

Part I

**Region-centric concepts
of development**

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1 The regional question in economic development

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Introduction

The role of regions as engines of economic development and growth has been widely recognized in recent years, and abundant documentation now exists on many of the most successful examples of this phenomenon in different parts of North America and Western Europe. The present discussion is focused on the more problematic case of regional development in low- and middle-income countries. We aim to demonstrate the relevance of a region-based approach to practical policymaking in these countries and its potential for improving their developmental prospects. At the same time, the discussion provides an opportunity for pinpointing a number of areas where the theory of development in general might be extended and strengthened.

In order to initiate the argument, a series of simple remarks may be articulated about the logic of economic development in general, and especially about the critical stage characterized by Rostow (1960) as take-off, when a given social formation starts to emerge from stagnation into the early phases of economic growth. Thus, many less developed economies are caught in vicious circles as represented by chronic labor surplus situations (Lewis, 1954), low-level equilibrium traps (Leibenstein, 1954), critical shortages of entrepreneurial talent and skilled labor, overdependence on primary products, and so on. In such cases, take-off is unusually hard to achieve, though growth can sometimes be initiated by certain kinds of push effects that open up promising developmental pathways (Murphy *et al.*, 1989; Rosenstein-Rodan, 1943).

Whatever the initiating factors of take-off may be, processes of cumulative causation will often set in as industrialization advances. As this occurs, intensifying flows of externalities and associated increasing-returns effects help to propel development forward. The same types of flow are apt to result in the concentration of economic growth in just a few regions, especially in take-off situations. Geographic concentration is consolidated by the locational strategies of producers who cluster together in order to translate latent benefits of these sorts into the realizable form of agglomeration economies. Of course, market coordination is essential for efficient resource allocation in cases like these, though externalities and increasing-returns effects significantly limit the overall

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efficiency-seeking powers of simple atomized competition. For these reasons alone, joint or collective action is required in order for rapid growth to be achieved.

In a globalizing world, national economic autarchy becomes less significant than it once was, especially where vigorous export-orientation policies are in place, and in these circumstances, small or less developed countries can afford to pursue strategies of specialized national/regional development to a degree that greatly exceeds what was once thought possible or advisable.

These remarks can be summarized in the proposition that economic development is critically dependent on the formation of dense industrial regions and cities, and that appropriate policies can greatly enhance the beneficial outcomes of this relationship. Of late years, numerous econometric studies have been published providing confirmation that economic growth and industrial agglomeration are indeed persistently and positively intertwined with one another. Even in low- and middle-income countries much evidence of this type has been forthcoming of late, as exemplified by the work of Becker *et al.* (1992), Henderson (1988), Henderson and Juncoro (1996), Lee and Zang (1998), Mills and Becker (1986), Mitra (2000), and Shukla (1988), among many others.

A brief perspective of development theory

Regions are not just passive receptacles of industrialization. Any region where industrial investment is proceeding also has some chance of emerging as a dynamic nexus of positive externalities and agglomeration economies. In turn, these outcomes will greatly enhance overall productivity and growth (though disabling negative externalities may also come into being if policy-makers fail to act). In low-income countries, the regional expressions of this process are particularly insistent because the restricted availability of capital for large-scale infrastructural investments means that development is all the more likely to be confined to a limited number of locations.

The contemporary literature ascribes the positive externalities and increasing-returns effects typically found in regionalized industrial systems to three main sets of socioeconomic relations.

First, networks of specialized but complementary producers are commonly found at the core of any burgeoning economic complex. These networks abound with external economies of scale and scope. For example, the presence of many different providers of goods and services in the local area means that producers can rapidly satisfy many crucial but unpredictable input needs. Equally, a high level of proximity between producers and their suppliers and subcontractors makes it possible for the former to adjust their input schedules frequently in response to market vagaries. Second, dense local labor markets invariably come into being in the vicinity of employment centers, and they too generate multiple increasing-returns effects. Thus, the presence of many workers in a given place enhances job-matching activities, reduces search costs, and facilitates the emergence of joint training efforts. Third, processes of creativity, innovation, and

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1 learning are often quite intense in regions marked by production networks and
2 local labor markets of these sorts. These processes are most likely to occur in
3 transactions-intensive complexes, especially where interaction is based on fre-
4 quent face-to-face relationships combined with active exchange of information.
5 Above and beyond these external economies, the mutual proximity of many dif-
6 ferent interrelated firms and workers helps to reduce overall transport and com-
7 munications costs, and ensures the rapid flow of circulating capital.
8 Regionalized industrial systems, in other words, have a marked propensity to
9 function as fountainheads of dense multifaceted agglomeration economies and
10 efficiency effects.

