

Chapter 6

Summary



Abstract Counterbalancing the endogenous forces of agglomeration by addressing any institutional bottlenecks, and incorporating a set of design principles to ensure that any proposed policies are compatible with the prevailing institutions are key to resolving dualism and inequalities. In many cases, they are more important than finding the right policies. Alas, reforming policies is far more difficult than reforming institution. Be that as it may, listening and understanding the perceptions of local people and MSME is a necessary starting point.

Keyword Structure of relations · Decentralization · Mental bandwidth · Behavioral insights · Policy design

The role of dualism in shaping income distribution is well known. So is the role of spatial dualism in shaping inequality between regions within countries (interregional inequality). The persistence of such inequality is a major policy concern confronting social planners in rich and poor countries alike. Indonesia is no exception. Given its size and archipelagic nature, by international standard the country has a large inequality between regions.

Inequality also exists in business activities, indicated by the performance gap between micro-small-medium enterprises (MSMEs) and large businesses. While across the globe the number of business establishment and unit is dominated by MSME, the figure in Indonesia is roughly more-than 99% and over 96%, respectively. It certainly accounts for the largest share of employment. It is no surprise that a statement like “MSMEs are the backbone of our economy” has been popular and frequently raised by policy makers such that it has become a bit of a cliché. With the outbreak of the Covid-19 that brought the country into recession, the expression goes even further, i.e., “MSME is the source of economic recovery.” Official statements and documents to support MSMEs have also been made repeatedly.

There is no deficit of publications and research reports on the issues of interregional inequality and challenges faced by MSMEs. On interregional inequality, a typical analysis focuses on the unequal allocation of investment between regions and the lack of regional capacity in utilizing the greater autonomy especially under a decentralized system. On MSME, many studies spend much time on pounding how inefficient, unproductive and uncompetitive MSMEs are. They typically show

a long list of problems faced by MSME, from the issues of financing gap, a lack of management skills, poor information, marketing difficulty, to the problem of limited access to technology. The list is usually followed by the suggested policy measures.

While some of the analysis on investment allocation and the limited capacity of the regions are true, and some of the statements and recommendations about MSME are valid, many are more myth than reality.

The focus of this book, is different. I avoid reinventing the wheel. On interregional inequality, the analysis is more on the role of endogenous forces of agglomeration and the structure of economic relations between regions as part of the prevailing institution. On MSME, it emphasizes their perceptions towards social capital and various policies, as well as the interactions between the two. My primary goal is to raise awareness about the importance of interplay between policies and institution, and to improve the understanding about the elements and mechanisms of their interactions. To the extent the highlighted issues are more institutional in nature, most policy interventions discussed throughout the book are justified because of institutional failure, more than market failure. To fulfil the stated goal, two tasks are performed: diagnose the causes underlying interregional inequality, and delve into problems faced by MSMEs that put constraints on the effectiveness of various policies.

The evidence of interregional inequality and the persistent challenges faced by MSMEs, including the performance gap between small and large businesses in Indonesia are discussed in Chap. 2. Given the fact that numerous policies have been implemented, it is argued that there is indeed a deviation between policies and outcome. The bulk of Chaps. 3 and 4 is devoted to the analysis about why such a gap. While dualistic characteristics of an economy in a large and diverse country like Indonesia may have been expected, persisting inequality poses risks of growing discontent and deepened political divides. It could also weaken the country's growth prospect. Contrary to the classical economic thinking, based on recent empirical evidence the contemporary economic thinking confirm that greater inequality tends to worsen growth.

The fundamental thinking behind the analysis is synopsisized in Fig. 6.1. The lure of external economies of agglomeration is too strong of a "pull" factor for policy interventions to counter and reduce the divergence between core and periphery. Yet, the contribution of another factor is no less-substantial, i.e., non-compatibility of policies with the prevailing institution. Policies, rules and regulations (formal institution) at the national and regional levels may have been in place to soften the agglomeration forces and mitigate their effects on inequality. But due to weak enforcement (part of informal institution), they are deemed ineffective. More importantly, other informal institutions are also at work, significantly influence the way the public respond to policies. They could range from bureaucratic and legislative norms, clientelism, paternalism, patrimonialism, habits, traditions, and codes of conduct, all may interact with the prevailing social capital (left part of Fig. 6.1). It is subsequently shown through the institutional model of decentralization in Chap. 3 that the quality of local leaders also matters.

