

## BALANCING PRIVATE SECTOR DEVELOPMENT AND LOCAL-CENTRAL RELATIONS

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*Although academics, civil servants and non-governmental organizations involved in development have continued to promote policies for local economies, many localities fail to catch up with average national development patterns. The body of knowledge on this topic has been split into two parts: private sector development (PSD) and local-central relations (LCR). This article argues that, in order for policies to be effective, PSD and LCR should be analysed simultaneously. Drawing on evidence from empirical work conducted in South-East Asia, the article offers policymakers some ways forward. Important features to be reckoned with are the sequencing of policies, the problem of historically rooted disabling institutions, the benefits of local enabling institutions, ethnic tensions and structural opposition from central Governments.*

### I. INTRODUCTION

Although academics, civil servants and non-governmental organizations (NGOs) have continued to promote policies for subnational economic development, many peripheral localities fail to catch up with average national development patterns (Coe and others 2007, pp. 57-183). This is particularly a problem in densely populated poor developing areas, such as the remote islands in the Philippines, many parts of Bangladesh, Rwanda and Haiti and southern Mexico. In such areas, outmigration to find employment elsewhere and sending remittances to relatives is not enough to create sustainable and resilient local economies. Moreover, excessive migration to booming cities leads to congestion and environmental pollution, as can now be observed in many large metropolitan areas. But in developed nations also, local economic development has remained an issue of importance (Braczyk

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and others 2003; Pike and others 2006). The southern part of Italy still lags behind the central and northern parts, but perhaps the most striking example is the small country of Belgium. The French-speaking part of Belgium suffers from relatively high unemployment and both French and Flemish-speaking localities have serious problems with the federal Government in Brussels. Indeed, the World Bank (2005, p. 204) has rightly pointed out that:

“Chronic regional underperformance can give rise to many concerns and threaten national unity—lost economic potential, unfairness in regional opportunities, potential instability, loss of social cohesion, and adverse social consequences, including higher crime and disease”.

The literature on policy-related practices related to local and regional economic development has generally been split into two parts: one part is concerned with private sector development (PSD) and deals with topics such as entrepreneurship, access to finance and the enhancement of local competitive strengths (among others Ettlinger 1999; Schulpen and Gibbon 2002; United Nations Development Programme Commission on the Private Sector and Development 2004). It is important to keep in mind that PSD also makes sense in rural areas given the increasing role of off-farm employment and insertion in global value chains (Ashley and Maxwell 2001; Rutten 2003; Andriesse and van Helvoirt forthcoming). The other part investigates how local-central relations (LCR) enable or disable the functioning of local economies (consider, for instance, the issues of geographically based budgeting, decentralization, and networks of members of parliament). This part normally has a somewhat more holistic perspective and benefits from the fields of politics, sociology and public administration (among others Melvin 2001; Crook 2003; Jomo and Wee 2003; Panday 2006). This article argues that, in order for policies to be effective, both PSD and LCR should be analysed simultaneously. Only by integrating these two phenomena can sustainable and resilient local economies be created. Drawing on evidence from empirical work conducted mainly in South-East Asia, the article indicates some ways in which simultaneous analyses and integration could take place. It consists of three major parts: the next section introduces the main bodies of knowledge on PSD and LCR; this is followed by a section in which the justification for integrating these two bodies of knowledge is presented. Based on the integrative section, the third part offers five policy tools/issues that would be beneficial for enhancing local economic capabilities. The last part presents conclusions.

