Implementing New Growth Strategies

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Country Competitiveness: The Path to Prosperity?

I. Competitiveness Defined

Over the past twenty years, a powerful analytical framework – *country competitiveness* - has emerged that assesses how nations manage their economic futures. This new field of study analyzes how government policies shape and develop business enterprises in the quest to increase national prosperity. In short, competitiveness measures the ability of a country to achieve sustained high rates of growth in terms of per capita GDP. As long as knowledge remains the critical driver of growth in modern economies, nations will find themselves in competition in an era of increasing globalization. Yet, the poorest countries in the developing world face not only a knowledge gap, but the inability to get a foothold in the global economy as well. The forty-nine least developed countries in the world account for less than one-half of 1% of world trade.

Development success stories consistently underscore the importance of government policies in shaping the environment in which enterprises operate and flourish (e.g., by establishing property rights, promoting domestic savings, creating tax incentives, creating trade zones, funding science education, investing in new technologies, and supporting worker training). In sound policy environments, every dollar of aid attracts two dollars of private capital. There is also little evidence of any country having achieved dramatic increases in economic growth without a strategy promoting private sector development. Country competitiveness is a powerful tool for developing such a strategy. Yet the principal development challenge will always be that of implementation – inevitably country leaders will face the challenge of maintaining their political commitment to the strategy, building national consensus around its implementation, establishing the rule of law to ensure its adoption and promoting entrepreneurship to achieve the sought after growth. Failure in any of these efforts risks derailing the entire growth process.

II. Points of Contention

Much of the resistance in the broader development community to competitiveness is rooted in the opposition to the notion that economic growth is the most effective means to alleviate poverty. Even among supporters, there are concerns over whether economic growth will be equitable in nature as research has shown that an increase in national income will not reduce the income gap within a country. Lastly, some development economists argue that nations themselves do not compete, but rather that enterprises, as the source of wealth creation, are the primary drivers of competitiveness.

The notion that enterprises are the instruments of wealth creation is indeed a truism, but some countries achieve productivity improvements while others do not; some expand their exports dramatically while others fail miserably. The ability of countries to increase productivity, generate exports, and create jobs depends heavily on microeconomic factors that shape the quality of the business environment and the competitive capacity of private firms. A growing minority of development practitioners argue that the traditional focus on macroeconomic reform has to be supplemented by targeted efforts to improve microeconomic conditions that directly affect business development. This is needed if economic reforms are to achieve the desired goals of growth, job creation, and poverty reduction -- all of which are needed to foster a growing middle-class.

While economists continue to argue that the business climate is hard to measure and even harder to affect, any successful entrepreneur or investor – if asked -- will quickly point out how their country's policies have either hindered or supported the value creation process at the enterprise level. Such insights abound in the developing world where political and economic elites have focused exclusively on protecting vested interests and promoting their own welfare at the expense of greater investment and faster growth.

As a result, the creative power of business is never unleashed and economies are left to stagnate because vested interests continue to block change. This terminal condition is now exacerbated by dramatic changes in the volume and profile of development assistance. Twenty years ago, about three-fourths of U.S. assistance to the developing world emanated from the public sector. Today, the opposite is true – roughly 82% of resource flows to the developing world come from the private sector, trade and investment, and remittances.

Although, the 1990s saw significant global progress in major development indicators, those gains relied heavily on the economic growth programs in China and India, the two most populous developing countries in the world. China promoted business development and private sector growth before reforming government policies. India combined economic reforms with long-term investment in high-end training and technical education, allowing business and high tech exports to expand. The competition for foreign direct investment and export growth in the developing world will require a "good performing" country to shift from being competitive temporarily (as a result of cheap labor) to being competitive permanently (as a result of an educated workforce). Taiwan, South Korea and Costa Rica are powerful examples of this type of transformation.

III. The Basic Model

The competitiveness model developed by Michael Porter of the Harvard Business School examines the sophistication of company strategies and operating practices as well as the quality of the business environment in a particular country. Porter argues that good macroeconomic conditions—a stable political order, good macroeconomic policies, and strong legal institutions—are necessary for growth but not sufficient in and of themselves. They must be complemented by microeconomic changes to improve the business environment and the capacities of companies. The two changes also must proceed in parallel—not macroeconomic first and microeconomic second.

Porter's work on country competitiveness shows that nations do not have to jump to perfection at either the macro or micro levels to make progress, but he underscores the importance of getting the sequence right from the beginning. Countries should focus on making micro-level improvements that can get business development started, then build on those evolutionary changes. One of the more promising approaches to introducing competitiveness strategies as well as indentifying those issues that can impede implementation of macro-economic reforms are "competitiveness councils." These councils bring together political, government, business, civil society and academic leaders to develop new initiatives to promote private sector development, attract foreign direct investment and increase exports. By introducing a politically galvanizing goal (i.e. country competitiveness) in a normally fractious environment, the councils serve as catalysts for macro and micro economic change. Councils currently exist in Columbia, Sri Lanka, Croatia, Bulgaria and Uganda, but the pace and profile of their impact in each county has varied.

