

UAE Competitiveness for the Third Millennium: The Role of Government

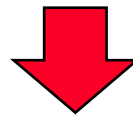
Professor Michael E. Porter
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Harvard Business School

United Arab Emirates
January 24, 2010

This presentation draws on ideas from Professor Porter's articles and books, including, *The Competitive Advantage of Nations* (The Free Press, 1990), "The Microeconomic Foundations of Economic Development," in *The Global Competitiveness Report*, (World Economic Forum), "Clusters and the New Competitive Agenda for Companies and Governments" in *On Competition* (Harvard Business School Press, 2008) and ongoing research at the Institute for Strategy and Competitiveness. 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 Michael E. Porter. Further information on Professor Porter's work and the Institute for Strategy and Competitiveness is available at www.isc.hbs.edu,
Version: December 17, 2009 (6:30pm)

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)
 - It is not **what** industries a nation competes in that matters for prosperity, but **how productively** 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
 - Relentless **innovation** in technology, products, and organizational methods is necessary to **drive productivity growth** and a rising standard of living



- 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

Sources of Prosperity

Inherited Prosperity

- Prosperity is derived from selling **inherited natural resources**
- Prosperity is **constrained** by the limited amount of resources available
- Dutch disease and macroeconomic volatility **undermine** the non-resource economy
- Focus gravitates towards the **distribution of wealth** as interest groups seek a bigger share of the pie



- **Government** is the central actor in the economy as the owner and distributor of wealth
- Resource revenues allow **unproductive policies and practices** to persist
- Resource revenues support **distortive subsidies**

Created Prosperity

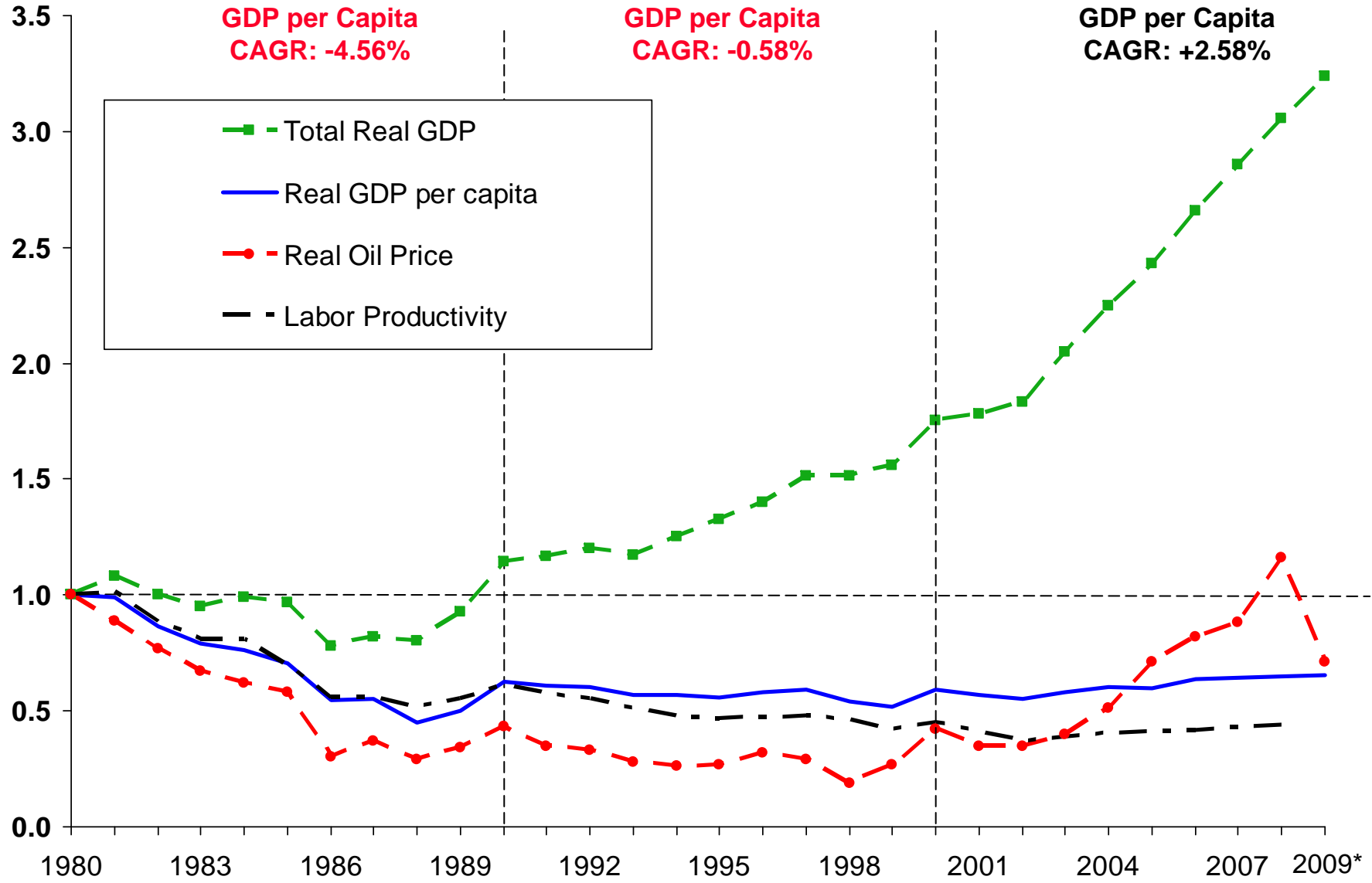
- Prosperity is derived from **creating valuable products and services**
- Prosperity can only be created by **firms**
- Prosperity is **unlimited**, based only by the innovativeness and productivity of companies and subsidiaries operating in the economy
- Creating the **conditions for productivity and innovation** is the central policy challenge for government



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

UAE's Long-Term Economic Performance

Index Values,
1980 = 1.00



Note: 2009 GDP figures are IMF estimates. 2009 Jan-Nov 2009 spot oil price used.
Source: BEA, IMF (2009), Groningen Growth and Development Centre (2009), EIU (2009)

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Determinants of Competitiveness

Natural Endowments

Natural Endowments in the UAE

Location

- Position on the trade route between Europe and Asia and access point to the Gulf economies
-

- *Natural basis for a trading hub*
- *Competing locations with similar advantages*
- *Infrastructure needed to leverage location*

Natural Resources

- Large reserves of oil
-

- *Significant financial resources*
- *Potential for Dutch disease and weak institutions*

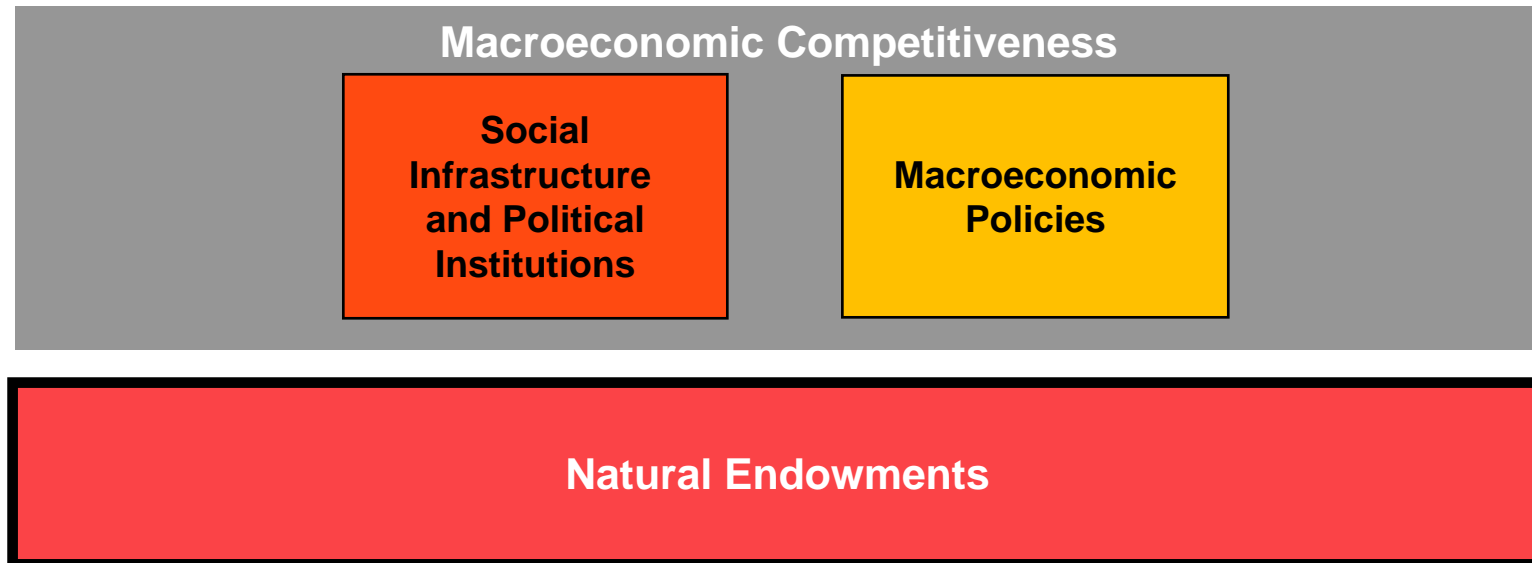
Size

- Small local population and moderate local market
-

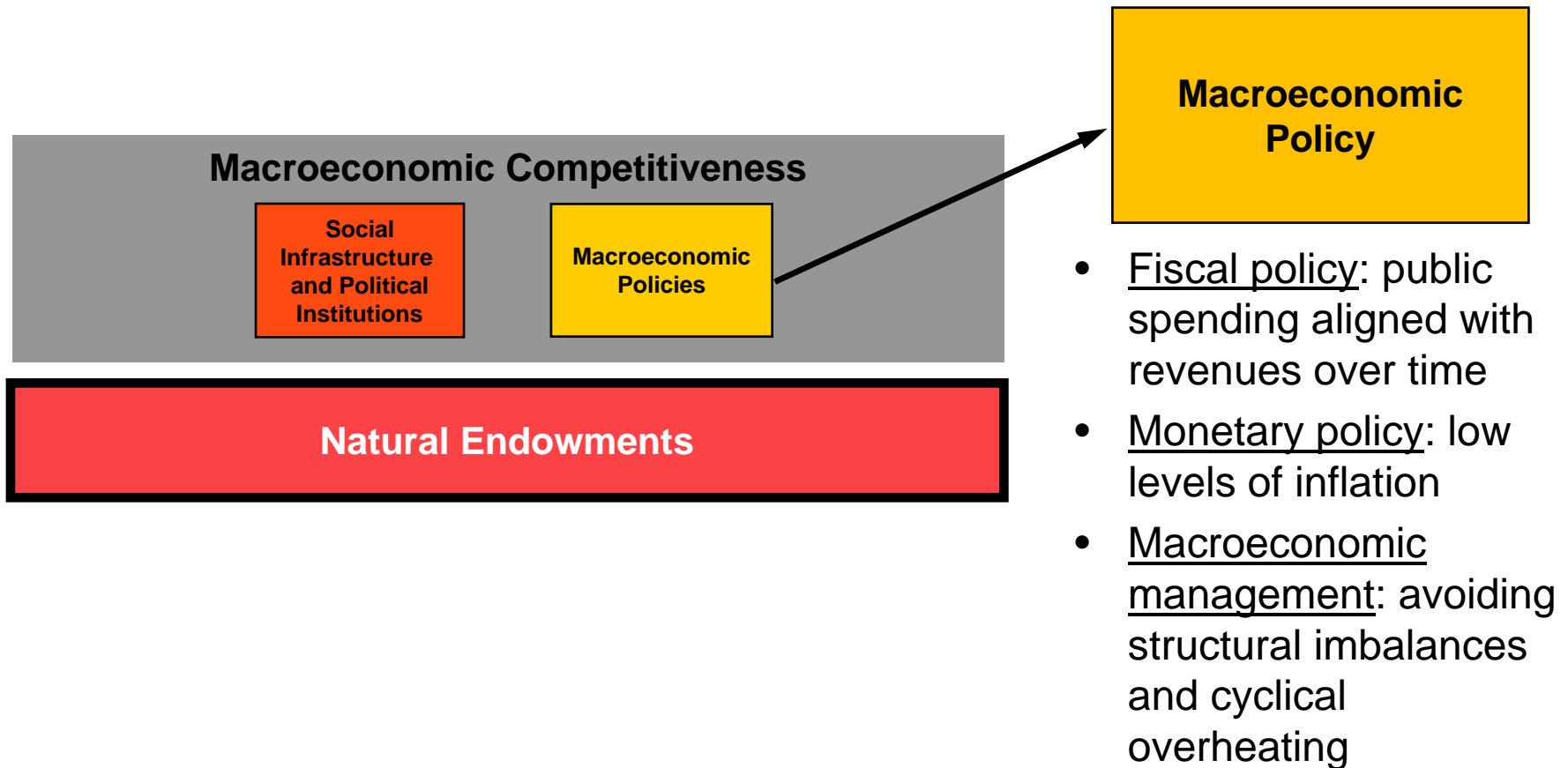
- *Mobilize for consensus and action*
- *Limited 'natural attraction' for foreign companies*