## II. PSD AND LCR: TWO SEPARATE BODIES OF KNOWLEDGE

Advocates of PSD view the firm as a central organization for the creation of employment and income and, ultimately, as a vehicle for poverty reduction. In this regard, Ettlinger (1999) has conceptualized development as the convergence of corporate and worker well-being. In her perspective, local development occurs “when 1) the local, independent corporate sector achieves sustainable competitiveness, thereby sustaining local employment, and 2) worker well-being is achieved”. Unfortunately, economic geographers have paid relatively little attention to developing areas. Journals such as *Regional Studies*, *Entrepreneurship and Regional Development*, *Economic Geography* and *Journal of Economic Geography* mainly publish theoretical and empirical work related to the developed world and the innovative capacity of such industries as fashion design, information and communications technology, automobiles and pharmaceuticals. This is a pity as economic geographers are well equipped to study subnational economies. For example, they could consider the topics of infrastructure, core-periphery relations, rural-urban linkages and migration. But perhaps one of their greatest strengths is the systemic analysis of coordination and cooperation among firms. Economic geographers such as Yeung (2000), Braczyk and others (2003), Boschma and Frenken (2006) and Coe and others (2007, pp. 321-347) have stressed the need to scrutinize the effectiveness of cooperative and coordinative institutions, subnational economic cultures and the changes that have occurred in these institutions and cultures over time. Note that Douglas North’s (1990) definition of institutions is followed here: “formal institution” refers to rules, regulations and contracts, and “informal institutions” refer to norms of behaviour and conventions. These issues are relevant not only in high-tech, innovative economies in the developed world, but also in many less prosperous areas. For instance, Helmsing (2001) has shown that chambers of commerce play important roles related to cooperation and networking within many Latin American local economies; Lyon (2003) does the same for Ghana, Callahan (2002) for Phuket, Thailand, and Van Helvoirt (2007) for the central Philippines. Schulpen and Gibbon (2002) have complained about the lack of analytical capacity on the part of aid agencies with respect to identifying the “strengths, weaknesses and dynamics of local private sectors”. One of the solutions could be to recognize the usefulness of the explicit economic-geographical focus on local entrepreneurial arrangements. Scholars of management sciences have also addressed PSD, but more on a national and international level. Here, a good example is *guanxi*, a set of specific *informal institutions* used by Chinese entrepreneurs in China and South-East Asia, which enables entrepreneurship and in which personal connections are often key drivers. Park and Luo (2001) wrote that *guanxi* “reflects delicate fibres woven into every person’s social life and every

aspect of Chinese society” and it is “transferable among parties, reciprocal, intangible and utilitarian rather than emotional”. A number of studies confirm the economic relevance of these informal institutions (Bjerke 2000; Carney and Gedajlovic 2001; “Vincent Lo, The King of Guanxi”, *The Economist*, 23 September 2004).

A topic that is investigated for firms both in the developed and the developing worlds is access to finance. Protagonists of the “varieties of capitalism” approach distinguish between banks, stock markets and public finance (see, for instance, Schmidt 2003). Nowadays, partly inspired by the 2006 Nobel Peace Prize awarded to the Grameen Bank and its founder, Muhammad Yunus, microcredits, loans for small firms and a variety of informal financial arrangements receive much attention from development experts and NGOs. The high-profile United Nations Development Programme’s Commission on the Private Sector and Development (2004) argues that broader financing options are needed, a possible source being remittances from international labour migrants. Indeed, such countries as the Philippines and Mexico rely heavily on remittances. Investing remittances in PSD represents a promising mechanism for local development in those countries. The Commission also promotes the sharing of knowledge. Currently, there are many different (micro) credit schemes in developing countries, which increases the opportunities for them to learn from one another. In fact, Mendoza and Thelen (2008) provide answers for the question how to broaden financing options. One of the issues they discuss deals with “group lending to serve low-income markets” in order to lower transactions costs and overcome both market and government failures. Banks such as Grameen in Bangladesh and Accion (based in Boston, United States of America) offer loans to groups of three to nine borrowers. This group lending has two advantages: (a) as borrowers generally belong to the same group of creditors, it can deal with the challenges of imperfect information by using information from borrowers to acquire knowledge about borrowers in the same group; (b) it enables the borrowers, who know each other well, to impose effective non-financial sanctions on each other in case some members of the group cannot meet their repayment responsibility. According to Mendoza and Thelen (2008), “there is evidence to suggest that group-lending strategies have a positive impact on the financial self-sustainability of the lending operations of microfinance organizations (Cull and others 2007; Karlan 2007)”.

A totally different group of scholars looks at regional economies from the perspective of LCR rather than the internal entrepreneurial capacities of localities. The body of knowledge on the political and economic relations between central and local governments views the firm as one of the drivers of creating resilient and sustainable local economies, not as the *main* driver. Instead, in essence this body

claims that effective and efficient LCR provide the best incentives for increasing living standards. Consequently, much theoretical and empirical work has appeared on a variety of ineffective and inefficient forms of LCR, such as excessive favouring of certain localities by central politicians, particularly members of parliament, corruption, problems of decentralization and the disadvantages of appointed local politicians. Well-known journals for this type of work are *Regional and Federal Studies*, *Political Geography*, *Public Administration and Development*, *Asia Pacific Journal of Public Administration* and *The China Quarterly*.

Before engaging in empirical inquiries and enacting policies that might reduce inefficient and ineffective LCR, it is imperative to bear in mind that the political functioning of localities is complex for various reasons. Each locality considers itself unique and tries to develop itself in many fields in order to achieve greater welfare and well-being, not only in absolute terms but also in relation to other localities in a country. Local politicians often feel responsible for the local population and will bargain and negotiate in the capital city for more financial and other resources in order to support a wide range of things, such as education, housing and land-use planning (Flint and Taylor 2007, p. 261). It is even possible for localities together with their politicians to oppose central Governments, which at the very worst may lead to violence and even civil war. Simultaneously however, a local government forms a part of the wider constellation of national government agencies. Central governmental authorities have often identified regional borders and regard local political organizations merely as instruments and frequently have the legal power to appoint local politicians. In short, in the words of Flint and Taylor (2007): "the most important characteristic of the local state is the ambiguity of its role. This is because it is part of the central State apparatus, but it can also be used to oppose the central State".

