PACA

Participatory Appraisal of Competitive Advantage

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Why Participatory Appraisal of Competitive Advantage?

When local actors embark on a local economic development initiative, they want results, and they want them quick. Conventional approaches, however, often involve huge up-front investment in terms of time and money, it often takes long for proposals to come up, the proposals are not always practical and compatible with the local mindset. We have created PACA as an action- and results-oriented methodology which is based on principles of rapid and participatory appraisal. Its basic elements are the following:

– The initial diagnostic should take no more than one to two weeks, and the results are presented and discussed immediately after that.

– Local actors must be involved in the diagnostic – not just as participants in workshops and respondents in interviews, but also actively, as interviewers and part of the research team. Their active participation facilitates the transfer of methodological and conceptual know-how, and it motivates and empowers them to continue with the initiative once the external consultants have left.

– External consultants play an important role in the first diagnostic, and they must be prepared to back-up local actors later on, but the main work in implementing concrete activities has to be done by local actors and institutions.

Successful local economic development initiatives depend, first and foremost, on the motivation, dedicatedness, and insistence of local actors. Identifying their latitude and motivation for action is a crucial task of a PACA diagnostic, and any practical proposal must closely relate to the capabilities and the motivation of local actors.

How does PACA work in practice?

PACA is a set of tools to come up with a diagnostic of the competitive advantages and disadvantages of a locality, and with concrete, practical proposals to stimulate the local or regional economy.

PACA starts with a kick-off workshop with the local stakeholders, followed by a series of interviews with local players (firms, business associations, supporting institutions, local government, and others), and mini-workshops with groups of local actors. Depending on the size and diversity of the locality, this takes between one and two weeks.

The diagnostic and the proposals are elaborated and presented immediately afterwards. The presentation includes a moderated discussion with the local stakeholders. After the initial diagnostic, the external consultants are prepared to conduct a planning workshop with local actors. Local actors take responsibility for the implementation of agreed activities. The external consultants are prepared to offer, on a limited scale, subsequent support.

PACA is based on concepts such as

– systemic competitiveness,

– Michael Porter's competitive advantage concept,

– cluster development,

– various concepts of local economic development

– actor-oriented and policy network concepts which have emerged from recent research in political science.

PACA employs several tools which have been developed in the context of participatory learning and action. Workshops are normally conducted using the Metaplan visualization method. Tools such as mapping, life-line, and four-field matrixes are used to structure discussions.

Where and for what purpose can PACA be applied?

PACA has been applied in cities and regions where between 50,000 and 400,000 people live. This included rural places as well as regions which host world-class industrial firms. PACA is not suitable for application in cities or regions which are much larger; however, it is perfectly applicable, say, at the level of one part of a large city.

PACA has been applied in two types of settings:

– in places where local actors wanted to do something about local economic development but were not sure how and where to start,

– in places where local actors were already conducting specific activities targeted at local economic development, but where the activities were isolated and where the local stakeholders disagreed about the definition of the problems, and even more about the remedies.

PACA can be used to kick-off a local economic development initiative or to investigate why existing initiatives show little effect. It is less useful in places where various activities are underway which are based on a broad consensus, except if the local stakeholders feel that an external evaluation of their activities is desirable.

PACA

Participatory Appraisal of Competitive Advantage (Projeto Marketing Municipal)

A Methodology to Support Local and Regional Development Initiatives, based on the Systemic Competitiveness Concept

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This paper is work in progress. If you have downloaded this paper and try to use it in your work, I would very much appreciate any feedback: Did you find the manual useful? Is it sufficiently practical and application-oriented? Did it fit into your reality? How did you use it? Have you been conducting PACA diagnostics, and what was the outcome?

Version History

1	June 1999	Description of the sequence of a typical PACA diagnostic
2.0	November 1999	Mafra case study added
2.1	December 2000	More on concepts (obstacles to cluster analysis, LED) and tools (mapping techniques)
3.0	December 2001	More detailed description of sequence of diagnostic
		More on concepts: the Hexagon of LED
3.1	January 2002	More detailed introduction, more detailed description of the sequence of a PACA diagnostic

This paper is work in progress. It is based both on earlier conceptual and empirical work and on practical experimentation. The methodology described in this paper was first developed in September/October 1998, March and September/October 1999 in municipalities in the state of Santa Catarina in Southern Brazil, and it was tested in November 2000 in a region in South Africa. For highly stimulating discussions I am indebted to the colleagues who collaborated in these projects – Pedro Paulo Wilhelm, Sandro Wojcikiewicz, Maurício Lessa dos Reis and especially Jairo Aldo da Silva in Brazil, and Bernhard Adam and Henning Banthien in the case of South Africa. I prepared Version 3.1 after two training workshops in Thailand which were sponsored by GTZ's SSIPP Project and attended by about 30 development practitioners. I am indebted to Ricarda Meissner for inviting me to conduct these workshops, and to the participants for all their questions and the necessity for clarification and better explanation thus demonstrated.

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1 WHY "PARTICIPATORY APPRAISAL OF COMPETITIVE ADVANTAGE"?

Local economic development (LED) is at the same time a simple and a difficult task. It is simple because the necessary concepts and instruments are available and widely documented in the literature. There is nothing particularly magic or intrinsically complicated about it. It is difficult because its success is based on the active involvement of many actors, and the successful communication and coordination among them. Local economic development can only to a limited extent be delegated to salaried professionals. Therefore, motivation is a crucial issue. This is the first point of departure of PACA.

A successful local economic development initiative relies to a substantial extent on voluntary work – businesspeople, government executives, and representatives of civic associations and other organizations spending time in meetings and doing work which often is unpaid. Any LED initiative is therefore in need of visible, tangible results, and preferably quick results. Quick and tangible results motivate local actors to continue dedicating their time. Therefore, coming up with viable, practical, quickly implementable proposals is crucial. This is the second point of departure of PACA.

A successful local economic development initiative builds on the motivation of individuals to pursue some project as well as the willingness and ability of many individuals to formulate a shared vision which is guiding the projects. Also, many projects will only work if several individuals work together. It does not make sense to suggest projects which local actors do not find plausible, and it does not make sense to suggest projects which involve the collaboration of actors who cannot imagine to work with each other. Thus, the aim to come up with a diagnostic not only of economic potentials and challenges but also of a clear idea of the capacity, motivation, and cooperative spirit of key actors is the third point of departure of PACA.

1.1 Why did the concept come about?

The concept presented in this paper was formulated as a response to an articulated demand for support of local economic development efforts. The demand came from municipal-level Chambers of Industry and Commerce (Associações Comerciais e Industriais, ACIs) in the state of Santa Catarina in the South of Brazil. Around 1997/98, some ACI directors and executives perceived that it was necessary to promote economic development at the local level – unemployment and a sense of crisis were increasing, and federal and state governments which had traditionally played a leading role in stimulating economic development were less and less active in this field. However, it was not at all clear how to promote economic development at the local level. The prevailing idea was to attract external investors – from other parts of the country or from abroad. But is was an open question how to do this, and whether other activities might be possible as well.

This was where Fundação Empreender (FE) came in. FE is an organization maintained by several ACIs in the Northeastern part of Santa Catarina; it emerged from a technical cooperation project between ACIs and the Chamber of Arts and Crafts for Munich and Upper Bavaria in Germany. Its main tasks are training of ACI professionals, other kinds of support for ACIs (e.g. moderation of strategic planning exercises), and dissemination of methodologies to stimulate organization development in business associations in other regions of Santa Catarina and Brazil (see http://www.fe.org.br).

FE's brand label for PACA is "Projeto Marketing Municipal". This label reflects the paradigm which usually prevailed in the places where practical work was conducted – local economic development means projecting the place elsewhere to attract firms. The label facilitates an easy connotation for local actors, unlike other possible labels like "Promoting local economic development" or even PACA itself – the latter are not only somewhat clumsy but it is also unpredictable what local actors will connotate. It is an essential part of PACA to stimulate a learning process among local actors that economic promotion involves more than trying to attract firms, and maybe even that attracting external investors at the moment is a remote possibility.

1.2 Key ideas in PACA

PACA has two basic propositions:

– First, it is an effort to support local actors in formulating concrete activities to leverage the local potential to create growth and employment and to identify locational advantages which can be helpful in attracting external investors.

– Second, it is designed as an initial intervention – which may be followed by subsequent interventions – with a very limited amount of time and manpower.

Indeed, a critique against traditional methods of strategic planning at the local level is implicit in PACA. What sense does it make to gather an enormous amount of data, come up with an "objective" analysis of the local situation, and suggest a series of initiatives based on "international best practice" if local actors do not believe in the possibility of action, or if local organizations are weak, or if they are not connected? PACA tries not only to analyze the economic potential, but also the potential for collective action. It was developed in a setting where organizational weakness and lack of interaction between institutions are commonplace. The explicit aim of concrete applications of PACA was therefore to identify possible points of entry to collaboration and collective action in order to create positive, encouraging experiences and initiate a paradigm change among local actors. Thus the emphasis on short-term effects – this is, in our view, the most promising way to give credibility to such an effort among local actors, especially firms which often have a very short-term orientation (like, for instance, six months as the maximum period allowed as a payback-period in investments). As firms and their associations are key actors in this work, taking their usual time-frame into account is crucial. Another consideration has to do with the observation that it is experience-based learning which tends to render the most sustained effects – preaching the best practice of local economic promotion seems much less promising than promoting projects which initially may appear timid and unambitious but which initiate a learning process, and over time a change in paradigm.

So it is important to point out what PACA is not:

– It is not a methodology for a local strategic planning exercise.

– It is also not the magic potion for those places where all sorts of other approaches have failed. It is however possible that in such a place a PACA comes up with an unconventional explanation of why earlier promotion activities have failed.

The purpose of PACA is to come up with a diagnosis of competitive advantages and disadvantages of a given locality and proposals for practical activities within one to two weeks, based on the work of a team of two or three consultants who are supposed to be accompanied by local actors. This proposal is much less audacious than it may appear. Our experience so far has shown that it is perfectly possible to come up with a reasonably reliable analysis of local conditions in such a short time, provided that methodologies based on the participatory appraisal and the participatory planning schools of thought, combined with concepts to analyze determinants of competitiveness, are competently used.

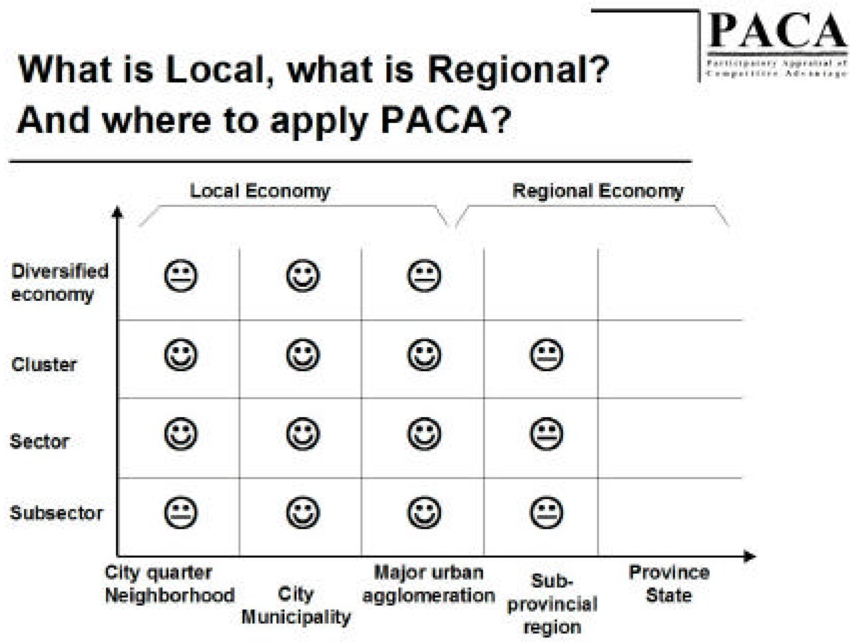
1.3 Where and who?

What do we mean by “local” and “regional” if we talk about Local/Regional Economic Development? Actually, it is hard to define these terms in a scientifically precise way. One would tend to identify local economic development with cities or municipalities, and regional economic development with aggregates of cities (usually up the level of provinces). But different countries define municipalities and provinces in different ways. Sometimes an urban agglomeration, which in economic terms is a functional entity, consists of several municipalities. In other cases, a municipality encompasses a set of cities without particularly strong economic interaction. In other words, the definition of local and regional very much depends on the case. The only certain thing is that "local" addresses a smaller geographic aggregate than "regional".

What is the kind of place where PACA can be applied? So far, we have been working in cities and regions between 50,000 and 400,000 inhabitants. Due to the characteristic features of the PACA methodology, it is unlikely that it can be applied in much larger locations. One of the places had agriculture as the predominant activity, others had a developed industrial base, and PACA worked well in both settings. An important feature of all places was a reasonably well-developed structure at the meso-level, albeit with the usual features of middle-income developing countries – a technical school, a SME support organization, sometimes a small local university with courses at graduate level, some other supporting institutions relevant for economic development, and some business associations. As one of the key issues in a PACA diagnostic is always to look for options of intensified networking and collaboration between organizations, PACA would not work very well in a place where such organizations are largely absent.

PACA is mostly an activity which targets local, not regional, economic development. However, it needs not necessarily address the entire local economy. For instance, it is perfectly viable to do a cluster diagnostic or a diagnostic of a sector (e.g. agriculture and its downstream activities in food processing and trade) using the PACA method. Figure 1 summarizes the kind of location and aggregate where PACA is very appropriate, denoted with a friendly smiley, or may be used though it is not a perfect setting, denoted with a neutral smiley.

Figure 1:



The main actors within a PACA project in Brazil have been local chambers of commerce and industry (ACIs) and local government. Two features must be pointed out in this respect.

– ACIs in some regions of Santa Catarina have achieved a level of competence that is clearly above the average of such institutions in Brazil. This includes, for instance, competence in applying participatory techniques like Metaplan in facilitating meetings. ACIs have taken the leading role in the initiation and implementation of PACA projects. We are very much in support of encouraging them to take a leading role – not the least because they are prepared to sustain a given initiative, even after changes in the presidency and the governing board. Alternatively, one may imagine that similarly competent and respected local non-governmental organizations can take a leading role.

– Local government is quite a different story. In Santa Catarina, it displays the same features that prevail in most places of Brazil – more or less permanently short on financial resources, personnel at the top levels staying in office only for short periods (it is quite common to have three to five different Municipal Secretaries for Economic Development within the election period of four years), a strong tendency to short-termism, opportunism, and clientelism, and a very limited technical competence. It is desirable to have local government involved in a PACA project even though it may have little to contribute. But as it is capable of creating all sorts of obstacles, not involving it may have a negative impact on the overall effort.

A further precondition for the successful conduction of a PACA exercise is a certain degree of problem pressure which generates among some key actors a determination to do something out of the usual to stimulate economic development. PACA may be useful in a setting where local economic development is already well under way, and local actors are looking for some additional ideas or need an external agent as a kind of arbiter. However, this is not the optimal kind of setting for PACA. On the other hand, PACA is quite useless in a setting where local actors are disarticulated and / or unwilling to question their prevailing mindset, or do not define economic development as a local task. PACA is most useful in a place where local actors want to start local economic promotion activities but do not exactly know where and how to start.

1.4 What is a local competitive advantage anyway?

PACA is specific in the way it operationalizes Michael Porter's work, differing for instance in the way this is done by Monitor Consulting which has conducted diamond-based diagnostics in many countries and regions. PACA is much more than just Porter. PACA puts more emphasis on the participation of local actors, and it also puts more emphasis on assessing the motivation, competence, and vision of local leaders. But it shares a crucial insight with Monitor's work, something Michael Porter is for good reason repeating over and again: competitive advantage is created, not inherited.

Why do we emphasize the issue of creating a localized competitive advantage? This is due to two reasons. First, it is important to realize that the competitive advantage of a company does not exclusively depend on its internal effort. There are places where it is much easier to create a competitive business than in other places. This does not only apply to countries; it needs no detailed explanation to understand why South Korea houses more world-class companies than North Korea. It also applies to locations within a given country. In our research in Brazil we found vast differences between neighboring cities in terms of business climate, the efficiency of specialized business support institutions, the responsiveness of business associations, etc. Some local communities are much more dedicated to creating a favorable environment for business than other ones. Therefore, it is not just bad luck or coincidence if one city has more unemployed and less income than its neighboring city. It is rather due to a deliberate effort. And there can be no doubt that cities do compete, not only when it comes to attracting investment but also to keep local firms within their municipality.

Second, there are two types of competitive advantages, namely static and dynamic competitive advantages. When we asked them about their locational advantage, local stakeholders in Brazilian cities often mentioned factors such as geographical location, industrial culture and a disciplined and industrious workforce. These are static competitive advantages. Geographical location (in this case "in the heart of Mercosur") is an important competitive factor, but it applies to many municipalities in that part of Brazil. A disciplined workforce was a relevant competitive advantage as long as the discipline of workers (e.g. consistently showing up for work, understanding the importance of consistent quality, being used to time-discipline) was a problem in other parts of the country. Today, however, this is no longer a differentiating factor.

In order to explain the difference between static and dynamic competitive advantage let us imagine a hotel which is built next to an exceptionally beautiful waterfall. As long as it is the only hotel in the place, the fact of being located next to the waterfall is a sufficient competitive advantage. In this sense, the waterfall is a literally a static competitive advantage – it cannot be moved, and its quality cannot be altered. The hotel does not need to bother about further effort to create a competitive advantage, as long as its provides a basic service and a minimum efficiency. However, things change radically as soon as a second hotel is set up in the same location. Now the existence of the waterfall does no longer establish a competitive advantage for the first hotel. It will rather have to come up with additional factors to differentiate itself from the new hotel, such as better rooms, better food, a better service, guided tours around the waterfall, canyoning, or something else. These additional factors then establish a dynamic competitive advantage.

1.5 PACA and development thinking

In the way it is presented in this document, PACA is more than just a recipe for how to have two exiting weeks. Underlying is a vision on how to do local economic development, including SME support and employment promotion. The key propositions of this vision are:

– Successful local economic development is based on collective action, and involves a partnership between the public sector, the private sector, and interested parts of civil society. It is not an activity to be pursued exclusively by the public sector.

– It is an approach which combines bottom-up and top-down approaches. It avoids focusing one of these approaches exclusively. But it has a clear bias. It is based on the conviction that bottom-up is extremely important, and will often have to be the prevalent pattern.

– It is an approach which combines supply- and demand-driven activities. The period when we developed PACA was also a period when the international donor committee formulated the Business Development Services (BDS) approach, which tends to be one-sidedly demand-driven. Like BDS, PACA puts a lot of emphasis on effectiveness, significance, and financial sustainability. But it acknowledges cost recovery as that what it is, namely a proxy for effectiveness, not a goal on its own.

Implicit in PACA is a distancing both from the traditional and the currently fashionable approach to development, in particular promotion of economic development. The traditional approach – not just in development cooperation, but also, interestingly, in fields such as corporate R&D – was supply driven. In R&D, the idea was that you needed brilliant science which would automatically spill-over into brilliant technology which would lay the grounds for hugely successful products. In development cooperation, the idea was that you had to build up the necessary structures and that development would start, hopefully, once the building blocks – human resources and institutions – were there. Today, the perspective tends to be the other way around: things have to be demand-driven.

PACA suggests that there may be a virtuous circle between demand and supply. With the completion of the first diagnostic, different local actors will start to implement, sometimes jointly, concrete activities. In doing so, they will probably notice missing elements – inadequate supply of training offers, or a mismatch between available financial resources and demand. They may decide to create those elements, and when they do so, it may appear pretty much like conventional capacity building activities, except that this time it is the outcome of the clearly defined demand, and those who conduct the activity know exactly what the purpose is. Supply-driven capacity building is a slow, cumbersome process – few people voluntarily do it if there is no clear goal except the abstract notion that this specific capacity may fit into something somewhere sometime and be crucial for development. Demand-driven capacity building can build on a strong motivation, since the capacity is necessary to solve a problem right here, right now.

PACA is also clearly distinct from other approaches to local development, such as strategic planning and the creation of Local Economic Development Agencies (LEDAs). If a local community starts to do something about economic development it is unwise to do strategic planning first. Strategic planning usually is conceived as a comprehensive effort which demands enormous resources and takes a lot of time. It also does not give much latitude for learning-by-doing in implementation. Strategic planning is a nice thing for government officials who dislike leaving their office, who like to subcontract work, and who are measured by input indicators and not by output. If a community is doing local economic development, it may after some time decide that it would be useful to think more strategically, and to have a strategic plan. But in this case, strategic planning is an outcome of a LED initiative, not the start.

Similarly, there is little use in proposing the creation of a LEDA as the main goal for LED. A LEDA is a means, not an end in itself. LEDAs exist in some places, but there they usually were the outcome of a long evolution of LED activities, and there are few cases where LEDAs are really the core actors in LEDA.

2 WHAT IS PARTICIPATORY APPRAISAL OF COMPETITIVE ADVANTAGE?

2.1 Background

Looking back at the evolution of thinking about economic development in the 1990s, one cannot fail to notice that there has been a major shift in paradigms. This shift can be described along three axes:

– Public – private: It was only in the 1980s that the assumption that government had to play an essential role in economic development was being questioned, and it was only in the 1990s that the skepticism regarding the role of government became relevant for policies, both in advanced industrialized countries, especially the EU, and developing countries. Traditional varieties of industrial policy and regional policy were increasingly criticized and often abandoned. Traditional industrial policy aimed at the creation of new industries, using instruments like subsidized credit, government subsidies, public ownership, and infant industry protection. In many cases it failed to deliver its promises, creating industries that were not internationally competitive (such as in most Latin American and many African countries, but also the European electronics industry) or trying to launch industries that were not viable (such as the European HDTV industry; Meyer-Stamer 1995). Traditional regional policy tried to lure firms into less advanced regions to promote local job creation. But it mostly failed in its attempt to create an endogenous dynamism, rather scattering industries all over the place instead of creating a critical mass anywhere. The main message of the "Washington Consensus" was that government should focus at creating favorable macroeconomic conditions and a business-friendly environment and leave industrial development to the private sector.

– Generic – specific: In terms of instruments, this did not mean that government was supposed to stick to interest and exchange rates. It was acceptable that government pursued measures to support private business in a more direct way. But these measures were supposed to be generic, open to all kinds of firms and sectors, rather than firm- or sector-specific. For instance, the World Bank (1993) in its both famous and infamous interpretation of the reasons for East Asia's industrial dynamism acknowledged that generic export promotion measures had played, and continued to play, an important role. Also other measures, such as incentives for R&D or training, were acceptable on the grounds that they helped diminish market failures without creating too many opportunities for government failure, high transaction costs and market distortions. But sectoral industrial policies and other specific instruments faced increasing criticism.

– National - local: The problem with the new orthodoxy was that it did not really work. Undoubtedly, it led to a redesign of macroeconomic policies which improved the conditions for private sector initiative and development in general, especially in those countries which had suffered from severe macroeconomic instability which, together with import-substitution strategies and overregulation, hampered private sector dynamism. But even though creating favorable conditions for private sector development is a necessary precondition for dynamism, it is not a sufficient one. For "systemic competitiveness" to emerge deliberate action of both public and private actors is essential (Esser et al 1995). This was especially clearly felt by actors at the local and regional level. At the national level, a high rate of unemployment (which was one typical outcome of structural adjustment) is a number. At the local level, it is personal tragedy, it is city quarters falling into decline, and quite often it is crime and violence. To alleviate such problems by stimulating economic dynamism, local level actors, such as city or provincial governments, started to fill the gap which was left by the central governments retreat from fields such as industrial and regional policy.

It is against this background that in many places, both in advanced industrial and in developing countries, local actors have decided to take their fate into their own hands, i.e. have embarked upon initiatives to stimulate economic development at the local level. When they do so, they can build on several useful concepts and tools and lots of experience from many places.

But it is more than just tools which local actors need when they start to run a local economic development initiative. In fact, they will go through three quite different types of learning:

– Learning on concepts and tools. This probably is the simplest part. Relevant concepts and experience are presented in subsequent sections.

– Learning what local economic development means in the first place. This is much more difficult. In locations where economic development used to be run by central government, most local actors initially have no clue what local economic development means. In fact, many of them find the idea that they should do it themselves, rather than waiting for central government to solve their problems, not plausible at all.

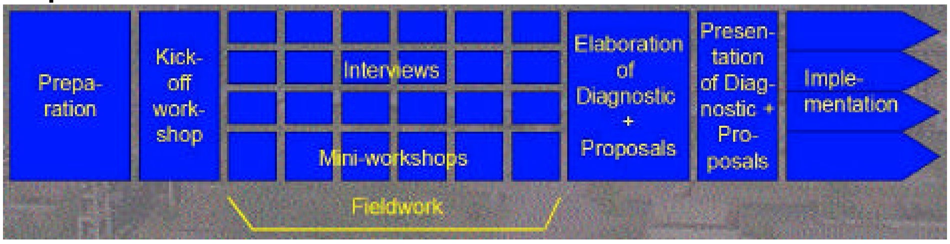
– Learning that local economic development means partnership, negotiation and joint action between various stakeholders. This is another challenging task, especially in places where the relationship between the public and the private sector is tense, for instance because public servants regard businesspeople with a certain sense of superiority (because the businesspeople may be less educated) or disgust (because they regard businesspeople as individuals exclusively interested in getting rich quick).

PACA is a method which takes these different types of learning into consideration. It is a method which is designed in a learning-oriented way. Any PACA is a constant learning process, not only for external consultants but also for local stakeholders.

2.2 Sequence of activities to start a local effort

In the following section I will outline a typical sequence of activities within a PACA project. Figure 2 summarizes the steps.

Figure 2: Sequence of a PACA



2.2.1 Preparatory activities

The first step in a PACA is that somebody has to decide to do it. If there is no champion for a PACA, it will not take place. The second step is that the champion has to convince other stakeholders to participate in the PACA exercise – not just to be interviewed, but to become actively involved, for instance by contributing one professional to the PACA team. If the champion does not convince other stakeholders, it should seriously consider not to conduct a PACA. It should only go ahead if there is good reason to expect that other stakeholders may get motivated in the course of the PACA diagnostic or as a result of the presentation of results and proposals.

The next step is to set up a PACA Team. The PACA Team should consist of one or two external consultants and three to five local persons.

– The external consultants should be experienced in the PACA methodology and knowledgeable in LED concepts and tools. The contribute their specific know-how, not only in terms of transferring it to local persons but also in terms of having a different bias. External consultants must question the views and convictions local persons are sharing, especially when it comes to defining the local reality and defining possible remedies. Local persons are often prisoners of a local discourse and cannot easily step out of their frame of mind.

– The local members of the PACA Team ought to meet two key criteria. First, they should not be too junior. They are not only participating in the diagnostic, but also have to play an important role in the implementation and accompanying of practical activities, and therefore they ought to be persons whose word carriers some weight. In particular, they ought not be junior university researchers with some theoretical knowledge but zero experience with real-life business and government institutions. Second, they should have different backgrounds. For instance, a good team might consist of one person from the local business promotion organization, the local Chamber of Industry and Commerce and the local university's community extension agency.

The next step is prepare the diagnostic in terms of content. Before starting the fieldwork, it is important to gather the available data. This is often quite complicated; in Brazil, we have found that systematic data on economic structures are often not available at the local level. Even leaving aside the problems of measuring the informal sector, it was often difficult to identify the sectoral composition and the internal structure of the sectors. However, with some knowledge of the country it was possible to get at least a rough idea. For instance, the Ministry of Labor maintains an excellent statistical database of formal employment by *município* and branch (which often is unknown at the local level). In larger towns, annual commercial publications with firm data (in Brazil: Gazeta Mercantil's *Balanço Anual*) are useful to get an idea of the performance of medium and large firms.

In analyzing these data, the PACA Team should try to answer two main questions. First, what is the economic structure of the locale? What are the main sources of employment and income? This kind of information is one of the inputs necessary to decide which kind of firms and branches to investigate in some detail. Second, what are the main tendencies? In which sectors employment is increasing or decreasing? How are important firms doing, and how is their financial viability? Based on this, the PACA Team should a first set of hypotheses which describe the reality and the possible strong and weak points of the locality, as well as consider possible proposals, based on available national and international experience. For instance, if one of the strong sectors in the local economy is a furniture cluster, it is useful to verify whether other furniture clusters elsewhere have tried to launch local economic development initiatives.

This leads us to another important question which should be pursued in advance: What the main tendencies of the main local sectors in a national and global perspective, the possible existence of a cluster, and the kind of involvement in international value chains. Regarding the first point, it is useful to have information about major trends available to be able to discuss competently with local businesspeople, and to compare their interpretation of the sector's reality with the prevailing view in other places. In terms of clustering, it is useful to identify in advance which clusters in the same sector exist elsewhere in the world, and what is going on there, in order to be able to do a rough benchmarking. Regarding international value chains, the opportunity may arise to talk to key actors in the chain (e.g. representatives of foreign buyers in the region) in advance and confront their perspective with that of local actors.

An essential part of the preparatory activities is to discuss concept, contents, and logistics of PACA with the local agent who organizes the work, preferably face-to-face. This includes discussing who should be invited to the initial workshop, and discussing which firms, organizations, and persons should be interviewed.

The following actors should be invited to the initial workshop:

– representatives of different sectors and groups within the chamber,

– representatives of local government,

– representatives of technical schools, university, R&D and MSTQ institutes, technology incubators, and other such institutions,

– representatives of SME and other business support organizations,

– representatives of business and important professional associations (e.g. associations of micro and small firms, association of retail firms, branch associations, engineers' association),

– representatives of trade unions, community organizations, and other non-governmental organizations which may have an interest in economic issues,

– representatives of local banks and important firms,

– representatives of the local and regional media. Information on the whole project should be disseminated among the media in advance.

When selecting firms, organizations, and persons to be interviewed, the following should be considered:

– Firms from the main local branches of agriculture, industry, and services. This should include both leading firms (in terms of size and competitiveness) and "typical" firms, especially SME.

– Firms which have a specific perception of the local business situation – banks, suppliers of key inputs, subcontractors, vendors and local manufacturers of capital goods, consultancy and software firms, transport firms, export agents, but also less obvious candidates like job placement firms, construction firms, insurance agents, or realtors.

– Supporting institutions, like the local chamber of commerce and industry, important business associations and trade unions, professional associations, SME support organizations, technical schools / polytechnics and the local university, business-related NGOs (including, for instance, agricultural-related NGOs and cooperatives), technology and testing institutes, and the like.

– Local government representatives, preferably the mayor, the secretary in charge of economic development, and representatives of other branches of local government which are relevant for firms, like for instance the local environmental agency.

– Key informants, for instance journalists or retired persons who were in important political, administrative, or private sector positions in the past.

Apart from face-to-face interviews, it is useful to organize mini-workshops with a group of about ten representatives of micro and small firms of the same sector. Since the available time is very limited and only few small firms can be visited, this has proved to be the most efficient way of getting insights into the tendencies, problems and potentials of this segment.

2.2.2 Kick-off workshop at the beginning of a PACA project

In order to start a PACA project, it has proved useful to organize a kick-off workshop with local actors. The workshop has two main aims:

– to spread the news about the project among local actors, and to motivate them to participate,

– to gather information from the participants – to complement the data gathered in advance, to get an idea how local actors perceive their economic situation, and to be able to design an adequate program of visits to firms and support institutions and of subsequent mini-workshops.

The workshop can be organized, for instance, by the local chamber of industry and commerce. We had a good outcome in those cases where the president of the chamber extended a personal invitation.

The structure of the workshop is as follows:

1. After a few introductory remarks, e.g. by the president of the chamber, the consultants explain what PACA is about – why an economic development effort at the local level makes sense, what are some key categories and main instruments of local economic development, and what kind of work will be done during the workshop and during the following days.

