Microeconomic Foundations of Competitiveness

- A New Agenda for International Aid Institutions -

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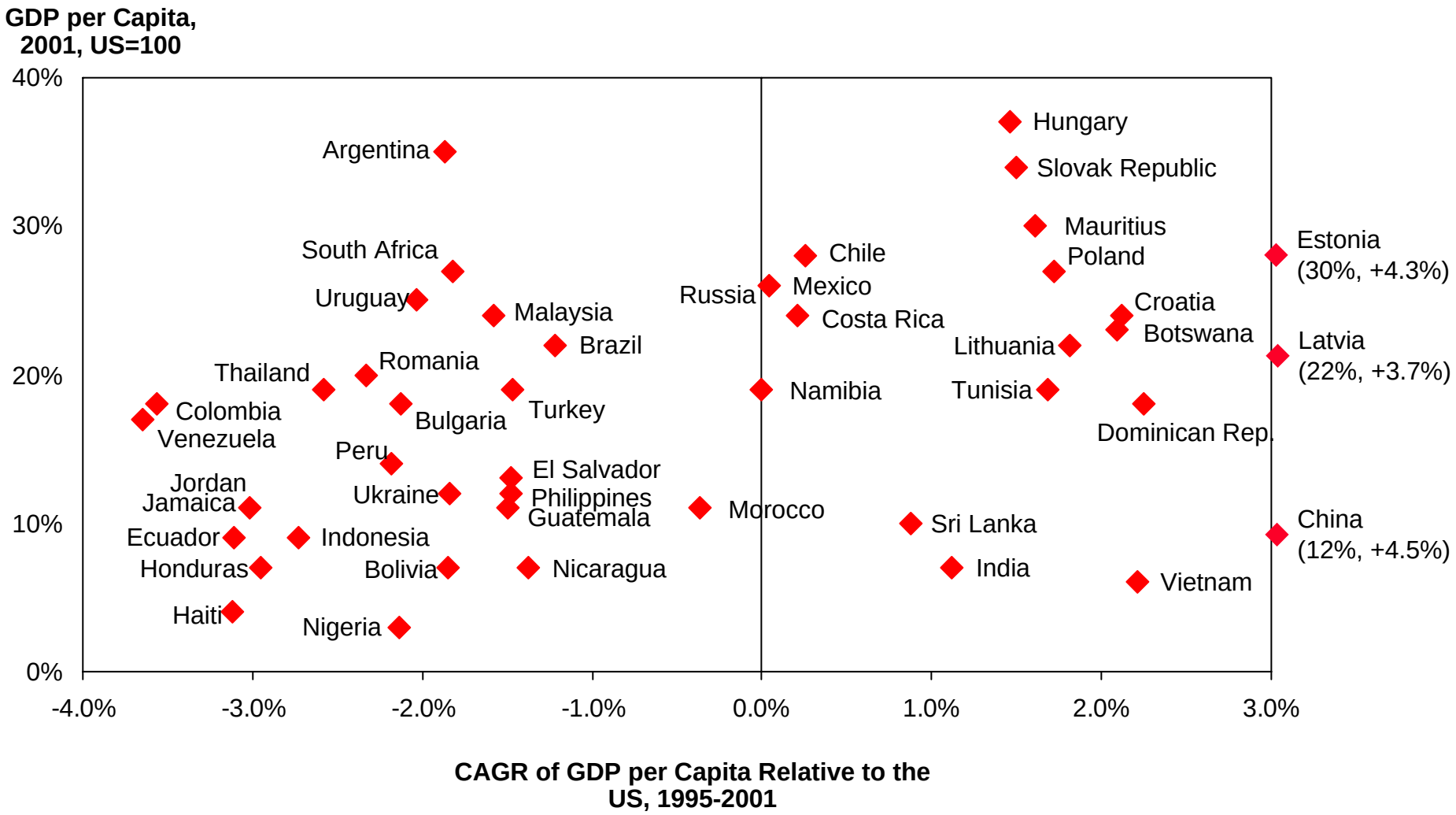
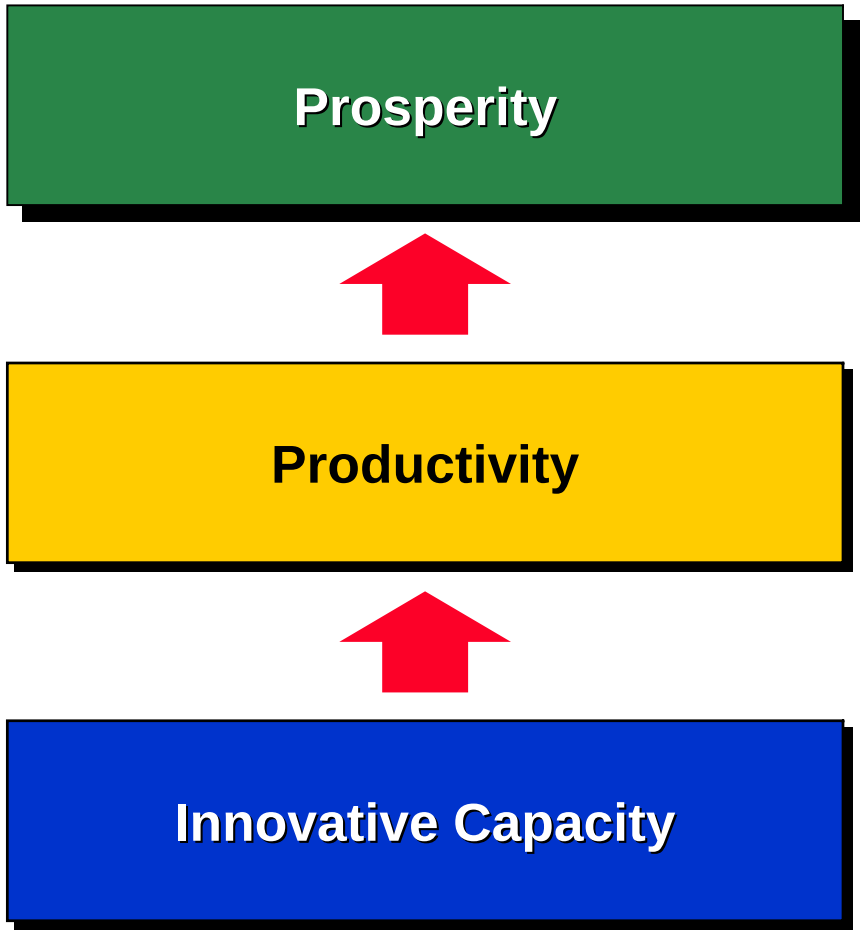
Comparative Economic Performance
Selected Middle- and Lower-Income Economies



Source: World Development Indicators 2002

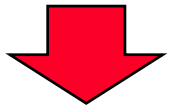
Drivers of Sustainable Prosperity



Competitiveness

What is Competitiveness?

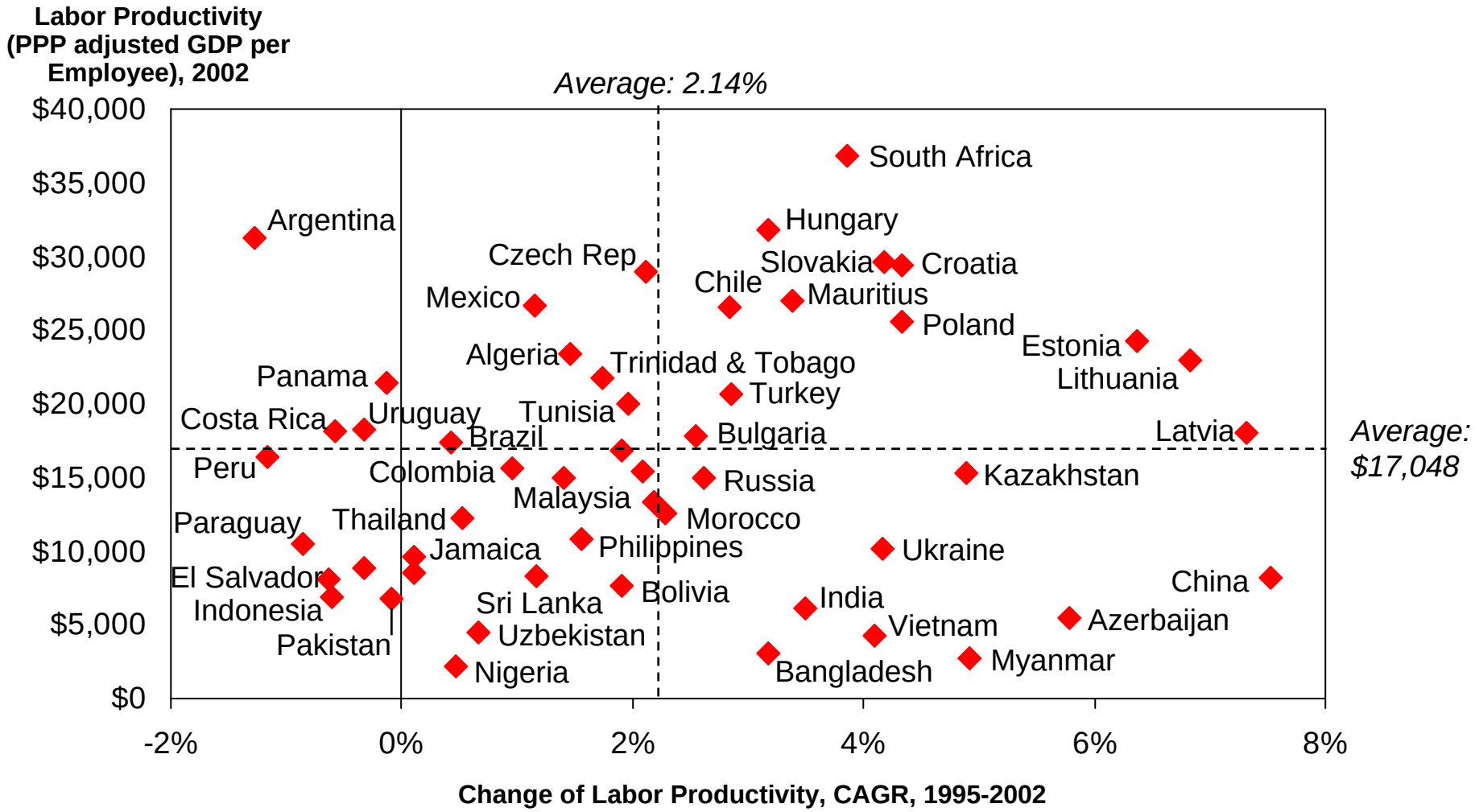
- Competitiveness is determined by the **productivity** with which a nation or region uses its human, capital, and natural resources. Productivity sets a nation's or region's standard of living (wages, returns to capital, returns to natural resource endowments)
  - Productivity depends both on the **value** of products and services (e.g. uniqueness, quality) as well as the **efficiency** with which they are produced.
  - It is not **what** industries a nation or region competes in that matters for prosperity, but **how** firms compete in those industries
  - Productivity in a nation is a reflection of what both domestic and foreign firms **choose to do in that location.** The location of ownership is secondary for national prosperity.
  - The productivity of **"local"** industries is of fundamental importance to competitiveness, not just that of traded industries
  - Devaluation does **not** make a country more competitive



- 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

Comparative Labor Productivity Performance

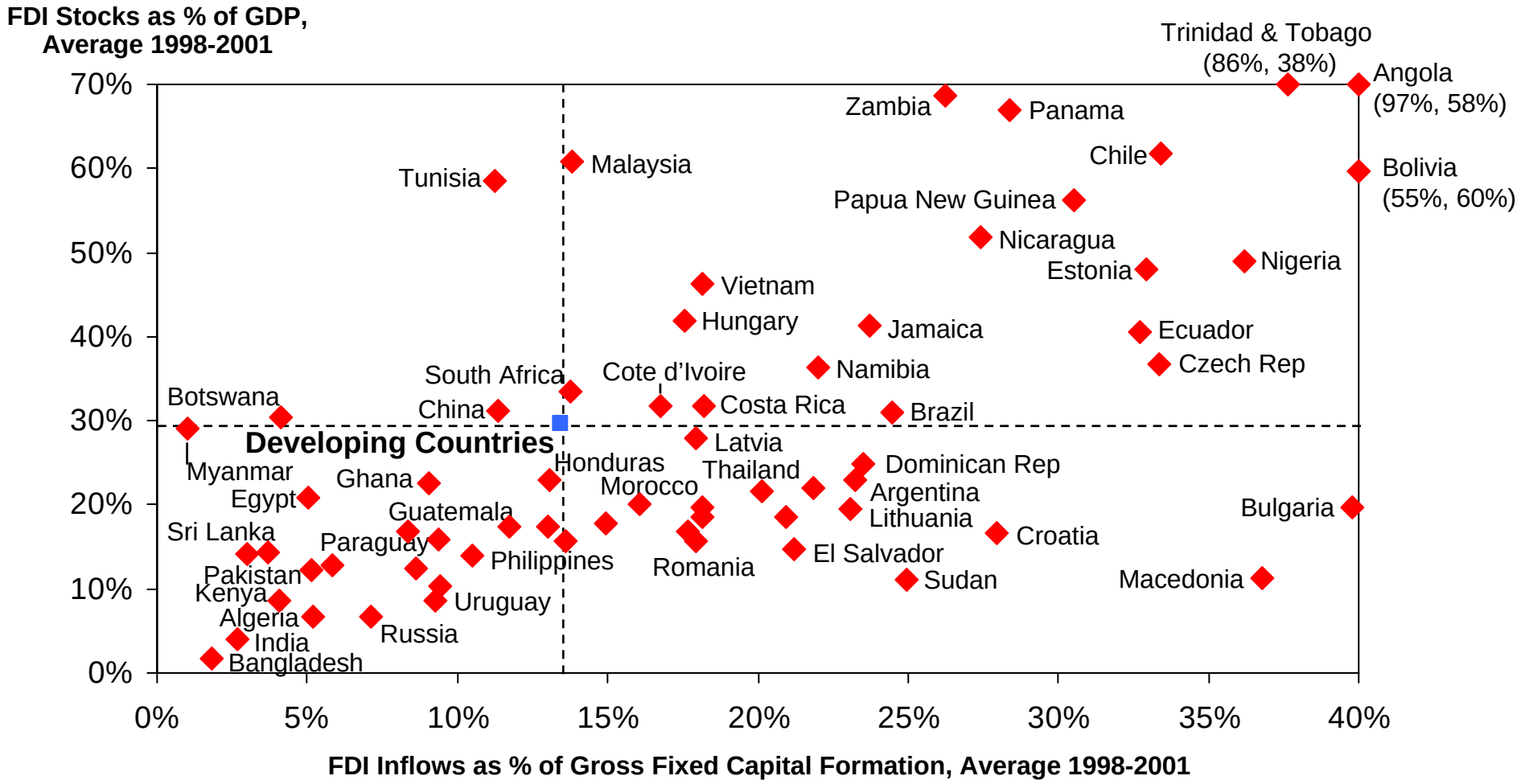
Selected Middle Income & Low Income Economies



Note: CAGR for China, Tunisia, Ukraine and Indonesia based on 1996-2002
Source: EIU 2003

