

# Endogenous Rural Development: Empowerment or Abandonment?

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## Abstract

In the last decades the endogenous development approach has gained influence in the rhetoric of European rural development policies. In contrast to those theories that relate to the new paradigm of self-enforcing regional growth, the approach of endogenous development allows for a positive definition of rural areas in economic terms because it stresses the importance of local factors in the absence of agglomeration. We find that potential draw-backs of the approach could be identified more easily if it was reformulated in terms of theories on interrelated institutions and strategic interaction. According to these theories, low factor-mobility enables the envisaged coordination between local actors. At the same time, though, low factor-mobility restricts regional economic development. Therefore, endogenous development does not free the state from policies of spatial redistribution if the political aim is in the creation of comparable living conditions.

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## 1. Introduction

In the last decades a considerable shift in concepts on regional policy has taken place. This change has sometimes been described as a change from the “hierarchically organised intervening state” towards the “cooperative state” (Wissen 2001). Up to the seventies, centralised decision-making on regional planning and active industrial policies was the rule. In many countries “central places” were identified and incentives were set such that enterprises installed branches of plants at respective places. Often infrastructure investments were a reaction to a reduced willingness to invest on the firms’ side. The respective (centralised and deterministic) “master planning” and “structure planning” was based on ideas of comparative advantages and supply-side policies.

In the 80’s economic development theories beginning with the new growth theory started to recognise formally the importance of knowledge as a production factor. At the same time, societies experienced an accelerating macroeconomic structural change from the industrial society towards the globalised “knowledge society”. In economic politics a shift occurred away from the welfare-state towards the market-liberal paradigm. As a result of these developments the new model for regional policies evolved. Stimson and Stough describe it as a shift from the focus on comparative advantage to the focus on competitive advantage. The new policy model stresses the importance of “soft factors” and is based on integrated strategic planning and on ideas of industry clusters (Stimson and Stough 2009). Integrated planning has also been described as a shift from sectoral towards territorial approaches on regional policies (Shucksmith 2010).

The link of the new growth theories to a spatial dimension proved fruitful in different directions. On the one side, the importance of knowledge-spillovers between co-locating firms and more generally the Marshallian idea of positive local scale effects exogenous to the firm gained new recognition. These ideas inspired different models of industry clusters (e.g., (Porter 1998; Piore and Sabel 1984) and uneven regional economic development (Krugman 1981; Hudson 1999). On the other side, by development practitioners and some regional scientists (Stimson and Stough 2009) it was also proposed in the course of this development that local knowledge and local preferences need to guide decisions on regional policy. This aspect was stressed most in approaches of policy making that refer to a loose bundle of ideas sometimes named “endogenous development”: “It considers development as a territorial process (not a functional process) that is methodologically based on case studies (not on cross-section analysis) and that considers that development policies are more efficient when carried out by local actors (not by the central administrations)” (Vázquez-Barquero 2006). Therefore, the optimistic notion that within a world of growing mobility and information-access regional development would mainly be determined by local actors’ capabilities and cooperation built one cornerstone of the new paradigm. The other cornerstone was the perceived need to enable local actors institutionally to participate in political decision-making. This involvement of local actors

was supposed to limit “the number of errors of diagnosis that are all too common when planning is carried out from the outside” (EUCOM 1988: 62).

In the consequent development of this notion regions emerged “as new political arenas, in which political, social and economic actors debate issues of local interest - most notably economic development” (Gualini 2004: 330) and that were expected “to develop and use their own devices to compete internationally in order to survive” (Stimson and Stough 2009). In Europe the 1988 reform of structural funds is sometimes seen as an important step into this direction of “new regionalism”. Nevertheless, “as concerns the implementation of ERDF-funds, in the view of some scholars and practitioners, the central state by no means easily vacates its powerful position. A contrast is rural policy and LEADER+, where the so-called local action groups can act fairly well outside the shadow of the hierarchy” (Kull 2009: 22).

Actually, in European Rural Development Policies (RDP), the idea of endogenous development became a ruling paradigm for those measures that target the wider rural economy. This may have been supported by the fact that according to this approach every (rural) region has principally the potential to create its own “virtuous circle for sustainable regional development” (Stimson, Stough, and Salazar 2009: 20). Therefore, development not necessarily originates in large cities. Just on the contrary, the approach’s most specific characteristic is the conceptual concentration on local factors. The paradigm therefore allowed for a positive definition of rural areas. On a more formal level, the concentration on the approach of endogenous development may also reflect the necessity to prove the complementarity of the measures of support for the wider rural economy to those measures financed by the cohesion funds (EFRE funds) (EC 20 September 2005). Whether this task-sharing between bottom-up rural development measures financed by the EAFRD and more conventional measures not directly targeted to rural areas financed by the EFRE is efficient from a social point of view remains questionable, though, since the approach of endogenous development has often been criticised for its weak theoretical basis.

We ask whether endogenous development with its concentration on the local actually has the potential to create sustainable growth within (rural) regions. This question is of high political relevance, since an ineffective empowerment could imply a hidden abandonment of support for peripheral areas. In this assessment we rely on the notion that a successful social development is only possible with a solid economic foundation. In order to address the question of the effectiveness of RDP, we analyse in how far the approach of endogenous development is congruent with (other) theories on regional development. We discuss that contrary to influencing interpretations of endogenous growth (Stimson, Stough, and Salazar 2009; Stimson and Stough 2009), rural endogenous development is not consistent with the new paradigm of self-enforcing regional growth as embodied for example by models of the New Economic Geography (NEG) or of cluster development in Marshallian districts. Instead we argue that the approach could be re-formulated more

rigorously in terms of theories on interrelated institutions and strategic interaction. In a confrontation of the idea of endogenous development with these different theories we substantiate our thesis that endogenous rural development with its concentration on local factors in peripheral regions does not substitute for measures of spatial redistribution if the aim is the creation of comparable living-conditions.

We start our conceptual critique with a qualification of the role of the endogenous development approach in European Policies for Rural Development (chapter 2). The “theory” of endogenous rural development is reflected critically in chapter 3. We show especially that the notion of endogenous development is not backed theoretically. Therefore the question as in how far rural economic development may be initialised endogenously remains open. In the search for an answer, rural development and the potential for “endogenous” rural development are then discussed in the light of comprehensive theories on regional development in chapter 4. We align these theories along their common evolutionary strands in order to identify central triggers of regional development (4.1). These triggers are then condensed in common conceptual driving forces. These driving forces that contribute to self-organisation in economic development are often positively related to factor-mobility while endogenous development stresses the importance of local resources. Therefore theoretical concepts that are congruent with the idea of endogenous development are identified based on their proposed relation between self-organisation and factor mobility (4.2). Thereby we show that endogenous development usually does not compensate for the lack of cumulative development in peripheral regions. Based on the congruent concepts, the idea of endogenous development is critically re-assessed on a theoretical basis (4.3). Chapter 5 highlights the specificity of rural economies and summarizes the findings of the foregone chapters. We end in a final assessment of the validity of the approach of endogenous development for the explanation of rural economic development.

## **2. European Policies for Rural Development**

Originally, the Common Agricultural Policy (CAP) as implied by its name had a strong sectoral focus. There was no other specialised support for rural areas. Subsequently, in reaction towards an increasing economic destabilisation and depopulation of some rural areas, infrastructural support and serviced factory sites and premises were provided and tourism was encouraged in order to attract new types of employment (Lowe et al. 1998). This concentration on the support of the competitiveness of farming and the top-down decisions on infrastructural investments have been interpreted as an expression of an “exogenous perspective on rural development” (Lowe et al. 1998: 7) by some.

Today the CAP is conceptually organised within two pillars. The first pillar addresses the agricultural sector and its market with market interventions, coupled subsidies and direct

income support. We are concerned with the second pillar that addresses rural areas with a less pronounced sectoral focus. The second pillar is built by three so called axes with the objectives of improving the competitiveness of the agricultural and forestry sector (axis 1), improving the environment and the countryside (axis 2), and improving the quality of life in rural areas and encouraging diversification of the rural economy (axis 3). Additionally a fourth axis was introduced that “based on the LEADER-experience, introduces possibilities for innovative governance”. In contrast to the other three axes this one is conceptualised as a cross-sectoral approach. One of the measures under this axis is explicitly concerned with rural competitiveness.