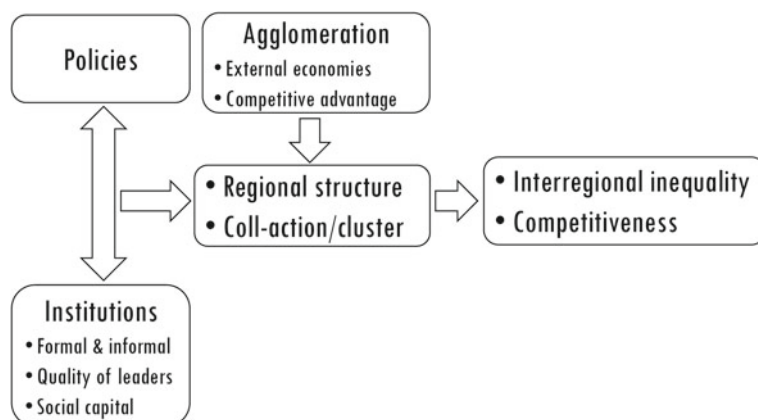


Fig. 6.1 Synopsized framework of analysis. *Source* Author's own creation

While all these elements of institution play a significant role in determining whether or not certain policies can be effective, incorporating them into some quantitative measures is a daunting task, let alone isolating the precise scale of its effect from other factors including the agglomeration forces. To the extent the working of institution is embedded in the regions' socio-economic structure, intra and inter-regional multipliers are used to uncover the direct and indirect effects of policy on interregional inequality. By comparing two scenarios of increased spending, one in core and another in periphery, asymmetry is revealed; i.e., if increased spending is made in regions outside Jawa (periphery), the cross-regions benefits accrued to Jawa (core) are much larger than those received by non-Jawa had the increased spending been made in Jawa.

Thus, if policy measures ignore the agglomeration forces and the prevailing institution reflected in the regional structure, both of which are encapsulated in the inter-regional multipliers, resolving spatial dualism by simply investing in outside Jawa does not guarantee that it will reduce the interregional inequality. The agglomeration forces simply offset the forces of dispersion. While improvements in infrastructure such as transportation can concomitantly support both the dispersion and agglomeration or concentration forces, the accessibility that core regions can have to a wider distribution system (e.g., through intermodal facility such as port, rail terminal or airport) may compensate the savings from lower transportation costs for the periphery to reach a larger market at core regions.

Interactions between policies and institution are also key in the efforts to improve MSME performance, in which high transaction costs (aside from operating costs) are at the center of the problems. They constitute not only the official expenses incurred in business activities (transportation, bureaucracy, network) but also the unofficial payments and other personalized transactions especially for permit-related matters. These costs are too burdensome and most of the time cannot be avoided,

forcing many MSMEs to remain informal and small. As a result, low productivity and competitiveness continue to plague their operations.

Potential countervailing forces, however, can be created to offset—albeit not avoid entirely—such high costs. Insofar spatially concentrated activities have the potential to benefit from agglomeration economies, MSMEs can also gain similar economies if they cooperate and act collectively in clusters. The connection between spatial concentration and firm's competitiveness has been also firmly established in Porter's model of competitive advantage.

Whether the benefits of operating in a cluster can exceed the transaction costs depends on the characteristics of cluster operation. These characteristics are determined by the quality of MSME participation and coordination in cooperation, and the effectiveness of collective actions among members. The quality of these participation and coordination reflects the prevailing social capital, which is an important element of institution. The mechanisms explaining how institution including social capital work jointly with policies to affect MSME performance are captured in a framework developed in Chap. 3. Based on that framework, a set of hierarchy and a network of interrelations among policies, social capital, and types of cluster are constructed, and used to compose questionnaires for the survey discussed in Chap. 4. The main purpose of the survey involving 121+ micro and small enterprises throughout Indonesia (only 1 'medium' enterprise included in the survey) is to capture their perceptions towards various problems they face that may have caused the disconnect between policies and the outcome.

The reason we rely on perceptions is because they are the ultimate lens through which MSME respondents view reality and operate with versions of that reality. What they operate is what matters here. Even if there is a gap between perception and reality ("wrong" perceptions), that is the way human operates. What MSMEs perceive is not necessarily what their eyes and ears tell them, but it is what their brain makes them see and hear, based upon which they make decisions to produce, diversify, use digital and green technology, export, cooperate, join a cluster, etc. It is because of relying on perceptions that a specific approach of pairwise comparisons and the measure of inconsistency are used to authenticate the answers to the questionnaires.

The hierarchy framework is designed to distill MSMEs' current conditions and their experience or aspirations for cooperation in a cluster, while the network is constructed to delineate the role of—and the interplay between—policies and social capital to determine the type of cluster deemed most relevant for cooperation and collective actions. Insofar the goal is to help improve MSMEs' competitiveness, three policy categories are tested, linkage policy, structural policy, and technology policy. The social capital consists of participation and coordination intended to make the cooperation for collective actions works more effectively.

Given the location, it is revealed from the hierarchy-based survey that monetary benefits especially from sales are viewed by most MSMEs to be greater than the non-monetary benefits, based upon which the business-oriented type of cluster is most preferred. Among the non-monetary benefits, majority MSMEs feel that acquiring information is most important, indicating their desire to learn and improve. From the cost side, operating cost is considered most burdensome, and the costliest type

of cluster is one intended mainly for social interactions. Comparing the benefit and the cost results, the preference towards business-oriented cluster remains at the top.

