



## EXTENDED ABSTRACT

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**Title:** INSTITUTIONAL CHANGE IN EMBEDDED ACTIVITIES: AN ENDOGENOUS DEVELOPMENT APPROACH

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### 1. Introduction.

For years, the rules in the mainstream of economic analysis have been put aside. However, from recognition of North's work (1990; 1994), formal and informal institutions are playing an important role in the interpretation of growth and structural change processes.

Endogenous development is a useful approach for understanding how territories evolve within a dynamic process of change, where networks, knowledge and innovation mechanisms, infrastructure and urban systems, interact in a territorial development process where agreements are made, and opportunities and threats emerge for different social groups and places. As a consequence, previous *status quo* situations may be altered, so as to find new approaches for local development.

Territorial development is not a determinist process, but it is shaped within local responses to external challenges and territorial opportunities, and taking advantage of the traditional knowledge accumulated in local societies. The response to global challenge is associated with the importance of local actors, tools and agreements in the territorial governance dynamics (Vázquez-Barquero and Rodríguez-Cohard, 2016).



The aim of this work is to analyze how local actors change their institutional dynamic in order to adapt the local production systems to global challenges. In this line, the paper answer questions like the following: what would make local actors change? What is the role of local actors in promoting strategic agreements? Is the local response toward territorial strategic planning useful?

The province of Jaen was used as an example of institutional evolution, comparing two very different clusters: the olive oil agro-industrial district, which is very outstanding, and the cluster of automotive components, managed by Valeo lighting Spain, an important multinational subsidiary of Valeo lighting group. In a long term analyses, the paper has used the Williamson's model (2000) so as to reinterpret territorial logic from data collected during the last twenty five years by the authors' work in both local production systems. The reinterpretation of data has provided new results for institutional change in embedded activities.

On the one hand, we are witnessing the emergence of "territorial entrepreneurs" within multinational subsidiaries embedded in the territory. In this context, a place-based approach is used for branches to be more competitive in a framework of internal competence within multinational corporations.

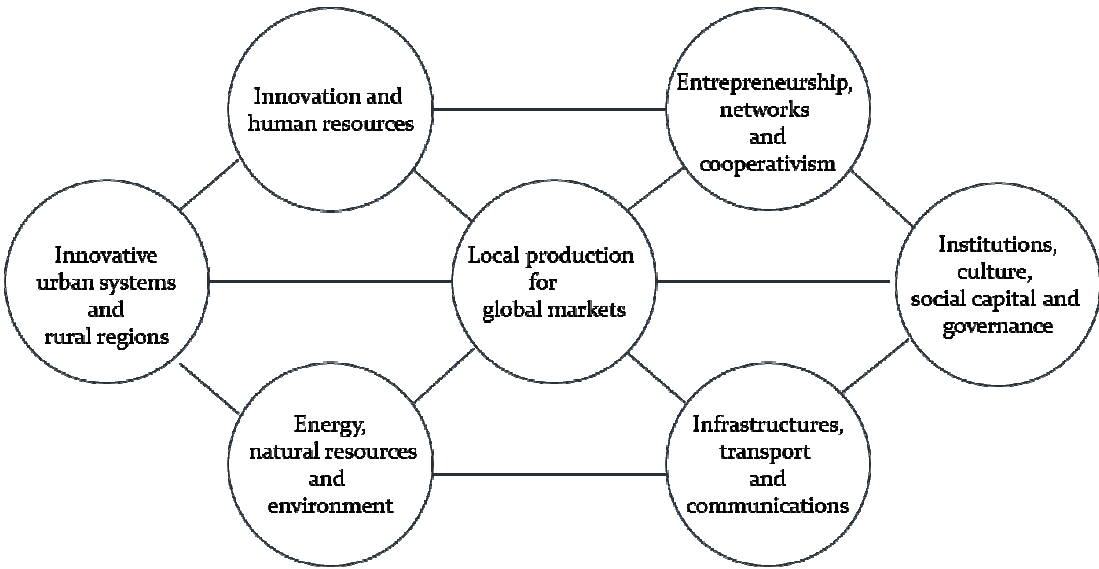
On the other hand, informal institutions play an important role in traditional activities, ruling local routines and offsetting standardization in global production and consumption activities. Territories are playing "reconnection" strategies to attract the interest of consumers to local culture and the behavior of specific institutions that were settled within the local context.