## **2.1 The complementary character of RDP**

The early claims of the reformed Common Agricultural Policy (CAP), which was set up as the “second pillar” by the Agenda 2000 reform, were “sustainability, [...] a multisectoral and territorial focus; the need for integrated, multiannual programmes; the importance of building private and community-based capacity in each local area through participation and decentralisation in design and delivery; and the need for monitoring and evaluation involving stakeholders” (Dwyer et al. 2007: 877). The RDP rhetoric thereby reflects what has been named “the new rural paradigm” (OECD 2006). This paradigm, according to the OECD is based on two principals: “1) a focus on places instead of sectors; and 2) a focus on investments instead of subsidies”.

The multi-sectoral claim for general economic development plays a central role in the justification of funds of the second pillar. The claim becomes apparent in paragraph 47 of the Council regulation on support for rural development: “Support should be granted for other measures relating to the broader rural economy. The list of measures should be defined on the basis of experience of the Leader initiative and having regard to the multi-sectoral needs for endogenous rural development.” In the fact-sheets of the European parliament concerning the second pillar of the CAP the claim to contribute to regional cohesion is underlined: “Agricultural and rural policy plays a key role nowadays in the territorial, economic and social cohesion of the Union and in the protection of the environment”.<sup>1</sup> The claim to support general economic development in rural areas is also stressed in the Community strategic guidelines for rural development: “Axis 3 helps to develop local infrastructure and human capital in rural areas to improve the conditions for growth and job creation in all sectors and the diversification of economic activities” (EC 2006) and especially the new programming period is seen as a “unique opportunity to refocus support from the new EAFRD on growth, jobs and sustainability”.

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<sup>1</sup> URL: [http://circa.europa.eu/irc/opoce/fact\\_sheets/info/data/policies/agriculture/article\\_7212\\_en.htm](http://circa.europa.eu/irc/opoce/fact_sheets/info/data/policies/agriculture/article_7212_en.htm)

Nevertheless, the Council regulation on support for rural development by the European Agricultural Fund for Rural Development (EAFRD) (EC 20 September 2005) also shows that RDP despite of this multi-dimensional construction still addresses first and foremost farms and agricultural production. This focus is striking since it may easily be shown that rural demographic and economic developments as well as the development of agricultural structures themselves depend to a high degree on the economic development of other industries in and outside from rural areas. The strong sectoral focus may actually be explained by institutional restrictions, especially the need of the EAFRD to prove its complementarity to the cohesion funds (EFRE) (EC 20 September 2005). If this complementarity is not given the need for the additional measures financed by the EAFRD would have to be questioned.

If we refrain from the discussion of sectoral policies directed at tourism and the diversification of farms, and of those measures aimed at an “improvement of the quality of life” this additional value in the economic sphere is supposed to be created within axis 3-measures related to the aim of diversification of the rural economy by “support for the creation and development of microenterprises with a view to promoting entrepreneurship and developing the economic fabric” (EC 20 September 2005: Article 52). The first impression is that the scope for support of the wider rural economy according to this niche-existence in central concepts is not large. A closer look at the opportunities offered under axis 3 reveals even more the restrictions that the need for complementarity with EFRE poses on possibilities for support. Support is mainly targeted towards industries related to tourism, recreation, environmental services, traditional rural practices and quality products (EC 2006: section 3.3).

A more general but nevertheless complementary possibility for support seems to be offered by axis 4 (the LEADER-axis). Its complementarity to other funds is guaranteed by the specific implementation of its measures that aims at “improving governance and mobilising the endogenous development potential of rural areas”. Among the possible key-actions enumerated in the guidelines is “promoting cooperation and innovation. Local initiatives such as Leader and support for diversification can play an essential role in connecting people to new ideas and approaches, encouraging innovation and entrepreneurship” (EC 2006: section 3.4). It is actually stressed explicitly that the “population of rural areas could receive support as part of an integrated, bottom-up approach” in order to fulfil the need for complementarity (EC 2006: section 3.6). The local governance approach of RDP is therefore seen to be complementary to measures from the Structural and Cohesion Funds as it contradicts at least rhetorically “the ‘pulling-upwards’” of decisions from the local level to national and supra-national levels that is presumably caused by these other European interventions (Ray 1999). The need for complementarity accordingly at least partially explains the concentration on the endogenous development approach on an institutional level.

Consequently, we identify a dilemma of RDP: On the one side, the sectoral focus needs to be overcome in order to justify the second-pillar funds from a wider economic perspective. On the other side, it was the sectoral focus that guaranteed the fund's complementarity with respect to measures of the cohesion fund. The crucial question therefore is, whether the targeted support for rural areas by the EAFRD in its current form addresses specific needs of rural areas more effectively than other forms of support offered by other funds.

## **2.2 Critique of the RDP**

The RDP has been criticised with respect to its lacking theoretical foundation, inconsistent implementation and perceived ineffectiveness. The weak theoretical foundation of the non-sectoral RDPs has frequently been criticised like, for example by Sotte (2003: 68), who deplors "the lack of a theoretical foundation for rural development and [...] the still insufficient analysis of the relationship between rural development and general development." Dax et al. state that "the gap between academic discourse and policy practice as experienced through implementation in EU countries and regions hardly decreased through the respective policy reforms" (Dax, Kahila, and Hörnström 2011: 6).

The formal structures and institutions that were created in order to support the non-sectoral measures of RDP have undergone empirical analyses. It was questioned, whether these formal structures would be filled with vital content on the various institutional levels, and whether they would actually contribute to a more effective support of the economic development of rural areas. Dwyer et al. (Dwyer et al. 2007: 880) identify a "deep-seated conservatism in the design and implementation of programmes". Especially they found that the existing variety in national and sub-national Rural Development Plans does not correspond consistently to existing structural and socio-economic differences among the corresponding regions. Instead, the existing differences may rather be explained by institutional path-dependence and inflexibility. Therefore, one may conclude that the "integrated approach" that was aimed at by the introduction of distinctive development plans remained largely unfulfilled.

Finally, there is also some evidence that second pillar policy measures were not successful in the promotion of cohesion between Europe's regions (Shucksmith, Thomson, and Roberts 2005). These results have been derived, though, on a rather superficial analysis of funds allocation and on case studies' results rather than on theoretically based reasoning or well founded impact analyses. The same holds true for the rather positive valuation of LEADER initiatives. Dwyer et al. (2007) for example, in accordance with Shucksmith et al. (2005) diagnose a better fulfilment of the goal of territorial sensitivity and multifunctionality in those regions with "prior experience of 'bottom-up', territorially grounded initiatives in integrated rural development, particularly LEADER".

In contrast to all of these critical approaches, we address the question on the RDP's potential to support the development of the wider rural economy on a conceptual level. This attempt comes down to an assessment of the endogenous development concept, which builds the conceptual basis of current rural development concepts. At least verbally, axis 3 of the second pillar of the CAP increasingly stressed the suspected necessity of bottom-up developments. The Council regulation on support for rural development from 2005 states in Article 52 that axis 3 for the private economic sphere not only offers "support for the creation and development of microenterprises with a view to promoting entrepreneurship and developing the economic fabric" but also "a training and information measure for economic actors operating in the fields covered by axis 3". The paragraph 47 of the Council regulation stresses the central paradigmatic role of the LEADER concept and thereby the ideal of surplus generation within networks among local residents. Moreover, innovation is within these new programs understood as a key-driver to success of local initiatives (Copus and Dax 2010). In the Rural Development Programmes of the programming period 2007-13 the LEADER concept has been given explicitly more weight in the so called "mainstreaming" process.

Obviously, this new paradigm and the policy concept that is roughly sketched by paragraph 47 and article 52 stresses "endogenous rural development" and the mobilisation of the rural people's potentials: "The designation of bottom-up approaches has spread across EU regions and became the symbol for a changed perspective on rural areas" (Copus and Dax 2010: 46). The authors also find that "endogenous growth" is among those "buzz words", which are often used in the European rural development policy literature. On the other hand, according to this source, concepts such as "post productivism", "rural restructuring" and "the network paradigm", that have played a certain role in the academic discussion on rural development seem to be rather neglected (Copus and Dax 2010). Actually, as early as 1996, the Cork declaration formulated that "[t]he emphasis must be on participation and a 'bottom up' approach, which harnesses the creativity and solidarity of rural communities. Rural development must be local and community-driven within a coherent European framework" (Cork 1997: point 5).

