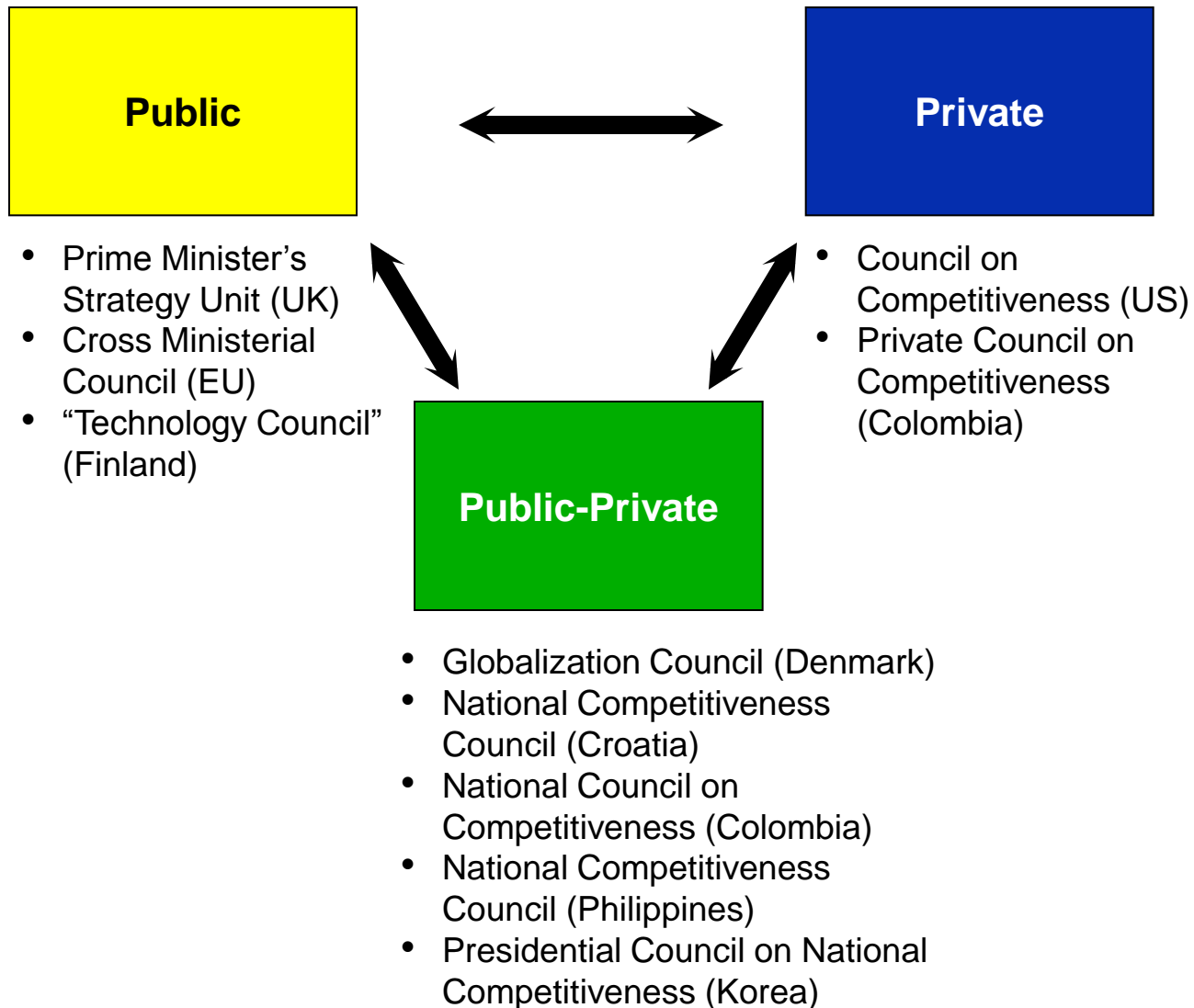
- Economic development is a **collaborative process** involving government at multiple levels, companies, educational and research institutions, and private sector organizations

- Competitiveness is the result of both **top-down** and **bottom-up processes** in which many companies and institutions take responsibility
- Translating policy into **action** is decisive in determining success