11 The published research on how these main sources of agglomeration
12 economies operate in practice is immense. Detailed accounts can be found, for
13 example, in Cooke and Morgan (1998), Garofoli (1983, 1992), Porter (2001),
14 Scott (1988, 1998), and Storper (1997). Agglomeration economies become even
15 more potent when set in a dynamic framework where networks, local labor
16 market structures, and innovation processes evolve and interact with one another
17 in a logic of circular and cumulative causation. By the same token, agglomera-
18 tion economies are purely social creations. More to the point: development at
19 any given location is not always or necessarily contingent on the existence of
20 some prior, naturally given *comparative* advantage. On the contrary, develop-
21 ment can also occur – and increasingly does occur – on the basis of endoge-
22 nously built up *competitive* advantages in specific regional contexts.

23 In an older version of development theory and practice based on growth-pole
24 and growth-center analysis as laid out by Perroux (1961) and Boudeville (1966),
25 the more advanced regions in less developed countries were seen above all as
26 focal points for capital-intensive industrialization based on large lead plants. The
27 propulsive effects flowing from these plants, in combination with import substi-
28 tution policies in response to perceived unequal returns from trade between
29 North and South *à la* Prebisch (1959) and Singer (1950) were then expected to
30 be the vehicle for eventual national economic independence. In today's world,
31 where export orientation is generally taken to be a preferred pathway to eco-
32 nomic growth, developing regions sometimes advance even on the basis of
33 small-scale labor-intensive industries, of sorts that were previously thought to be
34 the very antithesis of modernization, like clothing, shoes, jewelry, or furniture
35 (cf. Cadène and Holmström, 1998; Cawthorne, 1995; Schmitz, 1995; Scott
36 1994). Development strategies today are less and less concerned with the estab-
37 lishment of an autarchic and balanced national economy, than they are with the
38 search for a niche within the global division of labor. By the same token, one of
39 the principal problems that developing areas face is to find and maintain market
40 outlets in the global economy that are not already dominated by producers with
41 early-mover advantages. A successful strategy of export orientation offers the
42 further advantage that by widening final markets it also brings in its train an
43 intensification of increasing-returns effects in producing regions.

44 Appropriate collective action can greatly magnify the agglomeration
45 economies of developing regions. One obvious opportunity for such action is

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presented by the many market failures to which all industrial clusters are subject, but that are especially severe in developing countries. Another is related to the dysfunctional effects of social breakdown in areas of dense polarized growth. Yet another – above all in take-off situations where markets are often weakly developed at best – is based on the need to ensure some degree of complementary investment in the regional economy in order to foster accelerated growth. Moreover, once any regional economy enters into a spiral of cumulative causation, further forward evolution occurs in a path-dependent process where all elements of the system become mutually constitutive of one another in round after round of growth and development.

For example, a supply of entrepreneurs is essential for economic advances to continue; invariably, individuals can be found in the local area with distinctive personal features that equip them at the outset for the task of entrepreneurship. Contrary to purely behaviorist theories, however, entrepreneurs are also in part *made* within the evolving economic system as fresh structural spaces open up and as advantageous new prospects appear on the horizon. Irrespective of their personal attributes, individuals who are already caught up in the regional economy are notably well positioned to perceive and to seize these opportunities. But path dependency means that lock-in of the regional economy to suboptimal outcomes is an open possibility, and that some sort of collective steering mechanism may also be required in order to avoid the worst pitfalls of this condition. An immediate corollary of the above remarks, as we argue more closely below, is that the pro-market, anti-interventionist stance of the Washington Consensus and its avatars offers a severely deficient view of all that is at stake in the quest for development (Stiglitz, 2002).

In the same way, region-based economic growth and development are deeply dependent on complex socio-cultural processes of human mobilization and transformation. Regional production systems and their associated communities of workers are the locus of idiosyncratic social routines and conventions, and these phenomena are vital to processes of acculturation and habituation. To be sure, they are also sometimes rife with dysfunctional features. In low- and middle-income countries, moreover, the coming together of many jobless and underemployed individuals in dense urban settlements often results in costly social pathologies, particularly where hyper-urbanization occurs (cf. Wheaton and Shishido, 1981). Yet once this point has been conceded, and in contrast to the anti-urbanist views of development theorists such as Lipton (1977), the arguments already laid out suggest that the high road to development and growth is still more likely to pass through the admittedly troublesome way station of large-scale urbanization than it is through a dynamic of spatially dispersed and decentralized investment.

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1 **Macroeconomic structure and regional development**

2 3 ***The national economy as a framework for regional stability and*** 4 ***growth***

5
6 Much of the time, we think of the economy of any country as a purely macro-
7 economic phenomenon (e.g. national GDP, unemployment, inflation, export
8 performance, and so on), but we often fail to grasp its full meaning because we
9 tend to abstract away from its underlying geography. While the macroeconomic
10 level is obviously of major importance in its own right, we should not overlook
11 the fact that it is also in part constituted as an association of individual regional
12 economies, each with its own system of synergies and collective order. This
13 remark underlines the increasingly urgent need to explore the relationship
14 between national economic development processes and the regional bases of
15 both growth and decline. The point is of major importance in any attempt to
16 understand the difficulties encountered in practical experiences of economic
17 development and in implementing more effective strategies of regional planning.