Comparative Inward Foreign Investment

Selected Middle Income & Low Income Economies



Source: World Investment Report 2002

Determinants of Productivity and Productivity Growth

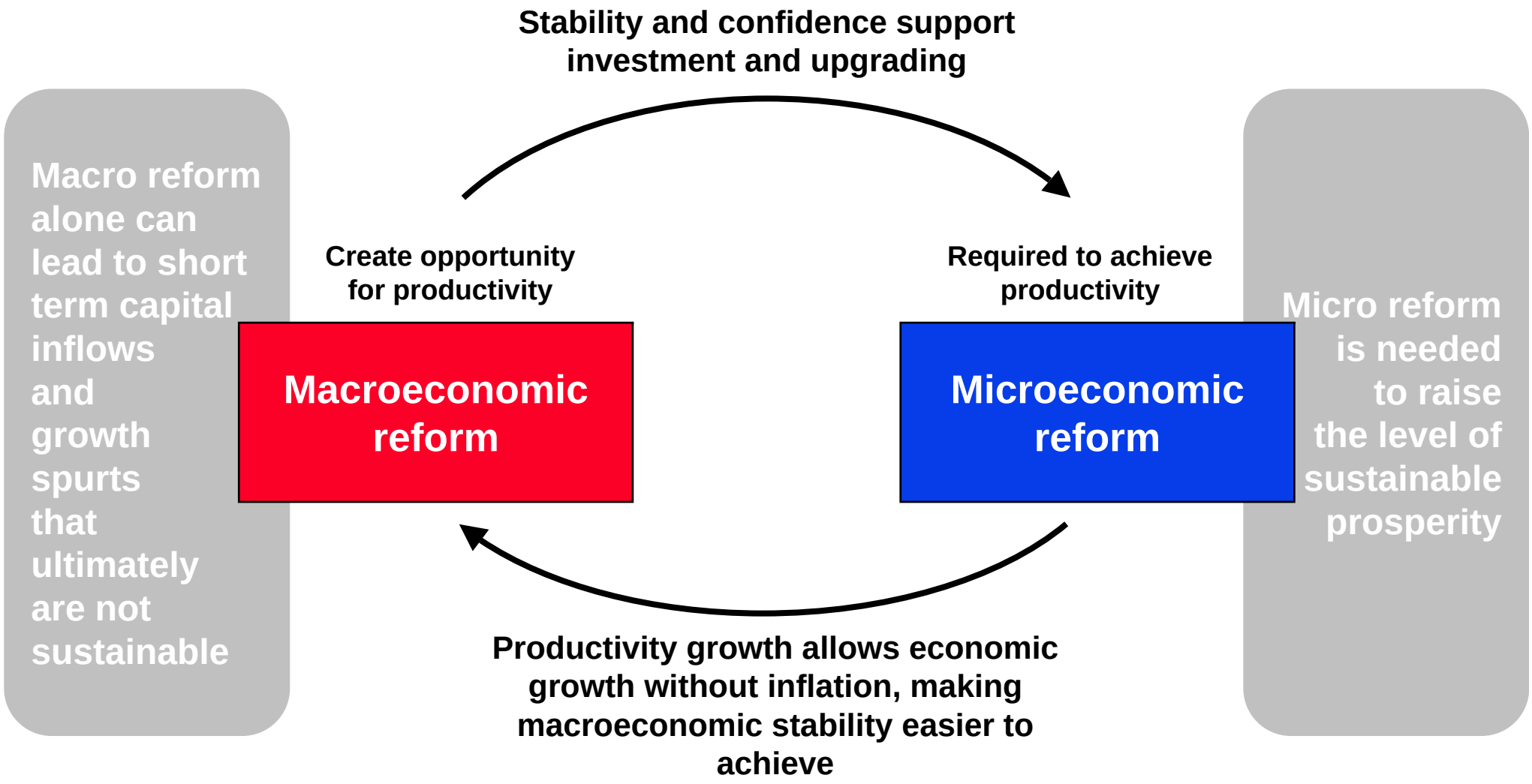
Macroeconomic, Political, Legal, and Social Context for Development

Microeconomic Foundations of Development

Sophistication of Company Operations and Strategy ⟷ **Quality of the Microeconomic Business Environment**

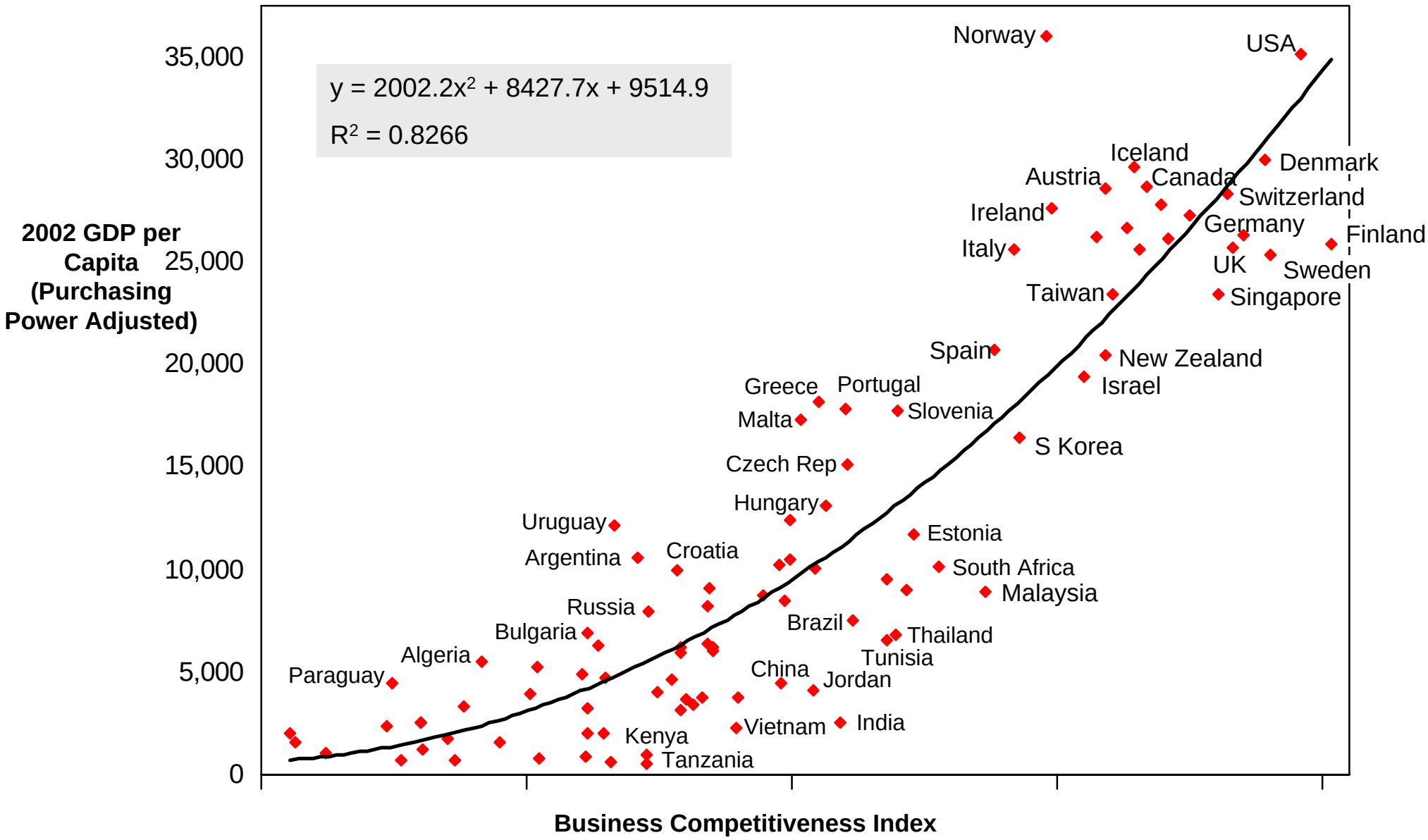
- A sound macroeconomic, political, legal, and social context creates the potential for competitiveness, **but is not sufficient**
- Competitiveness ultimately depends on improving the **microeconomic capability** of the economy and the **sophistication of local companies and local competition**

Integration of Macro- and Microeconomic Reforms



Business Competitiveness Index 2003

Relationship with GDP Per Capita



Source: Global Competitiveness Report 2003

Company Agenda and Economic Development

Low-Income Countries

Strategy

- Competitive advantages beyond cheap inputs
- Production process sophistication
- Broad value chain presence

Organization

- Reliance on professional management

Medium-Income Countries

Strategy

- Company R&D spending
- Control of international distribution
- Extent of regional sales
- Extent of branding
- Prevalence of foreign technology licensing

Organization

- Extent of staff training

High-Income Countries

Strategy

- Capacity for innovation
- Breadth of international markets

Organization

- Extent of incentive compensation
- Willingness to delegate authority

Typical Company Errors in Developing Economies

Corporate Direction

- **Opportunistic** pursuit of new businesses, seizing profitable opportunities in whatever area they arise
- Strategy driven by **government and other relationships**
- **Conglomerate business groups** compete in highly disparate businesses

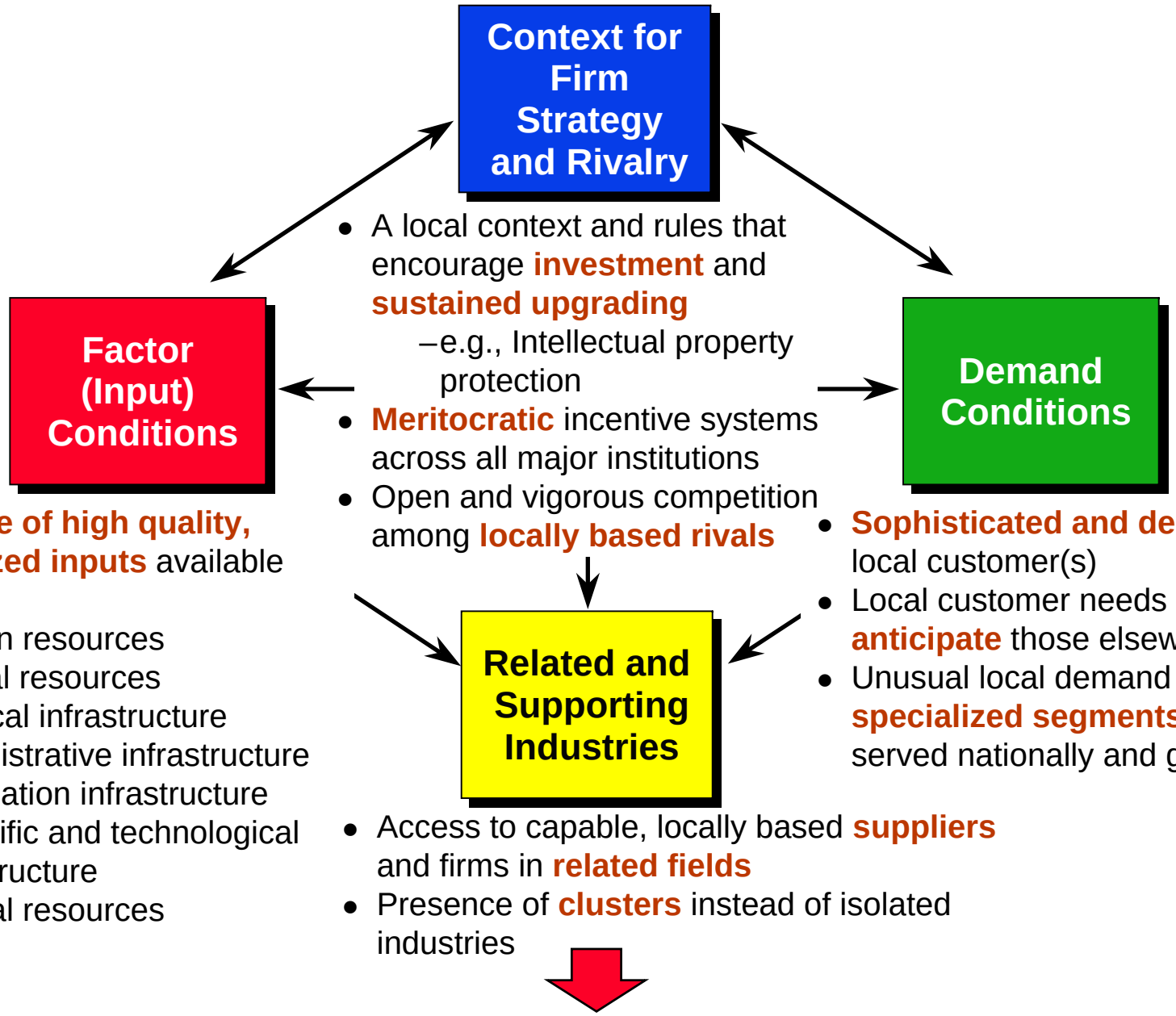
Strategic Positioning

- Focus on the **local** market
- **Wide product lines** serving all local industry segments
- **Price** is the primary basis of competition
- **Low input costs** are primary competitive advantage
- Emulate **foreign best practices**
- Imitate products and services of foreign and other domestic competitors

Activities

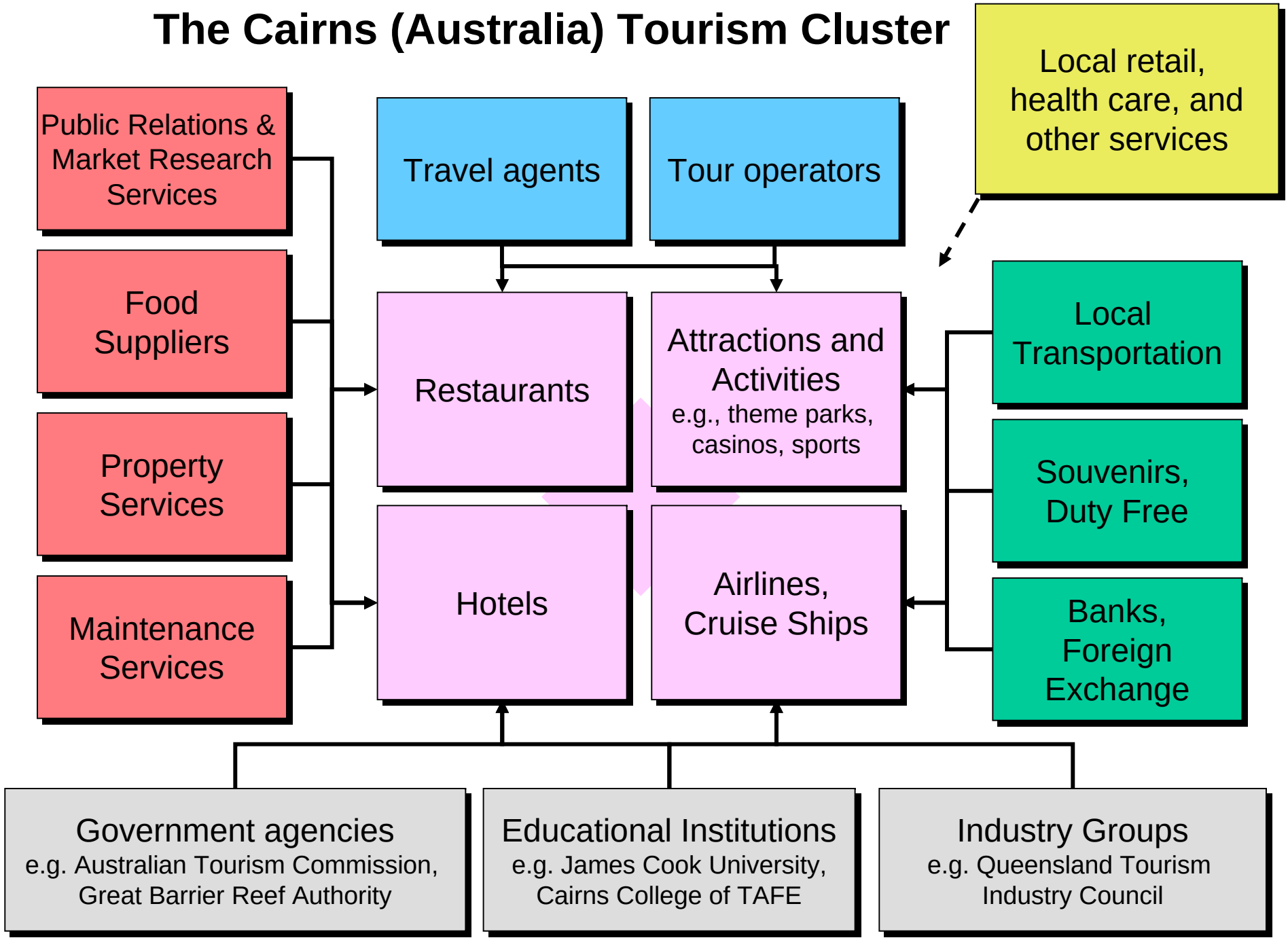
- **Labor intensive** parts of the value chain are emphasized
- **Low investment** in machinery, equipment, brands, R&D, and training
- **Foreign partners** provide many inputs, know how, and financing