The "new rural paradigm" (OECD 2006) mainly stressed the diversity of rural areas and the resulting necessity to focus not only on agriculture and farmers but also on other industries and different private and official actors. It also to a certain extent favoured the decentralisation and regionalisation of political and administrative decision structures. Endogenous approaches stress the capability of regions to create growth if these internal resources were only coordinated successfully. This is a hypothesis, or a hope, which came up as a reflection to the dominating political-economic trends of globalization and liberalisation, as some observers believe: "[R]ather than constituting a model of development with clearly identified theoretical roots, endogenous development is more readily characterised as an idealised descriptive contrast to frequently observed patterns and processes of development" (Slee 1993: 43). "The use of the endogenous ('bottom-up,'



‘participative,’ ‘community’) ‘hypothesis’ of socioeconomic development is a manifestation of the new ethos” (Ray 2000: 164). Actually it seems not to be clear, whether we speak about a scientifically founded hypothesis or an ethically grounded plea.

### **3 The “Theory” of Endogenous (Rural) Development**

The idea of endogenous growth has been favoured by many working on rural development because a “[...] model of endogenous development guarantees autonomy to the process of transformation of the local economic system. It does so by underlining the centrality of the decision-making processes of local social actors and their capacity to control and internalize external knowledge and information, and by generally assuming the traits of a self-sustaining process of development. The process of transformation is based, therefore, on local specificities and on the capacity to govern fundamental variables. A model of endogenous development is, in fact, based on the production of ‘social capability’ at the level of the community of firms and institutions that operate in the local sphere [...]”(Garofoli 2002: 228). Martin and Sunley (1996) note that “endogenous development” is here “synonymous with ‘locally-based’”. These authors refer to the concept of stimulating regional development by the support of “local enterprise, small-firm growth, and technological innovation”. They find a close resemblance to the concept of industrial districts. The authors rightly caution against a confusion of this concept of endogenous development with the theory-based concept of endogenous growth.

#### **3.1 The role of “endogenous growth” in “endogenous development”**

A connection between the two approaches of “endogenous growth” and “endogenous development” is constructed by some authors despite of the apparent oversimplification. The macro-economic theory of endogenous growth (Romer 1986; Lucas 1988) rests on the idea of positive externalities of production and of growing markets that cause positive scale effects. These ideas allow for an endogenisation of technical progress. Similar ideas have been transferred to models of the so called New Economic Geography (NEG) (Englmann and Walz 1995). Theoretical results showed that these externalities cause cumulative growth in developing agglomerations under certain conditions. Therefore, according to the contemporary interpretations of the new growth theory, “economic growth tends to be faster in areas that have a relatively large stock of capital, a highly educated population, and an economic environment favorable to the accumulation of knowledge” (Button 1998: 146). Accordingly, it implies divergent development and the role of public policy is rather limited (Marcouiller, Kim, and Deller 2004).

Therefore, the view that “[w]hat is significant about endogenous growth theory is that it places emphasis on the importance of local factors in creating and maintaining sustained

development as opposed to ones external to the region. That is, models of endogenous growth suggest an active role for public policy and domestic actors in promoting economic development” (Stimson, Stough, and Salazar 2009: 9) expresses an oversimplification that neglects the spatial dimension and cumulative dynamics of growth. The assessment may well be contested on the basis of the theory itself for three reasons. First, the relevant “local” factors of knowledge and entrepreneurship are no static entities that can be localised independently of the process of development. Second, while the theory implies that these local factors may sustain the development, it creates strong doubts on the possibility that endogenous forces will suffice in order to initiate such dynamic developments. Just as well, the conclusion may be drawn that some kind of exogenous shock is needed in order to initialise the self-enforcing process and the benefits of positive effects of scale. Third, the regional development described by the new growth theory within NEG without compensations and transfer-payments is no spatially neutral zero-sum or win-win game. Accordingly, the theory does not imply that all regions should show positive “endogenous” development in equilibrium. To summarize, “late-comers”, be it regions or nations, might not be able to catch up in development based on their internal factor endowment.

Since all of the theories concerned are a-spatial in the sense that they remain silent as it comes down to questions of the adequate scale of regions, one might still ask the question of whether not even rural places could turn into “growth-poles” of their surrounding. This approach has been chosen in what Daniels (Daniels 1989) ascribes as “internal combustion theory” to Harmston (1983). This approach, like the approach of endogenous rural development stresses the ability of local entrepreneurs in local central places to form businesses and create niches (Daniels 1989). Nevertheless, it is stressed that businesses “may be either export industries or local secondary base companies” in order to acquire the role of the region’s “growth machines”. The accompanying empirical studies (in a north-American context) of these hybrid approaches that combine ideas from central place theory and the export base theory (Daniels 1989) derive rather sceptic results, though. On the one hand it is found that business growth in smaller communities depends on population development (McGranahan 1984), on the other hand local development organizations are found to attract firms but not new population (Krannich and Humphrey 1983). Thereby, the initialisation of a positive dynamic is hampered. In addition it is found that small remote towns below 2500 inhabitants do not have the necessary resources to initialise a process of endogenous growth (Daniels and Lapping 1987). Therefore an infrastructural support of local growth-centres is proposed. The latter are than supposed to support smaller towns in the surrounding. One of the arguments in favour of this “regional settlement policy” is that it can be administered by regional authorities – a view that seems to be in accordance with that of proponents of endogenous rural development. The identification of possible growth centres by the administration poses great difficulties, though. Therefore, as for reasons of political economy and lacking empirical support for

the growth centre or regional approach, respective concepts were discredited by time (Irwin et al. 2010).

### **3.2 Fundamental ideas for endogenous development**

Actually, it is possible to contrast the ideas of endogenous development with those of the endogenous growth theory. Martin and Sunley warn against the confusion of these concepts, which they call the indigenous respectively the endogenous approach (Martin and Sunley 1996). In endogenous growth, economic activity facilitates innovation and thereby induces more economic activities.<sup>2</sup> The concept makes key-factors of growth endogenous to the production-function (Martin and Sunley 1996) – not endogenous in a spatial sense. Endogenous development (Garofoli 2002), indigenous development, and new industrial districts (Harrison 1992) in contrast interpret “endogenous” as “locally-based” (Martin and Sunley 1996).

The concepts on industrial districts apply the concept of social embeddedness (Granovetter 1985) mainly to the relation between local firms. In contrast, the concept of endogenous development ascribe an important role in the development of human resources not only to “innovative firms and entrepreneurs” but also to “governmental agencies” and “education institutions” (Stimson, Stough, and Salazar 2009: 11). That is, while endogenous growth theory gives primacy to the economic sphere, in endogenous development approaches the coordinating function of the administrative and political sphere is stressed. Stimson et al. (Stimson, Stough, and Salazar 2009: 12) name as examples of potentially influencing institutional factors “leadership and the cooperation of local leadership groups [...], entrepreneurship and the associated spontaneity which may alter the economic orientation of the region, and social capital which may contribute to increasing returns to a regional economy by reducing transaction costs”. Moreover, according to endogenous growth theory, economic development is a process induced and sustained by economic agents in a bottom-up process; but Stimson et al. state that “strong leadership means a city or a region needs to be proactive in initiating regional economic development strategy to monitor regional performance. It needs to set a vision for the future development of the region [...]”(Stimson, Stough, and Salazar 2009: 19).

The same authors propose a “regional competitiveness performance cube” with the three dimensions of leadership, institutions and market fit that resembles the idea of Porter’s diamond (Porter 1998). The critique that Porter’s theory provides no “insights into the dynamics by which diamonds can be developed in economies that are not already heavily

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<sup>2</sup> The importance of feedback effects of production is empirically backed for example by (Doran and O’Leary 2011).

industrialised” (Yetton et al. 1992) applies. The principal problem lies in the neglect of the endogeneity to economic development of those dimensions that constitute the diamond, respectively the cube. Actually, at the core of the approach lies the idea (hope?) that it would be possible to control at the local level the “use and implementation of local resources”, “the process of accumulation at the local level”, the “innovation capacity”, and “intrasectoral and intersectoral productive interdependences” (Garofoli 2002). If in contrast to these assumptions, these factors cannot be influenced purposely because they are endogenous to the process itself, a relocation of responsibilities for regional development to the local level might instead “favour a few, relatively well endowed regions” (Markusen 1996).

