Paradoxes and Ironies of Locational Policy, and how to Deal with Them

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Abstract

Locational policy is the effort of local stakeholders to create a favourable environment for business activities. It aims at improving the locational quality, so that existing companies may become more competitive, entrepreneurs find it attractive to start their business in the location and external investors prefer it in their locational decision. Moreover, it includes pro-active measures to stimulate and support the competitiveness of companies, and to shape structural change. In other words, locational policy is about upgrading – both of local companies and the location as such. However, determining exactly what upgrading means for companies is a difficult exercise, in particular in terms of direction, as upgrading does not necessarily mean moving upwards. Moreover, the contribution locational policy can make to companies' upgrading efforts is strongly influenced by the stage of the respective industrial life-cycle.

The ultimate justification for locational policy is globalisation. Yet, globalisation is creating difficulties for locational policy in two ways. First, the integration of local economies into global value chains creates obstacles for local collective action and locational policy (the "irony of upgrading"). Second, increasing globalisation of local companies creates complications for their involvement in locational policy initiatives (the "location paradox").

A possible conclusion would be to suggest a distinction between two types of locational policy. Generic locational policy would be the prevailing pattern, trying to improve overall conditions for business without wasting much time on specific, selective initiatives. Strategic locational policy would be a much more difficult and challenging approach, trying to define a common goal and to engage many stakeholders in action to achieve it; this variety is most likely pursued by locations with massive problems of unemployment and decline. However, I suggest that there may be a third type which I call reflexive locational policy. This variety is not selective, but rather involves various local stakeholders in organising efforts to reflect on structural change and options to shape it. It reduces the "dynamic uncertainty" companies are confronted with, but leaves the strategic decisions to individual firms and organisations.

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1 Introduction: What is locational policy?

This paper addresses the options for and limitations of localised efforts to stimulate and shape economic development, both in industrialised and in advanced developing countries.[1] I define locational policy as the effort of local stakeholders, both from government and non-government, to create a favourable environment for business activities. It aims at improving the locational quality, so that existing companies may become more competitive, entrepreneurs find it attractive to start their business in the location and external investors prefer it in their locational decision. Moreover, it may include pro-active measures to stimulate and support the competitiveness of companies, and to shape structural change. It is a response to deregulation and the demise of selective policies such as industrial policy at the national level.

Traditional locational policy addressed three issues: making real estate available and improving the infrastructure, attracting external investors, and facilitating communication between the business community and the public sector (Hollbach-Grömig 1996). As locational competition became more intense and unemployment levels rose, local actors in locations in industrialised as well as developing and transformation countries started to pursue a wider approach.[2] Typical approaches include the following elements:

- the creation of dedicated local economic development agencies to co-ordinate and organise local level efforts (ILO et al undated);
- the creation of roundtables, partnerships, alliances or public-private partnerships for local economic development in order to formulate and implement a strategy to sharpen the locational advantage or to revitalise old locations (OECD 2001, Wallis 1996, Küpper 2000);
- the implementation of cluster initiatives, often taking Porter's diamond concept as a point of departure (Raines 2000, Enright 2000).

There is probably little disagreement among local economic development (LED) practitioners that their work is about upgrading – upgrading of companies and upgrading of the location. What does "upgrading of the location" mean? In order to sketch what this may mean in practical terms, let us take a look from the perspective of Porter's diamond (Porter 1998) which continues to be a widely-used analytical tool. Using the diamond, local stakeholders would analyse the competitiveness of leading local companies, the availability of specialised suppliers, subcontractors and service providers, the quality of the factor conditions and the demand

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1 Apart from the research of the joint IDS/INEF research project "The Interaction of Global and Local Governance: Implications for Industrial Upgrading", I draw on the research we conducted between 1998-2001 in the project "North Rhine-Westphalia: Structural Economic Change, Regional Economic and Locational Policy, Ecological Formulation of State Policy - A Survey from the Viewpoint of Advanced Developing Countries", as well as on observations I gathered working as a consultant on local economic development in some municipalities in Santa Catarina and in the Greater ABC region, both in Brazil, in Mpumalanga province, South Africa, and in several places in Argentina and Thailand.

2 On the U.S. see Bradshaw and Blakely (1999), on Germany Meyer-Stamer (1999), on developing countries Helmsing (2001).

conditions. They would probably find that the supplier structure is patchy, and they would try to build a targeted locational marketing campaign to attract additional suppliers which fit into the local profile and fill important gaps. They would also focus their business start-up promotion at filling such gaps. In terms of factor conditions, they would probably find deficiencies regarding the availability of highly skilled, specialised professionals, inadequate technology transfer and a lack of venture capital. They would then start working with existing training providers, in order to create better targeted training offers. They may decide to set up something like a manufacturing extension centre. And they may start a business angel programme to remedy the lack of venture capital. Regarding demand conditions, they may try to leverage the know-how available in a few local branches of large corporations so that local SMEs get a better idea of sophisticated demand.[3] All in all, this would in all likelihood lead to increased competitiveness of companies in this location, and increased attractiveness of the location.

