

# Chilean Competitiveness: Ready for the Next Stage?

Professor Michael E. Porter  
*Institute for Strategy and Competitiveness*  
*Harvard Business School*

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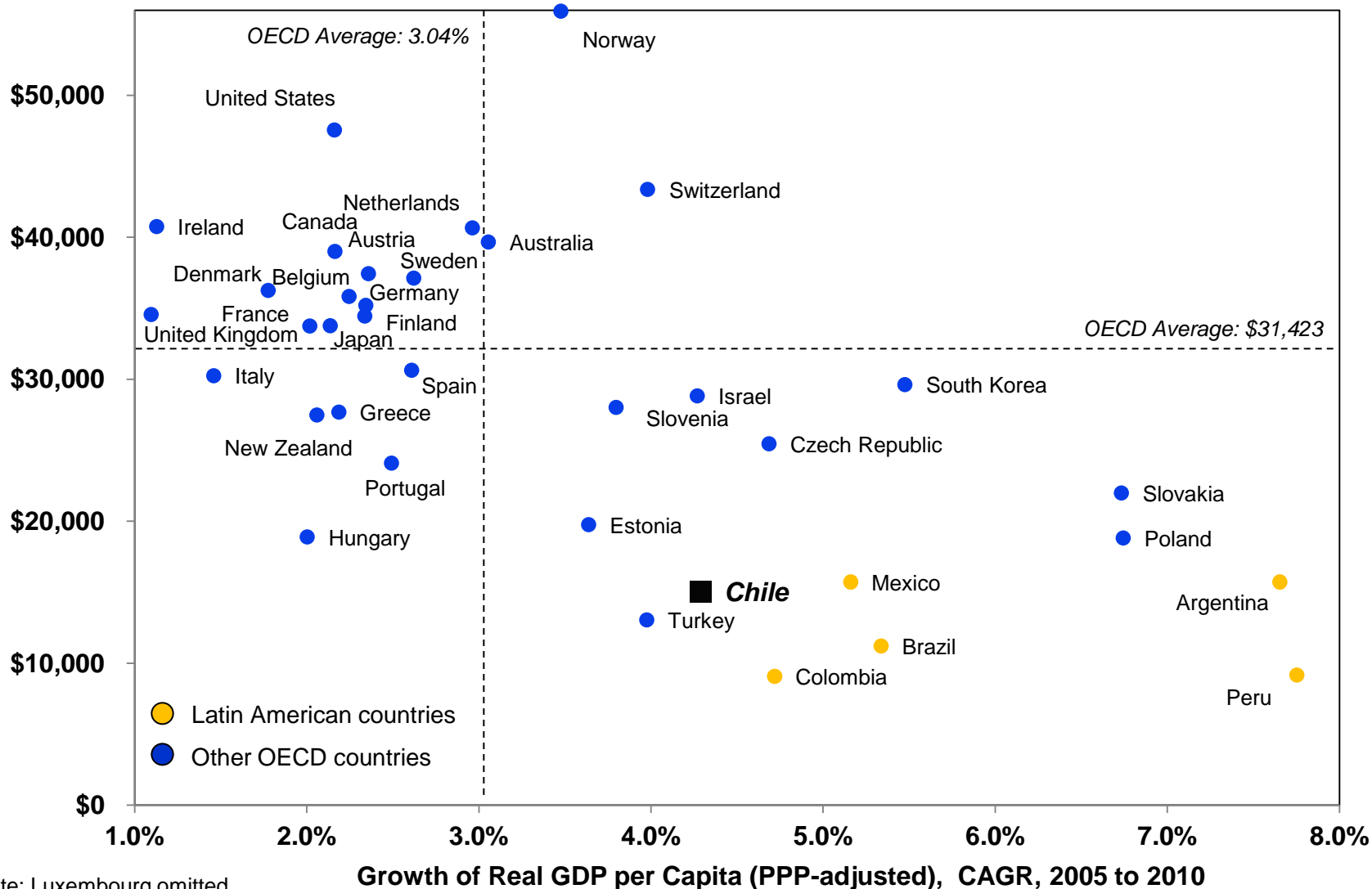
This presentation draws on ideas from Professor Porter's articles and books, including, *The Competitive Advantage of Nations* (The Free Press, 1990), "The Microeconomic Foundations of Economic Development," in *The Global Competitiveness Report*, (World Economic Forum), "Clusters and the New Competitive 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](http://www.isc.hbs.edu),

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# Prosperity Performance Across Countries

## 2005 - 2010

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



Note: Luxembourg omitted

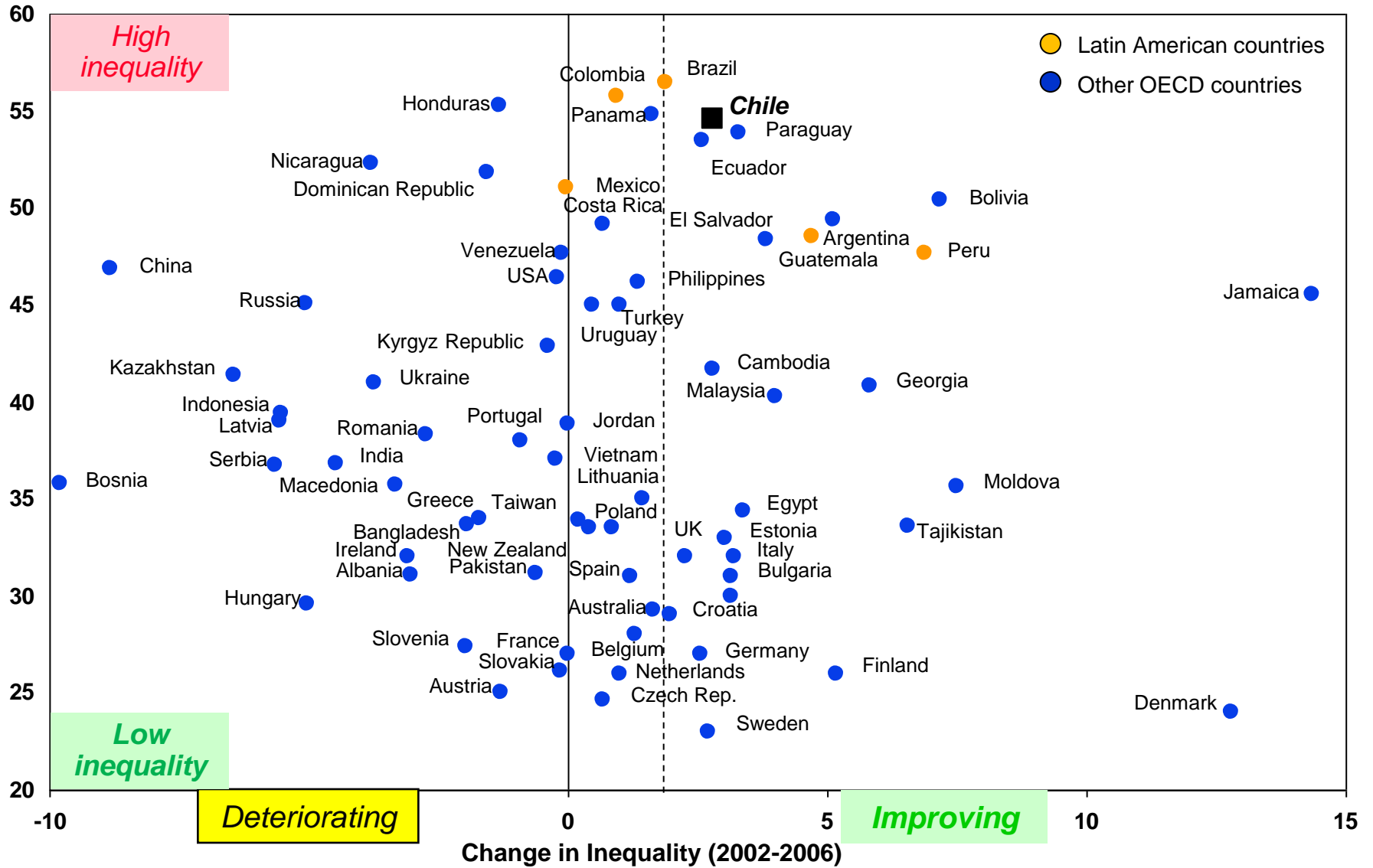
Source: EIU (2011), authors calculations

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# 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)

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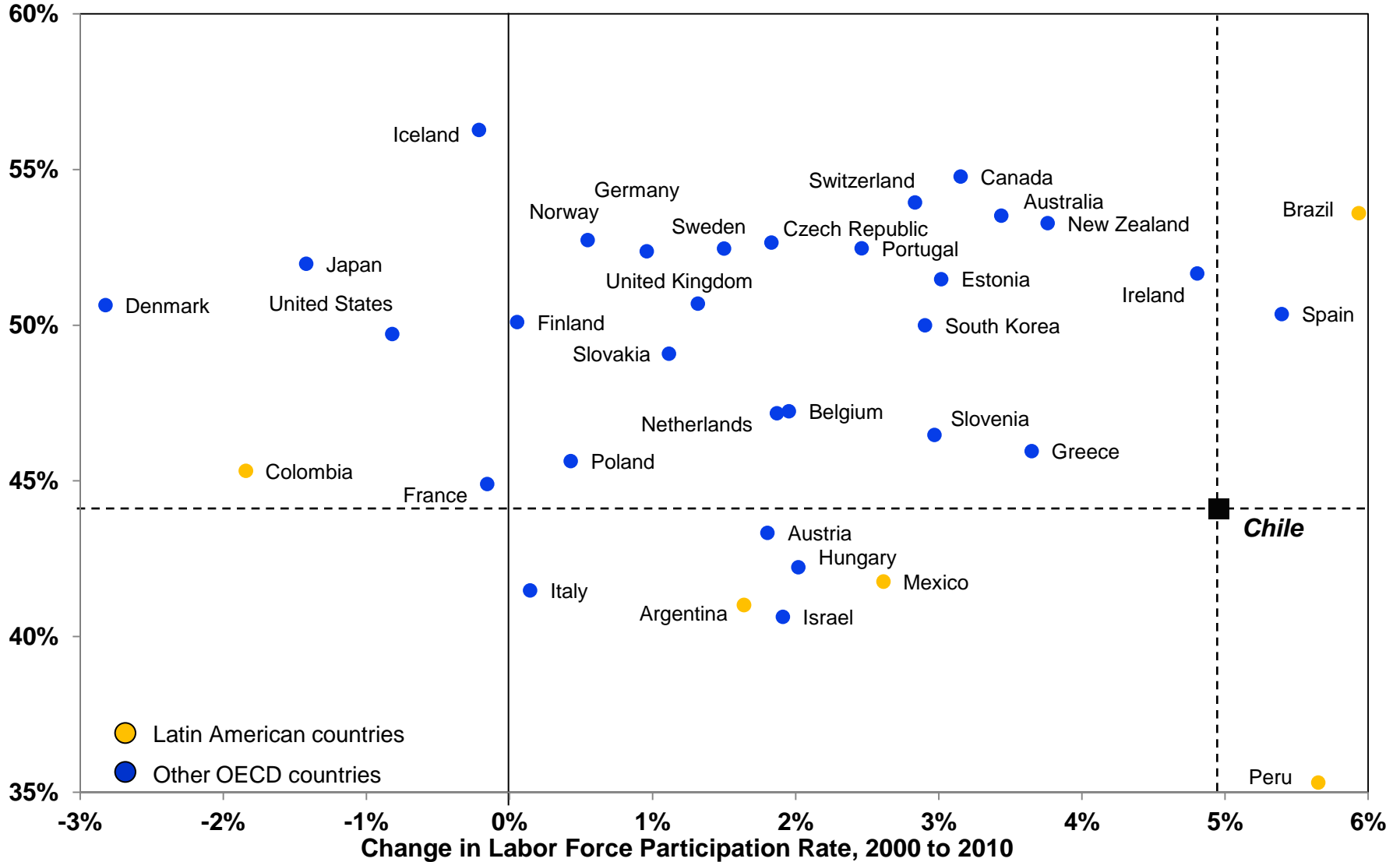
# Chile's Economic Situation in 2011

- 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



Note: Luxembourg omitted.

Source: EIU (2011), authors calculations

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# Chile's Economic Situation in 2011

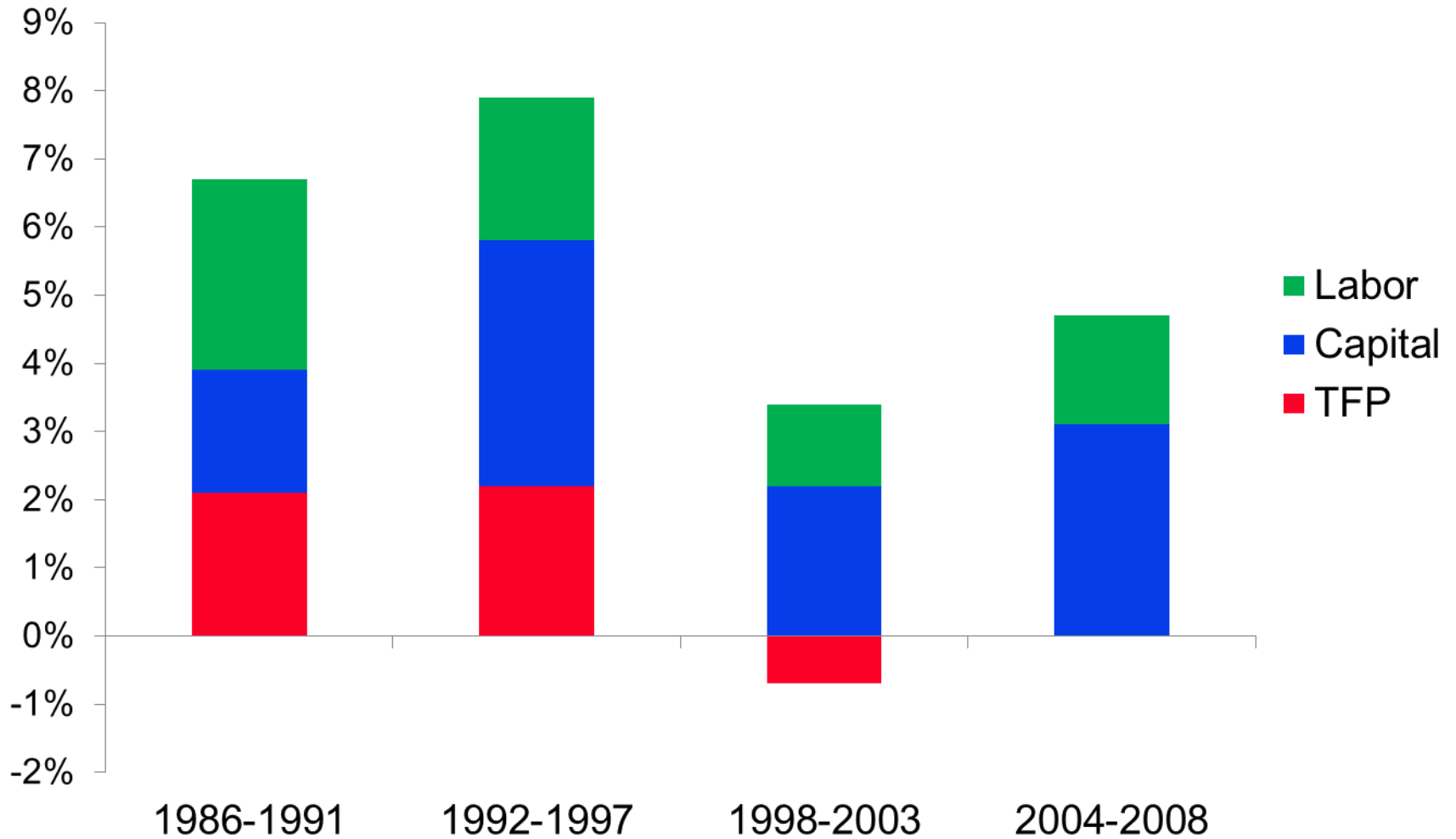
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**BUT**

