CATALYZING ECONOMIC DEVELOPMENT

Economic Clusters in LDC's

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UNLOCKING BARRIERS

Economic clusters – geographic concentrations of inter-connected companies and institutions in a particular field – have driven the development of regional industries and economies throughout modern history, from the trading houses of Venice and the shipbuilding industry in England to modern salmon farming in Chile, coffee and flower production in Kenya, and the Good Agricultural Practices (GAP) clusters of Thailand.

Successful economic clusters exhibit a number of common characteristics: strong brand identities; robust export strategies; extensive opportunities for inter-firm interactions and partnerships; and the presence of a diverse range of institutions from the public, private and academic sectors. As a result, clusters are also attractive 'one stop shops' for visiting investors and trade missions, important conduits for tapping into new international markets.

In addition, through their economies of scale; clusters can also anchor other economic sectors. The Napa Valley wine cluster, with $USD13billion in direct economic benefits in 2012, generated nearly $USD50B in additional benefits in such related sectors as bottling, corking, testing and wine tourism. In Indonesia's case, innovations in the fisheries and seaweed sectors have similar potential to serve as catalysts for the birth or expansion of a range of industries, from transport to processing to eco-tourism.

A regional development model that leverages the benefits of economic clusters will typically drive inwards investment and attract skilled workers that ensure an ongoing cycle of growth and innovation.

"Focusing on products and services which reflected the comparative advantage of each region."

With these intentions and historical precedents in mind, Indonesia adopted its Master Plan for Acceleration and Expansion of Indonesia Economic Development (2011-2025). A key element of this plan was the identification of industrial clusters and special economic zones which would extend beyond defined administrative boundaries at the provincial and district levels. This was included as an explicit effort to promote regional economic development, increase the economic competitiveness of rural areas, and encourage rural-urban and inter-regional linkages. Focusing on products and services which reflected the comparative advantage of each region, businesses and institutions engaged in the same sectors would then be encouraged to connect to join forces in addressing common challenges and opportunities. The public sector would then focus on initiatives to promote regional development and reduce existing barriers to trade within the regions.

Figure 1: A selection of Indonesia's Special Economic Zones.

Putting these theories into practice in a highly decentralized political economy such as Indonesia represents a significant challenge. In support of this effort, the governments of Canada and Indonesia developed the National Support for Local Investment Climates Project (NSLIC). Focused primarily on the two provinces of Southeast Sulawesi and Gorontalo, NSLIC will promote over its seven-year lifespan inclusive growth through the expansion of 'economic growth centres' in the agriculture, forestry and tourism sectors. Specifically, this innovative 7 year program will focus on:

- reducing regulatory and administrative barriers to investment and regional integration; and
- building the competitiveness of local SMEs.

This white paper provides a brief overview of the 4 key program considerations that, when taken together, provide a comprehensive and balanced approach to designing a successful regional economic development program of this nature:

- Establishing a strong & transparent foundation
- The role of the public sector
- The role of the private sector
- The role of academia

SETTING A STRONG FOUNDATION

Cowater's program managers, technical experts, and particularly our locally-based staff will often spend up to a year socializing key project concepts and goals with local stakeholders, as well as establishing the program governance structures required to align the interests of national, regional and district level counterparts. This is always time well spent, as the roles and relationships of the various parties are best defined before funds begin to flow towards project activities or grantees. Such allowances for broad stakeholder participation, consultation and transparency also go a long way to ensuring the active engagement in and support for the project. It is also critical to ensure a project presence at the provincial and district levels throughout the program's implementation, to deliver technical assistance and create the feedback loops required for effective and agile program management.

Similarly, establishing requirements for co-investment in selected project initiatives by grant recipients or other direct beneficiaries is a second and related priority. Quite simply, grants and related finding instruments which are not leveraged in some manner will likely not generate sustainable results beyond the end of the project funding period. For this reason, in Cowater's recently completed project, Supporting Indonesia's Islands of Integrity Program for Sulawesi - also financed by the Government of Canada - project investments to modernize and streamline district level service delivery facilities all required co-investments equal to at least 50% of the project's share. In reality, most of our 10 district and provincial government partners far exceeded this threshold.