This is the kind of evidence and proposals which typically come out of the analysis conducted at the beginning of LED initiatives, and it is a standard procedure in advisory work on LED (Webster and Muller 2000). The phenomenon of globalisation is behind the competition between locations and necessity of locational upgrading. In many if not most industries, firms nowadays have numerous options when it comes to choosing an attractive location. And as some locations succeed in improving the locational quality, other locations have to follow suit – or face the fate to be left in the dust, with local firms moving elsewhere and external investors not even shortlisting them. What is emerging is a pattern of competition between localities, i.e. cities, city-regions or other sub-national regions; this has been coined “competitive regionalism” (Jonas and Ward 2001) or “territorial competition” (Cheshire 2001).

The problem is that the implementation of LED initiatives often is not running smoothly, though not necessarily for the reasons elaborated in the academic literature. Geographers in particular have been discussing options and limitations for local economic development policies for quite a while, but they tend to do this from a structuralist angle, addressing the restrictions globalised capitalism creates for local action (e.g. DeFilippis 1999). They tend to formulate statements such as “Within any urban region, the socio-institutional form of local economic development strategies is ultimately an outcome of class struggle and other forms of socio-political contestation, pitting diverse social classes, state institutions and various place-dependent social forces against one another at a variety of geographical scales” (Brenner 1999, 6). This may be so, but it is not the kind of perspective which local politicians, trade unionists and business chamber representatives in place where, after the shut-down of a plant, open unemployment has just jumped from 13% to 18% will find particularly helpful.[4] To put it differently: there is a gap between practitioners’ need for concepts and theoretically reflected instruments and the academic literature.

3 Essentially, this is what Porter himself is suggesting; see Porter (2000).

4 It is also a view which is lagging behind the insights of contemporary critical approaches to urban studies. As Jacobs and Fincher (1998, 11) note, “Complicating the class assumptions of social polarization debates is an important step in chronicling the multiple faces of differentiation within contemporary cities”.

This also applies to other strands of the academic literature. The LED and the cluster discussion share the deficiency that they take the integration of the respective locality into the economy at large for granted, and in fact as the starting point for LED initiatives. It is rare to find in the academic and practitioner literature references to the specific restrictions the connection between a local economy and the global economy creates for LED efforts. It is more common to find, for instance in the international political economy literature, the argument that the global economy determines what can be done at the local level, namely next to nothing. This argument is easily falsifyable, as quite a few successful LED initiatives have been documented, and it is not the argument I want to make.

In this paper I will argue that our current understanding of local economies which is not adequate, and I try to take a step towards a better understanding, using an actor-oriented approach. I will look at two features which have not been raised in the literature so far, namely the upgrading paradox and the location paradox. The upgrading paradox addresses the goal of locational policy, namely upgrading companies to make them more competitive and upgrading the location to create jobs and increase the tax base. I will show that it is difficult to get a clear understanding of what we mean by upgrading, and that upgrading is a fuzzy goal. Also, there is the irony of upgrading; as locational upgrading takes place, the conditions for locational policy deteriorate. The locational paradox addresses the governance pattern of locational policy, and in particular the involvement of the private sector.

2 What is upgrading?

To start with, let us have a look at the term upgrading, first in terms of company upgrading, then in terms of locational upgrading. In this section, I will not yet look at issues directly related to globalisation. I will rather address intrinsic problems of locational upgrading.

2.1 Upgrading of companies

At first glance, the issue of upgrading appears to be straightforward enough. For a firm, upgrading means getting better – producing better products and producing them in a more efficient way. However, things are more difficult than that. Take the example of a garments manufacturer. Coming up with a new line of products every three months does not really imply upgrading. It is rather a routine in this business. However, if the firm has produced T-shirts, sweatshirts and polo-shirts for years and then decides also to include jeans and shirts in its product portfolio so that it can offer a more complete product range and thus establish a competitive advantage, this is clearly a case of upgrading, in this case product-related. Also, if it sets up its own unit with sophisticated finishing machines, so that the products shrink less and stay longer in shape, it is upgrading, in this case in terms of process. But still there are other options for upgrading which go far beyond these upgrading activities, such as going for forward integration by setting up a franchise network or even its own shops.