- 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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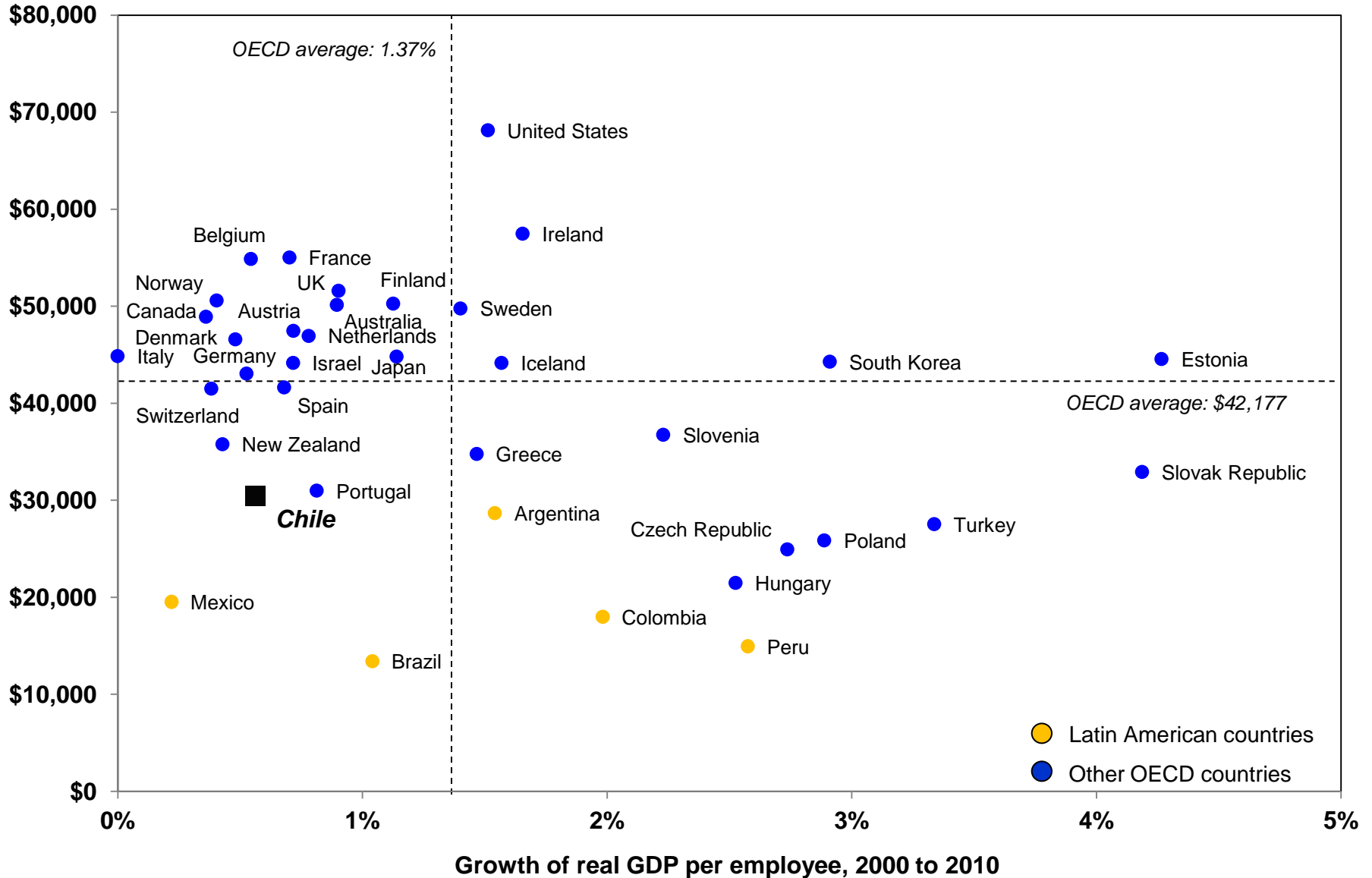
- There has been a **slow-down** of growth, both absolute and in comparison to peers
- Resilience of high **inequality** remains a serious problem
- Productivity growth has **stagnated**
  - Productivity growth is increasingly dependent on **capital deepening**
  - **Sectoral change** towards higher productivity industries has **slowed**
  - **Within sector** productivity growth remains **low**



# Labor Productivity Level and Growth

## Selected Countries

Real GDP per employee  
(1990 GK\$), 2010



Note: Luxembourg omitted

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

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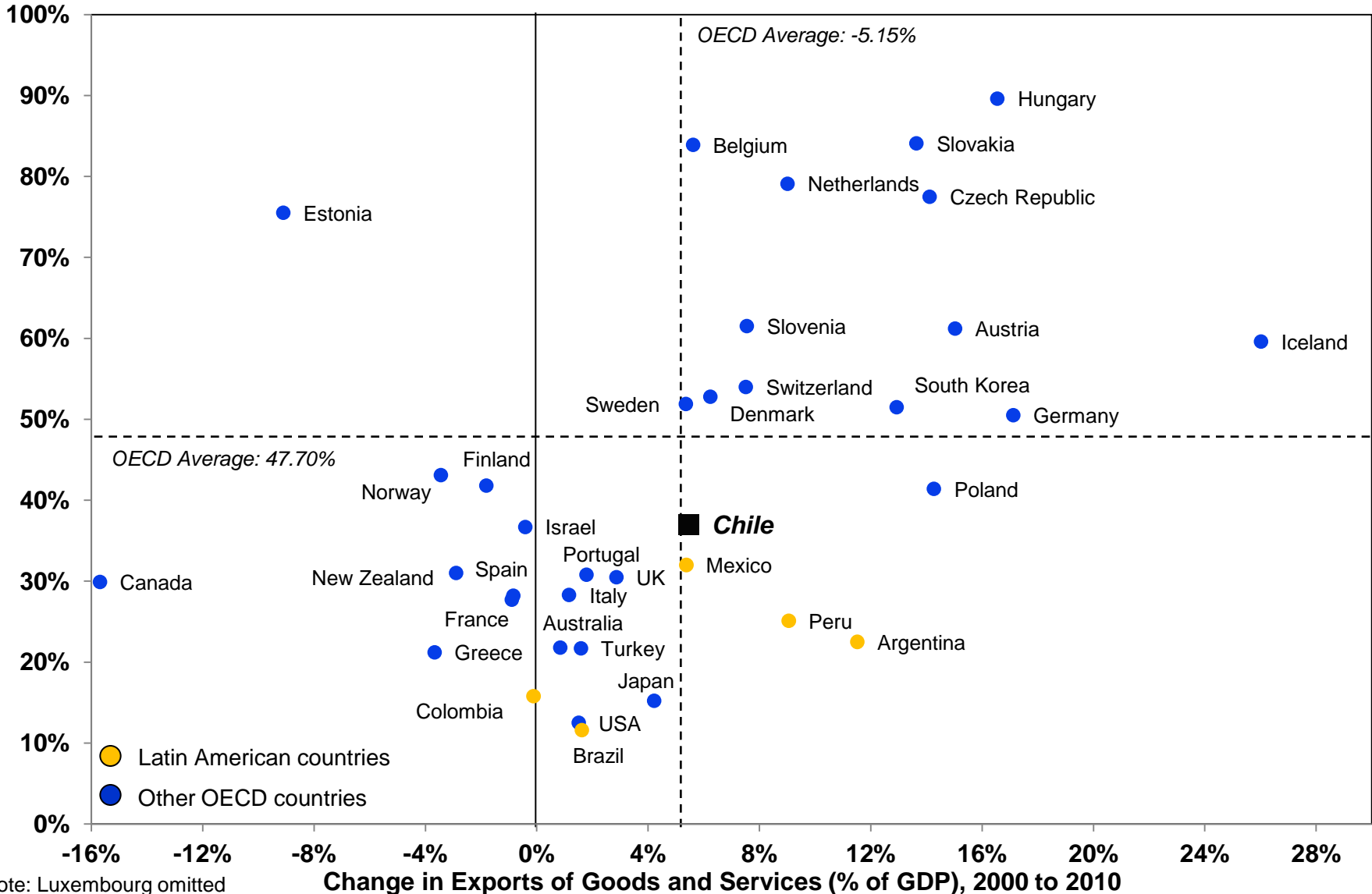
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# Export Performance

## Selected Countries

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



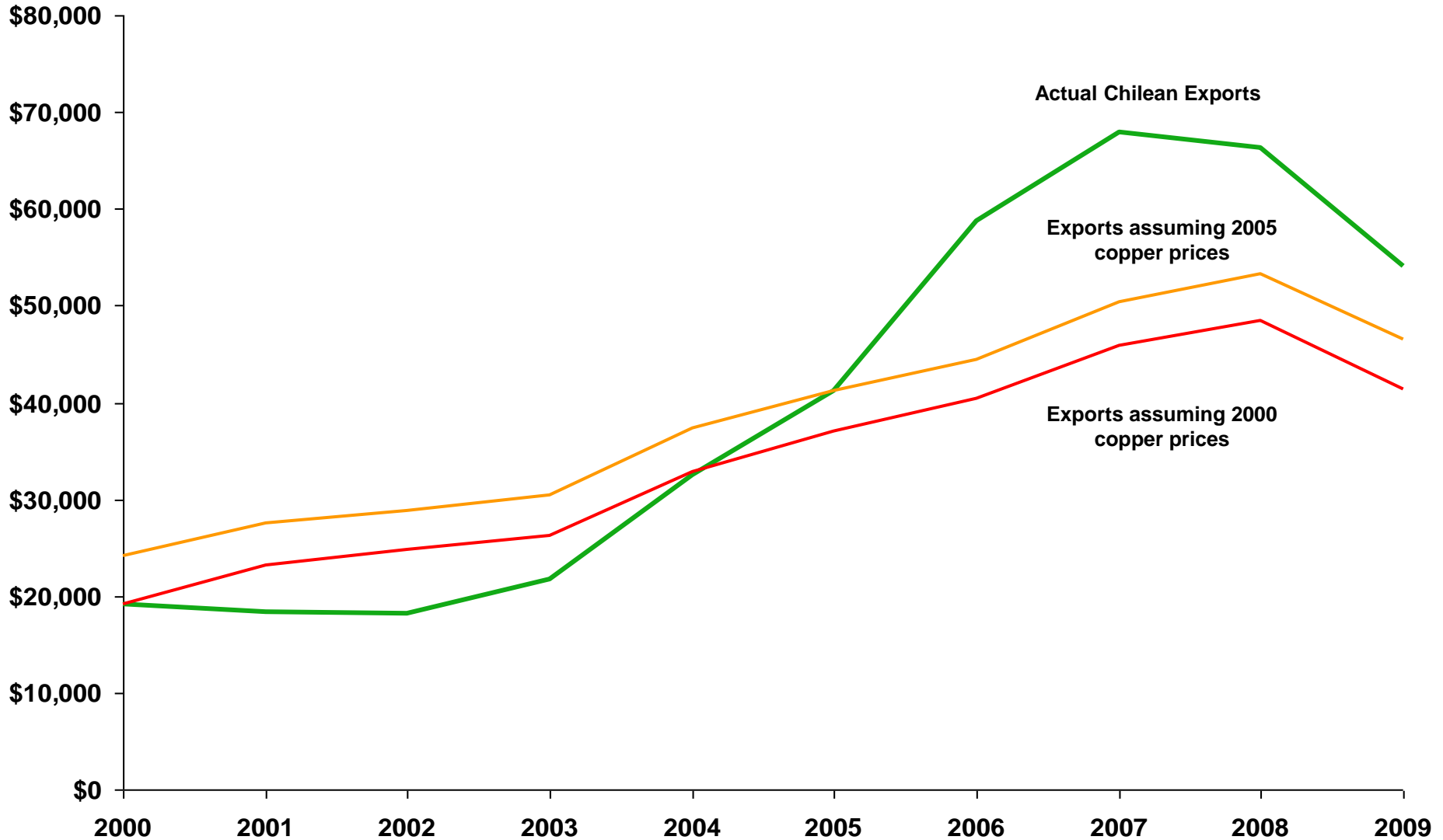
Note: Luxembourg omitted

Source: EIU (2011), authors calculations

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# Copper Price Effects on Exports

Total Export Revenues (US\$M)