As LCR issues are highly complex and relatively more holistic compared to PSD, empirical work has tended to focus on identifying problems rather than detailed policy prescriptions. Below, three main issues are briefly discussed. First, LCR has often been structured by ethnicity (Dwyer and Drakakis-Smith 1996). In the context of African countries, Crook (2003) argues that:

"If a regime is nervous about providing an institutional base for subnational, regional or ethnic political rivals or even political separatists...then it will often adopt a decentralisation scheme that deliberately fragments potential local power bases into smaller, weaker, politically insignificant units. This is often combined with central funding and control mechanisms that permit spatial redistribution and/or centrally focused patronage linkages".

Such decentralization schemes and funding and control mechanisms could obviously give rise to “chronic regional underperformance”, to use the World Bank’s (2005, p. 204) term, and in turn instability and violent conflicts. Indeed, in several African countries, LCR have been severely influenced by ethno-local politics, for instance Kenya, Uganda, Nigeria and Cote d’Ivoire (Crook 2003 and 1997). Two good current examples outside Africa are Bolivia and Georgia. The central Government of Bolivia aims to finance pro-poor policies by extracting resources from rich provinces in which relatively many non-indigenous persons live. These persons have protested vigorously against these policies. Problematic LCR between the national Georgian Government and ethnic Russians in the provinces of South Ossetia and Abkhazia led to a military intervention by the Russian army and even heated tensions between, on the one hand, the Russian Federation and, on the other hand, the European Union and the United States of America.

In fact, the collapse of the Union of Soviet Socialist Republics resulted in an array of potential LCR conflicts in the newly independent countries, due to new ethno-local political constellations and the mismatch of new formal institutions and historically rooted informal institutions.

As in discussions regarding PSD, the issue of informal institutions must be addressed; this brings us to the second empirical issue of LCR. Melvin (2001) demonstrates that, in Kazakhstan, Kyrgyzstan and Uzbekistan, the role of informally arranged LCR is more important than rules and regulations. This is not a threat if informal institutions are *enabling*, thus increasing the effectiveness and efficiency of LCR, but they become a serious problem if they are *disabling*. In many Asian countries, a pervasive disabling institution is the “convention” that politicians (especially members of national parliaments) and civil servants favour their home localities and localities that vote for their parties instead of reducing regional and local inequalities. Pempel (1998, p. 62) has documented this practice for Japan, Park (2003) for the Republic of Korea and Panday (2006) for Bangladesh.

The third issue is local elite capture, which is often a consequence of flaws in decentralization programmes (Johnson 2001). The term “elite capture” refers to the grabbing of a specific portion of available resources (for example, from international donor agencies) by local elites and leaving the leftovers to the poor (Khan 1998). In this regard, Bardhan (2002) asserts that “any discussion of delivery of public services has to grapple with issues of capture of governments at different tiers by elite groups more seriously than is the custom in the decentralization literature”. Elite capture has more chances to flourish if informal disabling institutions dominate LCR and if budgetary practices are insufficiently transparent. An infamous variant of elite capture has been the *chao pho*, a local

“godfather” in Thailand, somewhat comparable to southern Italian mafia traditions (see box 1).

### Box 1. *Chao phos* in Thailand

*Chao phos* are a sort of provincial “godfather” in Thailand. According to Chantornvong (2000), Thai people consider a *chao pho* as someone “whose influence is recognized not only by his own people but also by high-ranking government officials. In the eyes of the public, a *chao pho* is someone who can use his influence to further his interests in complete disregard of the law”. The first generation of regional *chao phos* were often Sino-Thai merchants who did not intervene in regional or local politics. They only *bought* protection and licences from government officials to secure their business interests. The second generation decided to become much more involved in local, regional and national politics. This generation started to achieve economic and political successes from the 1960s onwards. In 1991, the Police Department identified a total of 168 *chao phos* in Thailand. It is generally acknowledged that weak formal LCR greatly facilitated the emergence of *chao phos* (see, for instance, Wingfield 2002, and Mutebi 2004).

