Do institutions matter for regional development in the EU?

by

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**Abstract:** This paper discusses the question of whether institutions matter for regional development in the EU and, if so, of how can the institutional dimension be integrated in the European regional development effort. It finds that while the role of local institutions is crucial for economic development and as a means of determining the returns of European regional development policies, generating an institution-based general regional development strategy is likely to be undermined by the lack of definition of what are adequate, solid, and efficient institutions across regions in the EU. Problems related to the measurement of institutions, to their space and time variability, to the difficulties for establishing the right mix of formal and informal institutions, and to the endogeneity between institutions and economic development make one-size-fits-all approaches to operationalizing institutions within the European regional development effort possibly unfeasible. Development strategies that are specifically tailored to the conditions of different regional institutional environments across European regions are, in contrast, likely to yield greater returns.
1. Introduction

Do institutions matter for regional development in the EU? This is a question that would probably have not crossed the minds of decision-makers and the public in the mid-1980s, the time when the reform of the Structural Funds and of the European Regional Development Policy was being conceived. Despite the fact that social scientists had been analysing the role of institutions for more than a century (i.e. Tönnies, 1887; Weber, 1920 and 1921), the link between institutions and economic development had been fundamentally overlooked by mainstream economic theory, in general, and growth theory, in particular. Under a neoclassical growth framework, achieving economic development was mainly a matter of investing in physical capital (Solow, 1956). Differences in the stock and in the level of investment in infrastructure were regarded as the key elements in explaining differences in output and in the promotion of economic growth (Aschauer, 1989). The development of the endogenous growth theory around the mid-1980s brought further to the fore the importance of two other additional factors – innovation (Romer, 1986) and education (Lucas, 1988) – that had already featured prominently in neoclassical approaches to growth.

Hence, the recipe to spur economic development and growth in the periphery and to generate greater economic and social cohesion in Europe seemed rather straightforward: greater investment in infrastructure, in education and training, and in the promotion innovation and industrial activities would have, in theory, sufficed to generate greater economic growth. If this investment was mainly channelled to lagging regions in the periphery of Europe, it would also contribute to economic convergence. After all, three decades of strong national development policies based on these principles were considered to have contributed to a substantial reduction in the disparities between rich and poor regions in places such as Britain, France, Germany, Italy, or Spain. This was, as highlighted by Amin (1999: 365), a “firm-centred, standardised, incentive-based and state driven” regional policy, based on the belief that “a set of common factors (e.g. the rational individual, the maximising entrepreneur, the firm as the basic economic unit and so on)” (Amin, 1999: 365) lay at the base of economic success. As a consequence,
even after the reform of the Structural Funds and despite the introduction of a series of innovative features, the European Regional Development Policy remained very much embedded in the tradition of European national development policies. This tradition was firmly rooted in the belief that replicating top-down infrastructure, education, and industrialisation policies, regardless of the local institutional contexts, would suffice to generate greater growth and promote economic convergence (Pike et al., 2006). The influence of institutions on regional development patterns was fundamentally neglected by mainstream economic theory which tended to assume instead that utility maximising individuals satisfying individual preferences would result in efficient and socially optimal outcomes. EU regional development intervention over the last 20 years has struggled to part with this theoretical framework and the result has been development strategies that have frequently tended to mimic one another from Andalusia to Attica, from the Alentejo to Saxony – both in their generally top-down approach to development problems, in spite of the principle of subsidiarity, and in their emphasis on certain development axes, such as transport infrastructure, business support, and education.

This type of approach seemed adequate and logical at the time of the implementation of the reform of the Structural Funds in 1989. After all, on the one hand, institutional economics was still in its infancy and the link between institutions and economic development far from clear and, on the other, the EU’s approach to development had been tried and tested and had worked reasonably well. However, over the last two decades this panorama has changed. First of all, researchers do not completely agree on whether European regional development intervention has met its objective of generating greater economic and social cohesion. Recent independent analyses concerning this question reach widely differing results. While some studies conclude that, to a greater or lesser extent, the EU development effort since the 1989 reform of the Structural Funds has had almost no impact (e.g. Boldrin and Canova, 2001; García-Milá and McGuire, 2001; de Freitas et al., 2003; Dall’Erba and Le Gallo, 2007), others indicate that it has been a success (e.g. Cappelen et al., 2003). In between there are those who point out that the impact of the Structural Funds has been limited (e.g. Bussoletti and Esposti, 2004; Bouvet,
2009), mixed (e.g. Puigcerver-Peñalver, 2004; Eggert et al., 2007), or tends to vary according to differences in emphasis across development axes (Rodríguez-Pose and Fratesi, 2004) or from one geographical location to another (Antunes and Soukiazis, 2005; Percoco, 2005; Mohl and Hagen, 2008) [see Mohl and Hagen (2008) for a useful summary of this literature].