- Natural endowments create **opportunities or challenges**; the actual **outcomes** depend on the policy choices that countries or regions take in response

Determinants of Competitiveness



Determinants of Competitiveness



Macroeconomic Policy in the UAE

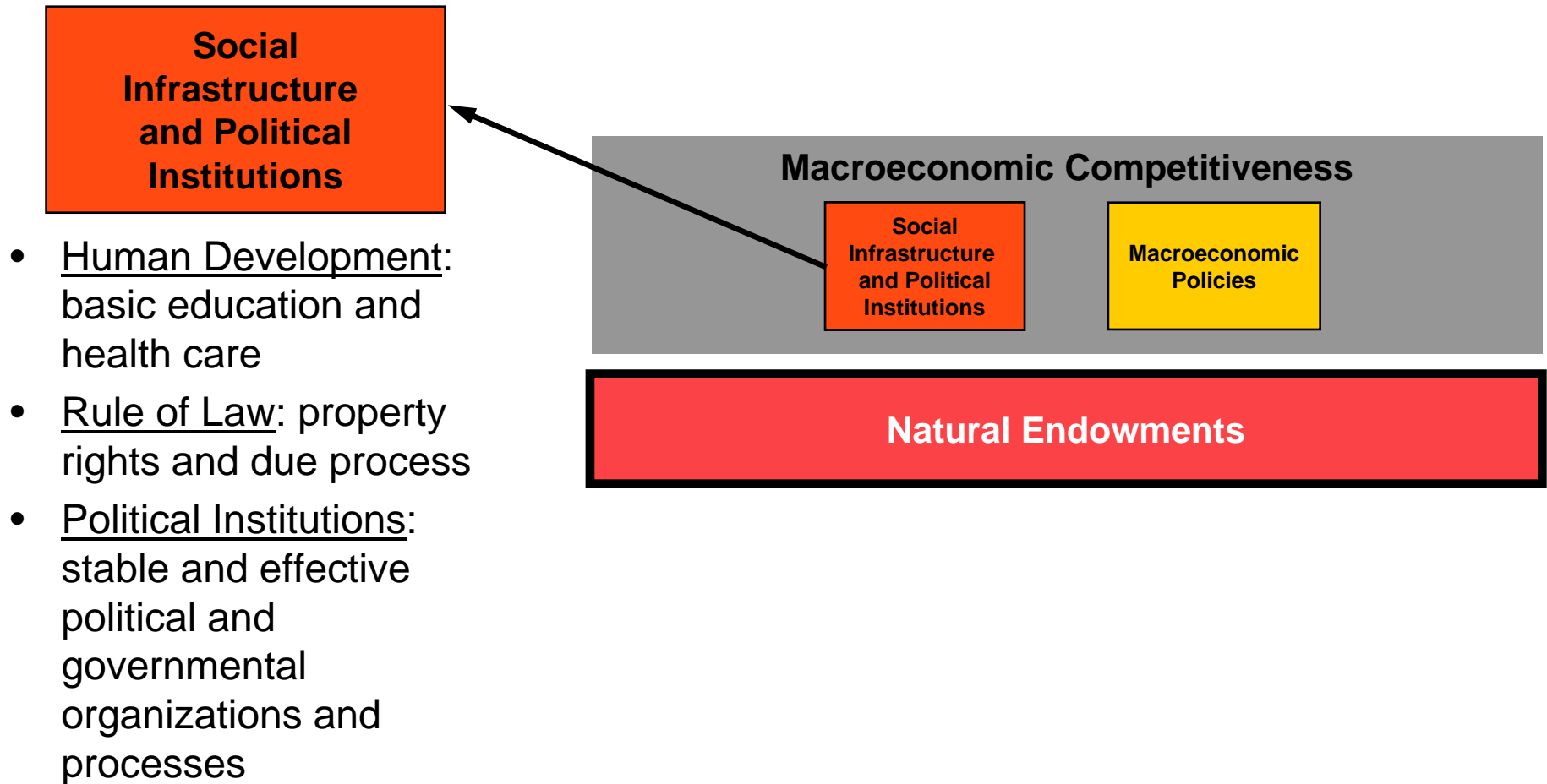
Observations

- The inflationary pressure prior to the crisis revealed the **challenges for monetary policy** in the context of the US Dollar-peg and the absence of a domestic bond market
 - Monetary policy is one of the few policy areas unambiguously controlled by the UAE level through the Central Bank
- The UAE benefited from responsible management of large oil revenues, but the simultaneous accumulation of foreign debt indicates the **challenges for managing fiscal policy**
 - Recently created Federal Council to Coordinate Fiscal Policy is a step in the right direction
- **Macroeconomic management** was effective in stabilizing the UAE financial system in the midst of the crisis, but failed to avert pre-crisis overheating and overleveraging



- A key challenge for the UAE is the **institutional architecture in macroeconomic policy**

Determinants of Competitiveness



Human Development Selected Countries

Country	GDP per capita (PPP US\$), 2007	Rank, 2007				
		GDP per capita	Human Development Index (HDI)	Life Expectancy Index	Education index	Gender Development Index (GDI)
Qatar	\$ 74,882	3	33	53	72	35
United Arab Emirates	\$ 54,626	4	35	40	108	38
Norway	\$ 53,433	5	1	14	7	2
Singapore	\$ 49,704	7	23	16	54	..
Kuwait	\$ 47,812	8	31	39	92	34
United States	\$ 45,592	9	13	31	20	19
Ireland	\$ 44,613	10	5	21	9	10
Hong Kong, China (SAR)	\$ 42,306	11	24	2	88	22
Sweden	\$ 36,712	16	7	10	17	5
United Kingdom	\$ 35,130	20	21	26	30	17
Germany	\$ 34,401	24	22	20	32	20
France	\$ 33,674	25	8	9	13	6
Japan	\$ 33,632	26	10	1	34	14
Spain	\$ 31,560	27	15	11	14	9
Italy	\$ 30,353	29	18	8	22	15
Bahrain	\$ 29,723	30	39	50	64	33
Greece	\$ 28,517	31	25	31	11	21
New Zealand	\$ 27,336	32	20	17	1	18
Slovenia	\$ 26,753	33	29	38	19	24
South Korea	\$ 24,801	35	26	29	8	25
Czech Republic	\$ 24,144	37	36	45	40	31
Saudi Arabia	\$ 22,935	40	59	82	111	60
Oman	\$ 22,816	41	56	53	120	56
Portugal	\$ 22,765	42	34	34	45	28
Estonia	\$ 20,361	43	40	77	24	36
Slovakia	\$ 20,076	45	42	59	46	40
Hungary	\$ 18,755	46	43	73	28	37
Croatia	\$ 16,027	52	45	48	51	43
Poland	\$ 15,987	53	41	51	33	39
Russia	\$ 14,690	55	71	133	43	59
Turkey	\$ 12,955	63	79	95	111	70

Human Development in the UAE

Observations

Primary and Secondary Education

- **Free provision** of primary and secondary education to all citizens
- High and rising primary and secondary education **completion rates** among the school age population
- **Illiteracy rates** in the UAE are still relatively high
 - A large segment of the expatriate labor force has low levels of education
 - Older generations are significantly less well educated
 - Variations across emirates and gender, with males falling behind
- Little internationally comparable **data** on education quality across the UAE, though some local efforts
- Relative **roles and responsibilities** of government agencies at the UAE and the emirates' level are unclear

Health Care

- **Free provision** of services to all citizens
- Growing health concerns related to rising prosperity (diabetes, etc.)

Political Institutions

Governance Indicators

Country	GDP per capita (PPP US\$)	2008 Index of Governance Quality, Rank					
		GDP per capita	Rule of Law	Political Stability	Government Effectiveness	Control of Corruption	Voice and Accountability
Qatar	\$ 74,882	3	48	36	56	32	156
United Arab Emirates	\$ 54,626	4	59	58	47	38	166
Norway	\$ 53,433	5	1	8	6	12	1
Singapore	\$ 49,704	7	14	9	1	2	136
Kuwait	\$ 47,812	8	62	82	86	62	141
United States	\$ 45,592	9	18	67	16	18	30
Ireland	\$ 44,613	10	13	25	18	17	11
Hong Kong	\$ 42,306	11	20	30	11	13	83
Sweden	\$ 36,712	16	5	26	4	6	2
United Kingdom	\$ 35,130	20	17	73	13	16	17
Germany	\$ 34,401	24	15	31	15	15	16
France	\$ 33,674	25	22	69	22	19	21
Japan	\$ 33,632	26	23	44	24	31	51
Spain	\$ 31,560	27	32	121	43	33	29
Italy	\$ 30,353	29	80	84	72	79	50
Bahrain	\$ 29,723	30	65	134	69	65	159
Greece	\$ 28,517	31	57	91	63	82	56
New Zealand	\$ 27,336	32	8	23	12	5	6
Slovenia	\$ 26,753	33	38	33	37	43	39
South Korea	\$ 24,801	35	55	85	30	64	73
Czech Republic	\$ 24,144	37	49	45	38	70	38
Saudi Arabia	\$ 22,935	40	85	146	93	81	198
Oman	\$ 22,816	41	54	43	70	55	174
Portugal	\$ 22,765	42	35	34	39	36	26
Estonia	\$ 20,361	43	33	70	34	44	36
Slovakia	\$ 20,076	45	70	46	49	66	53
Hungary	\$ 18,755	46	51	68	58	58	46
Croatia	\$ 16,027	52	95	71	65	80	84
Poland	\$ 15,987	53	74	56	68	68	58
Russia	\$ 14,690	55	169	160	117	176	164
Turkey	\$ 12,955	63	94	165	80	83	122

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.

Source: World Bank (2009)

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Political Institutions and Rule of Law

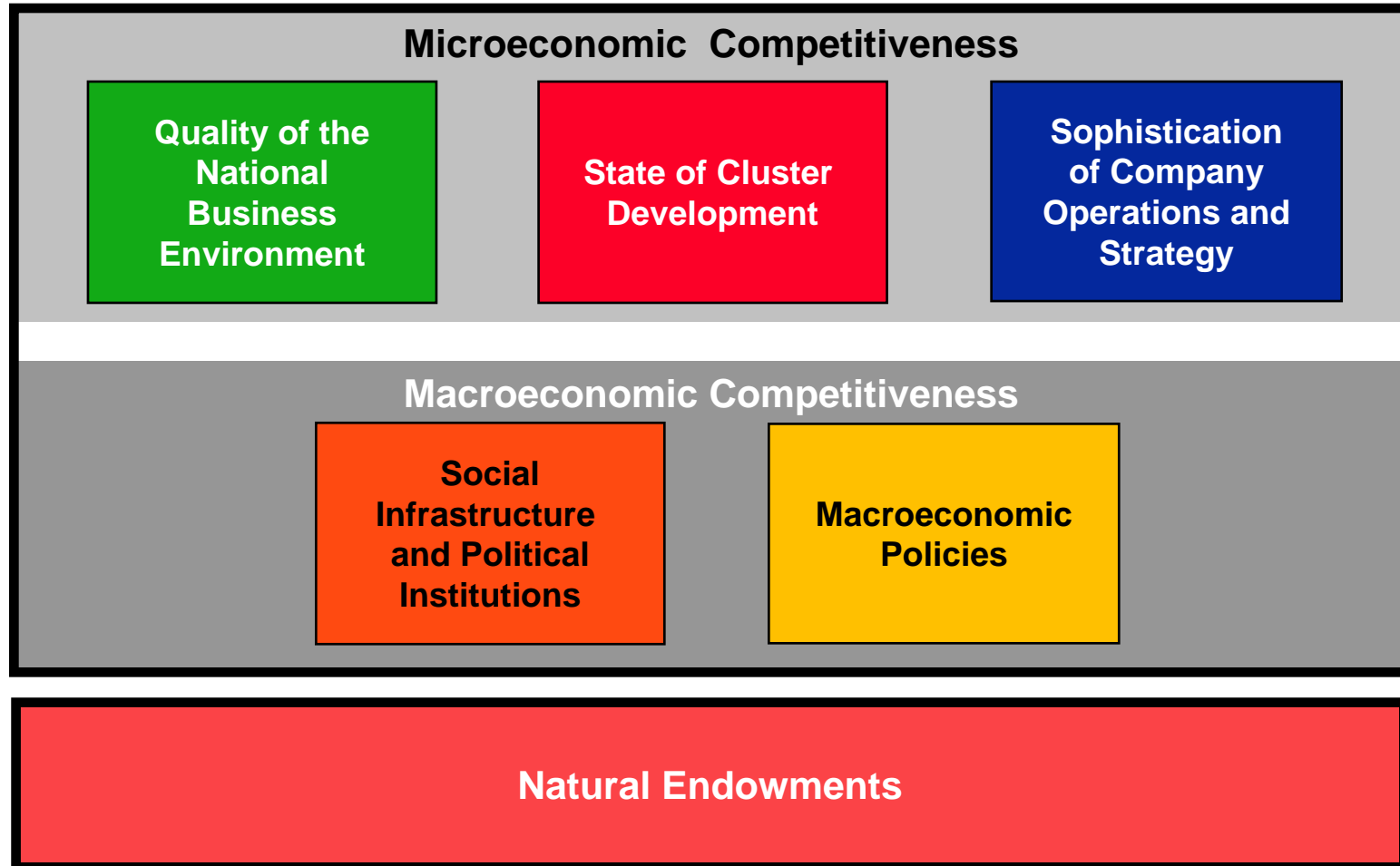
Observations

- **Solid overall ranking** on rule of law and many indicators of political institutions
- The UAE and its emirates have sought to improve the **legal environment** for business