18 In macroeconomic approaches, two different kinds of development paths or
19 strategies can often be observed. The first involves an emphasis on accumulation
20 in the manner of Nurske (1958) and Destanne de Bernis (1966, 1967). Here, the
21 role of the economic surplus is paramount (and, indirectly, income distribution
22 as well) and the trade-off between consumption and investment becomes a
23 major object of policy concern. Empirically, developing countries with high
24 rates of GDP growth tend to be marked by high ratios of investment to income,
25 often exceeding the 20 percent mark. The second tends to be favored by adher-
26 ents of the Washington Consensus. It preaches a doctrine of economic austerity
27 and flexibility, i.e. the imperatives of low wages and competitive labor markets,
28 the removal of political barriers to profitability, the dismantling of social protec-
29 tion policies, market discipline, and so on. However, this second kind of model
30 has led to much social unrest, increasing inequalities, and economic instability
31 in many of the countries where it has been applied, and as we have seen, it erro-
32 neously dismisses *on principle* the usefulness of collective action as a condition
33 of development.

34 Nowadays, it seems increasingly clear that economic development cannot be
35 managed at the macroeconomic level alone. Whereas there is broad acceptance
36 that macroeconomic stability is a prerequisite for development to occur, there is
37 also widening agreement that the fundamentals of the macroeconomic order
38 (inflation, budget deficits, public debt, trade balances, and so on) are not in and
39 of themselves sufficient to fulfill the objectives of economic development. Crit-
40 ical elements of the development process such as learning, innovation, upgrad-
41 ing of productive structures, labor training, and so on, are significantly related to
42 the aptitudes of local and regional decision-making systems and to the behavior
43 of individual firms. These kinds of outcomes depend heavily on strategic capa-
44 bility implementation at the local level and not just on macroeconomic actions
45 like the devaluation of the national currency or the reduction of import tariffs.

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The structural adjustment programs proposed by international agencies like the World Bank and the International Monetary Fund in the 1980s typically overlooked or under-emphasized this important issue. Thus, macroeconomic stability and coherent macroeconomic fundamentals are necessary but not sufficient conditions of development, and even recent European experiences confirm the same point. In fact, an overly aggressive macroeconomic policy will often have deleterious effects on many regions, undermining the very search for growth and development. Premature or poorly executed market-opening measures are examples of this kind of failure. Centrally mandated development policies are, in any case, usually ill equipped to respond to the detailed idiosyncrasies of individual regions and industrial communities.

The mesolevel: resources and institutions

The economic health of regional economic systems depends, in particular, upon the progressive accumulation of knowledge and practical competencies. These phenomena emerge in significant degree out of creative interactions among local actors and the continuous production of external economies in the regional milieu. This process of accumulation, together with its encouragement of innovation and new entrepreneurship, is the consequence of a dynamic economic and social environment, itself dependent on the capability of finding new opportunities and of exploiting specific social and cultural assets. Any capability of this sort is typically a socially constructed territorial resource; it is the outcome of a regional development process forming a space of human interplay and learning. For these reasons, the density of social and economic relationships is of paramount importance, as is the complementary role of institutions fostering positive interactions between the different spheres of regional life (industry, research, education, and so on) and supporting transfers of knowledge and experiences, thereby helping to upgrade the productive capability of local firms.

In successful experiences of economic development, then, governments at every level have invariably been of crucial importance, not only as agencies of coordination, investment, and system steering, but also as guarantors of the legal and social infrastructure that provides the basis for effective operation of market exchange relationships. In fact, without a network of collective order – whether it is government agencies as such, or (as is increasingly the case in contemporary capitalism) diverse institutions and organizations of civil society – economic life of any degree of complexity must necessarily collapse. This proposition follows not only from the market failures that are endemic in contemporary society, but also and more importantly from the inability of the atomized system of social and property relations that characterizes civil society in capitalism to reproduce itself unproblematically through time. The conflicts, collisions, diverging interests, and general immobilization that would necessarily follow from any dissolution of institutional and political order would almost certainly result in rapid economic decay.

More specifically and concretely, governmental and nongovernmental agen-

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1 cies are needed at the local level to mobilize investment capabilities and human
2 competencies, and to provide various kinds of bottom-up support. They are
3 needed to facilitate information flows, to underpin learning processes, to encour-
4 age local entrepreneurial cultures and network interaction, and, in general, to
5 manage the complex systems of synergies and externalities (both positive and
6 negative) that typically emerge as regional economic systems start to develop
7 and grow.