Source: EIU (2011), COMTRADE (2011), author analysis

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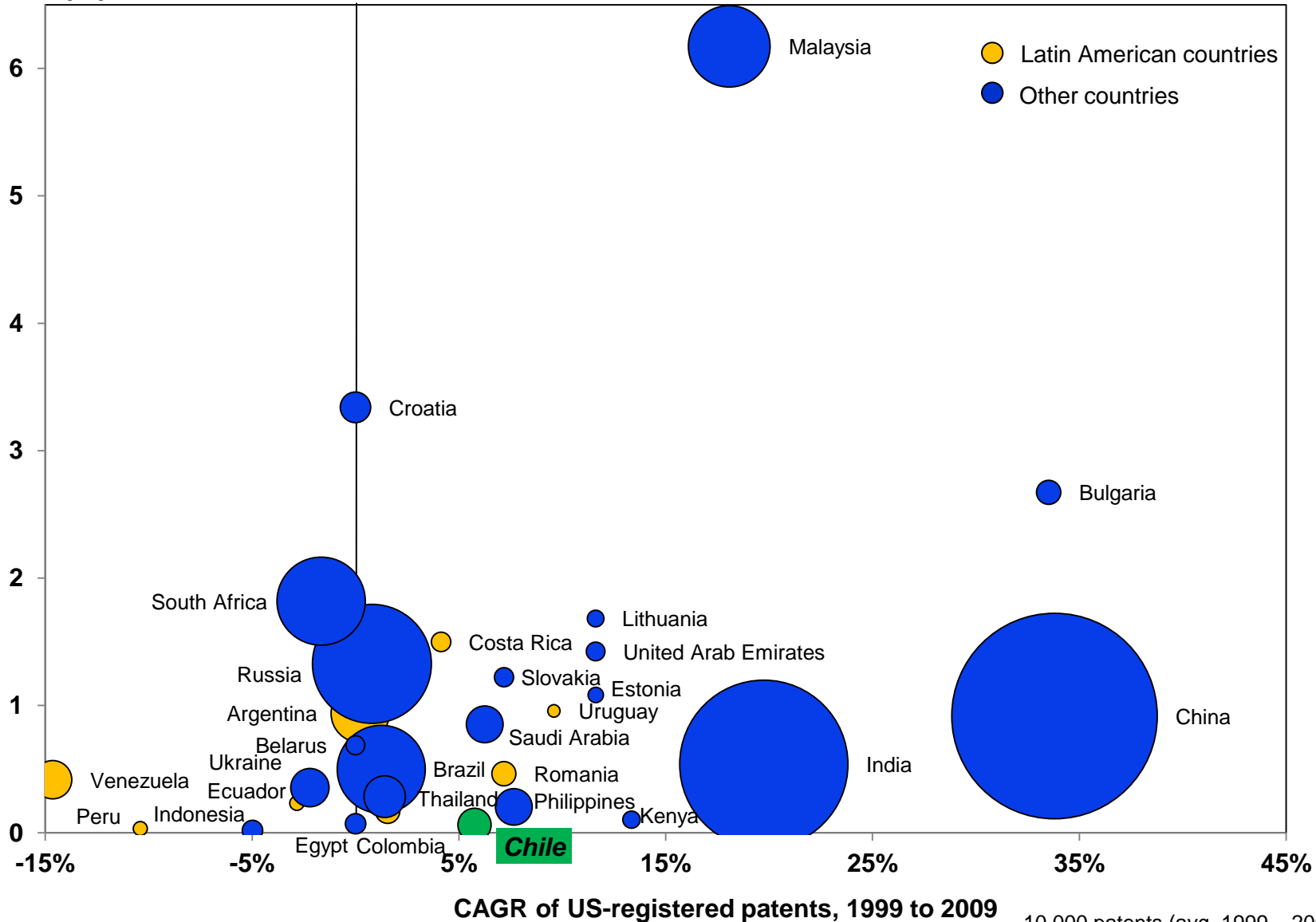
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- Innovation output is **weak**

# Innovative Output

## Selected Countries, 1999 to 2009

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



10,000 patents (avg. 1999 – 2009) = 

Source: USPTO (2010), Groningen Growth and Development Centre, Total Economy Database (2010)

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



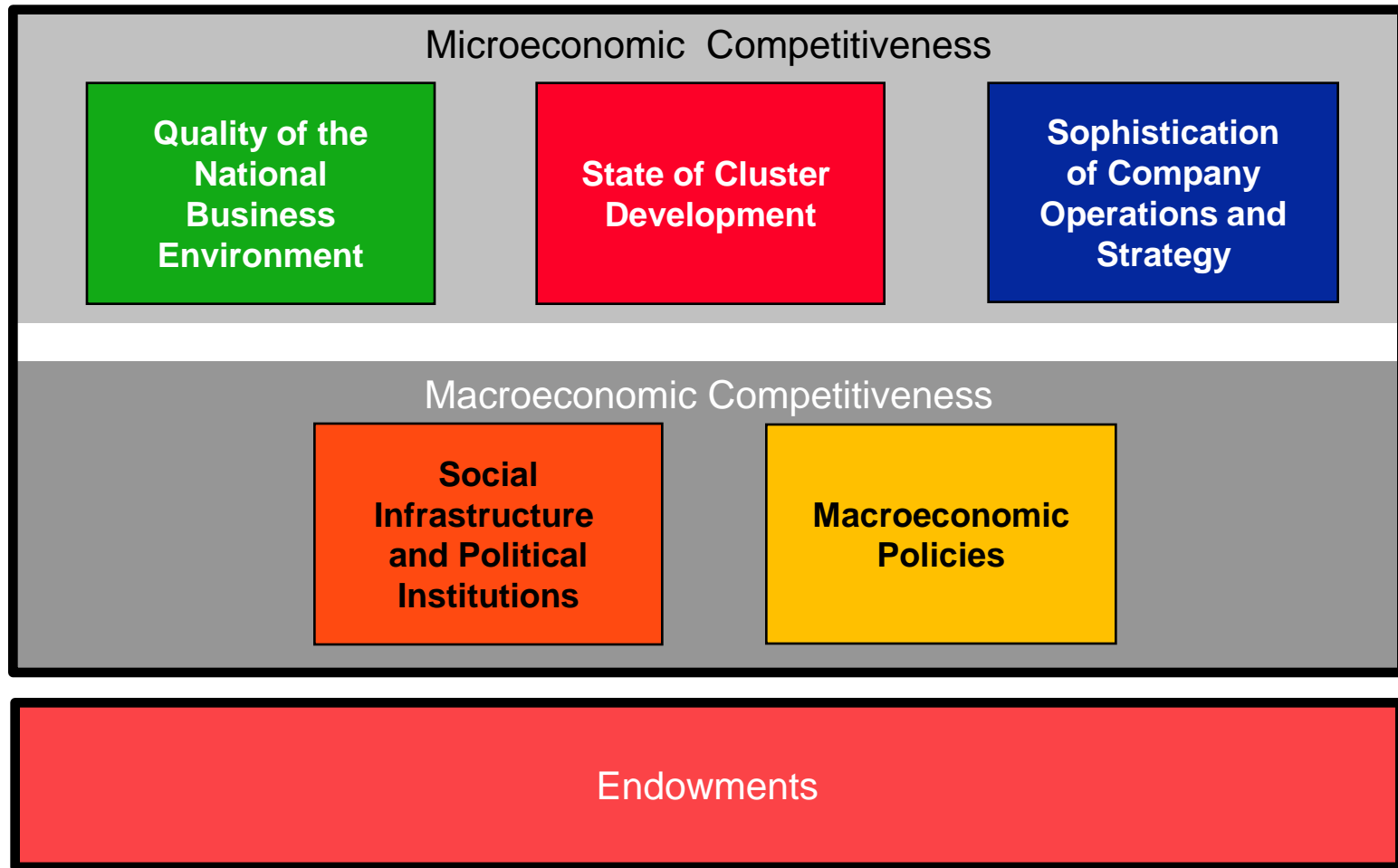
# What is Competitiveness?

- 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



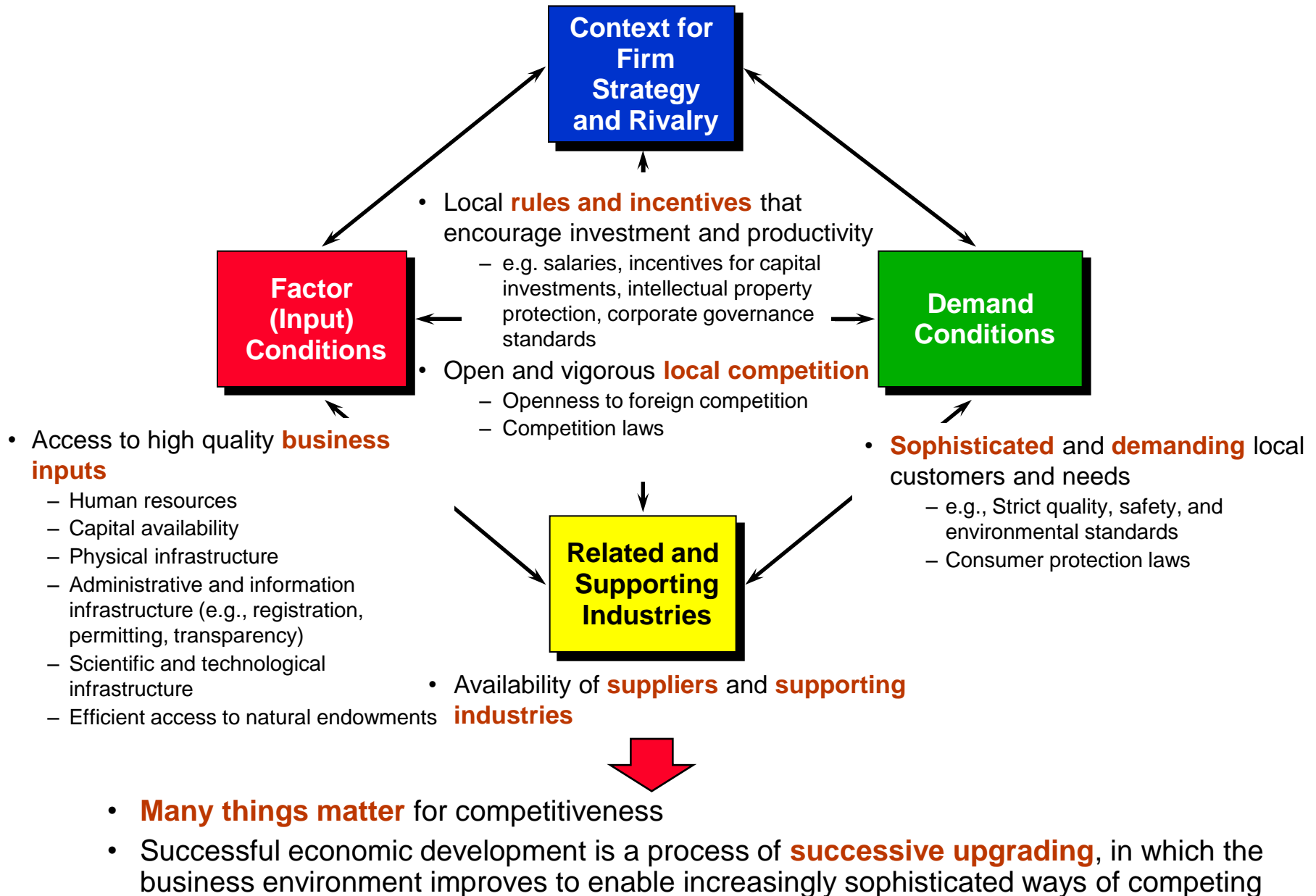
- Nations compete in offering the **most productive environment for business**
- The public and private sectors play **different but interrelated roles** in creating a productive economy

# 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**

# Quality of the National Business Environment



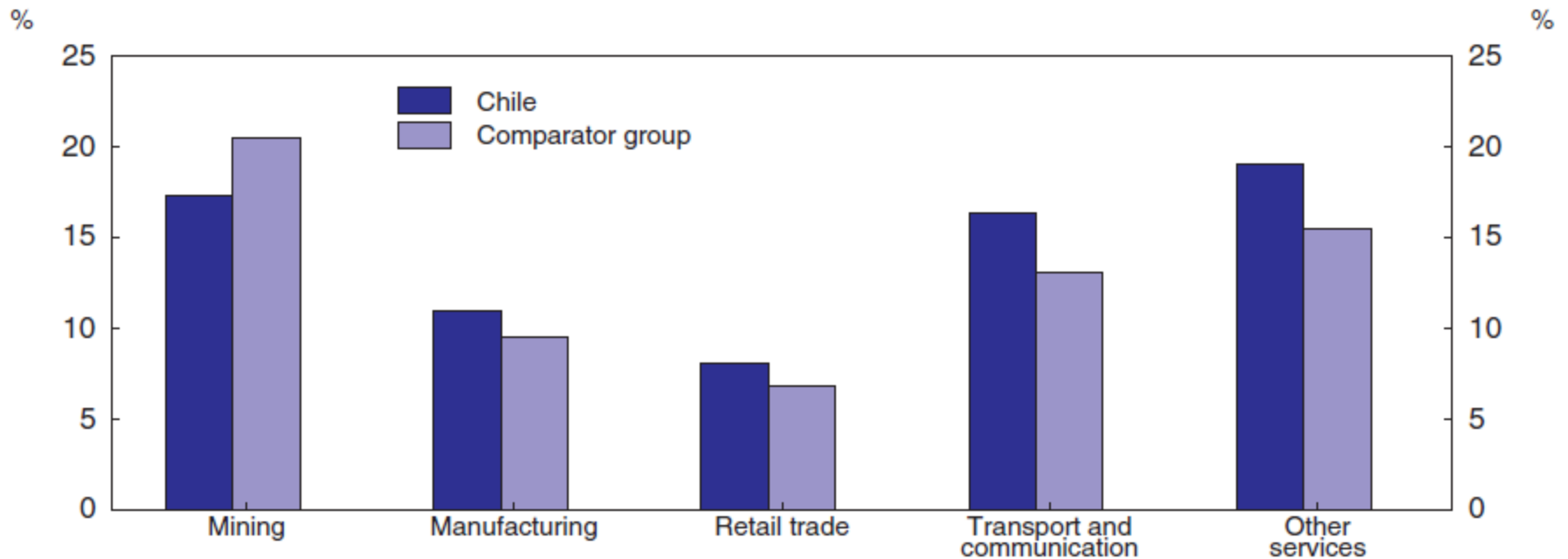
# Competition

- 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.