Referring to the scattered sources on endogenous development there is no clear idea on what the desired economic outcome of the endogenous approach would look like. The ideas presented in the last paragraph imply that some kind of industrial district or cluster, formed by interrelated firms in a competitive environment that makes the best from the local resources, would be envisaged. According to the vast amount of existing definitions, clusters may either consist of similar firms with few links or of firms, which are closely linked by trade, contracts and common institutions (Barkley and Henry 1997). In line with this argument, Stimson et al. note that the shift towards “an emphasis on endogenous processes” and “the increasing focus on integrated strategic planning” in the 1990s “led to a renewed interest in industry clusters [...]”(Stimson and Stough 2009). We would expect this relative concentration or specialisation especially in prosperous *rural* areas since absolute concentrations do not fit the definition of the rural and therefore clusters or specialised industry-patterns are a way of realising positive local scale effects. Regional specialisation might even be a general necessity for regional growth (Markusen 1996).

With respect to clusters it has been recognised, though, that their deliberate initialisation is problematic, since it is only after the initial formation of a cluster that a self-reinforcing dynamic starts to work “especially when local institutions are supportive and local competition is vigorous” (Porter 1998). Barkley and Henry (1997) discuss the potential relevance of the cluster concept for “Rural Industrial Development”. They define “rural” as “nonmetropolitan” and stress that certain conditions have to be given in order for clusters to evolve successfully. Due to the regions’ heterogeneity, these conditions are not given everywhere. Because of difficult ex ante decision on which industries to target as well as natural late comer disadvantages in these regions the cluster concept of policy support is likely to be non appropriate. Conditions are rather favourable, though, in regions with “well developed industry agglomerations” (Barkley and Henry 1997)S321. Therefore, even though clusters or regional industry-specialisations are a promising way of strengthening the competitiveness of (rural) places, they do not seem to be a natural outcome of a process of endogenous development. To summarise, clusters are a result of self-organising forces. Endogenous development, on the other side, is a process meant to be initialised in regions that are not favoured by self-organising processes. Therefore, a

successful cluster-development is a rather improbable outcome of endogenous development. The expected outcome of successful endogenous development remains unclear.

### **3.3 Rural endogenous development**

The proponents of *rural* endogenous development seem to concentrate on the dimensions of leadership and institutions in Stimson's cube. The dimension of "market fit" is seldom addressed explicitly, instead the topic of regional governance is a central theme (e.g., Shucksmith 2010). Thereby it is implied that good regional governance in a participatory style is a necessary if not even sufficient reason for economic development. As Ray writes, endogenous development "subscribes to a belief in the innate capacity of people in a locality to discover within themselves and their locality the means for the improvement of their socio-economic well-being." As synonyms for the term "endogenous" in this context he offers the terms "bottom-up", "grass roots" and "participation" (Ray 2000: 447). The "endogenous development hypothesis" in a rural context has been summarised relatively concisely by three constituent aspects: the territorial instead of the sectoral frame, the valorising and exploiting of local physical and human resources, and the focus on "needs, capacities and perspectives of local people" (Ray 2000). Thereby, the rural perspective on endogenous development puts a higher emphasis on social aspects than other concepts of endogenous development. Accordingly, "participation in rural development is now generally assumed to be a good if not vital thing. The assumption is that more participation is better than less and that past development strategies failed through its absence. There is, however, surprisingly little written about why participation is so important" (Lowe et al. 1998). The participatory approach seems to have two aims: On the one hand it is an aim in itself. Connected with this aim are many problems of democratic legitimacy and political economy. An appraisal of these problems of strengthening the civil society is beyond the scope of this paper. The other aim of participation is the increase of the efficiency of measures.

It has been acknowledged by the proponents of the concepts themselves, though, that because "all social groups and regions in the North are to some extent integrated into external market relations, autochthonous or self-sufficient local development is a utopian ideal" (Lowe et al. 1998). The concept has therefore been somewhat attenuated by the "neo-endogenous" concept of regional development. Here, extra-local forces are integrated. Ray, though, refers mainly to actors in the politico-administrative system and not so to extra-local entrepreneurs, industries and firms (Ray 2006: 278). While the neo-endogenous approach seems to acknowledge the vital role of external links the connected problem of heterogeneous interests within the territory has often been neglected. Therefore, not only need the aims of the local society to be determined consistently but the

realisation of these aims must also be secured despite of manifold different interests of local agents.

These problems are hidden by a rhetoric that ascribes agency to the territories themselves, which are seen as an “unproblematic and homogeneous ‘community of place’” (Shucksmith 2000: 208). Within these communities of places capacities are to be built and social capital is to be created, according to the LEADER concept. One of the questions then is, actually whose capacities have to be built (Shucksmith 2000). We find this problem of undefined agency in Ray’s “principles of endogeneity” that suggest local autonomy. He defines the principle as “the idea of local ownership of resources and the sense of choice (local, collective agency) in how to employ those resources (physical and intangible) in the pursuit of local objectives” (Ray 1999). Two central questions remain: (1) How can local agency be the main driving force of efficient economic development under conditions of fierce competition in a globalised world of heterogeneous interests? (2) Why should a concentration on locally available factors be advantageous if technical progress and knowledge are more often created somewhere in the world than within the region under consideration?

With respect to (2), Ray clarifies that endogenous development is also about a potential redefinition of the term “development”. Accordingly, the aim of endogenous development is not only to support economic expansion and job-creation (Ray 1999) but also to support and preserve local specificity (or “culture”). Nevertheless, this concentration on local factors may come at a cost that needs to be made transparent. If, for example, growth-industries with high innovative potential were to be set up in rural areas they would have to attract well-educated workers. Usually these firms are willing to pay a wage-premium in order to realise their growth-potential independently of exogenous restrictions (Storper and Walker 1989). For such industries the possibly locally existing low-wage work-force would be of not much value. On the other hand, the concentration on existing small size firms might be disadvantageous economically, since small-scale businesses are described as having “low investment levels, lack of access to knowledge bases and a limited ability to absorb new technologies” (Vaz, Morgan, and Nijkamp 2006). Instead it has been recognised by careful observers that the immigration of entrepreneurs has helped rural communities by the “injection of wealth and income” to strengthen their economic foundation (Bosworth 2008). Economic rural development that is as such initialised or supported from outside may result in certain conflicts between “rural values” and the (urban?) “growth ethos” (Meyer and Burayidi 1991). Nevertheless, preserving “rural values” has a cost that needs to be made transparent and discussed publicly.

Since the outcome of this public discussion and the following social decision-making process is not clear this leads us to the first question. Ray offers a scheme for the “attempt by rural areas to localize economic control - to (re)valorize place through its cultural identity” (Ray 1999: 526) by different modes: “Mode I occurs as action to commoditize a

culture through local products or services [...]. Mode II involves the encapsulation of cultural identity into a strategic image for the territory [...]”. These two modes seem to take place in the economic sphere, maybe resulting in some type of industrial districts or recreational areas. The problem faced is mainly that of coordination between economic agents. The third mode’s aim is “to cultivate a local solidarity within the territory itself”. The end to which this local solidarity is built remains open; the principal decision according to Ray is on a continuum between market integration and disengagement in the wider economy.

The main problem is that an answer to the question on how to construct local agency in this choice is not offered by Ray. “Territories” cannot choose, and the reaching of a consensus is not to be expected in the light of the possible trade-off between economic development and other possible aims of endogenous development identified above. In how far the interests of the different agents involved may be coordinated in an effective way remains open. This problem remains even if the territory is successful in reaching a democratically legitimated agreement on the target course of its development. The problem has been recognised by Johnson (2001), who assures that the place based concept requires the active participation of local residents but also stresses that the “ideas of place, differentiation, and local expression all lend themselves to thinking about rural development in a more formalized strategic framework” (Johnson 2001: 190). He stresses the potential role of modern game theory for the understanding and the assessment of such non-cooperative settings and hints to the fact that the seeds of respective ideas may be found in many papers on rural (endogenous) development. Only an effective coordination of interests guarantees a welfare-maximising “endogenous” development. The improved coordination of economic activity in a market economy by collective action, be it participatory or not, remains questionable.