Recently, there have been efforts to formulate typologies for this kind of upgrading, in particular with respect to developing countries which suffer from “immiserising growth” (Kaplinsky 2000) due to insufficient upgrading. Humphrey and Schmitz (2001) argue as follows:

“As more and more developing country producers are integrated into global markets, there is downwards pressure on the prices of both agricultural and manufactured products. For producers to maintain or increase incomes in the face of this pressure, they must either increase the skills content of their activities and/or move into market niches which have entry barriers and are therefore insulated to some extent from these pressures. This is the logic of 'high road' strategies for developing local industrial capabilities. We refer to shifts in activities which sustain higher incomes as upgrading. In the context of this paper, we are particularly concerned with four types of upgrading that firms or groups of firms within a value chain might strive to achieve:

- Process upgrading: firms can upgrade processes - transforming inputs into outputs more efficiently by re-organising the production system or introducing superior technology.

- Product upgrading: firms can upgrade by moving into more sophisticated product lines (which can be defined in terms of increased unit values).

- Functional upgrading: firms acquire new functions (or abandon existing functions) so that they increase the overall skill content of their activities. For example, they might complement production with design or marketing, or move out of low-value production activities altogether.

- Intersectoral upgrading: firms apply the competence acquired in a particular function of a chain to move into a new sector. For example, competence in producing TVs is used to make monitors and thus move into the computer sector. Such horizontal moves into new sectors seem to have been central to Taiwan’s ability to gain a foothold in skill intensive sectors.”

This typology is related to the example I have given above. It is, however, not entirely satisfying. To understand its weaknesses, it is useful to refer to the argument developed by Porter (1996, 61), who conceptualises upgrading in an unconventional way:

"The quest for productivity, quality, and speed has spawned a remarkable number of management tools and techniques: total quality management, benchmarking, time-based competition, outsourcing, partnering, reengineering, change management. Although the resulting operational improvements have often been dramatic, many companies have been frustrated by their inability to translate those gains into sustainable profitability."

Behind this, Porter argues, is the problem that firms confuse operational effectiveness and strategy. "Operational effectiveness (OE) means performing similar activities *better* than rivals perform them" (ibid, 62). "OE competition shifts the productivity frontier outward, effectively raising the bar for everyone. But although such competition produces absolute im-

provement in operational effectiveness, it leads to relative improvement for no one. (...) major productivity gains are captured by customers and equipment suppliers, not retained in superior profitability" (ibid, 63). "The more benchmarking companies do, the more they look alike. The more that rivals outsource activities to efficient third parties, often the same ones, the more generic those activities become. As rivals imitate one another's improvements in quality, cycle times, or supplier partnerships, strategies converge and competition becomes a series of races down identical paths that no one can win" (ibid, 64). The way out of this trap, according to Porter, is *strategy* – "choosing to perform activities differently or to perform different activities than rivals" (ibid.).

To phrase it differently: The principle of competition in globalised markets is *Running to stand still*. A company which is standing still, i.e. does not pursue some kind of upgrading all the time, has little chance of survival.[5] A company which puts a lot of effort into upgrading does not necessarily improve its competitive position. This is particularly true for clusters, where competition is localised and particularly strong and visible. For this reason the first part of the Humphrey/Schmitz quote above is not adequate. *Increasing the skills content* is something firms have to do all the time to maintain their competitive position. This is, in the words of Porter, about operational effectiveness. It is about performing activities differently than they themselves did in the past, but not necessarily about performing activities differently than rivals. *Moving into market niches which have entry barriers* is more likely to be what Porter would recommend in terms of strategy, though it does not create a strategic difference vis-à-vis competitors if it just implies copying the activities of more sophisticated rivals. It is not rare to observe that several competitors try to move into the same market niches. Looking at the four types of upgrading Humphrey & Schmitz suggest, the same argument applies to process upgrading and functional upgrading: both are typical manifestations of operational effectiveness, not of an improved competitive position.

To draw an interim conclusion, it would be useful to turn the typology proposed by Humphrey & Schmitz into a matrix which would look as follows:

	Operational effectiveness	Competitive advantage based on uniqueness
Process upgrading		
Product upgrading		
Functional upgrading		
Intersectoral upgrading		

The next step to turn this line of reasoning practical for LED initiatives would be do develop a set of indicators for each field of the matrix, so that they can assess the performance of local

5 This explains the otherwise somewhat discouraging story of Nadvi and Kazmi (2001), who finds that though surgical instruments firms in Sialkot, Pakistan, have gone through tremendous upgrading during the recent years, their position in the global value chain has not changed. Gibbon's account of failed efforts of garment manufacturers in Mauritius to integrate into downstream activities of the value chain shows that those firms are only just competent enough for the "running to stand still" scenario, but by far not sufficiently competent for functional upgrading (Gibbon 2000, 42).

firms and determine whether they are running to stand still or developing a specific advantage. This, in fact, would be a useful tool for locational diagnostics.