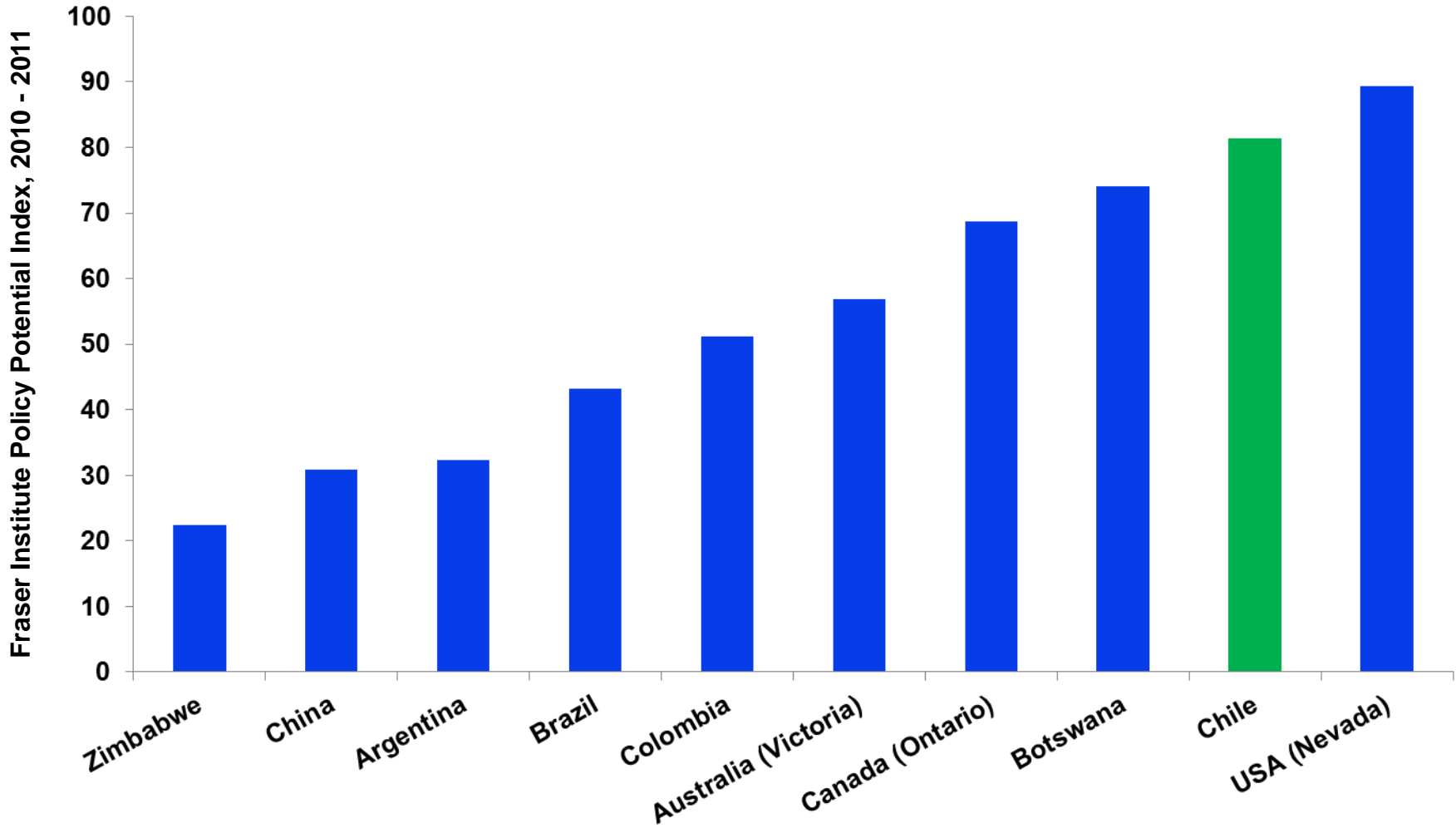
Source: Thomson Financial, *Wordscope Database*.

# 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

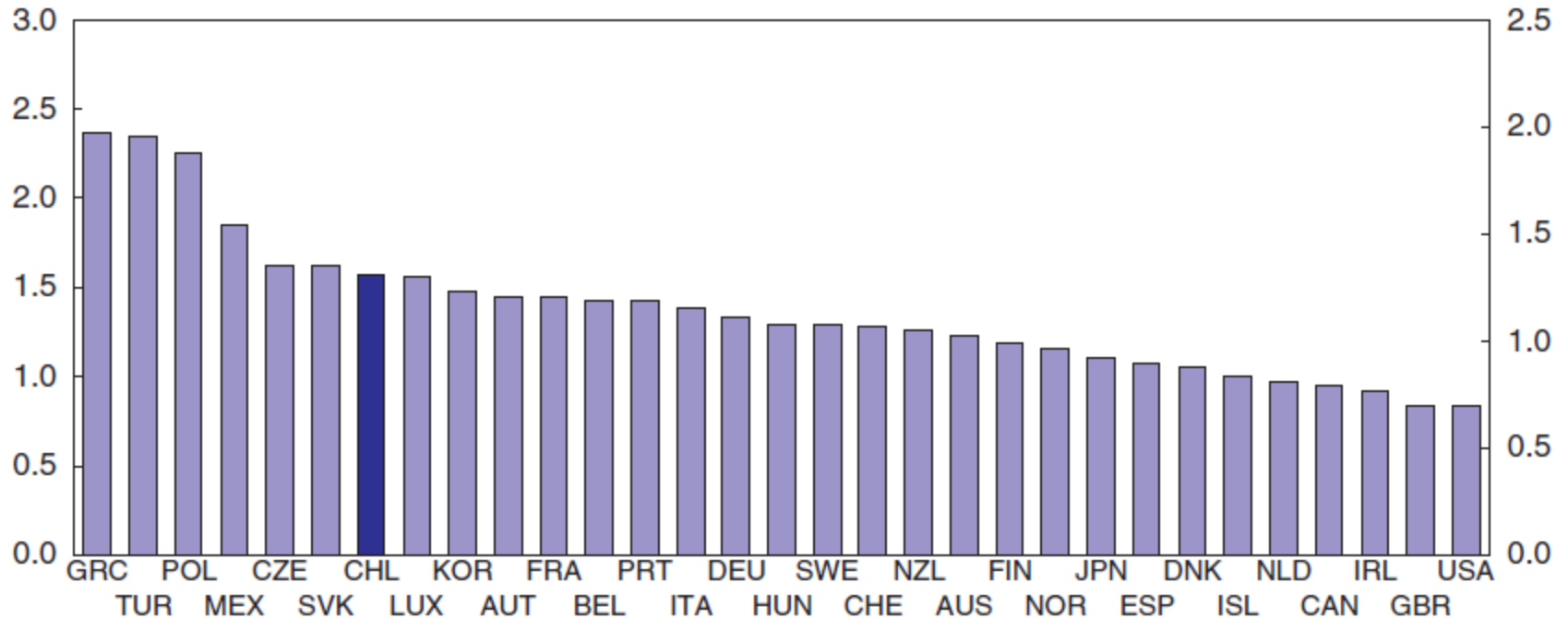
## Selected Locations



Source: Fraser Institute (2011)

# Product Market Regulation, 2008

Index of  
Product Market  
Regulation



1. Overall indicator.

Source: OECD, *Product Market Regulation Database*.



# 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**

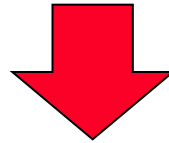
# Doing Business Selected Countries

Economy	Ease of Doing Business Rank	Registering Property	Paying Taxes	Starting a Business	Dealing with Construction Permits	Protecting Investors	Trading Across Borders	Getting Credit	Closing a Business	Enforcing Contracts
Mexico	35	67	22	105	46	44	107	58	81	23
Peru	36	54	97	24	15	20	86	53	110	96
Colombia	39	73	32	55	65	5	118	99	150	29
<b>Chile</b>	<b>43</b>	<b>28</b>	<b>45</b>	<b>46</b>	<b>62</b>	<b>68</b>	<b>68</b>	<b>68</b>	<b>72</b>	<b>91</b>
Brazil	127	128	112	122	89	74	152	114	98	132
Argentina	115	142	168	118	65	109	143	115	45	77

Note: Rank out of 183 countries. 2010 index omits "Employing Workers" metric Source: World Bank Doing Business (2011).

# 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

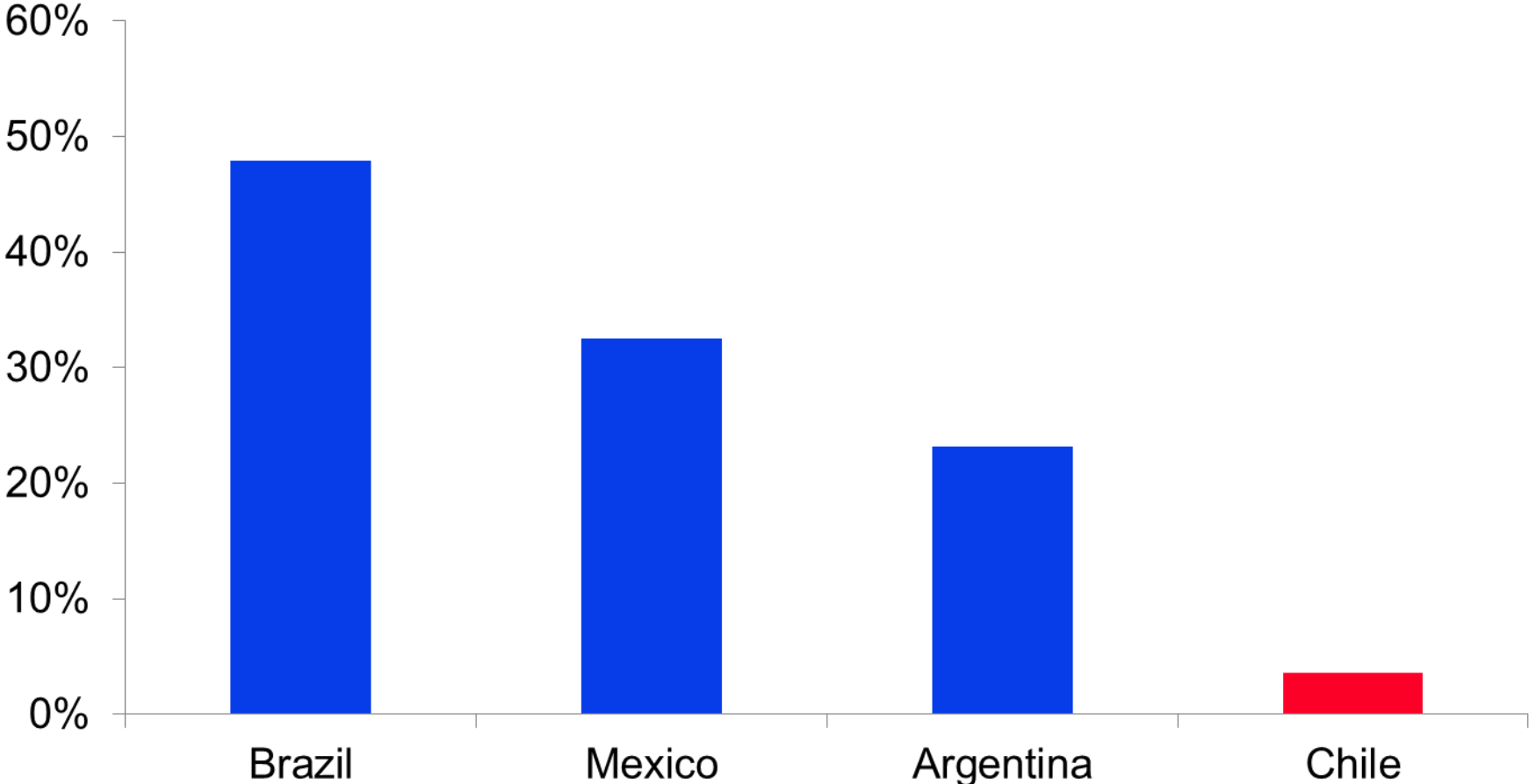
- On many traditional indicators of education Chile ranks **broadly in line** with peers but below its rank on other dimensions of competitiveness
  - Resources available for education
  - Educational achievement of students
  - University rankings
  - *GCR survey responses are much more negative about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