THE ROLE OF THE PUBLIC SECTOR

There are a number of areas where the public sector can focus their attention to support the development of economic growth centres, or clusters. For instance, one can look to the creation of sector-specific regional business councils which involve both public and private sector members; streamlining licensing and regulation requirements; or reducing overlapping duties and taxes for goods transiting through or to districts within a given supply chain.

Additionally, efforts to improve transparency in procurement and the delivery of public sector services can also have a dramatic effect on the economic health and attractiveness of a province or district wishing to host an economic cluster. And finally, as we have seen in over our time in Mozambique, efforts to modernize land management systems and formalize land tenure can serve as critical springboards to encouraging related businesses to congregate in a given area while boosting investor confidence in a given district or province.

The public sector interventions selected, will often vary between regions and level of government. Therefore it is critical they be selected based on broad private sector and community input while appealing directly to the comparative advantages of each region.

THE ROLE OF THE PRIVATE SECTOR

Building on the above, community consultation and efforts to identify regional and sectoral strengths or weaknesses within the "4P's" (product, price, place, promotion) for local businesses provides a critical first step in identifying priorities to support the development of economic clusters.

A central priority within this exercise is to identify the place of local businesses within the broader value chain – the "full range of activities that firms and workers carry out to bring a product/good or service from its conception to its end use and beyond" – in which they are situated." One finds numerous examples of gaps along this chain that impede the efficient marketing, and delivery of products and services. For instance, poor road conditions in Uganda cause breakage and spoilage of local beer during transport. Elsewhere, a limited supply of financial products and services to address the working capital needs of SMEs prevent the expansion of companies across the ASEAN region and inflates the costs of final and interim goods and services. And in regions with low post-secondary enrollment rates or weak technical and vocational institutions, companies can offer only limited value-add to products, services and other SME partners along this pathway. All of these challenges are only amplified for companies wishing to access international markets, a step that requires competing against firms and clusters already well established in their given areas of expertise.

If governments are to address these challenges in an efficient and impactful way, close integration with the private sector to ensure policy and investment priorities are aligned is a critical prerequisite to successful cluster development and local economic growth.

THE ROLE OF ACADEMIA

> **"Canada's 'Silicon Valley of the North' – Ontario's Kitchener-Waterloo region – is a perfect example of such synergies."**

When integrated into the broader economic cluster strategy, academic and research institutions can play a critical role in generating or testing concepts that can benefit the surrounding enterprises. Benefits may be realized through direct partnerships between firms, as well as through the fertilization of new product or design ideas by former students. Canada's 'Silicon Valley of the North' – Ontario's Kitchener-Waterloo region – is a perfect example of such synergies in action. There, the University of Waterloo has over the last two decades developed deep, foundational connections to the local software industry that have spawned numerous successful start-ups created by Waterloo alumni. Moreover, such alumni represent exactly the right talent these businesses will need in order to grow.

Rather than obliging each business to invest in research and development from scratch on their own, the investments already being made by pre-existing academic and research bodies can be leveraged multiple-times over at far less cost to each individual firm. These institutions can also be called up on 'as required' to bring in new ideas or to generate innovations to address key development challenges. These innovations can appear in the form of new technology, but also in the form of new processes and approaches to managing the value chain resulting from the cross-pollination of ideas between otherwise unrelated businesses.

LOOKING AHEAD

Converting the objectives of Indonesia's Master Plan into an innovative and sustainable regional economic development program presents a number of challenges. However, developing and executing a program anchored by the four pillars above - adaptable to the unique needs of each region - provides a critical proving ground for the creation of sustainable economic clusters within Indonesia. The experience gained through focused attention in the early years within these two provinces will allow the Government of Indonesia to confidently replicate and deliver similar programs to other regions as required in the latter years of the program and onward.

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INTERNATIONAL INC.
CANADA'S BEST MANAGED COMPANIES
275 Slater Street, Ottawa, ON

cowater.com

613.722.6434