8 The discussion above takes on added force in light of contemporary trends
9 toward globalization and international economic integration. These trends help
10 reinforce agglomeration in favored areas (by extending the market range of pro-
11 ducers) and they highlight the tendency of the national economy to assume the
12 form of a mosaic of regional structures of production and entrepreneurship. By
13 contrast, they also lead to an intensification of the developmental predicaments
14 faced by many less favored areas, as the latter struggle both to build their own
15 productive capacities, and to find appropriate niches in wider markets. In either
16 case, the relevance of the *mesoeconomic* level (i.e. the space of the local produc-
17 tive system, below the level of the national economy but above the level of the
18 individual firm) is critical to any concrete program of development. This meso-
19 economic level is a site of critical mass residing in the dense polarized systems
20 of firms and workers that represent the basic condition for the emergence of
21 multifaceted agglomeration economies (through the linkages between firms, the
22 structure of local labor markets, and the different organizations that hold strate-
23 gic knowledge).

24 The importance of critical mass for the achievement of economic develop-
25 ment was proposed more than a half-century ago in the “big push” approach of
26 Rosenstein-Rodan (1943). A geographical perspective on development leads to
27 the notion that “regional push” effects are also a significant issue (Scott, 2002).
28 The prime function of such effects is not so much to secure static efficiency
29 levels, but more importantly to set virtuous circles of cumulative causation in
30 motion. In some of its original formulations, the idea of critical mass (big push
31 theory, balanced growth, growth poles) was linked to capabilities for spending
32 and coordination on the part of central government, but gave little or no atten-
33 tion to participation on the part of small and medium enterprises. An extreme
34 case in this regard is represented by Algeria in the era of import substitution.

35 For a brief period in the 1970s, the notion of critical mass in development prac-
36 tice was downplayed by major international agencies in favor of so-called polar-
37 ization-reversal policies. However, these policies failed dramatically precisely
38 because networks of firms and their associated labor markets work most produc-
39 tively and innovatively where they achieve some minimal level of regional con-
40 centration. Thus, again, and in view of the successful experiences of bottom-up
41 development in many different parts of the world (both in more and less developed
42 countries), we must take into account the extraordinary opportunities for growth
43 offered by intervention in local economic systems with their distinctive endoge-
44 nous dynamics. Nevertheless, we must reaffirm the need for a coherent general
45 framework of national and regional economic policies, involving different levels

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of government. This remark points to the importance of capabilities linking macroeconomic objectives with mesoeconomic processes. Shortfalls of these capabilities account for many failures of development programs hitherto.

The region as a reservoir of competitive advantages

Economic development is always simultaneously a process of territorial adjustment, and it takes on geographic expression in many different shapes and forms. One of the most important expressions of this link between territory and development consists of dense regional agglomerations of capital and labor. Three major conditions help to reinforce this specific type of link, namely; (i) the existence of regional resources that cannot be easily transferred elsewhere (Colletis and Pecqueur, 1995); (ii) the emergence of a system logic binding firms and workers together into a functioning economic order; and (iii) the formation of project capacity, that is, an ability to deal with internal crises and to react to external challenges, which requires, in turn, the establishment of coherent mechanisms of local economic governance. We can describe this kind of territorial development in terms of the theory of local productive systems (Garofoli, 1983). The literature on local productive systems stems initially from the analysis of a small number of successful industrial districts in economically advanced countries in the 1970s and 1980s, but it has continued to evolve in various directions, including an important step forward into issues of endogenous development (Garofoli, 1991, 1992; Courlet, 2001; Vazquez Barquero, 2002).

By building on our arguments above, we can generalize the concept of local productive systems to any organizational model of economic activity rooted in geographic space and marked by the presence of specific resources, tacit knowledge (Becattini and Rullani, 1993), external economies, and mechanisms of social regulation. In this kind of system, the character of the local milieu depends crucially on a number of interrelated variables, namely:

- 1 *Production organization*, i.e. the operational structure of the local economic system, as reflected in rules and modes of management that allow for *divisions of labor* among firms. As we have already seen, this in turn fosters the formation of productive linkages, social relationships, and cooperation rules. Where trust and loyalty prevail, costs of inter-firm transacting are significantly reduced.
- 2 *Professional skills and competencies* are reproduced in the local area, both formally and informally. Social interaction and learning foster the acquisition of skills, and progressive learning stimulates new interests and abilities.
- 3 *Localized diffusion of knowledge and information* (about productive and managerial techniques, market outlets, local resources, competencies, and so on). Local modalities of competition and cooperation shape the diffusion of knowledge, on an involuntary basis in the first instance, on a voluntary basis in the second. Knowledge about local business conditions becomes a common heritage, a true public good.

- 1 4 *Structures of social regulation* help to solve common problems in the local
2 productive system and to negotiate points of political tension. These struc-
3 tures assume many different guises: governmental agencies, civil associ-
4 ations, private–public partnerships, and so on.
5

6 These points lead on to the related issue of endogenous development, i.e. the
7 notion that the local productive system possesses a degree of autonomy in regard
8 to its internal structure and evolutionary course. This degree of autonomy
9 derives from the decision-making capacities of individual and institutional
10 actors in the local area, and from their ability to control and internalize flows of
11 knowledge. Endogenous development is, in fact, based on the formation of
12 “social capability” at the level of the community of firms and institutions operat-
13 ing in the local sphere, through the progressive construction of critical regional
14 assets (Garofoli, 1991, 1992) of the sorts identified above. To be sure, endoge-
15 nous regional development does not imply regional closure or imperviousness to
16 external influences. On the contrary, it goes hand in hand with the insertion of
17 the local productive system in a wider economic environment with multiple
18 impacts via the emergence of new technologies, market shifts, national legisla-
19 tion, and so on. Endogenous development, in other words, refers simply to those
20 elements of the productive system that, by reason of their collective order and
21 mutual synergies, are imbued with certain powers of local social choice and self-
22 determination.