Productivity and the Business Environment



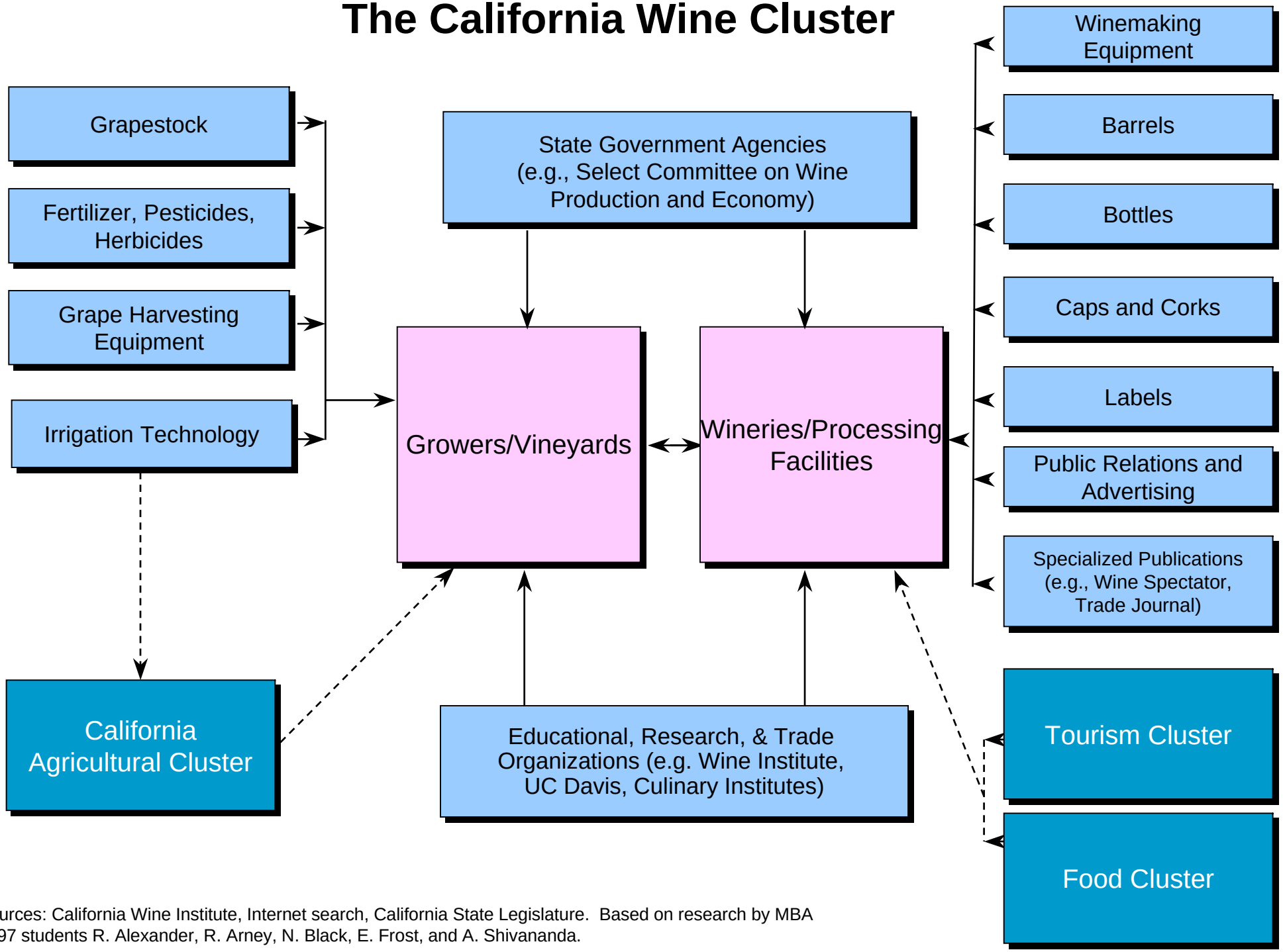
- Successful economic development is a process of **successive economic upgrading**, in which the business environment in a nation evolves to support and encourage increasingly sophisticated ways of competing

The Cairns (Australia) Tourism Cluster



Sources: HBS student team research (2003)

The California Wine Cluster



Sources: California Wine Institute, Internet search, California State Legislature. Based on research by MBA 1997 students R. Alexander, R. Arney, N. Black, E. Frost, and A. Shivananda.

Clusters and Competitiveness

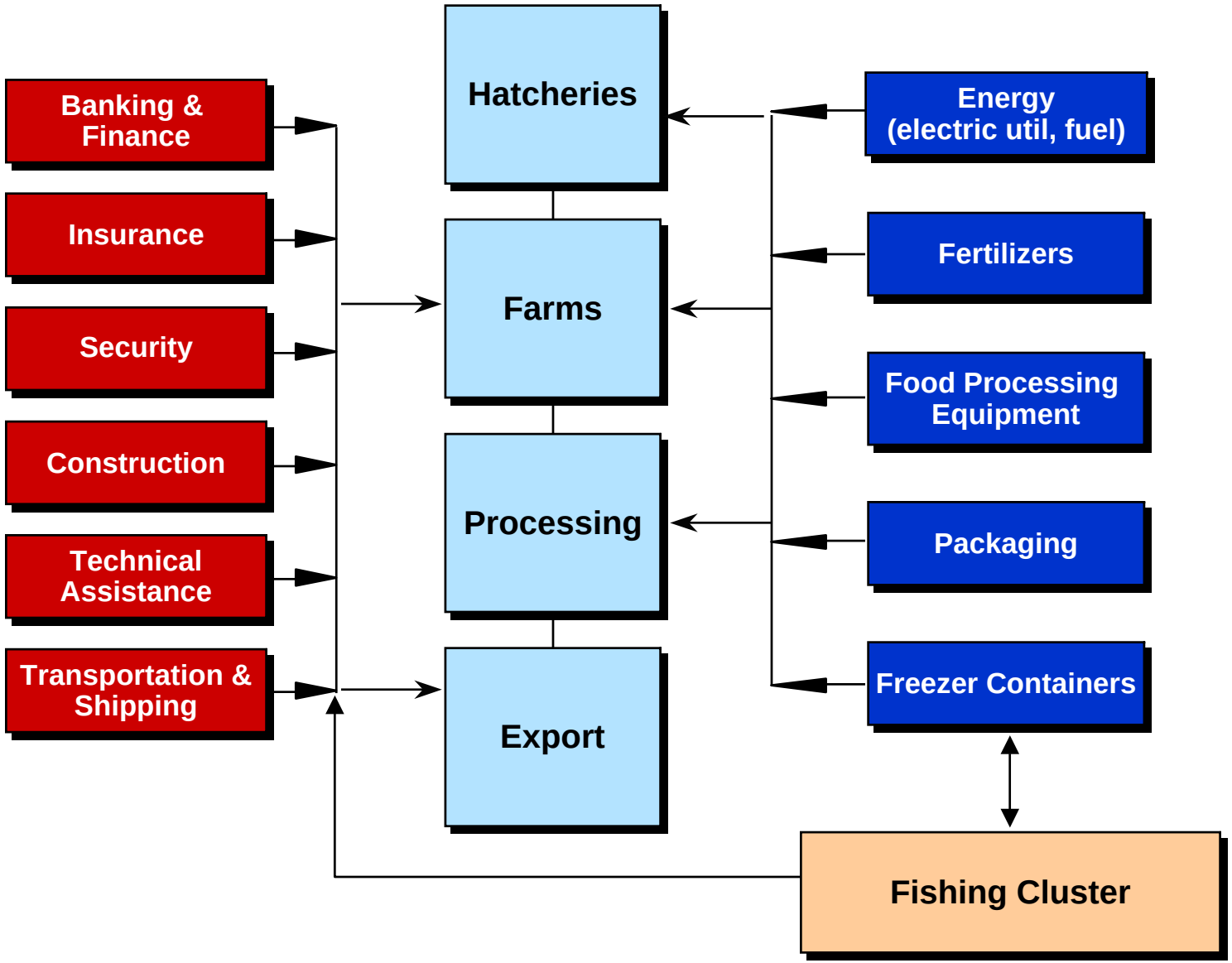
- **Clusters Increase Productivity / Efficiency**
  - Efficient **access** to specialized inputs, services, employees, information, institutions, and “public goods” (e.g. training programs)
  - Ease of **coordination** and transactions across firms
  - Rapid **diffusion** of best practices
  - Ongoing, visible **performance comparisons** and strong incentives to improve vs. local rivals

- **Clusters Stimulate and Enable Innovations**
  - Enhanced ability to **perceive innovation opportunities**
  - Presence of multiple suppliers and institutions to assist in **knowledge creation**
  - Ease of **experimentation** given locally available resources

- **Clusters Facilitate Commercialization**
  - Opportunities for **new companies** and **new lines of established business** are more apparent
  - **Commercializing** new products and starting new companies is easier because of available skills, suppliers, etc.

Clusters reflect the fundamental influence of **externalities / linkages** across firms and associated institutions in competition

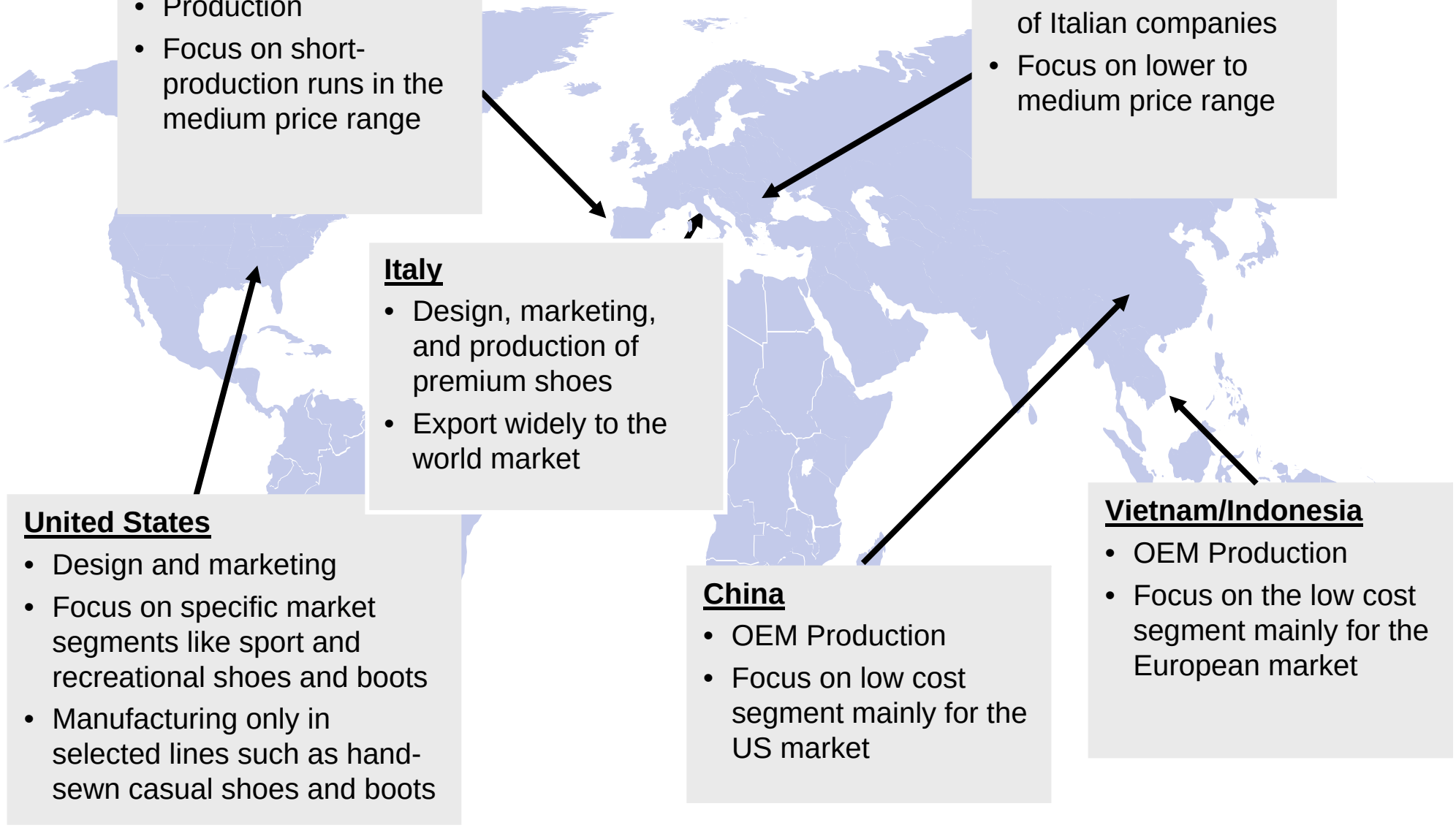
The Ecuadorian Shrimp Farming Cluster



Levels of Clusters

- There is often an **array of clusters** in a given field in different locations, each with different levels of specialization and sophistication
- Global **innovation centers**, such as Silicon Valley in semiconductors, are few in number. If there are multiple innovation centers, they normally **specialize** in different market segments
- Other clusters focus on **manufacturing,** outsourced **service functions,** or play the role of **regional** production, assembly or service centers
- Firms based in the most advanced clusters often **seed or enhance clusters** in other locations in order to reduce the risk of a single site, access lower cost inputs, or better serve particular regional markets
- The challenge for an economy is to move from **isolated firms** to an array of **clusters**, enhance **interaction** within clusters, and then to **upgrade the breadth and sophistication** of clusters to more advanced activities

Leading Footwear Clusters



Portugal
- Production
- Focus on short-production runs in the medium price range

Romania
- Production subsidiaries of Italian companies
- Focus on lower to medium price range

Italy
- Design, marketing, and production of premium shoes
- Export widely to the world market

United States
- Design and marketing
- Focus on specific market segments like sport and recreational shoes and boots
- Manufacturing only in selected lines such as hand-sewn casual shoes and boots

China
- OEM Production
- Focus on low cost segment mainly for the US market

Vietnam/Indonesia
- OEM Production
- Focus on the low cost segment mainly for the European market

Source: Research by HBS student teams in 2002

Institutions for Collaboration

General

- Chambers of Commerce
- Professional associations
- School networks
- University partner groups
- Religious networks
- Joint private/public advisory councils
- Competitiveness councils