The most infamous *chao pho* has been Mr. Somchai Khunpleum from Chonburi province (East of Bangkok), better known as Kamnan Po (normally, a *kamnan* is the highest-ranking government official of a subdistrict or *tambon*). Kamnan Po was a very influential businessman with investments in many industries, most of them illegal. His influence even extended into national politics. Several members of parliament (including two of his sons) were elected as a result of his efforts. He maintained a huge network of assistants and financed the election campaigns of politicians who would secure his business interests (Chantornvong 2000).

Another phenomenon is the *trakun*: an influential family at the provincial level as described in Askew (2006) and Nelson (2005). Examples of *trakun* are the Suwannawong family in Songkhla, the Chaisaeng family in Chachoengsao and the Tiyaiphairat and the Chongsuthanamani families in Chiang Rai. These families generally have an important position in the private sector at the provincial level and are also politically active.

Thus, PSD and LCR in Thailand have been significantly influenced by private interests and family-related political dynamics, especially in the 1990s.

### **III. THE ADVANTAGES OF INTEGRATING PSD AND LCR**

The previous section has outlined the main current insights into PSD and LCR. The former has a rather specific character, and much policy-related work has already appeared. The main strength of the body of knowledge and policies on PSD is its recognition of the potential capabilities of local entrepreneurs and the desire to raise living standards indigenously. When the local private sector succeeds in taking advantage of economic opportunities in an inclusive and sustainable manner, local economies are not dependent on central Government funding that may be unstable or insecure. Nevertheless, the limitation of an isolated focus on PSD is that it neglects three possibilities: first, disabling LCR resulting from a variety of conflicts, for instance ethno-local political conflicts, could obstruct PSD; second, the local private sector might be too divided by, again, a variety of conflicts, making some sort of central Government intervention funding necessary; third, in case the private sector is virtually absent in local economies, enabling LCR could be warranted in order to kick-start PSD and raise living standards.

In the light of these opportunities and limitations, a conceptual integration of PSD and LCR would seem welcome. Before a taxonomy can be introduced to enable such integration, there is a discussion of some empirical works on local economies in South-East Asia that have begun to find ways for simultaneous analyses. To begin with, several publications have acknowledged that the firm is not always the most likely candidate to spearhead PSD. At a macroeconomic and international level, it should be taken into account that the public sector has been a key driver of economic development in South-East Asia. Consider, for example, the huge financial capabilities of Temasek Holdings, an investment agency controlled by the Government of Singapore. Although many view Singapore's economy as a prime example of neo-liberal capitalist development, Temasek Holdings is a 54 per cent shareholder in Singapore Airlines, one of the most highly regarded and profitable airlines in the world; it owns 58 per cent of Indonesian Bank Danamon and 42 per cent of Thailand's Shin Corporation (Temasek Holdings 2008). More relevant for lagging local economies, Altenburg and von Drachenfels (2006) propose a breakaway with "minimalist" approaches towards PSD and are in favour of public policies that facilitate the growth of competitive industries, such as research and development and linking formalized successful firms with informal small-scale firms. They do not, however, tackle the issue of LCR.

Elvinia (2005), in an insightful study of Zamboanga City in the southern Philippines, has explicitly mentioned LCR as one of the determinants of local economic development. He concludes that decentralization has led to a certain degree of importance of the local government in terms of the support for small and



medium enterprises (SMEs). Simultaneously, however, Zamboanga City's civil servants are constrained in their capabilities, "partly because the central Government is taking a strong lead". This conclusion clearly demonstrates that PSD is not only an endeavour of local private and public actors, but also of the central Government of the Philippines. Nevertheless, in this case it is rather difficult to judge whether LCR are enabling or disabling. On the one hand, Elvinia (2005) states that the central Government has facilitated export successes; on the other hand, the functions of the local government are limited to a mere executing rather than a leading role. Therefore, the Government of the Philippines does not seem to have increased the capabilities or responsibilities of civil servants in Zamboanga City. He further concludes that:

"...it is most likely impossible that they [SMEs] can survive in the long run, unless they receive continued support. This creates a dilemma for SMEs: how to balance dependence on the government, vulnerability to global changes (e.g., international standards), and difficulties to grow by themselves".

It is precisely this balancing problem that necessitates a thorough understanding of the interdependencies between PSD and LCR.

Another study on the Philippines made a comprehensive effort to obtain insights into regional and local development. In their book, *The Dynamics of Regional Development: The Philippines in East Asia*, Hill and others (2007) cover many issues that are relevant for both PSD and LCR and ultimately local and regional development, such as insertion in global value chains, regional disparities over time and the effects of decentralization. Nevertheless, in the section on policy implications they do not pay much attention to the role of informal institutions and local elite capture. They mention the notion of the "strongly personalistic nature of Philippine politics", but do not connect it explicitly to its consequences for policy-related issues. This is a pity, as several publications have demonstrated the significance of these two roles. Van Helvoirt (2007), for instance, shows that patterns of PSD vary considerably across the central Philippines due to various manifestations and qualities of informal networking among entrepreneurs. As informal institutions are often historically rooted, it is imperative to include them in the equation when it comes to policy formulations. It is highly unlikely that any policy on PSD and LCR will succeed if it is running against local conventions and norms of behaviour.