# Government and the Process of Economic Development

- Competitiveness improvement requires sustained efforts across **multiple years and presidential administrations**
  - Mechanisms are needed to **improve the continuity of policy** over time
- Competitiveness is affected by **numerous government entities** and **levels** of government
  - Competitiveness is **never the sole agenda** of a single government agency
  - **Multiple agencies and departments** (e.g. finance, trade, science and technology, commerce, regional policy, energy, agriculture) have an influence on competitiveness
  - “**Economic**” agencies and “**social**” agencies are both involved
  - Multiple **levels** of government (nations, states, cities, etc.) affect the business environment and macro context
  - Intergovernmental relations with **neighboring countries** affect productivity
- A **coordinating structure** is needed (e.g. “competitiveness policy council”) that brings together the ministers and department heads necessary to formulate and implement an economic strategy

# Organizing for Competitiveness



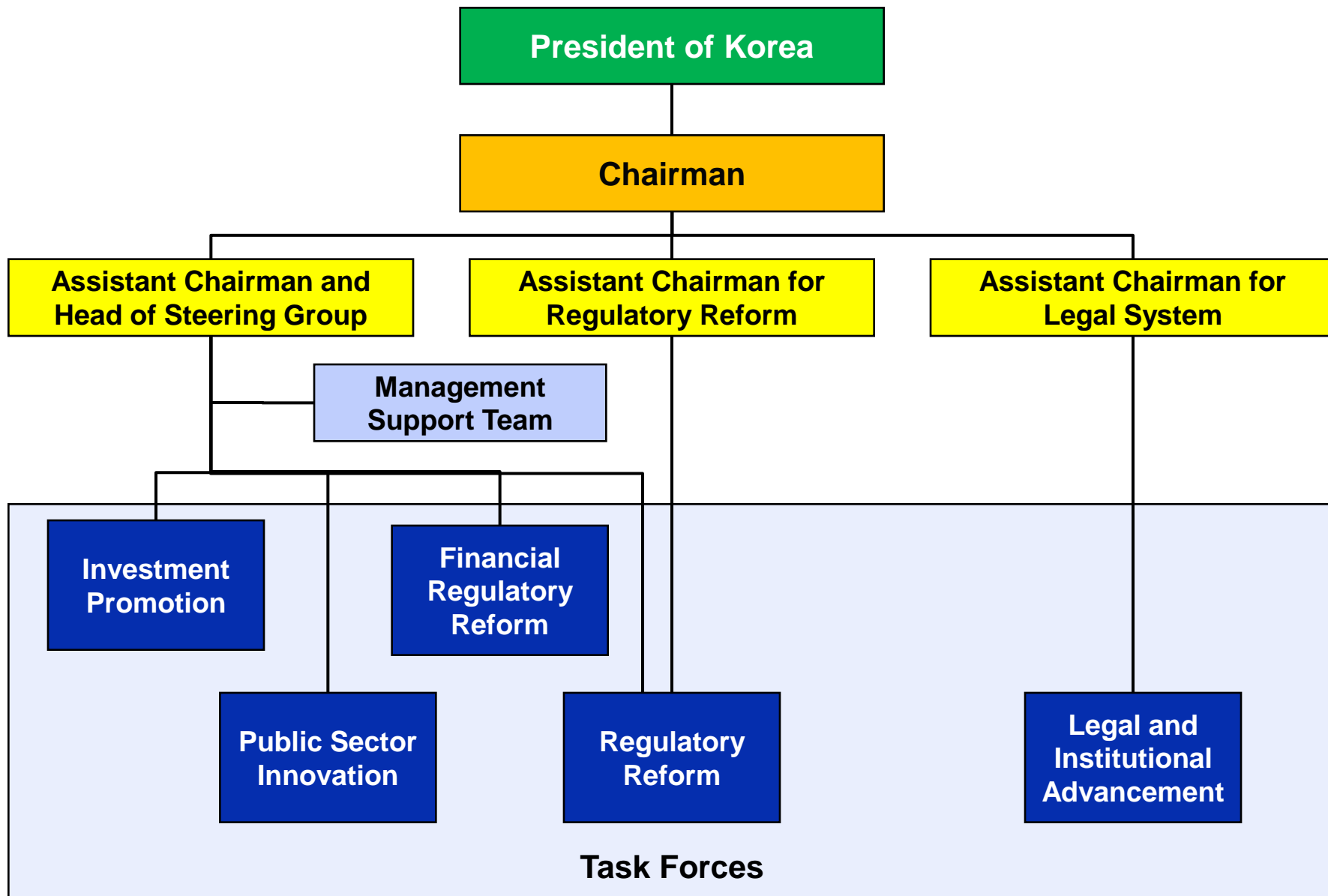
# Organizations for Competitiveness are Needed at Multiple Geographic Levels