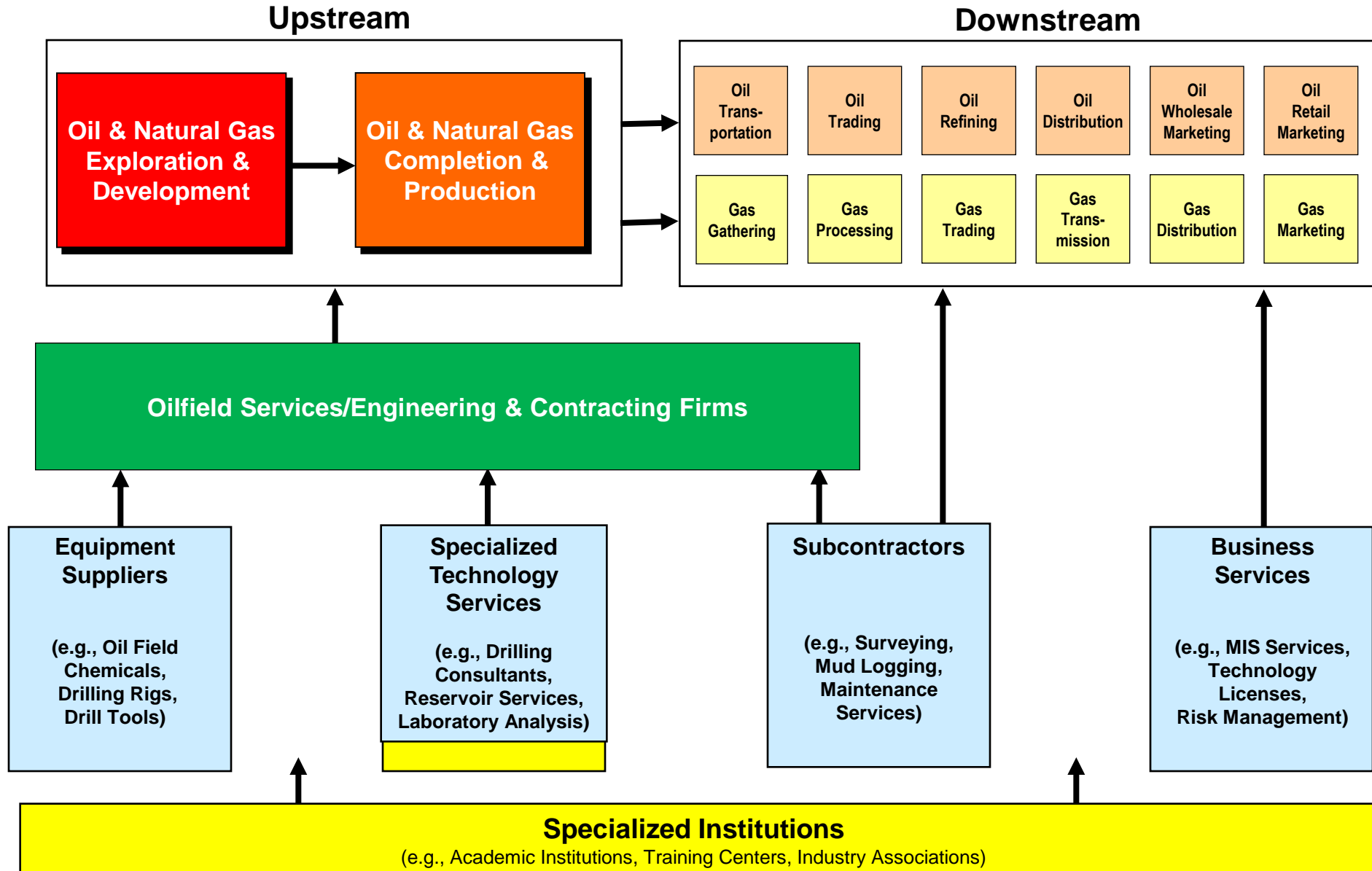
# Private Sector R&D Activity

## Share of foreign companies in total business R&D



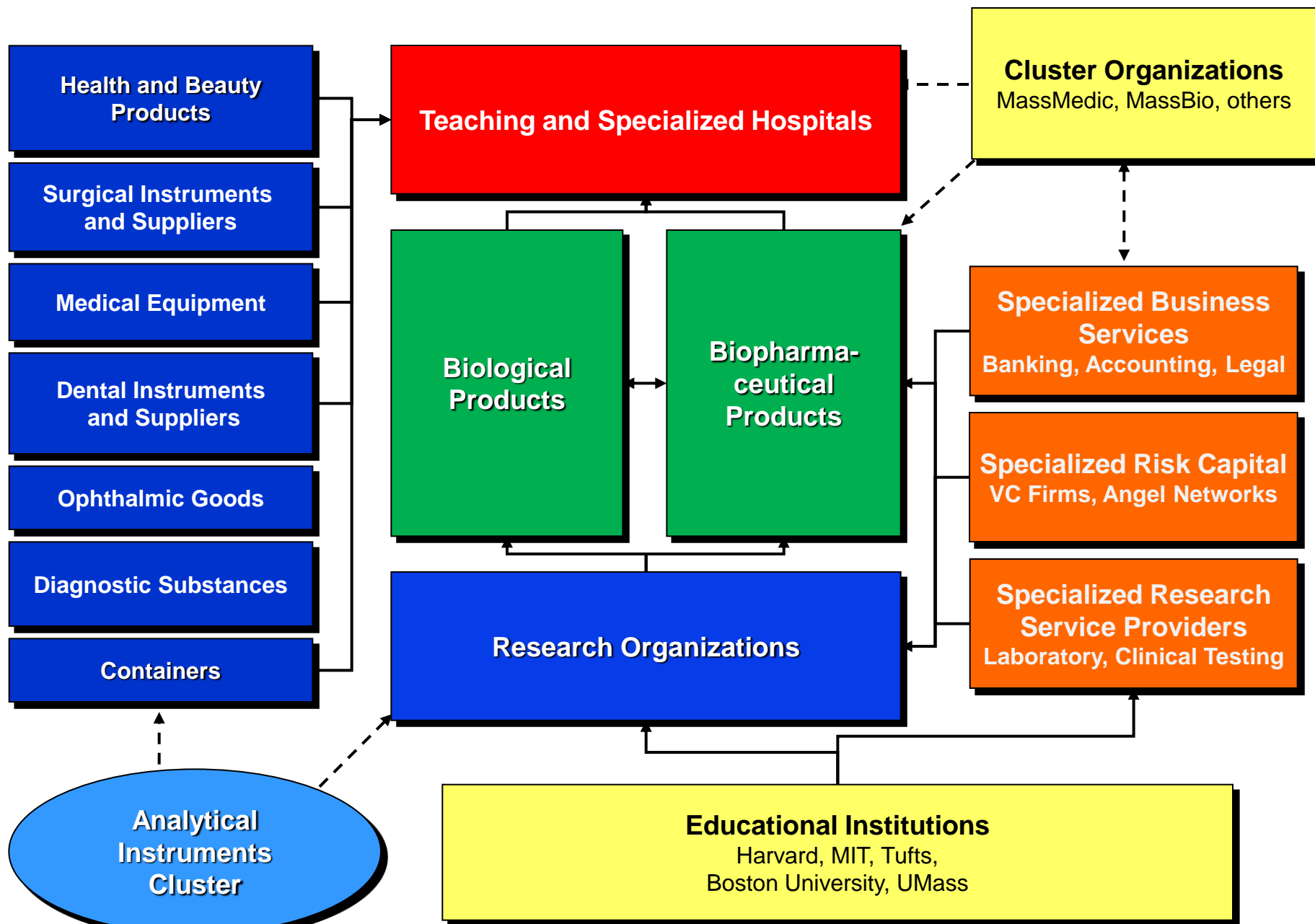
Source: OECD (2011)

# Houston Oil and Gas Cluster



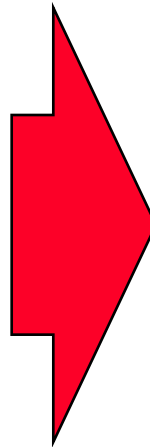


# Massachusetts Life Sciences Cluster



# Strong Clusters Drive Regional Performance

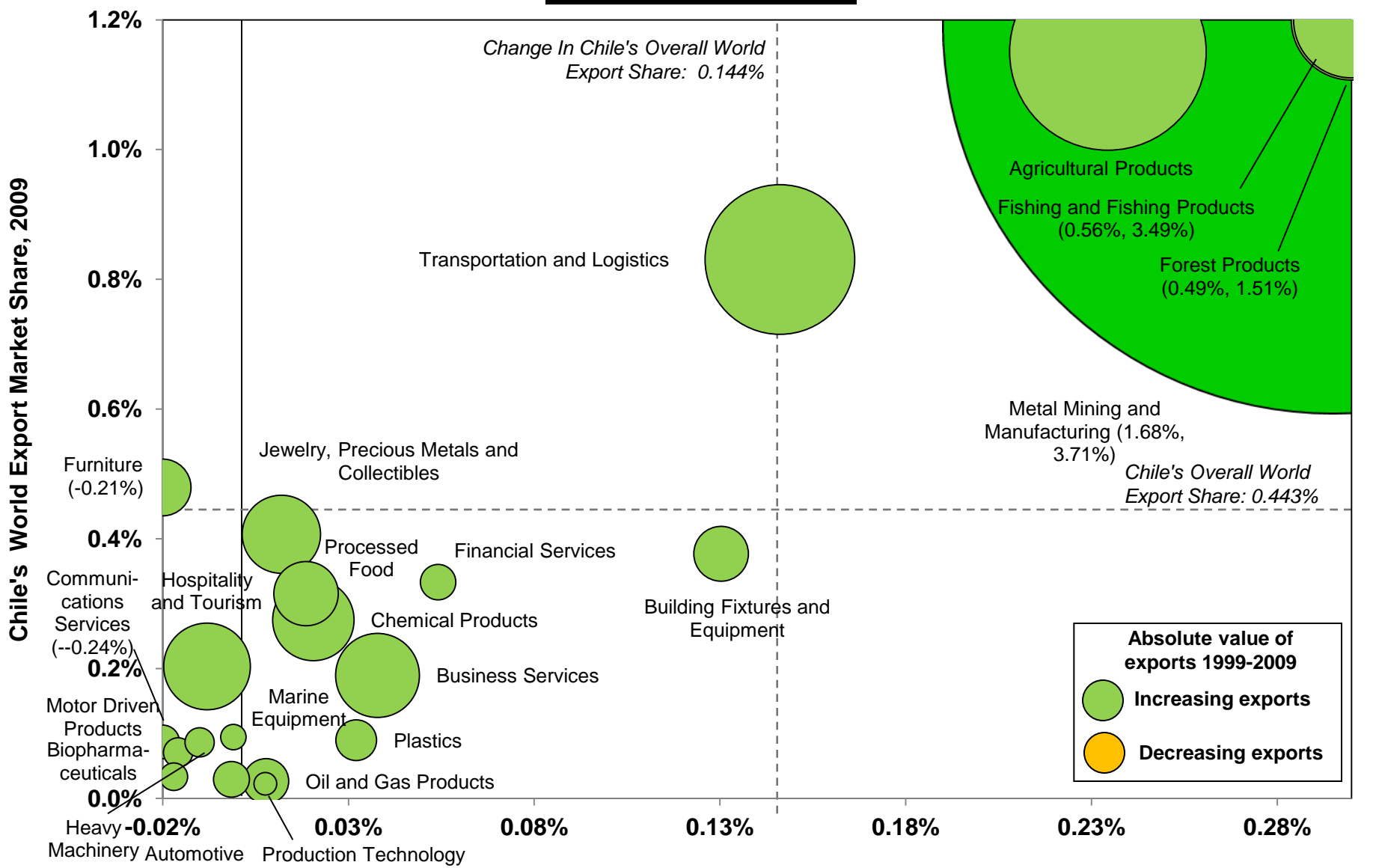
- Specialization in **strong clusters**
- **Breadth** of industries within each cluster
- Strength in **related clusters**
- Presence of a region's clusters in **neighboring regions**



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

# National Cluster Export Portfolio

## Chile, 1999-2009

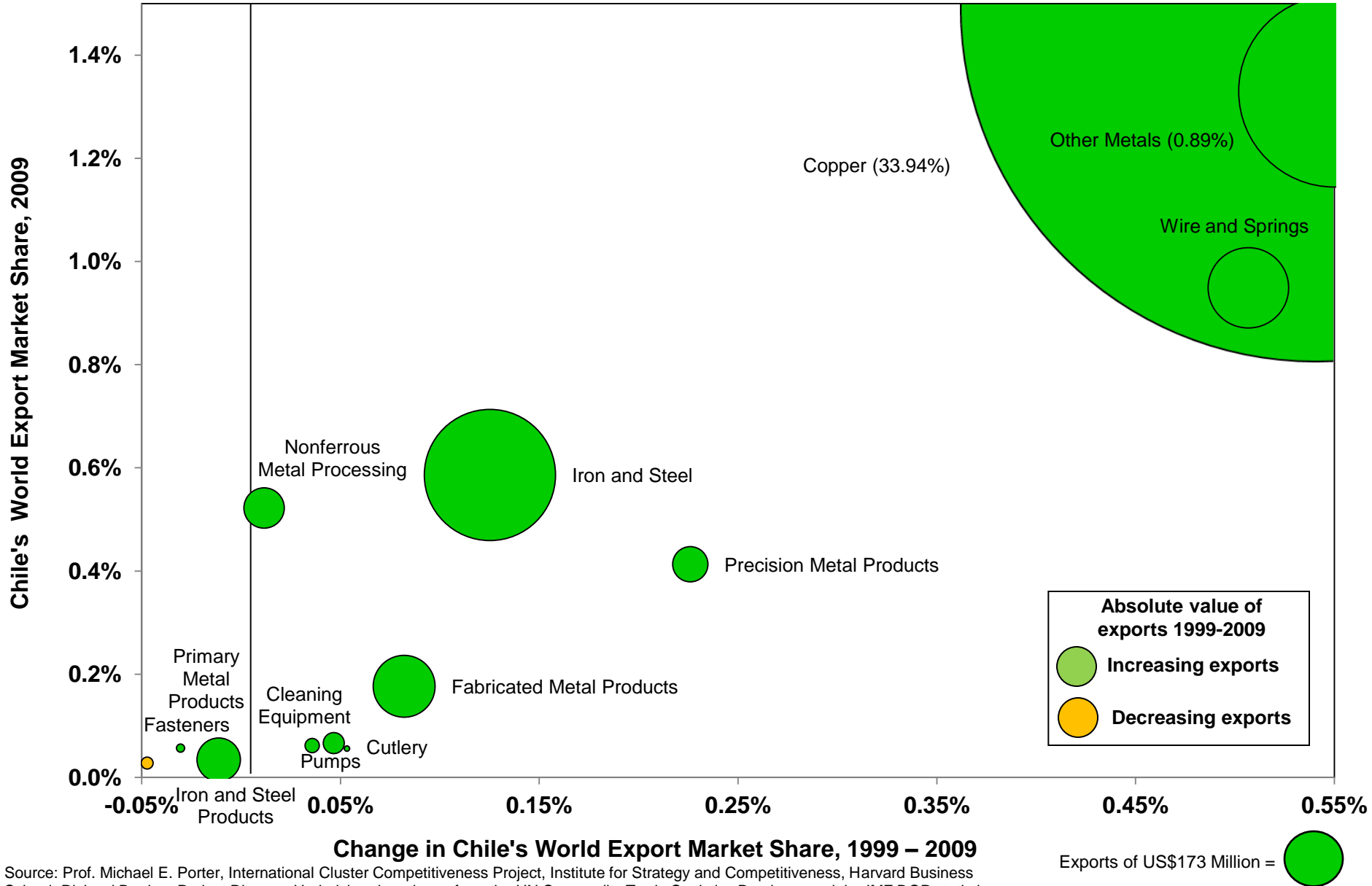


**Change in Chile's World Export Market Share, 1999 - 2009**

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.