However

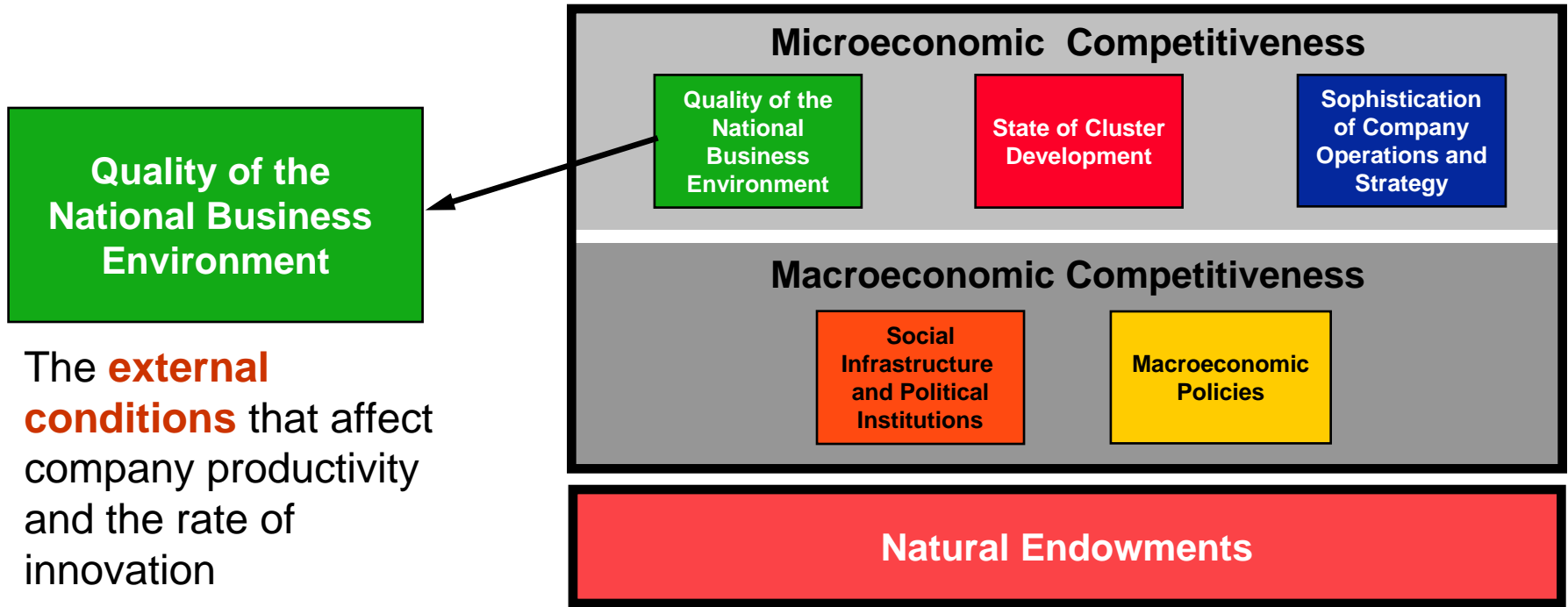
- The system of **legal rights** and **government decision making** is often unclear, ad-hoc, and fragmented
- The **dialogue** between government leaders and the private sector exists but lacks openness and supporting institutions
- Existing problems are usually resolved by one-off decisions that **circumvent root causes** instead of addressing them
- This approach was sufficient in the growth period, but has had **significant costs** in the downturn

Determinants of Competitiveness

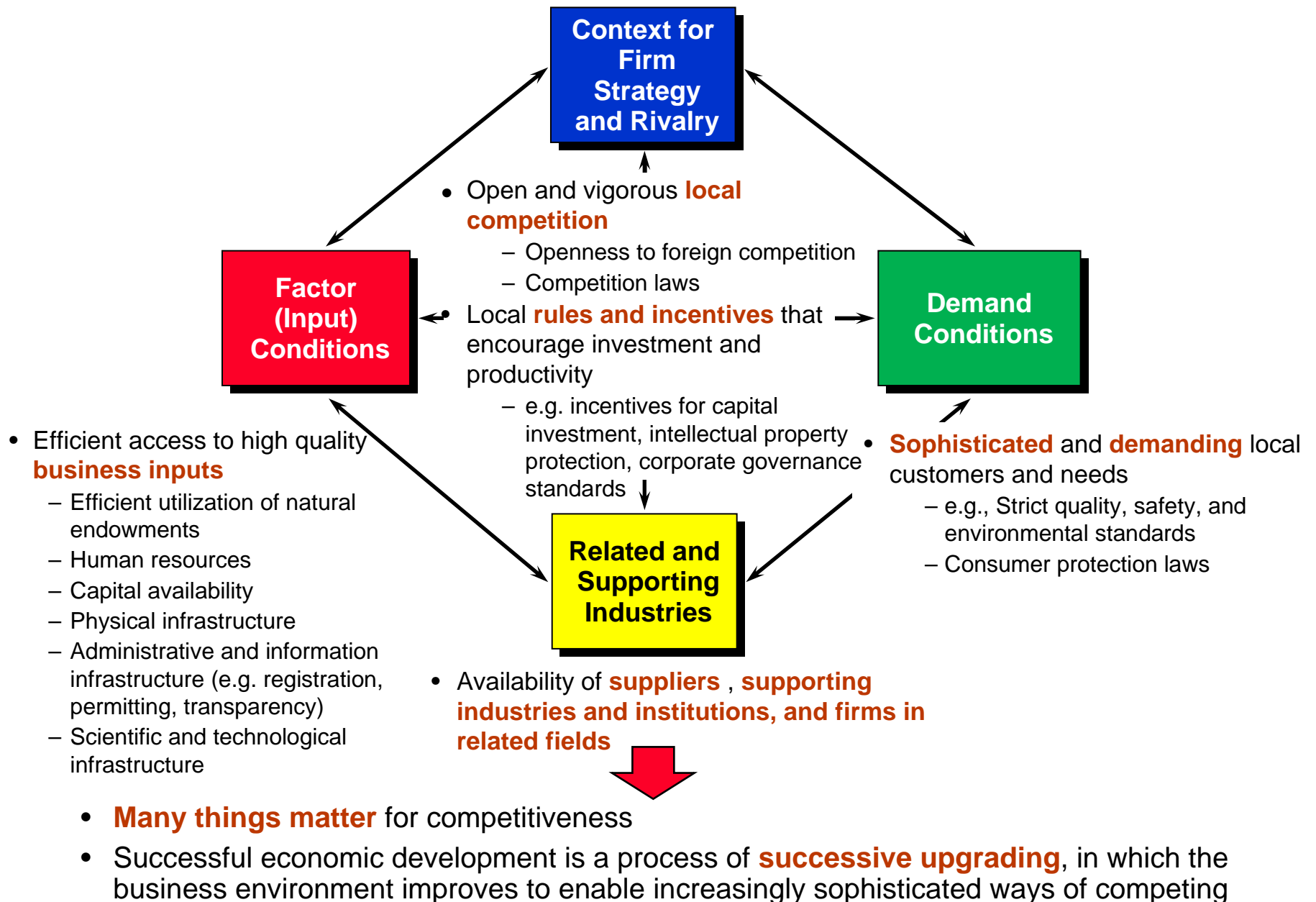


- Macroeconomic competitiveness creates the potential for high productivity, but is **not sufficient**
- Productivity ultimately depends on improving the **microeconomic capability** of the economy and the **sophistication of local competition**

Determinants of Competitiveness



Quality of the Business Environment



Factor (Input) Conditions UAE's Relative Position 2009

Competitive Advantages Relative to GDP per Capita

Communication infrastructure

Mobile telephone subscribers 1

Logistical infrastructure

Quality of air transport infrastructure 3

Quality of roads 7

Quality of port infrastructure 7

Administrative infrastructure

Burden of customs procedures 3

Burden of government regulation 5

Capital market conditions

Ease of access to loans 5

Venture capital availability 9

Financing through local equity market 12

Protection of minority shareholders' interests 12

Competitive Disadvantages Relative to GDP per Capita

Administrative infrastructure

Procedures required to start a business 46

Time required to start a business 39

Complexity of paying taxes (World Bank) 32

Ease of starting a new business 27

Capital market conditions

Strength of investor laws (World Bank) 66

Domestic credit to private sector 47

Soundness of banks 42

Financial market sophistication 27

Higher education infrastructure

Tertiary enrollment 67

Quality of management schools 16

Availability of scientists and engineers 16

Innovation infrastructure

Utility patents per million population 38

Quality of scientific research institutions 36

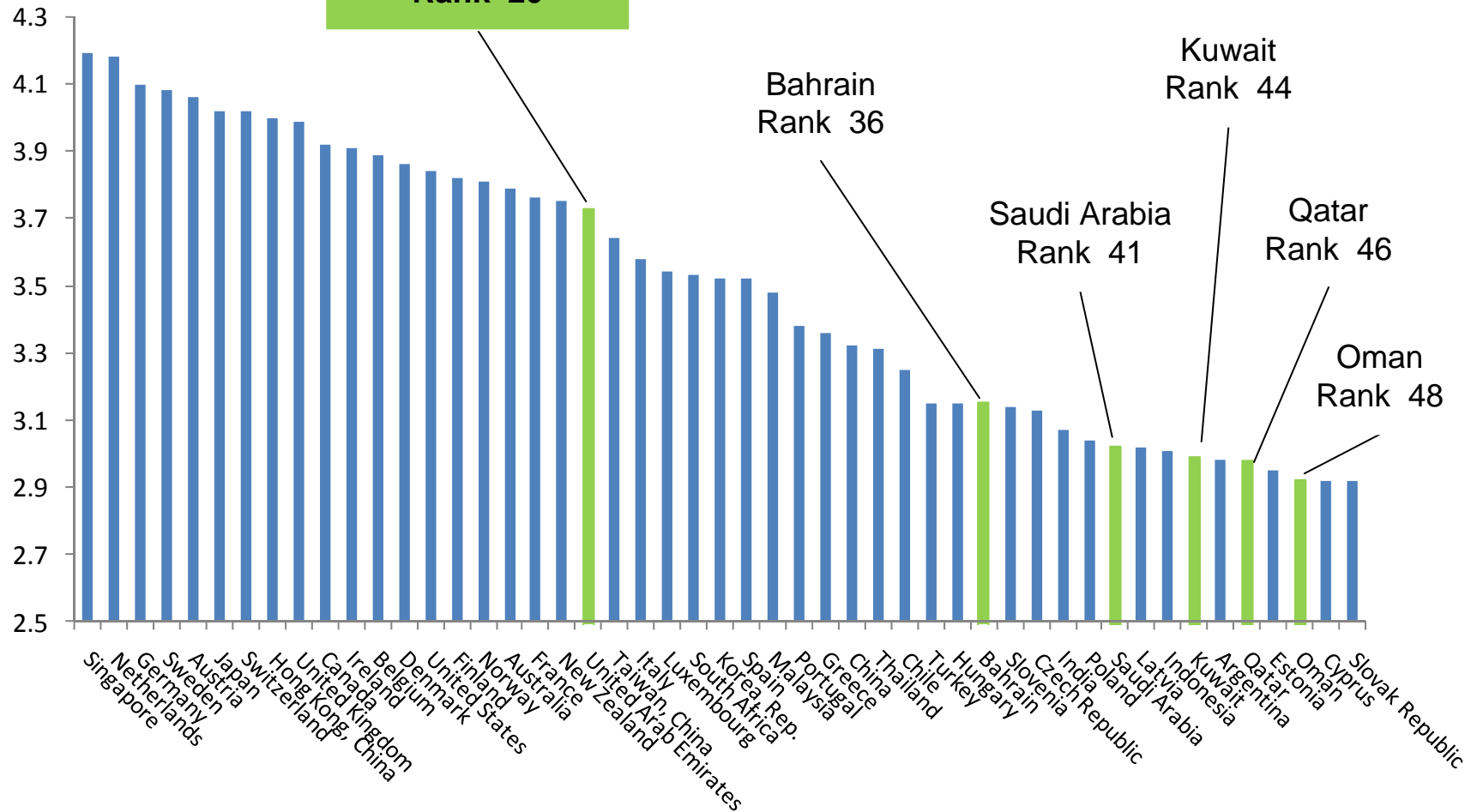
University-industry research collaboration 36