2. The consultants explain Michael Porter’s diamond. Among the concepts which aim at identifying key factors of successful development, this has the advantage that it can be explained rapidly (i.e. within 10 – 15 minutes) – its disadvantage, i.e. the neglect of several important factors, is ironically its advantage when it comes to do something quick. But it also has the advantage of introducing some crucial concepts which often have never been considered by local actors. In particular, this applies to the factor “sophisticated demand”.

3. The participants are asked to note strong points, weak points, and observations regarding each of the four factors of the diamond, i.e. first firms and business strategies, then suppliers, subcontractors, and service providers, then supporting institutions and other factor conditions, and finally sophisticated demand. This is done using the Metaplan method, i.e. writing with markers on cards sized 16 x 8 cm, with its three basic rules – one idea per card, up to three lines / seven words per card, and legibility of writing. Each participant will usually write between three to six cards for each of the four factors (though usually many participants find it difficult to come up with any cards when it comes to sophisticated demand). Each of the four angles of the diamond is introduced separately. The cards are attached to the wall and clustered according to strong points, weak points, and observations; in fact, it often happens that discussions erupt whether a given observation denotes a strong or a weak point. The result of this exercise will normally be a wall covered with a large number of cards (see Figure 3). This gives the consultants an important input in terms of both information about the local economic structure and impressions of the perceptions of local key actors. An important element of this exercise are diverging views and discussions which erupt between the participants.

Figure 3

Figure 4

4. Two complementary Metaplan exercises can be useful. The first question is "What is the competitive advantage of your city / region?", the second "What is going to be the backbone of the local economy in ten years' time?". Each participant is asked to prepare one card per question (see Figure 4). The first question often gives rise to the observation that there is actually no competitive advantage at all. In any case, it gives rise to interesting considerations because many participants have never asked themselves this question. It is crucial to have the participants consider the competitive advantage of their place in relation to comparable places in the region, not in relation to hypothetical places elsewhere (e.g. in less advanced regions of the country). The second question often gives an idea of what is the predominating local discourse regarding economic potentials.

5. Finally, it is explained to the participants that during the following days a series of individual interviews and mini-workshops will take place. Moreover, an appropriate time for the final presentation is defined.

What is Metaplan?

Metaplan is a method to communicate by writing cards and stick them to the wall instead of just talking. It is very useful to conduct brainstorming and planning processes in a group. The basic format consists in a card with a question being taped or pinned to a place which is visible to all participants, and all participants responding by writing the answer / comment / proposal onto cards, all of which are then read aloud and pinned or taped to the wall.

Advantages: Every member of the group can participate. More people can communicate at the same time. The communication is visible, it is traceable, and it is goal-oriented. The process is participatory. It also offers some degree of anonymity.

Disadvantages: Some people are not comfortable with the method, for instance because they are afraid that it might become embarrassing, or just because it is participatory. It is sometimes tricky to be applied in settings where the local culture gives a very strong emphasis on hierarchy, and where communication between persons from different hierarchical levels is not common.

Limitations: Metaplan is usually more efficient than oral communication. But it still needs some time, and there is a minimum time of usually one hour to run a useful Metaplan exercise.

Equipment: The basic equipment consists of cardboard cards, sized between 8 x 16 and 10 x 20 cm, markers, adhesive tape, and kraft paper sized about 90 x 120 cm. In the de luxe version, the cards are pinned to moveable panels rather than taped onto the kraft paper.

Rules: There are three basic rules: 1) write legibly, 2) aim at 7 - 10 words per card / 3 - 4 lines, 3) only 1 idea / observation / suggestion per card. More specific rules include the following: 1) read each card before putting it to the wall, and show the card to the participants when you read it, 2) clarify unclear cards and re-write unfocused / too general cards, BUT 3) always respect anonymity, i.e. never ask "Who wrote this?"; a way to enhance anonymity is to mix the cards before presenting them. If oral discussions come up, nobody should talk for more than 30 seconds at a time, and everybody should try to write her/his arguments on cards so that they are not forgotten. Cards which do not fit into the current question may be put, visibly, in a different section for possible later use. If observations are contested, the counter-argument should be written on a card, and argument and counter-argument should be marked with a flash.

2.2.3 Field research

Field research consists of interviews and mini-workshops. I have mentioned above a number of points regarding preparation, in particular selection of companies and institutions to be interviewed. In the Brazilian cases, the standard procedure was to discuss the selection criteria with the local chamber and to leave the final decision to the local chamber. The chamber would then contact companies and institutions and make appointments. If would leave some slots open for the last two days so that it was possible to fit in interviews with firms and organizations which were suggested in the kick-off workshop or came up during fieldwork.

Usually, the chamber would call the firms and institutions to make an appointment, would then send a fax describing the purpose of PACA and the interview and confirming the appointment, and would call again on the day before the interview to re-confirm the appointment. Preparation of mini-workshops proceeded in the same way.

Interview

Interviews are conducted with several firms and organizations as outlined above. Preferably, you would try to interview the owner, president, or chief executive in a company and the director or executive secretary in a supporting institution. Before you go out to conduct the interview, make sure that you know exactly whom you want to talk to, and where to find him or her. In particular in large organizations, it might otherwise be difficult and time-consuming to get past security and to locate the interviewee. Also make sure that you have your notebook and a spare pencil with you.

The interview is not based on a closed questionnaire, and it usually does not even involve the use of techniques like scoring and ranking or other quantitative methods. Rather, the idea is to stimulate the interviewee to outline the structure, activities, and performance of his firm or organization, including its relationship with other organizations, and to give his view of the local political and economic situation. Instead of a questionnaire, the interview is based on a guideline to make sure that all important issues are touched upon (see Annex for a rough outline of the guideline).

What is the sequence or the dramaturgy of the interview? First, you explain why you asked for the interview and what the purpose of the interview is, namely to gather information which will feed into a diagnostic of the local economy and, based on that, into real activities to enhance the competitiveness of the location. Second, there will be a warm-up phase. The purpose is to create an atmosphere which makes the interviewee feel comfortable to share information with the interviewers. One way of doing this is to have just a bit of chit-chat, of small talk. Another way is to mention some positive information about the company or institution and provoke the interviewee to comment about it. Yet another way is to enter into the interview straight on, but to start with a question that is entirely uncontroversial, such as “Could you tell us a bit about the history of your company / institution?”.

It is preferable not to stick rigidly to the sequence but rather to stimulate the interviewee to unfold his particular argument, in the sequence s/he prefers, and then to ask specific questions in order to touch upon issues s/he has not mentioned before. A typical observation is that in the first part of the interview, the interviewee will elaborate quite extensively on the issues which s/he finds most important. It is then the task of the interviewers to check which points in the guideline have already been addressed by the interviewee. Based on that, in the second part of the interview the interviewers will ask specifically about those points not mentioned spontaneously by the interviewee. Overall, it is a good estimate that the interviewer will talk no more than one third of the total time of the interview, and probably much less.

It is useful to keep some points in mind with respect to interviews / conversations:

– It may be that the interviewee has never been in this situation before, and therefore feels profoundly insecure as to how to behave and what to say. It depends largely on the sensitiveness of the interviewers to deal adequately with such a situation.

– Do not interrupt the interviewee too often. In fact, try not to interrupt at all, except if the he repeats himself or if he talks at length about issues which are irrelevant for your diagnostic.

– Do not ask suggestive questions, such as "How are your relationships with customers – highly conflictive?". If you ask like this the interviewee may answer affirmatively, but out of politeness, not because s/he thinks that this is the correct response. Rather ask questions such as "How are your relationships with customers – do you have a trust-based relationship, or is it a conflictive relationship?", i.e. questions where you give several options, so that you explain what the question is about without prejudicating the response.

– It is useful for the interviewers to combine signals to be able to communicate non-verbally during the interview, for instance in a situation where one of the interviewers starts to dominate the discussion, e.g. unfolds his arguments rather than listening to the interviewee.

– It is crucial to take notes during the interviews, and it is preferable that at least two interviewers take notes to be able to verify disputes on factual issues which occasionally emerge afterwards.

The typical duration of an interview is between one and two hours. When conducting it, it is important to remember one of the principles of PRA: direct contact to the field (Figure 5), even if this implies getting wet feet (Figure 6). In particular, this means that the interviewer should not just talk to a director or executive secretary but also ask to have a look at the factory or the facilities. This is important to check some of the information obtained in the conversation. For instance, it a company claims to have sophisticated quality management systems in place but the factory is a total mess, the interviewer knows that there is some inconsistency in the information s/he got. Similarly, if a supporting institution claims to have intense interaction with customer but there is no customer on the premises, it may be interesting to ask the interviewee about that.

Figure 5

Figure 6

In our experience, there are three idealtypes of interviews (or rather conversations, since this is the kind of atmosphere we try to create at the interview – rather than a quick succession of questions and answers).

– Interviews with persons who grasp quickly what the interviewers want, and who try to give their view of the situation of their firm / organization and of the overall scenario. It is useful to let the interviewee unfold his argument and only interrupt him when s/he starts to wander astray. The interviewers should write down questions which spontaneously come to their mind and ask them at a later point in time.

– Interviews with persons who do not quite know what the whole exercise is about, or who feel that they have little to tell, or who are suspicious that the researchers might be spies, and in any case are not very responsive. In such an interview, it is even more important than normally to create an atmosphere of trust. The main challenge is to encourage more that just brief responses to questions, i.e. to stimulate the interviewee to unfold his view, experiences, and arguments. Interruptions and an inquisitive style of interviewing are inadequate.

– Interviews with people who mistake the situation and start a kind of Sunday speech involving lots of rhetoric and little facts. This happens sometimes with political representatives and representatives of associations. In such a situation it is perfectly sensible to interrupt the interviewee, and to try to guide him to more specific and concrete issues. If he is unwilling to get away from rhetoric, it may be necessary to be moderately impolite or to try to provoke him to move to more specific issues.

It is important for the interviewers to realize that a series of interviews involves a rapid learning process on their side. This gives rise to both opportunities and risks. For instance, one of the opportunities is the possibility to form hypotheses in the course of the interviews, and to discuss them with interviewees in subsequent interviews. Probably the most important risk is to confuse facts and perceptions. Interviewees usually report both facts and perceptions, mental models, constructed reality, and the like. It is essential for the interviewer to figure out what information is based on personal experience, and what information is based on hearsay, common wisdom, and the like. It is disastrous if the interviewer assumes uncritically the mental models of the interviewees. In this respect, it is important to note that there is no reason for not contradicting interviewees, even though this may appear impolite in the view of the local culture. In fact, questioning views, perceptions, and mental models of interviewees can lead to important insights – actually on both sides. Interviews are also a learning opportunity for the interviewee, and may even occasionally lead the interviewee to question his mental models. In this respect, it is often useful to confront an interviewee with (non-confidential) information gathered in earlier interviews, and with other information gathered elsewhere (for instance, the consultants may have information on business support programs which are locally unknown).

One of the aspects mentioned in the paragraph before merits more consideration. In a given locale, there are usually two realities: the "objective" reality and the socially constructed reality. It is not rare that there is a wide gap between the two (Box 1). This gap may exist in different respects:

– perception of the business climate: it is rational for firms not to report good business, for instance to deter new entrants),

– economic structure: data on the current sectoral composition are often unknown, especially if the last industrial census was conducted a long time ago,

– business opportunities: as the media report selectively, and often focus on disasters and crises while neglecting positive news, some dynamic branches may be largely unknown.

It is essential for the consultant to unveil both realities, and the relationship between them, and to confront the local actors with the gap between the two.

Taking these considerations into account, it becomes obvious why it is essential that local actors are not only involved as interviewees but also as interviewers. We have had different experiences in this respect. In the city which subsequently unfolded the most effective marketing municipal activity, the executive secretary of the ACI took part in all the interviews. In another city, a professor of the local university took part in most of the field research. In other cities, ACI executives and consultants, and sometimes even directors, participated in the field research (and, of course, the elaboration of results). Their active participation involves a particularly rapid learning experience, creates the conditions for them to present the main findings later on, and motivates them to take an active role in the implementation.

Box 1: A socially constructed reality contradicted by the real reality

Blumenau is a city in Southern Brazil with a tradition in the textiles and garments industry which goes back to the late 19th century. After 1994, several of the six large firms which dominated the sector locally went into crisis, cutting down the number of employees dramatically. Two firms came close to bankruptcy. This experience created in the city a sense of crisis, which was formulated explicitly when we did a PACA there in early 1999.

In our field research, however, we came across a lot of evidence which clearly was not compatible with the sense of crisis. Labor brokers reported that it was extremely difficult to find skilled textile workers, even though thousands of them had been laid off. Subcontractors, for instance in embroidery, reported that they were expanding their production all the time.

What came out as an explanation was that in the shadow of the crisis of the traditional firms a booming sector of SMEs had begun to emerge. Most of these firms, however, were subcontractors or producing private brands for large chains, so that they were hardly visible. So one of the main points of our presentation was that in reality there were two Blumenaus – the old one, with big firms, in crisis, and the new one, booming, with a little known set of new firms.

Mini-workshop

The purpose of a mini-workshop is to gather information about specific segments of the local economy. It is more efficient that conducting interviews. At the same time, we must acknowledge that with this format we will miss some information which we would gather in an interview. This is why we conduct both interviews and mini-workshops. Mini-workshops are particularly useful in cases where you have sectors of the local economy with a large number of participants. For instance, if there are 200 local micro and small garment producers, it is unlikely that you have the time to visit, say, 20 of them. Also, after the first few interviews the additional information you get out of each further interview would most likely be very limited. In this case, it is useful to have one or two interviews, to see what such an operation looks like and to get information which people would not mention in a mini-workshop, and then to organize a mini-workshop with perhaps 12 to 15 businesspeople from this sector.

The basic structure of the mini-workshops is similar to the kick-off workshop. The first main difference is that participants of a mini-workshop should come from a more homogeneous group, e.g.

- one branch of industry or services,
- a group of businesspeople who are homogeneous for some other reason, e.g. a group of CEFE or EMPRETEC entrepreneurs, or a group of businesswomen, or a group of highly innovative businesses,
- a group of representatives from a given type of supporting institutions, such as training institutions.

The second difference is a slightly different topical focus. During the kick-off workshop, the first box of the diamond is introduced as “Leading sectors and firms in the local economy”.

– If the participants of the mini-workshop come from a sector which produces final products, the first box is usually introduced as “Competitive advantages and disadvantages of your firms/organizations”. The other boxes are introduced in the same way as in the kick-off workshop.

– If the mini-workshop involves a group of suppliers or service providers, the participants will address the box “Supporting industries” based on the question “What are the competitive advantages and disadvantages of your firms?”.

– If the mini-workshop involves a group of representatives of supporting institutions, the participants will address the box “Supporting institutions” based on the question “What are the competitive advantages and disadvantages of your firms?”.

In any case, the diamond is presented to the participants as shown in Figure 7.

Figure 7: Presentation of Porter’s Diamond in a mini-workshop

	Competitive advantages and disadvantages of lead firms in the given sector	
Supporting institutions (factor conditions): – training, technology, finance, infrastructure, public utilities, etc. – location, land what are the strong and the weak points?		Demand conditions: – sophisticated demand – unusual demand – pioneering / innovative demand What are the strong and the weak points?
	Supporting industries: suppliers, subcontractors, service providers (transport, real estate, IT, insurance, etc.) what are the strong and the weak points?	

The sequence of a mini-workshop is as shown in Table 1.

Table 1: Sequence of a mini-workshop

<table>
<tr><td colspan="2">1. Welcome, presentation of participants, explanation of the purpose of the mini-workshop: What is the background and the purpose of the PACA, and how does the workshop fit into the PACA? (5 minutes)</td></tr>
<tr><td colspan="2">2. Introduction of the Diamond concept (10 – 15 minutes)</td></tr>
<tr><td colspan="2">3. Participants are asked to write Metaplan cards with observations on strong points and weak points on leading firms in the given sector</td></tr>
<tr><td colspan="2">4. Participants are asked to write Metaplan cards with observations on strong points and weak points on supporting industries for the given sector</td></tr>
<tr><td colspan="2">5. Participants are asked to write Metaplan cards with observations on strong points and weak points on supporting institutions, particularly with respect to the given sector</td></tr>
<tr><td colspan="2">6. Participants are asked to write Metaplan cards with observations on strong points and weak points on demand conditions</td></tr>
<tr><td rowspan="4">7. Option 1:
End of the mini-workshop. Thank the participants and invite them to the presentation of the PACA diagnostic</td><td>7. Option 2:
If the participants insist on asking “What can we do to enhance the competitiveness of our sector?”, run a further Metaplan with this question</td></tr>
<tr><td>8. Ask the participants to rate their proposals
– either using the Pareto method
– or applying three criteria: Is this a realistic and viable proposal? Can it be quickly implemented? Can it render a quick and visible result?</td></tr>
<tr><td>9. Optional: Go into planning. Take the priority proposals and ask: How exactly to do it? Who is responsible? Who has to collaborate? What resources do you need? When will you start implementing?</td></tr>
<tr><td>10. Thank the participants and invite them to the presentation of the PACA diagnostic</td></tr>
</table>

Other tools

Some other techniques offer themselves for application in the field research. Most notably there are some techniques from the PRA/PLA toolbox, like mapping, lifeline, and walkover. We introduce some of these tools in a subsequent section.

The duration of field-research depends on the size and complexity of the locale. In smaller places (under 100,000 citizens) it took us a week, in larger places two weeks. Table 2 presents an idealtypical schedule.

This schedule is very dense, and it involves a very intense and also exhausting experience for the PACA Team. A schedule like this is appropriate if two criteria apply: first, the external consultant(s) are remunerated according to the number of days they spend in the locality, and the available funds are limited; second, the local members of the PACA Team are available most of the time. In case these criteria do not apply, a schedule may also look as shown in Table 3. Note that the sequence of activities on each given day is supposed to be the same as in; it is therefore not mentioned again. The difference regards the fact that there are PACA-free days in between, and that there is a kind of rotating scheme with respect to the local members of the PACA Team.

Table 2: Idealtypical schedule of a PACA diagnostic

	Monday	*Tuesday*	*Wednesday*	*Thursday*	*Friday*	*Monday*	*Tuesday*
Morning 1	Opening workshop	Large industrial firm	Bank	Large industrial firm	Large industrial firm	Elaboration of diagnostic	Elaboration of presentation
Morning 2	ACI professionals	Local government	Large industrial firm	Large industrial firm	Medium-sized industrial firm		
Lunch	ACI professionals	President of assn. of micro and small bus.	City council members	NGO activists	Journalists		
Afternoon 1	Small industrial firm	Export agent	Small service firm	Small software firm	Small industrial firm		
Afternoon 2	Technical school	President of retail association	Transport firm	Small subcontractor	Medium-sized industrial firm		
Afternoon 3	SME support organization	University	Human resources firm	Trade union representatives	Small service firm		
Evening	ACI directors	Mini-workshop with small businesses from branch A	Mini-workshop with small businesses from branch B	Mini-workshop with small businesses from branch C			Presentation and discussion of results

Table 3: Alternative schedule for a PACA diagnostic

	Week 1			Week 2			Week 3				Week 4
	Tuesday	Thursday	Friday	Tuesday	Wednesday	Thursday	Monday	Tuesday	Friday	Saturday	Monday
Morning	Kick-off workshop Entire PA-CA Team	EPC LPTM 2 LPTM 3	EPC LPTM 3 LPTM 4	EPC LPTM 1 LPTM 4	LPTM 1 LPTM 2 LPTM 3	LPTM 2 LPTM 3 LPTM 4	LPTM 1 LPTM 3 LPTM 4	EPC LPTM 2 LPTM 3	EPC LPTM 3 LPTM 4	Entire PA-CA Team: Elaboration of findings and proposals	
Afternoon	EPC LPTM 1 LPTM 2	EPC LPTM 2 LPTM 4	Entire PA-CA Team: Progress review	EPC LPTM 1 LPTM 3	LPTM 1 LPTM 2 LPTM 4	Entire PA-CA Team: Progress review	LPTM 1 LPTM 3 LPTM 4	EPC LPTM 1 LPTM 3	Entire PA-CA Team: Elaboration of findings and proposals		Presentation of PACA diagnostic

EPC = external PACA Consultant, LPTM = Local PACA Team Member

2.2.4 Preparation of findings

The preparation of the findings starts long before the end of the field research. In fact, it is useful to conceptualize the field research as an iterative process of formulating and falsifying or verifying hypotheses. (In our work, this often took place inside the car between interviews, with the obvious disadvantage being that it is complicated to document discussion processes under such a condition.) In other words, the preparation of findings does not start from scratch after the end of the field research but rather is based on extended hypothesizing during field research.

We found it useful to start the preparation of findings using the Metaplan technique, asking ourselves for observations regarding each of the important local branches. The result is a collection of cards with observations regarding the strengths and weaknesses of each sector (Figure 8). It is also useful to raise some cross-cutting issues, like entrepreneurial spirit, the quality and responsiveness of supporting institutions, or the behavior of local government. The next step is to discuss these cards; part of this exercise is to go back to the notes taken in the interviews to verify or falsify certain observations. Moreover, if there are four or more persons involved, it is useful to employ the Pareto method (putting points onto cards, with each participant having a number of points equivalent to 20 % of the total number of cards) to define priorities. The result of this is then transformed into a Powerpoint presentation.

Table 4: Sequence of steps to prepare the diagnostic

Step 1	Discuss and decide: What are the main sectors we should mention in our diagnostic? Specifically: - Which business sectors? - Can me make general observations for each business sector, or do we have to distinguish, for instance between micro/small and medium/large companies? - Should we address the supporting institutions at large, or should we distinguish, for instance between training institutions, finance institutions, business associations, and other supporting institutions? Should we name some institutions specifically, or should we keep our observations anonymous? - Should we address local government?
Step 2	Which hypotheses did we formulate on sector A - in the preparatory phase? - during the fieldwork? - Which hypotheses were formulated in the kick-off workshop?
Step 3	Metaplan: Based on our fieldwork, i.e. the interviews and the mini-workshops, what are the strong points and the weak points we observed regarding sector A?
Step 4	Pareto on the strong points of sector A Verify: Do you cover all four levels of systemic competitiveness? If not: Are there strong points on the level you missed so far?
Step 5	Pareto on the weak points of sector A Verify: Do you cover all four levels of systemic competitiveness? If not: Are there weak points on the level you missed so far?
Step 6	Which hypotheses did we formulate on sector B - in the preparatory phase? - during the fieldwork? Which hypotheses were formulated in the kick-off workshop?
Step 7	Metaplan: Based on our fieldwork, i.e. the interviews and the mini-workshops, what are the strong points and the weak points we observed regarding sector B?
Step 8	Pareto on the strong points of sector B
Step 9	Pareto on the weak points of sector B
etc.	etc., same sequence for each sector decided in step 1
Final Step	Overall picture: What are the strong and the weak points of the place in the perspective of the systemic competitiveness framework?

Figure 8

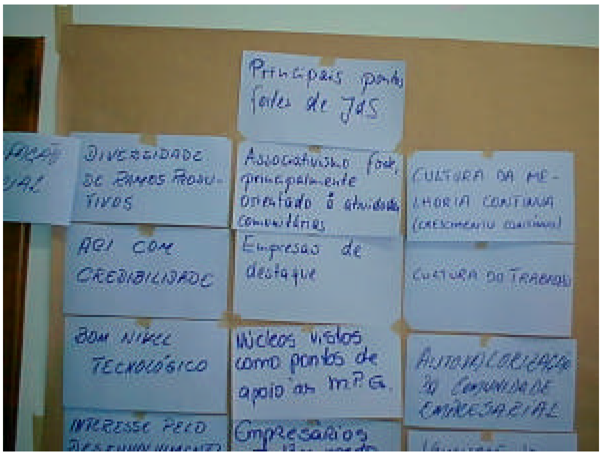


Figure 9

The preparation of proposals follows the same sequence: Preparing a Metaplan with proposals, discussing the proposals, defining priorities, and putting them into the same Powerpoint presentation (Figure 9). The first criterion for proposals, quite obviously, is that they make sense, i.e. that their implementation can improve the local competitive advantage. There are, however, further important criteria. The majority of proposals should be implementable within a short period of time. The basic idea of the whole project is to create a virtuous circle: Implement certain proposals, have a positive impact / payback with a short period of time (one to three months), thus reinforce the credibility of the whole venture and the motivation of key actors to define further, more ambitious activities. Therefore the main task is not to formulate as many proposals as possible, and also not to formulate proposals which are as fancy and state-of-the-art as possible, but to elaborate a list of not-too-ambitious proposals which is compatible with the number, capacity, and motivation of key actors. Furthermore, it is important to consider how proposals fit into the mindset of local actors. This is not to say that one should avoid proposals which break with established orientations and behavioral patterns. Rather, the point is to take the mindset of actors into account, and to present proposals in such a way that the actors do not feel criticized or alienated.

An important issue to be addressed in the elaboration of the diagnostic

Everybody's favorite prejudices: How do the local stakeholders describe the structure and evolution of the local economy, and does this match with our observations from the fieldwork?

It is not rare to find that opinions and viewpoints which are often heard in a local economy actually do not quite meet with the observations the PACA team made. If that is the case, it is crucial to mention this in the presentation.

An important issue to be addressed in the elaboration of proposals *Pet proposals: Are there proposals some stakeholder, or everybody, is making all the time, even though they are not really realistic and viable?* If sometimes happens that some key stakeholders have a favorite proposals, and they often suggest that realizing it would solve most problems with one strike. For instance, in regions with some tourism potential there are usually stakeholders who are convinced that having an international airport would have an enormous push effect. In fact, this is not quite true (as tourists do not come to visit an international airport but rather to spend the most important two weeks of the year in a nice place, so if your location is offering little attraction to spend two weeks, having an international airport makes not difference). The most pragmatic way of dealing with such unrealistic proposals, however, is to simply apply the three criteria. The international airport does not even match the first criterion, let alone the second and third one.

Table 5: Sequence of steps to define the proposals

Step 1	Go back to the minutes: Which proposals did you hear in the course of the fieldwork?
Step 2	Order the proposals by sector (i.e. the sectors defined in Step 1 of Table 4
Step 3	Looking at sector A – Brainstorming (Metaplan): What other proposals would the PACA Team like to make?
Step 4	Assess each proposal: 1. Is it realistic and viable, i.e. can it be implemented given the available skills and funds, and given the articulation and implementation capacity of key stakeholders? 2. Is this proposal quickly implementable, i.e. within the next few weeks? 3. Would the implementation of this proposal render quick and visible results, i.e. within maybe three months?
Step 5	Looking at sector B – Brainstorming (Metaplan): What other proposals would the PACA Team like to make?
Step 6	Assess each proposal: 1. Is it realistic and viable, i.e. can it be implemented given the available skills and funds, and given the articulation and implementation capacity of key stakeholders? 2. Is this proposal quickly implementable, i.e. within the next few weeks? Would the implementation of this proposal render quick and visible results, i.e. within maybe three months?
etc.	etc.

Two further points should be mentioned in this respect. First, there is no reason for not making proposals which have been mentioned by local actors in the course of the interviews and workshops, quite the contrary. Second, it can be useful to propose the continuation or amplification of existing activities, especially in those cases where the PACA Team perceives that they make a lot of sense but are facing opposition from certain local actors.

At the same time, it is important to note that the presentation may, and indeed under certain conditions should, be polemic. In a setting where local activities to shape a competitive advantage are inadequate, a moderate and friendly presentation runs the risk of reinforcing rather than overcoming an adverse mindset. For instance, in two cases we discussed two possible scenarios of future development – one under the "business as usual" assumption which outlines foreseeable disasters, and an alternative based on our proposals. The presentation should also explicitly discuss the consultants' perspective of both the local situation and local actors' perception of the local situation.

A further aspect regards the creation of some key phrases or concepts which summarize local problems, deficiencies, constellations, or options. After the presentation, key actors who want to implement certain proposals can refer to such key phrases rather than having to give complex explanations all the time. Also, the media love key phrases or terms which summarize the argument.

The overall structure of the presentation is:

1. presentation of the conceptual background, especially the concepts of competitive advantage and systemic competitiveness,

2. the diagnosis of the local constellation, mainly following the branch structure of the local economy and/or the four levels of systemic competitiveness, with an overall appraisal according to the four levels as a conclusion,

3. presentation of proposals (not only regarding what to do, but also naming who might implement them) in a structure that mirrors the diagnosis, with concluding remarks regarding the next practical steps to be taken. Examples of presentations are available at http://www.meyer-stamer.de/paca.html.

Table 6: Sequence of steps to prepare the Powerpoint file for the presentation

Step 1	As many PACA Team members as possible get hold of a PC with the Powerpoint software
Step 2	One person with good Powerpoint skills prepares a stylesheet for the presentation (.POT file) which is transferred to each PC
Step 3	Prepare a flipchart with the overall structure of the presentation - introductory part with brief explanation of PACA method - sequence of sector diagnostics - sequence of sector proposals > define the file name for each segment of the diagnostic and the proposals
Step 4	The PACA Team members divide among themselves the task of writing up the presentation
Step 5	Join the different files in the correct sequence
Step 6	Go through the file and verify - the content - the orthographics - the consistence of the layout
Step 7	Define which member of the PACA Team is going to present which part of the presentation
Step 8	Rehearse the presentation

The overall number of slides in the presentations we have prepared was between 35 and 50.

How to select the sectors which will be the target of local economic development activities?

As a matter of fact, this is a wrong question. Somebody who asks this question is probably a person who thinks along the lines of traditional business promotion activities. Those activities tended to be supply-driven, sometimes based on an analysis of various sectors which determined, scientifically, what were the "objective" problems of those sectors and how to address them. As a result, companies saw themselves confronted with promotion activities which they had not demanded and which usually did not fit with their subjectively perceived problems. Accordingly, demand for such promotion activities was low to nonexistent, and promotion agencies often lured companies by offering fringe benefits (e.g. seminars in beautiful resorts); I call this the Business Surprise & Entertainment (BSE) approach to private sector promotion.

As part of a PACA, we try our best to avoid repeating such mistakes. One of the purposes of a PACA is to identify in which sectors of the local economy businesspeople are looking out for support, or open to joint activities to resolve commonly felt problems, or perhaps open to a consultation on possible promotion activities. The main issue is not objective problems, but subjective motivation. Formulating proposals after the PACA fieldwork is not about the PACA Team selecting sectors, but rather about sectors selecting themselves: Those sectors will get involved in practical activities which take up proposals formulated as a result of the PACA diagnostic.

In fact, one will often find that local business sectors may be sorted into four different groups, as shown in Table 7. It is a bit of a simplification, but often we find that things are as simple as this: some sectors are doing well, others do not, and some sectors show a certain willingness to go for joint activities to enhance competitiveness, whereas others do not.

Table 7: Typical constellations regarding business sectors in the local economy

	Sector is doing well	*Sector is doing not so well*
Sector wants joint action to improve competitiveness	Strategic sector (1)	Desperate sector (2)
Sector does not want joint action to improve competitiveness	Busy sector (3)	Hopeless sector (4)

(1) **Strategic sector:** This is the dream of competitiveness scholars and practitioners, and it is also a very rare case. It typically occurs in cases where, for some reason, often due to historical coincidence, a sector has already developed a culture of joint problem solving. In such a sector, actors may be keen to get some fresh input on how to further improve their joint action.

(2) **Desperate sector:** This is a case which is convenient for a PACA Team – there is a sector which is not doing well, i.e. feels in a crisis, and is willing to do something about it.

Salami Tactics

It is not rare to find that local stakeholders have a pretty clear idea of how to address local development: Formulate a proposal for a big project, involving a budget of $ 5 million, submit it to central government, and then wait for something to happen (and more often than not waiting forever). This is, in another words, usually not the most effective way to proceed.

The alternative is Salami Tactics: If you want implement a big, ambitious project, do not wait eternally for a big heap of money but rather go ahead, implementing and financing it slice by slice.

Looking out for such sectors is an obvious option in a PACA. It may appear as a soft option, but actually it is not: Even in this case it is not trivial to start a joint problem solving initiative, and actually starting to do so may create an important showcase for other sectors.