Second, across a wide range of social science disciplines, researchers are increasingly resorting to analysing institutions in order to have a better grasp of how economic development takes place. Stubbornly high – and often growing – residuals in growth regressions have encouraged many scholars to look for additional factors that impinge on economic development and growth beyond traditional growth theories (Rodríguez Pose and Storper, 2006: 3). In the last few years research on trust (Knack and Keefer, 1997; Zak and Knack, 2001; Knack, 2003; Beugelsdijk and van Schaik, 2004; Bengtsson, Berggren, and Jordahl, 2005) and social capital (Putnam, 1993, 2000; Beugelsdijk and van Schaik, 2005) has boomed, leading some researchers to claim that the new ‘kid on the block’, institutions, matters as much, if not more, for economic development than long-established traditional factor-endowments, such as physical and human resource endowments, trade, or technology transfers (Hall and Jones, 1999; Acemoglu, Johnson, and Robinson, 2001; Vijayaraghavan and Ward, 2001; Rodrik, Subramanian, and Trebbi, 2004).

Putting everything together, if a) the returns of the European regional development effort since the reform of the Structural Funds are controversial and contested; if b) researchers are finding that institutions matter more and more for economic growth and development; and if c) European development strategies have, by and large, overlooked the institutional dimension, ergo institutions matter for regional economic development in the EU and therefore should become an essential part of the European regional development effort in order to improve its effectiveness. It's the institutions, stupid!
But it is this the case? This paper addresses the question of whether institutions matter for regional development in the EU and, if so, of how can institutions be included in the regional development effort. Although it will argue that understanding local institutions is critical for the design and implementation of efficient development strategies, the introduction of a institutional dimension into policy-making is much less straightforward than it may at first seem. In order to achieve this aim the paper first focuses on the role of institutions in economic development, before asking what are in fact institutions and how do they affect economic development. The final two sections deal with how can institutions be introduced into the development policy-making process and what are the problems related to it.

2. It’s the institutions, stupid!

Why are European regional development policies since the reform of the Structural Funds not universally regarded as a success? Why is the objective of economic and social cohesion across regions of Europe proving so difficult to achieve? The increasingly limited returns – or, at least, perceived returns – of many development initiatives is not an exclusively European phenomenon. Traditional development strategies, especially in the developing world, have come under scrutiny and are more and more regarded as relatively ineffective in an integrated, globalized world (Pike et al., 2006). Across the world there is growing dissatisfaction with ‘blueprint’ and ‘one size fits all’ development strategies which, particularly in the case of lagging regions, seem less able to deliver results than a few decades ago. In parallel there is a growing view among certain scholarly strands that neoclassical economic orthodoxies are proving less and less adequate in order to facilitate growth and have, in many cases, led, to imperfect interpretations of regional development and decline (Yeung, 2000: 308).

In attempt to look for the causes of the perceived limited returns of development strategies in the EU and across different regions around the world, growing attention has been paid to the influence of institutions on economic development. In effect, the tide has changed. While in 1990 North accused
western scholars – economists, in particular – and policy-makers of overlooking and taking the role of institutions in ensuring the efficient functioning of markets and, consequently, in fostering development for granted (North, 1990), the presence of solid and efficient institutions has become a must, a prerequisite for those dealing with economic growth and development. To North institutions are “the underlying determinant of the long-run performance of economies” (North, 1990: 107). Rodrik et al. (2004) go even further in saying that the quality of institutions trumps more traditional development factors, such as geography and trade, in determining levels of income and growth prospects.