23 This argument becomes clearer when we turn our attention to the role of
24 innovation in local economic development. Innovation is – at least in part – ter-
25 ritorial in nature by reason of the interaction mechanisms and learning process
26 that drive it forward, and that they themselves have a distinctive spatial expres-
27 sion. This general point can be found in a variety of theoretical contributions
28 from the growth pole concept of Perroux (1955, 1961) (with its emphasis on
29 lead firms as sources of new product innovation) to more recent ideas about
30 regional innovation systems as proposed by analysts like Asheim (1999),
31 Bureth-Llerena (1993), or Gaffard (1992). In the latter perspective, techno-
32 logical innovation derives from territorially specific processes through the inter-
33 action of individuals and institutions in the course of everyday work and life.
34 Territorial economic innovation and development are also and of necessity path
35 dependent (cf. Freeman, 1982; Nelson and Winter, 1982).

36 Two further distinctive lines of analysis have developed around the issue of
37 the relations between innovation and territorial development. These can be iden-
38 tified in terms of (i) the technological district (Antonelli, 1986), and (ii) the
39 *milieu innovateur* as formulated by Aydalot (1986), Camagni (1991), and
40 Maillat and Perrin (1992). In the technological-district approach, the process of
41 technological change is driven primarily by the existence of dense interactions
42 between firms located in close proximity to one another. In the *milieu innova-
43 teur* approach, innovation is seen as resulting from an environment made up of
44 the local productive system together with its various social and political
45 appendages. The notions of technological district and *milieu innovateur* are, of

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course, very close to one another. They share in common an evolutionary and nonlinear conception of technology and development; and they explicitly recognize the effects of spatial proximity in processes of technological innovation, and the importance of externalities (Courlet and Soulage, 1995).

These remarks now bring us full circle back to the question of spatial clustering, bearing in mind the words of Lundvall and Johnson (1994) that “in a world of learning economies the specialization of firms and countries becomes increasingly important for economic performance.” In short, the clustering and specialization of firms are critical foundations of competitiveness and innovation, and the region is a true (but not the only) nexus of economic development. We must not forget, however, that local productive systems are also sites of widespread, sometimes massive, market failure, so that collective action is called for as a means of dealing with resulting problems of inefficiency and misallocation. Much market failure in these systems consists of suboptimal information flows, inadequate supplies of skills and competencies, and under-provision of certain critical services in circumstances where requisite scale thresholds are not satisfied by local conditions. Examples of this latter condition can be found in deficiencies regarding knowledge about distant or emerging markets, failures in the transfer of technological know-how, or low levels of access to financial resources for small and medium enterprises.

Problems like these call for different forms of governmental action and institution-building in civil society. These instances of collective action are in turn subject to processes of *institutional and regional* learning, much like the so-called experimental regionalism as set forth by Sabel (1995). In the latter case, regions function like laboratories in which social experiments based on *learning-by-doing* and *learning-by-monitoring* are carried forward to various stages of completion by different corporate bodies.

The global dimension

Geographic agglomeration may be an indispensable adjunct to competitiveness for many industries, but without complementary mechanisms for the distribution of final outputs on wider markets, its full powers must remain stillborn. In numerous instances, especially in less developed countries, final markets do not extend in spatial terms much beyond some provincial or national frame of reference. However, the most successful and innovative agglomerations in less developed countries today are increasingly caught up in export-orientation programs through which their products are projected onto the global stage. Globalization is both a promise and a threat. It opens up the prospect of lucrative export opportunities over a vast diversity of market niches; but it also brings producers in developing countries into head-to-head competition with one another, especially given that so much of their advantage on world markets resides in their employment of cheap labor. The great expansion of Chinese exports over the 1990s, and the deleterious impact of this expansion on the exports of many other developing countries, exemplifies this observation with

1 some force (cf. Scott, 2005). Agglomeration is thus all the more important to the
2 stragglers because it tends to offer at least some degree of competitive edge, in
3 terms of both productive efficiency and possibilities for product differentiation.