## Examples



# Organizing for Economic Development

## Presidential Council on National Competitiveness (Korea)



# Competitiveness Organizations and Initiatives

## Success Factors

- Focused on the **microeconomic aspects** of competitiveness, not just macro
- Led by or heavily involving the **private sector** with the participation of all actors. Representation from the national government in state level initiatives
- Institutionalized in a **formal structure**
- Use a common **conceptual framework**
- Develop a **strategy**, not just discrete policy improvements
- Create a **prioritized** and **sequenced** action plan
- Measure and report **progress** and create **accountability** of implementing entities

# Agenda

- Competitiveness and Prosperity
- A General Framework for Competitiveness
- The Role of Geographic Levels in Competitiveness
- Clusters and Development
- Competitiveness and Economic Development
- Diagnosing Competitiveness
- Economic Strategy
- Organizing for Competitiveness
- **The Role of Business: Creating Shared Value**
- Implications for the World Bank



# The Role of Business in Society

- Only business can **create prosperity**
- Healthy businesses need a **healthy community**



- There is an ever **growing awareness** of major societal challenges
- Government and NGO's **lack sufficient resources and capabilities** to fully meet these challenges
- Companies are sometimes perceived to be prospering **at the expense of the broader community**, and a **cause** of social, environmental, and economic problems
- Despite growing corporate citizenship activities, the **legitimacy of business** has fallen

# The Role of a Company in Its Communities

## Evolving Approaches



# The Concept of Shared Value

**Shared Value**: Corporate policies and practices that **enhance the competitiveness** of the company while simultaneously **advancing social and economic conditions** in the communities in which it sells and operates