The work of these economists echoes and, to a certain extent, builds on research conducted by geographers, sociologists, and political scientists who, from different perspectives, tried to establish a link between place-specific institutional structures and economic performance. Most of this work deals with how effective social institutions improve the provision of collective or public goods, address market failures, and improve efficiency (Streeck, 1991). For these researchers, institutions generate trust among economic actors and reduce transaction costs (North, 1992; Fukuyama, 2000:1), provide collective goods (Streeck, 1991), foster transparency (Storper, 2005: 32), promote entrepreneurship, grease the functioning of labour markets (Giddens, 1990), and ultimately lead to greater economic efficiency (North, 1992: 479).

It is thus believed that specific local institutional arrangements enable localities and regions to embark on a sustainable and high-end road to economic development (Streeck, 1991). And it is often thought that these institutional arrangements work better at the local and the regional scale, as the national scale can be too distant, remote, and detached in order to be effective in mobilizing organisations (Rodríguez-Pose, 1999).

Different authors have concentrated on different types of institutional arrangements. Some have focused on social capital, understood as “features of social organization, such as networks, norms and trust that
facilitate co-ordination and cooperation for mutual benefit” (Putnam 1993:38). Putnam (1993) considers social capital as a valuable asset for the genesis of economic development at the local level. He argues that the different forms of social organisation and diverse levels of trust between the North and the South of Italy have been a key determinant of the differential levels of development between both parts of the country (Putnam 1993). Similarly, the World Bank has at times blamed an absence of social capital for the limited returns of parts of its intervention in specific regions (Englebert 2002). Others have tended to focus on the role of ‘institutional thickness’ as a driver of economic development. Institutional thickness can be understood as a “combination of features including the presence of various institutions, inter-institutional interactions and a culture of represented identification with a common industrial purpose and shared norms and values which serve to constitute ‘the social atmosphere’ of a particular locality” (Amin and Thrift 1995: 104). Institutional thickness is considered to help determine the capacity of any territory to adapt to changing conditions and generate and assimilate innovation (Hudson, 1994; Amin and Thrift, 1995). Furthermore, from this point of view, institutional thickness gives institutions legitimacy, generates trust, increases innovative capacity, expands common knowledge, and helps to embed economic activity in the local fabric (Amin and Thrift 1995). Others such as Woolcock (1998) divide institutions between ‘development’ and ‘dysfunctional’ institutions. ‘Development’ institutions are those that, by encouraging individual and collective freedom, result in an efficient bureaucratic system, a high degree of cooperation and flexibility, and low levels of corruption. ‘Dysfunctional’ institutions are unaccountable and corrupt and often captured by elites, detached from the common citizen, opaque, and failing to guarantee the rule of law (Woolcock 1998). These different approaches are frequently combined, with diverse institutional arrangements reinforcing one another. Institutional thickness is regarded as capable of increasing the stock of social capital (Jütting 2003), while the combination of social capital and institutional thickness in any given region is frequently linked to effective government performance (Amin 1998).
The bottom line of these views is that adequate, solid, and efficient institutions are essential for economic development at a local or a regional scale. Communities, localities, and regions with inadequate or inefficient institutions have, in contrast, a low probability of achieving sustainable economic development (Woolcock, 1998; Amin, 1999). From this perspective, in the absence of adequate institutions, it is “hardly surprising that attempts to implement even the most thoughtfully conceived development policies lead to early and frequent failure” (Woolcock, 1998:153). Institutionally thin environments often end up dominated by elites in what Amin (1998) calls ‘institutional sclerosis’, thwarting opportunities for sustainable development. Institutional sclerosis spreads dissatisfaction and distrust in the local public policy-making process, driving local actors away from the development process (Picciotto 2000). Institutional ‘lock-ins’ and ‘path dependencies’ further contribute to generate a downward spiral of relative underdevelopment in lagging regions.

As Putnam puts it, solid and efficient institutions are the “key enablers of innovation, mutual learning and productivity growth” (Putnam, 2000: 325) and thus pave the way for the design and implementation of efficient economic development strategies across territories and, ultimately, for economic growth.