Within South-East Asia, the vast archipelago of over 17,000 islands known as Indonesia obviously needs to be addressed. Although many publications can be found on either PSD (Ndoen and others 2000; Rutten 2003; World Bank 2006)

or LCR (Kristiansen and Pratikno 2006; Kristiansen and Santoso 2006; Setiawan and Hadi 2007), there are only a few authors who address these issues simultaneously. Perhaps one of the most insightful integrated analyses comes from Hadiz (2004), who presents a wealth of evidence on the effects of the post-Suharto decentralization programme, particularly as a result of fieldwork in Yogyakarta and Medan. A major strength of this publication is the attention paid to the remarkable response of provincial elites between 1999 and 2003. According to him, the devolution of economic and political power to the provincial and subprovincial levels has caused a variety of problems for PSD. First, local politicians introduced new levies on businesses “much to the distress of the local business community”. Second, decentralization has led to a lack of budgetary clarity. In Yogyakarta one top bureaucrat admitted that he had little idea of the financial ramifications of increased regional budgetary power, just a few weeks before the implementation date of January 2001. Third, local political and business elites have greatly captured provincial and subprovincial resources, sometimes even involving violence and crime/youth organizations. Hadiz (2004) calls this capturing of resources “predatory interests” and, as such, he views it as the devolution of elite capture from Jakarta to the provinces. Fourth, local economies without many natural resources have started to face limitations regarding revenue-raising possibilities. Eventually, conflicts between resource-rich and resource-poor provinces could lead to tensions similar to the current Bolivian case, as mentioned above. In sum, Hadiz (2004) shows how LCR can impinge upon opportunities for inclusive PSD and how provincial elites manage to (re)secure their interests within the changing dynamics of public administration.

Other evidence on the interplay between PSD and LCR has been documented in Andriesse (2008) and Andriesse and Van Westen (2008). In a comparative analysis of institutional arrangements between the bordering regions of Satun (southern Thailand) and Perlis (northern Malaysia), there is ample evidence of the powerfulness of scrutinizing PSD and LCR simultaneously.<sup>1</sup> Satun has had many opportunities for PSD due to low labour costs, a dynamic ethnic Chinese entrepreneurial community with easy access to finance and the insertion of the Thai seafood industry into global food markets. These opportunities have even compensated for weak LCR: stressful party politics; an appointed governor who is not inclined to raising living standards but looks forward to being promoted to

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<sup>1</sup> This empirical research, conducted between 2004 and 2006, consisted of questionnaires and semi-structured interviews and a social network analysis. It involved 213 actors: firms' owners, bank managers, chairpersons of business associations, civil servants, local politicians and the local journalists. A detailed overview of the methodology can be found in Andriesse (2008).

more strategic, Buddhist, provinces; and the Bangkokian image of Satun as a province that does not matter (Andriesse 2008; Andriesse and Van Westen 2008).

**Table 1. Socio-economic indicators in Satun, Thailand, and Perlis, Malaysia**

|   | <i>Year</i> | <i>Satun</i> | <i>Perlis</i> |
|---|-------------|--------------|---------------|
| Total population                                  | 1990        | 227 000      | 188 000       |
|   | 1995        | 244 000      | 209 000       |
|   | 2004        | 274 000      | 218 000       |
| Percentage of labour force working in agriculture | 1990        | 74           | 33            |
|   | 2004        | 57           | 15            |
| Per capita gross regional product (US\$)          | 2004        | 1 630        | 2 589         |
| Number of teachers at secondary school            | 1990        | 547*         | 1 037         |
|   | 1995        | 690          | 1 250         |
|   | 2004        | 1 105        | 1 970         |
| Number of hospital beds                           | 1990        | ..           | 404           |
|   | 1995        | 250          | 404           |
|   | 2004        | 366          | 404           |
| Registered cars (plus pick-ups for Satun)         | 1990        | 3 781        | 8 920         |
|   | 1995        | 4 666        | ..            |
|   | 2004        | 10 118       | 10 969        |

*Sources:* Thailand 2005, 1996, 1994, and Malaysia 2005, 1996 and 1990.

*Notes:* An asterisk (\*) indicates data for 1993.

Two dots (..) indicate that data are not available or are not reported separately.