(3) **Busy sector:** This is a case a PACA Team has to accept – a sector is doing fine, and companies are very busy and really do not have much time to waste for any meeting. Also, competitiveness seems to be just fine, so there is little obvious reason to start something difficult, such as a joint initiative.

(4) **Hopeless sector:** This is the nightmare of a PACA Team and of any business promotion practitioner – a sector which is suffering, which is in a crisis, where to the external observer it may appear obvious how to improve the situation through joint activities, and where the actors in the sector are unwilling to do so. There is little the PACA Team or any other local actor can do about this, except perhaps to identify viable, modest activities with little cost and immediate benefits to overcome the passive, non-cooperative disposition of the sector.

2.2.5 Presentation of results

For the presentation of the findings, the same persons and institutions which were invited for the initial workshop should again be invited. Moreover, all those persons who were interviewed or took part in mini-workshops should be invited. (In fact, the invitation should already be extended at the end of the interview / mini-workshop.)

We have found it useful to conduct the presentation in an usual place, rather than, say, the auditorium of the local technical school. Giving the presentation in an unusual place (for instance, in one case we did it inside a construction site) has the advantage of creating a special connotation among the participants. It is not just another event but something that will stick in their memory.

It may be preferable that the external consultants give the presentation; our experience so far indicates that local actors accept the observations of external observers more easily than those of local persons. Our experience so far indicates that the typical duration of the presentation is about one hour.

After the presentation, rather than opening the floor for questions and discussion, we distribute Metaplan cards and markers among the audience and ask them to write down questions, remarks, observations, and proposals. The cards are afterwards attached to the front wall of the auditorium and clustered by topic. The consultants then read the cards loudly, and after reading each cluster the floor is opened for a brief discussion. The advantage of this procedure is that more persons can participate and more points be raised than during a conventional discussion. Moreover, the discussion proceeds in a much more structured way. We also observed repeatedly that on some cards answers were given to questions posed on other cards, or that practical proposals on how to implement certain ideas (and by whom) were made.

2.2.6 Implementation and follow-up

Immediately after the presentation, the PACA Team should have a meeting with the representatives of the organization in charge of the PACA project and other local stakeholders willing to get involved in practical activities. The purpose of the meeting is to discuss the proposals in a more detailed way, i.e. to explain the background of each proposal, and to discuss possible ways of implementing it. It is desirable that a number of stakeholders adopt one proposal each and become the “champions” of practical activities based on the proposal.

How would a champion proceed to get some activity running? A typical sequence might go like this. Let us assume that the activity involves creating a working group to address the skills problems of local small and medium-sized ceramics firms. The champion is the president of the ceramics business association. He organizes a meeting which is attended by 15 business owners and facilitated by one of the PACA Team members. Based on the Metaplan method, they define more specifically what the skills problems are. This process takes 1.5 hours, and as some people have other appointments, the group decides to have a further meeting the next week, asking the facilitator to continue working with them. The second meeting addresses specifically the interaction between the firms and training providers. Again using the Metaplan method, the group defines the typical problems of interaction and the reasons for them. The group agrees to have another meeting the following week to discuss how to solve these problems, again inviting the facilitator to apply the Metaplan method. During the third meeting the group formulates a number of proposals for specific short-term courses. Four of the members of the group volunteer to have another meeting, jointly with a professional of the business association, to formulate a number of requests for proposal for specific training courses which will then be sent to several training providers. As the requests for proposal include a set of quality criteria, the group asks a retired teacher of the local technical school to support them in their work.

Another sequence might go as follows. Let us assume that one of the proposals was to set up a coaching scheme where owners and managers of highly competitive medium and large firms meet an owner of a small business on a quarterly basis to discuss his business problems and possible solutions. The champion of this initiative is the CEO of a large local company; actually, he is the person who suggested the scheme during the interview. The champion proceeds as follows. He talks personally to a number of other businesspeople he knows personally, trying to persuade them to join the scheme. He also presents the scheme at the weekly meeting of the directors of the local Chamber of Industry and Commerce. Eight other person volunteer to take part in the scheme. They meet during the following week, jointly with the executive secretary of the chamber, to discuss how to proceed. They agree that initially the small businesses to be assisted will be selected from the member base of the Chamber. Each of the volunteers names two or three sectors he feels familiar with. Three days later the scheme is announced in the weekly column the Chamber has in the local newspaper, and owners of small businesses are asked to call one professional of the Chamber to apply for the scheme. 23 businesses apply. As this is communicated to the volunteers, five of them decide to make themselves available on a monthly basis, i.e. to visit the same small firms every three months and to accompany three small businesses, visiting one of them per month. For the first meeting, the professional of the Chamber accompanies the volunteer. Future appointments are directly negotiated between the volunteer and the owner of the small business. After two months, the Chamber organizes a workshop for the volunteers where they share their experiences. A common observation is that small businesses are weak in human resources management, and it is decided that the Chamber will organize a weekend course on basic tools for human resources management. After the workshop, a press conference is organized to make the scheme more widely known and to motivate further volunteers.

Another sequence might go as follows. Let us assume that there is a local branch of a governmental investment promotion agency, and that its manager bought the idea of attracting complementary investors. Rather than trying to do this all alone, which would go beyond her resources, she decides to approach other local stakeholder. So she has a meeting with lecturers at the local university’s economics department and persuades them to gather and update data on the local economy, including this activity into the undergraduate training and employing students to do the legwork. She also has a meeting with the local Chamber, which is willing to prepare a quality of life assessment, based on a brief workshop which involves local businesspeople who have moved to the place over the past years and can thus compare it with other locations. She also has a meeting with representatives of the utilities to get up-to-date information about their specific schemes to attract new customers. Most importantly, she has a meeting with representatives of the most important local business sectors to discuss the kind of investor they would like to have attracted. It immediately becomes obvious that this issue cannot be settled within one meeting, and so they agree to have a separate meeting for each sector two weeks later. After about a month, she invites everybody involved so far for a presentation at the Chamber, where the results of the quality of life assessment are presented and discussed. As the participants of the meeting agree with most of the observations, the Chamber expresses a commitment to contract a journalist and a photographer to prepare a brochure on quality of life in the location. The following month, everybody is invited to another meeting where the university people present their data. This meeting does not run as smoothly, as some of the businesspeople observe that some the data are not relevant, whereas some really relevant data are missing. The facilitator, however, avoids any tension by suggesting a separate meeting between some of the businesspeople and the university people. In the meantime, the sectoral representatives have met repeatedly to come up with a list of types of companies, and also specific names of companies, which may be attracted to the location. As soon as the university concludes its data collection effort, these companies which be approached directly be the manager and the president of the Chamber.

Another sequence might go as follows. Let us assume that there was a mini-workshop with owners of restaurants, and a big issue which emerged there was a local parking problem. Given that the restaurant owners were adamant about trying to solve this problem, the local association of restaurants or the Chamber may decide to invite the group for another meeting to discuss possible solutions. This meeting would have to be facilitated using the Metaplan method. Its focus might be a brainstorming on possible solutions. One of the main questions might be to find out how the same problem has been solved elsewhere.

What have proposals like these to do with the idea of creating a local competitive advantage? To some extent, implementing these activities does mean a step towards shaping a competitive advantage. Apart from that, we expect such activities to be points of entry to LED activities, showing local stakeholders that stimulating economic development and competitiveness is something they can do themselves, rather than waiting for higher levels of government to solve problems for them. The idea is that modest activities create a virtuous circle, where a group of stakeholders gets motivated by the fact that they have solved a given problem, and then address the next problem.

We suggest that the external consultants who guided the initial diagnosis of the PMM project return after four to six months to discuss the progress of the project with local actors. It is useful to organize this in the form of mini-workshops with a duration of two to three hours. First, local representatives present what has been done so far, and they explain the obstacles which emerged. After that, a joint brainstorming is conducted, using Metaplan, to come up with ideas on how to continue the work. It is useful to have two to three days available, depending on the number of initiatives going on.

2.2.7 Resources necessary for a PACA project

The initial diagnosis of a PACA project involves a limited amount of time and money. The field research in its dense form has a duration of one to two weeks, plus two to four days for preparation and presentation of the results. As it involves two external consultants, the maximum amount necessary is 28 x (daily remuneration of consultants + per diem) + travel cost. It may be necessary to remunerate local participants, although it was not the case in any of the projects we did so far. Local transport was always organized and covered by the local organization. Further expenses include rental of a beamer (projection device to be connected to a laptop computer for the presentation), possibly rental of rooms for the workshops and presentation, and the cost of the Metaplan material.

2.2.8 Limits and problems of PACA

PACA has several strengths – it is fast, it is not expensive, and it is action-oriented. But is also has limits and deficiencies:

– We find it hard to imagine that it is applied in larger and / or economically more complex locales than the largest cities in Santa Catarina, i.e. Joinville and Blumenau (380,000 and 230,000 inhabitants, respectively).

– The consultants who conduct the initial diagnosis have to be experienced, versatile, and well qualified, i.e. knowledgeable about various concepts of competitiveness and participatory techniques. They have to be imaginative and critical, especially with respect to the difference between local reality and the local perception of the reality.

– The codifiability of the concept is limited. Whereas the application of the methodology is quick, training consultants in the methodology is a very time-consuming process.

– In its current form, PACA does not allow a systematic appraisal of the informal sector in a given locale. Conducting a systematic appraisal of the informal sector would involve some additional time. It would not involve a different methodological approach.

– Because the methodology may appear “quick and dirty”, it gives rise to doubts, and important local actors may question the relevance of the proposals, e.g. based on the argument that the base of the diagnosis is not statistically representative and that the whole exercise was not “scientific”.

2.3 Methodological issues regarding participation

A key aspect of the concept outlined in this paper is the participatory approach. It is by no means self-evident that local economic promotion, and especially the formulation of a local economic development strategy, is a participatory exercise. Quite often it is delegated to external actors, especially consultancy firms specialized in this field: External consultants parachute in, conduct a series of interviews, collect a lot of data, and present their results to an audience of surprised and impressed local agents. What happens afterwards, and in fact whether anything happens, is unpredictable.

In order to initiate a process which can be sustained by local actors it is crucial to involve them from the start. It is essential to find an adequate balance between inputs from outside and local activity. External inputs are important, in terms of bringing in both methodologies and concepts of development, especially in places where local actors have little to no experience with economic promotion. However, it must complement and stimulate local activities rather than substitute them. In practical terms, this means that it is desirable that at least one important local person, e.g. the executive secretary of the ACI, takes part in the whole field research and elaboration of the diagnostic.

The basic idea of the concept outlined in this paper is this: It is possible to undertake a rapid appraisal of strengths and weaknesses in a given locality and to come up with practical proposals. Rapid means: within a few weeks, at maximum three weeks for fact-finding and elaboration, presentation, and discussion of results, and in less complex localities even within days. A key aspect of such an appraisal is that it is conducted jointly by external specialists and by local actors. The appraisal should build on some principles which have been formulated in the participatory rural appraisal work:[1]

– offsetting biases (spatial, project, person - gender, elite etc, seasonal, professional, courtesy...)

– rapid progressive learning – flexible, exploratory, interactive, inventive

– reversals – learning from, with and by local people, eliciting and using their criteria and categories, and finding, understanding and appreciating their knowledge

– optimal ignorance, and appropriate imprecision – not finding out more than is needed, not measuring more accurately than needed, and not trying to measure what does not need to be measured. We are trained to make absolute measurements, but often trends, scores or ranking are all that are required

– triangulation – using different methods, sources and disciplines, and a range of informants in a range of places, and cross-checking to get closer to the truth through successive approximations

– principal investigators' direct contact, face to face, in the field

– seeking diversity and differences

There is no reason why this kind of approach should be limited to rural environments. On the contrary, our experience so far shows that such a perspective renders a very valuable diagnosis of urban economic structures as well, specifically if it is combined with analytical concepts to understand the key determinants of successful development.

At the same time, it is important to acknowledge the pitfalls and limits of PRA/PLA approaches. First, there are the risks of inadequate application of the methodology:[2]

1 Quoted from *The PRA Pages*, http://www.ids.ac.uk/pra/intro/origins.html.

2 ibid.

- failing to put behavior and attitudes before methods
- rushing and dominating
- pretending to be experienced trainers when not
- rigid, routinized applications
- taking local people's time without recompense, raising expectations
- demanding instant PRA on a large scale
- cosmetic labeling without substance

Second, there are some difficulties with participatory methodologies as such. Summarizing the literature on participatory monitoring and evaluation, which is a closely related approach, Estrella and Gaventa (1998) point at three issues: power, conflict, and methodological rigor. PRA sometimes is being presented as an instrument that overcomes issues of power and conflict. This is an idealistic view. The likelihood that a PRA exercise is biased by existing power structures, or that local actors try to move it around an existing conflict, is always there. It is specifically the insistence on participation which is creating risks in this respect – how would a PRA practitioner who is truly dedicated to participation justify that he is tackling the consistent evasiveness of local people when it comes to addressing certain touchy, conflict-prone issues? Likewise, methodological rigor can suffer if local actors feel consistently awkward in applying certain techniques, so that a trade-off between participativeness and rigor emerges.

2.4 Annex: More about Metaplan

The use of Metaplan as presented above is just one of several options. Metaplan generally is a method which can be used for all sorts of brainstorming and planning exercises, for instance to formulate hypotheses, to plan the research process, or to come up with and organize the findings.

A typical format in Metaplan-exercises is brainstorming → clustering → priorizing → next brainstorming. An example would be the following:

First **Question**: What are the main reasons for lack of interaction between companies and supporting institutions?

N responses. The responses are **clustered** into four groups: 1) company-related reasons, 2) reasons related to supporting institutions, 3) problems in the management of interaction, 4) framework conditions. (One of the purposes of this is clarify what exactly is written on the several cards, and to eliminate duplicates.)

The responses are then **priorized**. Each participant may mark those cards which s/he finds most relevant. The number of marks each participant may set is equal to 20 % of the total number of cards (*Pareto*-rule). Those cards which receive most marks are the point of departure for the subsequent work.

Let us assume that three cards get most marks: 1) supporting institutions are not business-oriented, 2) training institutions are too academically oriented, 3) there are not effective intermediaries between S+T institutions and firms. For the next step, there are two options for turning the first card into a question.

The second question may be: Why are supporting institutions not business-oriented?

The **second question** may also be: How can supporting institutions may be turned more business-oriented?

Let us assume that the second option is pursued. The participants then give a number of responses on cards, which are then **clustered**. Let us assume that three clusters emerge: 1) Career and incentives for employees, 2) financing structure of institutions, 3) voice of potential clients.

The total responses are then **priorized**. Let us assume that two cards get most marks: 1) tie the salary of employees to the income they generate for the institution, 2) reduce the core financing for the institutions. For the next step, there are again two options for turning the first card into a question.

The third question may be: How can the salary of employees be tied to the income they generate for the institutions?

The third question may also be: What are the obstacles for tying the salary of employees to the income they generate for the institution?

The exercise can go on in this fashion until the facilitator and the participants feel that they have explored a given track. This may mean that they have reached a conclusion, for instance a good set of hypotheses. It may also mean that they have come to reasonably specific and concrete proposals. In this case, it can be useful to operationalize the proposals in the following way:

Proposal	*How exactly will we implement it?*	*Who is responsible?*	*Who has to collaborate?*	*Which resources do we need?*	*When do we start?*	*How do we know that the activity has started?*
Proposal 1	...	...	...	...	...	...
Proposal 2	...	...	...	...	...	...
etc.						

At this point there are again two options. One option is to conclude the exercise. The other option is to go back to the results of the first question and go for the second proposal, i.e. search for ways to make training institutions less academically oriented.

It is obvious that the formulation of the questions is one of the keys to a successful Metaplan exercise. Good questions are neither too narrow nor too wide, i.e. give the participants a certain freedom to let their thinking roam without generating random responses. It is often useful to discuss the exact wording of a question with the group.

Structuring tools for Metaplan exercises

There are further options to make a Metaplan exercise even more effective. Several tools for structuring can be used. One of them is the transaction matrix. The basic structure of the matrix is like this:

Interaction between firms and supporting institutions in XY		
	Benefits Opportunities	Costs Risks
... for firms	(1)	(2)
... for supporting institutions	(3)	(4)

The participants are asked to respond by writing observations, for each field in turn, on Metaplan cards. It can be useful to ask the participants for a priorization. This is done using the Pareto method, i.e. each participant gets a number of points which is equal to 20% of the total number of cards, so that he can then mark those cards which he finds most relevant. For this exercise to be effective, it is essential that duplicate cards are eliminated beforehand.

Another useful application of the Four-Field-Matrix is in situations where a group has to decide between two options. The matrix then looks like this:

	Arguments in favor of Option 1	Arguments against Option 1
Arguments in favor of Option 2	(1)	(2)
Arguments against Option 2	(3)	(4)

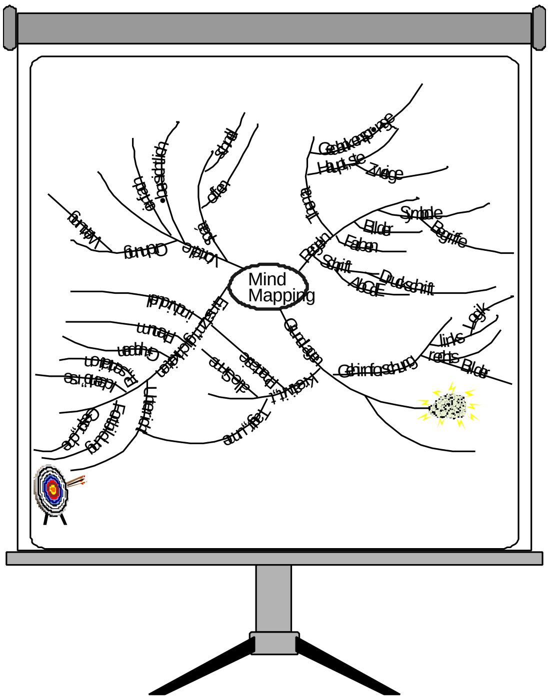
Such an exercise often helps to understand that many arguments for one option actually are not arguments against the other option, and vice versa. The discussion can thus be boiled down to a limited number of decisive arguments.

Another structuring tool is the SWOT matrix, which can take either of the two following shapes:

Strength (factors internal to the organization)	Opportunity (activities to strengthen the organization further)
Weaknesses (factors internal to the organization)	Threats (factors which can further weaken the organization)

Strength (current factors)	Opportunities (future factors)
Weaknesses (current factors)	Threats (future factors)

Another structuring tool is the mindmap, where interrelationships between different factors are explored. It looks like this:


Mind
Mapping

3 TOOLS

The purpose of this part of the toolbox is to present a number of research tools which help in the field research inside local economies. Quite obviously, it does not make sense to go to a place and ask local actors questions such as "Are you an industrial district?" or "Would you define your cluster rather as Italianate, hub-and-spoke or satellite?". More specifically, it may make sense to ask such questions in Italian clusters where local actors define their city as an industrial district. But almost everywhere else things are different.

In terms of research tools, there are essentially three possible approaches. First, the researcher may just ask. That is fine, and a lot of the fieldwork will involve just this. However, very valuable information may not turn up this way. So talking alone is not enough. Second, the researcher may sympathize with the idea of applying quantitative instruments, such as a local input-output-analysis or attempts to measure information flows. Such instruments can be very valuable; it was not by chance that OECD researchers in their recent investigation of innovation systems devoted a lot of effort to developing such tools. However, in the context of this project, which is counting with very limited resources in terms of time and money, it is unlikely that it will be possible to use such instruments, except if pertinent data are available and just have to be computed. Third, there are tools which come out of the participatory and rapid appraisal toolbox. The disadvantage of this instruments is that their applicability for "scientific research" is disputed. But this project is not only about academic interests, but also and in particular about policy issues. Therefore, such tools are perfectly applicable, individually and combining two or three of them. Their advantage is that they often unearth a huge amount of information, and do so in a structured way.

The following table gives an overview of the tools which are introduced in this section.

Name of the tool	*Description*	*Application*
Diamond (Michael Porter)	Distinguishes four determining factors of competitiveness: - Business strategy and rivalry - Supporting industries and clustering - Factor conditions / supporting institutions - Demand structure / sophisticated or unusual demand	- in individual interview, especially in firms and support institutions - in workshop with local stakeholders
Cluster economic mapping	Depicts the interaction between economically relevant agents (firms, business associations, supporting institutions, government, etc.), including the intensity of interaction and main characteristics of the relationship	- in individual interview - in workshop with local stakeholders
Local political mapping	Depicts the structure of the politically relevant local/regional actors, including the characteristics of the relationships between them	- in individual interview - in workshop with local stakeholders
Mapping of the value system (commodity chain)	Depicts the structure of the value system / commodity chain beyond the borders of the local cluster, from the generation of main inputs to final commercialization	- in individual interview, especially in firms and support institutions - in workshop with local stakeholders
Life line	Depicts the evolution of an organization, a community or a cluster, especially looking at the ups and downs and the turning points	- in individual interview - in workshop with local stakeholders

The idea is not to apply all these tools in all interviews and workshops. We rather suggest that researchers apply at least one of the, and maybe two or three, depending on the willingness of the interviewee or the participants of a workshop to take part in the application of such tools. They can also be applied as a set, i.e. Porter´s Diamond + Mapping; or Life line + Trend analyisis, depending on the purpose of the research´s as well as the characteristics of interviewees.

3.1 Michael Porter's Diamond

Porter's diamond is a tool which stimulates a view at a given reality which is structured in a specific way. I will not present the concept involved in the diamond here; there are numerous publications by Porter himself available where he does that. I will rather address one possible practical application of the diamond.

The main advantage of the diamond is that it encourages both researchers and actors to organize their perception of the reality in a new way, different from the story they usually tell. I have found the diamond particularly useful in little workshops, working with groups of a size anywhere between 5 and maybe 25 persons. The operationalization of the diamond in such a situation is as follows. The first issue is how to introduce the diamond to the group. I have found it useful to do it the following way:

1. Business strategy: I ask the participants to come up with observations who or what are the main firms and economic activities in the city or region - what are their strengths, what their weaknesses. In a cluster, the response may be predictable. But even there it is often interesting to see that, even though statistical data indicate that a given industry has a dominating position, local actors ascribe importance to other branches as well.

2. Supporting industries: This point is still about firms, again asking about strengths and weaknesses. The main challenge for the participants is usually to distinguish between core firms and supporting firms, the latter being the suppliers and service providers of the core firms.

3. Factor conditions: I usually introduce this issue in terms of strengths and weaknesses of “supporting institutions” in fields such as training, technology, finance, and business associations.

4. Demand conditions: I usually introduce this issue by asking for regional manifestations of sophisticated or unusual demand. This is usually the issue which is least clear to local actors, and for specifically this reason it often is particularly enlightening - if their is no sophisticated demand at all (which is a major weakness for a cluster), or if their is some unusual demand which local actors never considered as an asset.

I often introduce the diamond by stating that its disadvantage is also its advantage: It’s relatively simple. It is too simple since it does not address power relationships and governance patterns inside the cluster as well as its connection to external actors. It also does not systematically try to address the actors and their interests. Nevertheless, it is useful since it opens a systemic perspective at important features of the cluster, permitting to get a good idea of strengths and weaknesses.

The second issue is how to work with the group. One way is just to let the participants talk and to take notes. It is better to write down the things mentioned by the participants on a flip-chart, since seeing things written visibly often stimulates discussion. Still better it is to use the Metaplan technique, where each participant gets a number of cards (120 g/m2, 21 x 10 cm) and a thick pencil to write down his observations on these cards which are then fixed on large sheets of paper (such as packaging paper) which are taped to the wall. The following picture gives an idea of what this can look like. An illustrated description is available at http://www.moderationstechnik.de/en/index.htm. It is, however, important to note that the moderator who facilitates the whole exercise should have some experience in using the Metaplan technique.

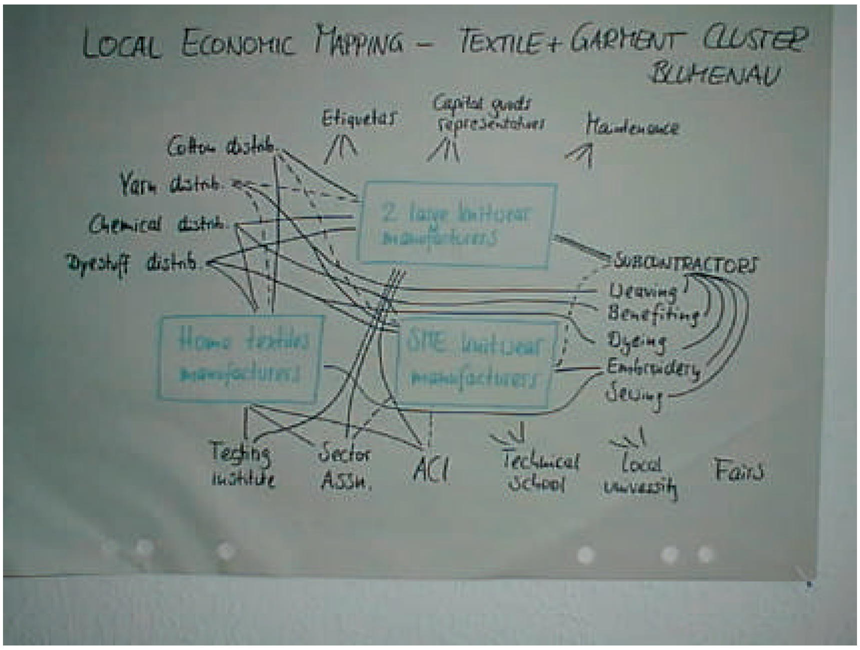
3.2 Cluster economic mapping

The purpose of an economic mapping is threefold. First, it serves to identify the actors who play a role in a given cluster - firms and types of firms, supporting institutions, associations, government, and others. Second, it is a way to depict the flows between firms and with supporting institutions. Third, it also is way to visualize the power structure between the economic actors.

The procedure is very straightforward: Take a piece of paper, preferably in size A-3 (42 x 29,7 cm) or larger and ask the interview partner or the participants of a workshop to draw. Your role, especially when working with a group of people, is basically that of an observer - taking notes on the comments the participants make when they draw the map, perhaps asking them to clarify certain issues, and asking about actors they have not mentioned on their own but who in your view may be important. The optimum size of a group to do mapping is 3 to 5 persons. It is feasible to do it with a larger group, but actually it is often more interesting, and also more fun, to split the group so that afterwards you have two or maybe three maps. Comparing them, and discussing the differences with the participants, may render important additional insights.

What are the main traps and errors? Actually, there are not many. Participants may confuse this kind of mapping with other types, i.e. the political and the value chain mapping, but that does not really create a problem. Participants may have contrary opinions about certain issues; you may suggest to note this in the mapping, or you may take an according note yourself.

The following figure gives an idea of how an economic map may look like.

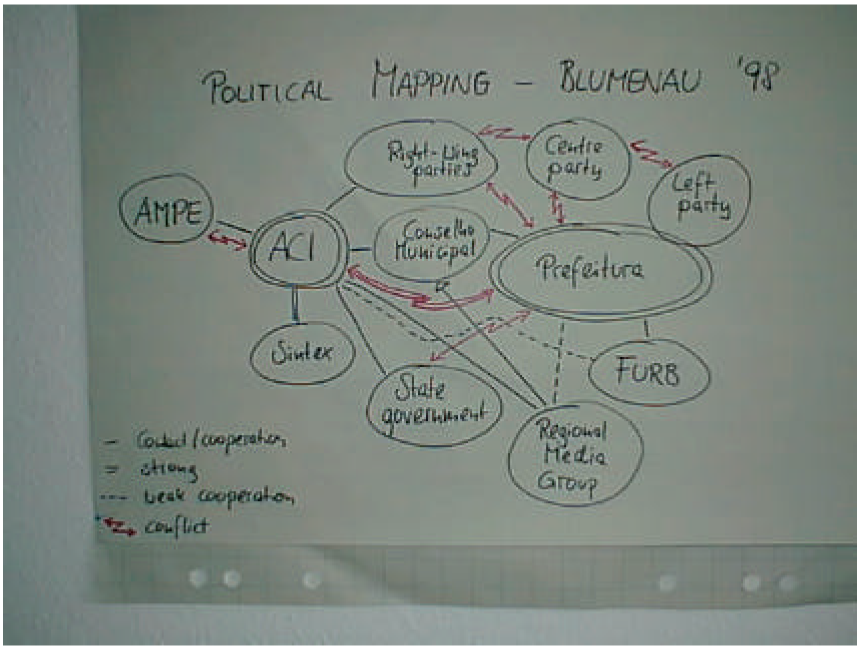


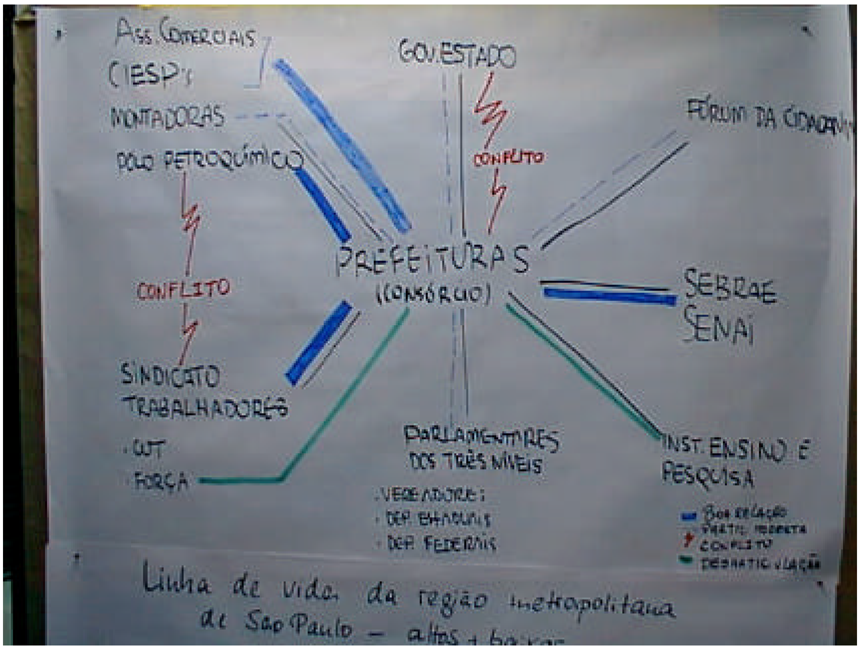
3.3 Local political mapping

When producing a political mapping, the procedure is basically the same as in the economic mapping. What is different is the focus. A political mapping is not primarily about economic interaction but about local politics and polity. The purpose is to draw a map which includes the important political actors (with special reference to economic issues, as opposed to, say, cultural issues) and the relationships between them - the relative power positions, power games, hierarchical relationships, conflicts, etc.

What are the main traps and errors? Probably the main problem is that participants may hesitate to address explicitly the existing political tensions and conflicts. It will rely on the persuasiveness and tact of you to overcome this kind of problem.

The following figures give an idea of how a political map may look like.