Cluster-specific

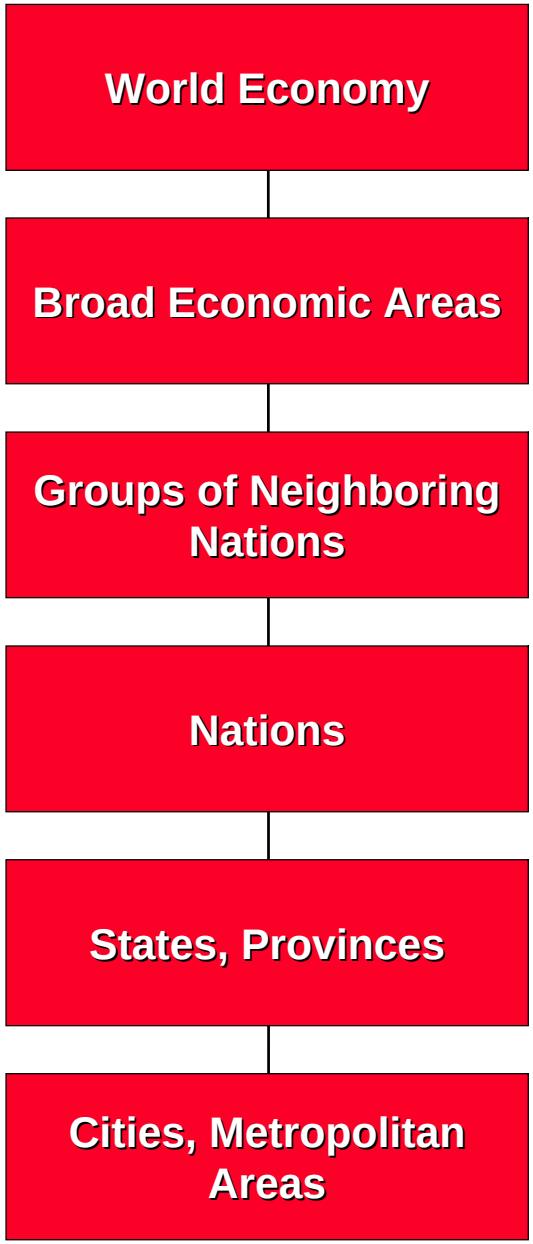
- Industry associations
- Specialized professional associations and societies
- Alumni groups of core cluster companies
- Incubators

- Institutions for collaboration (IFC) are **formal and informal organizations** that
  - facilitate the exchange of information and technology
  - conduct joint activities
  - foster coordination among firms

- IFCs can improve the business environment by
  - creating **relationships** and level of trust that make them more effective
  - defining of **common standards**
  - conducting or facilitating the organization of **collective action** in areas such as procurement, information gathering, or international marketing
  - defining and communicating common **beliefs and attitudes**
  - providing mechanisms to develop a common economic or **cluster agenda**

Influences on Competitiveness

Multiple Geographic Levels



Composition of Regional Economies

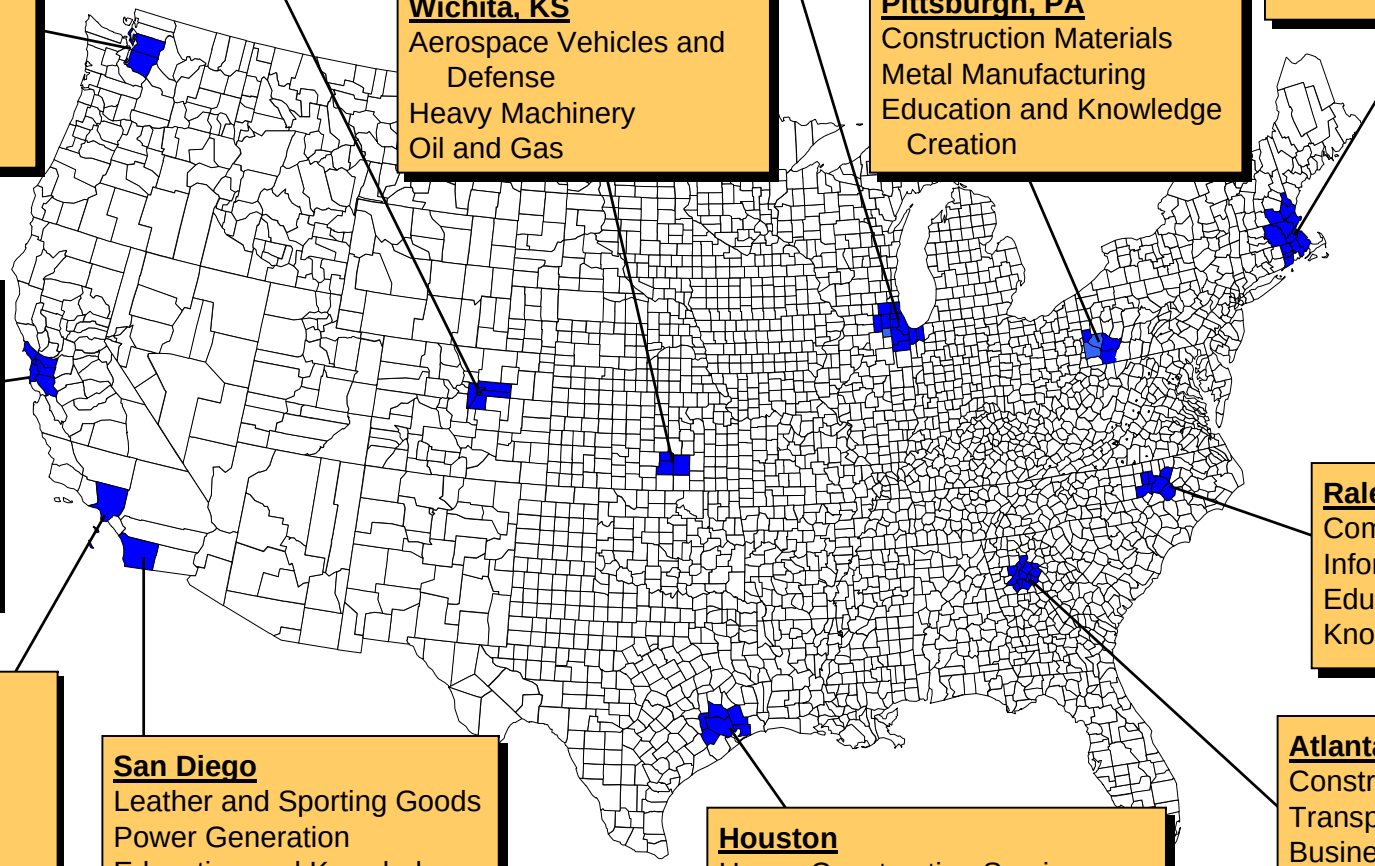
United States, 2001

	Traded Clusters	Local Clusters	Natural Resource-Driven Industries
Share of Employment	31.6%	67.6%	0.8%
Employment Growth, 1990 to 2001	1.7%	2.8%	-1.0%
Average Wage	$44,956	$28,288	$33,245
Relative Wage	133.8	84.2	99.0
Wage Growth	4.5%	3.7%	2.0%
Relative Productivity	144.1	79.3	140.1
Patents per 10,000 Employees	21.7	1.3	7.2
Number of SIC Industries	590	241	48

Note: 2001 data, except relative productivity which is 1997 data.
Source: Cluster Mapping Project, Institute for Strategy and Competitiveness, Harvard Business School

Specialization of Regional Economies

Select U.S. Geographic Areas



Denver, CO
Leather and Sporting Goods
Oil and Gas
Aerospace Vehicles and Defense

Chicago
Communications Equipment
Processed Food
Heavy Machinery

Boston
Analytical Instruments
Education and Knowledge Creation
Communications Equipment

Seattle-Bellevue-Everett, WA
Aerospace Vehicles and Defense
Fishing and Fishing Products
Analytical Instruments

Wichita, KS
Aerospace Vehicles and Defense
Heavy Machinery
Oil and Gas

Pittsburgh, PA
Construction Materials
Metal Manufacturing
Education and Knowledge Creation

San Francisco-Oakland-San Jose Bay Area
Communications Equipment
Agricultural Products
Information Technology

Raleigh-Durham, NC
Communications Equipment
Information Technology
Education and Knowledge Creation

Los Angeles Area
Apparel
Building Fixtures, Equipment and Services
Entertainment

San Diego
Leather and Sporting Goods
Power Generation
Education and Knowledge Creation

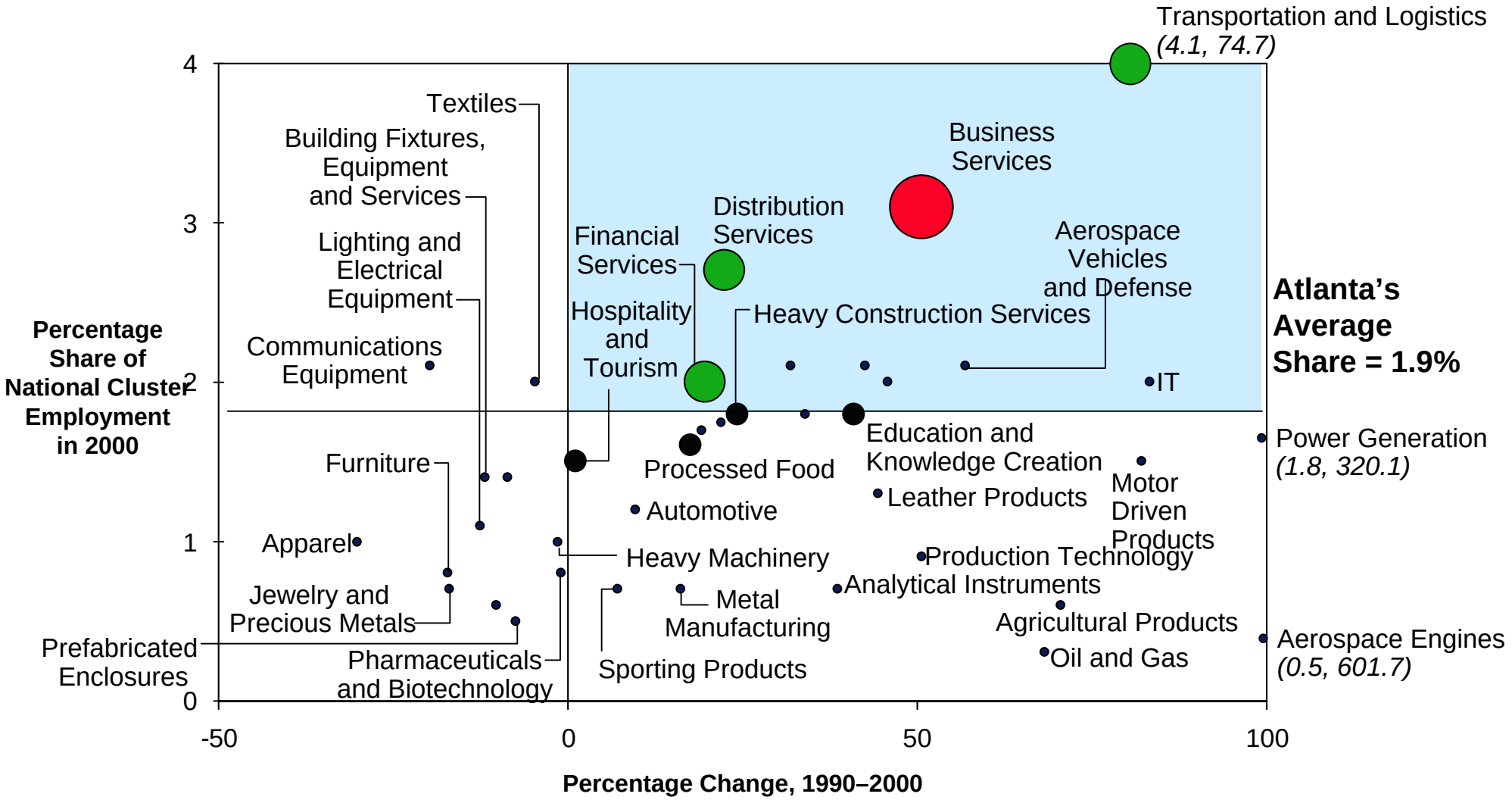
Houston
Heavy Construction Services
Oil and Gas
Aerospace Vehicles and Defense

Atlanta, GA
Construction Materials
Transportation and Logistics
Business Services

Note: Clusters listed are the three highest ranking clusters in terms of share of national employment
Source: Cluster Mapping Project, Institute for Strategy and Competitiveness, Harvard Business School

Specialization of Regional Economies

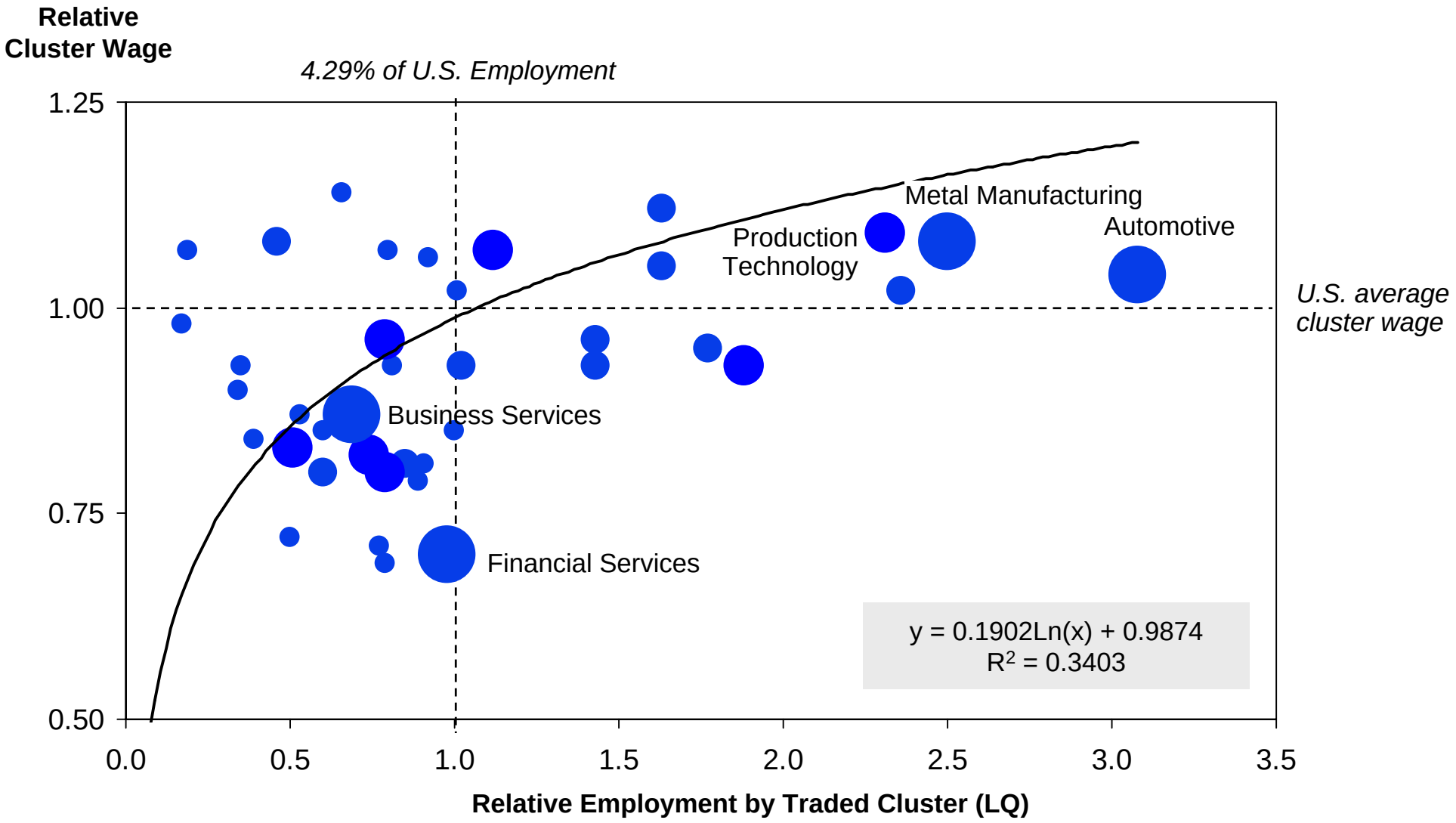
Atlanta Metro Area



Note: Uses narrow cluster definitions to avoid overlap = 0–19,999 = 20,000–49,999 = 50,000–99,999 = 100,000+