One explanation for this variance is the fact that key macroeconomic changes often have high social and political costs and therefore are rarely fully implemented. Overcoming this inertia requires microeconomic changes that can spur growth and build political support for greater reform. Incentives for change must exist at the microeconomic level if a larger transformation is to be achieved. Former World Bank economist William Easterly in his book, *The Elusive Quest for Growth,* documents numerous instances where development institutions did not provide the right micro-economic incentives and thus ultimately failed to meet the macro-economic goals in a particular country.

Another explanation as to why such changes fail to materialize has its roots in organizational management theory. Ronald Heifetz, founder of Harvard's Center for Public Leadership, has observed that a common source of failure in institutions and societies is the misapplication of traditional solutions to novel problems. He makes the distinction between "technical" and "adaptive" challenges.

The former pertains to problems where solutions are already known. Adaptive challenges, on the other hand, are those for which new solutions must be invented. Political leaders in the developing world are increasingly being forced by donors to clarify their values, develop new strategies and learn new ways of operating. Yet, often the toughest task for these leaders in effecting change is mobilizing people through organizations to do the necessary adaptive work. Political commitment and national consensus remain major challenges with respect to achieving economic growth in the developing world.

IV. Measuring Competitiveness Globally

Competitiveness is a powerful analytical framework for modern development economics because of its ability to examine a broad range of variables – particularly non-economic ones that have significant growth consequences such as political leadership, basic education, public administration, rule of law, value systems and information technology. It requires survey tools that drill down to the microeconomic level and examine the sophistication of company strategies, operating practices, and the quality of the microeconomic business environment in which firm's compete. The most widely known survey internationally is the Global Competitiveness Report (GCR), published annually by the World Economic Forum (WEF) with Michael Porter as one of its principal co-authors.

Eighty countries were ranked in the most recent GCR (2002-2003), accounting for 95.2% of the world's economic output. The GCR is divided into two indices based on an executive opinion survey conducted in each country. The survey includes over 100 questions that allow the GCR to derive 131 qualitative variables that serve as the basis for the two indices. The first is the Growth Competitiveness Index (GCI) which is based on three broad categories found to drive economic growth in the medium and long-term (e.g. technology, public institutions and the macroeconomic environment). The second is the Microeconomic Competitiveness Index (MICI) which examines the underlying conditions defining the sustainable level of productivity in each of the countries covered. The MICI determines the degree of company sophistication and the quality of national business environments. In this regard, the GCR provides valuable qualitative survey data in the areas of government corruption and corporate governance. This survey data is used by the World Bank and Transparency International to fill gaps (in official statistics) with respect to their research on corruption. The reliance on qualitative information for some indicators has led to academic criticism of the GCR's mixing of quantitative and qualitative data. There are also competing reports which are narrower in scope, most notably the World Competitiveness Yearbook of the International Institute for Management Development (IMD) and the Competitive Industrial Performance Index (CIP) developed by the UN Industrial Development Organization. However, the IMD report does not include an indicator of national competitiveness while the CIP does not rely on business perceptions to arrive at its competitiveness rankings.

V. Competitiveness & the MCA

The US government's policy formulation has been driven by the lessons learned from aid effectiveness literature and the best practices gleaned from the history of aid performance. One of the key lessons has been that developing countries are constantly tripped up by microeconomic failures. Countries can engineer spurts of growth through macroeconomic and financial reforms that draw in international capital, but the growth withers quickly in the absence of exports and new jobs. Porter notes that "the disappointment and the austerity that results from such cycles, is at the heart of the backlash against globalization." The Millennium Challenge Account (MCA) is well positioned to break this cycle by helping countries currently eligible for loans from the International Development Association (IDA) to establish the best conditions for development by promoting growth through private investment and international trade.

The MCA will provide substantial resources to a small number of poor countries that have demonstrated achievement in “ruling justly, encouraging economic freedom and investing in their people.” Only the best performing IDA eligible countries will be able to tap into the $1.3 billion dollars in MCA aid available in FY2004 (this amount will increase to $5 billion in 2006). Because country competitiveness examines the economic impact of a number of non-economic areas such as education, public institutions and corruption, it can be an important evaluation tool and organizing framework for the MCA.

Country competitiveness, by virtue of being a new field of economic knowledge, is not a mainstream concept inside donor agencies or within the developing world. USAID has been a leader in this field and has supported competitiveness activities in 26 countries over the last decade. However, annual USAID funding has averaged only $60 million which is a very small portion of the agency’s total programming. One of the key lessons learned from the field has been that to be effective, competitiveness programs must be implemented in a comprehensive manner over an extended period of time as most developing economies are at the beginning of a very steep learning curve with respect to promoting private sector growth. Most MCA eligible countries will not have in place a strong entrepreneurial culture, reliable infrastructure, business associations and developed export markets. The MCA will therefore need to provide strategic technical assistance to the private sector in order to increase enterprise competitiveness and to facilitate public-private dialogue. Greater public-private cooperation will be necessary to remove the barriers (e.g. corruption, regulatory burdens, etc.) to improving private sector competitiveness.