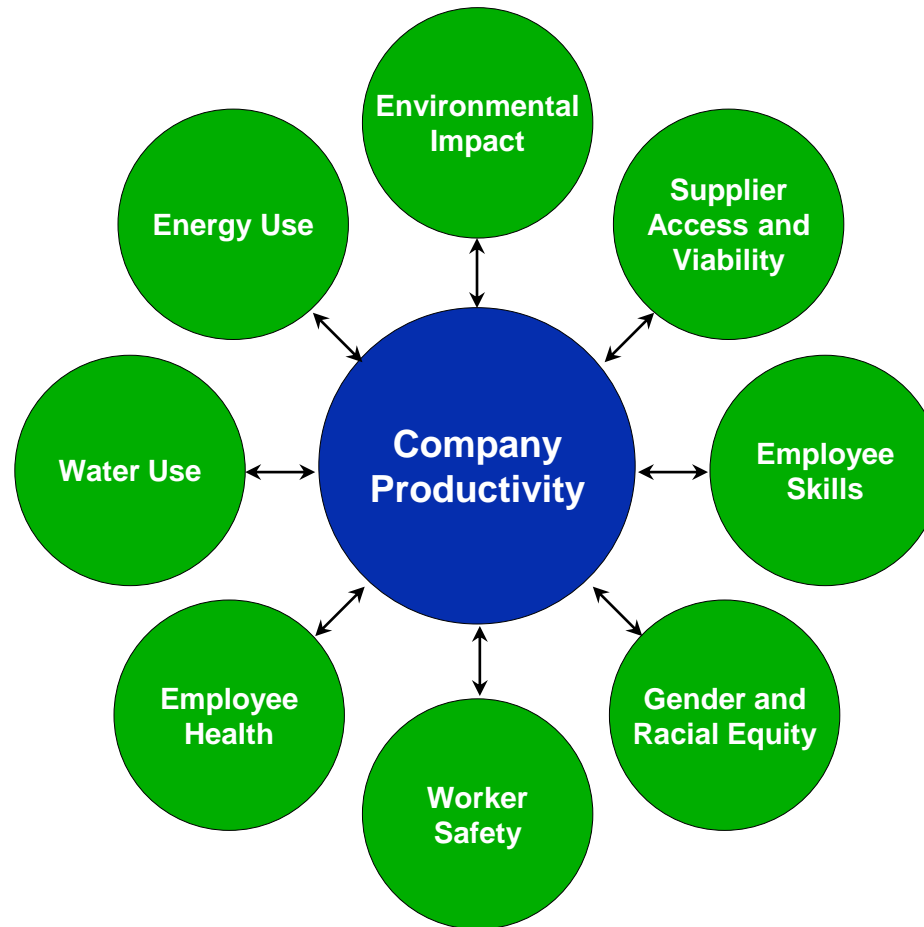
- **Shared Value IS:**

- Creating **economic value** by creating **societal value**
- Using **capitalism** to address social problems
- Solutions to social problems that are **scalable** and **self-sustaining**

- **Shared Value is NOT:**

- Sharing the value **already created** (philanthropy)
- Personal **values**
- **Balancing** stakeholder interests
- The same as **sustainability**

# Societal Needs and Economic Value Creation



- **Social** deficits create **economic** cost
- **External** conditions shape **internal** company productivity
- Social needs represent the **largest market opportunities**

# Levels of Shared Value

- Reconceiving **products, needs,** and **customers**
  - Meeting **societal needs** and reaching **unserved** or **underserved customers**
- **Redefining productivity** in the value chain
  - How the organization **better uses resources** in value chain, including employees, to improve fundamental productivity
- Enabling **local cluster development**
  - Improving available **skills, suppliers,** and **supporting institutions** in the region

# Creating Shared Value in Products

## Intuit SnapTax

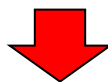
**SnapTax** provides low-income consumers with access to tax preparation services over the phone and enables rapid refunds

- **15 minutes for \$15**, electronic filing included
- Data extracted from **mobile phone photos** of W-2s via optical character recognition
- **Debit card** option for direct deposit of refunds for unbanked households
- **Simple IRA option** to enable use of refund for retirement savings