Two problems with PSD in Satun are the lack of inclusiveness and the natural environment. PSD is not inclusive at all because the majority of the population, who are Muslims of Malay descent, is virtually absent from the private sector and faces great difficulties in gaining access to finance.

Regarding the natural environment, Satun has followed unsustainable business practices that may well undermine the current economic model. “Unfettered private development of fisheries and aquaculture may well exhaust the natural resource base before diversification into other industries has sufficiently progressed” (Andriesse and Van Westen 2008). In contrast, extremely strong and enabling LCR have resulted in a public sector that has transformed Perlis from an agricultural state to a state based on manufacturing in the 1990s and public services (notably education) since the beginning of the new millennium. Table 1 displays socio-economic differences between Satun and Perlis. It shows that, whereas the

total population of Perlis is lower than that of Satun, there are more teachers at secondary schools, more hospital beds and more cars.<sup>2</sup> Moreover, in Perlis there are several technical colleges and other post-secondary educational institutes, but in Satun there are none. Therefore, it is safe to conclude that enabling LCR have expanded social capabilities in Perlis. But, although standards of living in Perlis are significantly higher than in Satun, PSD is not flourishing as it should because firm owners are more concerned with winning government tenders than with cooperating and coordinating among themselves. In addition, ethnic Chinese and Malay entrepreneurs are not willing to work together. This comparison provides some clues as to the differences between peripheral regions in general.

The World Bank (2005, p. 204) has come up with a taxonomy of peripheral regions based on the number of poor people per square kilometre and market access. In this framework, north-eastern Thailand and peripheral regions in Bangladesh are regions with high poverty density and low market access, while old industrial regions in the United Kingdom and the United States are shown as having low poverty density and high market access. But as it is, this taxonomy does not provide much explanatory power for the causes of regional or local underperformance. Hence, in this article an institutional taxonomy for peripheral regions is proposed on the basis of opportunities for PSD and for LCR (see table 2).

**Table 2. A taxonomy of PSD and LCR for local peripheral economies**

|                                |      | <i>Opportunities for inclusive PSD</i> |            |
|--------------------------------|------|--|------------|
|                                |      | <i>Many</i>                            | <i>Few</i> |
| Opportunities for enabling LCR | Many | A                                      | C          |
|                                | Few  | B                                      | D          |

With respect to PSD, inclusiveness is vital in order to create growing and balanced patterns of entrepreneurship. Excluding specific parts of local populations in economic activity might lead to tensions, unemployment and excessive forms of outmigration of persons aged between 20 and 50 years, and even violent incidents.

<sup>2</sup> The total population of Perlis might be lower in reality as states prefer to report a high number to the federal Government in order to receive more grants. In this respect, Thai data seem to be more reliable.

Unfortunately, it is not known how many pick-ups are registered in Perlis. Out of 3,781 vehicles in 1990, 3,034 were pick-ups, which are very popular in rural Thailand. Out of 10,810 in 2004, 7,887 were pick-ups.

With respect to LCR, an enabling environment could lead to better PSD. In the case of very few comparative advantages, enabling LCR is likely to result in a more effective public-sector driven economy, for instance the provision of public services without elite capturing practices. A locality situated in block “A” of table 2 no longer needs much policy assistance, as opportunities for both PSD and LCR are promising. Localities in block “B” wish to have better relations with central Governments only in case PSD is hampered by disabling LCR. In this case, policymakers and politicians should find ways to create a more enabling environment. The third possibility for a locality is to be positioned in block “C”. Here, neo-Keynesian local economic development policies might kick-start PSD, for example by guiding entrepreneurs from obsolete uncompetitive businesses towards new comparative advantages, triggering economic activities based on public services; such policies might also foster mutual understanding between ethnic groups. Obviously, the worst off are localities in Block “D”. Designing and implementing policies for the inhabitants of such areas is likely to be very difficult—in some cases impossible—due to mental walls dividing ethnic communities, a range of historically rooted disabling institutions and various forms of elite capture. It is also possible that central Governments will prevent such areas from prospering as a result of geopolitical interests *within* countries. Therefore, it is advisable to call in the help of international donor agencies. NGOs could take a lead role in designing PSD-related strategies. If a locality does not have any viable comparative advantage, the option of outmigration should be considered. Hill and others (2007) also conclude that outmigration might sometimes be the best solution in impoverished Philippine regions, but it should be noted that excessive rural-urban flows of labour generally give rise to congestion, insecure informal economies and slums in large metropolitan areas. Walking through Metro Manila and Metro Cebu, one can indeed find evidence of such negative impacts. During the aftermath of the 1997 Asian financial crisis, many poor inhabitants of Bangkok and Jakarta returned to their rural homelands because agricultural activity was less affected than urban-based manufacturing and services (Firman 1999; Webster 2004). Outmigration is therefore not a sustainable long-term solution if it remains limited to a relocation of socio-economic problems. Policies facilitating outmigration should be implemented cautiously. In sum, this section has shown that an analytical balance between PSD and LCR could provide clues as to how living standards in local peripheral economies could be enhanced. In the following section, five policy tools/issues are proposed on the basis of the empirical insights presented above and the taxonomy in table 2.