### **3.4 The normative foundation of the endogenous development approach**

The desire for concepts that promote at least the possibility of endogenous development, such as the cluster concept, has often been seen as originating from the political rather than from the scientific sphere. Accordingly, “macroeconomic and structural developments of the 1980/90s, requiring innovative strategies to stimulate endogenous growth in redundant or marginal areas” (Gordon and McCann 2000) could be among the major reasons for the success of respective concepts. Therefore, rather than being grounded in a sound theoretical basis or on confirmed empirical observations, the idea of endogenous development seems to be a normative reaction towards an exogenously driven development that was perceived as a “dependent”, “distorted” “destructive” and “dictated development” (Lowe et al. 1998) after some years of experiences with changes of location

of the most standardized parts of production of firms and enterprises<sup>3</sup> (Schenk and Schliephake 2005: 480).

Therefore „rather than constituting a model of development with clearly identified theoretical roots, endogenous development is more readily characterised as an idealised descriptive contrast to frequently observed patterns and processes of development” (Slee 1994). Loosely based on the prominent and much discussed examples of such “rural” regions like the Emilia-Romagna region of Italy “[t]he emphasis shifted to rural diversification, to bottom-up rather than top-down approaches, to support for indigenous businesses, to the encouragement of local initiative and enterprise and, where these were weak, to the provision of suitable training” (Lowe et al. 1998: 11). The success of regions that rest on small firms has by some been interpreted in terms of the concept of endogenous development.

As Hadjimichalis (2006: 82) writes: “For neoliberals the Italian IDs became the symbol of the success of small-scale flexible capitalism, with its highly individualistic and competitive character, which creates employment, increases family income and boosts exports without assistance from central state. Some radicals discovered in IDs a localized development model, which permits regions to again become global players”. From this viewpoint, endogenous development, instead of being a counter-movement to a presumably perceived “dependent” development may rather have been a reaction to the lacking empirical support to the neoclassical expectation of regional convergence. Successful regions like that often described example of Emilia-Romagna show exemplary that convergence is possible. In this interpretation, only coordination problems among local actors and their interests hinder area-wide convergence. The approach of endogenous development in this interpretation is an attempt to deliberately initialise a bottom-up process of convergence. Accordingly, under the neo-liberal main-stream politics of the 1980s and 1990s “central or national policies should primarily seek to facilitate conditions that would enhance the building of local capacity and capability in regions with a reliance on strategies of self-help. That represents the marked shift to an emphasis on endogenous processes of regional growth and development” (Stimson and Stough 2009).

Nevertheless, since in most of the concepts concerning clusters and industrial districts little is said about their evolution this interpretation is not compulsory. If the small firms are spin-offs of a large pioneer, their existence rather supports the idea of exogenously induced development. And even for dynamics that started out with smaller firms, the possible importance of immigrant entrepreneurs has recently been stressed (Bosworth 2008). Moreover, in contrast to those industrial districts that originate in pioneering large

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<sup>3</sup> This criticism might have to be understood in the broader context of more general criticism of imperialism (see for example (Galtung 1971))



firms, starting out with small firms a coordination problem in the evolution of the system has to be solved in the theoretical conception. This paper also deals with the question why the approach of endogenous (rural) development concentrates on local factors despite of these conceptual problems.

Only an understanding of the relation between rural areas and other areas allows for a theoretically based assessment of the idea of endogenous development. Obviously, the question of interregional mobility of factors of production, including knowledge, is central for such an understanding: “The crucial question is how local circuits of production, consumption and meaning articulate with extra-local circuits” (Lowe and Allanson 1996: 93). In order to identify an appropriate theoretical frame for such an integrated assessment we analyse in the following chapter, which role existing theories on regional economic development implicitly or explicitly attribute to factor-mobility and to rural areas.

## **4 The Rural in the light of regional development theories**

While the approach of endogenous development obviously does not possess a comprehensive theoretical foundation, it is nevertheless related to a variety of ideas that arouse in the course of the history of thought on regional economies. We will therefore analyse in the following in how far the idea of endogenous (rural) development is congruent with the different theoretical approaches towards regional development. Since numerous approaches exist, we try to get a hold of the question in that we align different approaches according to their common scientific origins and fundamental ideas.

### **4.1 Conceptual summary of theoretical approaches to regional development**

In tables 1a and b, the most important ideas and their evolution-strand as they developed from critical ideas within economic thought are depicted.<sup>4</sup> Which of the concepts applies is of high relevance for policies that aim to support rural economic development. The question is, whether rural regions should be treated as autonomous entities capable of endogenous development but with very distinct features, whether they should be supported just as all other regions in the context of regional development funds or whether they should not be addressed at all because the support of agglomerations provides a much higher macro-economic return that might afterwards be redistributed if necessary or creates spill-over effects that reach some of the hinterlands directly.

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<sup>4</sup> The collection is necessarily selective. A valuable complementary review of approaches to questions of regional economics can be found in (Dawkins 2003).

We believe that this evolutionary classification of central ideas is helpful in creating transparency with respect to the answer different theories give to this important question. The eight strands of theory evolution identified by tables 1 are each characterised by a common central trigger for regional development as identified by the assigned theories (table 2).

**Table 1a: Evolutionary strands of important theories on regional development, part 1**

	<b>1 Comparative advantage</b>	<b>2 Transport costs/local demand</b>	<b>3 Strategic competition</b>	<b>4 Positive external effects</b>
before 1900	<b>Theory of comparative advantage</b> (Ricardo, 1817)	<b>Transport costs and distribution of production in space</b> (von Thünen, 1826)	<b>Strategic competition on oligopolistic markets</b> (Cournot, 1839)	<b>Place based positive external effects of scale</b> (Marshall, 1890) => industry-agglomerations
1900 - 1930s		Central place theory (Christaller, 1933) Demand-driven growth (Keynes, 1936)	Undesirable strategic clustering in an oligopolistic setting (Hotelling, 1929) Monopolistic competition (Chamberlin, 1933)	Differentiation between urbanisation and localisation effects (Hoover, 1936)
1940s	Heckscher- Ohlin- Samuelson (HOS) theorem (1919, 1933, 1948):			
1950s- 1960s	Export-base theory (North, 1955; Andrews, 1953): growth driven by external demand based on internal resources => regional specialisation in "base" industries	Critique of export-base theory (Tiebout, 1956) => importance of residentiary activities, internal division of labour		Informal recognition of the relevance of local knowledge (Hayek, 1954) Critical role of cities for the initialisation of development (Vernon, 1960/ Chinitz, 1961) Learning by doing (Arrow, 1961)
1970s		Model to monopolistic competition with product differentiation (Dixit/Stiglitz, 1977)	Strategic competition as source of spatial structures; challenging of the Hotelling-model (Aspremont/ Gabzewicz/ Thisse, 1979)	Model to monopolistic competition with product differentiation (Dixit/Stiglitz, 1977) Relation between innovation and spatial structure (Aydalot, 1986)
1980s				Initialisation of new trade theory (Krugman, 1980; Dixit/Norman, 1980): incorporating positive scale effects, rationalisation of infant-industry argument New growth theories (Romer, 1986; Lucas, 1988): formal recognition of the importance of technological knowledge for development. Positive spillover of private investments
1990s		New economic Geography: Formal integration of positive scale effects in models of regional economics (Krugman, 1991)	Agglomeration due to vertical linkages in imperfect competition (Venables, 1996) Recognition of the relevance of factor- and product-specificity, diversity and spatial differentiation (Eaton&Lipse, 1997) => location specific rents Buyer-seller networks (Kranton/Minehart, 2001)	Acknowledgement of the relevance of cumulative causation (Myrdal, ca. 1935; Kaldor, 1972) in technical progress (Arthur, 1988) and industry location patterns (Arthur, 1986) Recognition of the growing relevance of dynamic efficiency (Porter, 1994): innovation & knowledge gains in relative importance Endogenous regional growth models (Englman/Walz, 1995): Incorporating knowledge spillovers Regional interdependences (Nijkamp, Poot, 1998): ambiguous dynamics