Note: Rank versus 133 countries; overall, UAE ranks 14th in 2008 PPP adjusted GDP per capita and 20th in Global Competitiveness

Source: World Economic Forum and Institute for Strategy and Competitiveness, Harvard University (2009)

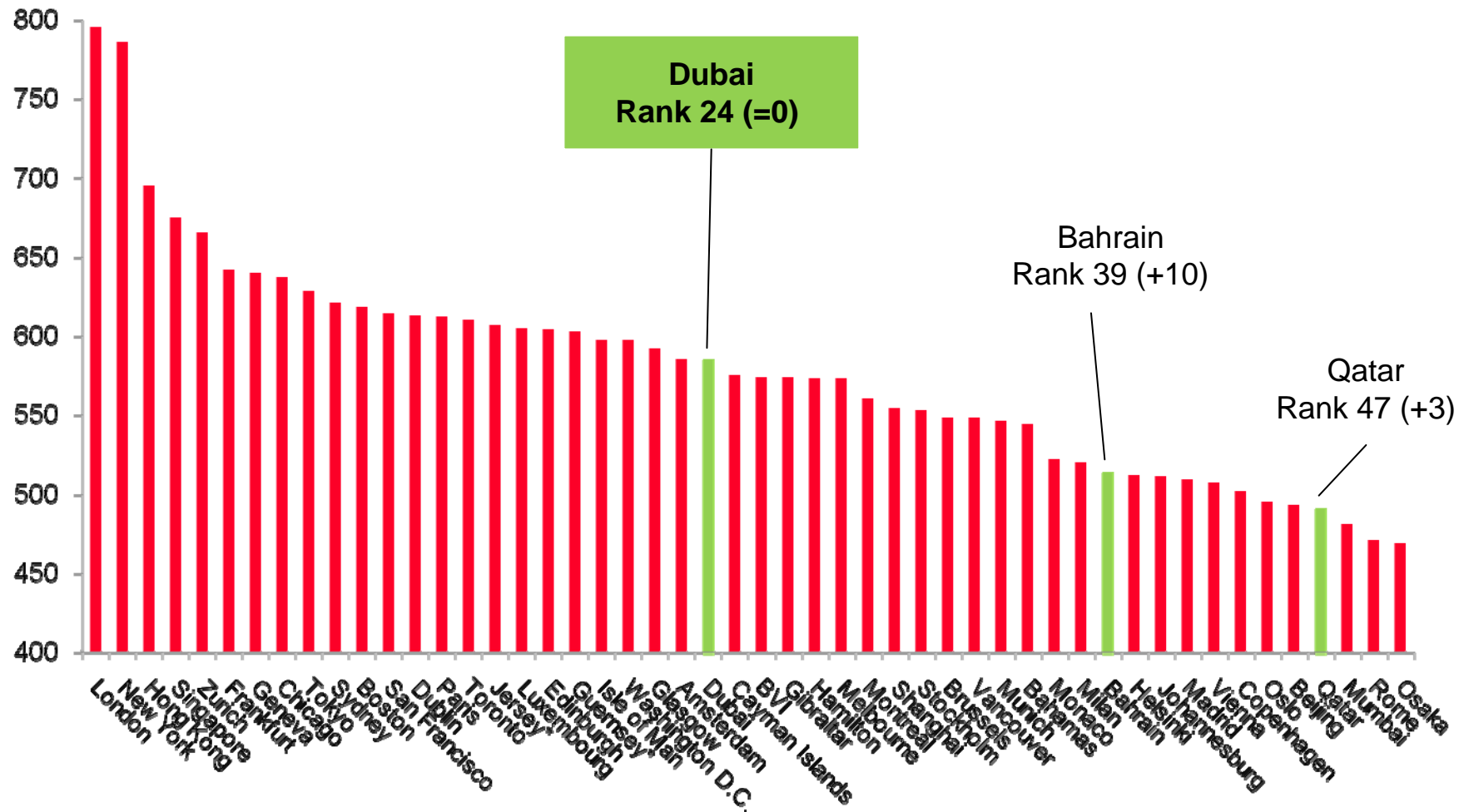
Logistical Performance Index

Logistical Performance Score, 2008



Ranking of Financial Centers

Financial Center Score,
2008



Note: figures in parentheses are change in rank between 2008 and 2007
 Source: Global Financial Center Ranking (2008), author's analysis.

Doing Business Selected Countries

Economy	Ease of Doing Business	Starting a Business	Dealing with Licenses	Employing Workers	Registering Property	Getting Credit	Protecting Investors	Paying Taxes	Trading Across Borders	Enforcing Contracts	Closing a Business
Saudi Arabia	13	13	33	73	1	61	16	7	23	140	60
Bahrain	20	63	14	13	22	87	57	13	32	117	26
United Arab Emirates	33	44	27	50	7	71	119	4	5	134	143
Qatar	39	68	28	68	55	135	93	2	41	95	33
Kuwait	61	137	81	24	89	87	27	11	109	113	69
Oman	65	62	130	21	20	127	93	8	123	106	66
Tunisia	69	47	107	108	59	87	73	118	40	77	34
Yemen, Rep.	99	53	50	74	50	150	132	148	120	35	89
Jordan	100	125	92	51	106	127	119	26	71	124	96
Egypt	106	24	156	120	87	71	73	140	29	148	132
Lebanon	108	108	125	66	111	87	93	34	95	121	124
Morocco	128	76	99	176	123	87	165	125	72	108	67
Algeria	136	148	110	122	160	135	73	168	122	123	51
Iran	137	48	141	137	153	113	165	117	134	53	109
West Bank and Gaza	139	176	157	135	73	167	41	28	92	111	183
Syria	143	133	132	91	82	181	119	105	118	176	87
Iraq	153	175	94	59	53	167	119	53	180	139	183
Djibouti	163	177	102	151	140	177	178	65	34	161	135
Middle East & North Africa	91.6	90.1	94.6	85.7	80.9	111.6	92.6	66.1	76.4	114.7	90.9

Rank out of 178 countries.

Source: World Bank Doing Business (2009).

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Context for Strategy and Rivalry

UAE's Relative Position 2009

Competitive Advantages Relative to GDP per Capita

Incentives

Impact of taxation on incentives to work and invest	3
Distortive effect of taxes and subsidies on competition	5

Openness

Prevalence of trade barriers	7
Restrictions on capital flows	9

Nature of competition

Intensity of local competition	6
Intellectual property protection	11

Labor markets

Pay and productivity	5
Low rigidity of employment	14

Competitive Disadvantages Relative to GDP per Capita

Nature of competition

Regulatory quality	47
Market disruption from state-owned enterprises	39
Quality of competition in the ISP sector	38
Effectiveness of antitrust policy	18

Openness

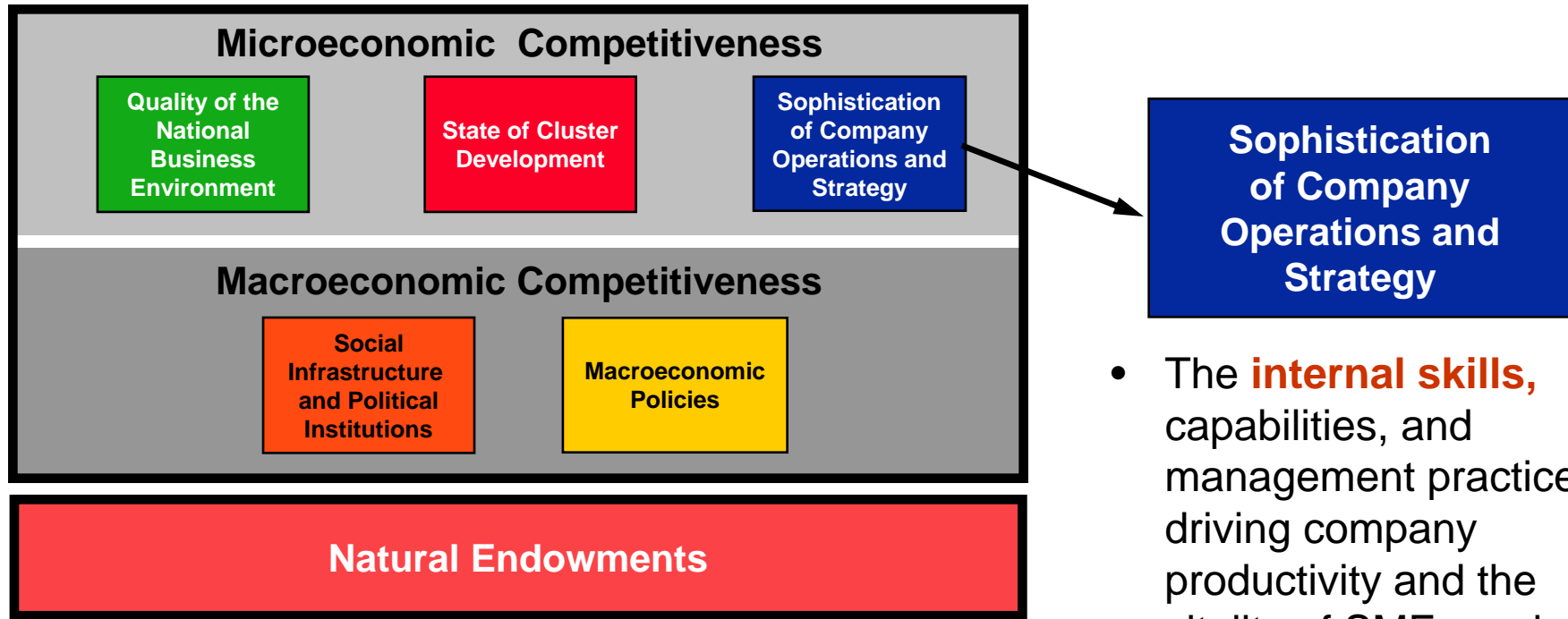
Strength of investor protection	71
Prevalence of foreign ownership	24

Corporate governance

Strength of auditing and reporting standards	28
Efficacy of corporate boards	17

Note: Rank versus 133 countries; overall, UAE ranks 14th in 2008 PPP adjusted GDP per capita and 20th in Global Competitiveness
Source: World Economic Forum and Institute for Strategy and Competitiveness, Harvard University (2009)