Source: Cluster Mapping Project, Institute for Strategy and Competitiveness, Harvard Business School

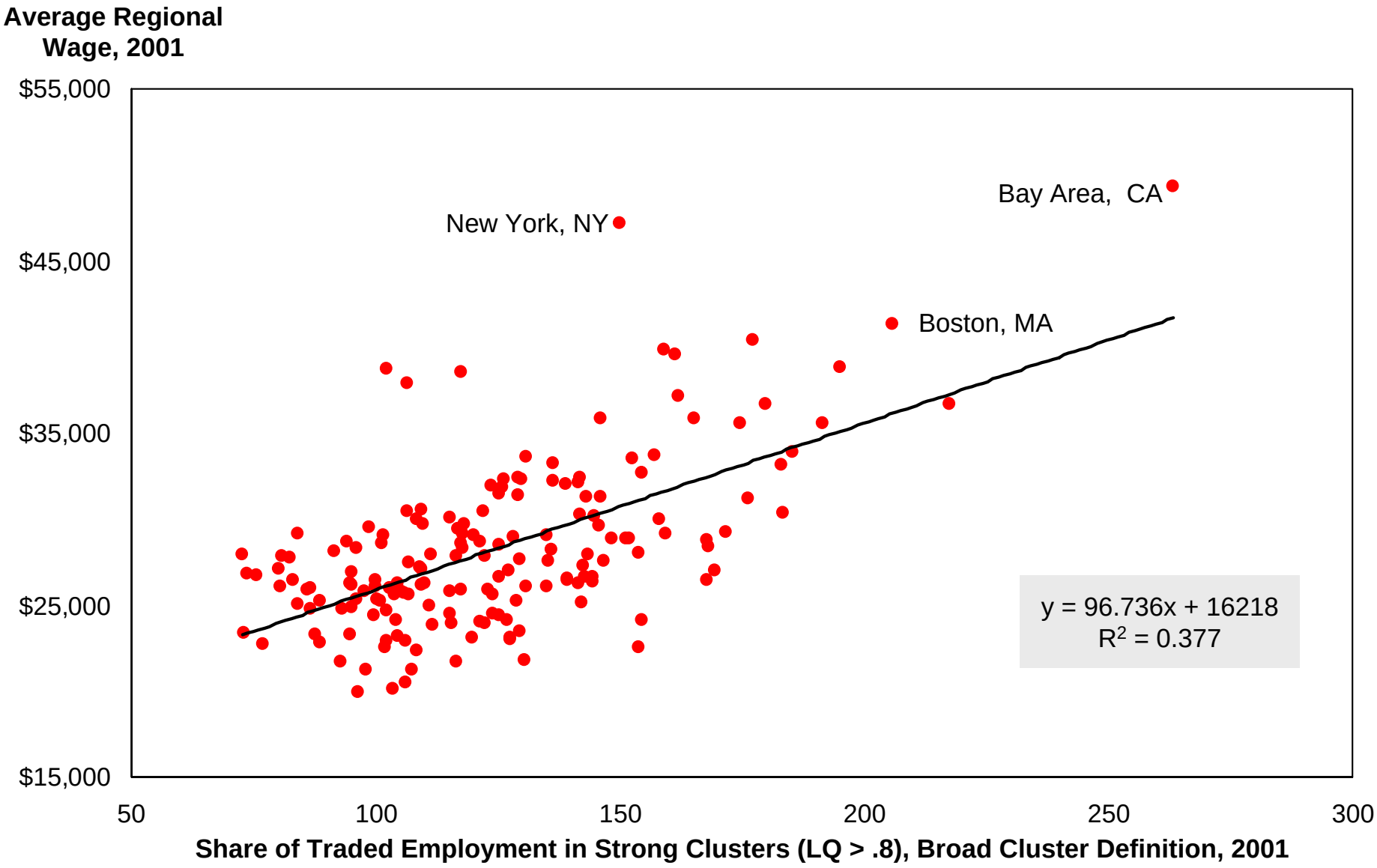
Traded Cluster Specialization and Relative Wage Levels
Ohio, 2001



Note: Uses narrow cluster definitions to avoid overlap; bubble size proportional to employment bracket
Source: Cluster Mapping Project, Institute for Strategy and Competitiveness, Harvard Business School

Determinants of Regional Prosperity

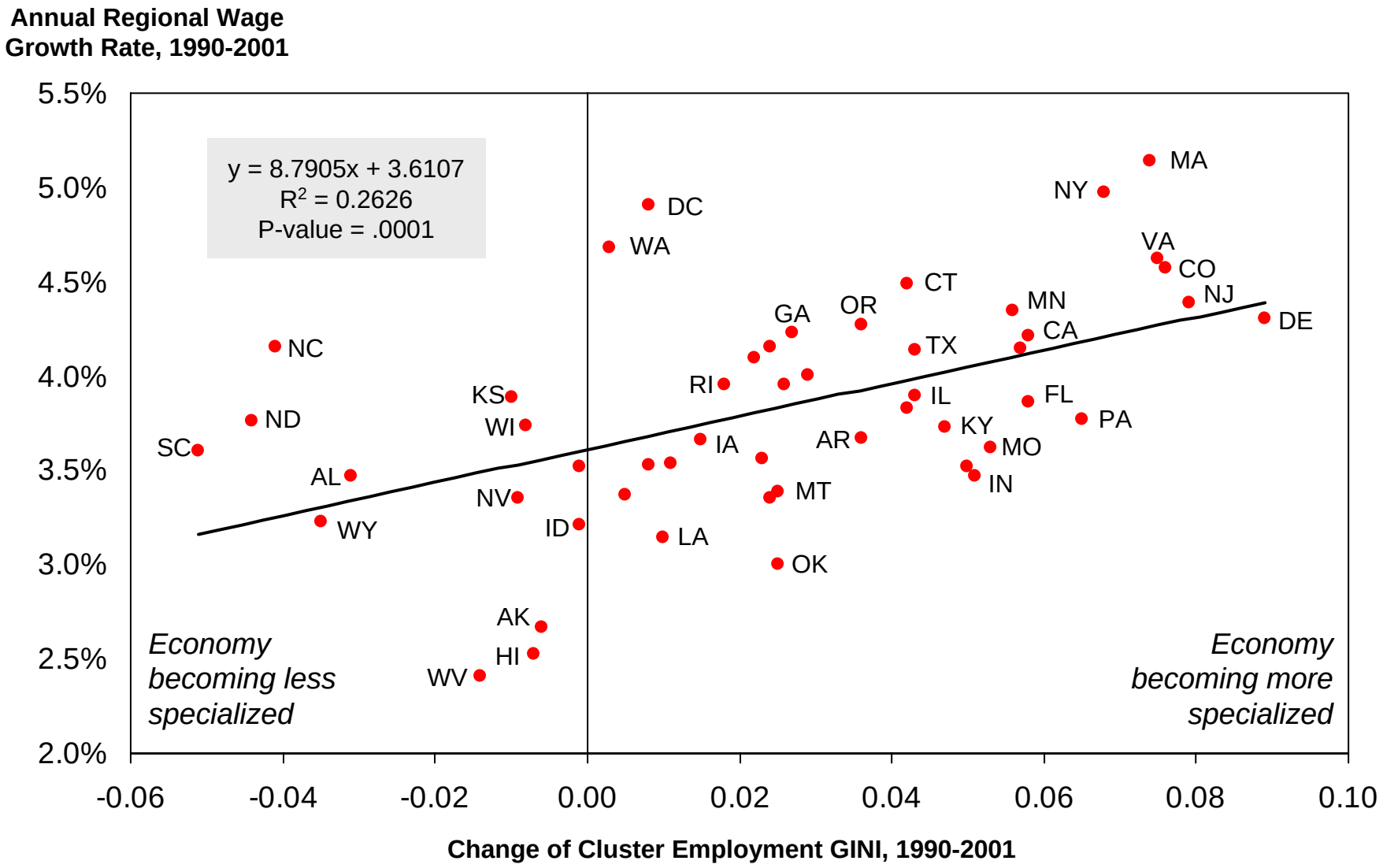
Cluster Strength and Wages



Source: County Business Patterns; Michael E. Porter, The Economic Performance of Regions", *Regional Studies*, Vol. 37, 2003

Determinants of Regional Prosperity

Change in Cluster Specialization and Wage Growth



Source: County Business Patterns; Michael E. Porter, The Economic Performance of Regions", *Regional Studies*, Vol. 37, 2003

Stages Of Competitive Development

Low Cost Inputs

Efficiency Through Heavy Domestic and Foreign Investment

Unique Value

Source: Porter, Michael E., *The Competitive Advantage of Nations*, The Free Press: New York (1990)

Factor (Input) Conditions

Factor (Input) Conditions
Russia's Relative Position

Competitive Advantages Relative to GDP per Capita

	Country Ranking, Arrows indicate a change of 5 or more ranks since 1998
Railroad Infrastructure Quality	17
Quality of Math and Science Education	18
Quality of Scientific Research Institutions	25 ↓
Availability of Scientists and Engineers	26
Patents per million Population (2002)	37
Quality of Educational System	38
Quality of Public Schools	41 ↓
Port Infrastructure Quality	42
University/Industry Research Collaboration	53
Air Transport Infrastructure Quality	57
Overall Infrastructure Quality	58
Quality of Management Schools	59

Competitive Disadvantages Relative to GDP per Capita

	Country Ranking, Arrows indicate a change of 5 or more ranks since 1998
Extent of Bureaucratic Red Tape	89 ↓
Financial Market Sophistication	84 ↓
Administrative Burden for Start-Ups	84
Police Protection of Businesses	80
Adequacy of Public Sector Legal Recourse	78
Judicial Independence	74
Ease of Access to Loans	72
Telephone/Fax Infrastructure Quality	70
Local Equity Market Access	70
Quality of Electricity Supply	66
Cell phones per 100 people (2002)	65
Venture Capital Availability	60

Note: Rank by countries; overall Russia ranks 65 (63 on National Business Environment, 48 on GDP pc 2002)
Source: Global Competitiveness Report 2003

Context for Firm Strategy and Rivalry

Context for Firm Strategy and Rivalry

Russia's Relative Position

Competitive Advantages Relative to GDP per Capita

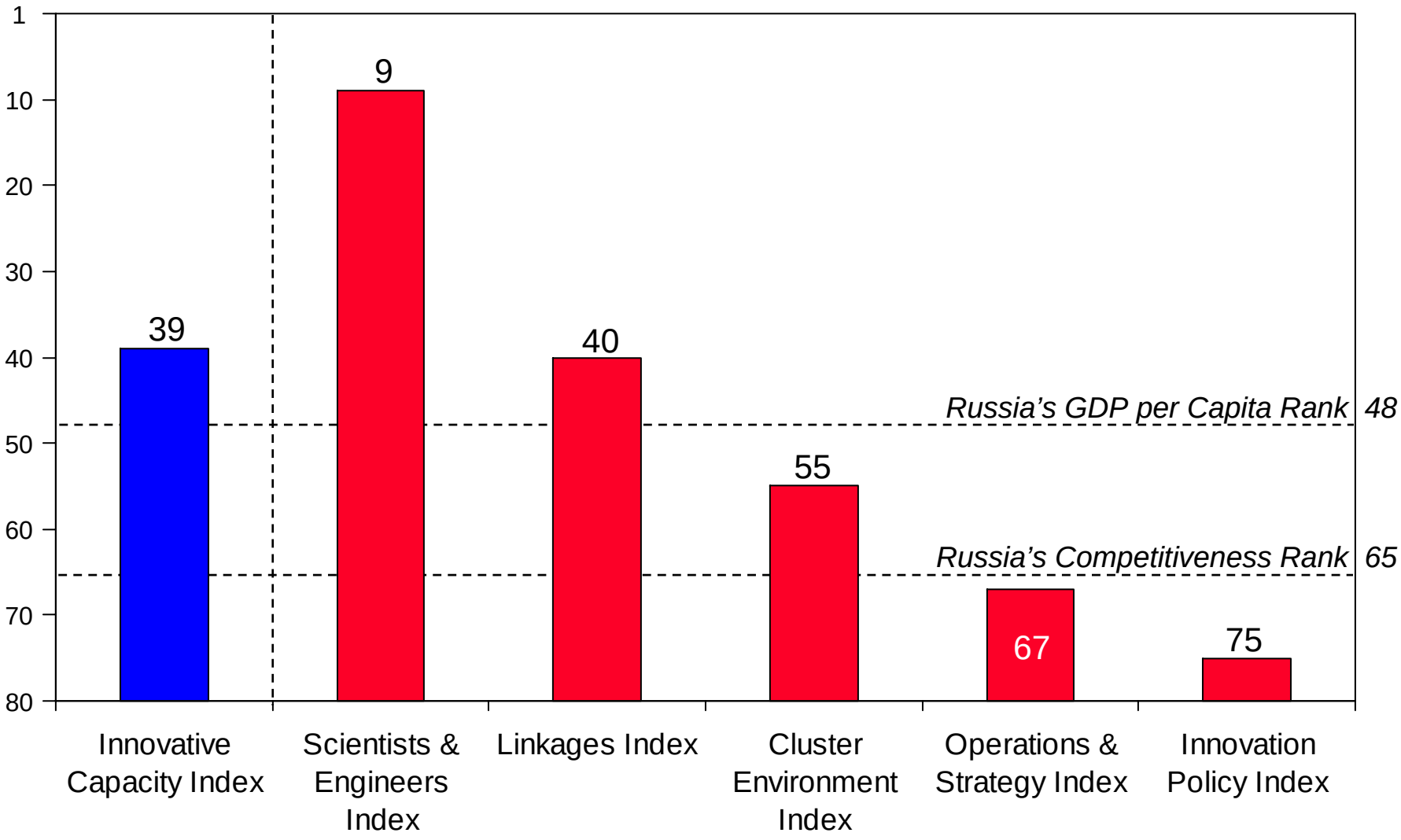
	Country Ranking, Arrows indicate a change of 5 or more ranks since 1998
Prevalence of mergers and acquisitions	30
Centralization of Economic Policy-making	33
Cooperation in Labor-Employer Relations	41
Extent of Locally Based Competitors	48 ↓

Competitive Disadvantages Relative to GDP per Capita

	Country Ranking, Arrows indicate a change of 5 or more ranks since 1998
Protection of Minority Shareholders	94
Foreign Ownership of Companies	93
Regulation of Securities Exchanges	86
Intellectual Property Protection	85
Intensity of Local Competition	83
Existence of Bankruptcy Law	82
Hidden Trade Barrier Liberalization	79
Tariff Liberalization	76
Decentralization of Corporate Activity	74
Favoritism in Decisions of Government Officials	74
Business Costs of Corruption	53