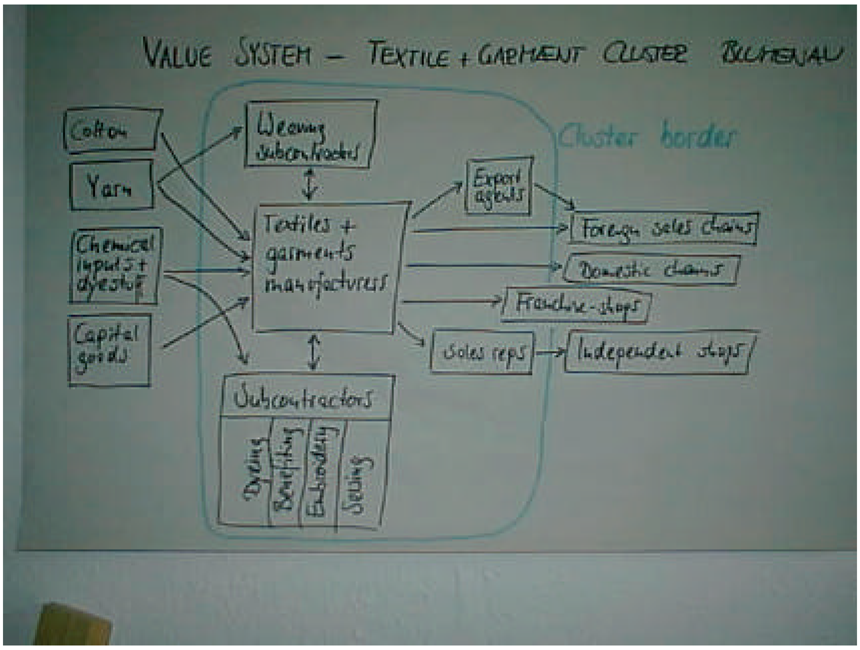


3.4 Mapping of the value system (commodity chain)

The mapping of the value system intends to provide a better understanding of the embedding of the cluster in larger economic structures. The purpose is to get an idea of the position of the cluster in the value system, both physically and in terms of power structures. Physically, this map is supposed to show the sequence of the value system, i.e. the main production steps along the chain as well as the key inputs. In terms of power structure, the idea is to denote in the map which actors are most powerful, for instance in terms of price negotiations.

What are the main traps and errors? Probably the largest problem is that participants have never thought about their reality in such a way, so that it may take some time to get the flow of observations moving. In this context, more than in the others, you may decide to suggest possible elements of the chain, in order to put the participants onto the track.

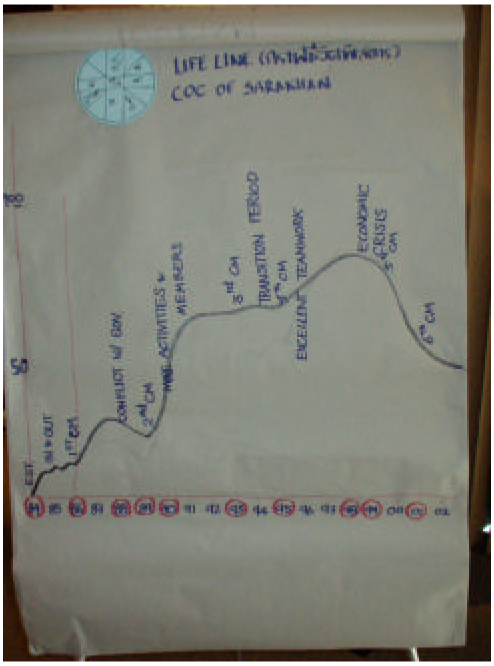
The following figure gives an idea of how a value system map may look like.



3.5 Life line

The life line is a useful tool to get information about the evolution of a cluster over time, for instance over the last 30 years. Basically, the researcher asks the participants to draw a line with the ups and downs and turning points of a given cluster. It can be useful to establish a base-line, to establish the opportunity to distinguish between periods of history with a positive and those with a negative connotation.

The following figure shows a life-line.



3.6 Concluding remarks

In my experience these tools are useful in all sorts of contexts. However, it is conceivable that with certain interviewees or groups, as well as in certain contexts (e.g. when there are strong conflicts), some of the tools are not applicable. It would be useful for our future research to have your feedback in this respect.

As I have mentioned before, it is perfectly possible to use different tools in the same interview or workshop. I find it difficult to suggest ideal combinations; I would rather expect that the choice of appropriate tools depends very much of the dynamic which unfolds in the interview or workshop. Regarding workshops, however, it is useful to develop in advance a "dramaturgy", i.e. try to imagine the process and the sequence of tools to be used; but do not hesitate to change your dramaturgy if you feel this to be appropriate in the course of the workshop.

Under certain conditions, complexity and demarcation may become problems. If a cluster is very differentiated, a mapping become so complex that it becomes confusing rather than enlightening. In such a situation, you have different options. One would be to ask the participants to draw only those elements which they perceive to be important. Another option is to ask the participants to distinguish, for instance by using different colors, between strong and weak elements of the cluster. Yet another option would be to question whether there really is one cluster, or maybe two or three (possibly related) clusters in the same locality.

The last option is related to the problem of demarcation. There are, in fact, three different problems when it comes to demarcation. First, there is the issue of whether there is one local cluster in a given industry, or maybe two or three. For instance, in my research I found that in a given textile and garment cluster there were in fact three clusters – a fabric cluster, a home textiles cluster, and a garment cluster. These clusters were connected only to a limited degree, especially in terms of drawing on the same pool of managers and technically skilled employees. In other respects they were clearly separated – little if any commercial transactions, different types of firms, different types of products, different types of customers, and so on.

Second, there is the question whether it is possible to clearly separate a cluster from other segments of the local economy. To give an example, in another locality I was surprised to find that a local metal-engineering cluster was closely connected to a local plastic products cluster, namely in terms of the machining shops which produced parts for the former and injection tools for the latter.

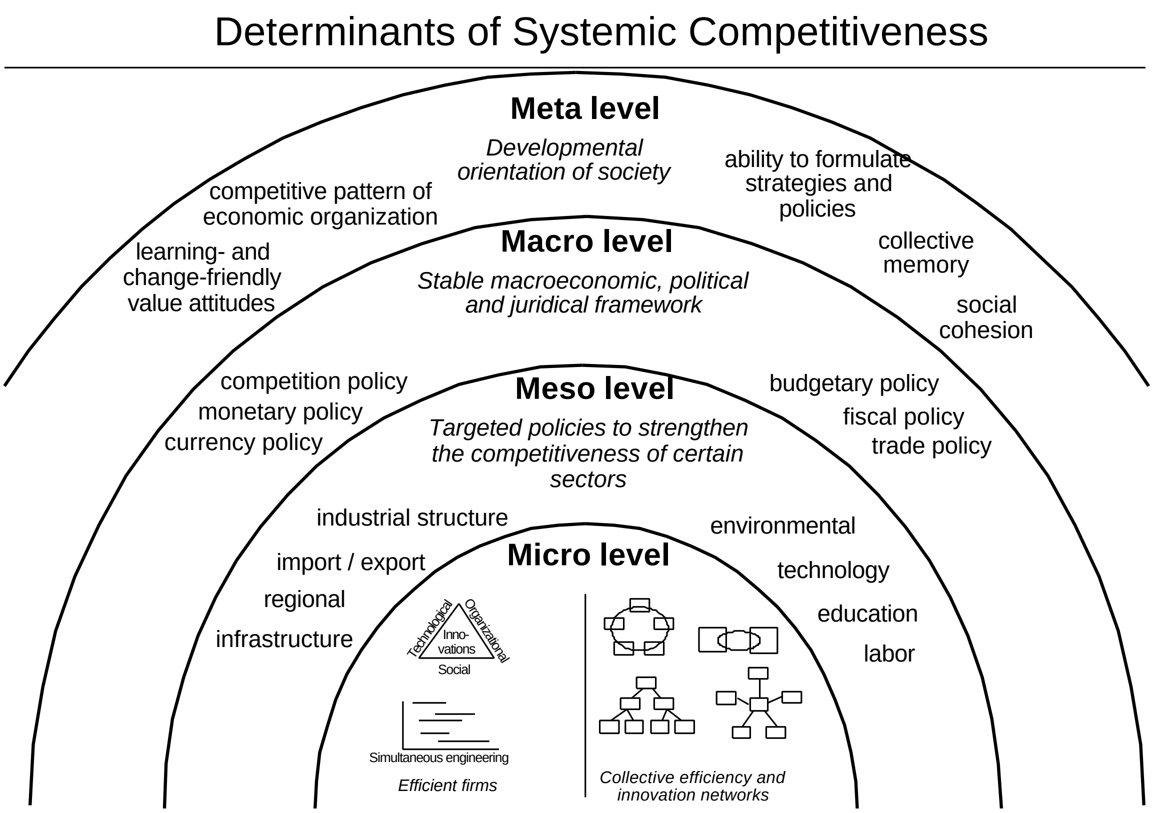
Third, there is the question where the cluster ends geographically. For instance, in the textiles case mentioned before, I found that two of the three clusters were closely connected with similar clusters in a neighboring town, so that in fact there were two regional clusters and one local cluster.

How do you resolve problems of demarcation? I see two possible suggestions. One would be: do it pragmatically. The other one, which I would prefer: let the actors, i.e. the participants in the workshop or the interviewee, decide. In the end, it is their interpretation of the local economy you want to know about. So, defining demarcations for them may distort the information you obtain.

4 CONCEPTUAL BACKGROUND: THE CONCEPT OF SYSTEMIC COMPETITIVENESS

The concept of systemic competitiveness tries to capture both the political and the economic determinants of successful industrial development. It refers to a pattern where state and societal actors are deliberately creating the conditions for successful industrial development as systemic competitiveness. The concept distinguishes between four levels: The microlevel of the firm and inter-firm networks, the mesolevel of specific policies and institutions, the macrolevel of generic economic conditions, and the metalevel of slow variables like socio-cultural structures, the basic order and orientation of the economy, and the capacity of societal actors to formulate strategies (Figure 10). It is not meant as a blueprint but tries, based on successful experiences, to give an orientation for both research and advisory work.

Figure 10:



The key ingredients of successful industrial development are

– at the metalevel: firstly, development-oriented cultural values which are shared by a large part of the society; secondly, a basic consensus on the necessity of industrial development and a competitive integration into the world market; thirdly, the ability of social actors to jointly formulate visions and strategies and to implement policies.

– at the macrolevel: a stable and predictable macroeconomic framework. This should include a realistic exchange-rate policy and general foreign-trade policy that stimulates local industry.

– at the mesolevel: specific policies and institutions to create a competitive advantage. This refers to specific, targeted policies to shape industries and their environment (technology institutes, training centers, export finance, etc.). Moreover, it is the world of local and regional industrial competitiveness initiatives to strengthen the firms' environment. Many of the institutions that act at the mesolevel are typically, or can in principle be, non-government entities, e.g. business associations, non-profit entities, or firms.

– at the microlevel: capable and continuously improving firms, and networks of firms with strong externalities.

The concept is meant to lead beyond sterile discussions of the state vs. market type. Successful industrial development was based on strong states and strong markets in the past, and developing countries typically suffer from weak states and weak markets, i.e. both state and market failure. The secret of successful development is to find an appropriate balance between intervention, i.e. formulation and implementation of targeted policies to stimulate and shape industrial development, and market forces.

It is now well understood that the main objective of structural adjustment programs of the 1980s and early 1990s, namely creating a stable macroeconomic framework, is a necessary but not sufficient condition for successful industrial development. It is also obvious that the specific pattern of state-led industrialization, which was the basis of successful latecomer industrialization in East Asian NICs, is hardly a serious option for today's developing countries. This is so for two reasons. First, most governments have neither the technical competence nor the standing to formulate, let alone implement, grandiose industrialization strategies. Second, the other countries (and in particular those countries that have pursued an import-substitution strategy for decades) do not start from scratch, as South Korea and Taiwan did in the 1950s. Rather, they already have an industrial structure. In the very least this consists of small and medium firms producing consumer non-durables for the domestic market, and medium and large state-owned firms in process industries like petroleum refining, steel, fertilizer, and cement. Any industry-related policy will first aim at restructuring these sectors. Therefore, the experience of East Asian NICs does not provide a blueprint for countries which had followed an import substitution-strategy in the past.

Dynamic industrial development requires deliberate action by both government and societal actors in order to stimulate and support firms in their effort to create competitive advantages.

In other words, it is the outcome not only of the invisible hand of the market but also of governance. Regarding the term *governance*, we follow here the World Bank's rather broad definition as *"... the manner in which power is exercised in the management of a country's economic and social resources for development"* (World Bank 1992, 1). Just like development in other sectors, governance of industrial development today has to be based on a participative model where societal actors interact with the state in defining strategies and policies. This kind of model has emerged spontaneously in the industrialized countries as a reaction to increasing societal complexity and the limited success of state interventionism. It is emerging, though hesitatingly, in the developing world, especially in those countries where democratization processes have opened some scope of action for civil society, and where the limited competence and inactivity of the state has created opportunities for non-governmental organizations.

4.1 Definition and scope of the concept

Definition of competitiveness: At the company level, competitiveness refers to the ability to sustain a market position. This ability requires the simultaneous achievement of several targets. The firm must supply products of adequate quality timely and at competitive prices. Moreover, it must usually be in a position to provide sufficiently diversified products to meet a differentiated demand, and it must respond quickly to changes in demand behavior. Beyond this, success is contingent on a firm's innovative capacity, its ability to build up an effective marketing system, to establish a brand name, and so on.

The concept of systemic competitiveness refers to nations, regions, industrial sectors or subsectors rather than individual companies. It should be noted that the notion of competitiveness applied to such aggregates is not synonymous to the concept of competitiveness of companies, as defined above, although nations (as well as other aggregates) just as corporations do have a more or less sustainable market position. Krugman rightly states that the competitiveness of companies has a clearly defined bottom line: *"if a corporation cannot afford to pay its workers, suppliers, and bondholders, it will go out of business. So when we say that a corporation is uncompetitive, ... it will cease to exist. Countries, on the other hand, do not go out of business ... they have no well-defined bottom line"* (Krugman 1994). Hence the measure for the competitiveness of nations is not sustainability in the market. Empirical evidence tells us that not even the trade balance is a reasonable indicator of a nations competitiveness, since trade surpluses can occur in phases of economic crisis and vice versa.

In the case of nations or regions, a loss of competitiveness does not lead to elimination as in the case of firms, but deteriorating welfare conditions. Therefore, normative parameters including socio-economic and environmental issues are necessary to assess the competitiveness of such aggregates as nations. We define national competitiveness as *the degree to which a nation can, under free and fair market conditions, produce goods and services that meet the test of international markets, while simultaneously maintaining and expanding real incomes of its people over the long term. This long-term perspective implies the need to reduce eco-*

logical impacts and resource intensity to a level at least in line with the carrying capacity of the nation's ecosystems.[3]

Why "systemic"?: By using the term *systemic* we want to point out several factors. First, a firm will generally not become competitive on its own, that is without a supporting environment of suppliers and production-oriented services as well as the competitive pressure of local competitors.[4] Microlevel competitiveness is based on interaction. Learning-by-interacting is a key element in firms' innovation processes, and feedback loops between firms and supporting institutions are crucial in order to establish dynamic competitive advantages.

Second, an environment that sustains competitiveness is rooted in a national system of norms, rules and institutions that defines the incentives that shape the behavior of firms (Nelson 1992).

Third, we maintain that the state has an important role to play in industrial development and restructuring. However, we take for granted that autocratic, hierarchical modes of governance are becoming obsolete. New forms of governance are emerging that are based on a new kind of interaction between state and societal actors, typically in horizontal networks (Mayntz 1991). Here we find, again, interaction and feedback-loops.

Scope of the concept: With increasing complexity of industrial organization, the systemic nature of competitiveness becomes more important. Especially the most innovative industries build upon positive external economies such as the existence of world class suppliers of intermediary goods and machinery, demanding consumers, specialized business services and other factors making up a supporting business environment. Nevertheless, certain industries can operate fairly well without such an environment. The systemic character of competitiveness is not equally important to all industries. Two exceptions are especially important with regard to the industrialization prospects of developing countries:

First, some mature production processes can be transferred to greenfields which lack most elements of a modern supporting business environment. This is obvious in the case of those light industries which are typical of Export Processing Zones (apparel, electronic assembly, toys, etc.). Basic infrastructure consisting of access to international airports and ports, electricity and minimal education of the workforce are sufficient conditions to attract such industries. Recently, even relatively complex state-of-the-art production processes including robots and modern management methods such as *kaizen* have successfully been transplanted to greenfields in developing countries. But it is important to notice that all these examples refer to mature industries which can be built up by transplanting codified knowledge embodied in

3 This definition is based on the *Report of the US Presidential Commission on Industrial Competitiveness*, which was elaborated in 1985 (quoted from OECD 1992, p. 242), adding the target of ecological sustainability as defined by the World Business Council for Sustainable Development (quoted from Fussler 1994, p. 71).

4 Cf. Porter (1990).

blueprints, machines and operation manuals. These industries may be called *blueprint industries* since they do not depend on more tacit forms of knowledge that are not codified in blueprint form, and therefore cannot be entirely diffused. These blueprint industries do not carry on substantial R&D and will usually not even produce much incremental technological change.

Second, despite the general trend towards tariff reduction, certain industries oriented towards developing countries domestic markets are not fully exposed to international competition. This is especially true for the low-ends of product markets. Therefore, firms can perform fairly well even if the supporting environment is weak. This is due to the fact that there are entry barriers to the domestic market which trade liberalization does not eliminate. Examples are (Altenburg 1996):

- high transportation costs;
- deficient communication systems;
- a market size too small to be interesting for potential foreign investors;
- underdeveloped marketing systems with large parts of the demand being served by street vendors or on the basis of informal credit arrangements;
- special local consumption patterns.

4.2 The roots of the concept of systemic competitiveness

The concept of systemic competitiveness draws on different strands of the discussion in economics and social science. The contribution of the concept is primarily to address the complementarities of largely unrelated discussions in different disciplines. We do not claim that systemic competitiveness is a theory but rather a heuristic framework to overcome the limitations of isolated disciplinary discourses.

In the field of economics we draw mainly on the contributions of four different schools: innovation economics and evolutionary economics, the post-structuralist school, some elements of institutional economics, and certain contributions from management science.

1. Innovation economists have done extensive research on the functional logic of innovation processes and innovation systems, to a certain degree continuing along lines established by Schumpeter.[5] In this view, innovation is not an event but a process that typically occurs along trajectories. Defining a trajectory implies a decision in favor of one and against other technological options. The decision typically reflects a specific historic constellation, including economic, political, technical, and other factors as well as coincidence. Once a trajectory has been established, the latitude for guiding technological development is lim-

5 Dosi et al. (1988); Freeman (1987); OECD (1992).

ited (path dependence). The innovation process is based on continuous learning in the form of learning-by-doing, learning-by-using, and learning-by-interacting, between firms as well as between firms and research- and technology-institutes. Innovation patterns differ from country to country due to different institutional frameworks and different incentive structures; thus emerge different national systems of innovation. Technological knowledge can never be fully codified, i.e. it is crucial to keep in mind the importance of tacit knowledge, which is not easily transferable and mostly person- and firm-specific. Therefore, in order to use a given technology, a firm has to undertake learning efforts to create the necessary tacit knowledge. Due to path dependence and the tacitness of knowledge, neo-classical views that suppose complete freedom to choose, transfer, and switch between technologies do not provide an adequate understanding. Accordingly, policy recommendations based on neo-classic thinking will often be inadequate.

2. A key issue in the post-structuralist discourse is the redefinition of the role of the state in processes of late industrialization.[6] Traditional structuralism pointed at the central role of the well-informed, powerful development state in guiding the industrialization process. The experience of the East Asian NICs has shown that this concept was not altogether wrong. However, it depended on a number of specific factors which had to be combined in a sophisticated way. Only few societies succeeded in doing so. In other parts of the world, particularly in Latin America, an etatist, market- and competition-unfriendly model of industrial development generated temporarily high growth rates. In the end, however, it led to mutually reinforcing blockade constellations and a deep economic and social crisis. The post-structuralist discussion still maintains that the state has to play an important role. At the same time, the importance of economic incentive structures is emphasized, especially the role of competitive pressure in stimulating technological learning and upgrading.

3. The new institutional economics tries (essentially inside the framework of neoclassical economics) to identify those rules, conventions, norms, and structures which shape the behavior of economic agents, especially firms.[7] Two elements are particularly important in our context. First, institutional economics emphasizes the importance of systems of rules, particularly property rights. Without well-established and enforceable property rights the conditions for entrepreneurship are severely circumscribed. Second, institutional economics points at the importance of transaction costs, i.e. the costs involved in the arrangement, supervision, and enforcement of contracts. High transactions costs, e.g. due to missing or badly-organized information systems (for instance regarding the credit standing of firms), will often lead to suboptimal patterns of organization (e.g. extreme vertical integration as firms prefer not to deal with suppliers and subcontractors due to high transaction costs).

4. In the view of management science there is no question that firms' competitive advantages do not emerge randomly but are created by strategic management. It emphasizes that firms should concentrate on their core competencies and outsource other activities and should

6 Amsden (1989); Lall (1992); CEPAL (1990); Hillebrand (1991).

7 Important authors are Williamson (1995) and North (1995). For an overview see Reuter (1994).

also strive for creating competitive advantages along the whole value chain. Apart from intra-firm features, management science has increasingly dealt with aggregates of firms over the last years.[8] Going beyond this perspective, Porter has argued that the distinguishing element between more and less successful economies is the difference in the quality of industrial clusters (and not just individual firms). According to Porter, successful industrial development has to be created through deliberate action. Sustained industrial competitiveness is based on four factors: competent firms with a strategic vision, a demanding domestic market, highly capable supporting industries, and a well-developed environment of specific supporting institutions.

In the field of social science, the concept of systemic competitiveness relates mainly to four strands of discussion: economic sociology, industrial sociology, economic geography, and political science.

1. Economic sociology tries to analyze structures and processes, and particularly power relations that shape economic transactions in the real world.[9] It aims at explaining outside the world of economic models why economic agents behave in the way they do. Important insights include the observation of the crucial role of trust and relational contracting. Economic transactions, e.g. between a firm and its most important suppliers, are not anonymous market transactions but embedded in a complex social relationship pattern. This insight arose from observations of such different phenomena like long-term supplier relationships in the Japanese industrial system and dense networks with highly differentiated forms of communication and sanction-mechanisms in Italian industrial districts.
2. Industrial sociology has made important contributions to the understanding of the fundamental changes in firms that have occurred since the 1980s.[10] It identified "new production concepts" which differed profoundly from traditional Taylorist concepts. While management science prescribed new organizational concepts (lean production, flat hierarchies, teamwork, strongly reduced division of labor inside the firm), industrial sociology also analyzed the obstacles to their quick introduction, particularly the power structures inside firms.
3. Economic geography has received increasing attention as other disciplines began to realize the importance of spatial concentration of firms and supporting institutions[11]. Spatial concentration stimulates formal and informal communication, thus facilitating rapid diffusion of information and collective learning – and these are the factors that decide on success

8 The work of Porter (1990) has been particularly influential. For an overview see Messner and Meyer-Stamer (1993).

9 Important authors are Granovetter (1992) and Platteau (1994a and b). For an overview see Smelser and Swedberg (1994). On the industrial district discussion, see the overview of Nadvi and Schmitz (1994).

10 Pathbreaking contributions were made by Kern and Schumann (1984). For an overview, see Sauer and Wittke (1994).

11 One of the most influential authors is Storper (1995).

and failure in ever tougher competition which is based on continuous innovation. In this context traditional concepts of regional policy that aimed at dispersing industries have increasingly come under criticism.

4. Political science has moved from optimism to pessimism and back again regarding governability, i.e. actively and deliberately shaping the fate, of industrial societies.[12] The 1970s were, in many industrial countries, marked by attempts to restructure societies in a top-down manner, using hierarchical governance modes. The success of these efforts was limited, not only due to various sources of resistance but also due to the objective problems of governing across different levels of government and across different sectors, which created extremely entangled structures with mutually reinforcing blockades. The result was deep pessimism regarding the governability of industrial societies, which shaped the discussion in the 1980s. Pessimism was theoretically well-founded, but it was at least partially rejected based on the observation of new, network-like governance patterns in fields like research, health, and telecommunication policy. The main finding was that such sectors were no longer governed through hierarchical structures under the guidance of the state. Rather, there were horizontal, heterarchical structures that involved state and non-state actors. Policy-networks in the shadow of hierarchy served to define problems and to find solutions. Involving societal actors, it turned out, mobilized essential know-how and creativity and improved the perspectives for successful implementation. This pattern supplants the traditional pattern of political organization based on division of powers and helps to overcome some of its deficits.

The common denominator of these different strands of theory is the notion of networks. The network feature is crucial for both the political and the economic dimension of systemic competitiveness. Firms that compete on globalized markets are not the atomized agents of textbook microeconomic theory. Rather, they are woven into dense networks that consist of other firms (suppliers, customers, and competitors) and of mesoinstitutions. Likewise, political actors that formulate industrial strategy are not the utility-maximizers of rational choice theory. Instead, they are also woven into networks, in this case policy-networks that consist of agents from different public institutions and representatives of different organizations of the civil society. These policy-networks complement the established, hierarchical governance patterns and democratic institutions. They are the place where joint definitions of problems are sought and concrete measures to solve them are formulated.

Creating the conditions for systemic competitiveness is profoundly different from the kind of state-led, guided, and interventionist industrial policy of the past. It is a market-friendly approach as it acknowledges that a functioning market is the key prerequisite for industrial dynamism. It is also an approach that can be much less costly than the traditional, subsidy-based industrial policy as it essentially involves stimulation, encouragement, and moderation, plus

12 Important authors are Mayntz (1991); Scharpf (1991). For an overview see Messner (1997).

the creation of specific mesoinstitutions which will not emerge spontaneously due to an initially unfavorable cost-benefit-ratio or problems of free-riding.

4.3 The four levels of systemic competitiveness

Orthodox economics address two levels, namely the macro- and the microlevel. The analysis of successful industrialization processes has shown that a well-functioning mesolevel of specific policies and supporting institutions is a further important dimension. In addition, it is obvious that successful development depends highly on the cultural values, the social composition and the political system in a given country. In trying to understand how competitive industries are being built up it is therefore important to address features at the metalevel.

Macrolevel: Linking Economic Stabilization and Liberalization to the Capacity to Transform

An enabling macroeconomic environment, i.e. well-functioning factor, commodity and capital markets, are crucial to securing the efficient allocation of resources. In view of the experience gathered from the 1970s it is now widely accepted that an unstable and highly biased macroeconomic framework (high inflation, persisting high budget and trade deficits and a distinct anti-export bias in the economy resulting from an overvalued exchange rate as well as high protectionist barriers) considerably reduce the ability of these markets to function properly, with negative effects being particularly on economic growth and exports.

Stabilization of the macroeconomic framework must in particular encompass a reform of fiscal, budgetary, monetary as well as currency and trade policies. The sequencing of such measures depends on the specific circumstances. When formulating and launching these reforms policy makers must, however, take into account that there is a latent field of tension between the goals of creating a stable and unbiased macroeconomic framework and securing the basis for future growth and the capacity to compete on world markets. Therefore, stabilization and liberalization measures for the economy as a whole should be linked as closely as possible to parallel, protracted structural reforms as well as the country's short- and medium-term capacity to transform.

Microlevel: Technological and Organizational Requirements

Firms are faced today with increasing challenges resulting from six different trends: First, globalization of competition in a rising number of product markets; second, an increase in the number of competitors on account of successful late industrialization processes and successful structural adjustment as well as export orientation; third, increasingly differentiated demand patterns; fourth, shortening product innovation cycles; fifth, assertion of radical technological and organizational innovations; and sixth, upheavals in technological systems in which the borderlines between sectors are newly demarcated, for example overlaps between computer technology and telecommunications (telematics) or between mechanics and electronics (mechatronics).

Firms have to optimize four criteria in order to be competitive: cost-efficiency, quality, variety, and responsiveness. The ability to offer a variety of products without sacrificing quality and efficiency is necessary to attend an increasingly differentiated demand. Responsiveness means the ability to react quickly to changes in demand and new opportunities.

In order to meet the new demands, firms must extensively reorganize themselves both internally and in conjunction with their immediate environments. Incremental changes as envisaged in the 1980s with far-reaching automation and information-technological interlinking (recall the "automation of Taylorism") are simply not enough. In order to increase efficiency, quality, variety, and responsiveness at the same time, profound changes in three areas are needed:

– **Organization of production:** The aims are a reduction of time-to-market and through-put times, for example by replacing traditional conveyor belts and transfer systems by cellular manufacturing in order to be able to respond quickly to customers' demands, and by a reduction of stocks, in order to reduce the costs of current assets. Further aims are improvements in quality and quality costs (defect and rework ratios), which can be achieved by approaches like total quality management.
– **Organization of product development:** The strict division between development, production and marketing has not seldom led to product designs which resulted in too high production costs and/or did not meet customer preferences. Parallel organization of various development stages and reintegration of development, production and marketing (simultaneous engineering) lead to drastically reduced development times and to products which can be more efficiently produced and are easier to market.
– **Organization of the value chain:** Firms reduce vertical integration in order to be able to concentrate on their core competence. They reorganize supply and subcontracting, especially by introducing just-in-time linkages. And they reorganize their supplier pyramids by reducing the number of direct suppliers by upgrading some of them to system suppliers and by integrating them also into the product development process.

In all three areas the key issue is the interaction between organizational, social and technical innovations. Reorganization is often what first creates the conditions for the use of new computerized hardware. Social innovations (reduction of hierarchical levels, a much wider scope for decision-making at the operative level) are prerequisites for the functioning of new organizational concepts.

A separate issue that has to be addressed at the microlevel is that of the structure of industry, and the appropriate framework for analyzing it. A traditional view would be to distinguish consumer non-durables and durables, intermediate goods, and capital goods. Another view, addressing technological issues, is the distinction between supplier-driven, scale-intensive, specialized supplier, and science-based industries (Pavitt 1984). Yet another view, addressing the interaction between profound changes in the macroeconomic framework and adjustment at the microlevel, is the distinction between resource-intensive, qualified labor-intensive, and R&D-intensive industries (Katz 1996). These concepts are often helpful in analyzing specific circumstances. It is furthermore important to note that hardly any industry, and any firm, qualifies *a priori* for any of these classifications; the Finnish pulp and paper industry was probably much more R&D intensive than the Brazilian computer industry. It is thus essential not to confuse empirical concepts (*How do I order a given reality?*) and prescriptive concepts (*Which industry should I try to stimulate because it has a particularly positive impact on welfare?*)

Mesolevel: Supporting the Efforts of Firms

The increasing challenges to firms go hand-in-hand with increasing demands on their support structures. In the world economy therefore, it is no longer only individual firms that compete with each other but industrial clusters, groups of firms organized in networks, whose dynamic development depends on the potential of the particular location. This potential is shaped by continuous and close contact with R&D facilities, technology formation and dissemination institutions, universities, training institutions, finance institutions, export information institutions, and many other entities. Due to increasing global competitive pressure the demands on the local, regional and national level to create and support the business environment are increasing; this applies to demands on business associations and other non-governmental actors as well as to demands on the state at all these levels.

There are two different ways of addressing the mesolevel. First, there are mesoinstitutions which offer specific services to industrial firms. Second, there are mesopolicies, i.e. selective, targeted policies to shape sector-specific regulatory and other conditions and to create mesolevel institutions.

Mesoinstitutions: A well-developed industrial location hosts a broad set of institutions which offer services and support to firms (Figure 2). This set of institutions is usually the outcome of a long learning and upgrading process of individual firms, institutions, and the interaction among them. Porter's differentiation between basic and advanced factors, and generalized and specialized factors, is useful in addressing a typical sequence of development of a set of mesoinstitutions in a given location:

> "*Basic factors* include natural resources, climate, location, unskilled and semi-skilled labor, and debt capital. *Advanced factors* include modern digital data communications infrastructure, highly educated personnel such as graduate engineers and computer scientists, and university research institute in sophisticated disciplines. (...) *Generalized* factors include the highway system, a supply of debt capital, or a pool of well motivated employees with college educations. They can be employed in a wide range of industries. *Specialized* factors involve narrowly skilled personnel, infrastructure with specific properties, knowledge bases in par-

> ticular fields, and other factors with relevance to a limited range or even to just a single industry." (Porter 1990, 77 f)

In the early stages industrial development in a given location will be mostly based on basic and generalized factors. Only after a certain period of time advanced and specialized factors will be created, partially through private enterprise (e.g. provision of venture capital or specialized business consultancy), partially through the activities of business associations (e.g. technology information), and partially through government activities (e.g. university research and education). As a matter of fact, a closer look at the elements mentioned in Figure 2 reveals that most factors at the mesolevel can be provided through the private sector, either by specialized individual firms or by business associations. It is thus important to note that shaping the mesolevel does not necessarily, and not even predominantly, involve government activities.