After this introduction, the paper follows with a theoretical approach towards endogenous development and globalization. Then, methodology is presented. Third, previous results will be discussed. Finally, the paper ends with comments on institutional change, development and globalization.

**2. Endogenous development, institutions and global markets.**

The endogenous development approach argues that the territory is no longer simply a place where resources and economic activities are located. Its analysis explains how economic viability is possible due to the generation of a surplus and how it is affected by economies of scale and the reduction of production and transaction costs. In this process, the territory works as an agent for its transformation because local firms and social actors interact in order to develop the economy and society. It is in this way that endogenous development can be understood as a process of economic growth and structural change, which employs its local development potential to improve the population's standard of living (figure 1).

**Figure 1**  
**Factors affecting endogenous development for global markets**



Source: Adapted from Vázquez Barquero (2010).

Understanding power dynamics in local networks is paramount to achieve adequate results for the implementation of policies. In embedded activities, local productive systems are those with a high number of firms working in a network where the economic power is diffuse and not very concentrated. The literature has used different



concepts to explain this situation, such as industrial districts (Becattini, 1979) or clusters (Porter, 1990) in urban areas, and local productive systems (Vázquez-Barquero, 1987) in rural areas, in most cases with relevant economic policy implications.

The strategies of territories and firms are conditioned by globalization processes, fostering transformations in local productive systems. The organization of production is more flexible due to the international value chains, the networks of different size of firms and the strategic agreements between companies, public bodies and NGOs worldwide. From a spatial point of view, the production is organized in rural and urban clusters (Porter, 1998).

In this context, global value chains are linked within clusters of firms in different countries and regions (Rabellotti *et al.*, 2009; Rullani, 2008). The stream of production depends on the continuous transformation of economic rules and institutions, giving rise to new ways of organization of production (Scott and Garofoli, 2007; Schmitz, 2007).

The governance of these global value chains is more and more complex, since the firms find it difficult to act within a global system of relations with incomplete and vague regulations. At the same time, rural areas are more diversified, combining agriculture, industry and services activities, altering cultural identities. However, rural culture is, paradoxically, more and more valued in global markets (Porter *et al.*, 2004; Saraceno, 2006).

Communication and transport systems were developed when markets were changing from national to global, adopting innovations in the production and organization of companies, in the location of cluster, the expansion of local activities and the urban configuration of the territories. Institutions ruling activities were modified by innovations in communication and transport systems altering the relations between social and economic actors (Schumpeter, 1934; 1939).

Local productive systems are embedded in a social context (Polanyi, 2001), where power dynamics and territorial policies rule the process of institutional change. Embedded activities evolution differs from others, not only because of the products made or the



performance of the markets, but because of the way local productive systems undergo the process of institutional change.

In the most innovative territories, governance systems are shaped by firms, public actors and civil organizations, which are the actors making investments decisions. These processes are conditioned by social and economic institutions affecting economic development processes. Likewise, changes in other factors of growth bring about institutional changes (Lewis, 1955).

North (1990 y 1994) and Williamson (1985) state that commercial and non-commercial costs reductions in the economic exchanges and transactions are possible thank to the links between institutions and economic growth. Economic activity is soaked in a tissue of social, cultural and political structures conditioning economic results, since economic actors and organizations are uncertain when making their decisions and strategies.

Economic territorial policies are focused on increasing the competitive capacity of the territory, in order to maintain and raise employment. Improving local innovation processes and encouraging the emergence of external economies, are the main instruments for developing the local productive systems. However, territorial policies could have different results depending on the nature of the local systems.

In order to reduce uncertainty and transaction costs, old formal and informal institutions turn into new ones in a process of slow institutional change. Community relations shaped by cultural and personal links are based on trust, but formal relation links depend on strategies linked to the goals of the firm (Arrow, 1974), forged in formal agreements that could lead to relations of trust in the future. Trust is considered an individual capital based on actors' reputation, but it could be seen as social capital spreading out across the local productive system (Fukuyama, 1995): a territorial specific factor, very difficult to find in other contexts outside the cluster.