Note: Rank by countries; overall Russia ranks 65 (63 on National Business Environment, 48 on GDP pc 2002)
Source: Global Competitiveness Report 2003

Innovative Capacity Index
Russia's Relative Position

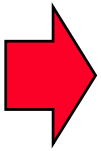


Source: Global Competitiveness Report 2003

Shifting Responsibilities for Economic Development

Old Model

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

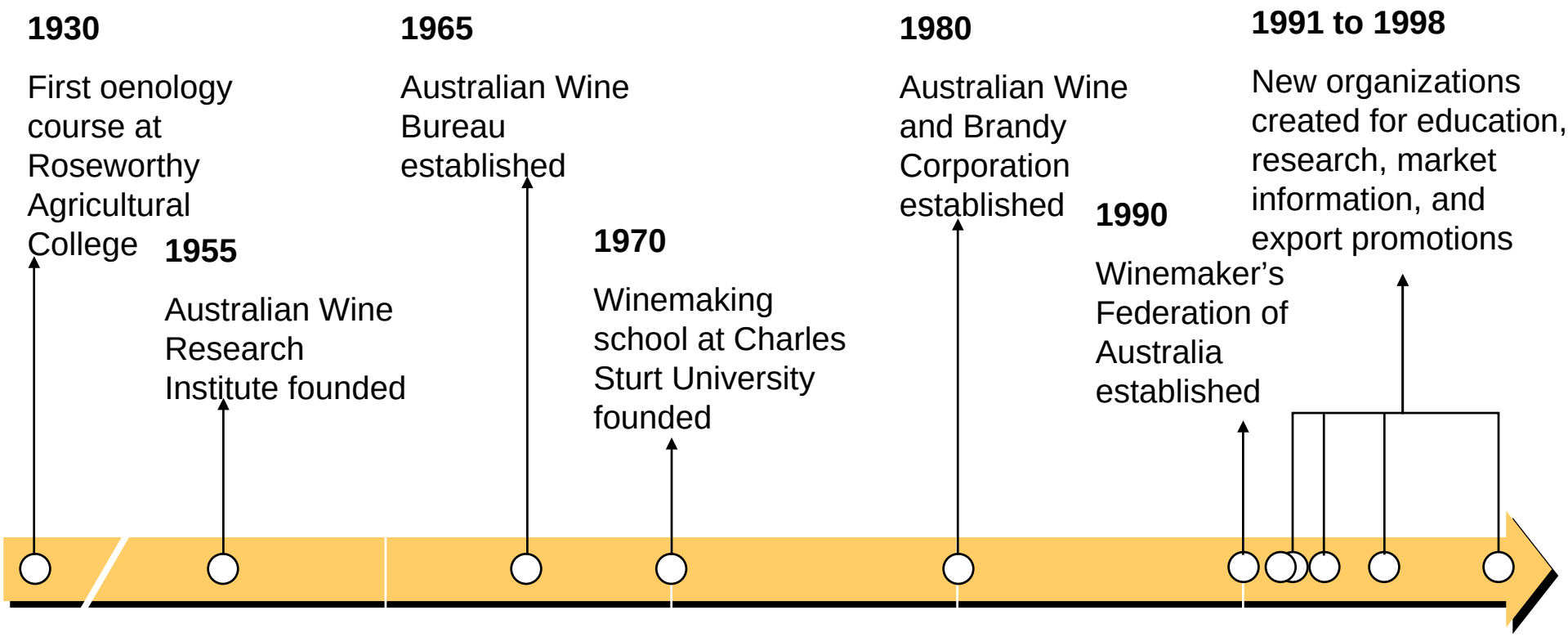


New Model

- Economic development is a **collaborative process** involving government at multiple levels, companies, teaching and research institutions, and institutions for collaboration

The Australian Wine Cluster

History



1950s

Import of European winery technology

1960s

Recruiting of experienced foreign investors, e.g. Wolf Bass

1970s

Continued inflow of foreign capital and management

1980s

Creation of large number of new wineries

1990s

Surge in exports and international acquisitions

Source: Michael E. Porter and Örjan Sölvell, The Australian Wine Cluster – Supplement, Harvard Business School Case Study, 2002

The Australian Wine Cluster

Recently founded Institutions for Collaboration

Winemakers' Federation of Australia

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

Cooperative Centre for Viticulture

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

Australian Wine Export Council

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

Grape and Wine R&D Corporation

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

Wine Industry Information Service

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

Wine Industry National Education and Training Council

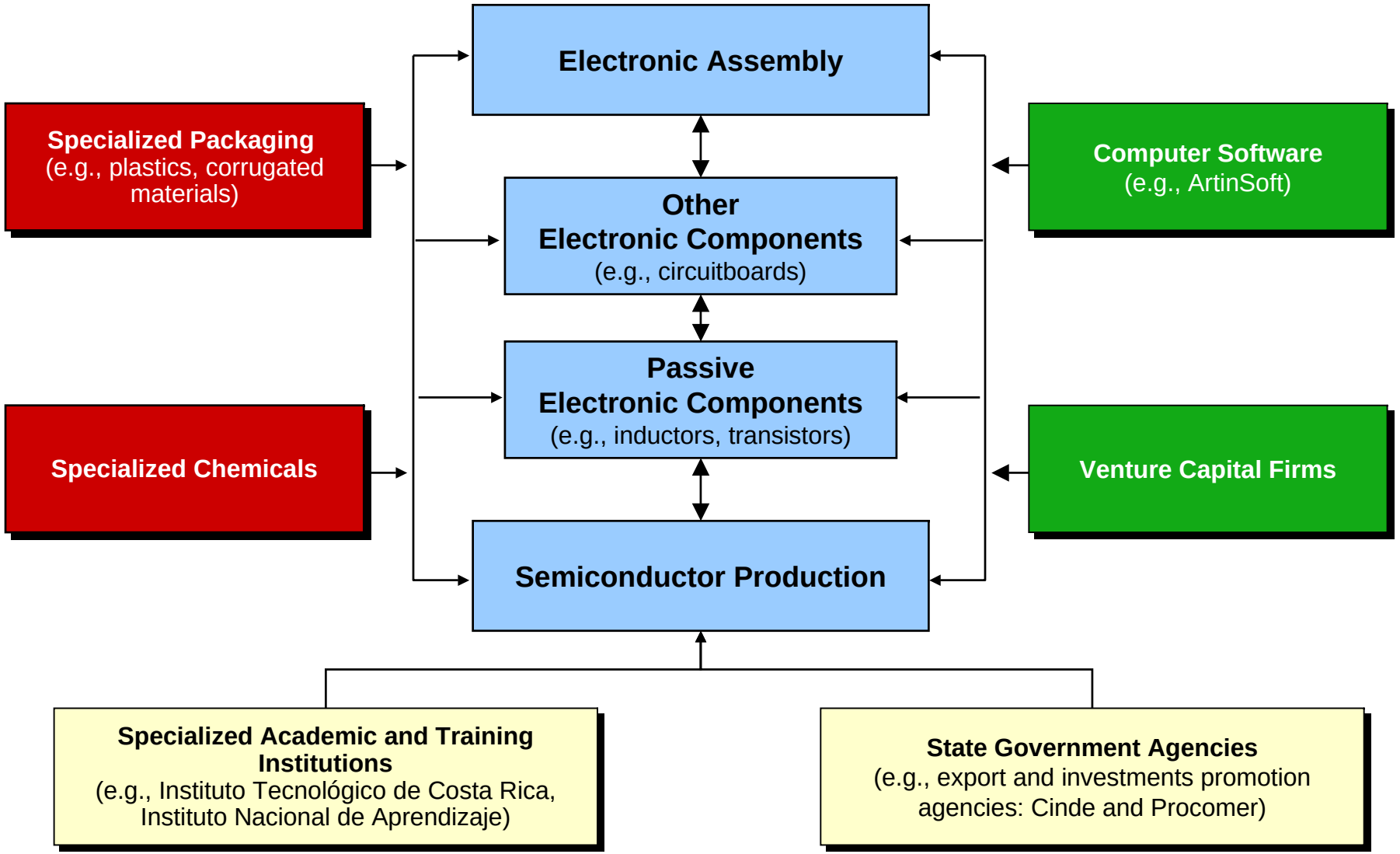
- Established in 1995
- Focus: Coordination, integration, and standard maintenance for vocational training and education
- Funding: Government; other cluster organizations

Source: Michael E. Porter and Örjan Sölvell, The Australian Wine Cluster – Supplement, Harvard Business School Case Study, 2002

Cluster Development Initiatives

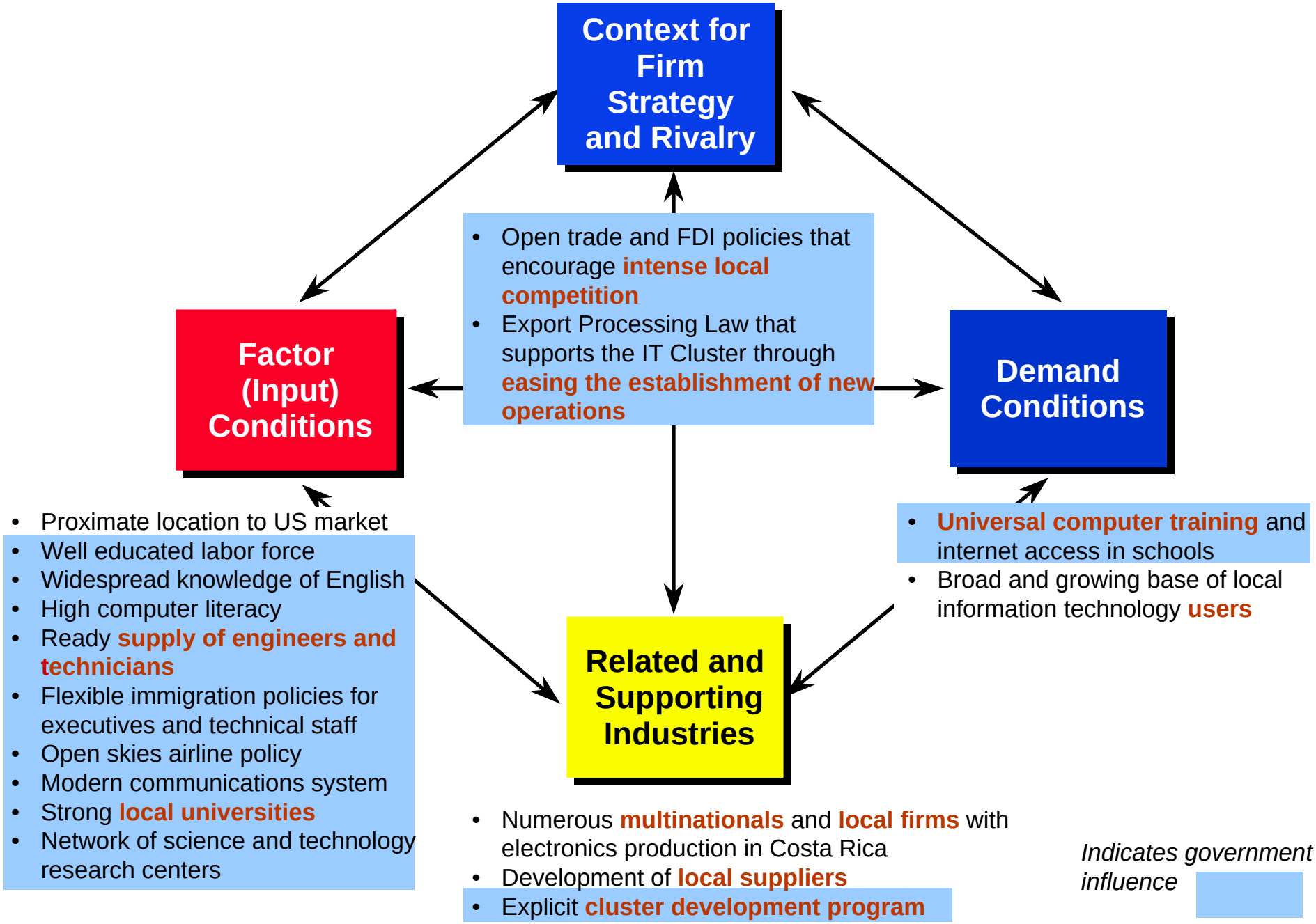
- Cluster definition
  - Cluster definitions need to be **broad enough** to include all relevant industries and institutions that have material linkages with the core activities of the cluster
  - Cluster definitions need to be **narrow enough** to cover companies that face a common set of barriers to upgrade productivity and performance
- Cluster selection
  - Competitiveness depends on **all clusters** a region or nation is active in
  - Prioritization of cluster efforts should be based upon the **potential and willingness to upgrade** of the regional cluster instead of generic factors such as size or technology
- Structure of the cluster initiative
  - Only **sustained, private sector-led** cluster initiatives can be sufficiently specific and persistent in achieving real improvements in cluster performance
  - All relevant parts of public administration and the legislature need to be involved to insure **broad backing** and **quick implementation** of recommendations
  - **Leadership** by a committed individual is need to keep momentum and integrate individual constituencies into a common upgrading process

The Costa Rica Information Technology Cluster



Source: Niels Ketelhohn research for Professor Michael E. Porter

The Costa Rica Information Technology Cluster



Appropriate Roles of Government in Cluster Development

- A successful cluster policy builds on **sound overall economic policies** and improvements in the **general business environment**
- Government should support the development of **all clusters**, not choose among them
- Government, in cooperation with the private sector, must identify all **existing** and **emerging** clusters
- To **qualify** as an emerging cluster there must be
  - Some viable companies present
  - A core of cluster-specific advantages in the diamond
- Government policy should **reinforce established and emerging clusters** rather than attempt to create entirely new ones
- Government's role in cluster initiatives is as **facilitator** and **participant.** The most successful cluster initiatives are a public-private partnership

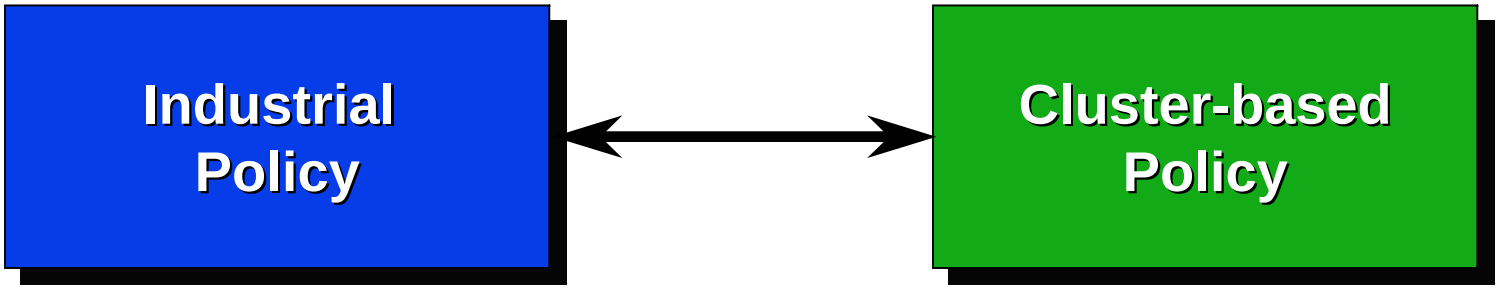
Export Processing Zones and Competitiveness