3. But, what are institutions?

Given the above mentioned developments in the analysis of institutions, few dispute these days that institutions matter for economic development – as few also dispute that investment in infrastructure, in education, or innovation ultimately makes a difference for the development prospects of any given territory. However, one thing is acknowledging that ‘institutions matter’, another is agreeing on what are institutions and on which institutions matter for development. And while investment in infrastructure, education, or innovation tends to be – despite the richness and complexity of these factors – relatively easy to grasp, operationalize, and implement, the concept of institutions is more subjective, less clear, more controversial and, precisely for that reason, much more difficult to operationalize. Under most circumstances, greater investment in infrastructure, education, innovation is
likely to have a positive impact on the development of any given territory. Targeting institutional deficiencies is much more difficult to achieve, especially if the institutions needed are always qualified as ‘adequate’, ‘solid’ and/or ‘efficient’. As Bardhan (2000:245) puts it, “there are still many differences among reasonable people on which institutions affect the process of development and how”, raising the questions of how do we intervene in institutions and how do we create ‘adequate’, ‘solid’ and ‘efficient’ institutions.

In order to address these questions, we must first define what is understood by institutions. Defining institutions is notoriously difficult and the current literature on the topic far from agrees on a common definition. The most commonly cited definition is that by North who describes institutions as “the rules of the game in a society; (and) more formally, (as) the humanly devised constraints that shape human interaction” (North, 1990: 477). This definition is however far from universally accepted. In addition, the panorama is further complicated by the existence of multiple types of institutions. As Amin (1999) indicates, any economy is moulded by “enduring collective forces”, which include “formal institutions such as rules, laws, and organization, as well as informal or tacit institutions such as individual habits, group routines and social norms and values” (Amin 1999: 367). Although the terminology varies greatly among researchers, most of the literature on the topic tends to agree with this two-tier division. Scholars tend to distinguish between, on the one hand, what are variously described as ‘formal’ or ‘hard’ institutions or ‘society’ and, on the other, ‘informal’, ‘tacit’, ‘soft’ institutions, ‘community’ or social capital. More specifically, ‘formal’ institutions (also known as ‘hard’ institutions or ‘society’) can be regarded as universal and transferable rules and generally include constitutions, laws, charters, bylaws and regulations, as well as elements such as the rule of law and property rights and contract and competition monitoring systems (North, 1992; Fukuyama, 2000: 6). ‘Informal’ institutions (also known as ‘soft’ institutions, ‘community’ or social capital) include a series of features of group life “such as norms, traditions and social conventions, interpersonal contacts, relationships, and informal networks” (Rodríguez-Pose and Storper, 2006: 1), which are essential for generating trust (Fukuyama, 2000: 3).
They tend to arise spontaneously through repeated community interaction and prisoner’s dilemma type decisions (Fukuyama, 2000).

2.1. And how do solid and efficient institutions foster regional development?

Institutionalists generally believe that the renewed protagonism of regions and localities in a more globalised environment is intimately related to the idea that markets are socially constructed (Bagnasco 1988), “markets are not the free floating phenomena described in neo-classical theory”, but they are considered as “social constructs made and reproduced through frameworks of socially constructed institutions and conventions” (Pike et al. 2006, p 91). Local and regional institutions hence become much more than simple regulators of economic activity. They determine the level of activity and its efficiency. Hence, efficient local institutions are believed to promote development and growth through creating the necessary ‘orgware’ (Vázquez-Barquero, 1999) – that is, the adequate conditions for investment, economic interaction, and trade, that, at the same time, reduce the risk of social and political instability and conflict (Jütting, 2003). By lowering uncertainty and information costs, institutions smooth the process of knowledge and innovation transfer within and across regions and improve the conditions for the development of economic activity (North, 1990, 1995; Vázquez-Barquero, 2002). At the same time, they can shape the sets of incentives and disincentives that contribute to establish an ‘adequate’ balance between coordination and competition among local economic actors, hence facilitating the learning process (North, 1995). Formal and informal institutions help territories to adjust and react to change, generating a degree of ‘adaptive efficiency’ that highlights the willingness and capacity of local actors to adopt new knowledge and to engage in innovative and creative activities (North 1990). Institutions more than any other factor determine the learning capacity of any region (Morgan, 1997).