# Chile Metal Mining and Manufacturing, 1999 - 2009

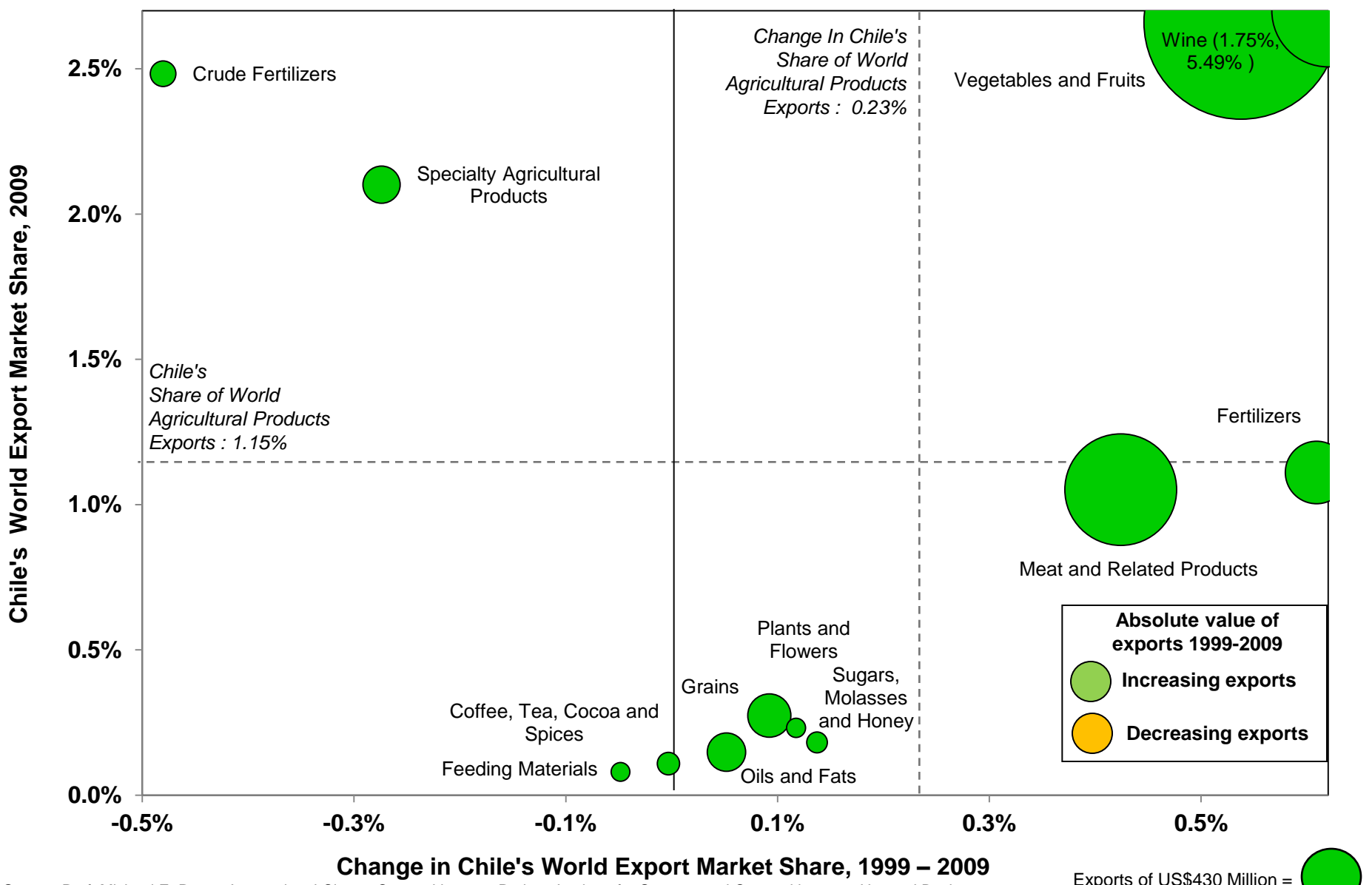
## Specialization by Subcluster



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.  
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# Chile Agricultural Products Cluster, 1999 - 2009

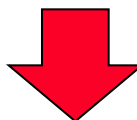
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# Current Chilean Approach to Cluster Mobilization

- **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 Relative to Competitiveness Rank (change since 2005)

Breadth of international markets	9 (↑3)
Extent of incentive compensation	16 (↑11)
Extent of marketing	27 (↓3)
Reliance on professional management	28 (↓2)

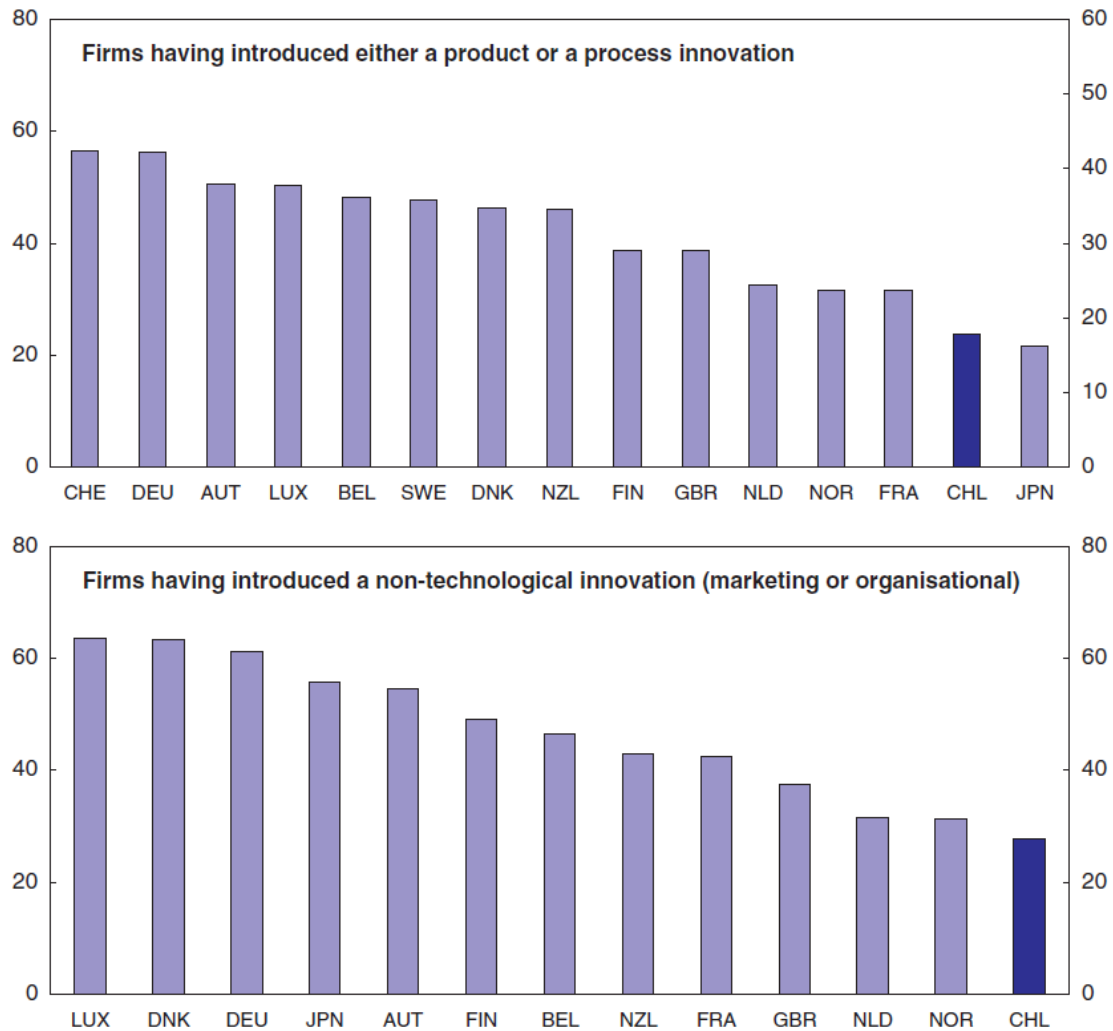
### Competitive Disadvantages Relative to Competitiveness Rank (change since 2005)

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

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

Source: Institute for Strategy and Competitiveness, Harvard University (2010), based in part on survey data from the World Economic Forum.

# Firm Innovation

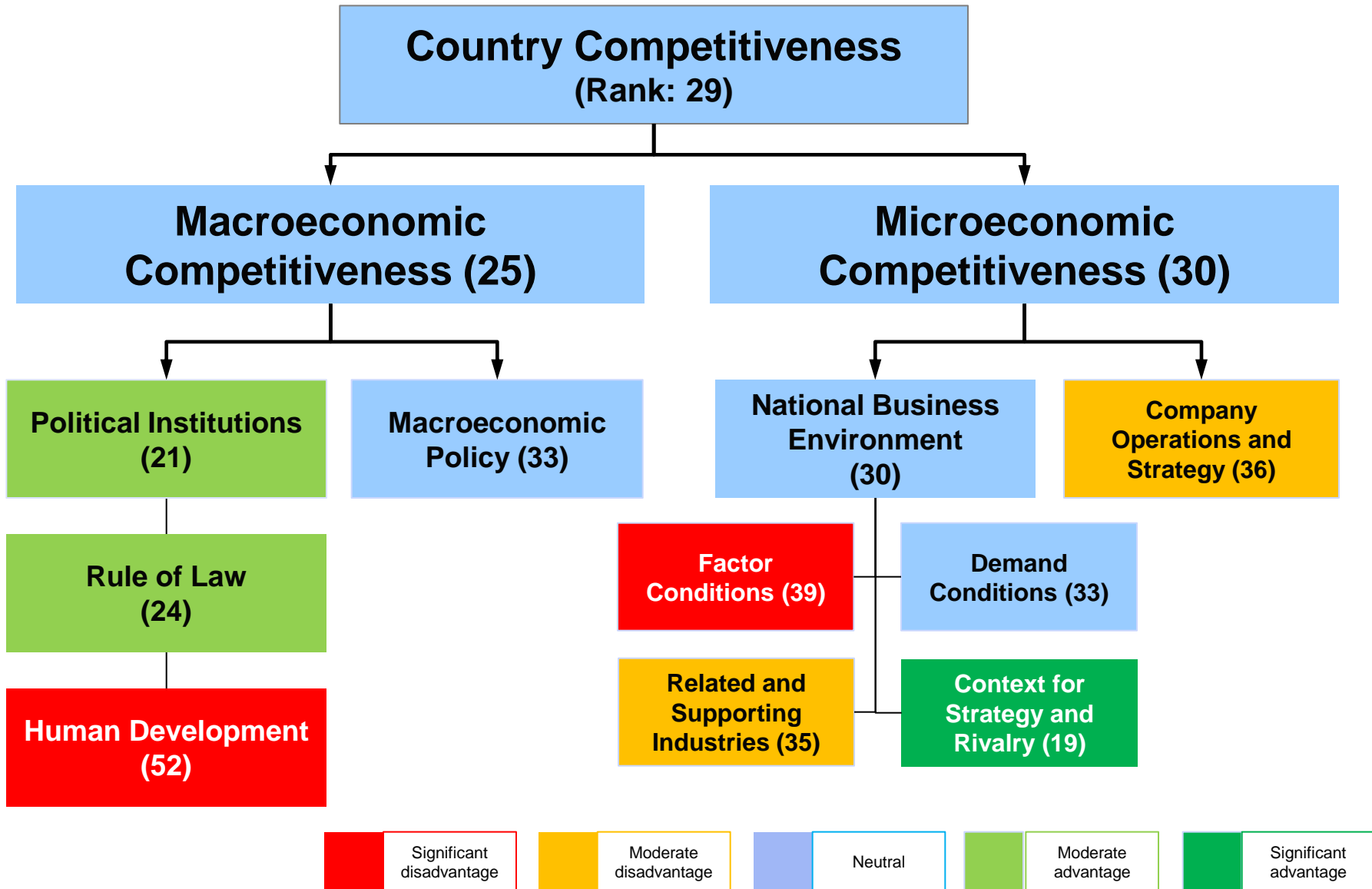


1. Two-year reference period 2004-05 and 2005-2006 for Chile.

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



# Chile's Competitiveness Profile 2010



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

Source: Institute for Strategy and Competitiveness, Harvard University (2010), based in part on survey data from the World Economic Forum.

# 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

## DEVELOPING ECONOMIES

## ADVANCED ECONOMIES



### Policy priorities

- Inward FDI
- Vocational training
- Technology transfer institutions

### Policy priorities

- Inward FDI
- University education
- Applied research organizations
- Cluster development

### Policy priorities

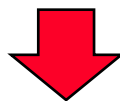
- Inward and outward FDI
- Advanced university education, especially in science and technology
- Scientific research organizations
- Cluster deepening

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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

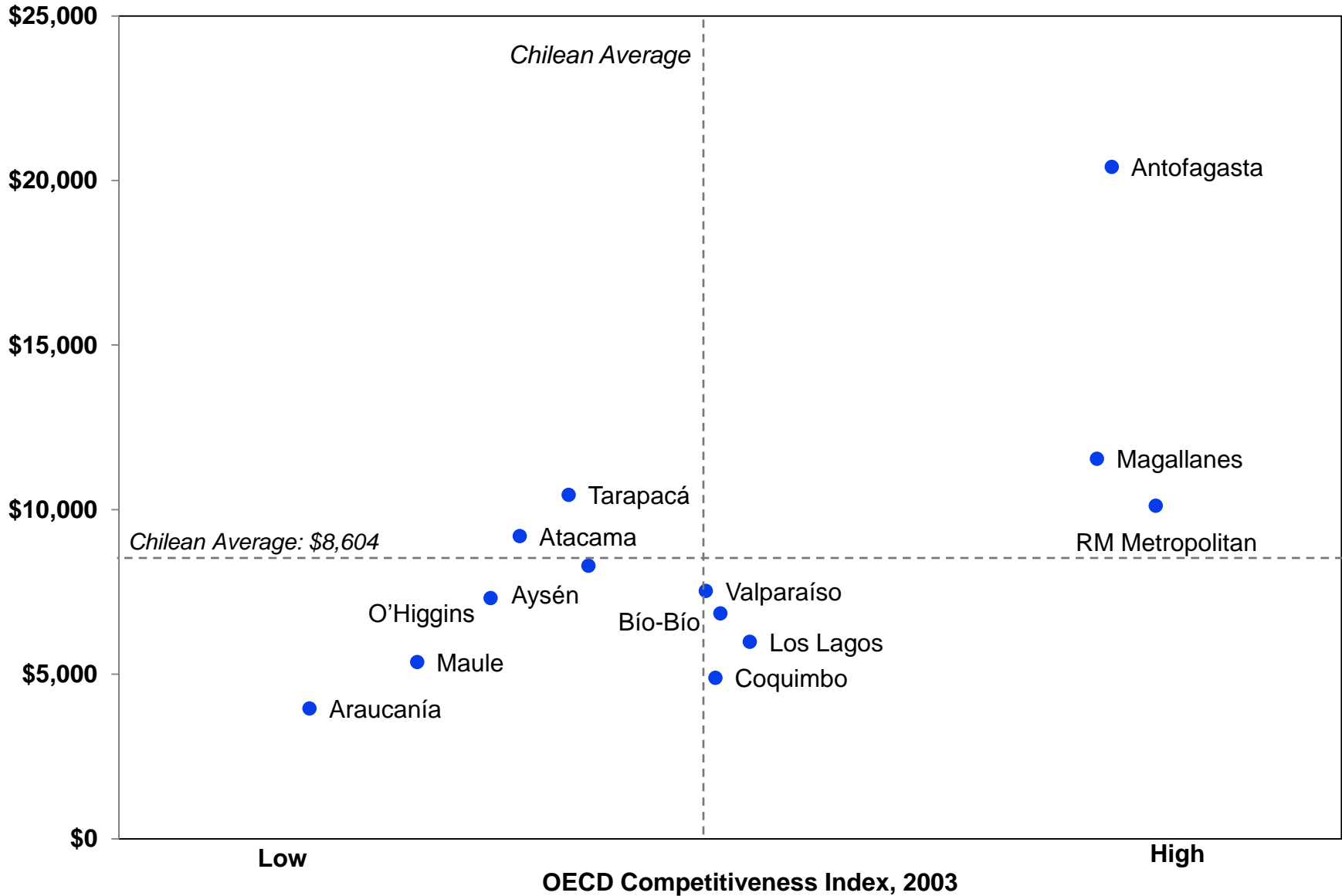


- **Decentralization** is important to foster regional specialization, internal competition, and greater government accountability
- Effective decentralization requires clarity on roles and responsibilities, and sufficient administrative **capacity at local and regional level**