Interestingly, although a government-mandated type of cluster is perceived highly beneficial, for some MSMEs especially those operating in trade and using digital technology, such an option is viewed as allowing government controls and intervention that could hinder their business operations. Hence, it is perceived as very costly. As a result, the resulting benefit/cost ratio of the option is relatively small. This underpins the importance of measuring both the upside and the downside associated with people's perceptions.

More central to our hypothesis is the network-based survey to evaluate the interplay between policies and social capital in determining the cluster type. Over half of MSMEs confirm that policy is not what matters the most to make the cooperation for collective action effective; the role of social capital is critical. Majority of rural-based MSMEs and those that have received assistance from BI for a longer-than-average period have the same view. Even among those who put a higher weight to policy cannot dismiss the importance of social capital.

Although the results vary depending on the characteristics and spatial dimension of MSMEs, linkage policy is perceived as the most important as it is expected to strengthen the linkages between MSMEs and larger firms, among MSMEs themselves, and to enable MSMEs to benefit from the products and services of supporting industries. On the latter, a lack of packaging industries has been frequently expressed by many respondents outside Jawa as among the most serious bottlenecks. Within social capital, consistent with the results from the hierarchy-based survey, active participation especially for acquiring information through transparent and informal coordination is ranked the highest. This is expressed particularly strongly by MSMEs operating in the rural area. Those located in Jawa, Sulawesi, Papua, Maluku and NTT, and those that have received assistance from BI for a longer-than-average period also share a similar view.

It is discernible that the costs of undermining the forces of agglomeration and ignoring the role of social capital based on the prevailing institution can be enormous. Investing in periphery without considering the structure and interactions between regions could paradoxically widen the interregional inequality, and assisting MSMEs by simply allocating more money without considering local characteristics could lead to problems and waste while generating only limited improvements. Direct provision of credit and other non-financial assistance may fail to deal with the underlying causes of the problems faced by MSMEs. They may substitute for the undeveloped or missing markets but cannot overcome the institutional failure. Where regions thrived and MSME succeeded, they might have achieved it in spite of, not because of, government assistance.

To complement the analysis and to corroborate what has been conceptualized, some case-based evidence highlights the importance of understanding local wisdom, mutual trust, and listening directly to the MSMEs about their problems and constraints, before making and announcing new measures. In some cases, external interventions are not needed. They could be even undesirable in cases where MSMEs themselves know how to solve but unable to do so due to a myriad of tasks they have

to deal with day by day. What external parties could do is to facilitate a condition under which own-solution is encouraged and could be implemented. Only when the MSMEs face a vicious-circle problem—where the response to the original problem creates new problems which aggravate the original one—that an external assistance is needed.

The evidence of success from working together and solving problem among themselves also suggests that external parties should avoid giving a cliché advice such as “adopt new technology” or “work harder” etc. Those advices maybe suitable under certain conditions but too difficult to execute because of a lack of supporting means (for adopting new technology) or due to behavioral insights that reflect the mental bandwidth of those we intend to help (for working harder). Many MSMEs are perfectly aware that working harder will boost productivity and competitiveness, but due to other tasks they are unable to exert self-control or ‘pay attention’ on working as hard as they themselves would like to; they can do all the tasks including working harder at once only if those tasks are not demanding and relatively easy to do. After all, exerting self-control is not physiologically effortless. It requires an allocation of attention to the effortful mental activities similar to ‘slow thinking’ or ‘System 2’ which are often associated with the subjective experience of agency, choice and concentration (Kahneman, 2011). Enticing members to “work through hard things together” would be more helpful as it could better counter most adverse conditions.

Considering local wisdom also implies respecting local customs and tradition that prevail in a community where MSMEs operate. That includes respecting the community’s customary laws when such laws exist. In a country like Indonesia, where millions of people are considered members of indigenous communities and many of them have their own customary laws, MSMEs operating in those communities should be able to do their business with legal certainty. When the customary laws are not entirely in sync with the state laws, or when the disputes related to the rights of indigenous communities arises, e.g., over the forest and land use, absent of such a certainty could jeopardize their operations. Yet, for some MSMEs and indigenous peoples, land could be their only source of income from running small commercial activities or even their only means of subsistence. Incorporating important clauses of the customary laws into the state laws and harmonizing the two, as was done in several regions throughout the country, is the first step in a right direction.

In sum, counterbalancing the endogenous forces of agglomeration and incorporating a set of design principles into policies to ensure their compatibility with the prevailing institutions are a lot more important than just allocating budget to periphery regions and providing financial assistance to small businesses. To reduce dualism, it is imperative to understand the structure of interregional interactions and institutional arrangements, and to delve into the internal problems of MSMEs by digging up their perceptions. Those perceptions reflect the prevailing social capital. Any efforts to help MSMEs should take those perceptions into account. Just listen to them, so we will understand better about why they choose as they do and what motivates their decisions and actions.

Finding the right policies is crucial and must continue, but without considering the agglomeration forces and the behavioral insights of MSMEs, those policies are

likely to have limited reach and effectiveness. The importance of design principles in policy that matches the prevailing institutions and public perception is second to none.

Reference

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