- Export processing zones are more successful if they are targeted around the needs of specific **clusters**
  - Use a cluster-based approach to FDI promotion
  - Involve companies already present in the zone to attract further specialized suppliers and service providers

- Export processing zones can improve a country's or province's competitiveness if they **trigger broader changes** in the business environment
  - Creation of specialized input factors, such as specialized suppliers and research facilities
  - Upgrading of rules and regulations, for example in the labor market
  - Improvement of government services, for example in customs services

Source: Michael Porter, Niels Ketelhohn (2003)

Cluster Policy versus Industrial Policy



- Target desirable industries / sectors
- Focus on domestic companies
- Intervene in competition (e.g., protection, industry promotion, subsidies)
- Centralizes decisions at the national level

Distort competition

- **All** clusters can contribute to prosperity
- Domestic and foreign companies both enhance productivity
- Relax impediments and constraints to productivity
- Emphasize cross-industry linkages / complementarities
- Encourage initiative at the state and local level

Enhance competition

Role of the Private Sector in Economic Development

- Companies have a stake in enhancing the **local business environment** and upgrading their **cluster**
- Private investment in **"public goods"** should complement the role of government
- The private sector brings **continuity** and a long time horizon often missing in government

- Take an **active role** in upgrading the local infrastructure
- Nurture **local suppliers** and attract new supplier investments
- Work closely with local **educational and research institutions** to upgrade **quality** and **create specialized programs** addressing cluster needs
- Provide government with **information** and **substantive input** on regulatory issues and constraints bearing on cluster development
- Focus **corporate philanthropy** on enhancing the local business environment

- **Trade and industry associations** have a vital role in competitiveness

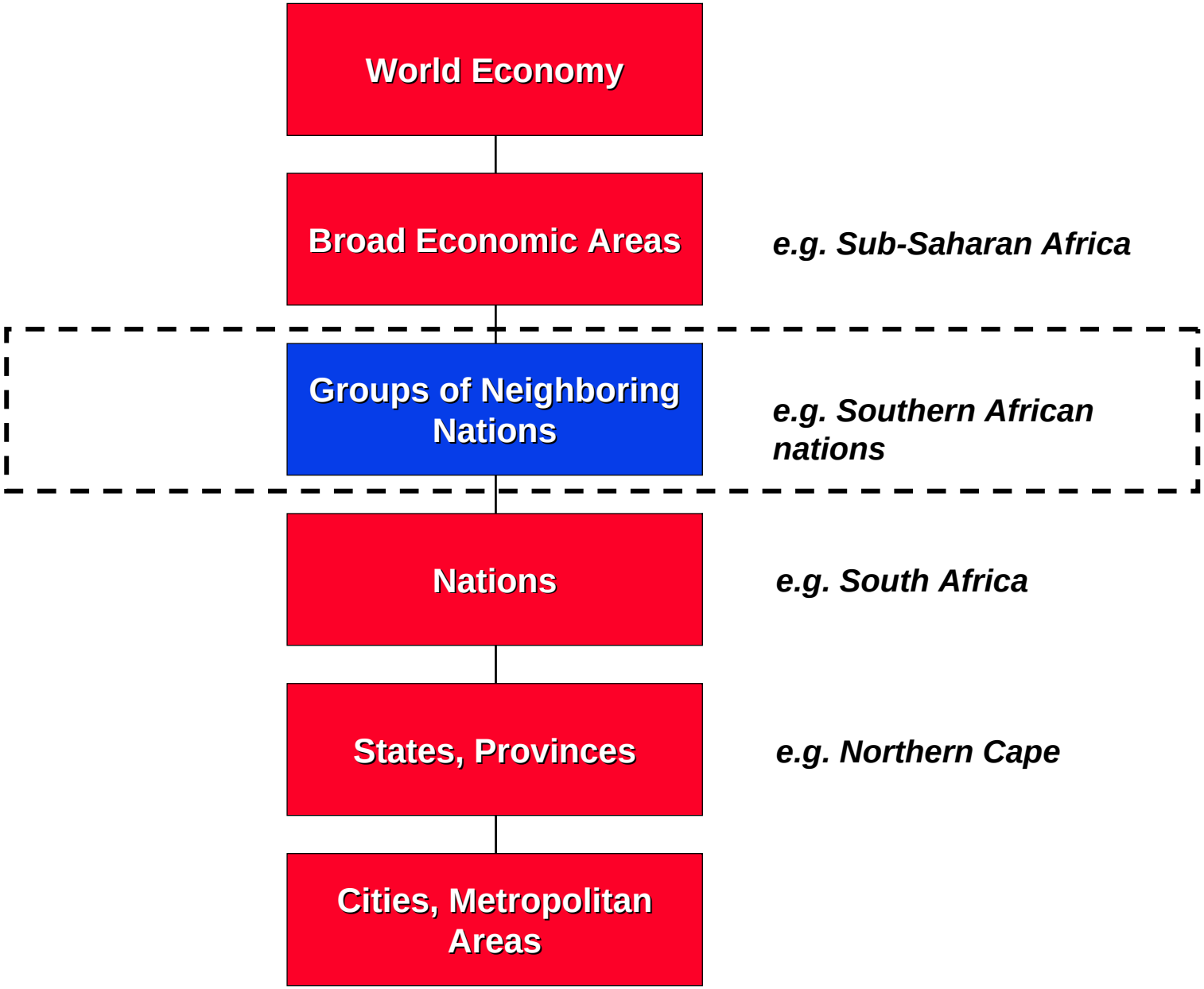
Clusters as a Tool For Economic Policy

Overview

- A **new way of thinking** about an economy and organizing economic development efforts
- Better aligned with the **nature of competition and sources of competitive advantage**. Clusters capture important **linkages** in terms of technology, skills, information, marketing and customer needs that cut across firms and industries. Such linkages are fundamental to competition and, especially, to the **direction and pace of innovation**
- Focused on improving the competitiveness of **groups of related firms** rather than programs to benefit individual companies
- **Recast the role** of the private sector, government, trade associations and educational or research institutions
- Brings together **firms of all sizes**
- Creates a **forum** for constructive business-government dialog
- A means to identify **common opportunities, not just common problems**
- Provides guidance for both **economic and social policies**

Cross-National Economic Coordination

Alternate Geographic Levels



The Importance of Regional Trade for Developing Economies

Trade Solely with Advanced Nations

- Exports tend to be restricted to industries relying on **inherited** comparative advantages
  - Natural resources
  - Cheap labor
- Can lead to a narrow export base and limited local company presence in the value chain
- Inbound FDI can focus heavily on accessing resources versus more productive activities
- This position is vulnerable to exchange rate swings and macroeconomic shocks

Trade with Developing Nations/Neighbors

- Exports can be based on **created** competitive advantages
  - Industries where a country has achieved greater productivity than neighbors
  - Differentiated products that meet regional needs
  - More efficient production processes than neighbors
- The export base broadens
- Skills widen in the value chain
- There is outbound not just inbound FDI

- Boosts **productivity** across many parts of the national economy
- Stimulates the improvement of skills by local firms and provides a **stepping stone** for wider internationalization

Cross-National Regions and Economic Strategy

Traditional Views

- Regions as **free trade zones**; regions as **economic unions** (e.g., United States, European Union)

New View

- Regional strategy is fundamental to enhancing **competitiveness** across countries through
  1. Increase internal trade and investment

     AND
  2. Upgrading **company** operations and strategy
     - Expanding trade in **non-traditional** export industries
     - Enhancing the **competitive capability** of firms
  3. Enhancing the **business environment** and improving productivity
     - Mutual benefits to the **productivity of the business environment** through policy coordination that captures **external economies** and the benefits of **cross-border specialization**
  4. Encouraging **cluster development**
     - **Cross-border cluster** specialization and integration
  5. Enhancing **inward foreign investment**
     - An investment in **any** country accesses the entire region
  6. Enhancing interest and investment in the region by the **international community**
  7. Speeding up the **economic policy making process**

Cross-National Economic Coordination

Illustrative Policy Areas

Factor (Input) Conditions

- Improve regional **transportation infrastructure**
- Create an efficient **energy** network
- Upgrade/link regional **communications**
- Upgrade/link **financial markets**
- Upgrade **higher education** through facilitating specialization and student exchanges
- Expand cross-border business and financial **information access and sharing**
- Coordinate activities to ensure **personal safety**

Context for Strategy and Rivalry

- Coordinate **macroeconomic** policies
- Eliminate **trade and investment barriers** within the region
- Simplify **cross-border** regulations and paperwork
- Guarantee minimum basic **investor protections**
- Agree on foreign **investment promotion guidelines** to limit forms of investment promotion that do not enhance productivity
- Coordinated **competition policy**

Demand Conditions

- Set minimum **environmental standards**
- Set minimum **safety standards**
- Establish reciprocal **consumer protection laws**

Related and Supporting Industries

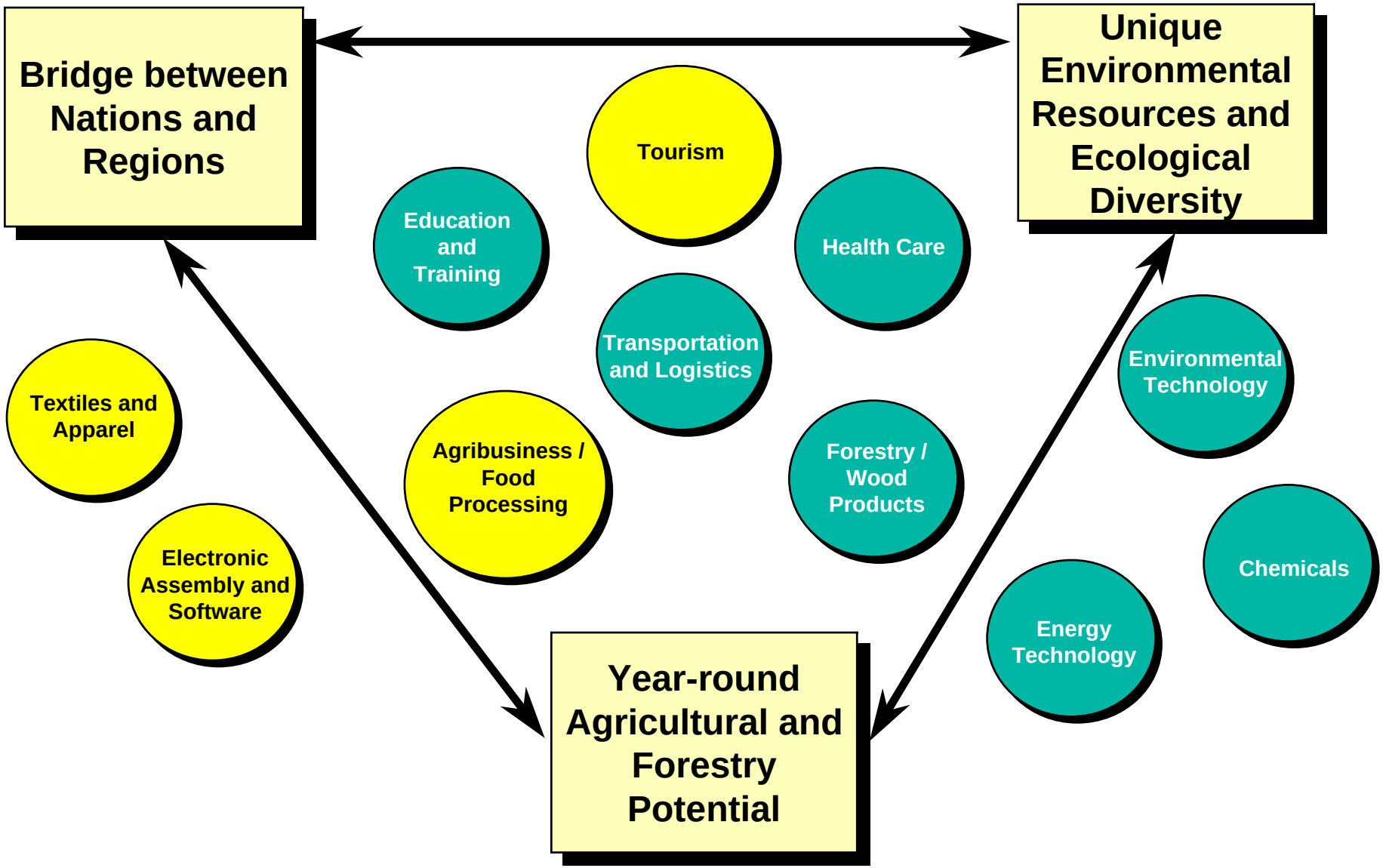
- Establish ongoing upgrading process in **clusters that cross national borders**, e.g.
  - Tourism
  - Agribusiness
  - Textiles and Apparel
  - Information Technology

Regional Governance

- Share **best practices** in government operations
- Improve regional **institutions**
  - Dispute resolution mechanisms
  - Policy coordination body
  - Regional development bank
- Develop a regional **marketing** strategy

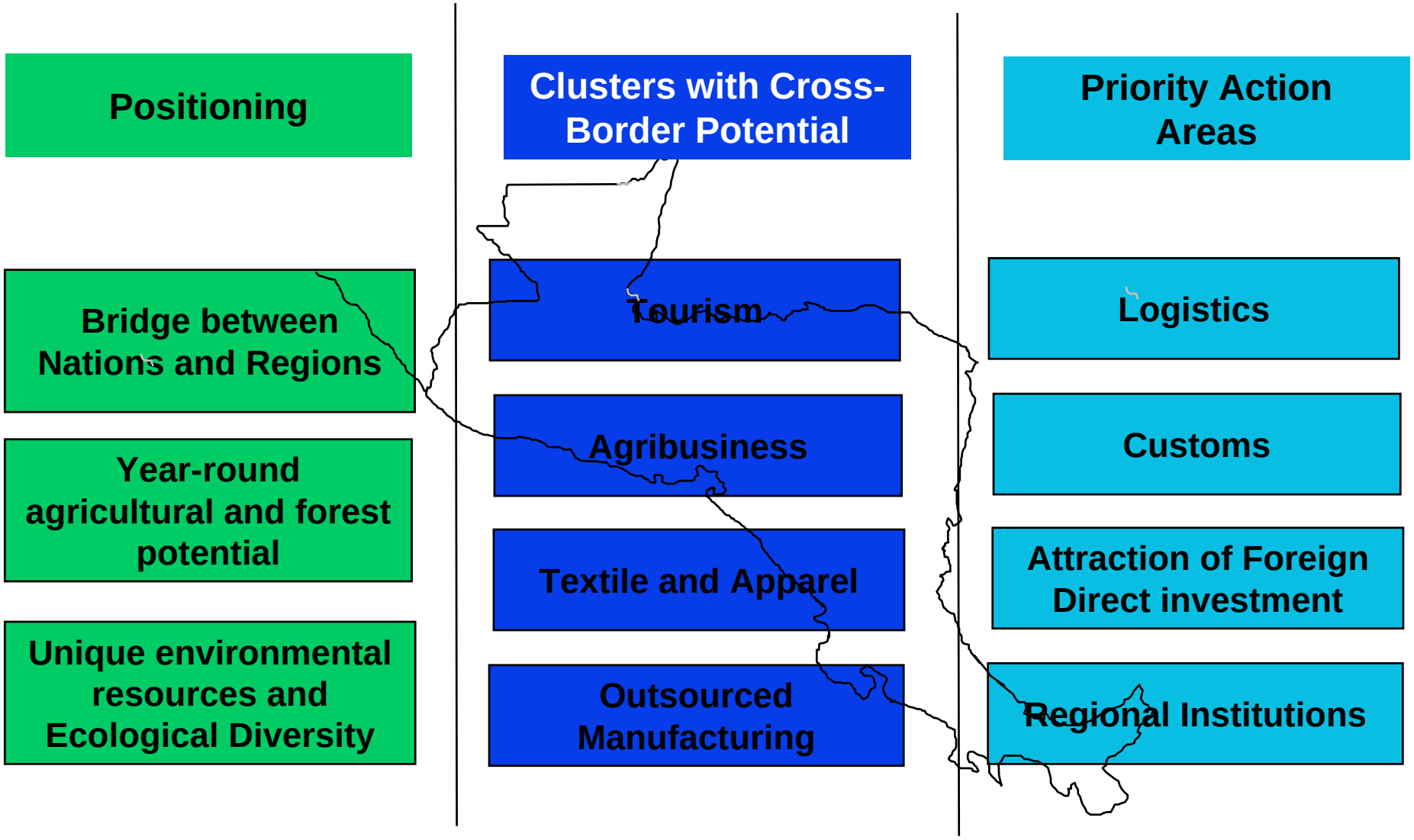
The Competitive Potential of Central America