Mesopolicies: Mesopolicies to create systemic competitiveness consist of three main elements:

– Regulatory policy: Based on the "Washington consensus", one might argue that there should be no mesolevel regulatory policies, i.e. there should be a uniform macrolevel regulatory framework that applies to all industrial branches and sectors. However, there is still a justification for selective regulatory policies. Regarding import policies there is still a case to be made for infant industry protection, albeit on a fixed-term and performance-related basis. Regarding environmental policies, it can be sensible to target different industrial branches in a differentiated way.

– Financial instruments: These are useful in fields like R&D support and export promotion where market failure is likely. Tax incentives and direct subsidies can stimulate intra-firm R&D which would otherwise not take place on the scale that is desirable in a macroeconomic perspective due to external effects and limited appropriability. Export credit and insurance is often provided by state agencies, or reinsured by government, because factors like political risk lead to private underinvolvement in this field.

– Government activities to create and upgrade mesolevel institutions: These are justified in the case of market failure or if collective action by the private sector fails to happen. Market failure is very likely in R&D and training, certain areas of infrastructure (especially provision outside dynamic centers), and environment. In the particular case of less advanced developing countries, it may also happen in finance due to the small size of the market, high risk, and high transaction cost.

It is complicated to strike an adequate balance between supply- and demand-driven measures in creating mesolevel institutions; this is something that SME support and regional policies in advanced countries as well as national development policies in and technical assistance to developing countries are constantly struggling with. Supply-driven measures, i.e. measures that anticipate a potential or future demand of firms for support by mesolevel institutions, are often not successful. This applies especially to early phases of industrial development when firms are small, are showing deficits in most business functions, and have for exact these reasons no obvious receiving structure for support by mesolevel institutions. The work of mesolevel institutions becomes much easier once firms are highly competent and a culture of micro-meso interaction has been established. It is, however, also risky to rely exclusively on demand-driven measures. Mesoinstitutions like technology demonstration centers are by definition supposed to generate changes in behavior rather than waiting for them to happen. One way of resolving this dilemma is to establish close communication between government, business, and other actors active in the area of mesoinstitutions who should be able to articulate existing and anticipate foreseeable demand.

Competitiveness-oriented mesopolicies should not be confused with certain traditional variants of industrial policy. Mesopolicies to create systemic competitiveness are about stimulating competition, and supporting firms to make the best of a highly competitive environment. Traditional industrial policy often was the exact opposite, for instance protecting domestic industries against foreign competitors or even stifling domestic competition by encouraging the emergence of national champions. Regulatory policies (e.g. import and local content regulations or licensing procedures) and financial instruments (e.g. direct subsidies) were main instruments of such traditional industrial policies. Both are still important instruments, but in a different way. A further traditional instrument, state ownership, has currently fallen out of favor as state enterprises tended to show an unsatisfactory performance.

The interrelationship between the regional and the national level: The *locus* of industry-related policy-making is changing. Traditionally, industrial policy, technology policy, and other specific policies that shaped industrial development were prerogatives of central governments. The situation has changed. As firms get under increasing pressure due to globalization, their demands on their local environment increase. Consequently, mesopolicies increasingly have to be formulated at the regional and local level. In some countries, regional or local governments have the responsibility in key mesopolicies anyway, e.g. in education.

One crucial aim of mesopolicies is to create specific locational advantages. These are, by definition, highly localized. Decentralization of mesopolicies is therefore desirable; it does not make sense if central government starts to define dozens, if not hundreds of policies for different regions. A local policy should be formulated by local actors, tailoring it to the strengths and weaknesses of the given region. It will often be easier to mobilize locally the know-how for diagnosing strengths and weaknesses of firms and their environment, and to formulate measures to strengthen strengths and overcome weaknesses.

Yet central government can play an important role in stimulating local and regional policy formulation:

– It should check on subsidies offered by regional and local governments, thus inhibiting subsidy races between regions and stimulating creativity races instead.

– It can introduce creative local strategy formulation as a condition for the allocation of subsidies (like regional development funds), thus introducing a performance incentive in this field.

Apart from that, certain mesolevel tasks remain with the national government. These include, for instance, large-scale technology initiatives and the formulation of an overall long-term strategy.

Metalevel: Governance for Industrial Competitiveness

Demands at the metalevel: At the metalevel, one important aspect concerns the existence of development-oriented cultural values which are shared by a large part of the society. Such values include, i.e., social recognition of economic success, general acceptance of the idea that predatory behavior and freeriding jeopardize social development, a priority for long-term investment in education and training and a high propensity to save. If such values are not rooted in a society, it is very hard to stimulate them through macro- or mesopolicies. This explains why similar instruments designed to promote for instance entrepreneurship, interfirm cooperation, or savings cooperatives perform very differently across countries.

A second crucial precondition for competitiveness is the existence of a basic consensus on the necessity of industrial development and a competitive integration into the world market. Taking into account the increasing internationalization of the economy, societies cannot choose development paths randomly. The key actors have to accept the world market as a framework. This does not necessarily imply a high export ratio. It rather means that firms should aim to get close to international quality and efficiency standards, since even in their open domestic markets they compete with imported goods. As long as there is fundamental disagreement on these issues, macro- and mesopolicies will be erratic, and firms will develop a defensive posture in order to be able to react quickly to changes in the rules of the game.

The third basic element at the metalevel is the ability of social actors to jointly formulate visions and strategies and to implement policies. This implies a vision shared by a relevant group of social actors about which position should be targeted in the international division of labor, which comparative advantages should be developed in the long run, how profits and costs of market integration should be distributed among social groups, etc. Such a shared vision is important to concentrate resources. Moreover, long and medium-term orientations are important for asserting future interests against current interests and for generating stable expectations. The construction of such a basic consensus is a complex political process and makes high demands on social actors: entrepreneurs, workers and other concerned members of the civil society have to be ready to get involved in institutions and commit themselves to the achievement of common targets.[13] In addition, they must be willing to find a compromise with other interest groups. This makes the difference between democratic and corporatist cultures, because the latter excludes relevant social groups from strategy formulation.

13 This willingness has been termed "social capital"; see, for instance, Bazan and Schmitz (1997).

The metalevel in developing countries: Cultural values are obviously very heterogeneous across countries and explain much of their different economic performance. On the other hand, some characteristics of the metalevel are widespread among developing countries. In the following, we will point out some of these common features.

Until recently most developing (as well as socialist) countries were characterized by centralized political decision-making processes and a bureaucratic, inefficient government apparatus. Often this was even overlaid with rentist-corporatist structures which allowed privileged groups effectively to realize their particular interests (Kaufman 1990, Cavarozzi 1992). These power structures corresponded with forms of social disintegration and fragmentation which were characterized by the exclusion of broad segments of the population as well as by political and social polarization. All this established obstacles to successful industrial development at several levels. Firms did not cooperate as mistrust and predatory behavior was pervasive. Workers and trade unions resisted modernization efforts. Disparities in income distribution led to low savings rates and accordingly low capital formation. Social unrest and political instability favored stop-and-go policies which compromised firms' efforts to a day-to-day struggle for survival.

The economic crisis of the 1980s showed the limited viability of inward-oriented development patterns and created a growing consensus on the necessity to integrate into the world market. Structural Adjustment Programs strengthened the market mechanism and partly eliminated incentives for rent-seeking behavior and clientelist relationships. Moreover, institutional reforms introduced more transparency in institutional decision-making. On the other hand, Structural Adjustment Programs failed to recognize that in most developing countries, markets are not fully developed and the civil society is weak. Under these circumstances, deregulation and the downsizing of the public administration are obviously not sufficient to create a competitive economy and to guarantee social development. Social disintegration may even be further exacerbated if macroeconomic reforms fail to establish regulatory and governance capacities (government reform, formation of complex linkages between strategic actors) and the requisite social structures.

As systemic competitiveness cannot emerge without social integration, its creation implies a social transformation venture that goes far beyond correcting macroeconomic framework conditions. For one thing, it requires fundamental restructuring of business associations and trade unions, as well as other key organizations of the civil society. The process of restructuring organizations and the creation of new intermediary institutions follow three complementary logics. First, these organizations and institutions need to be restructured internally; second, they must strengthen their ability to represent their interests vis-à-vis government or other societal actors; third, they must shape their own environments through cooperation and networking with public or private institutions.

Major groups in society must learn that safeguarding government from influential, privileged groups may establish a positive-sum game. Only a relatively autonomous government is able to gear its activities toward overall social and economic interests. Transparency and accountability are crucial. Autonomous functional subsystems are based on a clear-cut division of responsibilities between government, industry, and societal actors. They may then be further developed by intrinsic learning processes, flexibility and responsiveness, and by dialogue and efforts to search cooperatively for optimal solutions involving government and societal actors. This may occur on the national as well as at the regional and local levels.

The need for heterarchical governance patterns: Although the dogma that government is obliged to assume a strictly subsidiary role vis-à-vis market processes is inadequate, the neoliberal critique of the traditional ways of government intervention is basically correct. The idea that government alone, as a kind of central control center of a society, can selectively direct technological and economic processes presupposes that government bureaucrats are more capable and better informed than other actors in society, including firms. This may have been the case in some latecomer countries, most impressively in East Asia (Cumings 1984), although even there it is important to note that the pattern also involved strategic action on the side of the private sector, and close interaction between public and private sector. Anyway, as societies get ever more differentiated, and firms as well as other actors undergo learning processes, the ability to formulate and implement joint strategies moves from the public to the private sector. The necessary know-how and the implementation capacities are distributed across a variety of governmental, private, and intermediary agencies. One-dimensional, etatist and centralist patterns of governance are therefore unsuitable for the development and support of complex entrepreneurial networks and specialized institutional landscapes – in OECD countries as well as in industrially advanced developing countries (Best 1990).

Still, the conclusion that the state has no role to play at all is not well founded since this proposition ignores the indisputable fact that new forms of governance have emerged, initially in a number of OECD countries where government policy no longer follows the pattern of a traditional interventionist state. Rather, government acts as a coordinator, moderator and communicator in policy networks with firms and their associations, science, intermediary institutions, and trade unions. It aims at collecting and disseminating relevant information and working out joint medium- and long-term visions that can serve as points of reference for government mesopolicies as well as private initiatives. This makes it possible to relieve the government's burden by shifting decision-making processes into intermediary arenas, to ensure a higher degree of information availability, to heighten the legitimacy of government decisions, and to mobilize the creativity available among societal actors by involving them and their respective problem-solving capacities in a strategic fashion. Policy networks do, however, presuppose on the part of societal actors a capacity to compromise, to perform and learn, and to accept transformation.[14]

Thus, aside from the forms of governance already prevalent in societies organized along the lines of market economies – hierarchic co-ordination and steering in firms and public institutions, market-like co-ordination among firms, and hierarchic governance of society by gov-

14 Cf. Scharpf (1991); Mayntz (1991); Héritier (1993); Atkinson and Coleman (1989).

ernment – network-like forms of organization are emerging (Powell 1990). This is happening in particular at the mesolevel, where the emerging forms are characterized neither by simple market allocation (competition and price) nor by centralist governance mechanisms (hierarchic control and state interventionism).

The predominant discussion in the 1980s of market vs. government overlooked these innovative forms that were involved in the shaping of social structures. They are based on a combination of market, government and a variety of forms of self-coordination, these operating in the shadow of the market, the shadow of hierarchies, and in self-organizing networks. This view of increasingly differentiated forms of social organization and governance surmounts the classical dichotomies of market versus government and of total autonomy of decentral actors (liberalism) versus totally integrated society (socialism).

Successful policy networks are based on six core elements (Mayntz 1991, 16):

– autonomous collective actors capable of internal conflict resolution;
– trust and commitment to fair exchange;
– orientation towards a substantial outcome (problem-solving, beyond minimum consensus);
– joint decision-making based on information-sharing;
– reciprocity, or a just distribution of the costs and benefits of a joint decision (or a given problem solution); and
– voluntary restriction of each actor's freedom of action because it is accepted that each actor has a legitimate claim that his interests be respected.

Policy networks differ from traditional corporatism in that the role of the state has changed: rather than the state's organizing private interest and arbitrating between corporatist groups which hardly interact among each other, representatives of associations interact with each other and with state bureaucrats on an equal basis. Policy networks are also different from the 1970s brand of European neo-corporatism which basically involved the central state government and the peak organizations of capital and labor. Yet it is difficult to find a profound difference between 'mesocorporatism' and policy networks: both terms describe arrangements that used to have a certain level of institutional (albeit often informal) stability and a set of (albeit often tacit) rules that govern the interaction process.

Policy networks tend to be organized on a sectoral basis, dealing with fields like science policy, technology policy, or health policy; and they tend to be embedded in political structures where there is some higher level that may intervene in case a policy network runs astray. The state can, for instance, stimulate the build-up of local or regional policy networks that set out to formulate an industrial strategy. It can make sense to support such efforts financially as long as this support is linked to performance criteria. At other levels, for instance a network for technology policy on the national level, the threat that the state might unilaterally devise measures that run counter to the interests of the parties involved is an important stimulus for the proper functioning of policy networks.

4.4 The four levels of systemic competitiveness and different levels of aggregation

It is important to note that the concept of systemic competitiveness does not only apply to countries. It is useful in understanding both sub- and supranational factors that determine firms' competitiveness. The following table gives an overview.

Table 8: Levels of Systemic Competitiveness and Levels of Policy-Making

	Supranational	*National*	*Regional*	*Local*
Meta	Competition between different models of market economy Culture of international cooperation	National integration Strategic capacity of national actors	Regional identity Strategic capacity of regional actors	Local identity Strategic capacity of local actors Trust creative milieu
Macro	International flow of capital (opportunity + performance-pressure International trade	Stable macro-framework Liberal trade policy Competition policy Generic environmental policy	Solid fiscal policy Investment capacity	Solid fiscal policy Investment capacity Attractive environment, quality of life
Meso	EU industrial policy EU technology policy Montreal protocol	Technology policy Education policy Regional policy Industrial policy Specific import policy Export promotion Sector-specific environmental policy	Regional economic promotion Technology demonstration centers R&D institute Education and training institutions Financial institutions	Local economic promotion Education and training institutions Technology centers, incubators Effective chambers
Micro	Transnationals International firm alliances Global commodity chain	Medium and large firms Disperse networks Supplier relationships national alliances	SME Cluster Supplier relationships	SME Cluster Industrial Districts

Most of the elements have already been mentioned before, others are self-explaining or obvious. Nevertheless, it may be necessary to emphasize the importance of addressing meta- and macrolevel issues at the regional and local level. Regarding metalevel issues it is essential to understand that it is not just generic cultural features which shape the behavior of actors. In a given country, regional and local cultures, especially business cultures, are often vastly different; concepts like "innovative milieus" address precisely this issue. Metalevel elements like trust and cooperative spirit are key issues in research on industrial districts.

Regarding macrolevel issues, it does not need mentioning that government at the regional and local level has little influence on monetary or foreign trade policy. Nevertheless, is has a profound influence on the generic economic framework conditions for firms – especially if it runs huge budgetary deficits, or if its budget practice is guided by clientelism rather than developmentalism. In such cases the state's capacity to create an adequate business environment suffers, even in terms of basic features like paved roads.

5 Conceptual background: Clusters, Networks, and Commodity Chains

For the past ten years, one of the most influential concepts to understand and to promote economic development, especially at the local and regional level, has been the cluster concept. In this section I will give an introduction to different analytical approaches to clustering. I will also discuss obstacles to cluster promotion and some options to overcome them.

5.1 Michael Porter and competitive advantage

Main message: Competitive advantage is created, not inherited. The competitiveness of firms, clusters and regions is based on four factors (the "Diamond"): Business strategy and rivalry, supporting industries, factor conditions, and demand conditions.

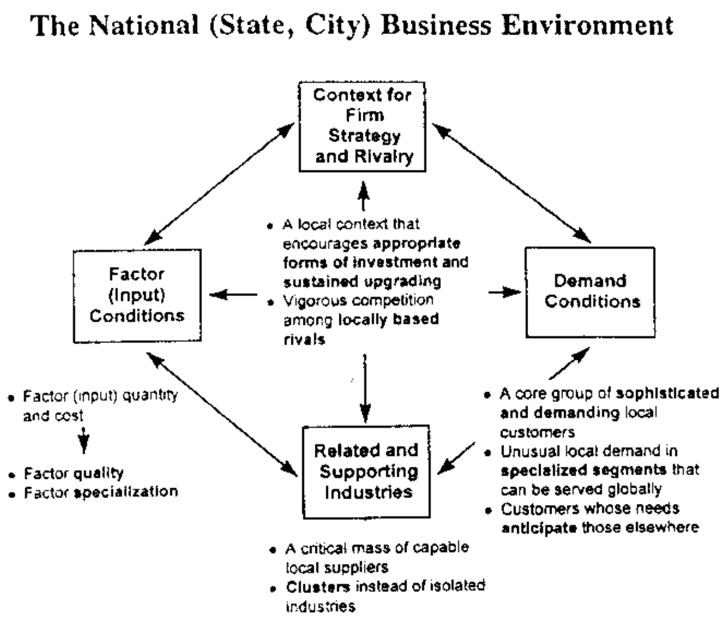
In fact, this is probably the major difference compared to traditional approaches: it is no longer about creating production capacity but about competitive advantage. Competitiveness is the key issue in all these activities. The term *competitive advantage* was coined by Michael Porter in his work on firm-level factors (1986) and clusters of firms (1990). It marks a departure from traditional economic thinking which was focusing on comparative advantage. Essentially, comparative advantage is inherited (availability of basic factors of production, like cheap labor or energy, or natural resources) whereas competitive advantage is created. Looking back at the history of industrial development, one can perceive a series of firms, regions, and countries busily creating competitive advantage. Sustained industrial growth has hardly ever been built on inherited factors. As a rule is has been the outcome of interlinked factors and activities.

What are these interlinked factors? Porter himself boils it down to four factors (Figure 11):

1. Business strategies and structures and rivalry: Porter notes that despite all differences and national peculiarities one characteristic shared by competitive economies is that there is sharp competition among national firms. In a static perspective, national champions may enjoy advantages of scale; but the real world is dominated by dynamic conditions, and here it is direct competition that impels firms to work for increases in productivity and innovation; here, anonymous competition often turns into concrete rivalries and feuds, in particular when competitors are spatially concentrated. *"The more localized the rivalry, the more intense. And the more intense, the better."* (Porter 1990, 83) This is all the more true, as its effect is to cancel out static locational advantages and compel firms to develop dynamic advantages.

2. Existence or lack of related and supporting industries: Spatial proximity of upstream or downstream industries facilitates the exchange of information and promotes a continuous exchange of ideas and innovations. Porter refers, among other things, to experiences with industrial districts in Italy, whereby, however, he strongly qualifies their specifics (see below). On the one hand, he points out that even upstream industries should in no case be sheltered from international competition; and he notes on the other hand that when certain upstream industries are lacking, recourse can be had to the supply available in the world market.

Figure 11: Michael Porter's "Diamond"



Box 2: Porter's Five Forces Analysis

Another analytical concept developed by Porter is the Five Forces Analysis. It is a useful concept in analyzing the competitive position and strategic challenges of an industry. The five forces are:

- *Rivalry among existing firms*. Issues to be adressed in this respect are: numerous or equally balanced competitors, slow industry growth, high fixed or storage costs, lack of differentiation or switching costs, capacity augmented in large increments, diverse competitors, and high exit barriers.
- Bargaining power of suppliers. Issues here are: number of suppliers, the degree to which the supplier is obliged to contend with other substituted products, the importance of the industry as a customer of the supplier group, the importance of the supplier's product to the buyers business, the degree to which the supplier's products are differentiated or it has built up switching costs, and the question whether the supplier group poses a credible threat of forward integration.
- *Bargaining power of buyers*. Issues here are: the share of individual buyer's volumes relative to the seller sales, the share of the purchases of key buyer's as a portion of the buyer's total costs, standard or undifferentiated products, switching costs, importance of the product to the quality of the buyers' products or services, and the degree to which the buyer has full information.
- *Threat of new entrants*. Issues here are: economies of scale, product differentiation, capital requirements, switching costs, access to distribution channels, cost disadvantages independent of scales, and government policy.
- Threat of substitute products or services. The main issue here is that of radical technical change, i.e. the emergence of new products or services which offer a better performance and/or a lower price.

3. Factor conditions: These include, e.g. the availability of qualified manpower or adequate infrastructure. *"Contrary to conventional wisdom, simply having a general work force that is high school or even college educated represents no competitive advantage in modern international competition. To support competitive advantage, a factor must be highly specialized to an industry's particular needs – a scientific institute specialized in optics, a pool of venture capital to fund software companies. These factors are more scarce, more difficult for foreign competitors to imitate – and they require sustained investment to create."* (Porter 1990, 78).
   Here, disadvantages in general factor endowments need not necessarily prove disadvantageous, and they can even stimulate the development of competitiveness. If cheap raw materials or labor are available in abundance, firms will often yield to the temptation to rely solely on these advantages, and even to put them to inefficient uses. Conversely, certain disadvantages (high real estate prices, scarce labor and raw materials) can force firms to behave innovatively. This of course presupposes that positive impulses are generated by the other factors.

4. Demand conditions: The more demanding the customers in an economy, the greater the pressure facing firms to constantly improve their competitiveness via innovative products, through high quality, and so on. And the more localized the competition, the more directly firms feel it, and the better their performance has to be.

5.2 Clusters and industrial districts

Main message: Small and medium-sized companies which are working in close connection can overcome the disadvantages of small size and create a competitive advantage based on specialization and innovation. Through deliberate collective action they may create locational advantages which are not easily replicated elsewhere.

Porter's perspective, especially regarding his emphasis on competition and his neglect of cooperation, has not remained undisputed. A different line of argument starts from a similar empirical observation, namely clustering of industrial and service firms. Industrial clusters are spatial agglomerations of firms of the same sub-branch, say women's footwear, wooden musical instruments, ceramic tiles, or agricultural machinery, plus specialized suppliers, providers of services, and the like. In some places, most notably in several spots in Italy, such clusters are marked not only – as Porter would point out – by fierce local rivalry but also by dense cooperation. Such a cluster where a lot of cooperation and networking is apparent has been called Industrial District (not to be confused with the traditional use of the term which means no more than a area reserved for industrial firms).

The kind of competitiveness which emerges through deliberate cooperation within an industrial district (ID) has been coined "collective efficiency" by Hubert Schmitz (1995a). He has identified a number of criteria which distinguish an industrial district from a mere cluster (Schmitz 1995b):

- Sectoral specialization: An ID usually has a very narrow specialization profile – for instance, not just shoes but women's medium-price fashion shoes.
- Dominance of small- and medium-sized firms: Italian-style IDs consist predominantly, if not entirely, of SMEs.
- Strong division of labor: There is a dense network of business transactions and other kinds of interaction between firms.
- A high degree of specialization among firms: Firms in an ID are highly specialized, both in terms of product and specific steps of the production process.
- Strong competition, especially via innovation: Despite strong interaction there is also fierce rivalry between local firms. However, local competition is not based on factors like predatory pricing but on product and process innovation.
- Information network: Interaction between firms involves not only business transactions but also exchange of information. Information about changes in market, business opportunities, or product or process innovation spreads rapidly in an ID.

– Highly qualified workers: Both the level of formal qualification and the degree of tacit knowledge of workers tends to be high in IDs. As firms are small and highly specialized, there is little space for low-skilled labor.

– Socio-cultural basis for trust: Transactions between firms are mostly not based on formal contracts. The trust which is necessary to sustain this is both based on repeated positive experiences in business transactions (and also implicit means of sanctions if trust is misused) and on a wide variety of social transactions in other fields with create and increase social capital.

– Active role of the state: Although IDs emerge spontaneously, the state plays an important role in strengthening them in a later phase, especially by means of creating supporting institutions.

Research on IDs has provided important and valuable insights on the possible of having cooperation and competition at the same time ("coopetition"). It has also demonstrated that SMEs have an enormous potential in globalized markets provided they stick together. However, this approach has also received its fair share of criticism. Main issues are the transferability of the model to different places and cultures, the integration of IDs into international value chains, and the importance of central government policy in terms of opportunities and limits for local development:

– IDs exist not only in Italy. ID-like structures have also been observed in other European countries, in the U.S., and also in developing countries (Sinos Valley / Brazil, Sialkot / Pakistan). Therefore, the criticism that IDs can only emerge based on a specific local culture which has emerged over several centuries can be refuted. However, this does not mean that the ID concept is applicable to any kind of agglomeration of firms of the same sector. In fact, clusters are a typical phenomenon linked to industrial development, and one finds clusters all over the place. However, in developing countries the typical kind of agglomeration of small firms produces low-price consumer non-durables of mediocre quality and without much innovation in terms of new technology or new management concepts. Barriers to entry are low whereas barriers to upgrading are high. This often leads to a situation of oversupply, especially in times of crisis when demand drops and supply increases (as laid-off workers set up their own microfirms), and this in turn leads to predatory pricing. Moreover, there is often not only little innovation but in fact a lot of copying going on. Due to predatory pricing and copying, the local business-culture is marked by a high degree of mistrust. These are serious obstacles to inter-firm cooperation. But opportunities for inter-firm cooperation are also limited. As firms often operate with a low level of technical and managerial sophistication, the potential to reap the benefits of inter-firm specialization is limited. Whereas in an Italian ID each firm is highly specialized and the number of firms doing exactly the same thing is limited, in a typical developing country small-firm cluster essentially everybody is doing exactly the same thing. One might argue that inter-firm cooperation and specialization might precisely be the way out, but this will often be a very long process – it is not easy to move toward a knowledge-based development trajectory with business owners who have completed just a few years of primary school.

– Clusters and industrial districts are often integrated into international value chains. These value chains are often governed by firms outside the cluster – by large industrial firms, for instance in the case of the motor car industry, or by large sales chains, for instance in the clothing, footwear, and furniture industry. It is important to understand the structure of the international value chain to be able to understand the options and limitations for local action. For instance, local firms may compete for privileged access to foreign buyers; this can be a serious obstacle to local cooperation. Also, outside firms may deliberately play local firms against each other, particularly to prevent local collective action, for fear of losing ground in negotiations on price and delivery conditions.

– National-level policy defines a large part of the framework conditions local firms and clusters have to deal with. Macroeconomic conditions may create an unfavorable environment for cooperation at the local level. For instance, in the case of Brazil frequent macroeconomic stabilization programs in the 1980s and early 1990s created a situation where about 40 % of intra-firm contracts had to be renegotiated, thus creating a climate of opportunism and mistrust in inter-firm relationships. Moreover, macro-regulatory conditions can also create obstacles to inter-firm cooperation. In the case of Brazil, this applies to both taxes (which are cumulative on inter-firm transactions) and labor legislation (which can make a firm responsible for the fate the employees of a subcontractor). It is important to understand such macro factors in order to better understand the rationale of local actors, especially firms. Otherwise, entering into a cluster with an industrial district-perspective in mind one may perceive the behavior of local agents as irrational, and practical proposals may be inadequate to local conditions.

To sum up, it is important to understand both the strengths and the weaknesses of the industrial district approach. If it is possible to create a local milieu which is based on trust and thus facilitates cooperation, or if elements of such a milieu already exist, it makes a lot of sense to initiate a process of turning a cluster into an industrial district. However, such a strategy must be based on a very sober assessment of local factors in order to figure out whether an ID perspective is really a realistic one.

5.3 Obstacles for cooperation and cluster promotion

The literature provides us with a series of case-studies on successful co-operation and collaboration which lead to improved competitiveness in clusters. To the external observer, the logic of collective action appears compelling and the possible benefits overwhelming. Accordingly, the researcher tends to find it unlikely that co-operation does not materialize, or only to a very limited extent. At the same time, conversations with cluster practitioners and insiders from various clusters lead us to the observation that in a large number of clusters obvious opportunities for co-operation are not exploited. I have tried to explain such a behavior as a result of bounded rationality and path dependency (Meyer-Stamer 1998). Moreover, we have tried to analyze further reasons for lack of co-operation in clusters (Altenburg and Meyer-Stamer 1999). Nevertheless, it appears to me that so far we have only been scratching at the surface of the logic of non-cooperation in clusters. This note is an attempt to add some further observations.

5.3.1 Possible areas of co-operation

Based on the case-studies from successful clusters we can identify three main areas of co-operation:

- bilaterally and multilaterally between firms,
- between firms and supporting institutions,
- between the private sector and the public sector.

5.3.1.1 Co-operation between and among firms

Co-operation between and among firms refers to business transactions and other types of exchange. Co-operative business transactions are opposed to arms-length transactions. They include a certain amount of information exchange which is not covered by contracts, and usually not remunerated. A typical example would be close interaction between firms along the value chain.

Other types of co-operation may include co-operation between competitors. These may be contract-based ventures, such as joint product development projects, joint representation at a fair, or export consortia. A different kind of co-operation is not based on contracts, such as informal information exchange between firms. Still a different kind of co-operation involves ad-hoc coalitions between firms to solve immediate problems, especially by joint contracting of consultants or lobbying vis-à-vis government.

5.3.1.2 Co-operation between firms and supporting institutions

Co-operation between firms and supporting institutions involves individual firms, or groups of firms, on the one side and business associations or governmental, private, or PPP institutions on the other side.

A well-developed business association ought to display a number of features. It articulates the interests of the private sector vis-à-vis government. It has well-functioning communication channels with its member firms to know about things it has to articulate. It offers services to its member firms. It has a number of qualified professionals to do this. The relationship between professionals and elected directors is balanced. There is a degree of internal transparency and democracy which makes sure that different types and sizes of firms are represented in the association.

Business support institutions, be they governmental, private, or public-private partnerships (PPP), ought to display the following features. They have a clear customer focus and well-established communication channels with the customers. Frequent feedback leads to constant development of the services offered. They are organized in a business-like way, both to make their mindset compatible with that of their customers and to improve efficiency. They have systems for quality management and knowledge management in place.

5.3.1.3 Co-operation between the private and the public sector

Successful, dynamic clusters display a close, constructive relationship between the private and the public sector. This may be the result of a development-oriented public sector or of collective action and lobbying by the private sector. The public sector supports the competitiveness of firms. It streamlines its operations, reduces red tape, and sets up one-stop- or first-stop-agencies. It extends and maintains the infrastructure. It offers real services to firms, especially in fields which are rarely profitable and where collective action may fail due to free-riding behavior, such as training.

Moreover, the public sector may play a strategic role. It may take a leadership role in moving from "passive" to "active" cluster advantages, and it may pursue a deliberate strategy to strengthen the cluster, for instance by attracting complementary firms. In other places, where clustering is not yet expressive, public actors may pursue a cluster-oriented economic promotion strategy, for instance by stimulating the emergence of technology poles.

5.3.2 Typical obstacles for co-operation

In order to identify typical obstacles for co-operation, it is useful to look at each of the three main areas of potential co-operation.

5.3.2.1 Between firms, 1: Co-operation and prisoners' dilemma

Co-operation between firms involves a special type of prisoners' dilemma. In the textbook constellation, there are two prisoners who have jointly committed a crime without leaving evidence, are interrogated separately and offered a reduced sentence if they confess (blaming their partner). Both will confess (i.e. behave opportunistically, non-cooperatively), and both will be condemned to full sentences. If they co-operate, i.e. avoid opportunistic behavior, they cannot be sentenced.

In a cluster, the a-priori-constellation is quite different. Rather than acting jointly, firms are fierce rivals. Unlike the textbook prisoners' dilemma, it is not personal preferences and features or coincidences which will determine the decision for or against opportunistic behavior but a long history rivalry which will create a strong bias towards non-cooperation. Typical events in the evolution of a given cluster will reinforce this bias, for instance the emergence of spin-off-firms which cater towards the same customers, and whose founders may take trade secrets from their former employer with them.