Determinants of Competitiveness

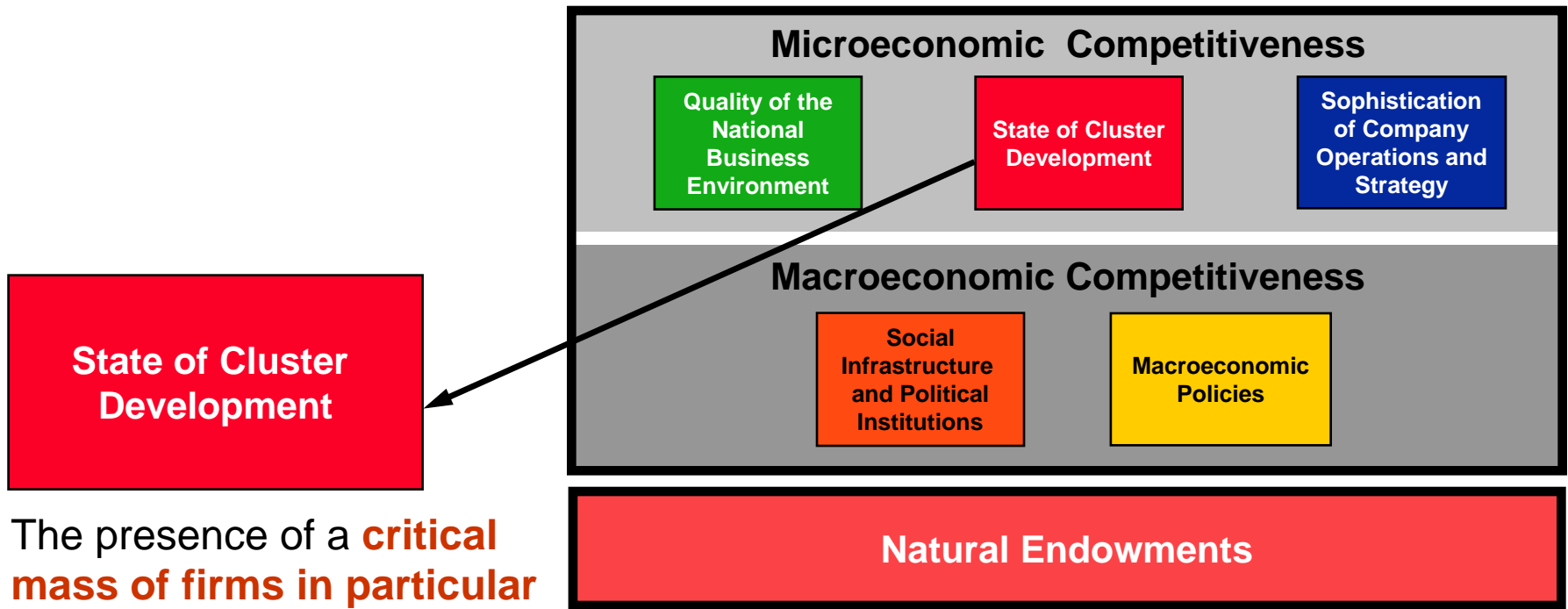


Company Sophistication in the UAE

Observations

- The traditional local sector is **weak**
 - Old family groups focusing on retail/wholesale trade, often as local partner of multinationals subject to limits on foreign ownership
- **Entrepreneurship** and new firms play a very limited role
- GLCs are the **dominant** local companies
 - Created recently with a combination of petrodollars and expatriate management
 - Compete largely on operational efficiency and ability to serve to growing local demand, not on strategic positioning
- Foreign companies are focused on **servicing local demand**
 - Serve the growing local market
 - Or use UAE as a headquarters to serve the Gulf region due to relatively attractive living conditions for foreign expatriates
 - Virtually no activities serving the broader global market

Determinants of Competitiveness



- The presence of a **critical mass of firms in particular fields**, together with specialized skills, infrastructure, and institutions, that enable productivity through externalities across related firms and supporting services

Related and Supporting Industries

UAE's Relative Position 2009

Competitive Advantages Relative to GDP per Capita

Depth of clusters

Availability of latest technologies	8
Local supplier quantity	8
Local availability of process machinery	13

Cluster Policy

Extent of cluster policy	6
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Competitive Disadvantages Relative to GDP per Capita

Effectiveness of clusters

State of cluster development	27
Extent of collaboration in clusters	19

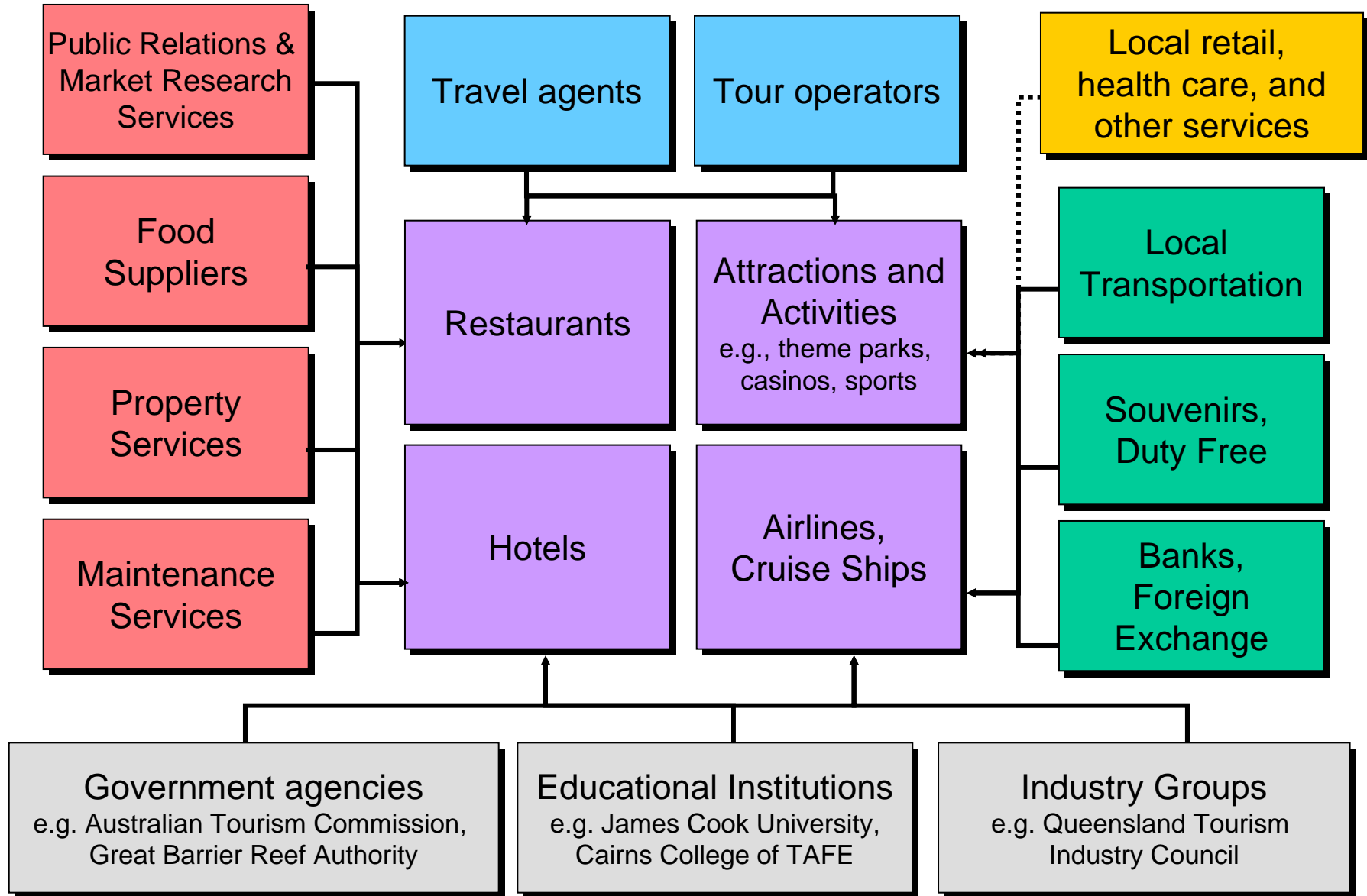
Depth of clusters

Local supplier quality	23
Local availability of specialized research and training services	20

Note: Rank versus 133 countries; overall, UAE ranks 14th in 2008 PPP adjusted GDP per capita and 20th in Global Competitiveness
Source: World Economic Forum and Institute for Strategy and Competitiveness, Harvard University (2009)