## IV. POLICIES THAT MAY INCREASE LOCAL ECONOMIC CAPABILITIES

### Sequencing effectively

Obviously, a first crucial outcome of this article is the requirement for policymakers to be able to find out in what block of table 2 designated local economies are situated before any strategies are formulated. Then, given the complexities of fostering local economic development, effective sequencing of policies is needed. A major prerequisite is a policy atmosphere that can, if necessary, address both PSD and LCR. For instance, it would be ineffective to create massive and costly PSD schemes for localities that find themselves in blocks "A" or "B" of table 2. Recently, the weekly *Time* commented on the economic problems in Indonesia generated by the 1999 decentralization programme.<sup>3</sup> For many Indonesian provinces, LCR has become so vague and blurred that *Time* suggested the Government should "demarcate federal, provincial and local powers, and reconcile conflicting laws". Hence, in the Indonesian case it is likely that, in the current institutional environment, focusing on LCR before PSD makes more sense than the other way round. For localities in block "D" without the prospect of improved LCR in the short term, however, it might be better to more or less neglect the central Government and instead try to find ways to increase living standards by PSD. The case of Satun in southern Thailand, as outlined in the previous section, demonstrates that local economic growth (albeit not inclusive) is possible with a single-pronged approach. Therefore, it is important to acknowledge that sequencing is not only dependent on theoretical economic logic, but also on political and institutional geographical settings.

### Addressing the problem of historically rooted disabling local institutions

Much more attention should be paid to the problem of historically rooted disabling institutions that obstruct PSD and LCR. In particular, LCR-related policies have paid insufficient attention to local disabling institutions that adversely influence decentralization programmes and to the effects of top-down policies creating a variety of mismatches at the local level. While designing policies, one should certainly take into account the informal ways of practising local politics that sustain inequality within communities. Another issue is the dilemma of appointed versus elected local politicians. It is generally perceived that more democracy is conducive for greater transparency and accountability, but where strong disabling institutions are present, transforming the political system from appointed to elected politicians

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<sup>3</sup> Michael Schuman, "What's holding Indonesia back?" *Time*, 11 September 2008, pp. 24-28.

might lead to the unintended outcomes of vote-buying, elite capture (predatory interests) and ultimately exclusive rather than inclusive socio-economic development.

### **Capitalizing on local enabling informal institutions**

One of the major points in the recommended actions in the United Nations Development Programme's Commission on the Private Sector and Development (2004, p. 39) report is the need to formalize economies: to transform informal ways of doing business into formalized institutional arrangements. Nevertheless, the empirical findings on local and regional economic development in South-East Asia suggest that informality is not a priori detrimental to economic performance. Local entrepreneurial communities could flourish without contracts or formal loans if transaction costs were sufficiently reduced through informal ways of cooperation and coordination, generating high levels of trust. In this respect, Elvinia (2005) has argued that the development agendas of SMEs should be "more profound and reflective of local context" and "above all, public services/support should be *demand driven* rather than *supply-driven*".

Integrating this point and issue 2, policy formulations and implementation for PSD and LCR could perhaps be carried out following the concept of *deliberative development*, as presented by Evans (2004). Evans criticizes one-size-fits-all blueprints for local economic development as adopted by central Governments and Western NGOs based on uniform institutional assumptions that do not hold in social, political and economic realities at the local and regional levels. He based his ideas on, among others, the Nobel laureate Amartya Sen (1999), who views processes of participation as "constitutive parts of the ends of development in themselves", and Rodrik (1999), who favours institutional arrangements that allow for endogenous social and political choices. Evans praises the participatory political institutions that have improved public service delivery in Porto Alegre, Brazil, and that have facilitated higher life expectancies and literacy rates in Kerala, India. The advantage of such a process of policy formulation and implementation is that it increases the chances of overcoming disabling institutions and capitalizing on enabling institutions. The disadvantage is that it is perhaps difficult to implement in heavily centralized countries as politicians and civil servants in central Governments often have predatory interests which they do not wish to jeopardize. Indeed, it is therefore no surprise that Evans took examples from two relatively decentralized countries: Brazil and India.