# Creating Shared Value in Products and Markets

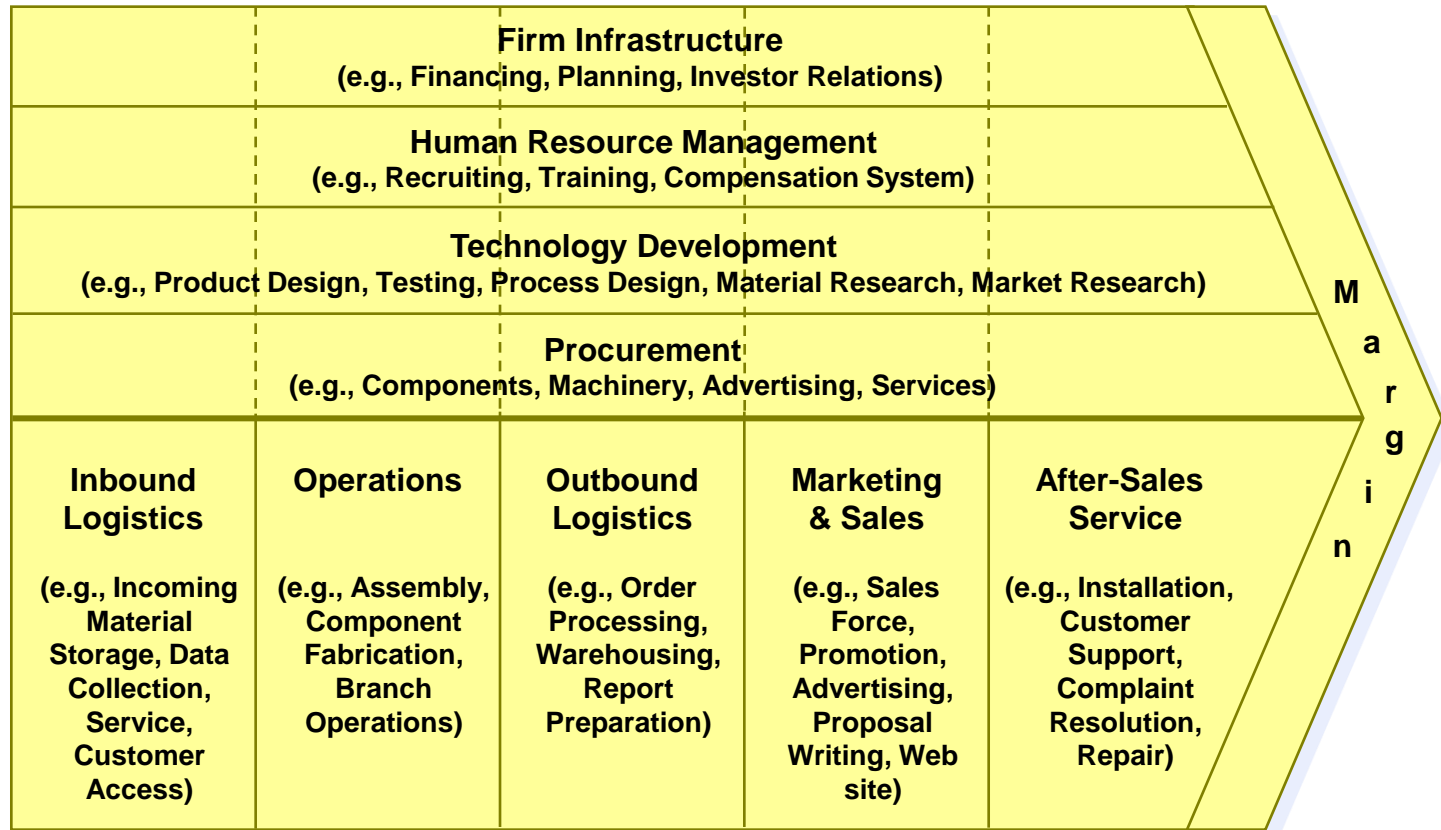
## Novo Nordisk in China

- **Diabetes training programs for physicians** in partnership with government, NGOs, and opinion leaders to promote the latest thinking on diabetes prevention, screening, treatment, and patient communication
  - The program has **trained 55,000 physicians** to date, each treating approximately 230 patients
- New types of **diabetes education programs for patients** focusing on prevention, lifestyle changes, and effective use of insulin products
- **Product design** that reflects Chinese patient demographics and culture



- Since 1994, Novo Nordisk **market share in China increased from 0% to 63%**, and China became the **third largest market** with **revenues of \$935 million** in 2011
- Company efforts saved **140,000 life years in China** by 2010, and **\$2,317 of total lifetime costs per patient**