Source: Own figure

**Table 1b: Evolutionary strands of important theories on regional development, part 2**

	<b>5 Evolutionary approach</b>	<b>6 Interrelated industries</b>	<b>7 Neoclassical growth</b>	<b>8 Interrelated institutions</b>
before 1900				
1900 - 1930s	<b>Innovation and "creative destruction"</b> as fundamentals of growth (Schumpeter, <b>1939</b> )			
1940s	Innovative oligopolistic competition (Schumpeter, 1942) Stage theory on structural change (Hoover/Fisher, 1949)	<b>Input-output model</b> (Leontieff, <b>1941</b> )  Big-Push theory (Rosenstein/Rodan, 1943): Minimum thresholds for necessary investments (simultaneous industrialisation of many sectors) in order to initialise development due to external effects		
1950s- 1960s	Product cycle approach (Vernon, 1966): export oriented development	Regional input-output model (Leontieff/Isard 1950) Growth pole theory (Perroux, 1950) Backward and forward linkages between industries (Hirschman, 1958) Production of commodities by means of commodities (Sraffa, 1960)	<b>Neoclassical growth model</b> (Solow, <b>1956</b> ): Growth via capital-accumulation, technical change exogenous Capital and labour mobility (Borts/Stein, 1964) Heterogenous saving rate (Cass/ Koopmans, 1965): conditional convergence	<b>Social behaviour as exchange</b> (Homan, <b>1958</b> ): socially embedded behaviour
1970s		Social accounting matrices (Pyatt/Round, 1977)		Exchange relations and networks (Emerson, 1967) New institutional economics (Williamson, 1975): formalisation of transaction cost problems; internalisation of externalities
1980s	Evolutionary economic theory (Nelson/Winter, 1983): relevance of incomplete knowledge and routines, path-dependency Profit cycle theory (Markusen, 1985)	Relevance of market-size effects (Murphy, Shleifer, Vishny, 1989) in the explanation of non-linear development (formalisation of Big-push-theory)		Social-network model: Social embeddedness of economic action (Granovetter, 1985); contracts as substitutes for trust (Harrison, 1992) Industrial districts (Piore/Sabel, 1984): relevance of flexible specialisation; network-model replaces inside/outside firm transaction-cost model
1990s	Relevance of organisation of production and changing markets for localisation (Storper and Walker, 1989): Strong and weak competition Evolutionary concept of "window of locational opportunity" (Boschma, 1994): rejection of determinism Application of evolutionary concepts (Boschma/Lambooy, 1999): multidimrsional, contingent relative fitness	Structure and organisation of production in space with interlinked industries (Sheppard/Barnes, 1990): following Sraffa  Agglomeration due to vertical linkages in imperfect competition (Venables, 1996)		Specification of different types of organisation of production in space (Markusen, 1996)

Source: Own figure

The further condensation of these triggers to conceptual driving-forces (table 2) shows that peripheral regions according to the classical/neoclassical concepts 1 and 7 do not need to be treated differently than other regions since decreasing returns to capital and/or exchange on the product market offer them (comparative) advantages. Therefore (conditional) convergence is approached. Unconditional convergence will be enabled by factor mobility. In Concepts 2, 4, and 6, on the other hand, due to positive scale effects external to the firm, self-enforcing growth causes higher growth rates in well developed regions. These theories in their most extreme versions imply that support should be concentrated on “growth poles”.<sup>5</sup> Comparable living conditions could best be provided by a spatial redistribution of wealth.<sup>6</sup> Finally, concepts 5, 8, and 3 ascribe a special role to historic, idiosyncratic events, to institutional rules and strategic behaviour. In these schools of thought, potentially evolving coordination problems call for place-specific policies and a special support for rural areas.

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<sup>5</sup> There are also empirical studies that test the hypothesis of positive external effects of production on efficiency. Ciccone and Hall (1996) after analysing the relation between density of economic activity and labour-productivity on the level of US-American States conclude that “[o]ur empirical work also suggests that rising density over time may be an important factor in growth”. Respective ideas have been picked up by applied economists, regional planners and politics. For example, the Swiss Federal Law on Regional Policy (Bundesgesetz über Regionalpolitik vom 6. Oktober 2006) states as one of five fundamental principles that regional centres are to act as motors for development (“Die regionalen Zentren bilden die Entwicklungsmotoren”). In Germany the frame of action for Regional Policy (Raumordnungspolitische Handlungsrahmen, 1995) states that “Metropolitan areas are motors of the economic, social and cultural development of international relevance and accessibility” („Motoren der wirtschaftlichen, sozialen und kulturellen Entwicklung mit internationaler Bedeutung und Erreichbarkeit“). In the German Regional Development Report 2005 (Raumordnungsbericht 2005) the necessity for a growth-oriented policy for regional development is stressed, which should be concentrated at existing regional growth-poles. On international level the World Development Report 2009 from the World Bank stresses the importance of positive general agglomeration effects. Rather than propagating the re-localisation of industries to remote areas, a further support of agglomeration is proposed: “For policy makers the challenge is to best relax the constraints generated by the congestion and overcrowding of land and resources so that the benefits of agglomeration can be maximized”. They describe possible diseconomies to scale only to conclude: “But restricting the growth of cities is not the answer. There is no evidence that the agglomeration economies of megacities have been exhausted” (Gill 2009: 144).

<sup>6</sup> If the idea of positive external effects due to knowledge spillovers is combined with Krugman-type models of the NEG it can be shown that “the additional growth spurred by agglomeration may lead to a Pareto-dominant outcome such that, when the economy moves from dispersion to agglomeration, innovation follows a much faster pace. As a consequence, even those who stay put in the periphery are better off than under dispersion, provided that the growth effect triggered by the agglomeration is strong enough” (Fujita and Thisse 2003: 121). The authors add that this result does not require any transfers. On the other hand, according to the authors’ results, the growing wealth does not imply convergence.

**Table 2: Trigger and conceptual driving forces in concepts of regional development**

Concepts	Trigger	Driving forces
2 Transport costs/ local demand	Labour mobility, trade costs	Selfenforcing growth due to growing product/commodity markets and spill-overs
6 Interrelated industries	Intensity of competition	
4 Positive external effects	Shock ("big push") or interregional knowledge spill-over	
5 Evolutionary approach	Chance, creative destruction	Historic / idiosyncratic events
8 Interrelated institutions	Planned coordination	Strategic behaviour and institutional rules
3 Strategic competition	Restricted competition / network formation in oligopolistic markets	
7 Neoclassical growth	Capital mobility / functioning capital markets	Decreasing returns to capital
1 Comparative advantages	Free trade, specialisation	Exchange

Source: Own figure

The first three concepts in table 2 (2, 4, 6) and even the neoclassical growth concept<sup>7</sup> (7) have been analysed lately within the paradigm of New Economic Geography (NEG), which is usually thought to have originated from Krugman's seminal article in the 1990s (Krugman 1991). In models inspired by this paradigm, self-enforcing growth is usually set in force by increasing returns that are external to the firm. The connection between the idea of cumulative causation and the self-enforcing growth in Krugman-type models has been mentioned in the literature (Dawkins 2003). Nevertheless, reference to the paradigm of NEG is not necessary in order to recognise self-enforcing growth as a common ground of those theoretical strands that evolved around transport costs/local demand, interrelated industries and positive external effects. Interrelated industries with positive transport-costs intuitively imply a self-enforcing co-location of firms; this notion has been given additional support with the formal identification of the possible relevance of market-size effects (Murphy, Shleifer, and Vishny 1989). With respect to positive external effects, the argument that non-tradable spill-overs support co-location has been made by Marshall as early as 1890 (Marshall 1890).

<sup>7</sup> At least for a super-national context it has been shown that relying on the new paradigm of the NEG a core-periphery structure may even be derived with assumptions that resemble those of the neoclassical growth theory if only capital and capital owners are not internationally mobile (Baldwin 1999).

The theories of the evolutionary approach (5) are characterised by the relevance they attribute to given industry-structure (Storper and Walker 1989; Markusen 1985), which determines the further development but is nevertheless historically contingent itself (Storper and Walker 1989; Boschma 1996). This contingency is basically due to the relevance of the location decision of single large firms or to historically unique events that enable the coordination of the location decision of many smaller firms.