Moreover, different forms of institutions are in constant interaction and tend to affect one another in different ways (Rodríguez-Pose and Storper, 2006). According to Amin (1999), a solid development
strategy requires a balance between formal and informal institutions. Formal institutions are important as they provide adequate incentives for growth by minimizing risk, uncertainty, and corruption. As a consequence, they also facilitate efficiency in economic performance (Chakravarti, 2005: 28). Informal institutions can, under certain circumstances substitute for weak formal institutions and are essential for the reduction of transaction costs, for rooting economic activity within any given territory and enhancing local interdependencies, generating greater local economies of association (Amin, 1994: 230).

Areas without solid and efficient formal institutions can, however, still have efficient informal institutions, which can improve government efficiency and lead to greater economic efficiency as well (Boix and Posner, 1998:689-693). In turn, formal institutions can also help improve informal institutions. The interaction between formal and informal institutions contributes to explain the disparities in growth and developmental paths adopted by different regions and localities (Haris et al. 1995).

Many researchers working on institutions have consequently linked the potential outcomes of local and regional economic development strategies to the thickness of local institutions (e.g. Amin and Thrift, 1995). While regional institutional thickness is considered to foster the clustering of economic activities and stimulate entrepreneurship (Amin and Thrift, 1995), the absence solid and efficient institutions hampers the ‘learning’ capacity and thus the potential for agglomeration and clustering in any territory. The success of cluster promotion policies is also affected by the institutional thickness in the territory. Formal and informal institutional systems thus become critical for the generation of clusters (Amin and Thrift, 1995). In a similar fashion, Storper’s (1997) emphasis on the presence of ‘untraded interdependencies’ – institutional cumulative-causation prone externalities – further stresses the fact that economic development and growth depend, to a large extent, on shared conventions embedded locally through efficient institutions that generate positive externalities. This sort of virtuous
institutional arrangements have been frequently described in the formation of successful industrial districts in central and northern Italy. The unique institutional setting of this area, operating both at the local and at the regional level in regions such as Emilia-Romagna, Tuscany, or Veneto transformed what could have been simple agglomerations of small- and medium-sized business into dense networks of externalities at the heart of the development of competitive economic activities (Trigilia, 1990). This dense ‘institutionalization of the market’ (Trigilia, 1990), characterized by strong communitarian bonds, and the presence of a shared political, social, and cultural identity, contributed to the generation of the necessary ties of cooperative and competitive behaviour among economic actors and to the promotion of stable networks of inter-firm relations. The success of the Italian industrial districts has therefore been linked to the high level of territorialisation of socio-economic interaction within industrial districts.

Taken to its limits, ‘institutional thickness’ – or its closely related term ‘institutional capital’ (Healey, 1998) – determines to a great extent the development potential of any territory. Institutionalists believe that the greater the density of combinations of ‘intellectual capital’ (i.e. knowledge resources), ‘social capital’ (trust, reciprocity, cooperative spirit and other social relations), and ‘political capital’ (capacity for collective action), within any given territory, the greater the potential for economic development and growth (Amin and Thomas, 1996; Morgan, 1997; Cooke and Morgan, 1998).

Even the medium-term success of inward attraction is variously linked to the existence of institutions that help embed any new economic activity into the local economic fabric. In the absence of this adequate institutional environment, the attraction of inward investment is often achieved solely on the base of financial incentives that frequently leave territories dependent on external actors and limit the chances of successfully embedding the new economic activities in the local economy (Amin and Thrift, 1995; Vázquez-Barquero, 1999). The absence of solid and efficient local institutions is thus likely to
inhibit economic activity by fostering “high transaction costs, widespread rent seeking, inequality and a lack of trust” (Rodríguez-Pose and Storper, 2006: 14).

Thus, from an institutionalist perspective, it is widely believed that acknowledging the importance of institutions would lead to development strategies more responsive to the needs of the local institutional environment. This implies taking greater consideration of the functioning and needs of local institutions in the design and implementation of the strategy and continuously working with them in order to improve the economic efficiency and returns of any development intervention (Vázquez-Barquero 1999). Otherwise, the risk of failure of any development strategy becomes ever present, as has been the case in the regions of the Italian South, the Mezzogiorno. Here more than the absence of institutions, the weak ‘institutionalisation of the market’ and the absence of solid and efficient institutions, in contrast with Central and Northern Italy, made successive waves of top-down national development strategies virtually self-defeating (Trigilia, 1992). National development strategies in the long-run thus became mere vehicles for income support ultimately leading to the formation of a more dependent and assisted economy.