# Redefining Productivity in the Value Chain

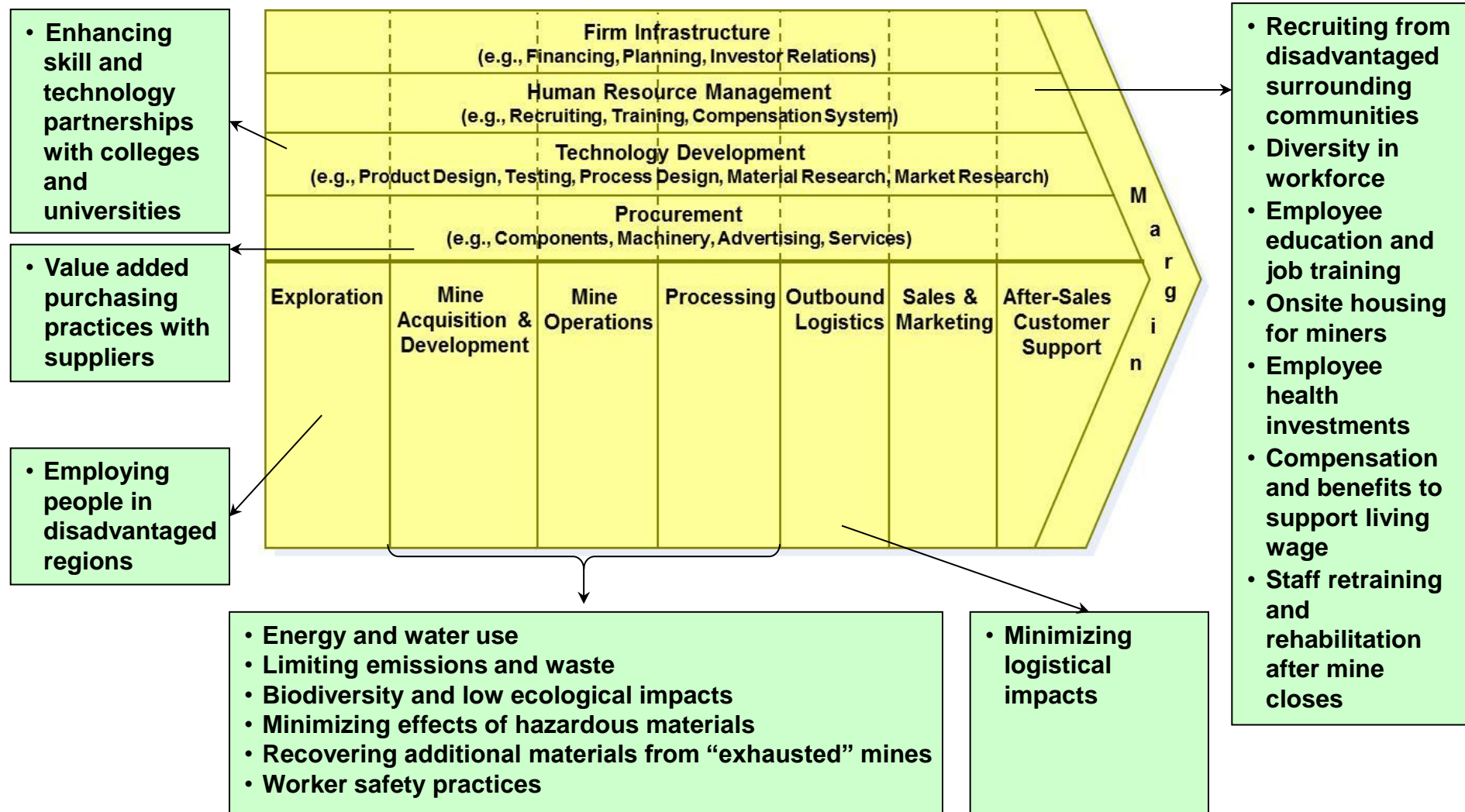


- Shared value purchasing
- Energy use
- Resource use
- Location of facilities / supply chain
- Logistical efficiency
- Employee productivity



# Identifying Opportunities for Shared Value in Mining

## The Value Chain



# Cluster Development in the Company's Major Locations

- A strong local cluster improves **company growth and productivity**
  - Local suppliers
  - Supporting institutions and infrastructure
  - Related businesses
- **Companies**, working collaboratively, can catalyze major improvements in the cluster and the local business environment



- Local cluster development **strengthens the link** between a company's success and community success

# Local Cluster Development

## Anglo-American

- Anglo American has established Anglo Zimele, a South African enterprise investment fund, for **mining-related small and medium-sized businesses** in South Africa
- As of 2010, the fund had invested in **509 businesses**, which collectively employed 9,514 people with annual revenues of \$215 million

### Economic value

- Anglo-American has created reliable, high-quality **local suppliers**
- Local suppliers reduce transaction costs and improve **service levels** and **quality**

### Community value

- **10,000 new jobs** created
- Significant increase in **income** for SME employees and owners
- **Spillover effects** of these new businesses on their communities

# Creating Shared Value

## Opportunities for Pharmaceutical and Medical Devices Companies

### Reconceiving Products and Markets

- R&D for drugs, vaccines, and devices that **fill unmet health needs**
- Modification of **existing products** to reduce complexity and cost
- **Tailored product offerings** to meet local market conditions

### Redefining Productivity in Value Chains

- **Efficient, local supply chains** and **manufacturing** to reduce production costs
- **Locally-adapted sales and distribution** to reduce cost, access new markets, and better meet patient needs

### Enabling Local Cluster Development

- **Behavior-change campaigns** to create more sophisticated consumer demand for health care
- **Strengthening of health systems** to enable the delivery of needed products and services
- **Advocacy and capacity building** to strengthen the policy and the regulatory environment