# Regional Prosperity Differences

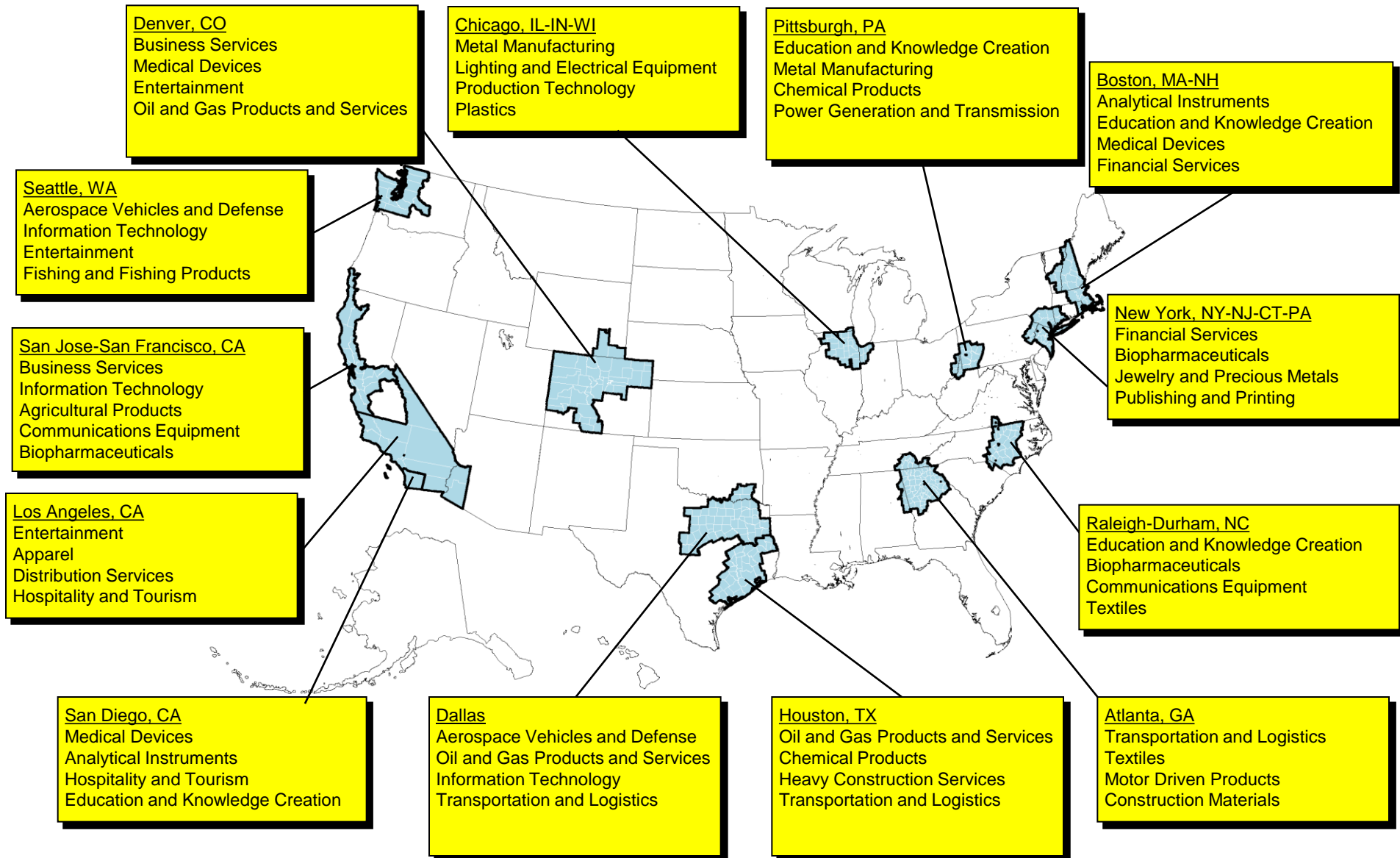
## Chilean Regions

Real GDP per capita,  
PPP-adjusted, 2007



# Specialization of Regional Economies

## Leading Clusters by U.S. Economic Area, 2008



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

# Towards an Action Agenda for Chile

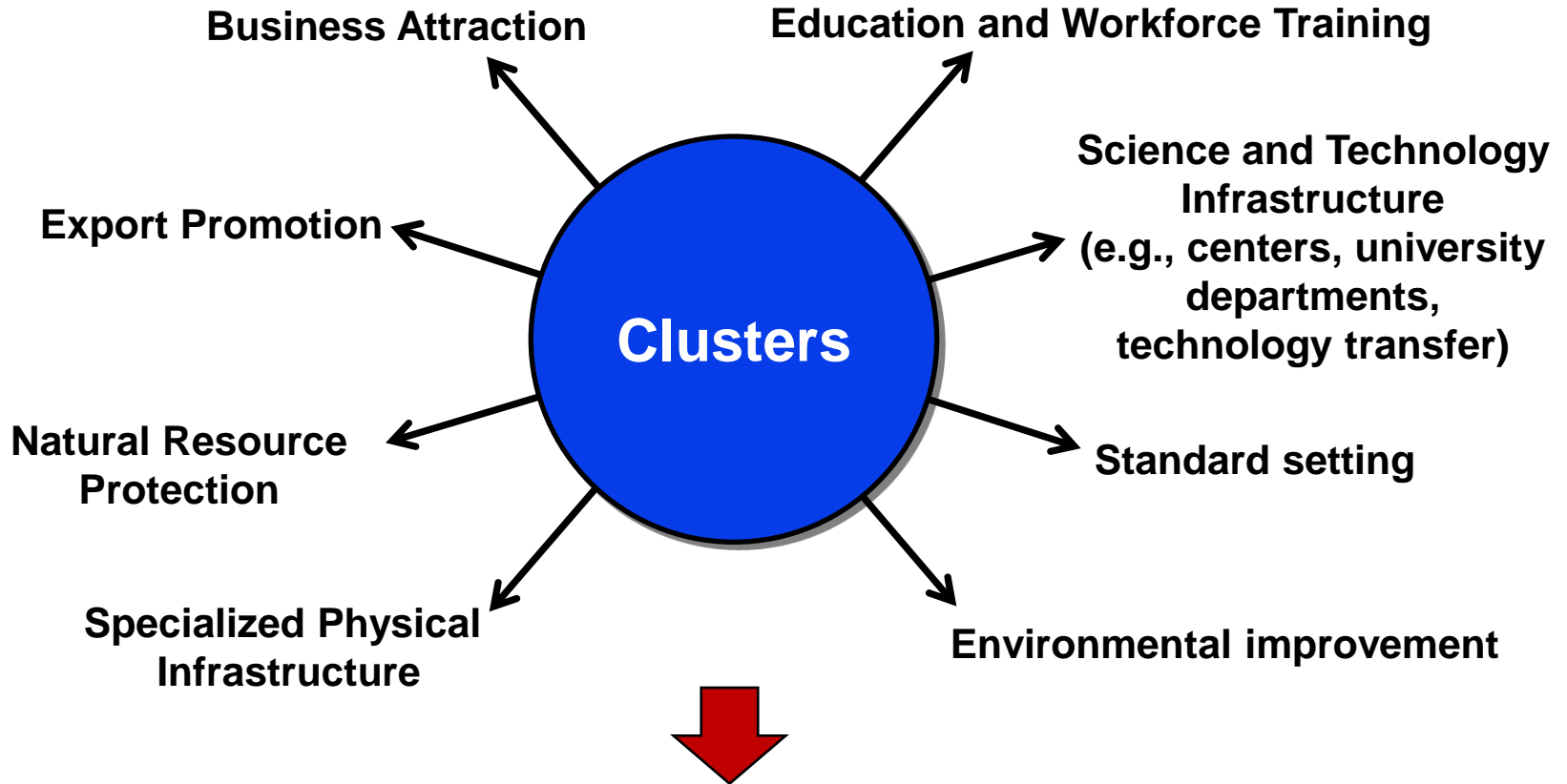
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- Tackle labor market **inflexibility**
- Mount a comprehensive **workforce skills development program**
- Better align **innovation policies** with the current needs of the Chilean economy
- Develop a comprehensive strategy for **regional development**
- Broaden the approach to **cluster mobilization**



# Clusters as a Tool For Economic Policy

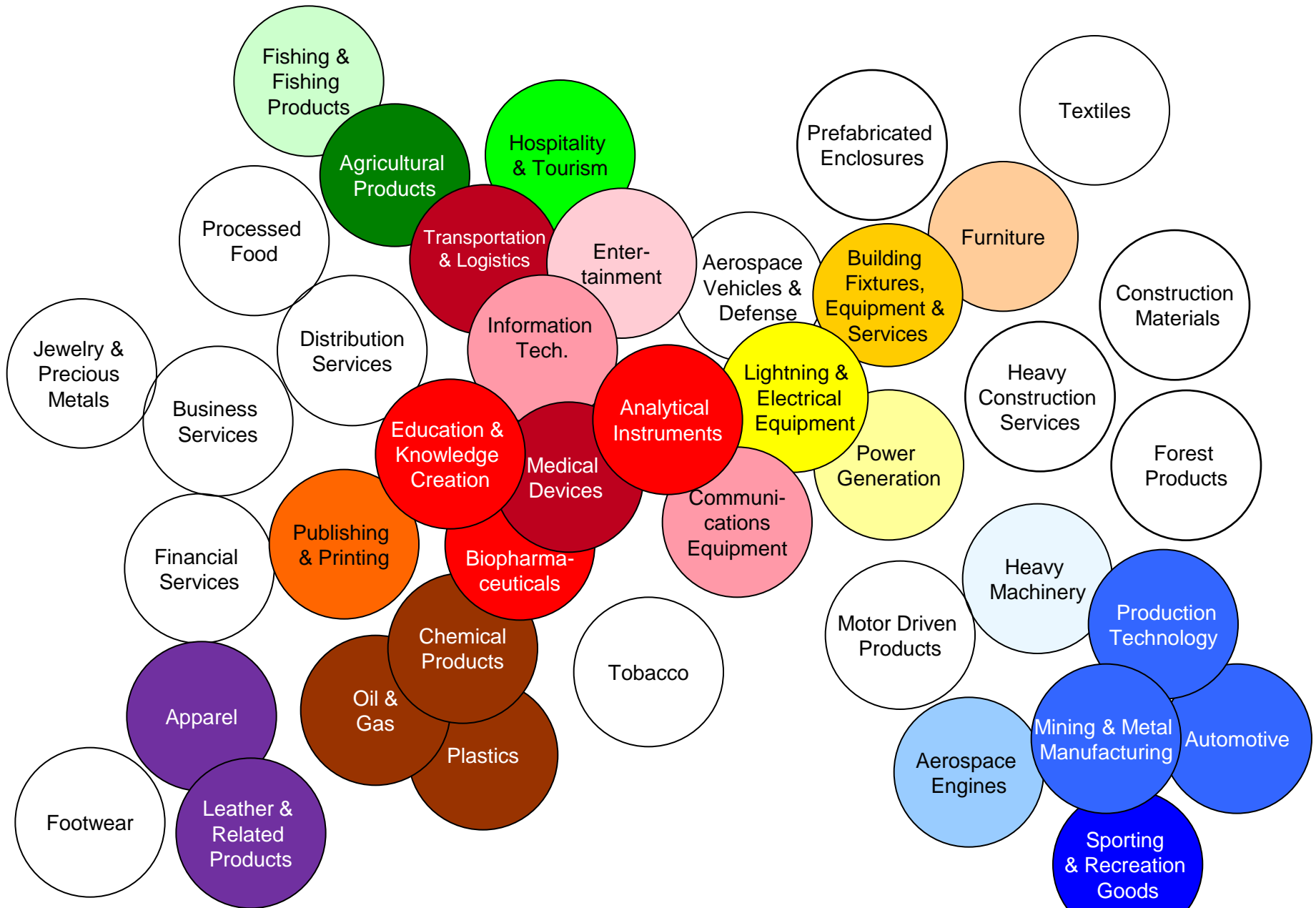
- A forum for **collaboration** between the private sector, trade associations, government, educational, and research institutions
- Brings together **firms of all sizes**, including SME's
- Creates a **mechanism** for **constructive** business-government dialog
- A tool to identify **problems** and **action recommendations**
- A vehicle for investments that strengthen **multiple firms/institutions** simultaneously
- Fosters **greater competition** rather than distorting the market

# Aligning Economic Policy and Clusters



Clusters provide a framework for **organizing the implementation** of many public policies and public investments to achieve greater effectiveness