Another important aspect is the stability which both constellations, co-operation and non-cooperation, tend to display. Moving from one constellation to the other is complicated. This is most obvious if one starts with non-cooperation. Isolated attempts of individual actors to co-operate will evoke opportunistic behavior by other actors, thus reinforcing the non-cooperative game. But the co-operative game is quite stable as well, as Axelrod (1997) has shown that even repeated opportunistic behavior will not necessarily destroy a co-operative game.

Empirical research on prisoners' dilemma has shown that the probability of co-operation is higher than 50 % in repeated games a actors learn that opportunistic behavior is detrimental. The stability of the co-operative game is further enhanced if direct communication is possible and if the game is further stabilized through two mechanisms: rules (and sanctions if rules are broken) and the emergence of trust. In a cluster, the basic constellation is quite different, especially if many firms produce more or less identical products. Everyday business behavior will tend to be opportunistic. Firms are desperate for sales, and if they are competing for the same customers they will tend to underbid each other; it is not by chance that in his early publications Porter (1990) emphasized the importance of rivalry for cluster dynamics. From both a theoretical and an empirical perspective one thus has to expect the emergence and reinforcement of non-cooperative games in clusters, and any kind of cluster initiatives has to be based on the assumption that it will be very difficult to switch to a co-operative game.

5.3.2.2 Between firms, 2: Costs, benefits and risks of co-operation

In the view of the industrial researcher, clusters offer all kinds of opportunities. The perspective of the businessperson will often be the opposite. In his view, any decision regarding networking and co-operation has to be based on an assessment of benefits on the one hand and costs and risks on the other hand. And quite often, the benefit will be long-term and hypothetical, whereas costs and risks are obvious and immediate.

For a firm, the most obvious risk is the loss of trade secrets, such as technology or knowledge regarding markets and customers. Such risks are an important motive for firms not to enter co-operative ventures which involve direct competitors.

Another relevant risk regards anti-competitive behavior. Many firms basically like the idea of co-operation, in particular if it involves the creation of market-power or the elimination of market processes, such as purchasing or sales co-operatives. Such practices are common in many industries, and in countries with an operational anti-trust-policy many firms will have a clear idea of the costs of such co-operation, namely the fines they had to pay. In fact, in this respect firms may find government agencies which promote clustering and co-operation somewhat strange, and may prefer to distance themselves from such initiatives as long as the anti-trust implications are not resolved.

Direct costs of co-operation include first and foremost transaction and opportunity costs. Meeting have to be prepared, and there has to be some follow-up, and discussion papers and minutes have to be prepared. All this puts a strain on the scarce time resources of decision-makers in firms. If firms agree on concrete activities, this will generate further costs, e.g. the investment and operational costs of joint development projects. This may lead to the kind of problems which are well-known from R&D and training, i.e. a discrepancy between the individual and the collective benefit which leads to underinvestment. In the field of R&D, governments subsidies firms' activities. Likewise, it may be necessary to subsidize co-operative ventures, i.e. cover at least part of the transaction and opportunity costs.

5.3.2.3 Problems of co-operation between firms and supporting institutions

There are basically two kinds of problems regarding co-operation between firms and supporting institutions. First, there is often a complicated relationship between firms and business associations, especially between SME and chambers of industry and commerce. SME often perceive, correctly or not, that chambers are dominated by large firms, and they feel that the support they receive from their chamber is inadequate. At the same time, the chambers often have to deal with expectations which they cannot meet, given their limited resources.

Second, there are the usual problems of co-operation between firms and supporting institutions. For many supporting institutions, the satisfaction of local customers from the private sector is not the only, and often not the most important, performance indicator. This is most evident in education and training institutions, especially in higher education, where academic merits play an important role. It also applies to R&D institutions which have a difficult job balancing the demands of private sector customers and academic criteria, something which is further complicated by profoundly different standards -- researchers want to publish their results quickly and widely, and they aspire a profound understanding of problems, whereas firms want a quick problem solution, want to keep research results secret, and possibly sell them at a maximum price.

5.3.2.4 Problems of co-operation between public and private sector

Both local and global governance issues establish limits for cluster initiatives. Local governance patterns establish manifold problems:

– It has sometimes been observed that a crisis lead to a dynamization of cluster potentials (see, for instance, the Criciúma case in Meyer-Stamer 1998). However, it is by no means obvious that this happens. Just as likely the opposite may happen. Local actors may perceive a profound crisis as a structural crisis, they may define the dominating branch in the cluster as a sunset-industry which does not deserve promotion, and they may direct their promotion activities at diversifying the local economic base, preferably achieving broad diversification in order to avoid the vulnerability of depending on just one branch. In other words, local actors may perceive a de-clustering policy as the best option.

– Another constellation has been observed in old clusters, for instance the Ruhr Valley (Grabher 1993). Communication and co-operation between local actors may become so intense that their ability to perceive changes outside the cluster suffers, leading to efforts to keep old industries alive rather than promoting and shaping structural change.

– One important actor will only with great difficulties play a constructive role in cluster initiatives, namely chambers of industry and commerce. Chambers cater to firms from all sorts of sectors and branches. A cluster initiative will involve only a limited set of branches, and those firms not directly linked to the dominating branches in the cluster will feel frustrated if the chamber puts much effort into the cluster initiative. Especially in those locations where one cluster dominates the local economy, the firms from other branches will complain loudly since they tend to perceive that the chamber is dealing too much with the cluster-related branches anyway.

– There is no reason to believe that politically motivated differences can more easily be overcome at the local level than at other levels. It is rather likely that political differences are intertwined with other factors, such as personally motivated aversions, traditional enmity between families or elites, economic rivalries, etc., and that thus a complex set of obstacles emerges which makes a coherent initiative very complicated.

Global governance patterns create two types of problems for local initiatives:

– A crucial element of cluster initiatives is networking between persons rather than organizations. This may serious obstacles in cluster where important firms are not locally-owned, and directors are changing frequently. Moreover, in large groups the director of a local branch plant frequently has a limited freedom of decision. In this respect, dramatic changes in framework conditions for clustering initiatives can occur if a local firm is taken over by some external investor.

– External firms can also have a strong impact on cluster initiatives in a different way. Clusters, especially in developing countries, are often part of global commodity chains which are ruled by some large firm elsewhere, for instance large distribution chains in industrialized countries. Such a large firm may have an interest in the long-term perspective and performance of the cluster, but usually its short-term considerations will prevail. This frequently means that external buyers are playing cluster firms against each other to get the best price. This leads us back to the observation that fierce rivalry between local firms is often a major obstacle for local co-operation.

Excourse: Global commodity chains

The global commodity chain concept (GCC; Gereffi 1996) addresses the linkages between producing firms, and between producers and traders, both in terms of technical aspects and of power relationships. The concept thus introduces a notion into the analysis of economic development which is obviously important but has been neglected in the past.

Theories of international trade treat the world market as the locus of spot transactions between atomistic agents. This idealized view has been critized for quite some time. For instance, 20 years ago the proponents of the "new international division of labour" (NIDL) approach pointed out that a substantial part of transborder economic transactions occur within firms, being the outcome of firms' attempts to utilize low labor cost advantages in developing countries for certain steps of their production process (Fröbel, Heinrichs and Kreye 1977).

However, it has also become obvious over the last 20 years that the NIDL view of the world has severe limitations. It involved predominantly US apparal, footwear, and electronics manufacturers, and it could not account for the larger part of firms' internationalization strategies, namely those activities that were market-oriented. Moreover, it could not grasp a phenomenon that has become increasingly important: the organization of international supply chains, most prominently by firms like Nike, Ikea, The Gap or Otto, which did not involve capital ownership and thus were not reflected in foreign direct investment statistics.

It is here that GCC comes in. It addresses explicitly the fact that international trade consists of three main types of transactions, namely anonymous market transactions, intra-firm trade, and international supply arrangements. It deals most intensively with the last type.

The GCC concept is one of the approaches that address the fact that the boundaries of the firm are increasingly fuzzy. Other approaches have been dealing with this phenomenon on the local / national basis, e.g. the analysis of just-in-time supply arrangements. The GCC concept deals with blurred inter-firm boundaries in international transactions. The most striking examples are the arrangements of firms like Nike, Reebok, and Liz Claiborne which don't own a singly production facility. They focus on design and marketing, and are managing a vast network of suppliers scattered all over the world (although mostly located in Asia and Central America).

Global commodity chains are a prominent and increasingly important feature of the clothing and footwear industry. Both have important low-skilled labour intensive segments which are often located in early industrializing countries in the developing world. The increasing important of GCC in these industries reflects a change in the roles played by industry and trade. Whereas in the past, huge Fordist factories have been dominant players, this role has recently been taken over by increasingly concentrated retail firms which now command the sector; this has been labelled a "buyer-driven commodity chain". This kind of arrangement can be found in other sectors as well; Ikea's GCC would be an example (Normann and Ramirez 1993). The analysis of buyer-driven commodity chains adds a crucial dimension to the understanding of industrialization processes, particularly in developing countries.

GCC adds a missing dimension to the systemic competitiveness concept. In the latter, world market integration and competitive pressure is taken for granted, and the focus is mainly on the producing firms. It is, however, essential to understand both features thoroughly to understand why competitiveness emerges, or why it does not.

One of the initial concerns of the systemic competitiveness concept was to understand what happens in closed economies which have to give up their import substitution strategies. The difference between an import substitution economy and an open economy is fundamental, but not all sectors in an open economy are affected equally by world market integration. Analyzing commodity chains helps identifying important elements of the incentive structure firms in a given industry are facing. This refers both to national commodity chains, i.e. the market structure inside a given economy, and international commodity chains.

Some firms are in a position to control upstream and downstream activities, but most are not. For those firms which are dependently involved in commodity chains, this establishes a crucial determining factor of their competitiveness. It defines the conditions they have to meet, i.e. sets the rules according to which a given firm, or network of firms, in a given location has to define its competitive strategy.

5.3.3 Conclusions

Summing up the considerations elaborated before leads us to the following overview:

Table 9: Main obstacles to co-operation in clusters

Co-operation between firms	*Co-operation between firms and supporting institutions*	*Co-operation between private and public sector*
– firmly established non-cooperative game – costs and risks of cooperation	– tension between SMEs and chamber – different modes of operation in firms and institutions	– local political fallacies – global vs. local factors

What does this mean for field research? First and foremost, it means that it is essential to be extremely careful in interpreting local realities in the respective localities where case-studies are to be conducted. More specifically, it will be crucial not to reach premature judgements when comparing local reality against the often somewhat optimistic or even romantic views presented in the cluster literature. Even in Italy clusters are rarely friendly, harmonious, and peaceful communities. They have rather found a way to balance competition, which is usually fierce, and co-operation. Finding this balance is a very demanding challenge, and many businesspeople cannot even remotely imagine how this is going to work.

Identifying local realities which diverge widely from the picture painted in the cluster literature, it is, in my experience, useful to look for rationality in what at first glance appears as unreasonable behavior. Being academics and working in an environment where the costs and benefits of co-operation are quite different from those encountered by firms in competitive environments, we sometimes tend to judge the behavior of businesspeople prematurely and unfairly. The problem is that the rationality of non-cooperation is sometimes not so obvious. For instance, in a given locality opportunistic behavior may be common, but businesspeople may find this embarrassing and prefer not to mention it when interviewed. In my own field research I have found it useful to formulate hypotheses to try to explain what I was observing when still in the field, and to discuss these hypotheses during interviews with local businesspeople and other actors. In some cases, this has provided me with very valuable insights into the rationale behind behavioral patterns which I found puzzling.

6 CONCEPTUAL BACKGROUND: LOCAL ECONOMIC DEVELOPMENT

6.1 Introduction

In developing countries, there is an increasing awareness of the necessity to formulate and implement economic development strategies at the local and regional level. There is a departure from traditional approaches to industrial, structural, and regional policy. Within the traditional approaches, activities were

- formulated (and quite often actually not implemented) by central government,
- formulated and implemented in a top-down manner, without consultation and involvement of the target group,
- based on an external evaluation of potentials and problems, rather than a process of local awareness building and learning,
- often based on huge development projects, like large dams, and huge investments, like petrochemical, steel or other basic industries,
- creating perverse incentives due to the availability of government subsidies for regions with low performance.

This approach is no longer being pursued for a variety of reasons. One of the most important ones is the inability and unwillingness of central governments to conduct such activities – inability due to lack of funds, unwillingness due to the predominance of the neoliberal doctrine which, in the simplistic / fundamentalist variety, is opposed to active development-oriented policies. Another important reason is the observation that, in leading industrialized countries, development policies are quite successfully formulated and implemented at the local and regional level.

Decentralization is not the only difference to traditional approaches of industrial policy. Two main aspects of traditional industrial policy are absent in the new approach. First, there usually is no creation of public enterprises. Quite the contrary, not only state enterprises in industry and infrastructure are being privatized but also traditional government activities like economic promotion. Second, there is no infant industry protection. Instead, there is a variety of (mostly supply-side) instruments which aim at improving the environment for firms so that they can create a competitive advantage.

The purpose of this section is to gather and organize concepts, instruments, and tools which can be useful for local or regional development initiatives. Before you dive into this complex material, you may find it useful to have a look at some general considerations:

- What actually is local / regional economic development?
- Why think about local economic development in the first place?
- What is the political rationale of local economic development?
- What is the economic rationale of local economic development?
- What are the differences between LED initiatives in urban and rural settings?

6.1.1 What is Local Economic Development?

Defining the core characteristics of local economic development seems to be a straightforward exercise: it's something about economic development, probably some kind of promotional activities, and it's happening at the local level.

However, things are a bit more complicated:

- One way of defining LED would be to say that it's the same as national economic development, but in a downscaled way. This view would not be adequate. A national economic development policy includes several activities which are completely out of the reach of any LED initiative, and vice versa.
- Another way of defining LED would be to say that it's all those activities which aim at promoting investment in the locality. This view would be misleading as it may imply an exaggerated focus at inward investment.
- Yet another definition would be to say that it includes all the activities which aim at improving the well-being of the local population. This again would too wide a definition. It is important to distinguish between local development and LED. Local development is the wider concept. Apart from LED, it includes community development, local social development and other types of local initiatives. As these different types of initiatives follow different logics, pursue different goals and operate with different incentive structures, it is important to make a clear distinction between them (at least analytically – there are, of course, many potential synergies between such initiatives).

What then is the essence of LED? LED is about creating employment and jobs at the local level. The main approach to do so is

- to create a favorable environment for business,
- to promote the competitiveness of firms,
- to create opportunities for new businesses, be they external investors or local entrepreneurs.

Local competitive advantage

Another way to put it would be to say: LED is about competitive advantage – the competitive advantage of local firms, but also the competitive advantage of the locality. The prominent economist Paul Krugman has argued that the term "competitiveness of nations" does not make sense. This is true. But it does make sense to talk about the "competitiveness of a locality". If you are creating competitive conditions at your locality, you may attract investment which otherwise would go elsewhere and create jobs and income in another city. And if the conditions to do business in your locality compare unfavorably with other locations, you will see that businesses move elsewhere, taking the jobs with them.

Local vs. national economic development

Local economic development is different from national economic development in several respects:

- Instruments: There are numerous instruments to promote economic development which are out of the reach of local initiatives, for instance all those that have to do with generic framework conditions, such as the exchange rate, the tax rate, anti-trust policy, or the legal framework for employment. At the same time, many instruments of LED are not really viable for national government, e.g. the development of real estate or business coaching programs.
- Actors: National economic development is formulated and implemented by government. Non-governmental actors are involved in the policy process, for instance in terms of lobbying or by sharing information and knowledge. But in terms of execution of policy, they are much more targets than executors of policy. At the local level, and in particular in the context of lively LED initiatives, things are different. In the most extreme cases, LED initiatives can be designed and executed by private actors without any participation of government. Under normal conditions, LED initiatives involve close cooperation between government and non-governmental actors (chambers and business associations, trade unions, universities and research institutes, companies, NGOs, etc.) during diagnostic, planning, implementation and evaluation.
- Governance: National economic development programs involve a clear definition of roles between the legislative and the executive branch of government. LED initiatives usually

involve fuzzy role definitions, and clarifying and defining the roles of different stakeholders is one of the main challenges of every LED initiative.

Rather than writing local/regional development, the text so far mostly addressed local economic development. What is the difference between local and regional economic development? Actually, it is hard to determine this difference in a scientifically precise way. One would tend to identify local economic development with cities or municipalities, and regional economic development with aggregates of cities (usually up the level of provinces). But different countries define municipalities in different ways. Sometimes an urban agglomeration, which in economic terms is a functional entity, consists of several municipalities. In other cases, a municipality encompasses a set of cities without particularly strong economic interaction. In other words, the definition of local and regional very much depends on the case. The only certain thing is that "local" addresses a smaller geographic aggregate than "regional".

6.1.2 Why Local Economic Development

It may seem paradoxical, and yet it is true: One of the main reasons why local economic development (LED) is receiving increasing attention is globalization. This is so for a number of reasons:

- As national borders become less important, national markets become more accessible to foreign competitors, and therefore the competitive pressure on domestic producers is rising. Domestic companies undertake all sorts of efforts to raise their competitiveness. One of the important strategies is to focus on core competencies and to externalize all those functions which are not creating a competitive advantage. This is creating demands for the environment, and in particular the local environment, in terms of availability of suppliers, service providers and supporting institutions. A dense fabric of supporting industries and institutions becomes ever more important.

- For many industries the number of viable locations increases. The mobility of companies increases as well. A competition between locations emerges – they want to keep or attract companies to raise taxes and create employment. Not only companies but also locations – cities, regions – have to consider how to increase their competitiveness.

But local development is not only about attracting companies. It is also about the endogenous potential. It is not rare to find local economic development actors with just one thing on their mind: how to attract the one big external investor who brings thousands of jobs. But these investors are rare. It is often more promising to enhance the competitiveness of companies which are already there, and to stimulate and support the emergence of new companies (i.e. stimulate entrepreneurship). This is the endogenous potential.

Moreover, local economic development is not only about integration into external markets. Sure, this is often the main preoccupation, and there can be little doubt that it is a main justification for local economic development. But local economic development ought to be more than that. It is an approach which is also important for locations which are hardly touched by the forces of globalization. An important rationale for local economic development is to close local loops. Local economies are often fragmented. Business opportunities are not exploited since they are not visible. Local companies look for suppliers and customers to the outside, rather than in their location. Stimulating interaction between local businesses creates new business opportunities.

What then is the difference between LED and traditional centralized approaches, such as a national industrial policy? The big difference has to do with scope. Industrial policy used to be a specialized activity, implemented by a specialized agency (such as the Ministry of Industry). It used to be clearly separated from other activities, such as technology policy (implemented by the Ministry of Technology), skills development (implemented by the Ministry of Manpower), regional development (implemented by the Ministry for Regional Integration), and so forth. LED may sometimes occur in a likewise fragmented way. But it ought to pursue a systemic approach which cuts across different portfolios. And it has a fair chance to do so. Fragmentation at the national level is not just due to political factors. It also reflects the fact that there has to be some division of labor, as otherwise a nation state cannot be governed: it is simply too complex. A locality is necessarily less complex than a nation state. Therefore, at the local level it may be possible to pursue an integrated, systemic approach which links skills development with SME support, technology upgrading with R+D, supplier development with upgrading of associations, employment promotion with infrastructure upgrading, and all of them among each other.

6.1.2.1 The Political Rationale of Local Economic Development

The political rationale of local economic development is straightforward. Politicians seek legitimacy. One of the key elements of legitimacy is economic prosperity. In most locations, the main source of economic prosperity is local jobs (in some locations, transfers from elsewhere, be they through government programs or from migrant workers, may be more important than local jobs). Therefore, politicians have a keen interest in making sure that somebody is creating jobs. This may be government itself. But as public funds are increasingly scarce in most countries, it is the private sector which has to deliver jobs.

A second point has to do with one of the big trends of the 1980s and 1990s: the demise of central government industrial policy and other types of statist development policy. In the context of structural adjustment, and the predominance of neo-liberal concepts of economic management, selective policy interventions such as industrial policy came under fire and were reduced or phased out. This, however, left a lacuna in all those places where markets work less than perfectly, that is about everywhere. This leads us back to the first argument: Local actors had to jump into the fray to secure their legitimacy. It is unlikely that a local election has ever been won on the basis of strictly neo-liberal, non-interventionist agenda.

6.1.2.2 The Economic Rationale of Local Economic Development

The economic rationale for local economic development (LED) is linked to the problem of market failure. It is an accepted fact that in the real world markets never fit into the idealized assumptions of simple neoclassical models. There are not perfect markets, and market failures have to be accepted. Any intervention which pretends to remedy market failure has to be assessed in terms of the additional distortion and transaction costs it creates.

However, at the local level there are specific types of market failure which can be remedied at little cost and creating little distortion. An important market failure is asymmetrical information. There may be all sorts of companies offering all sorts of goods and services, but the only practical way of scanning them is often the yellow pages. The suppliers have good information about their offer, but potential customers have little relevant information: systematically assessing the quality and price of all the available suppliers and providers is a costly exercise. Therefore, established companies will often rely on long-time suppliers and providers, creating inefficiencies and barriers to entry for new suppliers. A simple way to remedy this problem is the organization of local fairs. If this is a viable business it will be done by specialized companies. But often this will not be the case, and then a public or para-statal development agency may organize a fair to match suppliers and customers.

A similar logic applies to entrepreneurship development and support for new businesses. With inadequate information, the barriers to entry for a potential entrepreneur will often appear unsurmountably high. Improving information on existing local demand, not only through fairs but also through other types of information events, is an activity which can clearly be justified in terms of market failure.

6.1.2.3 A Metaphor of Local Economic Development: The Stone Soup

One of the key ideas of local economic development is this: everybody contributes something, and out of bits and pieces something big and important may emerge. LED is not necessarily about huge amounts of money, but rather about intensified communication and co-ordination. A good metaphor in this respect is the story of the stone soup.

Stone Soup

It is told of a wise, wandering wayfarer who stumbled upon a very poor town in his travels. Coming out of the lush Irish hills in search of a morsel to eat, the wayfarer had spied the little village and thus came to find himself in the main square. Here, he first went to a small tavern and asked if they could but spare this tired man a morsel to hold him over since he had not eaten in a fortnight.

The tavern's keeper, a ragged old woman, said "I would feed you good sir if I had the morsel to give but we are a poor people and I must keep every scrap to keep my family well." and thus bid him upon his way.

Only a short distance down the road he saw a small shop with a small man out front and again asked the man if he might have morsel of food. And, again the man told him no, to be off for he could but barley feed his own.

On the wayfarer went till he reached a farm at the outskirts of town. Here he asked the farmer and his wife if they could spare him a morsel and he would be on his way. The farmer and the woman told the hapless wayfarer to be gone, that not only did they not have enough to feed him but that he should be flogged for begging from such an obviously poor people.

Disappointed the wayfarer headed back up toward the hills. That evening he lay cold and hungry and decided what he had to do with the dawning of the new day. Early in the morning he headed back down toward the town to the very center. As good fortune would have it most of the townspeople were there including the people he spoke with the previous day. Upon entering the square he politely asked the tavern's keeper again if she was sure she had not a morsel to spare.

The keeper told him "woe that I could feed you I would feed all of the town and we would be happy again."

The wayfarer looked at her and said "alas my good woman if only I had brought my magic soup stones then I could indeed feed your entire village."

The old woman scoffed "magic stones indeed, feed the whole village stone soup."

The townspeople were beginning to gather around now curious about the commotion. "My fair maiden if ... " and he stopped... "you know it was country just like this that I originally found my magic stones for the stone soup recipe. It is a magic recipe taught me by a wizard many years ago. Know kind woman that truly it is not the stones, though they need to be exactly the right kind, but he magic of the wizard's recipe that will make soup to feed the entire village."

Intrigued the shop owner said... "There are some very beautiful stones just over the first hill near the brook."

"Then let us have a look" said the wayfarer. And the whole town followed him to the brook were he carefully examined 30 or 40 rocks. Each one he would pick up, scan it and then taste it... and toss it down, splashing as they hit the water..."that one won't work". Finally he picked up a very round, reddish rock and smiled "this rock is perfect" he said "there may be stone soup for all yet."

The whole town started to murmur, you could sense the excitement, for they all in their individual poverty's were indeed hungry. The Wayfarer ran to another part of the stream picking up another red rock and dancing a bit of a jig as he held it in the air for all to see... It was then a little boy came forward to the wayfarer and held out a stone he had found and asked... "Is this a magic stone sir?"

The wayfarer looked at the young child and took his stone and examined it very closely. At last he spoke, as the crowd grew silent. "This young child has indeed found the third stone...and tonight my good people we shall all feast on Stone Soup!"

The Wayfarer turned to his audience and asked "Who then has a huge kettle?" The brawny Blacksmith responded positively that he had an old kettle, not to rusted, behind the barn and went off with several of the towns men to get the pot.

"Then we need wood for the fire!" The towns carpenter voiced up that he had scraps of wood and left to gather them.

With the kettle cleaned and in place, full of fresh water from the brook and the fire briskly burning underneath... the wayfarer, with the entire town watching removed the stones from his pocket and holding them over the kettle loudly spoke a chant : "From not one stone, from not two stones but from three stones will we feed all." The cantation finished he then tossed the stones - gerblunk, into the boiling water. Grabbing the huge wooden ladle he began to stir and hummed an old Celtic folk tune as he did.

After about 10 minutes the crowd was growing restless... noticing this the wayfarer stood and stirring once more raised the ladle to his lips and tasted the stone soup... From somewhere in the crowd came the question... " is it soup yet?"

The wayfarer smiled after tasting the soup and said "It is good, very good, but alas if I had but a but a pinch of salt it would be perfect."

The shop keeper spoke up "I have a pinch of salt even some pepper we can add" and he ran off to get them.

Another few minutes passed and again the wayfarer stood and stirring once more raised the ladle to his lips tasting the stone soup.

The wayfarer smiled broadly and said "It is good, very good, but alas if I had but a few carrots to add for extra flavor then the soup would be perfect."

The farmer's wife spoke up "I have a few carrots, a potato, and some onions from my garden we can add" and she ran off to get them.

As more time passed the wayfarer stood over the hot kettle, of steaming, bubbling liquid whose aroma lofted into the air tantalizing the town people, and he once more tasted the soup.

The wayfarer looked very pleased and said "It is good, very good it may be the best ever, but if I had but a few small chunks of mutton, ahhhhh then the soup would indeed be perfect, fit for a king!"

This time the farmer spoke up "I did just on the morrow slaughter one of my last remaining sheep - we can add some of it" and he ran off to get it.

And so it went until all the towns people had all contributed a small portion of something they had preciously hoarded for themselves ... and the soup turned out to be so filled with the many little contributions that it was more like a stew then a soup. So it was the town feasted all night on the glorious soup. The Baker brought out loaves of bread and the Tavern's owner even broke out a keg of Gruel for the feast... it was a night to remember. That amazing night everyone in the village including the wayfarer found themselves filled to their content and as such that evening slept very soundly.

In the morning as the wayfarer headed out of town to continue his journey the towns people bestowed on him many gifts and supplies. The wayfarer as a gesture of thanks handed over the precious stones to the Tavern's keeper and he told her and the whole town..."you can feast like this when ever you desire, if you follow my recipe exactly, and everyone adds just a little of what they have to season the soup to perfection..." and with that the satisfied wayfarer headed off into the sunset and the hills of Ireland!

6.1.3 Local and regional economic development in urban and rural settings

LED is often connotated with urban development, for the simple reason that one encounters it more often in medium and large cities than in small towns, let alone villages. Things are different when it comes to regional economic development. In developing countries, integrated development projects in rural areas were probably much more frequent than regional development exercises in urban agglomerations. As far as the development of urban agglomerations was concerned, establishing a practice of zoning was already quite an achievement, and implementing it was a nightmare in all those cities where squatter settlements spring up over night. Planning and development efforts beyond zoning were rather rare; one of the few cases is the Greater ABC region in the south of São Paulo, Brazil.

Is the prevalence of LED in urban agglomerations and regional development in rural regions a coincidence, or does it reflect necessities, restrictions and opportunities? There are strong arguments in favor of the latter view. LED at the level of a small city, say of 10,000 inhabitants, makes little sense, in particular in developing countries with their less differentiated economic systems. It is unlikely that it is possible to have a critical mass for the creation of a competitive advantage at this level. Things are different when it comes to somewhat larger rural regions. Case studies show that there can be a lot of latitude for the creation of differentiated products, even when working with poor families with limited skills.

At the same time, regional development in urban agglomerations, while often appearing highly plausible, tends to suffer from major problems. It appears plausible when administrative borders do not reflect economic realities, and when neighboring cities which are economically interlinked should pursue a joint effort to create a locational advantage. It also appears plausible in those regions where neighboring cities are involved in a kind of beggar-thy-neighbor policy, for instance by trying to lure companies away from the next city by offering tax incentives.

But the problems are often bigger than the opportunities. Mayors and city councils are accountable to their local constituency, which often will not appreciate if jobs are created in the next city for the sake of economic welfare of the region. Apart from that, creating governance structures at the regional level is a major challenge. Moreover, the bigger and more differentiated the region becomes, the more complex, and thus the more difficult to design and implement, economic development strategies become.

6.1.4 Structure of this section

It is possible to organize the main concepts and instruments of local economic development (LED) along a number of triangles. This is useful because it helps to memorize the key issues. Altogether there are six triangles:

(1) The target group of local economic development: companies

(2) Locational factors

(3) Synergies: Economic Promotion, Employment Promotion, Urban/Regional Development

(4) Sustainable Development

(5) Governance

(6) Participatory Planning, Monitoring and Evaluating

6.2 First triangle: The target group of local economic development: companies

Economic development is based on the efforts of companies – some of them government-owned, but most of the private. The main target group of local economic development (LED) are thus companies, in particular the private sector. Further target groups include the workers and the public sector; we will come to them when we discuss locational factors.

What kind of companies are the main target group? In many cases, LED efforts are mainly directed at external companies. The main goal of traditional LED efforts (i.e. in industrialized countries: from the 1960s to the 1980s) was to attract new investors. It would be much too narrow, however, to leave it at that. Basically, there are three types of companies which can be the target of LED:

(1) External investors

(2) Local companies

(3) Start-up companies

It depends on the features of a given location which of these three types is the priority target. External investors are particularly relevant for locations with a weak local company base and little entrepreneurial dynamism. In locations with a strong local economic base, promoting the competitiveness of existing companies is often much more relevant than attracting companies.

Yet the main message is: Do not conceptualize the three target groups in an either/or manner. Instead, try to realize the synergies between them. The following figure tries to visualize the potential synergies.

Figure 12

Let us have a look at the two arrows linking "strengthening local companies" with the other two activities.

1. When trying to attract external investors, try to attract any kind of company is one option. But it is not necessarily a promising option. If there already is a local economic base, say in the food processing industry, why would an electronics manufacturer find this location attractive? If there is little if any economic base, why would any external investor find such a place attractive? External investors tend to cluster. So if your location has a profile, like in food processing, you would be well advised to try to attract complementary investors.

How can you do that? The most promising approach is to consult with local companies. They are the experts on their industry, they know the players in the industry, and therefore they are in a privileged position when it comes to identifying potential investors. The main objective is to identify companies which may strengthen the local profile, in particular in terms of providing specialized inputs, services, and capital goods. You will also find that you can "sell" your location much easier to an external investor who finds a strong local demand for his products or services.

2. Regarding promotion of start-ups, it is important to note that this can be closely linked with the existing economic base. Existing companies may want to outsource certain activities, but cannot find adequate subcontractors. Training new entrepreneurs or underperforming businesspeople is a possible approach to improve the conditions for local subcontracting, thus at the same time increasing the competitiveness of lead companies and creating opportunities for new businesses. Another approach is the support for spin-offs. Professionals in existing companies may consider to set up their own shops to produce specific inputs or provide services to their current employer, but hesitate to actually do so since they feel insufficiently prepared. Again, targeted training courses may be an option.