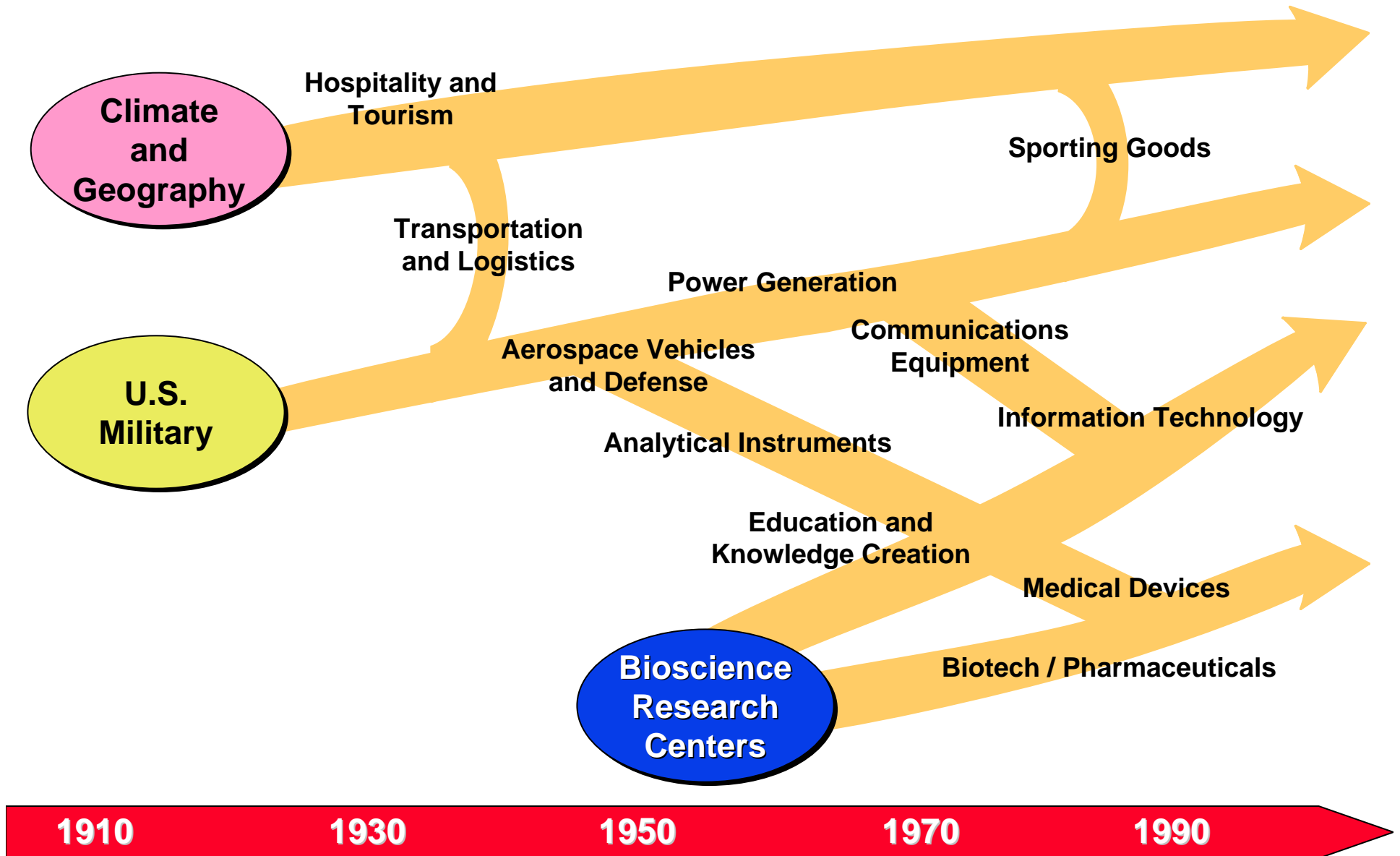
Enhancing Cluster Development

Tourism Cluster in Cairns, Australia



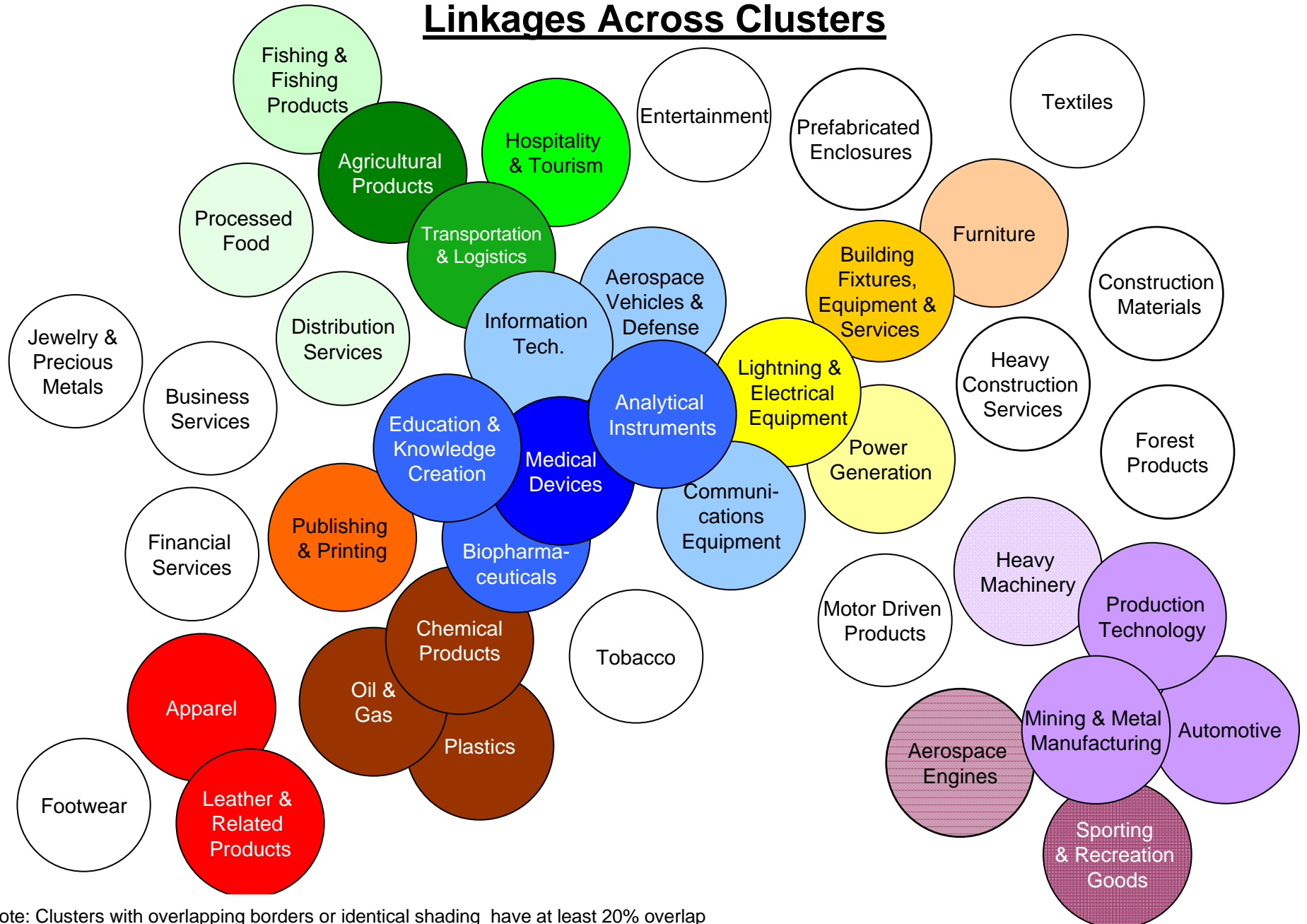
The Evolution of Regional Economies

San Diego



Clusters and Economic Diversification

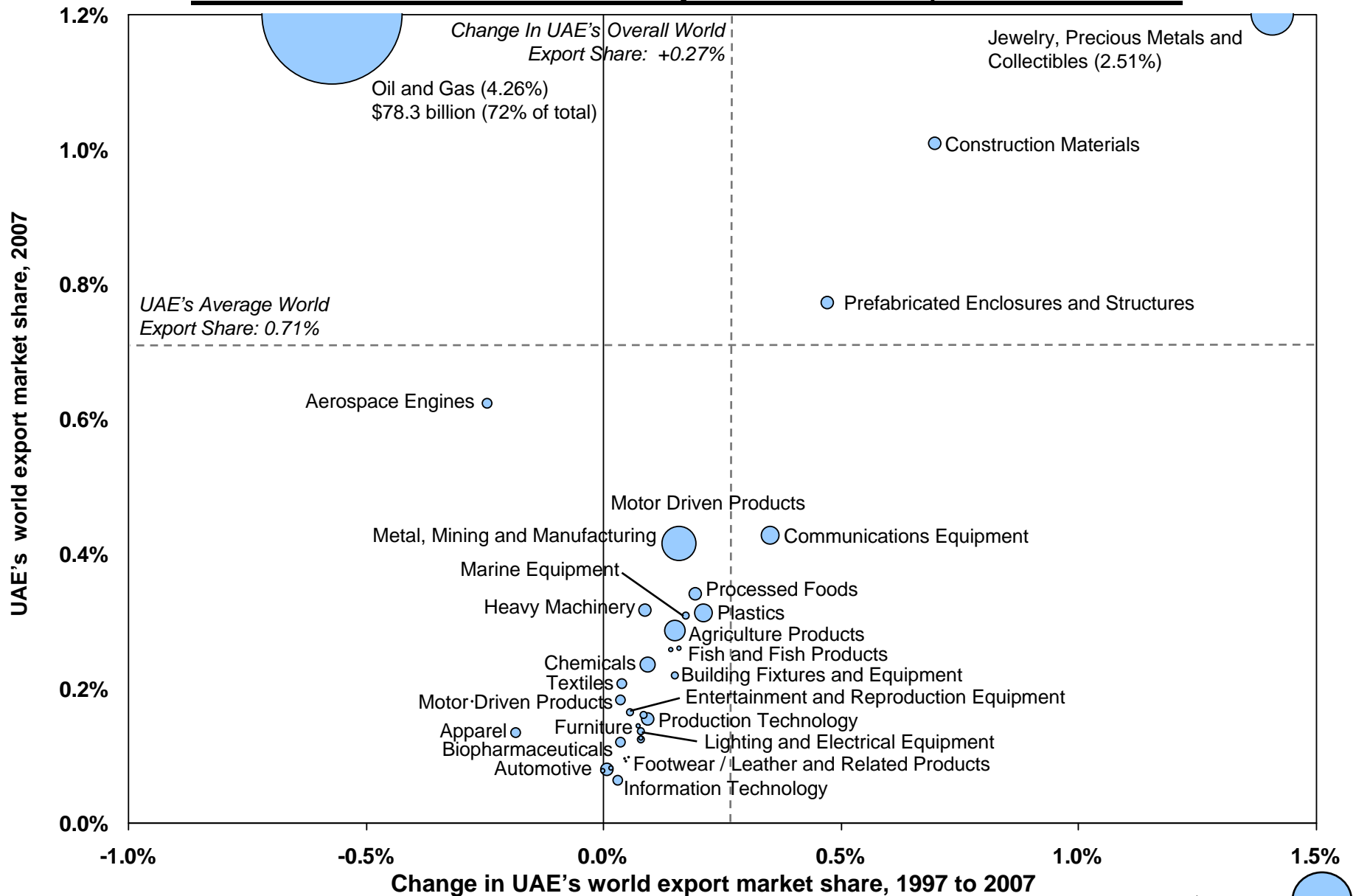
Linkages Across Clusters



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

Cluster Development

UAE's National Cluster Export Portfolio, 197 to 2007

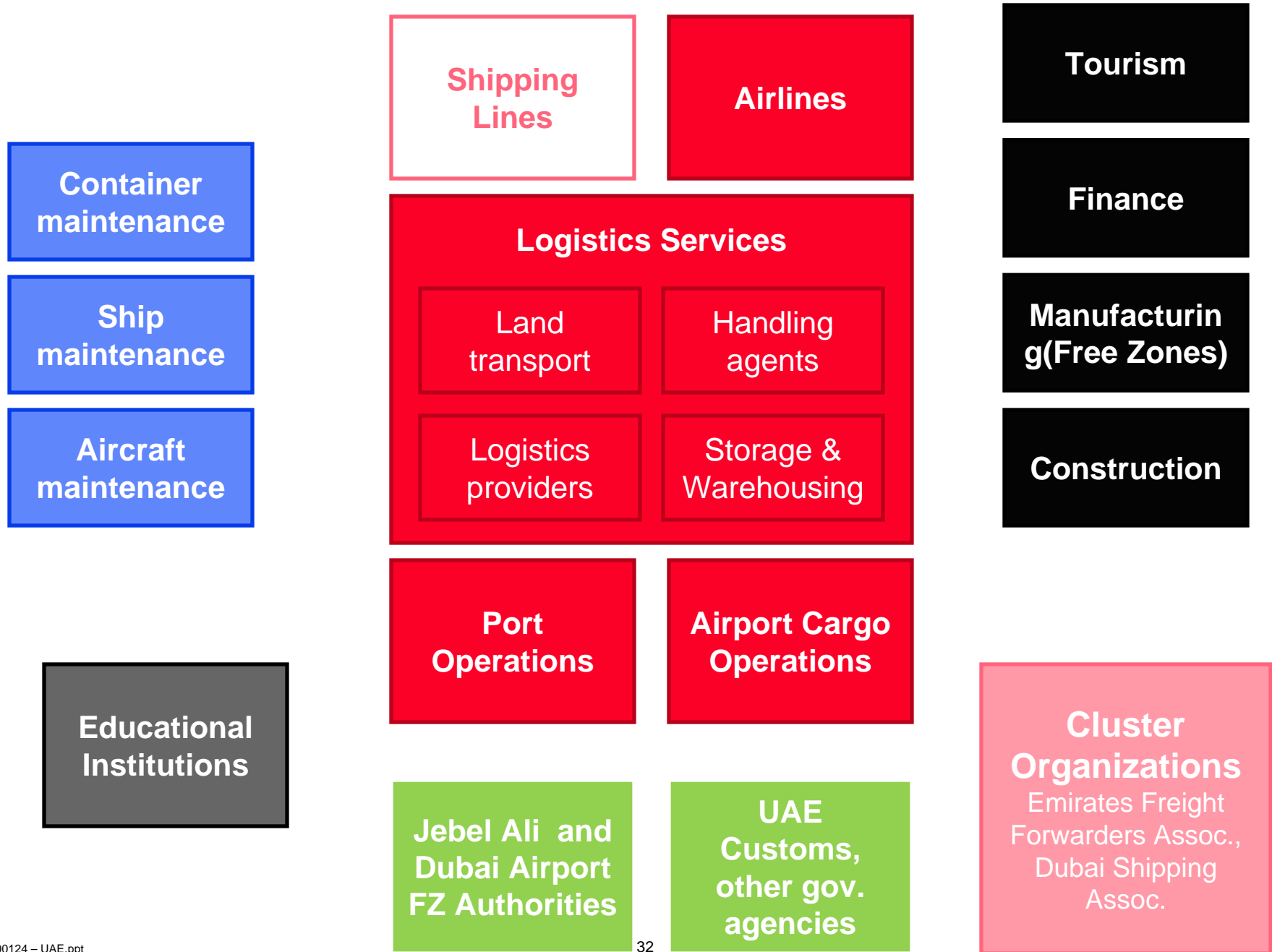


Source: Prof. Michael E. Porter, International Cluster Competitiveness Project, Institute for Strategy and Competitiveness, Harvard Business School; Richard Bryden, Project Director. Underlying data drawn from the UN Commodity Trade Statistics Database and the IMF BOP statistics.

Exports of US\$13 Billion =

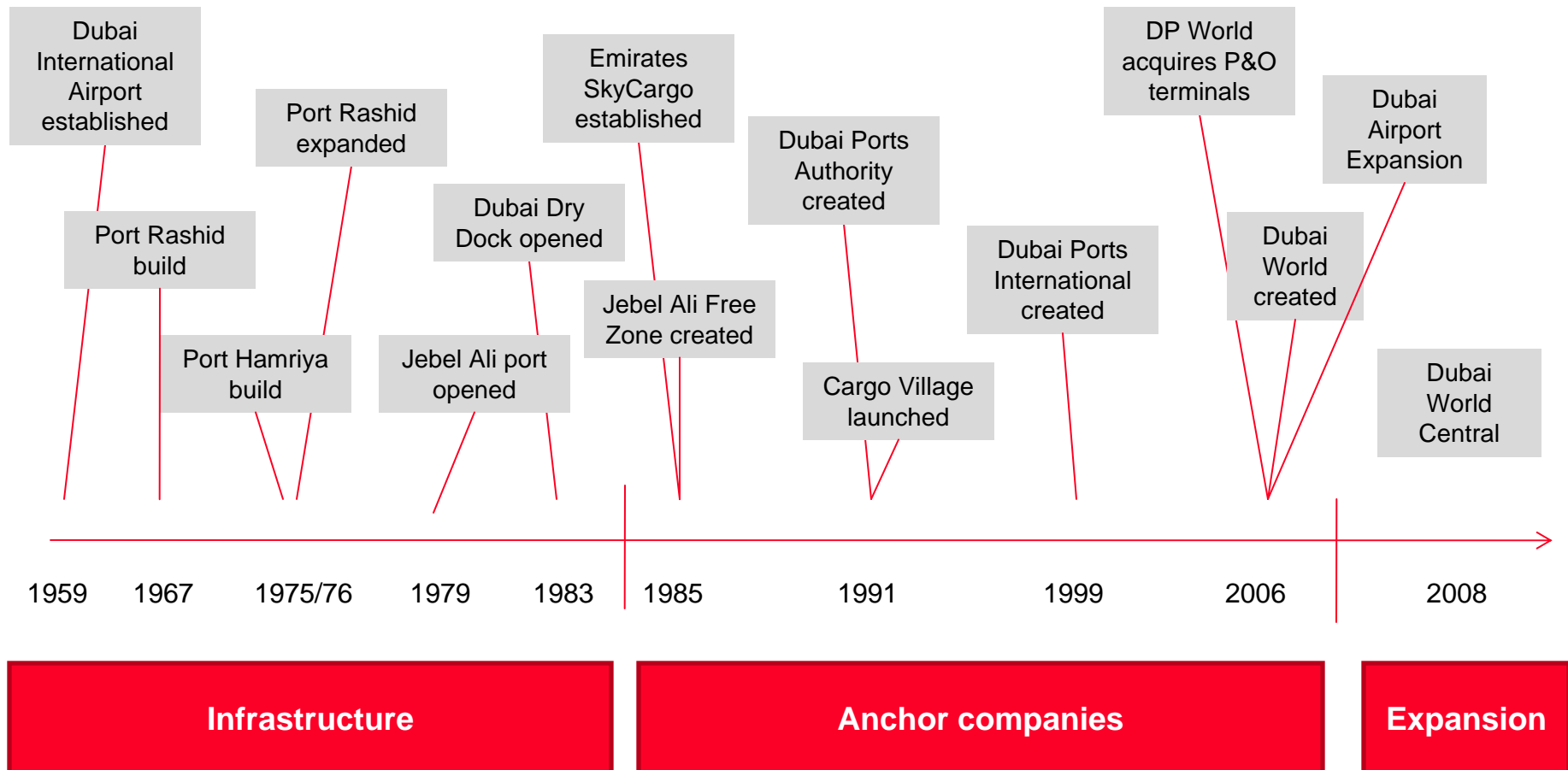
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The Dubai Logistics Cluster Map