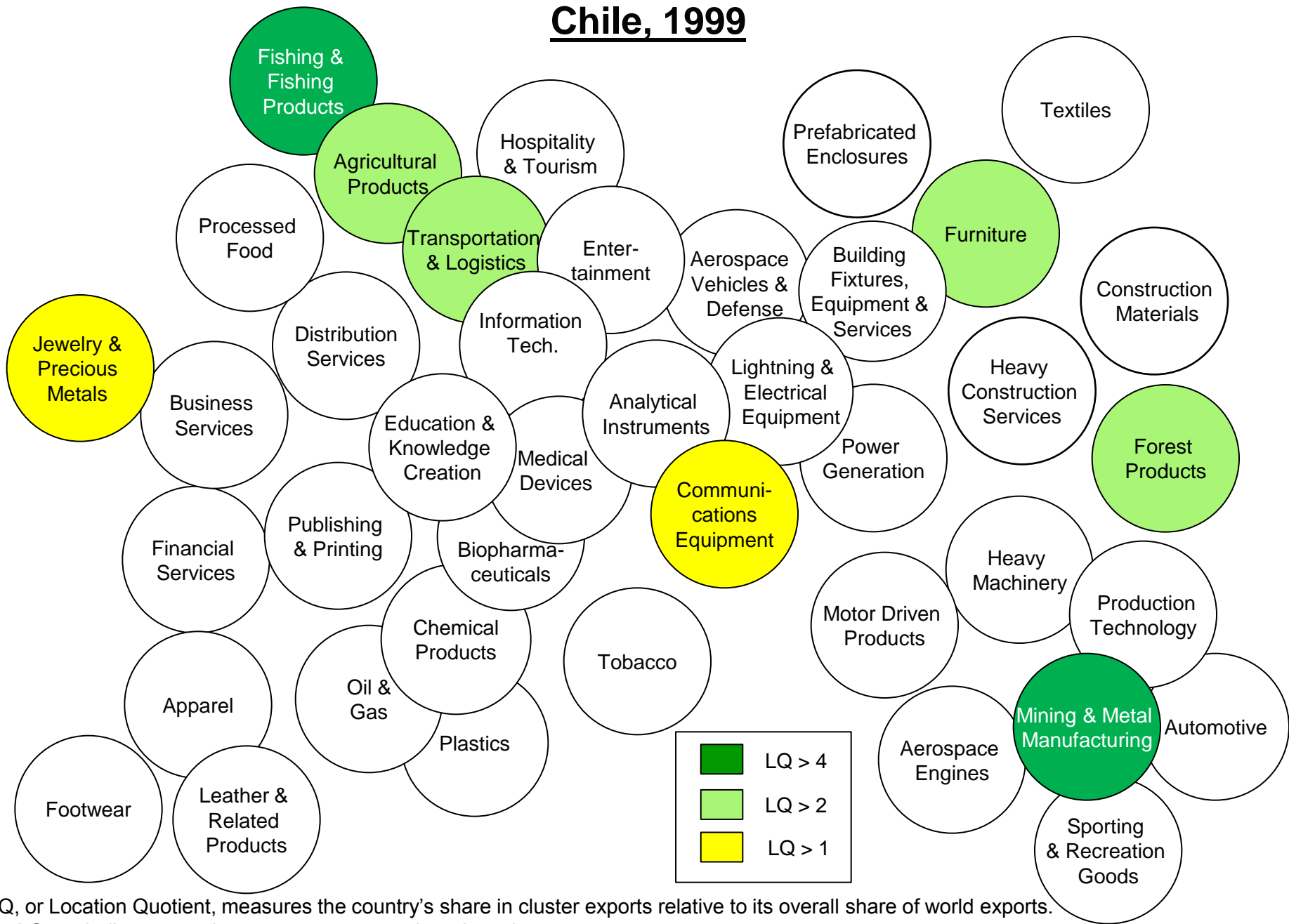
# Cluster Linkages and Economic Diversification



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

# Cluster Linkages and Economic Diversification

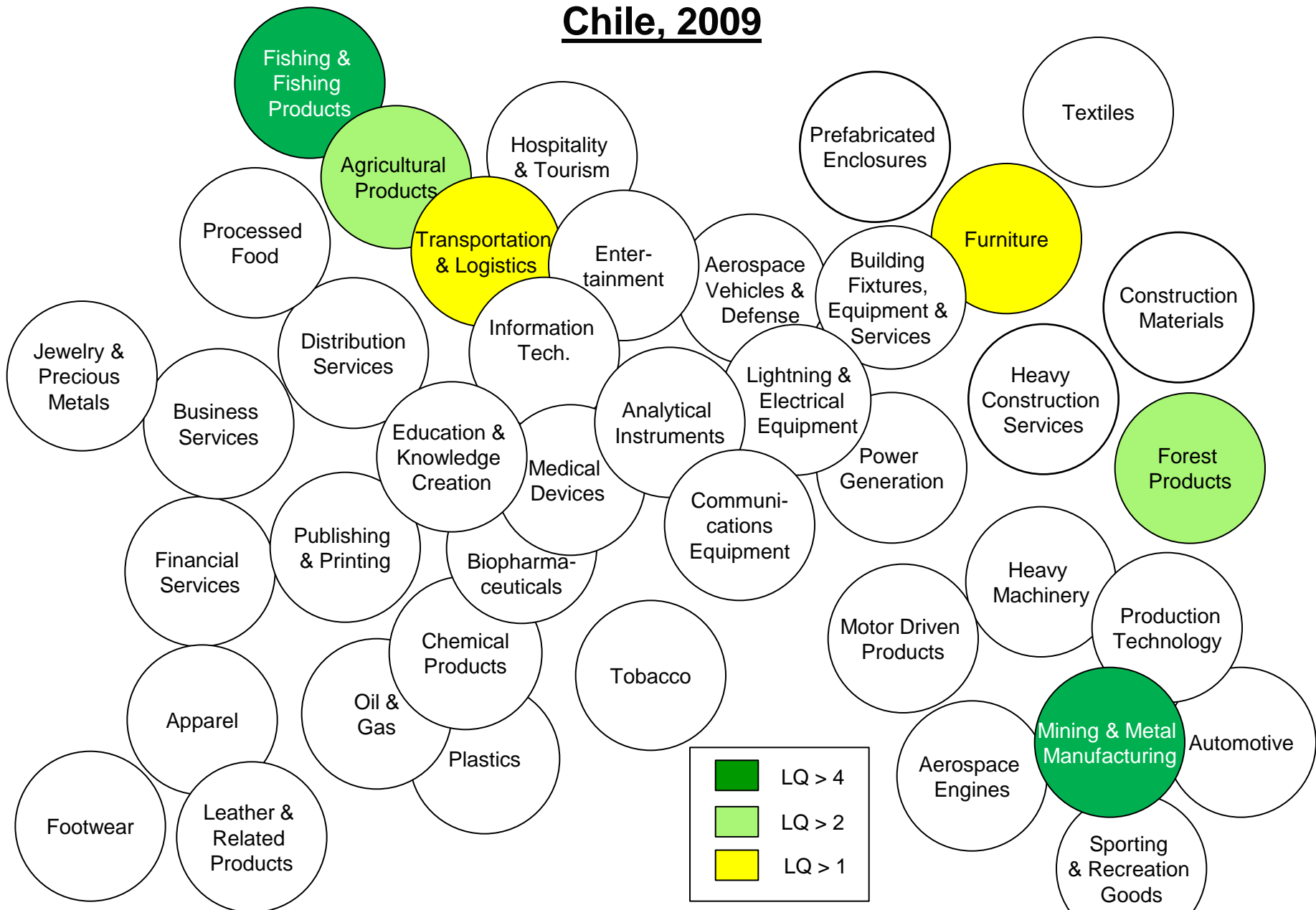
## Chile, 1999



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.

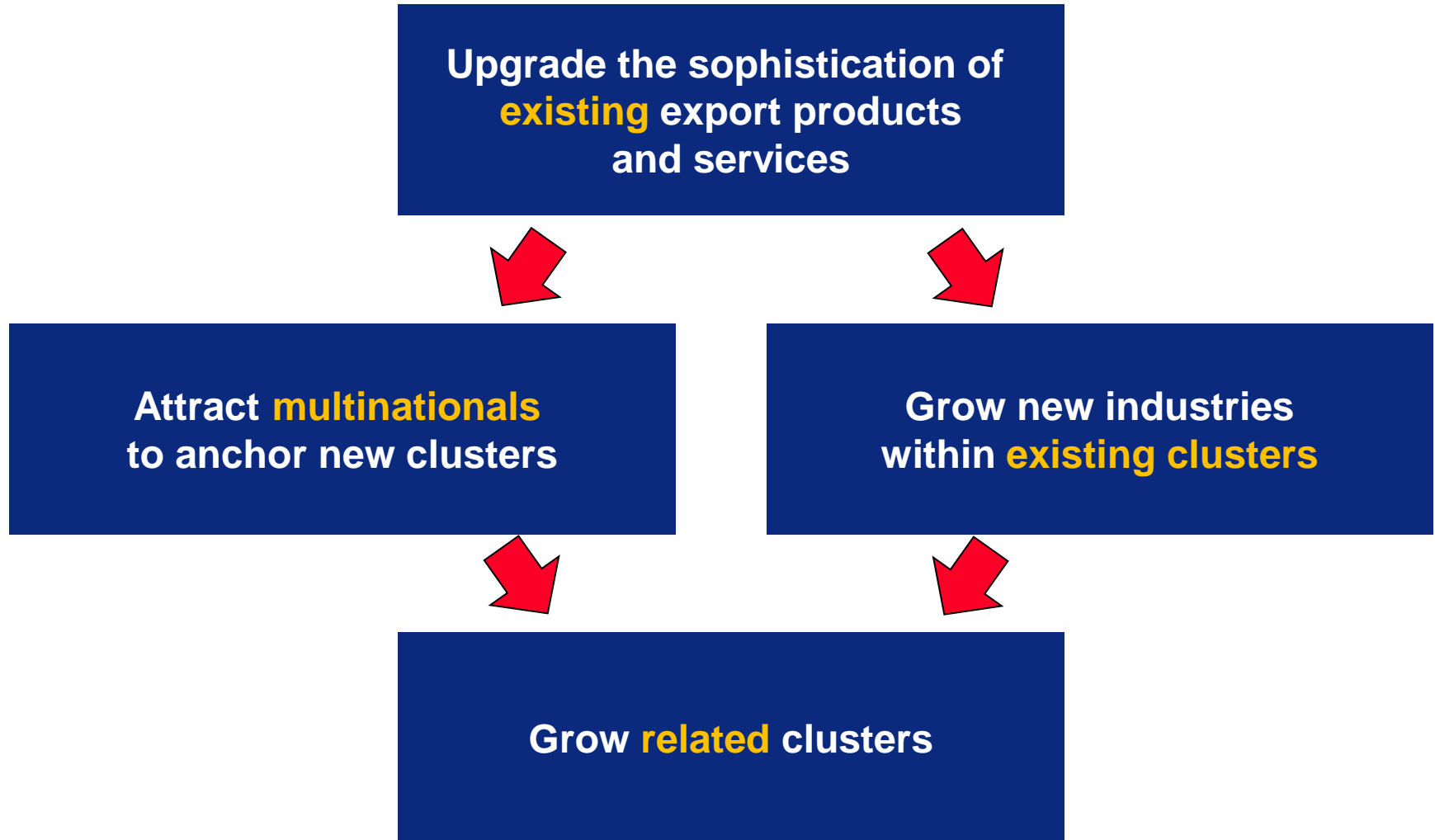
# Cluster Linkages and Economic Diversification

## Chile, 2009



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.

# Clusters and Economic Diversification



# 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

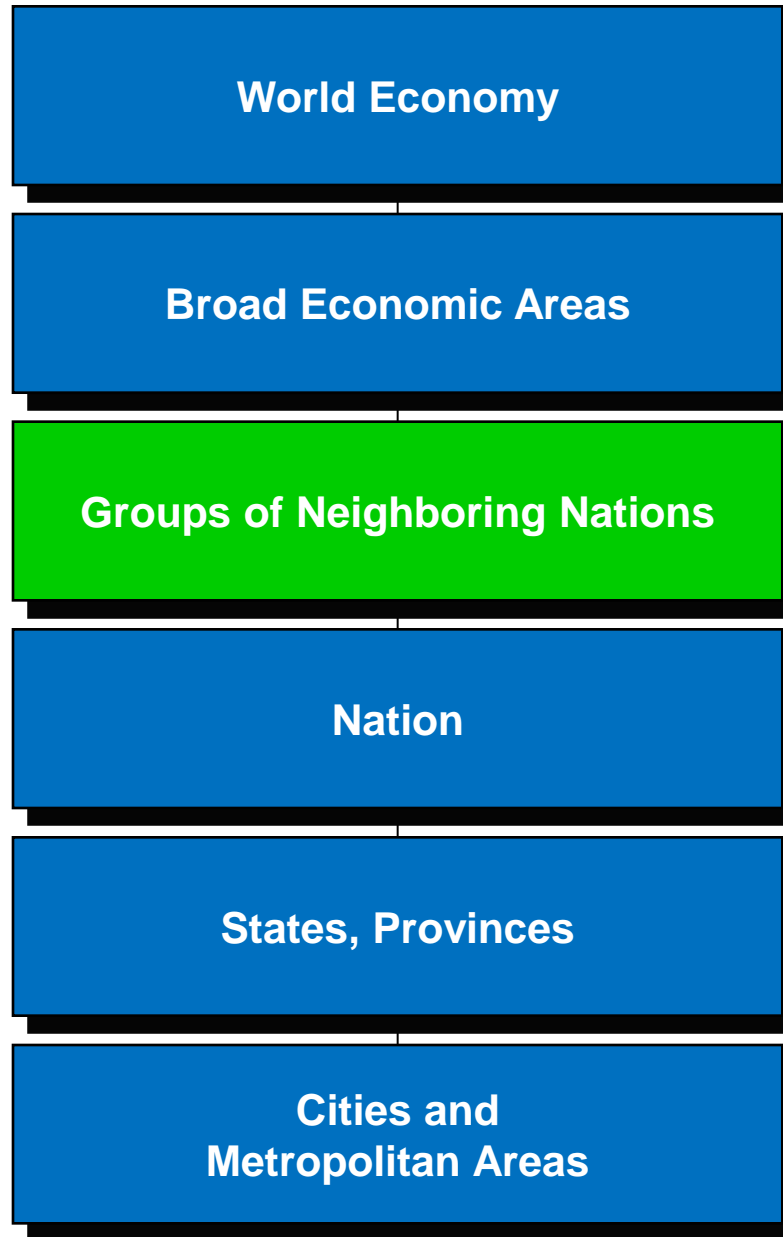
- Pick favored clusters
- Pick favored companies
- Subsidize or distort competition
- Define cluster action priorities

# Towards an Action Agenda for Chile

- 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**



# Geographic Influences on Competitiveness



# 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**

#### 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**

### 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**

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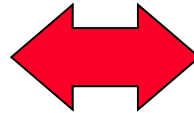
# The Need for an Economic Strategy

## 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 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

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- 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**