4 Global flows of products from industrial agglomerations in less developed
5 countries can be usefully categorized in terms of three broad types, i.e. direct
6 exports to final markets, intra-firm trade, and flows associated with outsourcing
7 activities. Direct exports of low- and medium-priced products from less to more
8 developed countries represent a small but growing share of world trade. Intra-
9 firm trade occurs between the different units of large corporate organizations. In
10 this case, products flow from dependent branch plants in low-wage countries to
11 facilities located for the most part in North America, Western Europe, and
12 Japan, where finishing, marketing, and distribution activities are carried out.
13 These plants have a great affinity for locations in special economic zones, export
14 processing zones, maquiladoras, and the like, as well as in specialized agglomer-
15 ations where they can tap into an assortment of local productive assets. Out-
16 sourcing or production sharing involves the putting out of work by firms (such
17 as branded manufacturers, wholesalers, retailers, and so on) in high-wage coun-
18 tries to independent contractors in low-wage countries. Outsourcing activities
19 are increasing at a rapid rate as the costs of international transacting continue to
20 decline, and as entrepreneurs in low-wage countries learn how to produce to
21 global standards. Bair and Gereffi (2003) argue that large multinational firms are
22 actually tending to relinquish branch plant operations in favor of outsourcing,
23 which generally entails much lower fixed costs.

24 As long ago as the late 1970s, intimations of widespread international sub-
25 contracting and production sharing were already apparent in the shift of low-
26 skill, low-wage work in industries like clothing and electronics assembly to the
27 so-called world periphery, and in the concomitant intensification of advanced
28 design and production activities in core countries. The seminal work on the issue
29 at the time was the book by Fröbel *et al.* (1980), in which the term the “new
30 international division of labor” was coined to designate the hypothesized chang-
31 ing production relations between rich and poor countries. As useful as this term
32 was, and is, it tends to impose an unduly schematic rigidity on thinking about
33 the economic geography of contemporary globalization. We prefer to invoke the
34 notion of a worldwide mosaic of regional economies at various levels of devel-
35 opment and economic dynamism and with various forms of economic inter-
36 action linking them together. This notion allows us to describe global
37 geographic space as something very much more than just a division between two
38 (or three) broad developmental zones, and to acknowledge the numerous coun-
39 terexamples to the predictions of the theory of the new international division of
40 labor that are to be found in the contemporary world. These include – among
41 others – the persistent growth and development of clusters of low-wage sweat-
42 shop industries in high-wage countries, and steadily increasing numbers of
43 dynamic technology-intensive poles in low-wage countries.

44 Lall (1991) has pointed out that the received theory of international trade
45 assumes *tout court* that if any firm can match world prices, then there is no

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reason why it cannot immediately sell its output on external markets. In practice, international trade is far from being generated by self-realizing supply–demand mechanisms like a simple textbook model, especially when the source areas lie in less developed countries. Even in the case of direct trade, the existence of some sort of intermediate marketing and distribution capacity is a prerequisite for supply and demand to interconnect with one another.

Where outsourcing is involved, the need for mediating arrangements is even more pressing given that firms at both ends of the trading relationship must constantly engage in extensive scanning, monitoring, and coordination of their interrelationships. For this reason, any analytics of trade in general, and international production sharing in particular, must take seriously not only the measurement of physical flow, but also the institutional frameworks that sustain this flow. In this regard, the notion of the *value chain* is of key importance, with its double resonance signifying both movements of product between an origin and a destination, and a set of social relationships by means of which these movements are managed in quantitative and qualitative terms through time (Gereffi, 1994). Moreover, just as increasing-returns effects can be detected within the institutional structures of agglomeration, so do they emerge in value chains as well, above all in regard to search and monitoring costs, and learning-by-exporting processes. Agglomeration and trade, in short, are mutually reinforcing phenomena, which may be why we find that for many products, only a few countries dominate world export patterns at any given moment in time Lall (1998).

Gereffi (1994, 1999) suggests that we need to distinguish between producer-driven and buyer-driven types of value chain. The former type is found in large-firm manufacturing sectors such as the automotive or aircraft industries, where suppliers generally have the resources to mount their own distribution and marketing networks. The latter is more commonly associated with small-firm sectors where manufacturers lack the resources to undertake distribution and marketing functions themselves. Buyer-driven trade is dominant wherever production-sharing arrangements prevail in the guise of putting out by big-brand manufacturers, wholesalers, and chain retailers to firms in low-wage countries. International putting out activities can range from simple assembly tasks to more complicated operations, all the way up to full-package subcontracting in which the buyer simply lays out the design specifications of the final output and the manufacturer then executes the entire physical process of production, including the acquisition of basic material inputs. The output is then marketed under the buyer's brand.

Gibbon (2001) and Sverrison (2004) argue that we also need to recognize a third type of chain involving trader-driven exchange. Case studies reveal that in both the more and less economically advanced countries of the world, brokers, export agents, and traders frequently play an important role in promoting links between producers and buyers. The “*impannatori*” in the industrial district of Prato, Italy, are a case in point (cf. Becattini, 1987), as are the celebrated traders of Hong Kong and Taiwan (Hsing, 1999). Intermediaries like these are all the more important because they provide a means whereby even small firms in the

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1 more advanced countries can work with offshore producers in the developing
2 world, whether by direct acquisition of final outputs or by putting out selected
3 work tasks.