# Creating Shared Value

## Efforts in the Pharmaceutical Industry are Mutually Reinforcing

### Redefining Productivity in Value Chains

- Improve reliability
- Reduce costs
- Leverage local expertise



### Reconceived Products and Markets

- Center on patient needs
- Improve affordability
- Tailor to local conditions

### Strong Local Health Clusters


- Enable delivery of products and services to new populations
- Improve the ability to pay
- Promote health-seeking behavior

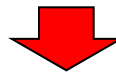


- Leading firms are beginning to design **multi-level approaches** to harness this **multiplier effect**

# New Stakeholder Roles and Relationships

- Shared value thinking is driving **new relationships** between **companies**, **philanthropists**, **NGOs**, and **government** in addressing social issues

	<u>Traditional Roles</u>		<u>New Roles</u>
<b>Companies</b>	<ul style="list-style-type: none"><li>• Donate to charitable causes</li></ul>		<ul style="list-style-type: none"><li>• Initiate and scale shared value strategies</li></ul>
<b>Philanthropists</b>	<ul style="list-style-type: none"><li>• Donate to charitable causes</li></ul>		<ul style="list-style-type: none"><li>• Partner with companies and NGOs to catalyze shared value initiatives</li></ul>
<b>NGOs</b>	<ul style="list-style-type: none"><li>• Receive grants to provide social services</li></ul>		<ul style="list-style-type: none"><li>• Enable implementation of new shared value business models</li></ul>
<b>Governments</b>	<ul style="list-style-type: none"><li>• Regulate business practices; operate social programs</li></ul>		<ul style="list-style-type: none"><li>• Partner with companies and NGOs to make platform investments and support shared value strategies</li></ul>



- **NGOs** that do not harness shared value will face a **decline in traditional funding flows**
- **Governments** that fail to leverage shared value will achieve **slower progress in addressing societal needs**

# Creating Shared Value

## Implications for Government and Civil Society

- Government and NGOs often assume that **trade-offs** between economic and social benefits are **inevitable**
- Government and NGOs will be most effective if they **enable shared value** by business

### Implications for NGOs

- NGOs bring unique **expertise**, **implementation** capacity, and relationships of **trust** with communities

#### A New Type of NGO

- **TechnoServe** Promotes the development of agricultural clusters in more than 30 countries
- **RootCapital** Provides financing to more than 400,000 farmers and businesses
- **Bill & Melinda Gates Foundation** Forms partnerships with global corporations to foster agricultural clusters

### Implications for Governments

- Governments should make **platform investments** in public assets and infrastructure to enable shared value by business
- Governments should regulate in a way that **reinforces and rewards shared value** in business, rather than working against it