3. But, can we really intervene in institutions?

Given the potential effect of institutions on the economy, developing and improving institutional capacity and correcting for market failures becomes an essential part of the economic development process. There is a strong belief amongst institutionalists that even the best development strategy can be undermined by a poor institutional environment. However, bringing institutions into the development process is easier said than done. Accepting that formal and informal institutional constructs are essential for the success of development strategies is one thing, implementing measures for the improvement of institutional capacity and for local and regional capacity building is another. There is little agreement about what improving institutional capacity and creating solid and efficient institutions really means and even less about what to do in order to root out institutional inefficiency across what are widely varying geographical contexts, such as that of the regions of the EU. Additionally, there is a lack of
consensus as to whether institutions are a prerequisite or a natural outcome of development. How do we intervene in and affect institutions that seem to be, on the one hand, highly dependent on geographical conditions and, perhaps more importantly, highly resilient to historical change? A series of factors may affect our potential to intervene in institutional building, leading researchers and policy-makers to a catch-22 situation where it is easier to attribute the success or failure of regional development strategies to the absence of adequate, solid, and efficient institutions, rather than to actually do anything about it and come out with ways of improving the institutional environment in less favoured regions. These factors include the following:

1. First, measuring what are adequate, solid, and efficient institutions is virtually impossible. A myriad of complex bilateral interrelations lie at the base of any institutional environment and these interrelations are affected by numerous context-specific factors, making local institutional constructs virtually intangible (Fine, 2000). This makes operationalizing institutional capacity building across what are diverse territories and institutional-constructs, as De Blasio and Nuzzo (2006) find out for the Italian context, unworkable. In their attempt to assess Putnam’s 1993 work on Italy, De Blasio and Nuzzo (2006) report that apparently identical formal institutional structures yield differences in social capital. They conclude that further research is necessary in order to assess how and to what extent apparently similar institutional arrangements affect regional and local economic performance.

2. Second, adequate and efficient institutions are context- and geography-specific. Geography exerts a significant effect on the type and quality of institutions (Easterly and Levine, 2003). What is a solid and efficient institutional arrangement in one region, does not necessarily mean a solid an efficient institutional arrangement in another (Chang, 2003). And, vice versa, very different institutional contexts may yield similar economic results. That, is for example the case of the highly contrasting experiences of Denmark and the clusters of the Third Italy. In Denmark, a highly flexible labour market combined with a developed and efficient welfare state has brought
about an efficient labour market which has been one of the foundations of decades of sustainable
economic development (Kristensen, 1992; Amin and Thomas, 1996). The industrial districts of
Emilia-Romagna, Tuscany, and Veneto, in contrast, blossomed in a rigid national labour market
legislative setting, which made the hiring and firing of employees very difficult in comparison
with Denmark (Cook and Morgan, 1998). As De Blasio and Nuzzo (2006) indicate, even in
highly integrated institutional and geographical contexts, such as the Italian regional setting,
formal – and often informal – institutional arrangements that, on surface, hardly differ contribute
to yield very different economic outcomes. So what are ‘good’ institutional arrangements in one
place may turn out to be ‘bad’ in another, as “moderate changes in [region- and] country-specific
circumstances (policies and institutional arrangements), often interacting with the external
environment, can produce discontinuous changes in economic performances, which in turn set
off virtuous or vicious cycles” (Rodrik 2003: 9). This underscores the relevance of local
intangible factors and cognitive frameworks in determining the economic returns of institutions
(once again, the residual factor).