History of the Dubai Logistics Cluster

Key Developments and Institutions



Clusters in the UAE

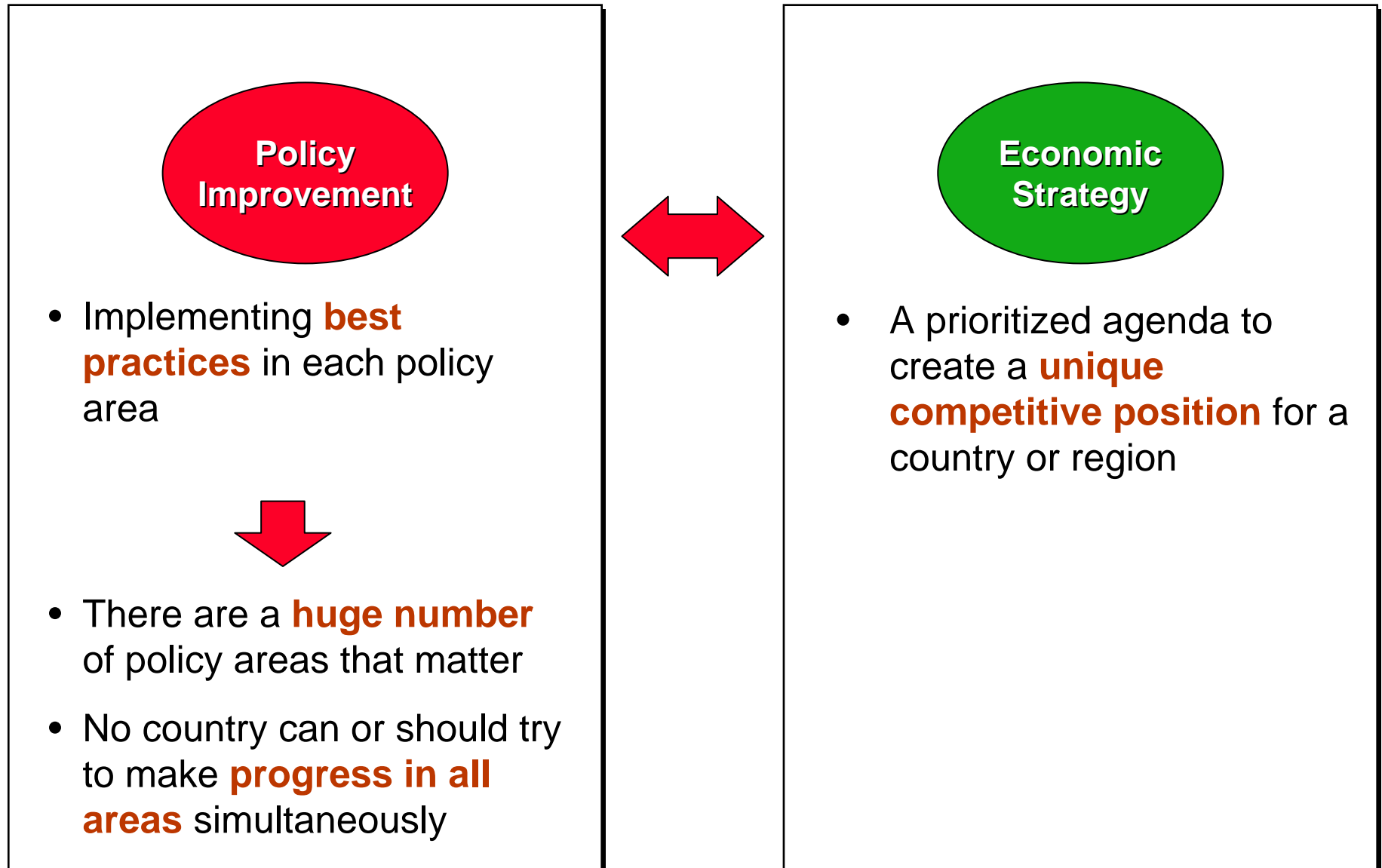
Observations

- Clusters and cluster development efforts exist at the **level of individual emirates**
- There is **significant overlap** between cluster efforts within the UAE; collaboration is very limited
- Current UAE's clusters build on **natural endowments, infrastructure investments**, and the **attraction of foreign firms and talent**
- Despite **aggressive government efforts**, success in creating clusters in areas outside traditional fields has been limited
- Dialogue and active collaboration **within clusters** is limited, even where there is a significant degree of co-location of activities



- The UAE has made more progress in **cluster-based economic diversification** than many other oil-driven economies
- However, building a broader portfolio of **dynamic, sustainable clusters** remains a major priority

The Need for an Economic Strategy



Defining an Economic Strategy

National Value Proposition

- What are the **distinctive competitive assets** of the nation's economy given its location, legacy, rate of progress, existing strengths and potential strengths?
 - What unique value as a business location?
 - In what types of fields / clusters?
 - What roles with neighbors, the region, and the broader world?

Developing Unique Strengths

- What elements of **institutional context** and the **business environment** can be unique strengths relative to peers/neighbors?
- What **existing** and **emerging clusters** can be built upon?

Addressing Crucial Constraints

- What are the crucial **weaknesses** and **constraints** that must be addressed to achieve parity with peer countries and allow the country to move to the next level?

- **Priorities** and **sequencing** are a necessity in economic development

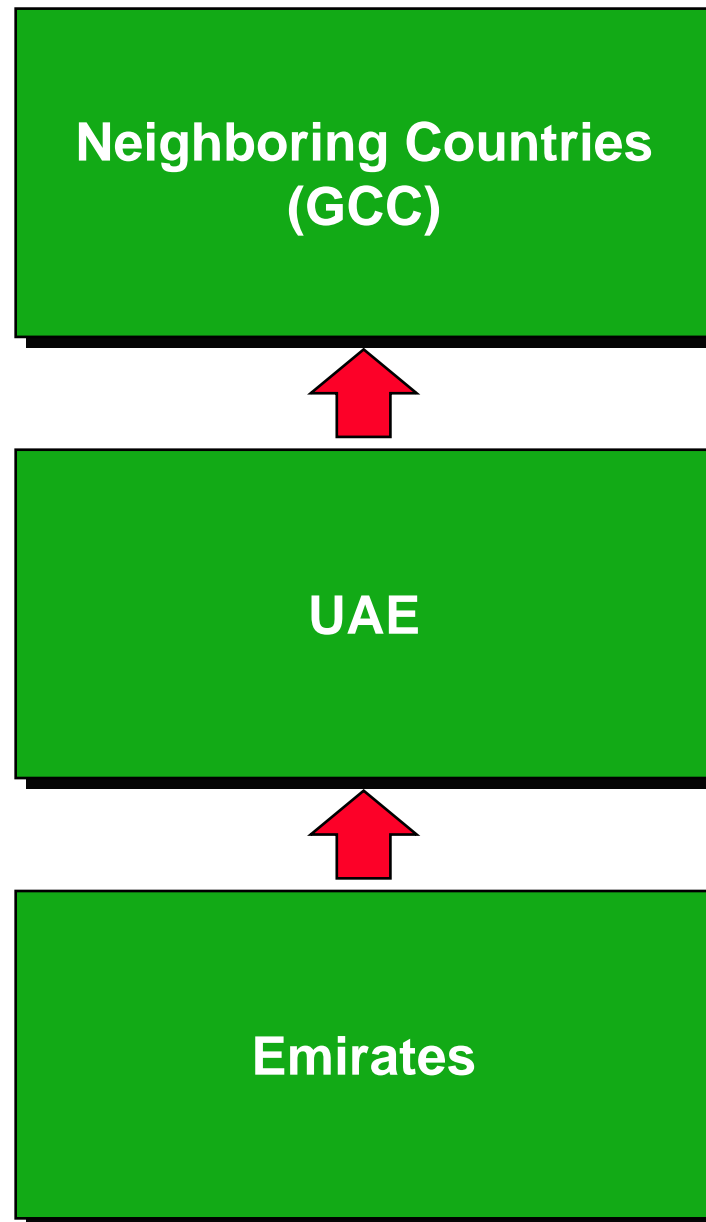
Economic Strategy in the UAE

- The **UAE government** has in early 2007 announced the government strategy for the coming years, outlining activities and ambitions
- Different **emirates** have developed their own economic strategies, e.g., Abu Dhabi Economic Vision 2030 and Dubai Strategic Plan 2015
- For economies that are in the process of economic transformation such documents are particularly important as they **outline new qualities** to be achieved
- These documents also provide important orientation to **coordinate the activities of new government agencies** that are emerging



- Current strategies focus on **aspirations** and particular **policies**, not on specific competitive advantages to be created
- There is **insufficient integration** of strategies and policies at different levels of government

Geographic Influences on UAE Competitiveness



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**
- Rules and regulations ensuring open, effective competition, e.g. trade policy, general rules and regulations for business, are best coordinated **across regions**
- Region's **specialize** in different sets of clusters
- **Cluster strength** directly impacts regional performance
- Each region requires its own distinctive **competitiveness agenda**
- **National policies and investments** can help all regions to be more effective in the competitiveness efforts
- Improving competitiveness requires **effective policy collaboration** between regions and the national government
- Neighboring regions have to find a productive **balance of competition and collaboration** to avoid zero-sum rivalry

Regions and Competitiveness in the UAE

- The large **heterogeneity** in economic size, profile, and performance across the Emirates of the UAE is not untypical
- In terms of economic development, more **cooperation** and coordination across the individual Emirates is required
- Competitiveness-related rules, regulations, and policies are **less aligned** across the UAE than in most other countries
- The federal government needs to strengthen the regulatory and legislation frameworks



- The UAE needs to significantly increase the **transparency of roles and responsibilities** (legal as well as actual) across different levels of government
- The UAE needs to focus more on **coordination** and **integration** across different levels of government

Economic Integration Among Neighboring Countries

UAE's Neighborhood



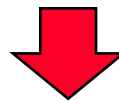
- Economic coordination among neighboring countries can significantly enhance competitiveness
- Integration offers greater opportunities than participation in broader economic forums (e.g., EU)

Competitiveness and the Neighborhood

- A nation's most natural trading and investment partners are its **neighbors**
- A nation's competitiveness can be **significantly enhanced by economic coordination with neighbors**
 - Capturing **spillovers** in policy and infrastructure
 - Facilitating **internationalizing of local firms**
 - **Specialization** in the **value chain**
 - **Attracting FDI**
 - Clout in **international negotiations**
- Economic collaboration among the neighborhood can enhance the effectiveness of domestic competitiveness efforts by helping to overcome domestic **political and economic barriers**

Regional Collaboration within the GCC

- The Gulf Cooperation Council has made **some progress** in enhancing regional collaboration
- However, too often policy action has remained significantly behind an ambitious rhetoric that did not acknowledge **differences in interests**
 - GCC member countries compete in a number of economic development efforts head on (finance, logistics, etc.)



- The traditional approach focused on market integration and is generating **decreasing returns**
- An effective regional agenda focuses on areas where joint action can **enhance national efforts** to improve competitiveness
 - Transparent rules and regulations
 - Skill development
 - Data infrastructure
 - Etc.