The process of territorial governance involves economic and social actors, public and private organizations, firms, banks, chambers of commerce, entrepreneurship associations and trade unions. Governance refers to commercial and non-commercial transactions in a social and political context ruling actors and organizations relations, as



a consequence of a historical process. Endogenous development, then, is an interpretation analyzing how institutions encourage development forces fostering economic and social progress (Vázquez-Barquero, 2002).

### **3. Methodology.**

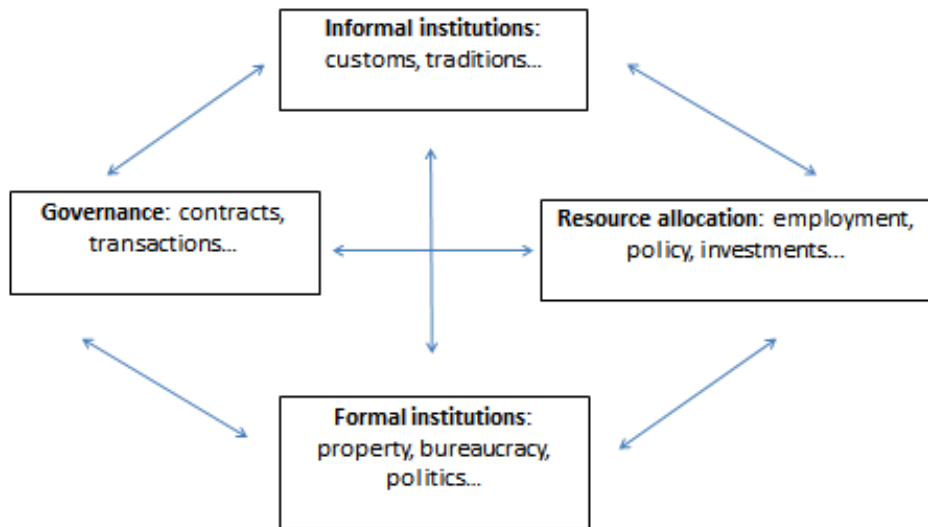
We use two examples of local productive system in rural areas to explain the institutional mechanisms that command the change of development process: the agro-district of olive crops in Andalucía (Rodríguez-Cohard and Parras, 2011) and the cluster of automotive components in Jaén, managed by a subsidiary of Valeo Lighting Systems (Rodríguez-Cohard and Muñoz, 2006).

The first one is an endogenous productive system influencing the world's olive oil market. Data and relevant information was collected during the last 25 years, with quantitative and qualitative analysis (Rodríguez-Cohard, 2004; Rodríguez-Cohard et al., 2017; Rodríguez-Cohard et al., 2018).

The second one is a cluster shaped by foreign investment, which have generated a local productive system in line with the growth pole theory (Perroux, 1955; Lasuén, 1969), but as well as a consequence of corporation' strategic decisions (Lasuén, 1973; Vázquez-Barquero, 1999), bringing about unbalanced local network of power (Hakanson and Johanson, 1993). This is a paradigmatic case of a multinational subsidiary capturing the benefits of regional policies implementation (Quesada, 2017) and sharing value with territory alike (Porter and Kramer, 2011). This case allows us to distinguish the institutional change provoked by organizational and technical innovation in a context of geographical proximity.

The reinterpretation of these cases was carried out using Williamson's model (2000) of Institutional System, which is shaped by four level of analysis: informal institutions, formal institutions, governance and resource allocation (figure 2).

**Figure 2**  
**Institutional Dynamic**



Source: Adapted from Williamson (2000).

1. Informal institutions are customs, beliefs, traditions, conventions, and so on, that were created within a historical process where the foundation of territorial behavior was built.

2. Formal institutions are conditioned to some extent by informal institutions, due to the influence exerted on the politicians by the society as a whole.

3. Governance follows the formal and informal institutions, as a specific mechanism to reach agreements and reduce transactions costs.

4. Resource allocation depends on the contracts, informal agreements, beliefs and formal institutions, in order to make the most of scarce local resources.