4 These comments focus only on cost, and abstract away from other important
5 factors such as trustworthiness and product quality. However, value chains – or
6 rather, the governance dimensions of value chains – are precisely a means of
7 ensuring that these other factors remain within some sort of tolerance range.
8 This is especially important where production-sharing relationships are in play
9 (cf. Schmitz, 2004). In contrast to spot markets, production sharing almost
10 always entails heavy front-end search costs together with recurrent monitoring
11 costs to ensure smooth ongoing relations (Grossman and Helpman, 2005). The
12 literature reveals that many different types of value chains are underpinned by
13 long-term collaborative relations that help to compensate for market failure
14 problems. Rauch (2001, p. 1180) has written that “[social] networks facilitate
15 trade by building or substituting for trust when contract enforcement is weak or
16 nonexistent.” Network institutions, in other words, contribute to the suppression
17 of opportunistic behavior and ensure at least minimal standards of performance
18 by all parties concerned. For major buyers, these standards concern the critical
19 variables of product quality, price, and delivery time (Egan and Mody, 1992).

20 Collaborative interactions and long-term relationships have been shown, in
21 addition, to be important conduits through which many different forms of
22 process and product upgrading occur in industrial clusters in developing coun-
23 tries (cf. Bair and Gereffi, 2003; Bazan and Navas-Alemán, 2004; Gereffi, 1999;
24 Humphrey and Schmitz, 2002; Schmitz and Knorringa, 2000). Upgrading in
25 these cases occurs not only as a consequence of informal flows of information
26 from more to less experienced firms, but also as a result of deliberate interven-
27 tions on the part of the former as they seek – in their own interests – to induce
28 their partners to improve their manufacturing capabilities.

30 **Institutions and markets: regional development strategies**

32 Dense regional production systems are major elements of the development
33 process in general, and critical engines of productivity in particular. Markets are
34 essential moments in this dynamic, but so too is the joint extra-market genera-
35 tion of virtuous circles, positive externalities, and competitive advantages. This
36 extra-market dimension is of special significance in regions in low-wage coun-
37 tries where neither industrialization itself nor the social context of industrializa-
38 tion, has attained to any strong degree of self-reproduction. Because of these
39 features, there is always and necessarily a collective set of interests at stake (as
40 well as purely individual interests) in local economic development and growth.
41 This means, in turn, that a tissue of institutional arrangements and an apparatus
42 of policymaking are crucial for success. The urgency of effective collective
43 action in less developed countries is all the more intense because the emergence
44 of negative externalities is likely to be especially damaging to local economic
45 prospects.

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These remarks, obviously, represent a direct challenge to neoclassical development theorists like Krueger (2000) or Lal (1983) who see extra-market intervention in economic affairs as being doomed of necessity to irrationality; but our observations here need to be taken seriously insofar as pervasive externalities and other market failures can indeed be shown to prevail in regional economic systems. Included in these failures are deficits in the politico-institutional arrangements on which the existence of markets depends in the first place.

More specifically, coordinating and steering mechanisms need to be constructed in order to deal with such issues as the efficient provision of infrastructure, the enhancement of information flows (in both production networks and local labor markets), agglomeration-specific training and research programs, social welfare, and so on. There is also an important part to be played by local institutions in helping to instill interrelated firms with useful norms of trust and collaboration, and, in situations where firms are too small or too unqualified to take the initiative themselves, to provide what Brusco (1992) calls “real services,” including the gathering of data on export markets. Additionally, institutional guidance of the path-dependent process of cumulative causation can sometimes help to avert lock-in of the local economy to various kinds of low-level equilibrium traps. Market relations, capitalist forms of property, and macroeconomic stability provide a framework that potentiates success in take-off situations, though it bears repeating that these phenomena themselves are dependent variables within the overall developmental process.

In particular, at the regional level, a finely balanced and mutually sustaining mix of emerging market relations and institutional order is indispensable. And not just any institutional order will do, of course. Depending on their precise design, institutions can significantly promote or significantly hinder development, and hence issues of institutional quality (transparency, accountability, flexibility, competence, etc.) call for very careful attention above and beyond the particular strategic goals these institutions are meant to achieve (Rodrik, 1999). Among other things, institutions need to be sensitive to local social idiosyncrasies, and they need to be continually readjusted as the economic system (both local and national) evolves through time.

Actual development experiences provide a number of lessons about the general objectives that regional policymakers might usefully pursue in low-income countries. Above all, policymakers need to focus intently on ensuring that the following dimensions of a healthy regional economy are in place, and that forms of public support are geared to overall collective efficiency. The best general mode of approach, therefore, will usually be from the bottom up rather than from the top down.

- 1 The shoring up of critical localized masses or agglomerations of firms and workers is essential to the achievement of accelerated growth and development. Agglomeration encourages the division of labor and the formation of value-added networks. These processes also promote entrepreneurial spin-off and new firm startups.