Theories that rely on the idea of interrelated institutions (8), such like the concept of industrial districts (Piore and Sabel 1984), or on strategic competition in imperfect markets (3) (Hotelling 1929; d'Aspremont, Gabszewicz, and Thisse 1979) must incorporate strategic behaviour and institutional rules. Therein the newer technical approaches to games in networks show the relevance of strategic behaviour for network formation and of networks for strategic behaviour (Kranton and Minehart 2001). Both theory-strands stress the notion that behaviour is not exogenous to (industry) structure.

Theories on neoclassical growth (7) or comparative advantages (1) imply at least relative or conditional convergence. It is important to state here that especially the comparative advantage approach implies convergence in factor payment only given the differences in initial resource. The concept is therefore static in nature and does not imply necessarily convergence in per capita income (Dawkins 2003). Moreover, the neoclassical growth theory and the comparative advantage approach rely on different mechanisms. With differing comparative advantages regions are partially compensated for their resource base in the process of trade. In the neoclassical growth theory, on the other side, decreasing returns to capital set incentives for investment in regions with a low capital-labour ratio, which implies induced structural change.

## **4.2 Integration of endogenous development in the theoretical landscape**

The approach of endogenous development seems to distrust factor mobility as a trigger of development of peripheral/rural regions. Most theoretic concepts attribute a positive role to factor-mobility for regional development, since trade allows for regional specialisation and the realisation of comparative advantages, factor mobility and trade may speed up convergence or the capture of spill over benefits increases growth. Factor mobility contributes to the diffusion of technology, such that “compared with the situation of autarky, the equilibrium capital intensity is lower, the rate of return to capital is higher and income per capita grows at a faster rate” (Nijkamp and Poot 1998: 22). Despite of this, the endogenous development approach consciously advises to concentrate on local factors in order to promote rural development. We try to understand this better in that we analyse the role of factor-mobility in the different theoretical strands (table 3).

**Table 3: The role of factor mobility in the different theoretical strands**

Concepts	Driving forces	Role of factor mobility
2 Transport costs/ local demand	Selfenforcing growth due to growing product/commodity markets and spill-overs	Initialises path-dependent development
6 Interrelated industries		
4 Positive external effects		
5 Evolutionary approach	Historic / idiosyncratic events	
8 Interrelated institutions	Strategic behaviour and institutional rules	Hinders coordination
3 Strategic competition		
7 Neoclassical growth	Decreasing returns to capital	Facilitates convergence
1 Comparative advantages	Exchange	

Source: Own figure

Initial factor mobility contributes positively to self-organising forces. Accordingly, agglomerations, clusters and specialised regions (outcomes of 2, 4, and 6) are supported by factor-mobility in their development, while they themselves restrict (channel) factor-mobility after their initialisation. Here factor mobility is a trigger for later path-dependent development. The contribution of factor mobility to foster agglomeration actually causes difficulties in explaining changes in the position of individual regions in the growth continuum in models of cumulative causation (Nijkamp and Poot 1998). In classical and neoclassical approaches (7 and 1 in table 3) factor mobility just on the contrary is supposed to support convergence “as long as a production factor moves in the “right” direction (i.e. to where its price is higher)” (Nijkamp and Poot 1998: 19) and “trade has in fact no role to play beyond speeding up convergence” (Nijkamp and Poot 1998: 22). Nevertheless, peripheral regions only sporadically benefit from path-dependent dynamics and the absolute convergence predicted by the most optimistic interpretation of the neoclassical growth theory was not supported by experience. Accordingly, the idea of endogenous development with its neglect of the option of factor mobility may reflect a residual policy option. Its rejection of factor mobility implies an affinity to the theoretical strands of interrelated institutions (8) and strategic competition (3) in table 3. The formation of stable networks and strategic interaction is fostered by restricted interaction and hindered by high factor mobility. This is implied by those games in networks that very lately seem to build a unifying frame around the two theoretical strands (section 4.1).

Restricted mobility hinders (absolute/unconditional) convergence and the participation of many rural areas from positive dynamics in clusters and agglomerations. There is also no doubt that the inability to attract important factors of production restricts growth of specific places within a single country.<sup>8</sup> Recognizing this inability leaves policy makers

<sup>8</sup> This may depending on specific institutional situations not necessarily apply for the international context as pointed out for example by infant-industry arguments.



and planning practitioners with a second best option for rural development. This option implies that via coordinated action of local firms and institutional support by the wider local economy the region's firms' and industries' competitiveness may be supported. We speak of a second best option since this approach of coordinating local actors' decisions makes the best from the relative closeness of local markets without overcoming this obvious disadvantage. This possible trade-off between the ability for local coordination of decisions and global competitiveness of regions and firms has seldom been discussed by discussions of approaches of endogenous development. Therefore, transparency concerning the second-best character of this approach for rural development has not been created, too. A more rigorous formulation of the approach that brings with it transparency on its potential draw-backs may be possible within the theoretical models of the conceptual strands of interrelated institutions and strategic competition (Table 1). An outline of most urgent aspects of a rigorous reformulation of the endogenous development approach is given in the next section.

### **4.3 Reconsidering endogenous development**

Morgan (Morgan 1997: 501) in the description of his understanding of "learning regions" describes a concept of endogenous development: "I would suggest that this is precisely what innovating in the periphery means: working with what exists, however inauspicious, in an effort to break the traditional institutional inertia in the public and private sectors, fostering inter-firm networks which engage in interactive learning, nurturing trust and voice-based mechanisms which help to lubricate these networks and promoting a cultural disposition which sets a premium on finding joint solutions to common problems"<sup>9</sup>. Nevertheless, a more rigorous problem formulation in terms of the relevant theoretical strands on strategic interaction and network-formation would have the potential to make transparent the potential drawbacks of a publicly supported endogenous development:

- It is questionable under what circumstances informal networks of producers and others are stable. Stability of networks is rather improbable in highly competitive markets.
- If local networks are formed, local competition may be reduced. On the other hand, according to Porter (Porter 1998) it is especially strong local competition that contributes to a cluster's firms' strong competitiveness.

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<sup>9</sup> Morgan does not seem to think of this approach as being adequate for regions without economic basis. This solid basis is necessary because learning regions build upon the existence of manufacturing and services of different kinds as it has the goal to "embed existing foreign plants, promote more robust linkages between these plants and indigenous firms, and helps to disseminate 'best practice' throughout the regional economy" (Morgan 1997)S501. Morgan stresses that projects created according to the concept may not create many new jobs but rather help to preserve existing jobs (ibid.).

- The macroeconomic consequences of locally coordinated strategies are insecure.
- It remains unclear how non-market actors are supposed to coordinate economic decisions.
- In times of global competition and high-tech information technologies, why should an approach that stresses coordination and cooperation among different actors be concentrated on spatially related agents?

Johansson and Quigley (2004) point out that networks might produce the same positive scale effects external to the firm like agglomerations. They could therefore partially substitute for spatial proximity (*ibid.*). In this case, from a network theoretic viewpoint not local networks would need to be supported but rather interregional networks. More generally, on the theoretical side there are few empirically or theoretically based sound hypotheses on how and under what circumstances precisely information is transferred between firms and why this transfer should be related to distance (Combes and Duranton 2006). Combes and Duranton (2006) for example analyse in a game-theoretic framework the willingness of firms to engage in information exchange if it is connected with labour poaching. Their analysis relies on the insight that in a competitive environment firms will be interested in inflows but not so in outflows of information. Combes and Duranton construct a three-stage duopoly game in that firms decide on their location in the first stage, on their degree of poaching of labour and their wages in the second stages and on final output subject to price competition on the last stage. Their results show that the willingness to exchange information, respective labour, depends on the competition on the final product market (Combes and Duranton 2006: 4). Therefore, clusters (and networks) do not need to be advantageous in the eyes of firms from all kinds of industries. Moreover, the results show “that co-location, although it is always efficient in our framework, is not in general the non-cooperative equilibrium outcome” (Combes and Duranton 2006: 1).