The Vision in 1996

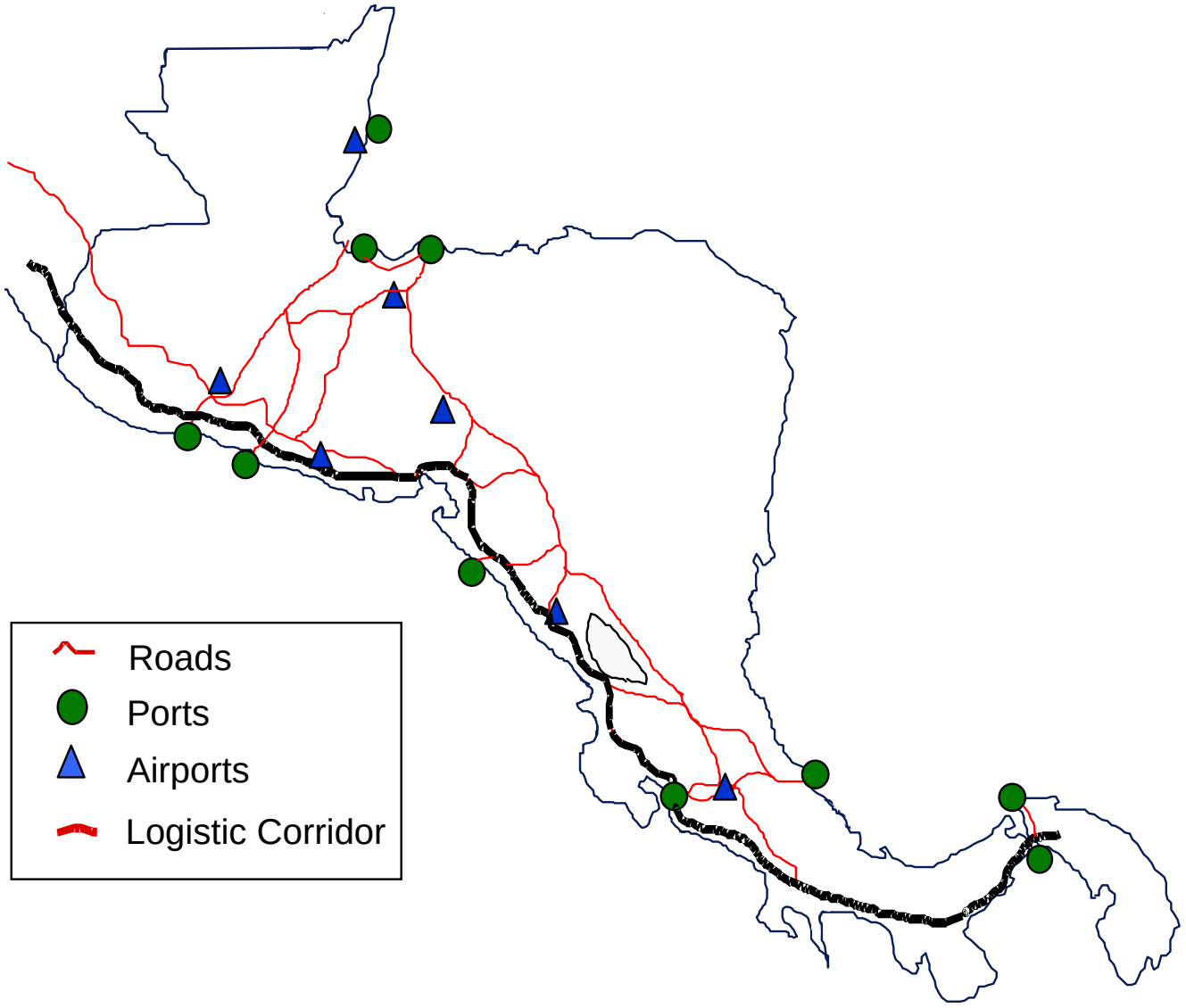


Central America's Competitiveness Agenda

Summary

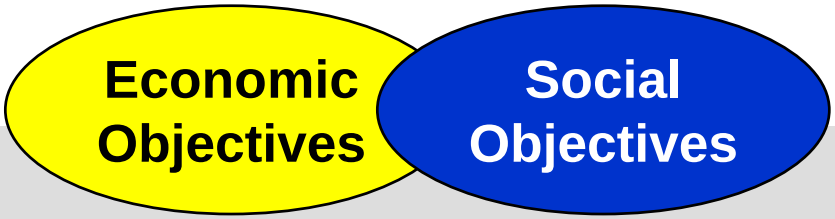


Central American Logistical Corridor



Integrating Economic and Social Policy

- In the new thinking on competition, there is **not an inherent conflict** between economic and social objectives, but a long term synergy



- The **competitiveness of companies** depends heavily on
  - Rising skill levels
  - Safe working conditions
  - A sense of equal opportunity
  - Low levels of pollution (pollution is a sign of unproductive use of physical resources)
- However, efforts to meet "social" objectives must be **aligned with productivity** and prepare and motivate individuals to **succeed in the market system**
- Efforts to meet "economic" objectives must include explicit programs to **raise human capability**, improve the lives and **sense of opportunity** for individuals, and enhance the broader business environment

Integrating Economic and Social Policy
Examples

Training

- Organize training investments around clusters

Housing

- Create mechanisms to encourage home ownership; provide incentives for new company formation in the construction cluster; reduce unnecessary costs of housing construction due to regulatory and permitting delays; secure property rights to residents and property holders

Health Care

- Create incentives for private insurance; open health care delivery to competition

Social Security

- Establish a private pension system. Integrate welfare payments with training and incentives to return to the workforce

Environmental Quality

- Institute a regulatory regime that encourages movement to more environmental friendly methods; invest in technical assistance in eco-efficient processes and practices

Evidence on Development Policy[1]

Economic Policy	Evidence
• Increase capital investment	• Aid does not increase capital investment; capital investment is **neither necessary nor sufficient** for prosperity growth
• Increase education spending	• Higher rates of schooling or overall educational spending have **no significant positive relationship** with prosperity growth
• Reduce population growth	• Population growth has **no significant relationship** with prosperity growth
• Forgive foreign debts	• Debt forgiveness has **no positive effect** on prosperity growth

Source: William Easterly, The Elusive Quest for Growth, MIT Press, 2001.

Prosperity and Official Development Aid
Findings

- Development assistance over the last decade has **no clear relationship to competitiveness or prosperity**
  - ODA per capita over the last decade is not systematically related to GDP per capita or Business Competitiveness (BCI)

- Development aid over the last decade has had **no clear impact on the improvement of competitiveness or growth of GDP per capita**
  - Controlling for initial GDP per capita, ODA inflows (total or per capita) are not positively related to GDP per capita growth or improvements in BCI

- The relationship between BCI and prosperity becomes slightly stronger if ODA per capita inflows are deducted
  - This suggests that development aid has been a windfall gain for countries **with little sustainable benefit**

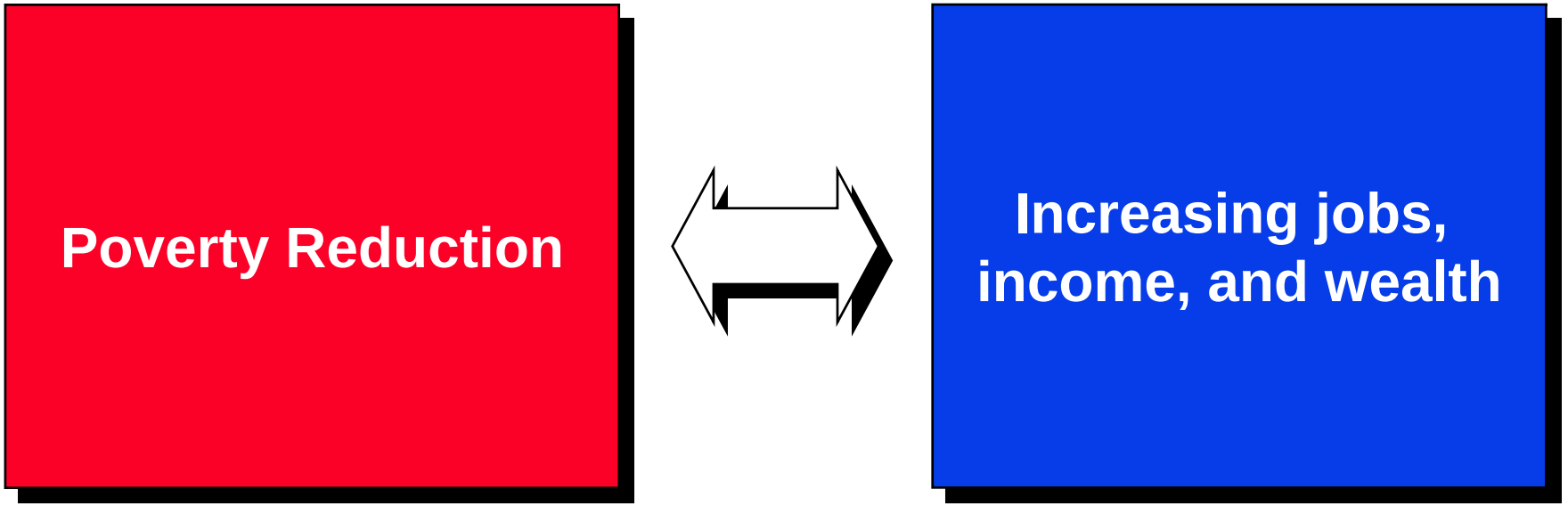
Source: Global Competitiveness Report 2003

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 leave much to be desired
- The **incentive structures** of both donor and recipient countries often work against the effective use of aid

Making Foreign Aid an Investment

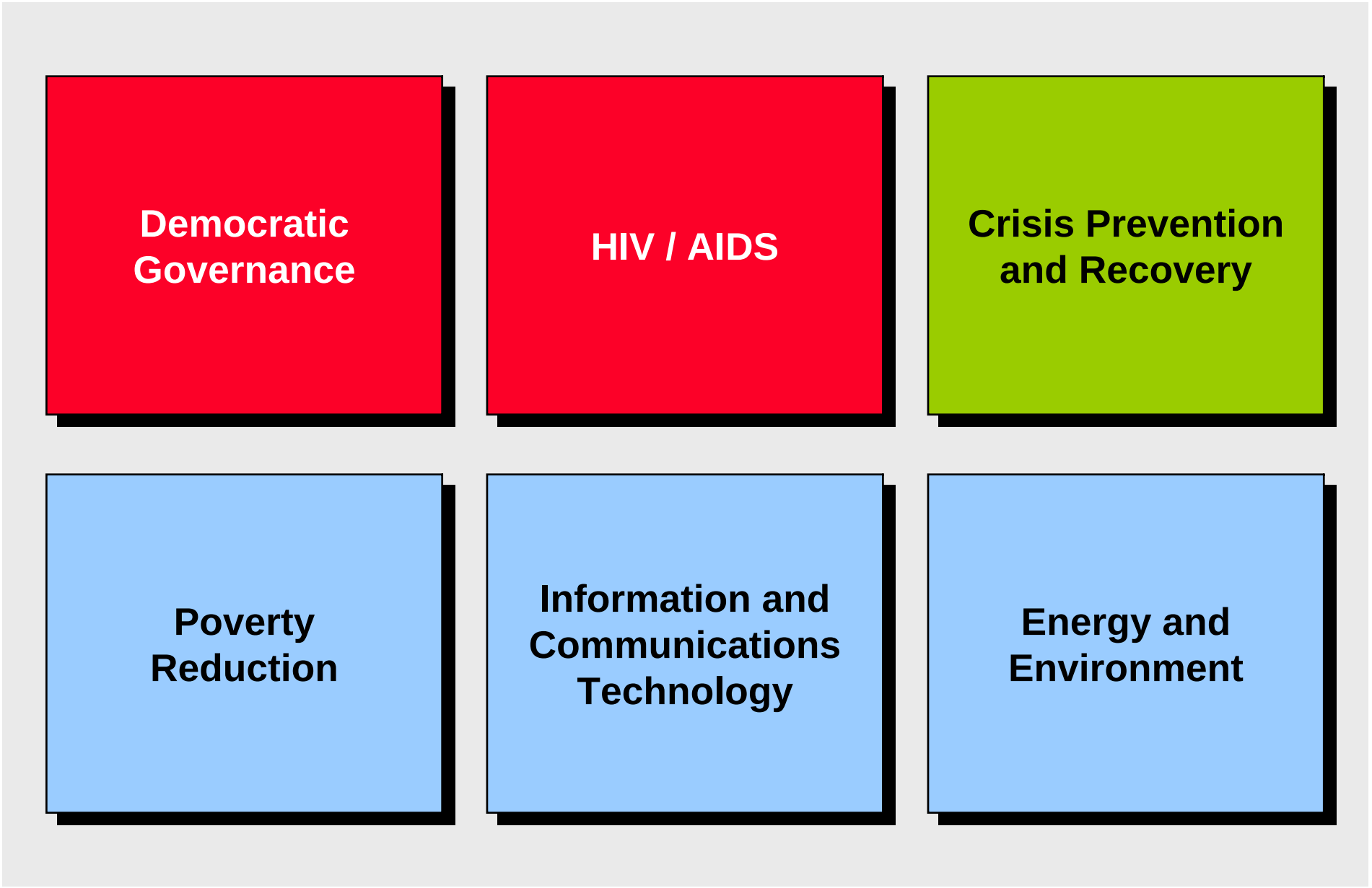
Framing the Goal



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

UNDP
Areas of Focus



Process for Investing Development Aid

Overview

- Development aid should be focused on improving the **microeconomic foundations of competitiveness**, the long-term drivers of sustainable prosperity
- Aid should meet the particular **needs of the recipient country**, not only the strategic interests of the donor
- The investment process should require recipient countries to develop a **national development strategy** that would identify which foreign donors could address the priority issues most effectively
- Significant focus should be addressed on the **sub-national level**
- A **national competitiveness committee**, chaired by the head of state but including private sector, university, and local NGO leaders, should oversee the prioritization and implementation process. Foreign donors as well as investors should be represented as advisors
- A **cabinet council** on competitiveness, including all relevant ministries, is necessary to coordinate the activities within government
- An independent **competitiveness institute** should be created with sustainable funding to compile and analyze credible data on national competitiveness, issue an annual benchmarking report, and provide the capacity to undertake competitiveness studies and initiatives
- The new attention to **measurement and accountability** is welcome, but it will be important to avoid a bias toward easily measurable project areas

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