Cluster development holds the key

EFFICIENCY: Relaxing constraints and eliminating inefficiencies will boost economy

For any country that cares to know where it stands in its competitiveness with the rest of the world, there is no dearth of league tables on competitiveness. The World Bank's Ease of Doing Business (Malaysia ranks 18th), World Economic Forum's Global Competitiveness Index (Malaysia ranks 20th) and the IMD World Competitiveness Scoreboard (Malaysia ranks 12th) are among the leading ones.

Given such global scrutiny, it is, therefore, disconcerting to hear Paul Krugman, the economics Nobel laureate, argue that national competitiveness is a myth. He contends only companies compete; countries don’t. In essence, he is right.

Competitiveness resides in companies. When we say that a nation is competitive, we mean the companies within it are competitive: that is, they are able to earn more through productivity improvements, pay more wages, export more and, collectively, help build an environment that recruits further investments into the economy.

Competitiveness springs from many sources. Companies are competitive because they have critical resources, such as a brand name, to execute their strategies.

Competitiveness can also spring from a company’s positioning in its industry (AirAsia's positioning in a competitive airline industry). Strategic partnerships among companies, such as joint-ventures, can also offer a competitive advantage through the synergy from pooling resources.

Yet another factor in a company's competitiveness is its business environment. That includes its co-location with other competitors, suppliers and supporting industries, including related government institutions in a geographical cluster.

For example, Penang's electrical and electronics (E&E) cluster offers ready access to resources, research and development and cheaper logistics to make E&E companies there competitive.

However, Krugman’s argument that national competitiveness is meaningless downplays the economic role government has in sharpening the competitiveness of industries and their related clusters.

What can the government do?

Competitiveness goes beyond securing macro-economic and political stability. It transcends improvements in infrastructure and ease of doing business. These factors are a prerequisite to economic development.

What we also need is an integrated set of economic policies to foster cluster development.

Many of our economic policies, such as the promotion of export-processing zones, tax incentives and investment grants, spice up the competitiveness of individual firms and industries, such as E&E.

We have also devised policies to boost broad sectors, such as manufacturing.

Doubtless, these policies have aided us in the past in stimulating investments and entrepreneurship in those priority industries.

However, subsidies and tax incentives to benefit individual firms or industries are market-distorting and can limit competition.

Targeting policy at particular industries or sectors presumes some are better than others in fostering competitiveness.

Further, the emphasis in industrial policy has shifted. It has shifted from aiding individual companies or industries to cluster development as the key to economic development.

It is in clusters that companies find the needed resources — capital, talent and supplies — at close proximity to improve their productivity and competitiveness.

A similar proximity among competitors ensures the sharing of specialized information on market trends.

Such sharing can further spark innovation — an essential ingredient for productivity and competitiveness enhancement.

R&D centres and government institutions that are co-located, too, will spike greater innovation and productivity among all cluster participants.

Tailoring economic policy to profit individual companies and industries may be warranted by other considerations.

However, a more efficient use of government resources will be in strengthening their respective cluster through relaxing constraints and eliminating inefficiencies that shackle cluster productivity and innovation.

For example, Netherlands, in developing its cut-flower industry, does not aid firms individually. Rather, it develops the cut-flower cluster through, among others, R&D, infrastructure support, protection of intellectual property, sound competition laws and governance, and quality certification.

Such policies have enabled the Netherlands to internationalise this industry where its harsh soil and frosty climate would have otherwise killed it.

We have not been napping, either. Our 10th Malaysia Plan and our industrial master plans document the central role of clusters as a means of competitiveness and economic development. These blueprints advocate the economy moving up the value chain into higher value-added activities through advanced technology.

Clusters offer a base from which companies with less sophisticated activities in a particular field can expand into more sophisticated technologies.

Clusters have a synergistic effect of boosting the productivity of other clusters. An obvious example is where the upgrading of the education cluster will have far-reaching effects on other clusters in terms of skills development.

Hence, in refocusing economic policy we should consider the following four factors.

First, economic policy should target all clusters. Nevertheless, given resource constraints, relative priority or health of individual clusters, their development can be sequenced.

Second, just as our 10th Competition Act and its competition commission offer a level playing field for competition and productivity growth, so too should the government offer incentives to promote competition within an industry.

Third, location-based incentives, another prong of our economic policy to promote balanced growth, should encourage industries to locate in existing or emerging clusters rather than in industrially undeveloped areas. Moving into such clusters will ensure life-support — supporting infrastructure and industries — for a company.

Fourth, in determining these locations for development, economic policy should capitalise on the advantage that a particular location has. It could be food processing, eco-tourism or the availability of critical resources. A cluster can then be developed around the unique offering of that location.

The benefits from the cluster’s activities, such as skills and infrastructure development, and employment opportunities, will then flow into neighbouring areas. That stream will then lead to the balanced regional growth and inclusiveness desired by our economic policy.

An integrated economic policy that has cluster development as its core can not only ensure the desired economic progress but also the viability of companies therein. We hope the 11MP will continue the focus on cluster development as of the past plan.