These strands interact with each other making up the dynamics of the institutional system in the territory. The institutional system conditions policies, investments, employment, agreements, transactions cost, etc.

The system is dynamic, but at different paces. Thus, informal institutions change very slowly in an unconscious way; formal institutions change with tensions between national and local stakeholders; the way in which governance is fulfilled depends on both of them, and the local incentives to allocate resources, that will be tailored by the local responses to the globalization processes.

#### **4. Previous results.**

The evolution of institutions using the four level of analysis aforementioned: Resource allocation, Governance, Formal and Informal institutions, is presented:

##### *4.1. Resource allocation.*

This was divided into two allocators: public and private.

Public allocators implement policy instruments in order to encourage economic activity and raise the level of employment. In both cases, the government has stimulated the emergence of technologic parks and centers, with different results. In the case of olive oil system, the instrument has failed, given the slow reaction of local firms to this facility. In the case of the automotive components cluster, the instrument has been captured by the subsidiary, far away from the initial intentions of regional government, since it was the upgrading of local firms to avoid the great dependence on the multinational corporation (Quesada, 2017).

Private allocators use the market to better allocate resources. In the case of olive oil, markets have pushed the election of new modes of cultivation, more intensive, with the entrance of new actors and firms (Rodríguez et al., 2017). In the case of automotive components cluster, the reaction has been similar.





#### 4.2. Governance.

Governance has influenced three processes of change: the appearance of new institutions, changes in the decision process and the emergence of new actors.

1. New institutions have appeared, such as quality, cooperation and new rules.
  - a) Quality, as a new institution, has influenced not only routines, but have conditioned the emergence of new actors in the olive oil system, such as PDO or PGI. Besides these bodies, farmers' own requirements, on the one hand, and market demands, on the other hand, have encourage its arrival, with the support of public institutions. In the cluster of automotive components, multinational requirements are most important.
  - b) Cooperation was developed in the olive crop industry during the last century so as to face the reduced prices local buyers offered for the olives, creating cooperatives that are now key actors in the world market. In the cluster of components, cooperation has been imposed by the subsidiary in order to implement Toyotism since 80s.
  - c) New rules are imposed in the process of new governance. In the olive oil system, early harvesting is a new rule that has changed rural routines, that before were striking to the less innovators, but now, once profits were proven, the new process of harvesting is slowly being incorporated into the rural conventions to obtain a higher quality olive oil. Local firms in the cluster of automotive components have incorporated new rules in the organization of production, related to externalization and specialization, changing traditional behaviors for strategic ones.
2. The institutional process of change has pushed the emergence of new actors, such as innovators in olive oil system: the rural creative class making excellent olive oil to be sold in *gourmet* markets. In the cluster of components, policy entrepreneurs have entered the scene when the subsidiary



has taken part in the policy design of embedding instruments between regional government and the local executives.

3. The territorial decision process is changing from an individual to a more participative one, especially important when a high number of actors are involved. However, in the case of olive oil system the decision process runs the risk of groupthink instead of being strategic.

#### *4.3 Formal Institutions.*

During the last century, Common Agriculture Policy gave rise to an intensification process in the local olive oil productive system, putting at risk biodiversity and sustainability. Now, it is being redirected to more environmentally friendly norms, in a productive system that is not market oriented.

For centuries, inheritance laws have stimulated the dissemination of properties, reducing the scale of agricultural plots. Now, most of them are under the profit level and will require new strategies in order to deal with new international competitors.

#### *4.4 Informal Institutions.*

Culture, tradition, family and other informal institutions have conditioned the local productive activity for years, even centuries. In olive crops system, tradition and family have influenced on properties, carrying out a process of dissemination. Nowadays, the globalization process is pushing to new propositions, which could bring about new institutions, such as cooperation in crops, and even new property reallocations.

In the case of Valeo lighting system, the institutional change is the quest for a new work collaborative ethic, between the interests of local society and the multinational subsidiary (Rodríguez Cohard, 2004; Quesada, 2017).