6.2.1 Strengthening Local Companies: Localized SME Support

Why would one limit considerations regarding support for local companies to SMEs? Are there no LED instruments which are oriented at large firms? Actually, there are. Incentives and subsidies are often, and sometimes overwhelmingly, directed at large firms. We deal with this issue under the heading of investment promotion. But looking at other instruments of business promotion, empirical observation shows that the main target group are SME. This is mostly due to the fact that they are, by and large, more dependent on their location that large firms. Large firms are mostly multi-locality operations. They are involved with local initiatives, in particular in terms of community development and sponsoring activities. But they are rarely part of local economic development initiatives. Often cited examples such as Volkswagen’s strong involvement with the development of the Wolfsburg region are rare exemptions. Big multi-locality firms do not perceive the local level as a high-priority level of action. If they deal with the public sector, they usually deal directly with national governments, since this is the level where decisions are taken which are strategically important for large firms. If a given location does not offer satisfactory conditions, it is not rare that a large firms swiftly closes down its operation and moves elsewhere rather than getting involved in the cumbersome effort of getting involved in a local policy network to negotiate local upgrading initiatives.

The mobility of SMEs is much more limited. For them, the trade-off between the cost of changing location and the cost of participating in a local policy network tends to be solved in the favor of the latter – they sometimes get actively involved in LED efforts, and they certainly are an important target group for LED initiatives.

Now, in many countries SME promotion is a well-established policy field that has been shaped by central government for quite some time. What is the difference between SME promotion at large and SME promotion at the local level? Is there any difference at all? One can convincingly argue that there is. There are certain SME promotion activities which are genuinely national level activities, just as some other are genuinely local level. By the same token, there are LED activities which are generic, whereas others specifically target SMEs. The following matrix summarizes important examples for each point.

Table 10: SME Promotion, LED and Local SME Promotion

	Generic economic promotion	*SME promotion*
National	– Efficient legal framework – Cutting red tape / reducing bureaucracy – Labor law – Regional policy – Technology policy – Control of subsidies	– Specific legal framework conditions (e.g. simplified tax reporting) – Credit programs – Export promotion – Information programs (e.g. Y2K) – Training (including environmental management, innovation management, design, energy efficiency) – Innovation promotion – Competition policy
Local	– Real estate development – Location marketing / investment promotion – Improving the infrastructure – Communication with public administration – Skills development	– Specialized real estate, e.g. craft condominiums – Specific skills development – Promotion of start-ups – Coaching – Networking, business contacts – Fairs, information systems

6.2.2 Investment Promotion

Investment promotion and facilitation is about creating a favorable setting for private investment, not necessarily foreign investment only, and about getting the message that such a setting exists across to decision-makers in companies. A somewhat simplified view would suggest the following sequence:

1. Create favorable investment conditions:

– allocate dedicated real estate (e.g. industrial estates)

– create a competitive infrastructure to develop and connect the industrial estate

– make fiscal incentives and other subsidies available

– facilitate the investment by reducing and simplifying permits and licenses, and streamlining the processing of permits (including the creation of first-stop- or one-stop-agencies)

2. Communicate the investment conditions:

– publish advertisements in international trade journals

– send investment missions to potential countries of origin

– promote the location at trade fairs

– invite missions from potential countries of origin

– direct mailing to potential investors, as well as specialized consultancy companies

3. Constantly upgrade the investment conditions:

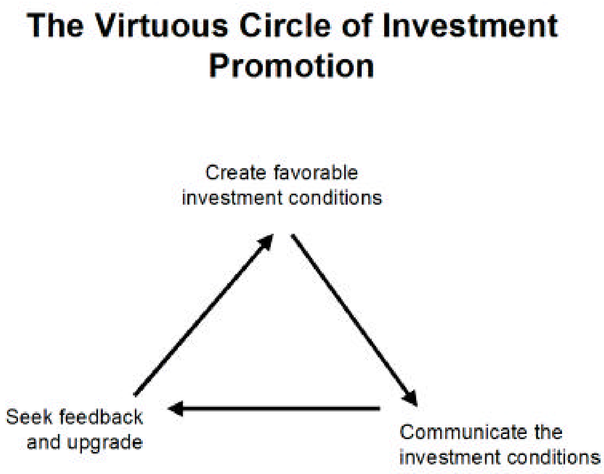
– establish fora for frequent communication with investors

– establish feedback mechanism for investors

– adapt the investment conditions to the specific needs of investors

Proceeding in this way can establish the virtuous circle which is depicted in the following figure.

Figure 13



This kind of approach is oriented at the typical set of criteria a company will apply when it selects a location for a new investment. The two following tables give an overview of the kind of criteria a large multinational manufacturing company will apply in, first, selecting an appropriate country, and, second, a location in that country.

However, before we take a more detailed look at this approach to investment promotion and facilitation, it is essential to mention one point: The basic attractiveness of a country is not defined by its investment promotion policy. The basic attractiveness of a country is determined by two other factors:

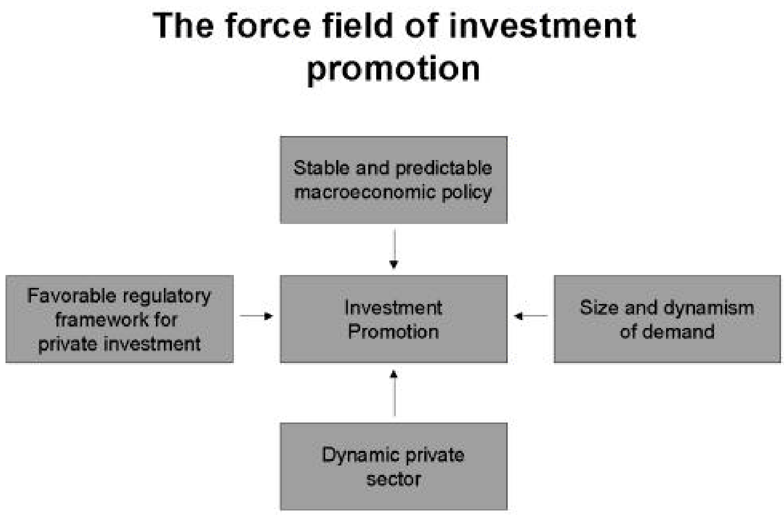
– The overall economic performance. Those countries attract most investment which have attractive domestic markets. For instance, the reason why FDI in China exploded since the 1980s is, first and foremost, the fact that foreign companies perceived China as a very promising market. The largest part of FDI is market-seeking, i.e. companies set up factories in countries to produce for the local market. The more attractive the local market is, the more companies will consider to set up companies.

– The image of a country. If a country has, in the course of time, established the perception among multinational companies that doing business there is convenient, there will be a reinforcing effect. FDI follows a certain herd effect. But there is more to it than that. The more foreign investors are active in a given country, the more political clout they have, in particular in terms of shaping conditions to their favor. A company will think twice before it is the first to go to a given location. The image factor appears to be particularly relevant when it comes to export-oriented investment.

These factors explain why FDI in developing countries is so massively clustered in just two handfuls of countries: ten countries accounted for 88.2 % of FDI inflows in developing countries in the first half of the 1990s. Some of them, such as China, Brazil, and Indonesia, have large domestic markets. Other ones, such as Singapore, Malaysia, and Hong Kong, have established very positive images with foreign investors, combined with and reinforced through competent investment promotion policies.

What conclusion may we draw from this? We suggest that the most useful conclusion would be to conceptualize investment promotion in the context of the following force field.

Figure 14



Investment promotion activities alone do little to distinguish a location. It can do nothing about the aggregate demand in a country, and it has only limited effect in terms of building image since the image of a country is a function of the other factors. The other factors are to a certain extent mutually substitutable. Not all the countries which attract a lot of FDI are famous for their stable and predictable macroeconomic policy. Investors are, up to a point, willing to trade stable macroeconomic conditions with the access to a large market. But it is quite obvious that a country which ranks low regarding each or most of the four factors will have little chance of attracting FDI.

The one factor which may not be immediately obvious is "Dynamic private sector". In this regard, the argument goes like this. A country which does not have a dynamic private sector (or a dynamic and competitive sector of government-owned enterprises) may still attract FDI, but only of a specific variety, namely extremely low value-added, such as isolated steps of garments assembly. The income effect, as well as the structural effect, of such FDI is limited. In all other activities, a potential investor will look out for competent suppliers, subcontractors, and service providers, and if he does not find them he will look somewhere else. Accordingly, we would argue that attraction of FDI and private sector development are complementary activities.

Specific instruments regarding investment promotion are described in the following subsections.

6.2.2.1 Image-building techniques

Typical image-building techniques are

– Advertising in general financial media

– Participating in investment exhibitions (in the country, in the region, elsewhere in the world)

– Advertising in industry- or sector-specific media

– Conducting general investment missions from source country to host country or from host country to source country

– Conducting general information seminars on investment opportunities

The purpose of such activities is not to target individual companies as potential investors, but rather to spread the news that a given location is actively seeking investors and is trying to create favorable conditions. Image-building is based on communicating the general investment conditions, i.e. why a given place is an attractive market or an attractive location for export-oriented investment.

It is important to note that image-building techniques suffer from two limitations:

– The effect of image-building can be entirely offset by countervailing evidence, for instance if a country receives a very low score in the World Economic Forum’s or the IMD’s country competitiveness index or Transparency International’s corruption index.

– Image-building rarely has a direct, immediate effect in terms of attracting investment. In order to achieve this, it has to be complemented with investment-generating techniques.

6.2.2.2 Investment-generating techniques

Typical investment-generating techniques are

– Engaging in direct mail or telemarketing campaigns

– Conducting industry- or sector-specific investment missions from source country to host country or vice versa

– Conducting industry- or sector-specific information seminars

– Engaging in company-specific research followed by “sales” presentations

Such techniques can be directed at either potential investors or at consultancy companies specialized in locational advice.

Unlike image-building techniques, which are something like a scattershot, investment-generating techniques involve intense research which tries to match the locational advantages of ones own place with the criteria applied by certain companies or industries. If a company or an industry which might find one’s location attractive has been identified, investment-generating techniques try to address them directly. Research has shown that the result of investment-generation is, not surprisingly, directly linked to the quality of the research. If the research fails in identifying not just companies but key decisionmakers in those companies, investment-generation will only have a limited effect.

In particular with respect to foreign investment, it is important to note that there is a broad variation in terms of the number of potential investors between sectors. There are sectors such as the garments industry where the number of potential investors is relatively large. But in many industries, such as food processing or pulp and paper, the number of potential investors is limited, sometimes less than a dozen, rarely more than a few dozen. Analyzing such companies internationalization strategies, based on their websites and published material, is viable and permits the identification of individual companies which might be attracted to one’s own location.

6.2.2.3 Investment-service techniques

Typical investment-service techniques are

– Providing investment counseling services

– Expediting the processing of applications and permits

– Providing postinvestment services

The purpose of these activities is not such much to attract investors but rather to keep happy those who have come, i.e. to prevent them from relocating and to persuade them to extend their investment.

6.2.2.4 Investment incentives

Investment incentives play a paradoxical role when it comes to attracting investors. They are rarely relevant in the investor's decision making process, but hardly any location can afford not to use them.

Incentives are most commonly conceptualized in the context of attracting foreign investors. The following tables give an overview of types of incentives in this perspective. However, many of these incentives are also applicable when it comes to attracting domestic companies, or even in cases where local companies have enough bargaining power to force government to come up with incentives.

Table 11: Main types of fiscal incentives for Foreign Direct Investment

Profit-based	Reduction of the standard corporate income-tax rate; tax holidays; allowing losses incurred during the holiday period to be written off against profits earned later (or earlier).
Capital investment-based	Accelerated depreciation; investment and reinvestment allowance.
Labor-based	Reductions in social security contributions; deductions from taxable earnings based on the number of employees or on other labor-related expenditure.
Sales-based	Corporate income-tax reductions based on total sales.
Value-added-based	Corporate income-tax reductions or credits based on the net local content of outputs; granting income-tax credits based on net value earned.
Based on other particular expenses	Corporate income-tax deductions based on, for example, expenditures relating to marketing and promotional activities.
Import-based	Exemption from import duties on capital goods, equipment or raw materials, parts and inputs related to the production process.
Export-based	Output-related, e.g., exemptions from export duties; preferential tax treatment of income from exports; income-tax reduction for special foreign-exchange-earning activities or for manufactured exports; tax credits on domestic sales in return for export performance. Input-related, e.g., duty drawbacks, tax credits for duties paid on imported materials or suppliers; income-tax credits on net local content of exports; deduction of overseas expenditures and capital allowance for export industries.

Source: UNCTAD, Incentives and Foreign Direct Investment, New York and Geneva 1996

Table 12: Main types of financial incentives for FDI

Government grants	A variety of measures (also loosely referred to as “direct subsidies”) to cover (part of) capital, production or marketing costs in relation to an investment project.
Government credit at subsidized rates	Subsidized loans; loan guarantees; guaranteed export credits.
Government equity participation	Publicly funded venture capital participating in investments involving high commercial risks.
Government insurance at prefential rates	Usually available to cover certain types of risks such as exchange-rate volatility, currency devaluation, or non-commercial risks such as expropriation and political turmoil (this type of insurance is often provided through an international agency).

Source: UNCTAD, Incentives and Foreign Direct Investment, New York and Geneva 1996

Table 13: Main types of other incentives for FDI

Subsidized dedicated infrastructure	Include provision, at less-than-commercial prices, of land, buildings, industrial plants, or specific infrastructure such as telecommunications, transportation, electricity and water supply.
Subsidized services	Services offered may include assistance in identifying finance; implementing and managing projects; carrying out pre-investment studies; information on markets, availability of raw materials and supply of infrastructure; advice on production processes and marketing techniques; assistance with training and retaining; technical facilities for developing know-how or improving quality control.
Market preferences	Preferential government contracts; closing the market for further entry; protection from import competition; granting of monopoly rights.
Preferential treatment on foreign exchange	Special exchange rates; special foreign debt-to-quity conversion rates; elimination of exchange risks on foreign loans; concessions of foreign exchange credits for export earnings; special concessions on the repatriation of earnings and capital.

Source: UNCTAD, Incentives and Foreign Direct Investment, New York and Geneva 1996

Explaining foreign-direct-investment motivations

The key factors that influence the decisions of TNCs fall under three broad categories (in the terminology of John Dunning, one of the most prominent researchers in the field):

a) company specific (or ownership) advantages, which give a company competitive advantages in global markets (these include, for example, technological assets, product differentiation, management skills, production efficiencies, size and concentration)

b) internalization advantages, which exist when the internalization of cross-border transactions with in a company becomes a more efficient form of servicing markets than arm’s length transactions

c) locational advantages, which occur when the local conditions of potential host countries make them more attractive sites for FDI operations than the home country, taking also into account how these conditions combine with the ownership and internalization advantages of the company. Locational determinants include natural factors (e.g., market characteristics, natural resource availability), political and economic stability, economic conditions (e.g., production costs, transport costs, exchange rates) and policy factors (such as trade barriers, openness to foreign ownership, fiscal regimes or investment incentives)

6.3 Second Triangle: Strengthening Locational Factors

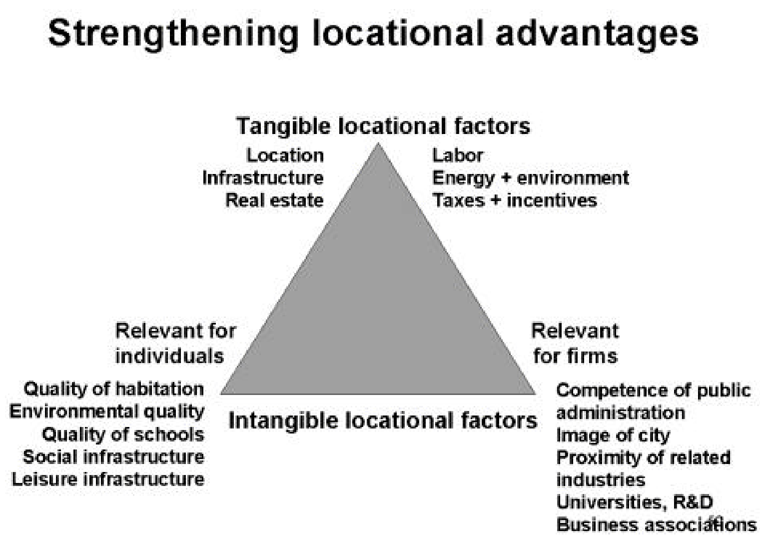
The second triangle is about locational factors, i.e. those features which determine whether a given city or region qualifies as a favorable setting for doing business. There are three types of locational factors:

1. Tangible locational factors, which are mostly "hard" criteria and which can often be quantified

2. Intangible factors relevant for companies, which are "soft" factors and not easily quantifiable

3. Intangible factors relevant for professionals, which are basically those factors that define the quality of life in a given location

Figure 15



There is a clear hierarchy between the three types of locational factors. Most relevant are tangible factors. It is only after tangible factors become increasingly similar across locations that intangible factors become relevant as a distinguishing feature. To put it differently: If your location, unlike other locations which are nearby, suffers from unreliable electricity supply, water scarcity, and dreadful roads, even excellent supporting institutions and the most effective business network program will have only a limited effect.

6.3.1 Tangible Locational Factors

Tangible locational factors are mostly "hard" criteria which can often be quantified. The relevant locational factors are the following:

Location in relation to markets for purchases and sales

The main criterion a company will use when evaluating a possible location for an investment or an expansion is the location. Companies want to be close to their customers and their suppliers in order to minimize transport cost. Accordingly, proximity is a key criterion.

Geographical location is a criterion which can hardly be influenced by a given region or city. However, it can be compensated by favorable factors with respect to other criteria. It is not rare to observe that geographically attractive locations squander this advantage by failing to create favorable overall conditions for private sector activitiy. It is also not rare to observe that what would first appear as an unfavorable location manages to compensate its geographical disadvantage by creating other favorable factors; in Europe, examples such as Ireland and Scotland come to mind.

Transport infrastructure (roads, rail, water, air)

Regarding the transport infrastructure, the main message seems to be obvious: The better your infrastructure, the more favorable your location. However, things are not as simple as this. Creating and maintaining a physical infrastructure is a costly exercise, and there is thus a trade-off – to build a good infrastructure a place needs a lot of money, and to have a lot of money means to have high taxes, which again reduce the locational attractiveness.

A second important point is that having an infrastructure is one point, but having an efficient infrastructure is something quite different. Congested roads are of little help. Congested, slow and costly ports and airports are no locational attractions, either. Managing the infrastructure in a way which creates a locational advantage is a big challenge, and it requires constant benchmarking with competing locations to find necessities and options for improvement.

A third important point is the observation that, in particular in more advanced developing countries and in industrialized countries, infrastructure is ever less a distinctive feature. Economic promotion officials in such regions tend to underestimate this aspect. In order to assess not only the quality, but also the relevance of the infrastructure as a competitive advantage it is crucial to analyze the own location vis-à-vis neighboring ones.

Communication infrastructure

As electronic data interchange between companies and e-commerce between companies as well as between companies and consumers become increasingly important, the relevance of the communication infrastructure in increasing. Long gone are the days when the availability of phone lines as such was sufficient; locations where this is still a difficult challenge are at a massive disadvantage. Competitive locations display today a variety of, mostly privately-owned, providers of value-added communication services.

Labor (cost, quantity, quality)

The relative cost of labor is a crucial criterion when evaluating the relative attractiveness of a given location. What is crucial here is not the cost as such, but the relative cost in two respects.

First, there is the issue of labor productivity. It is not rare to find locations where wages are close to zero, but where the skills, the trainability and the discipline of workers are so low that the relative cost is still to high to be competitive. Thus, apart from analyzing wage levels it is crucial to analyze productivity levels as well. For a location, this means that it may create a strong locational advantage by providing an alert, skilled and trainable workforce.

Second, there is the issue of availability of workers. This is particularly relevant for external investors. For them, average wage levels are irrelevant. When they set up a new factory and need to attract workers, they have to pay more than the average wage, especially in those fields where skilled people are scarce and may have to be lured away from other companies.

Availability and cost of real estate

The availability of real estate can be either a very relevant or a very irrelevant criterion. In weak, unattractive locations real estate is easily availabe, but this does not create any advantage. In highly dynamic, attractive locations, real estate is usually scarce and expensive. In such places, unavailability of real estate may create severe limits to growth. It is a key task of public sector to anticipate and manage this issue.

In more mature industrial locations, what often becomes an issue is conversion of abandoned industrial estates, which are often contaminated. Cleaning up such estates is often a very expensive undertaking. It is not rare that the former owner is incapable of covering this expenditure, for instance if is was a company which has gone bankrupt. The public sector will often find itself in a position where it must cover the cost of rehabilitation of estates. Experience from industrialized countries shows that it can make sense to create a dedicated utility for this purpose, which accumulates experience and thus reduces learning cost. Such utilities may also be linked with dedicated, possibly revolving funds to finance the acquisition of old estates, cover the cost of rehabilitation and sell the estate.

Environmental regulation

Extensive research has shown that environmental regulation has hardly any effect on trans-border investment. The hypothesis that companies are relocating polluting industries from densely regulated industrialized countries to other locations has never been verified.

However, environmental regulation becomes a crucial criterion when it comes to micro-decisions, i.e. the choice between neighboring locations. It is not rare to find that regulations vary from one city to the next.

A key issue in this context is the management of environmental regulations. What is creating obstacles to investment is not necessarily the existence of environmental regulation but rather the level of red tape and predictability in their application. When permit requirements are complex and intransparent, and permit periods are unpredictable, and even the outcome of a permit process is unpredictable, then a company will tend to choose a more efficient location.

Energy and environmental costs

There is a whole set of energy- and environmental-related costs, including the cost of water. Companies have high, and often extremely high requirements in terms of energy and water inputs. Their price may become a crucial point in the evaluation of alternative locations.

Moreover, companies tend to have a certain set of non-product output, i.e. solid waste, waste water, and gaseous emissions. The cost of waste disposal and wastewater treatment may also establish an important differential between locations.

Local taxes and subsidies

Local taxes often vary between cities, and cities often try to attract or keep companies by offering them special tax treatment. This issue is closely related to the overall issue of subsidies and incentives.

6.3.2 Intangible Locational Factors, relevant for Companies

Intangible factors are "soft" factors and not easily quantifiable. They become increasingly important to the extent that tangible factors become increasingly similar across many locations. Intangible factors which are often mentioned in the literature are

– Local and regional economic climate

– National economic climate

– Image of site location

– Image of city / region

Climate and image of a place are closely related to the overall economic performance and to the behavior of government vis-à-vis business. The economic performance is the outcome of a multitude of factors, and government can only influence a part of them. However, government can do many things to create a business-friendly environment.

– Contacts with companies of same branch

– Cooperation opportunities

These factors can be summarized as networking opportunities.

6.3.2.1 Business-friendly Orientation of Government

There is a whole set of elements if a local government wants to create a business-friendly setting. The relevance of these factors is hard to overestimate – they tend to be more relevant than any specific business promotion activities local government is pursuing.

Agility in responding to solicitations

What companies tend to find particularly annoying is long delays when they ask government institutions about something. Indeed, long delays are sometimes bigger obstacles than restrictive regulations. They create an overall uncertainty and unpredictability, which can be disastrous for a company which wants to exploit a business opportunity which is just arising. It is important to see that companies and public administration are profoundly different in this respect: Public agencies tend to be in a routine, doing the same kind of work day in, day out. In the business sector, by contrast, it is often *First come, first take*, and often there are first-mover advantages which mean that a company which enters a given business or market belatedly is at a distinctive disadvantage vis-à-vis its competitors. If this delay is caused by inefficient or incompetent government agencies

Agility in dealing with permits

Things are similar when it comes to permits. A business will typically need all sorts of permits, e.g. building permits, health permits, tax permits, labor safety permits, etc. It is obvious that a company in location A which can get the necessary permits, say, to expand a plant within two months is at a distinctive advantage over a competitor in location B who has to wait for two years. Streamlining the permit process, and speeding-up the delivery of permits, has become one of the most, if not *the* most, relevant economic promotion measures in many industrialized countries.

First- and One-Stop Agencies

One of the reason for lengthy permit processes is the multitude of government agencies which have to emit them. A first step of dealing with this problem is the creation of **first-stop agencies**. They give an orientation to companies as to what kind of permits they need and where and how to get them. Taking this idea one step further is the concept of **one-stop agencies**. Here, the company is only dealing with one intermediary in obtaining the necessary permits. The next, and most difficult, step is the minimization of permits.

Effective support for companies in dealing with supervisory bodies

Even if local government succeeds in cutting red tape and permit requirements, there is still a lot of permit requirements which come from national and provincial governments. Supporting companies in dealing with them, i.e. explaining what kind of permits they need and how to obtain them, is a substantial business promotion activity.

Economic competence and hospitality of key actors (e.g. mayor)

Reading through the stories of huge investment projects, such as car assembly factories, there is a common theme: In the end, when the multitude of locational options had been cut down to a shortlist of very attractive locations, it was very often the behavior of key actors, in particular the mayor and other elected representatives, which made the difference. If high-ranking officials take a personal interest in attracting or keeping companies, this gives an important signal, not the least to employees in government agencies.

Friendly climate between public and private sector

The overall style of interaction between local government and local companies can be another distinctive factor in creating an attractive location. If relations are hostile, this often leads to lengthy permit processes or even random decisions of government on permits. It is also not rare to find that government officials display a high level of graft and corruption, and that government seeks to relax its financial constraints by harrassing companies with random tax hikes and unjustified fines. This kind of behavior is much more effective, in a negative way, than whatever image-building activities can be.

Permanent, constructive dialogue between public and private sector

Business-unfriendly behavior of local government is not necessarily a result of bad intentions. Quite often, it is the result of lack of communication. Even in democratic settings, the business community is only one among many communities, and often it is not a united one. One can often observe that the threshold level for the local business community to articulate systematic pressure regarding specific issues is very high. This may even be the case if business associations or chambers are present, since they often suffer from internal fragmentation, lack of articulation, or incompetence. Therefore, the fact that there are no massive complaints by the private sector need not mean that there is nothing to complain about. If a local government sets out to promote economic activities, seeking communication with the private sector, and with all segments of the private sectors, is the first thing it should do. There are several means of doing so: (1) Creating the institution of an Ombudsman, i.e. a person or office which is the addressee of companies‘ complaints. (2) Sending out interviewers to evaluate the private sector’s perception of government. (3) Organizing public events where businesspeople can, formally or informally, voice their opinions and complaints about the public sector.

Streamlining the Permit Process

When a local government wants to streamline the permit process, there are several options as to how to proceed.

– As a first step, it is useful to conduct a survey of existing permit requirements. Permit requirements evolve over time, as governments address new issues. It is common that new permit requirements are created without an analysis of the cost of compliance and of the consistency with other permit requirements. Therefore, a mapping of the permit requirements may become a somewhat surprising experience for public sector officials who have never before considered the multitude and variety of requirements the government has created over time. Moreover, it is useful to evaluate the time which is necessary to deal with permit requirements, both on the side of the company and the public administration. The amount of time necessary to fill out forms, carry them to a public agency, interact with officials, and possibly to rewrite them, and the amount of time spent in agencies to process a permit application, can serve as a base to determine the direct cost of permits. Local government may then compare the overall cost of a given permit requirement with the possible damage that might occur if this permit did not exist.

– In order to speed up permit processing, government can consider to introduce parallel processing. It is not rare that a given permit has to pass through different departments, spending a lot of time in in- and out-trays. If different departments process the permit at the same time, the overall length of the process can be cut down drastically. Another option is to install an automatic process, i.e. if a permit has not been denied within a given period of time it is automatically granted.

– Some industrialized countries are practising cost assessments of laws and regulations, something that is also applicable at the local level. It means that the cost of compliance with a regulation under discussion is calculated in advance, so that legislators can make a better informed decision.

Institutional structures of economic promotion

Economic promotion activities can be organized in different institutional forms.

In many industrialized countries, as well as in some advanced developing countries, regional and local economic promotion is organized as a separate **public** service entity. This may be a department of local government or an organizationally separate entity.

Another option is to organize economic promotion as a **public-private** partnership, where it depends on the specific circumstances which side has the majority stake.

Yet another option is an active role of **Chambers and Associations** or **utilities** in local economic promotion. In particular in the U.S. it is quite common to find that utilities play this role, which is motivated by the interest to attract new large-scale customers for their services.

The following table summarizes the advantages and disadvantages of each type. It should become obvious that there is no clear first-best option.

Table 14: Institutional structures for economic promotion

Type	*Advantage*	*Disadvantage*
Public	Direct contact to public administration Potential strategic role, beyond short-term thinking	Distance to private sector Risk of bureaucratic culture Risk of political peddling
Public-private	Flexibility Potentially business-like organizational culture	Lack of democratic accountability Different, potentially conflictive expectations of public and private stakeholders Distant from economically relevant departments of public administration
Chambers and Associations	Very close to the private sector Business-orientation	Distance to the public sector Conflict between lobbying and promotion
Utilities	Business-orientation Clear performance indicators	Distance to the public sector

6.3.2.2 Business Networking

The logic of business networking is striking – at least to academics who try to understand the determinants of corporate competitiveness. For companies the logic is frequently quite different.

What is co-operation between companies?

Co-operation between companies typically involves three features which can be analytically distinguished, namely relational contracting, information exchange / joint learning, and collective action.

Relational contracting is the opposite of arms-length relationships. Whereas the latter typically involve spot transactions, often based on auctions or auction-like arrangements, relational contracting involves a long-term business relationship. Arms-length relationships require extensive legal dealings, whereas relational contracting is often based on trust. Relational contracting occurs both within hierarchical settings (for instance in supplier relationships in Japanese industry) and in heterarchical environments (e.g. industrial districts).

Typical kinds of information exchange between companies include the following:

– Informal information exchange between companies in supplier/subcontracting arrangements, going beyond what is necessary for arms-length transactions. The customer may give assistance to his suppliers, e.g. how to work with certain new materials or how to deal with quality problems. This may happen both among neighbouring companies and within global supplier networks.

– Formal and informal information exchange between companies in strategic alliances. There has been a strong increase in the number of national and international strategic alliances between companies, i.e. co-operation ventures aiming at the development of a given technology on the basis of a contract. Behind this is the necessity to pool R&D resources to reduce development lead-times and to realise synergies.

– Formal and informal information exchange between companies in business associations. They often are a forum for technical discussions.

– Information exchange between companies' employees in professional associations, which may be formal (e.g. presentations in conferences) or informal (e.g. discussions during meetings and conferences).

Frequent types of collective action include the following:

– the provision of real services by business associations.

– jointly maintained, organisationally separate mesoinstitutions in fields like training, technology information, or export information.

– political lobbying and active participation in forums which work on shaping locational advantages.

In the real world, relational contracting, information exchange, and collective action will often go hand-in-hand; in fact, all three types of activities will reinforce each other, i.e. meetings in well-functioning business associations open opportunities to informal information exchange, and information exchange may reach barriers that can only be overcome through collective action. Taken together, this leads to the emergence of inter-company networks.

Why companies may co-operate

In the view of institutional economics there are two major reasons why companies co-operate, namely transaction costs and principal-agent problems in arms-length relationships. Arms-length relationships require an elaborate contract which is costly to set up, negotiate, and enforce, thus causing high transaction costs. Principal-agent problems emerge to the extent that, for instance, a subcontractor or supplier is contractually obliged to employ certain process technologies but chooses a cheaper alternative, and the principal contractor is not easily able to tell the difference (for instance in surface treatment or chemical treatment of textiles). Some co-operation arrangements (e.g. strategic alliances) may also involve principal-agent-problems. Relational contracting and dense, long-term networks may offer substantial benefits in terms of minimising transaction costs and reducing principal-agent problems. Such arrangements are based on mutual trust. Agreements are self-enforcing to the extent that companies run the risk of eroding trust, and thus possibly drop out of the network, if they behave opportunistically.