3. Third, time also affects the influence of institutions on economic development and leads to the
questioning of any static definition of efficient institutions. As conditions change over time, “what
are good institutional forms at one stage are no longer appropriate at others” (Storper 2005: 44).
The adaptability of diverse institutional settings is therefore an essential characteristic of the
efficiency institutions. Once again, the example of the Third Italy highlights how institutional
flexibility has allowed industrial agglomerations of small- and medium-sized firms to remain
competitive, even in the face of drastically changing global circumstances. Industrial districts in
Emilia-Romagna, Tuscany, Veneto, and surrounding regions managed to weather successive
crises in the 1970s and 1980s and adapted to the challenges of globalization through the flexibility
of their unique mix of competitive-collaborative institutional relations among economic actors.
This contributed to limit the growth of uncertainty and opportunism and facilitated problem-
solving (Storper 1997). In the particular case of Emilia-Romagna, the regional development
agency, ERVET, constantly adapted to changing circumstances. Set up in a context of national decentralization in the 1970s with the aim of providing technology-transfer and marketing-related support to SMEs, it fulfilled its task successfully until the 1990s, contributing to engender an adequate environment for the diffusion of knowledge among economic actors that often compete with one another. During the 1990s and the first decade of the 21st century ERVET has adapted and helped to adapt industrial districts in Emilia-Romagna to the new challenges of increasing competition from industrial production in developing countries. This was done by further stimulating innovation, a better channelling of finance to firms, the outsourcing of more routine activities to medium- and low-income countries, and through fostering mergers and acquisitions within the districts. ERVET itself witnessed a surge of private-sector participation in its activities. The combination of all these factors enhanced the already existing system of flexible and adaptive public-private support, known as ‘progressive government’ (Pike, et al. 2006). This process of ‘institutional migration’ (Rodríguez-Pose and Storper 2006) has proven key for the sustainability of development in Emilia-Romagna.

4. But while institutional arrangements can adapt to changing times and migrate to new equilibria, they can also prove extremely resilient to change and, under certain circumstances, become a fundamental force in shaping transformation. As Duranton et al. (2009) show, medieval family structures across regions in the EU have not only proven extremely resilient to change, but have also become embedded in territorially-specific institutional arrangements, making them key drives of secular change. Consequently, medieval family structures, regardless of whether they still exist or not, are an excellent predictor of differences in wealth, economic dynamism, employment, and social conditions among the regions of the EU.

If measurement, geographical and time problems do not discourage those trying to insert institutions into regional development policies, identifying the right mix – or density – of institutions may just do so. As mentioned earlier, an optimistic view of the role of institutions tends to highlight that a high
density of institutions, or a dense institutional thickness, and the right mix of formal and informal institutions may be the way forward. However, it is the quality of institutions more than their density that matters. A high density of poor, inefficient and often corrupt institutions has been for decades undermining the development potential of the Italian Mezzogiorno (Trigilia, 1992). In other cases, in contrast, territories can make do and even thrive with weak institutions (Rodrik 2004). China, for example, “has been able to attract a huge amount of foreign-investment despite the proliferation of what are by current definition...‘poor institutions’” (Chang 2003: 137). Moreover, while ‘solid’ institutions can facilitate the opportunities for economic activity, they can also end up creating vicious circles of suboptimal development trajectories through institutional lock-in, which takes place in the presence of rigid institutions that can neither anticipate, nor respond to changes economic circumstances (Unruh, 2000). The existence of local institutional thickness per se is no guarantee of local economic regeneration and growth (Hudson 1994, 212).

An excess of either formal or informal institutions may also be counterproductive for economic development. An excessive role of communitarian groups, accompanied by limited cross-group bridging, may undermine the collective decision process of any society and generate insider-outsider and principle-agent problems, rent-seeking and free-riding behaviours, while imposing other negative externalities for economic development (Fukuyama, 2000; Putnam, 2000). An excess of communitarian institutions in the absence of strong and efficient societal structures “may lead to greater social polarization by hampering equal opportunity and may exacerbate problems of imperfect competition and impacted information” (Rodríguez-Pose and Storper, 2006: 4). Paradoxically, in other cases, strong communitarian bonds can play an important role in lowering transaction costs and generating trust, making any preconceived ideas about the amount of formal and informal institutions desirable for the promotion of development and about their mix unworkable in practice (Pike et al., 2006). In other cases, strong societal institutions in the absence of well developed community or informal institutions
may lead to an inadequate provision of public goods, confrontational situations and costly conflict resolution (Rodríguez-Pose and Storper, 2006).

Finally, bringing institutions into regional development policies is rendered even more complicated by the endogeneity between both factors. Institutional arrangements affect economic development, but are also in part the outcome of economic development – they are cause and consequence of development – making “institutional quality […] as endogenous to income levels as anything can possibly be” (Rodrik 2004: 10). Institutions and economic development are mutually reinforcing (Boix and Posner, 1998; Rodríguez-Pose and Storper, 2006) and the direction of causality at any given time and in any given territory is difficult to predict.