### **5. Final comments: Discussion and previous conclusions.**

The results, using the model selected, show how very different local productive systems are in their institutional evolution. However, in both cases new institutions are adopted in order to ease the adaptation of the territory to new forms of competition. The process



of change is evolutionary, and it is conditioned by the actions and actor's decisions made in a context of complexity, in order to answer global challenges.

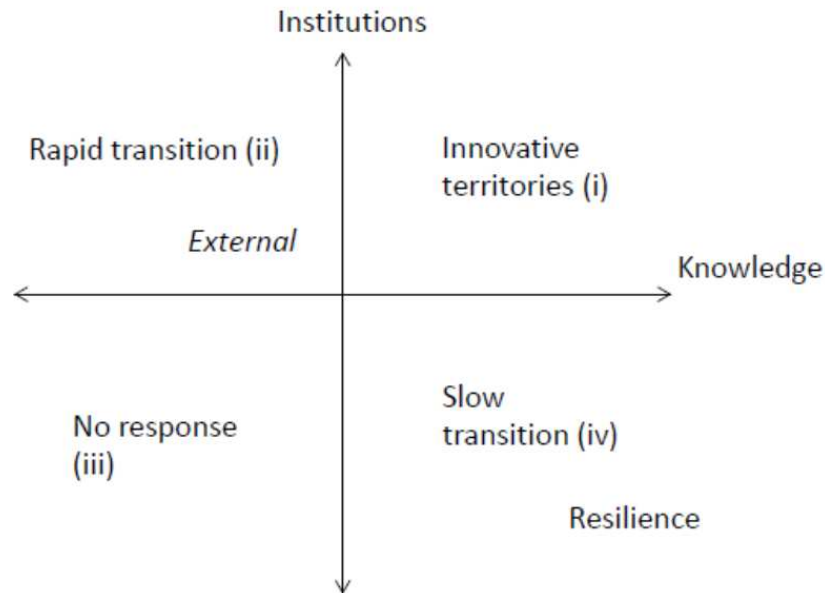
The capacity of change and the pace of it depend on the adaptive institutional system and on territorial knowledge. In this regard, a typology of territories (figure 3) might be proposed in relation to their capacity to make a more inclusive institutional framework in combination with the level of productive knowledge accumulated locally:

1. Innovative territories that put in motion the formal institutions that assimilate the cultural and institutional informal context, easing their absorption as an instrument to improve the business environment in combination with productive and technical knowledge.
2. Territories where formal institutions are flexible and accepted by the local sphere, but lack innovative knowledge have problems to accede to international markets on their own. In these cases, foreign investments could facilitate a rapid response to global challenges in favor of local employment, but putting at risk future restructuring processes. These are places for creating linkages with international companies in order to up-grade local capacities, and share the created value with local development agents.
3. Spaces where formal and informal institutions are outside the market rules and where commercial knowledge is scarce find it difficult to implement local initiatives as answers to global challenge.
4. Territories with sufficient possibilities to make the most of local technical and cultural knowledge setting in motion local initiatives, but where local institutions, very often informal, slow down the response to increasing competition. These territories could be identified as slow cities or slow territories. There, resilience is featured as one of the best options to resist and respond in the long run.



**Figure 3**

**Territorial capacity to give answer to global challenges**



Source: Own elaboration.

Cases have shown how institutional change could be a possible response to global challenges, even in rural and peripheral territories, using endogenous resources in combination with public policies. But local productive systems are complex in their process of dealing with globalization, because old institutions struggle with new ones in a process of continuous change

The responses are conditioned by the innovation processes adopted in new products, processes, markets and social dynamics, and social innovation being important for assessing successful reactions. However, when local productive systems are embedded in traditional contexts, risks of groupthink could appear.

New emergent institutions arise in rural territories to make them more flexible and resilient to global challenges. Likewise, new actors emerge, conditioning the future of the local activity. Changes are in relation to the dynamics of local power. If local elites try to keep the new actors under control in order to increase their power and income, the



effect of distribution of power in local productive systems could have consequences on economic policy implementation.

Taking into account that globalization has demonstrated its profound effect on income distribution (Piketty, 2014), could place-based policies be an adequate instrument to fight against increased territorial inequality?

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