In the perspective of innovation economics, co-operation between companies is a crucial feature since innovation is a cumulative process, involves learning-by-doing, -using, and -interacting, and often yields increasing returns. Particularly important is learning-by-interacting. There is both an empirical and a theoretical argument behind the emphasis innovation economics puts on learning-by-interacting. Behind the empirical argument is the notion that the most frequent type of innovation, namely incremental innovation, is not an event but a process of continuous improvements. The process of incremental innovation takes up speed as a development trajectory of a given technology becomes established, that is as an increasing number of researchers and companies agree that a given technology is preferable compared to other technologies. After this (often implicit) agreement, two things happen. First, there is less uncertainty, i.e. the risk that investment in R&D will have to be completely written off because a given technology has to be dropped is minimised. Second, an increasing number of researchers concentrate on improving a given technology, and a mesolevel structure of research groups or institutes, training courses and textbooks, norms and standards, etc. is being created.

The theoretical argument addresses the issues of opportunity costs and increasing returns. The alternative to inter-company co-operation in innovation would be an autarchy approach, i.e. each company tries to go through its own research effort and learning processes. In a certain way, this occurs in the real world; it is usually referred to as the *not-invented-here-syndrome*. This approach involves high opportunity costs as companies could have avoided replication and repeating dead-end tracks by learning from the experience of other companies.

In the view of innovation economics, the issue of transaction costs involves the different forms learning-by-interacting can take. Formal technology transfer, e.g. by licensing, is one of them. However, as the use of technology implies a lot of tacit knowledge, no technology transfer contract can define all the details that are involved; it can try to define as many as possible, something that would be extremely costly in terms of drafting, supervising and enforcing the contract. The alternative is a combination of formal agreements and informal communication. Moreover, there are other forms of technological learning based on communication between companies, e.g. discussions in standardisation bodies or at congresses. These mechanisms have low transaction costs.

Agreement between various actors -- companies, researchers, and others -- on a given technological trajectory can create the preconditions for increasing returns. There are both increasing returns to scale due to a large number of companies and researchers improving the same technology, i.e. returns for the producers, and to adoption of a given technology, i.e. returns for the users.

Why companies may not co-operate

Despite all its advantages, it is by no means self-evident that companies co-operate. The advantages of co-operation may be obvious to innovation economists and SME-support policy-makers, but many business-people do not find them obvious at all, and for good reasons. Avoiding co-operation may be perfectly rational behaviour. In our fieldwork we have found four main reasons why entrepreneurs may choose go-it-alone as much as possible.

First, business-people often find the idea of co-operation repulsive because they consider other companies in the same branch to be rivals, and one would prefer not to communicate with them in order to avoid uncovering business secrets.

Second, macroeconomic conditions may discourage inter-company co-operation. There may be high taxes on inter-company transactions, thus stimulating vertical integration. If the macroeconomic framework is unstable and the "rules of the game" are constantly changing, transactions between companies may be seen as isolated rather than repeated prisoner's dilemmas, creating a situation where defaulting may appear as an attractive option.

Third, even though co-operation can reduce transaction costs, it also creates them. Co-ordinating a network often involves a substantial amount of time to prepare meetings, to participate in them, and to take care of the follow-up. Also, it is quite natural that conflicts will occur, and resolving them again will require a lot of time and effort. Therefore, there may be a discrepancy between the incentive for individual companies to co-operate and the intensity of co-operation that would be desirable from a macro perspective.

Fourth, there is the issue of the business culture and trust. In an environment where companies are highly vertically integrated, where they stick to themselves, where there have been occurrences of failed co-operation ventures and predatory behaviour, a business culture arises that is characterised by isolation and low trust. Both co-operation and non-co-operation in a certain way result in increasing returns. In the case of co-operation, successful joint ventures create more social capital, thus improving the conditions for more co-operation. In the case of non-co-operation, failed co-operative ventures strengthen the notion that co-operation is impossible, thus undermining the prospects of success of further efforts to stimulate co-operation. Both co-operation and non-co-operation are thus path-dependent, with a particularly strong lock-in effect in the case of non-co-operation as it is much easier to destroy trust than distrust.

Against this background, the observation that clusters, i.e. geographical concentrations of companies, do not necessarily mean dense co-operation between companies does not come as a surprise. The emergence of clusters is a ubiquitous phenomenon that is mainly due to the uneven distribution of production factors, positive externalities, and historical chance events. It is by no means a matter of course that co-operation emerges within clusters. Whether is actually occurs, and which forms it may take, depends on specific historical, local, institutional and sub-sector circumstances. In the next section we look at distinct patterns of co-operation in different types of industrial clusters in developing countries.

Promoting inter-company co-operation

In promoting inter-company cooperation, it is important to distinguish two consecutive steps. The first step is to get companies involved in a cooperation effort, i.e. to overcome their hostility against any sharing of information and experiences. The second step is to mount a sustained exercise of interaction and collective learning.

Starting with the first step, one should not

– assume that there exists companies’ demand for support, based on common understanding or surveys. A survey may find that lack of cooperation is one of the main reasons for low competitiveness. However, companies will often have a profoundly different perception.

– take the analysis of key problems provided by the companies themselves too seriously. Companies will often see problems everywhere except internally.

– overestimate the willingness of businessowners to start a joint learning effort with other business-owners, particularly of the same branch.

Accordingly, the traditional approach – prepare an analysis of firms' problems and start to offer them certain services – is inadequate. Moreover, starting an effort that aims at stimulating inter-firm cooperation does not make much sense. Inter-firm cooperation is a means of enhancing competitiveness, not an aim in its own right. Rather, the first step should be, in an exercise that involves businesspeople and support agencies (which need not be government agencies!), to define the key bottlenecks that firms are facing, and to identify those bottlenecks that can be overcome in the short term. This process should aim at mobilizing the knowledge of all the firms involved, i.e. stimulate inter-firm cooperation as a side effect. Promising areas are, for instance, environmental issues like wastewater treatment and treatment of waste, or training issues. These areas do not touch directly on what firms perceive as their core competence so that there will be less fear of giving away industrial secrets and more willingness to cooperate.

Regarding the second step, the crucial issue is to find a way of transforming the local business culture on a sustained basis. Business associations may play a key role here as they are by definition the place where cooperation between companies should take place. In the past, however, they were often merely vehicles for policy entrepreneurs or social clubs rather than effective entities. Technical assistance to promote inter-company cooperation should therefore target business associations. The aim should be to encourage and accompany organizational development processes in these organizations. In fact, the conditions to do this may not be bad in those locations where companies are under an increasing competitive pressure. In some places, associations have entered into a virtuous circle: By offering assistance to struggling companies, they have created an incentive for voluntary, paying membership, thus increasing their funding base. This in turn made it possible to widen the scope for assistance to companies, again widening the funding base, and so on.

Such initiatives are most likely to succeed if they meet four criteria:

– they address immediate problems of companies,

– they do not touch what companies perceive as their core activities,

– they open little or no latitude for predatory behavior,

– they offer the potential of savings through economies of scale.

These criteria can be explained by briefly outlining typical activities which do not meet them and usually fail. For instance, a technological co-operation, such as the joint development of a new production process may exist. In such a case, participating firms fear that other firms get to know pieces of information which they perceive as essential to their competitiveness. Accordingly, they put pressure on their technicians not to unveil any possibly critical information, what in effect means that it is unlikely that the co-operation project gets anywhere. Firms may also choose their less competent technicians to take part in the project, something that also does not enhance the probability of success. As another example, when one mentions the option of co-operation, businesspeople in a non-cooperative cluster typically come up with ideas which effectively are anti-competitive, such as forming a purchasing co-operative. However, if firms do not trust each other, a supplier who is the target of the co-operative will easily break it by offering preferential purchasing conditions to one or some of the participating firms.

6.3.2.3 Supporting Institutions

Stimulating Co-operation between Companies and Support Institutions

Institutions such as training and technology institutes tended to operate in a kind of vacuum and were highly auto-referential. In the import substitution era technology institutes found little demand from the private sector which was under little pressure to innovate in a not very competitive market. Training institutes encountered an environment which was marked by massive skills shortages so that whatever training they provided was gladly accepted by the private sector. It was remarkable to see that even though a large part of the vocational training system was administrated by the private sector itself the possibilities of companies articulating their specific demands vis-à-vis the training institutes were often very limited. With a new, more competitive environment, institutions have to face the challenge to meet the same basic criteria as companies – efficiency, quality, flexibility, and responsiveness. The obvious way to do this is that they organize themselves in a business-like manner.

Co-operation between the private and the public sector puts high demands on both sides. On the side of the private sector, it is, first and foremost, essential to have effective organizations. Large companies can interact with government, especially local government, on an individual basis. Small and medium-sized companies will find this difficult. They will have to unite their voices to be heard; this leads us back to the issues mentioned before in terms of creating effective business associations.

On the side of the public sector, the first issue is that it has to take an active interest in the fate of the private sector. This is much less obvious than might be expected. In Brazil, research found that local government often did not care about private business, except as a source of revenue. First, private businesses had been growing for decades without support from local government, and second, there had been all sorts of policies from central and state government so that local government developed a disposition to wait for their action rather than acting on its own.

The second issue is that government, before starting cluster initiatives, ought to get its own house in order. Government at all levels tends to erect all sorts of obstacles for private business – some of them essential and in fact important to stimulate competitiveness, such as environmental regulation and consumer protection, but many of them either inefficient or altogether not very sensible. Reviewing regulation, removing those obstacles which are not essential, and reorganizing what remains is the most important task for government. In practical terms this means different things at different levels, such as moving from command & control to economic instruments for environmental policy at the national level or creating one-stop or first-stop-agencies at the local level.

Only after addressing the obstacles it has created for the private sector does government have the credibility to get involved in meaningful private sector promotion activities, such as a cluster initiative. Government agencies at the local or regional level can play two important roles in this respect. First, they can act as moderators, mediators, and facilitators, i.e. provided they have competence and credibility they may play a crucial role in overcoming mistrust among companies. Second, they may cover part of the transaction costs any co-operative venture incurs. In this respect, the justification is pretty much the same as in terms of government support for R&D. In a microeconomic perspective the costs of co-operation will often be substantial whereas the benefits are hypothetical, and the appropriability may appear dubious. Therefore, companies will tend to underinvest in co-operation.

6.3.3 Intangible Locational Factors, relevant for Individuals

– Career opportunities

– Quality of housing and neighbourhoods

– Environmental quality

– Quality of schools

– Social infrastructure

– Recreational opportunities

– Attractiveness of city and region

– High and popular culture

Instruments to strengthen intangible factors relevant for professionals

– Improve housing and quality of neighborhoods

– Improve environmental quality

– Assure high quality of educational institutions

– Create an attractive social infrastructure

– Improve leisure facilities (sports, high culture, popular culture)

6.4 The Triangle of Synergies: Economic Promotion, Employment Promotion, Urban/Regional Development

Local economic development is not just about things like business promotion, SME support and microenterprise promotion.

– The overarching goal of LED is to create jobs, and therefore it is crucial to involve employment promotion measures and organizations in a given LED effort.

– One of the key issues of LED is to enhance the locational quality of a given place. If you look at the tangible and intangible locational factors which define the quality of a location, you find that some of them are closely related to business promotion, whereas many other have to do with issues which are usually addressed under the heading of Urban Development or Regional Development. These are the disciplines and organizations where issues such as zoning or urban quality are being addressed.

From the perspective of a business promotion agency /actor, it is crucial, in order to design and implement an adequate LED effort, to understand what is going on in these two neighboring fields: What are the main concepts and instruments used there? And what are the synergies which can be realized by connecting concepts, measures and actors from these different fields?

Figure 16

Figure 17

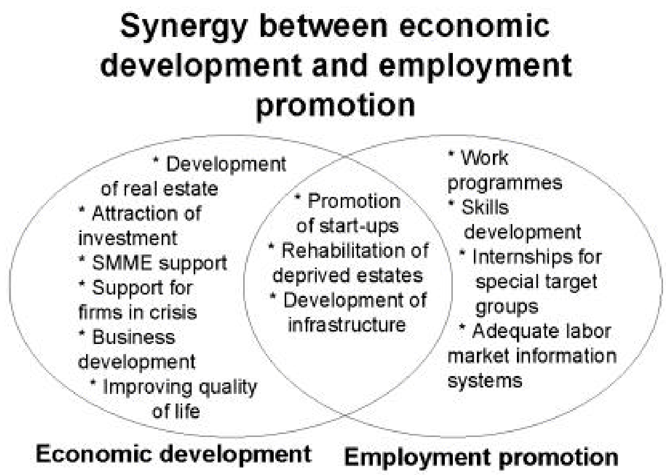


Figure 18

Why there is a tension between economic and community development

Principles of economic development:

- **Rivalry / competition**
- **Invisible hand of the market**
- **Survival of the fittest**

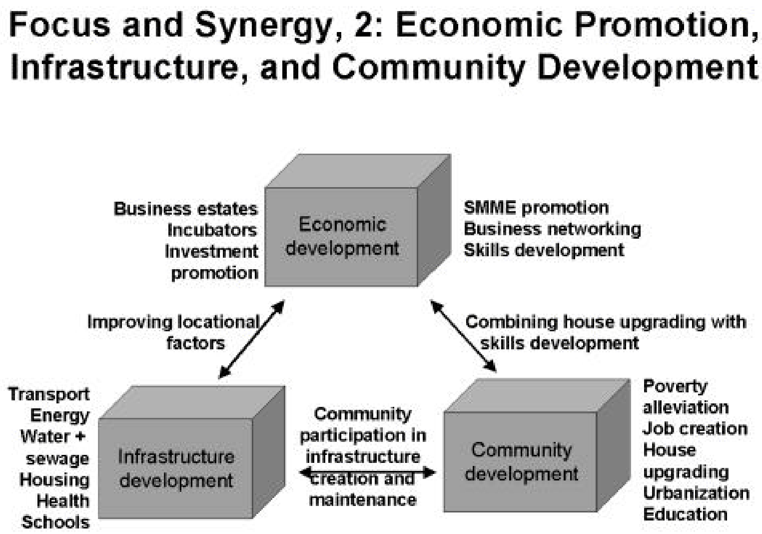
Principles of community development:

- **Solidarity**
- **Collaboration**
- **Support for the weak and disadvantaged**

Consequences:

- **It is important to separate economic development and community development in terms of organization and implementation**
- **It is possible, and indeed essential, to seek areas of overlap, to create synergies, and to learn from each other**

Figure 19



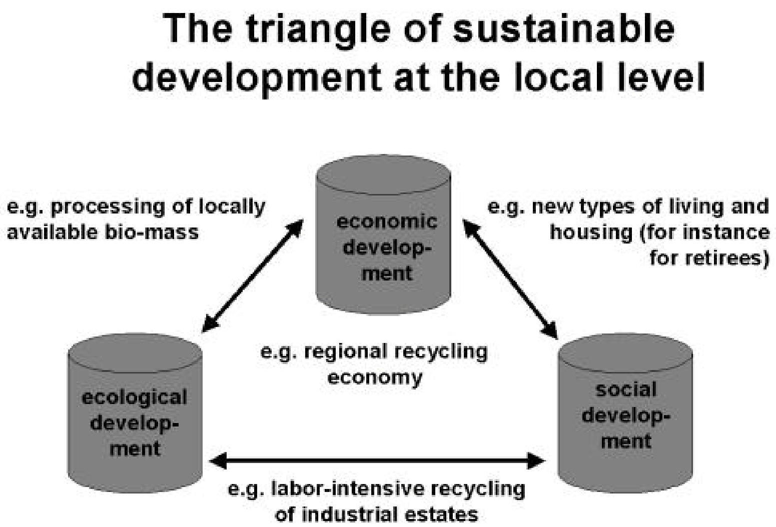
6.5 The Triangle of Sustainable Development

Sustainable development often appears as a somewhat abstract concept. However, it becomes much less abstract if is being conceptualized at the local level. A good example is vegetable oil. Have you ever considered how much vegetable oil is being consumed in your city, in particular by restaurants and industrial kitchens? And have you ever considered that much of it is actually not consumed but rather disposed of after some period of use? If you start to ask around, you may come to figures which amount to several tons of vegetable oil which is monthly poured into sewers or local rivers. This is not only creating environmental problems. It is also a big waste. Used vegetable oil still has a high energy content, and after a process of refining it can be used, for instance, in vehicles. Why not run local buses on recycled vegetable oil? If you think about it, it quickly becomes obvious that this is an excellent manifestation of the concept of sustainable development:

- it solves several environmental problems (pollution of rivers, air pollution from conventional petrol),
- it creates an economic opportunity, since the collection and refinery operation ought to be run as a private enterprise (probably with some public seed money),
- it makes a contribution to social development, in particular in terms of creating low-skilled jobs in the oil collection business.

This example shows two things. First, sustainable development can be a very concrete concept. Second, thinking about issues from this perspective opens the mind to note potentials which otherwise go unnoticed. In this sense, sustainable development can play the role of giving orientation in terms of strategic orientation. It can also contribute to motivate local actors for a LED effort. There are many places, even in poor regions, where environmental problems such as waste disposal are pressing. Many such problems indeed are business opportunities, and conceptualizing them in this way can pave the way for an effective LED initiative.

Figure 20



6.6 The Triangle of Governance

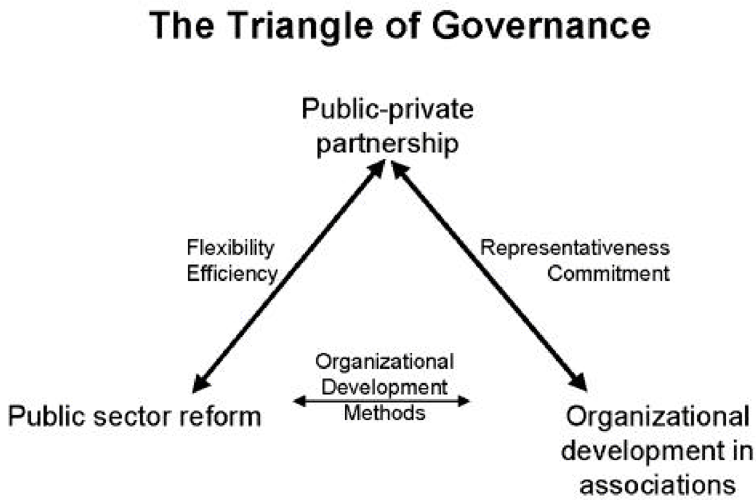
Any local development effort involves public and private actors. On the public side, the legislative and several branches of the local or regional executive have to play a role. On the private side, chambers and other business associations have to participate. But there may also be active involvement of companies, most obviously real estate and development firms and utilities, but also other companies, such as large firms involved in supplier development or community development activities.

In many developing countries, it is still common to find not particularly adequate actors on either side. Public agencies are underfinanced, lack highly skilled staff, are excessively bureaucratic, have no idea what a business mindset is like, etc. Private organizations, in particularly chambers and association, are understaffed, not very professional, highly politicized, offer little services to their members, lack a clear mission, etc.

In a setting like this, it is tricky to launch a LED initiative. At the same time, it will often be unlikely that these problems get sorted out for some reason in the medium term. Therefore, stakeholders who want to launch a LED initiative have work with the institutions which are there. Rather than waiting for public sector reform to happen and organizational development in chambers and associations to fall from heaven, a LED initiative creates an opportunity, and possibly a motivation, for these things to occur.

It is, however, crucial to point out that in many places both public sector reform and organ-izational development are closely linked to the viability of public-private partnership (PPP). LED ought to be based on PPP. But if a setting fits into the description above, it is unlikely that PPP can work out, except in a traditional clientelist way. Organizational evolution within the process of LED can create the preconditions for successful PPP.

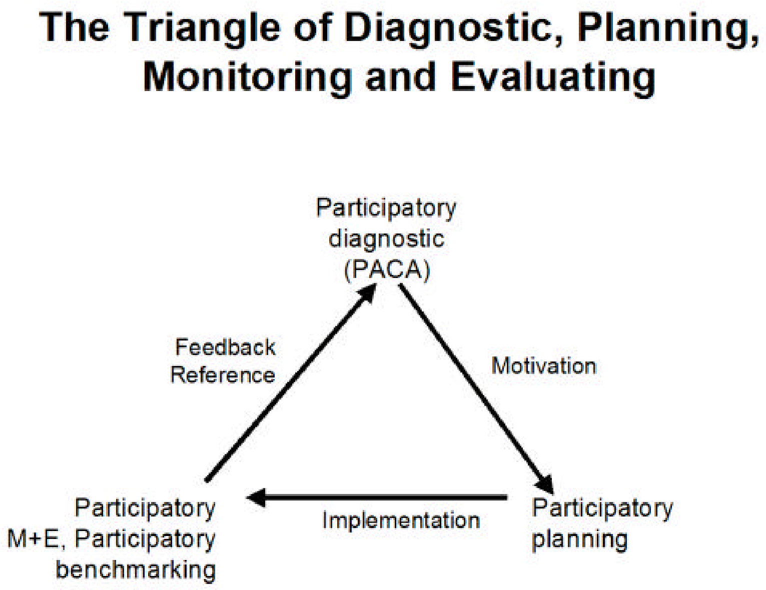
Figure 21



6.7 The Triangle of Diagnostic, Planning, Monitoring + Evaluation

The last triangle is about the process cycle management of a LED initiative. It addresses the start-up in terms of diagnostic, the operationalization of proposals in terms of planning, and the reflection on progress and problems in terms of monitoring & evaluation and benchmark-ing.

Figure 22



Diagnostic: Combining the principles of

– Systemic Competitiveness

– Competitive Advantage (Michael Porter)

– Participatory Appraisal

Rapid process to analyze

– Economic potentials and bottlenecks

– Orientation and disposition of stakeholders

– Develop practical proposals to develop a regional competitive advantage

Planning and implementation:

– Based on results of diagnostic, not on wishful thinking

– Aiming at creating markets, not at substituting them

– Targeted towards private sector dynamism

– Striving to create a locational advantage

– Quick iterations of diagnostic, planning, implementation and M+E

Benchmarking: Using Systemic Competitiveness as a framework of reference

Participatory M+E:

– involve the participants / stakeholders

– stakeholders elaborate indicators

– monitoring is an integrated part of the process

– self-evaluation, quick results, open presentation and discussion of results

– frequent, action-oriented evaluation

7 A case study of a successful Projeto Marketing Municipal: Mafra

Mafra is a city of about 50,000 inhabitants which is located at the border between SC and Paraná, where it has a twin city, Rio Negro with about 35,000 inhabitants. Even though only a third of Mafra's population is living outside the boundaries of the urban parameter, it is basically a rural place. Mafra's industry is resource-based – sawmills, furniture and other wood products, brick manufacturing; the only apparently "modern" firm is a ceramic tile manufacturer whose performance indicators, however, are below those of competitors elsewhere in SC. Mafra has got a somewhat stronger profile in services (especially wholesale and retail trade, medical services, and education) as it is the center of a micro-region encompassing a number of smaller towns. Per-capita-GDP was about R$ 4,800 in 1995 (at that time, the Real had about at 1:1 parity with the Dollar), i.e. 20 % below the average of SC.

Economic promotion activities started in the mid-1990s. In 1996 local government succeeded in attracting a factory of an U.S.-firm which will employ 85 employees at its final stage. The firm is producing surface replacements for truck tires, using a high-tech process. There were no subsequent investments, but this experience created a consciousness regarding the possibilities of local activities. In 1997, a new mayor entered office who picked the former president of the local chamber (ACIM) as secretary for economic development. Both participated in 1997 in a seminar on concepts and instruments of local economic promotion organized by Fundação Empreender (FE). In 1998, ACI and city government invited FE to support the elaboration of an economic development strategy, called "Projeto Marketing Municipal". The proposal of the FE consultants was to conduct a quick appraisal of competitive advantages and disadvantages.

The appraisal exercise was conducted in September 1998 by two FE consultants, accompanied by the executive secretary of ACIM. The main findings were

– relatively weak structure of industry, overall mediocre competitiveness of industrial firms, but some potential in trade and agriculture;

– an adequate structure of support institutions, especially regarding education and vocational training, a highly competent agricultural extension NGO (BNAF), two credit cooperatives for agricultural development with some potential, and a very high credibility of ACIM;

- a critical financial condition of the city government;
- a strong commitment of local leaders and organizations to get involved in economic promotion as a result of a sense of a looming crisis, plus a strong commitment to collaboration between organizations and associations.

The proposals of the FE consultants included conceptual issues and concrete suggestions. Regarding conceptual proposals, the consultants tried to convince local actors that the main approach to local economic development should be to mobilize existing potentials (rather than trying to create from scratch some structures in areas which appear to hold a lot of potential, like conference tourism where Mafra so far has next to nothing to offer). They also tried to get across the message that economic promotion should be about creating a difference, a specific local profile which cannot easily be replicated elsewhere, a profile which creates a localized competitive advantage. Concrete suggestions included connecting local agriculture with local trade, strengthening existing industries (for instance by launching energy efficiency programs), and developing a difference in the area of tourism. The subsequent activities of ACIM focused mainly on agriculture/trade, tourism, and energy (Santa Catarina is being connected to the Bolivia-Brazil pipeline for natural gas, and it is crucial for the region of Mafra with its energy-intensive resource-based industries to get connected).

7.1 Linkages between local agriculture and local trade

Activities in this respect built on the existing initiatives of BNAF, which had gone on for two years and so far had gone more or less unnoticed by other local actors. The work format of BNAF was based on a new concept of associativism. BNAF encouraged smallholders to form associations with about ten members, each initially focusing on just one product. Each association is accompanied by BNAF's consultants. Each smallholder who wants to enter an association is obliged to pass through a week of training at EPAGRI, a government agricultural research and advisory agency. At the beginning, the main product was tomatoes which were grown in simple, cheap greenhouses (consisting of a wooden frame covered with robust transparent plastic). Subsequently, new products were introduced, including some cultures for greenhouse cultures (zucchini, cucumbers, melons, and strawberries) as well as other products (milk, honey, beans, snails, and rabbits). BNAF receives a small amount of government subsidies and is otherwise reliant on financial support from its target group, i.e. families owning small properties. It is scanning worldwide experiences in agricultural innovation; BNAF consultants have paid visits to Israel, France, China, and Mexico to get first-hand information on new techniques. In September 1999, BNAF gave assistance to 800 smallholders in Mafra as well as neighboring towns, with more families waiting to be integrated.

The cooperation between BNAF and ACIM involved two aspects: linking BNAF and its clientele with local trade, and conflict resolution. Linking local small producers with local trade was no easy task. Local supermarkets had tried to purchase vegetables from local producers before, but this had failed due to unreliable and predatory behavior of the producers. Ever since local producers had sold their products to wholesale traders in Curitiba (two hours away from Mafra), and supermarkets had purchased fruit and vegetable there. Convincing the supermarket owners to give it another try with local producers, this time with the intermediation of ACIM and BNAF, involved intense persuasion by the executive secretary of ACIM. Initially, it involved only tomatoes (with everybody being better off – producer prices were 31 % higher, purchasing prices for supermarkets 22 % lower, and the consumer price dropped by 15 %), subsequently being expanded to other products. Local marketing of milk involved one association investing in equipment to sterilize and package the milk. Producer prices rose from R$ 0,16 to R$ 0,41, with the producers still selling it at a much lower price than large firms. It happened thus that the association won a bid to supply local schools against large competitors like Parmalat.

An unexpected effect of the link between producers and trade, and of the trust which quickly built between BNAF and ACIM, was that local trade firms started to deposit money at one of the local credit cooperatives which is working closely together with BNAF. Initially, this involved an amount of about R$ 600,000, which by September 1999 had grown to more than R$ 4 million and then also involved the other credit cooperative. While in September 1998 BNAF had various projects in the drawer and was desperately, and with little success, looking for funds, today the situation has reversed – BNAF has to work hard to put all the money at productive use.

Conflict resolution by ACIM so far involved two cases which might have blown the whole experience. First, BNAF had come up with the idea to organize joint purchases of all the affiliated smallholders. It turned out that the best way of organizing this was to organize an open auction, with the suppliers bidding against each other until the lowest acceptable price for various inputs was reached. The suppliers reacted by asking ACIM for support in forming a cartel to deal with BNAF. It took the executive secretary of ACIM several meetings to dissuade the suppliers from proceeding with this scheme, mainly by pointing out the fact that local agriculture is going through a period of crisis (since traditional cultures are becoming less productive and earning lower prices, while interest rates have been raised to extremely high levels during the last three years), and that is was in the long-term interest of suppliers to strengthen local producers.

Second, apparently one of the representatives of a large milk producer bribed a health inspector of the city government to classify the milk produced by the association as hazardous. The inspector inspected the association's installations at ten o'clock in the morning, and by 3 p.m. came up with the incriminating exam. The manipulation was immediately obvious since the next laboratory is located in Curitiba; it was technically impossible to have an exam in hands within such short time. The association alerted ACIM, which immediately called for a meeting. It was decided to send a sample to Curitiba for an examination, and ACIM was to call the local newspapers immediately to alert them of the inspector's fraud. This worked just fine – the real exam arrived the next day, showing that the milk was just fine; the newspapers published this result, thus reinforcing the standing of the local producer; and ACIM successfully lobbied with the mayor to have the corrupt inspector fired.

7.2 Tourism and paleontology

In terms of tourism, Mafra has a lot of potential – a nice landscape, beautiful waterfalls, extensive forests, and so forth. However, this is no particular advantage since all the municipalities in the region have such a potential. The difference between Mafra and neighboring cities is the fact that Mafra has a number of important paleontological sites, which are not just normal sites but actually prove the hypothesis that millions of years ago Africa and America were a single continent. These sites have been known since the 1930s, but they have never been systematically explored or exploited. The existence of these sites came back to the memories of many local actors when such a site was uncovered during the earth-moving for the construction of the plant of the U.S. firm mentioned before, with an immediate intervention of federal authorities and an acute risk that the firm would cancel its investment. It was through swift action of several local actors that the findings could be secured in the local university, and construction could proceed.

Leveraging the paleontological sites to attract tourists was one of the suggestions of the Projeto Marketing Municipal. Local actors liked this idea, and ACIM convened a working group of representatives of several organizations, not only from Mafra but also from neighboring Rio Negro, to elaborate a project (among them a retired professor, an internationally renowned specialist in the field). The project which evolved was quite ambitious: Create a National Center for Paleontology, not just for tourism but also as a research center, especially catering to visiting researchers and groups of students from Brazil and abroad. It also took not long to find the ideal place: a big and very beautiful building in Rio Negro, constructed as a Franciscan seminar at the beginning of the century, abandoned since the 1970s and recently partially renovated.

It took some time to overcome short-sighted rivalries and jealousies between Mafra and Rio Negro to get the project moving. A big step forward took place in August 1999 when the working group, together with representatives from the two city governments and city councils, defined six separate elements which together make up the whole project, which are to be divided evenly between Mafra and Rio Negro. In September, a memorandum of understanding was signed by the two mayors, the two presidents of the city councils, and the two presidents of ACIs. Three persons were identified who will work full-time for the project – one paid by the city of Mafra, another one by the city of Rio Negro, and the third one by both the state governments of Santa Catarina and Paraná. In terms of Brazil, such a project involving two cities from two different states is very unusual and a big achievement.

The direct economic effect has been estimated at R$ 5 million per year. However, this calculation was based on very restrictive assumptions, and counted tourism income only. It is quite likely that the direct and indirect effect of the project, once it will be up and running (probably early 2000), will be more substantial. Apart from that, it will raise a lot of attention for Mafra, which so far is perceived as a relatively unimportant backwater, and it will enforce the self-esteem of local actors in Mafra and Rio Negro, thus creating favorable conditions for further projects.

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