The Process of Economic Development

Shifting Roles and Responsibilities

Old Model

- The **central government** drives economic development through policy decisions, spending 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 must be a **bottom-up process** in which many individuals, companies, and institutions take responsibility and act

Appropriate Roles of Government in Economic Development

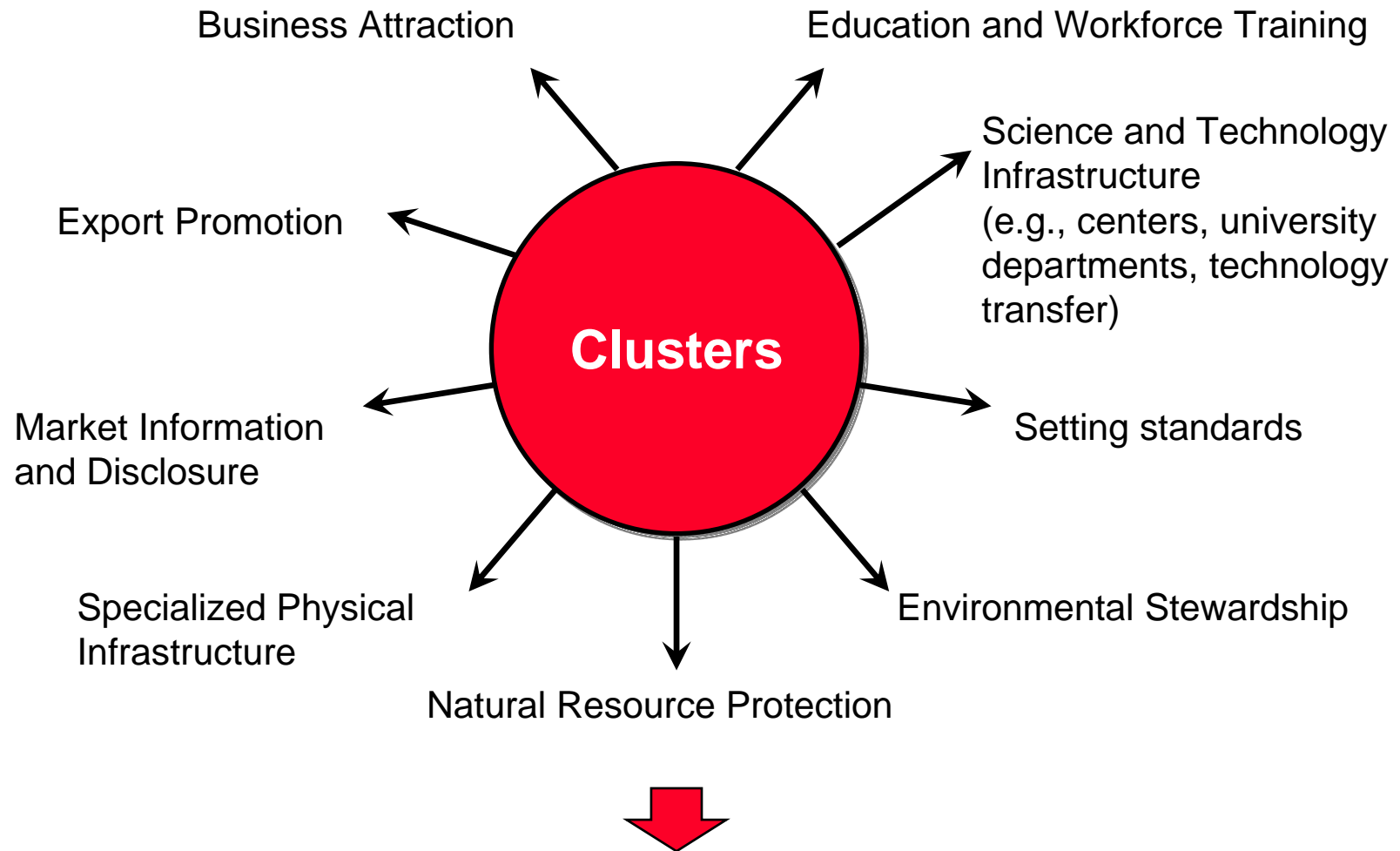
1. Establish a **stable and predictable** macroeconomic and political environment
2. Improve the availability, quality, and efficiency of **general purpose inputs, infrastructure and institutions**
3. Establish overall **rules and incentives** governing competition that encourage productivity growth
4. Facilitate **cluster development and upgrading**
5. Convene and actively support a long-term **process for economic upgrading** which informs and mobilizes government at all levels, the private sector, educational and other institutions, and civil society.

Strategic Issues for UAE Competitiveness

Action

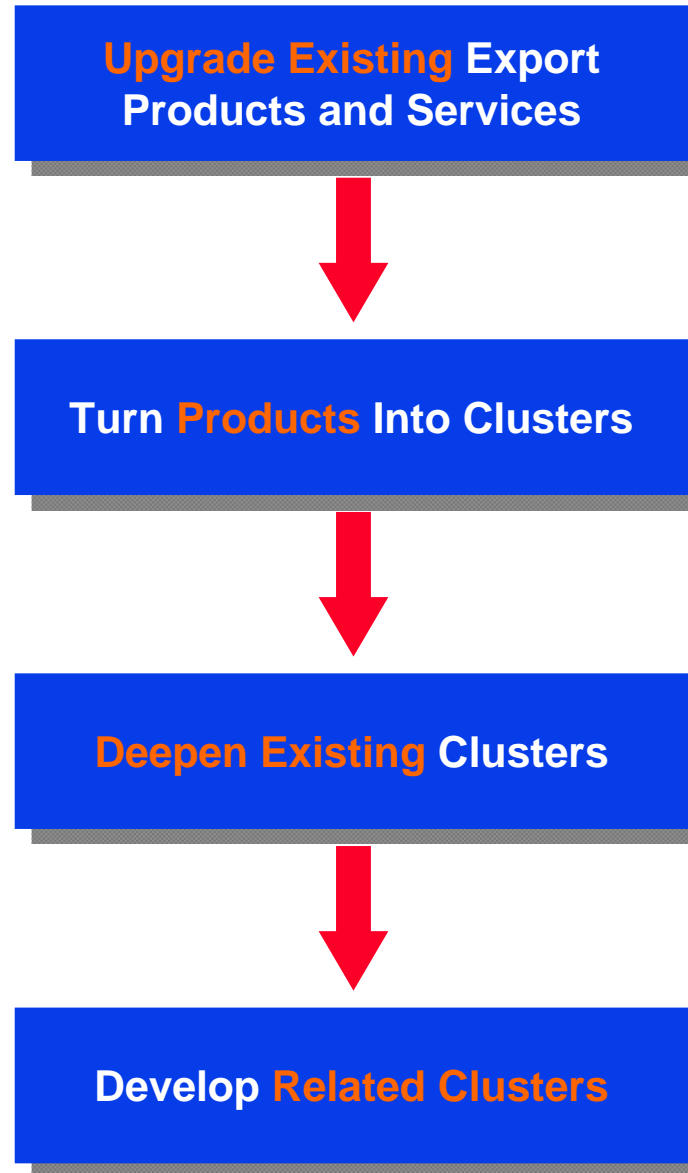
- Enhance public availability of **data** for fact-based policy making
- Upgrade **administrative capacity** and **coordination** across government
- Strengthen **macroeconomic policy** coordination and management
- Leverage **clusters** to organize economic policy delivery, coordinate government action, and direct diversification efforts

Cluster and Policy Implementation



- Clusters provide a framework for **organizing the implementation** of public policy and public investments towards economic development

Clusters and Economic Diversification



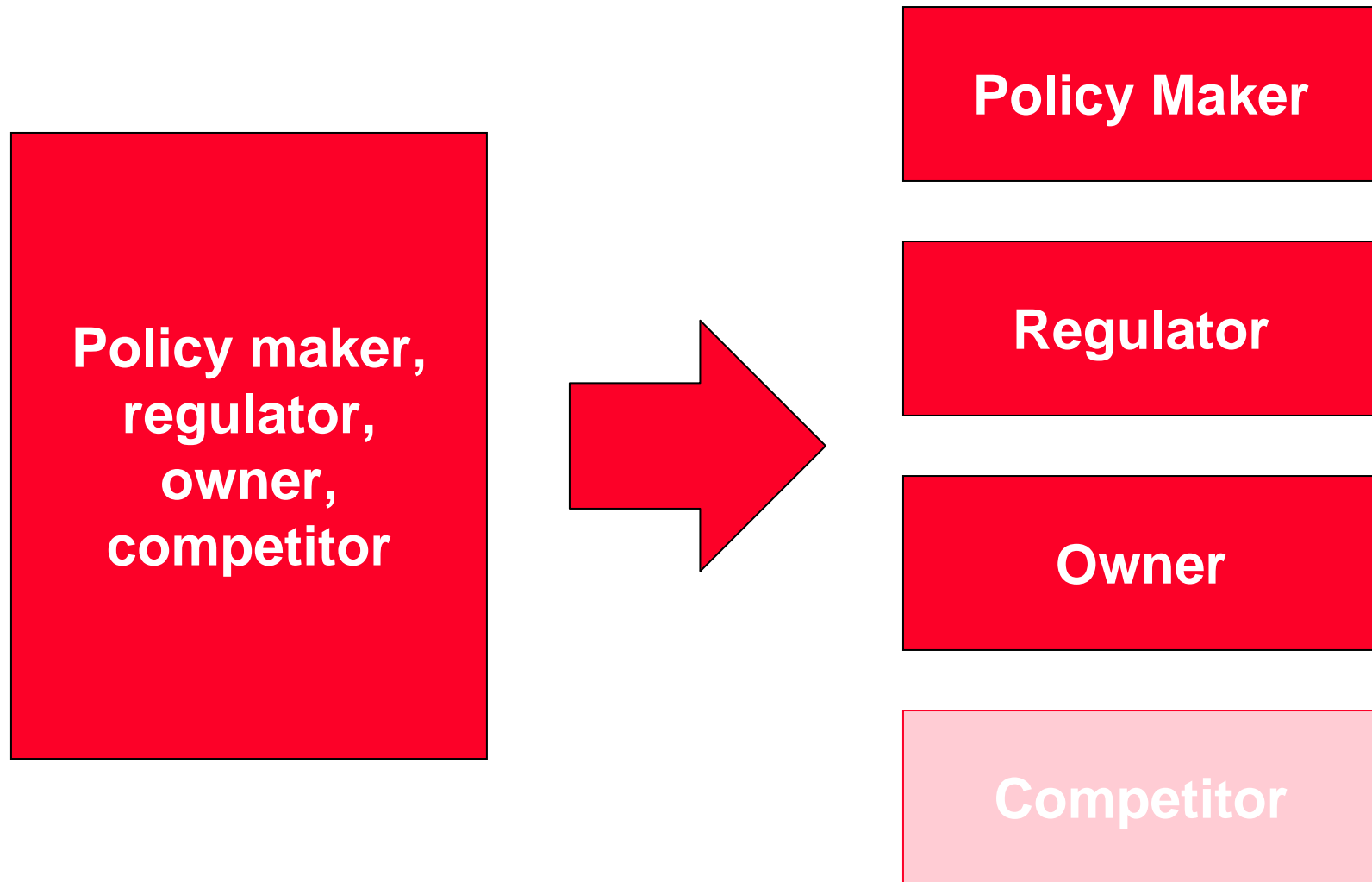
- Local firms
- MNCs

Strategic Issues for UAE Competitiveness

Action

- Enhance public availability of **data** for fact-based policy making
- Upgrade **administrative capacity** and **coordination** across government
- Strengthen **macroeconomic policy** coordination and management
- Leverage **clusters** to organize economic policy delivery, coordinate government action, and direct diversification efforts
- Address remaining weaknesses in the **rules and regulations affecting business**
- Strengthen the **governance** of government-linked companies

Transforming the Role of Government



Strategic Issues for UAE Competitiveness

Action

- Enhance public availability of **data** for fact-based policy making
- Upgrade **administrative capacity** and **coordination** across government
- Strengthen **macroeconomic policy** coordination and management
- Leverage **clusters** to organize economic policy delivery, coordinate government action, and direct diversification efforts
- Address remaining weaknesses in the **rules and regulations affecting business**
- Strengthen the **governance** of government-linked companies
- Launch an aggressive effort to enhance private **entrepreneurship**
- Focus on **skill development** for the local population, addressing both the supply and demand for high-quality education

Process

- Clarify the role and responsibilities of the **different levels of government** within the UAE
- Improve **transparency** of the policy process and legal system
- Strengthen **platforms for public-private dialogue** and give them a clear role in the policy process

UAE Competitiveness: Entering the Next Stage

- Within less than one generation, the UAE has **transformed** its economy and competitiveness
- The UAE's competitiveness agenda reflects the **new demands** at the level of development reached
- The crisis exposed some of the **structural weaknesses** that threaten further development; it is not a sign that past progress was an illusion
- At this junction, the UAE needs **a new set of policies and institutional structures** to succeed