## Taking into account ethnic tensions

The empirical evidence presented in this article shows that ethnic tensions frequently hamper inclusive PSD and effective LCR. In local economies with an entrepreneurial community consisting of one specific ethnic group, PSD policies should focus on lowering divisive ethnic walls or targeting ethnic groups that have thus far been excluded. With respect to LCR, it is possible for local politicians and members of parliament representing a particular locality to originate from a single ethnic group, which would affect their political influence in various tiers of government. Although root causes can, no doubt, be found elsewhere, the *continuation* of the conflict in the troubled southern Thai provinces of Yala, Pattani and Narathiwat is explained by the following mix: relatively rich Thai and ethnic Chinese entrepreneurs, an Islamic majority of Malay descent that does not benefit sufficiently from PSD and very weak LCR as the members of Parliament representing the Islamic population have little influence, while the appointed provincial governors are de facto puppets of the Ministry of Interior in Bangkok. The three provinces unfortunately find themselves deeply trapped in block “D” of table 2. Merely instituting infrastructural works, as was done in recent years, does not feed local economic capabilities. Instead, LCR and PSD policies should try to lower ethnic barriers and reduce the impact of various disabling institutions.

## Structural opposition

How can one grapple with central Governments that are structurally opposed to improving economic conditions and the quality of life in certain localities? Inhabitants of localities falling under blocks “B” and “D” of table 2 could ask themselves such a question if they do not receive any effective support from the central Government in the long run. In those cases, there are three options: focusing on PSD, seeking help from NGOs or migrating to better-endowed localities. If a complete overhaul of LCR is possible—for example, after a military coup or a devastating natural disaster, such as the tsunami in Aceh, Indonesia—one should be wary of creating LCR problems in other areas. Due to ethno-local politics, informal institutions and elite capture, a radical change in LCR might be beneficial for locality *x* but detrimental to locality *y*. Malaysia would be a case in point: transforming LCR based on affirmative policies that support the Malay population into pro-poor ethnic-neutral LCR is likely to create some problems in non-impooverished regions that have an above-average share of Malays vis-à-vis ethnic Chinese and ethnic Indians.



## **V. CONCLUSIONS**

This article has shown that balancing private sector development (PSD) and local-central relations (LCR) would be a fruitful endeavour for creating resilient and sustainable trajectories of economic development in peripheral and lagging localities. Most importantly, the integration of PSD and LCR enables a holistic process of expanding existing economic capabilities and fostering new ones. In some localities, more attention will be paid to internal factors; in others, the effects of external factors are the key drivers of economic activity and, ultimately, poverty reduction. Perhaps the greatest threat to the successful balancing of the two bodies of knowledge is the tendency of power holders in central Governments to avoid dismantling disabling institutions if their own (predatory) interests are at stake (Bardhan 2000 and 2005, pp. 27-85). Obviously, power holders can greatly influence the effectiveness of LCR, but even in the domain of PSD, there are several issues that depend on political decision-making—for instance, support for localized Islamic financing products in non-Islamic countries.

Regarding the refinement of the policy environment, this article has focused extensively on the interaction between informal institutions and policy implementation. This under-researched topic is extremely important because informal ways of organizing PSD and LCR often play crucial roles in development. Making PSD more inclusive and LCR more effective requires a thorough understanding of the ways to overcome disabling institutions and capitalize on enabling institutions. In the light of the evidence presented above, further research and policy work could focus on three interrelated topics. First, table 2 in this article could be used as a start for the refinement of handbooks, appraisal documents and manuals, increasing the analytical capacity of policymakers and donor agencies if they seek to diagnose socio-economic and politico-economic realities in lagging economies. Second, Evans's (2004) concept of deliberative development deserves more attention. As mentioned above, it is a promising concept in relatively decentralized countries. Based on the Porto Alegre and Kerala cases, one of his conclusions is that:

“Rather than making the ‘rational’ choice that their individual input will have little impact on the final outcome and therefore doesn’t warrant the cost of lost time, ordinary citizens appear to agree with [Amartya] Sen that the ability to make choices is an intrinsically valuable and rewarding mode of human functioning”.

Further research and policy work could be beneficial for implementing participatory and inclusive processes of local development. In ethnically divided localities, for instance, multi-ethnic citizen councils could be established that try to

solve ethnic conflicts and bring various ethnic communities closer together. Another opportunity offered by deliberative councils is the reduction of elite capture such as that described in box 1. Third, the phenomenon of migration out of highly impoverished localities remains a sensitive issue. Neo-classical regional economists view it as a suitable solution in order to reach conditions for equilibrium in domestic and international labour markets; but for densely populated areas, this is not likely to suffice. PSD and LCR policies should address the plight of those who are not able to migrate. If such policies lead to higher living standards, they could even result in reverse migration—out of huge congested and polluted cities.

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