Moreover, it has been shown theoretically in networked games that firms do collaborate in order to generate competitive advantages but that the evolving stable networks are often asymmetric (Goyal and Joshi 2003). Thereby the evolving network has possibly a strong and asymmetric impact on specific firms, even if firms have been identical in the beginning. While under the given assumptions network-formation is socially preferable, the socially efficient networks are not always formed, especially if set-up costs of networks are high and competition is strong (price competition) (*ibid.*).

If one departs from the restrictive assumptions of respective models the efficiency of networking or co-locating from a social viewpoint is questionable. On the one side, with respect especially to small firms, the notion of learning by interacting has been propagated as a road to competitiveness (Hudson 1999). On the other side, networks might possibly enable collusion in local oligopolies and thereby reduce competition (Overgaard and Møllgaard 2008). Nevertheless, according to Porter, local competition is an important trigger in the development of firms' competitiveness (Porter 1998).

With respect to the cooperation between market-actors and non-market-actors the theories on governance, embeddedness and social networks may give some guidance. Empirical analyses of networks and their role in natural resource utilisation have shown a significant relation between the outcome and the network-structure (Bodin and Crona 2009). We have hardly any idea, though, what kind of networks are to be expected to evolve under what circumstances in endogenous (rural) development processes. In the governance literature rule-based and relation-based models are contrasted frequently (Li 2003: 657): “[R]ule-based governance largely relies on public information (i.e., publicly verifiable information), while relation-based governance largely relies on local information (i.e., mutually observable information by the two transaction parties). [...] In relation-based governance, one needs to screen, test, and monitor each and every transaction partner. The acquired relational information is implicit and person-specific, and hence non-(publicly) verifiable and nontransferable” (ibid.). According to concepts of endogenous development within networks in rural communities, local information is supposed to be transferred in order to help in the coordination of economic activities. Since agreements may be controlled either by rule or by relation “and by nothing else” (ibid.) these participatory networks clearly need to rely on relational governance. Nevertheless, significant drawbacks of this model of governance seem to exist. Li (2003: 658) describes that due to the non-transferable information, the person specific relations and the resulting low exit- and entry mobility in institutions that are built around relation based governance “(personal) power and loyalty are the norm. [...] Thus, both the information structure and the decision-making mode are closed, informal, and centralized.” He also stresses, though, that this concept has positive sides in terms of efficiency and effectiveness in small markets.

Since a discussion of the democratic legitimacy and the participatory reality of policies relying on endogenous development is not our aim, the main question is under what circumstances participatory networks will evolve and stabilise in a region and what role they are able to play in economic coordination. According to Kali (Kali 2003), only with a low level of economic complexity is cooperation due to social embeddedness probable. Strong ties evolve due to the need for enforcement at low-level complexity and weak ties evolve for the exchange of information. Nevertheless, the set-up of “intermediary” institutions that support information processes and enforcement of cooperation-rules may benefit coordination. How these institutions are to be constructed in order to work efficiently remains largely a question of institutional economics as “strategy and mechanisms for negotiation and contracting are likely to be a big part of the new rural development framework” (Johnson 2001: 191).

We conclude that the question, in how far networks that involve agents from different social groups will be able to coordinate economic development, needs further analytical scrutiny. It must be analysed what type of networks evolve under what circumstances and how power is distributed within these networks. In how far economic actors participate in

respective cooperations depends on the strength of the intermediary institutions in terms of information processing and enforcement of cooperative behaviour. In the economic sphere, endogenous development aims at a coordination of firms' strategies. Nevertheless, the rigorous models on networks and strategic interaction show that the support of coordination between firms may reduce competition and thereby competitiveness. Moreover, the selective support of cooperating firms may have a selection effect with respect to local industries, since firms from competitive industries are not approached. The structure of specific local industries may also be affected by the approach of endogenous development, since networks of initially similar firms are often asymmetric and possibly strengthen central firms. How these allocative effects impact upon growth is not clear at all. A rigorous re-formulation of the endogenous development approach in terms of the concepts of interrelated institutions and strategic interaction would reveal its complexity and further research needs.

## **5 Conclusion**

While on the one hand with new evolving "socio-technological networks" the rural-urban distinction has been blurred (Murdoch 2000: 407) on the other hand "[...] rural areas continue to follow their own stubborn logics of change and stasis". Kilkenny calls into remembrance important features of rural areas that might explain their distinctiveness: the relative importance of a service sector that due to the small local markets faces severe constraints, the relevance of site-specific amenities as "nonmarket attributes tied to land", and the function of products of the natural resource industry as intermediate goods, while the final goods are sometimes site-specific (e.g., regional specialities) (Kilkenny 2008). These characteristics illuminate the importance of specialisation and niche-production. Thereby, even on small local markets economies of scale may be realised and a premium may be obtained that allows for production in remote areas despite of high transport costs.

Accordingly, rural areas play different roles in the nation-wide economy. But only few of them actually are able to benefit from the self-enforcing dynamic that is usually initialised by historic or idiosyncratic reasons and is in the centre of many of the newer theories on regional development. At the same time, the convergence between regions that has been promised by classical and neoclassical theories according to their most optimistic interpretations has not been experienced so far. The conditional convergence that might have occurred is not satisfactory in the light of political aims such as the creation of comparable living conditions. It is not rural areas that attract the most important factors of production or create and transfer the most relevant knowledge. Accordingly, it may be judged as a rational second best option for rural areas to make the best from low factor mobility if they cannot overcome their relatively low attractiveness for outside investments. While low factor mobility is disadvantageous for regional development according to (neo-)classical approaches and self-enforcing growth processes, it might be

supportive in developments that rely on coordinated decisions of local actors. Therefore, the endogenous development approach may be judged as an appropriate second best option for rural regions.

On the other hand the Rural Development Policy (RDP) is expected to be complementary to other policies from structural and cohesion funds. Therefore, an assessment of the concept of the RDP in its current form needs to rely on knowledge on how the relative situation of rural areas is affected by these other policies. If structural and cohesion politics support convergence of rural areas, the RDP might be an expensive but nevertheless valuable additional support with the potential for additional positive effects on welfare in rural areas. If, on the other hand, structural and cohesion politics have no positive impact on rural areas or affect their convergence even negatively, this could not be compensated for by the RDP in its current form. In this case, it would have to be recognised, that the need for redistributive activities of the state cannot be replaced by policies that support endogenous development if the aim is the creation of comparable living conditions.

Moreover, it has been demonstrated that the concept of endogenous development lacks a theoretical foundation and a rigorous definition. It has been shown, though, that the approach could be congruent with the theoretical strands that collect theories on interrelated institutions and on strategic competition. To some extent a methodological unification of these strands has lately been achieved with the development of games on networks. According to these theories, the low factor-mobility that is assumed by endogenous development approaches enables coordination between local actors – an important ingredient of endogenous development. It is proposed that a more rigorous reformulation of the approach of endogenous development will be possibly based on these theories and models. A re-assessment of the approach in the light of respective theories has illuminated its complexity and potential draw-backs: The support of coordination between firms is expected to have unintended allocative effects with unknown welfare implications and the coordinating capacity of the wider local society with respect to economic development depends on the willingness to cooperate of economic actors. How this could be supported awaits further analyses.

Therefore, we conclude that approaches that one-sidedly stress the regions' endogenous potentials without an explicit consideration of the spatial environment and of the given internal structure of the respective regions are over-simplistic. Policies need to be place-specific but not local in the sense implied by many proponents of endogenous rural developments. The non-local may determine the potential for endogenous growth while on the other side support for local coordination may even be detrimental from a macro-economic viewpoint. This partially puts into question the popular idea of local governance and extended subsidiarity. An integration of the approach into the wider theoretical landscape shows that endogenous development is only a second best approach that does

not free the state from policies of centrally coordinated spatial redistribution if the political aim is in the creation of comparable living conditions. Endogenous development might under certain conditions enable local actors to coordinate their decisions and contribute thereby to an efficient usage of local factors. Usually this coordination does not suffice, though, to compensate for the fundamental force of cumulative causation that is in the heart of theories of “new growth” and “new economic geography”. Transparency has to be created with respect to the fact that many regions will not be able to realise convergence by their own means, otherwise an ineffective effort for their empowerment runs into danger to disguise their effective abandonment.

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