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- 2 Concomitantly, the encouragement of intensified backward and forward inter-linkages is a major factor in development (Hirschman, 1958, 1977). In this way, dynamic specialization and complementarity effects are generated as well as extended channels of interaction through which information is transmitted between firms.
- 3 Labor training programs are of primary significance in any agglomeration, especially in view of the chronic market failures that characterize the supply of appropriate skills and sensitivities.
- 4 The production and internalization of knowledge externalities is crucial. This process can in significant ways be managed by local agencies via incentives to greater information exchange and adjunct network services. Industrial innovation and upgrading can be enhanced by regional institutions offering agglomeration-specific intelligence and advice
- 5 In developing countries, it is especially important to promote the access of industrial clusters to international markets. This proposition indicates that strategic goals need to be focused not only on individual agglomerations, but also on the value chains that enable individual producers to contest far-flung markets and to broaden their overall industrial and commercial experiences (Gereffi *et al.*, 2005).

The broad aim of these objectives is to allow selected regional production systems to achieve a high degree of endogenous development as identified at an earlier stage in this chapter. Endogenous development, in turn, implies the realization of a certain degree of autonomy of the regional growth process, as represented by a series of outcomes involving improvements in engineering and design, increased capacities for product differentiation, intensified marketing expertise, and so on. More generally, this process amounts to progressive improvements in the quality of human resources and management, and the creation of dynamic competitive assets through circular and cumulative causation. All of this re-emphasizes the central role played by dynamics of social transformation and, in particular, the critical function of intermediate institutions able to identify common needs and to organize collective action in the face of actual and latent crises.

We have argued that much important new light can be thrown on development theory and practice by taking the regional question seriously. This proposition holds for economies at every level of per capita income, but it is especially pertinent to the case of economies poised at the stage of take-off where resources are scarce and competitiveness is limited. We have also argued that a policy-friendly approach offers useful lines of attack on economic backwardness, though finding exactly the right mix of arrangements to fit any concrete situation obviously presents enormous challenges. All-purpose boilerplate approaches are certainly unlikely to be successful in any long-run perspective. By the same token, the approach to development broadly sketched out here calls for a process of creative self-discovery. In this manner, with the passage of time, hitherto unsuspected local talents and potentialities are apt to be discovered and

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mobilized, in line with the idea that economic development means “the utilization of unused, hidden resources” (Hirschman, 1958). Last, but not least, we must take into account the overarching need for coordination of the national and regional dimensions of development policy. One vital manifestation of this need can be found in the circumstance that the formation of dense industrial agglomerations in any country often brings in its train persistent interregional income inequalities, above all in countries at an intermediate stage of development (Williamson, 1965). Scott and Storper (2003) have argued that exacerbated regional inequalities may lead to political tensions that in turn can threaten further economic advances. In circumstances like these, both social justice and the ultimate workability of the region-centric development model make it imperative for compensating macroeconomic policies of redistribution to be put into place. Redistribution, however, is not simply a burden on the wealthier regions of the national space-economy, for it also helps broaden the overall extent of the market and, eventually, to encourage the formation of new proto-agglomerations.

A world of regions?

We have laid out two main propositions at some length. First, we have tried to demonstrate that the model of local productive systems as worked out for the more advanced economies of North America and Western Europe has – with suitable modifications – considerable relevance to the analysis of less advanced economies in Africa, Asia, and Latin America. Second, we have proposed that policymakers in low-income countries need urgently to take this circumstance into account, and that considerable enhancement of economic-development strategies can be expected by more vigorous pursuit of the region-centric approach. At the same time, we have insisted on the continuing need to pay attention to macroeconomic issues, and to ensure that appropriate coordination of the macroeconomic and mesoeconomic levels of policymaking is secured.

The overall discussion ultimately points in the direction of a global economy that is also in part an ensemble of local economies, or, in its most dramatic form, a worldwide network of city-regions (Scott *et al.*, 2001). The old postwar international order with its developmental geography rooted in a core-periphery system seems more and more to be giving way to a new geography in the shape of a global mosaic of regional economies. Likewise, the dynamics of economic take-off and development in many countries increasingly revolve around regional concentrations of production and work, and the orientation of markets to export opportunities. If this analysis is correct, it suggests that selected urban areas on the current margins of world capitalism are likely to eventually accede as vigorous nodes to the expanding worldwide network of city-regions. Places like Seoul, Taipei, Hong Kong, Singapore, Mexico City, São Paulo, and others have already moved far along this developmental pathway. Many others now appear to be in the early phases of their own assimilation into the global division of labor. These city-regions represent privileged growth places within individual

national territories, and they are the principal nodal points through which wider developmental impulses diffuse to less urbanized areas.

That said, not all parts of the less developed world are susceptible to this process of transformation; some seem to remain immune from any kind of meaningful economic take-off; others industrialize up to a certain point and then stagnate or reverse direction. Hence, interspersed through our hypothesized worldwide mosaic of regional productive systems, we are likely to continue to find stubborn pockets of resistance to development, the left-behinds of the global economy. Perhaps the most pressing development-policy problems of all are posed by this perplexing situation.

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