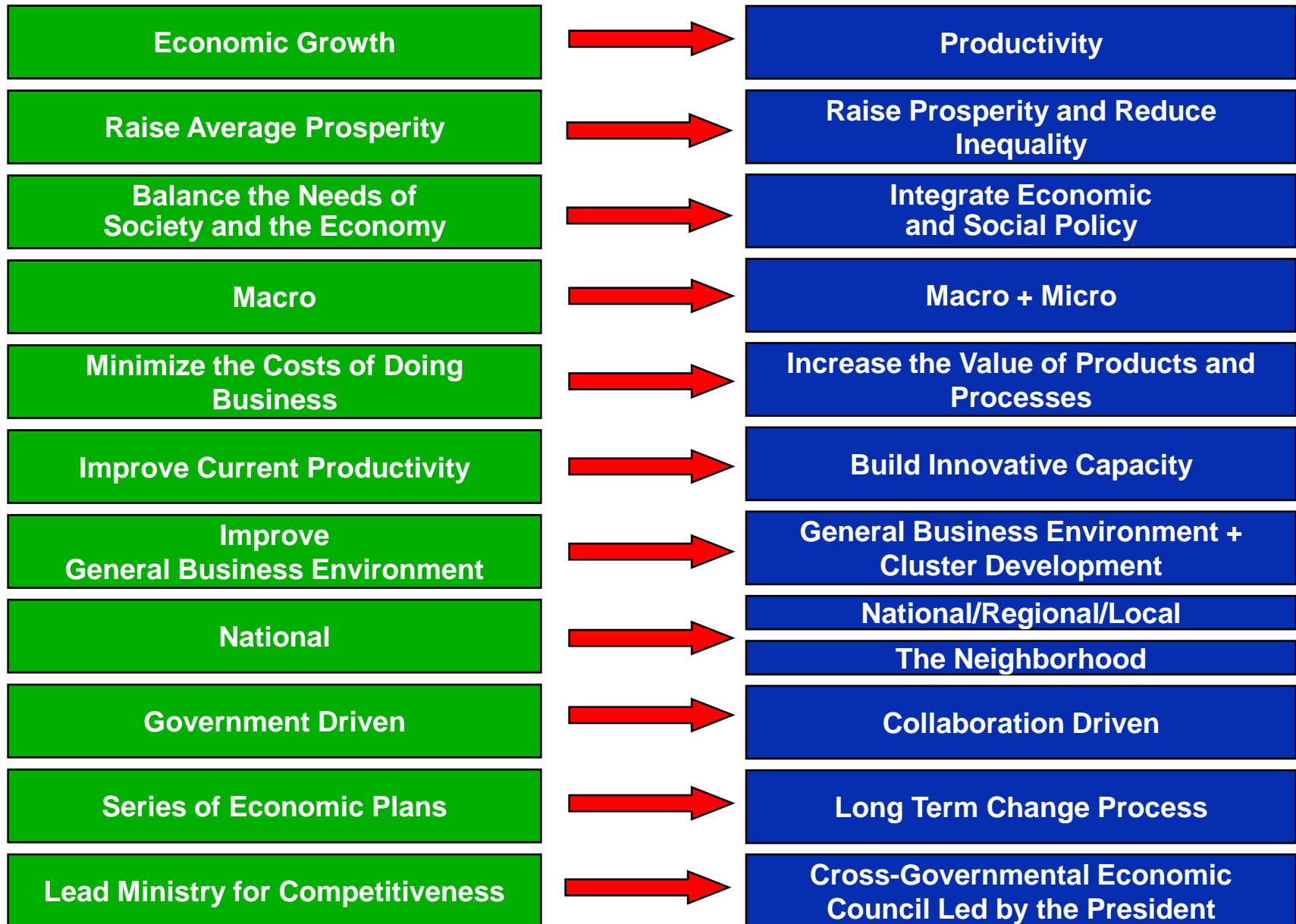
# Agenda

- Competitiveness and Prosperity
- A General Framework for Competitiveness
- The Role of Geographic Levels in Competitiveness
- Clusters and Development
- Competitiveness and Economic Development
- Diagnosing Competitiveness
- Economic Strategy
- Organizing for Competitiveness
- The Role of Business: Creating Shared Value
- **Implications for the World Bank**



# Enhancing Competitiveness

## Shifting Understanding of Agendas and Challenges



# Evidence on Foreign Aid Organizations

## Some Observations

- The activities of foreign aid organizations tend to be **fragmented** and **uncoordinated**
- Aid organizations tend to have their **own agendas** and favored project areas, independent of the recipient country's agenda or needs
- The **institutional structures** governing aid at the country level are often weak
- The **incentive structures** of both donor and recipient countries in many cases work against the effective use of aid

# Engagement Options for Aid Organizations

## Tools

- Funding
- Technical support
  - Data
  - Training
  - Specialists
- Policy dialogue

## Channels

- Government
  - National
  - Regional and agencies
- IFCs
  - Creation
  - Capacity enhancement
- Direct
  - Financing programs
  - Providing services

# Making Development Aid Strategic

## Principles

**Investment in assets**

**Vs.**

**Support consumption**

**Sustainable programs**

**Vs.**

**Programs requiring ongoing outside support**

**Investments that leverage other investments**

**Vs.**

**Stand alone projects**

**Adding value**

**Vs.**

**Just giving money**

**Distinctive focus**

**Vs.**

**Areas covered by multiple aid organizations**

# The Evolving Role of the World Bank

## Traditional

## Recent

## Emerging

**Provide General Recipes**  
(e.g., Washington Consensus)

**Suggest Generic Action Priorities**  
(e.g., Poverty Reduction, Governance, ...)

**Offer Toolbox for countries to use depending on their needs**

**Support Strategy Development and Implementation**  
(Data, Diagnostics, Process)