In addition, there is also great uncertainty and ambiguity about the relationship between institutions and other basic constituents of economic development, such as investment in infrastructure, human resources, or innovation. This makes the whole policy equation extremely complicated as, as Glaeser et al. (2004) emphasise, the relationship between economic development and institutions may be more than bidirectional, hiding in its wake the effects of other endogenous factors – and especially of human capital – on development. Furthermore, the relationship between institutions and other factors affecting growth may be non-linear and influenced by different thresholds in the level of development of any given region. Below certain thresholds of development – which may or may not be found in the poorest regions of the EU – the development of formal and informal institutions is a basic prerequisite for other development intervention to take hold. Beyond that threshold, the development of institutions not only affects other factors promoting development, but is also affected by them. This conundrum is clearly illustrated in Putnam’s (1993) work on Italy. His key index of ‘civicness’, which is the result of centuries of evolution, is rooted in what becomes a fixed institutional context which hardly takes institutional migration and how it affects present day economic outcomes into account (Tarrow, 1996).
4. Conclusions: So, what do we do?

The above discussion has made clear that while institution-building is an essential element of economic development and growth, the effectiveness of any type of institution-based regional development intervention in the EU is likely to be undermined by the problems of defining what are adequate, solid, and efficient institutions in the many regions of Europe. The problems of measuring institutions, their space and time variability, the difficulties for defining the right mix of formal and informal institutions, and the endogeneity between institutions and development, on the one hand, and between institutions and other constituent factors of development, on the other, makes establishing overarching guidelines for institutional intervention nigh to impossible. As Farole et al. (2009: 12) indicate, “there are few systematic lessons from the literature as to how policy can improve or build institutions, and indeed, the widespread vagueness about the subject carries a risk of squandering public funds”. The only elements that are clear is that a) institutions are crucial for economic development and deserve to be considered in any development policy and that b) institutional intervention “cannot be done via a ‘one size fits all’ policy framework or simplistic criteria for intervention” (Farole et al. 2009: 10). The institutional component of development policies needs thus to be targeted to every specific region in the EU, following a true subsidiarity principle, as a clear and effective type and density of institutions cannot be prescribed for every development strategy in areas as diverse as the regions of the EU. Policies need to understand the potential of place-bounded institutions in order to make the most of intervention in human capital, infrastructure, or innovation (Vázquez Barquero, 1999: 85). Hence, development strategies may need to be specifically tailored to the conditions of different regional institutional environments, thus requiring an in-depth understanding of local conditions and an assessment of the feasibility of different types of interventions under current institutional circumstances. This implies better delivery of policy intervention, or a better “match between institutional setting and the strategy, compatibility between this setting and the strategy’s implementation requirements and the wider national and supra-national institutional setting” (Batterbury, 2002:862).
In addition, regional development intervention would also have to consider the need to promote the adaptability of local institutions to changing environments and conditions. Stronger, more supple institutions are needed in order to embed economic activity and generate sustainable development. Place- and context-specific intervention may, in this way, stimulate – even in the cases of very weak institutional settings – institutional change and enhance the economic returns of intervention.

This approach is complicated as it implies greater variation in policies and strategies and ‘true’ subsidiarity. It also means empowering and giving more control of decision-making of the development effort to lower tiers of government and formal institutional organisations at the local level and being open to the reality that many different and even contrasting institutional arrangements may be needed in order to achieve sustainable development across regions in Europe. This may also imply greater moves from government to governance for the implementation of development strategies and a much greater resort to genuinely bottom-up policies, empowering individuals, encouraging voice, and mobilizing all local institutional resources.

In sum, taking into account that a) economic activity is socially and institutionally embedded; that b) institutions adapt and mutate in time and are place- and context-specific; and that c) institutions are essential in determining economic activity in any given territory, there seems to be no “single emergent formula” (Storper, 1997: 131) for a more effective implementation of European regional development policies. Different institutional arrangements and different types of institutional intervention would be required in different regions of Europe, in order to be able to achieve the objective of greater social and economic cohesion. The best regional development policy for Europe will be one that acknowledges institutional factors, their variability and limitations and attempts to address the potential shortcomings of institutions in a place-specific manner.
References