2.2 Upgrading, downgrading and sidestepping

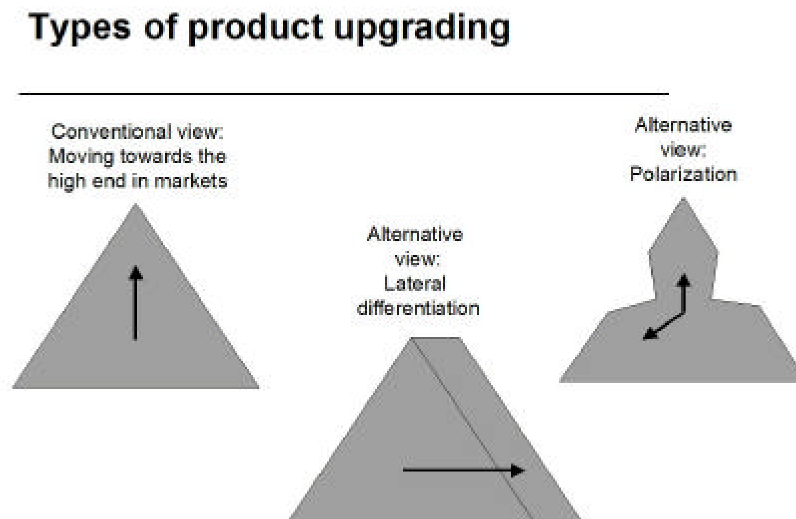
However, this does not solve the upgrading issue. The upgrading discussion has a major shortcoming, namely suggesting that upgrading means to move up. However, companies may choose different options. For instance, in her case study of the Brenta footwear cluster, Rabellotti (2001) tells a story of voluntary downgrading. Shoe producers used to work with buyers in places such as Germany, offering their own design and taking an active role in marketing. However, as competition on the German market became more intense, many producers opted for becoming subcontractors of Italian luxury brands. They are upgrading their products, but downgrading their companies' competences: they are dropping the design and the marketing function, i.e. activities which one would usually recommend as key activities for upgrading and increased earnings.

The behaviour of the Brenta firms was based on the fact that the high-end of the shoe market expanded strongly in the 1990s. This seems to indicate that there are few limits in terms of product upgrading towards the high-end of a given market. However, this is not necessarily the case. We must also consider a totally different scenario, namely the possibility of product upgrading into nowhere. A prominent example is the German capital goods industry, which was creating ever more sophisticated machine tools which at the end were far beyond the necessity of most customers (Widmaier 1998). In other words, there is not only the "sandwich situation" frequently encountered by producers in newly industrialising countries, which are caught in between technologically superior competitors in industrialised countries and lower-cost producers in less-advanced countries. There is also a "thin-air situation" encountered by high-end producers which try to upgrade further, thus creating increasingly baroque products which are out of sync with their customers' needs.

In our investigation of the ceramic tile industry, we found yet another pattern, namely simultaneous product upgrading and downgrading (Meyer-Stamer, Maggi and Seibel 2001). In particular Italian producers are famous for their high-end tiles, with unique designs in terms of colour and surface structure. However, the same producers put a lot of effort into entering into arrangements with large retail chains in places such as Germany. This is not the place to sell high-end tiles, on the contrary. The tile producers manufacture private brands for these chains, which are sold at rather low prices. This behaviour is rational for two reasons. First, the tile market seems to display, at least in countries with a mature retail structure, a tendency towards polarisation, i.e. the high-end is growing, the low-end is also growing, whereas the medium segment loses importance. For companies, it is attractive to have a presence in both the high- and the low-end as long as the low-end products do not cannibalise the high-end products. With differentiated design and the existence of private brands, this risk is low. Second, even though the margins, and perhaps even the absolute earnings, at the low-end are smaller, the scale of production is larger, thus permitting a quicker amortisation of new equipment. As new equipment plays an important role in product upgrading, this may create the economic

base for continuous investment in new machinery and thus, ironically, for constant innovation in the high-end product segment.

Figure 1



The pattern observed in the tile industry is depicted by the right-hand figure in Figure 1. What about the centre figure, i.e. lateral differentiation? Examples for this pattern would be the Swedish apparel retailer Hennes + Mauritz and its Spanish competitor Inditex/Zara, which have created a new segment of the market, i.e. low-price highly-differentiated garments. They are renewing the stock in their shops on a fortnightly basis, thus catering in particular to the demands of young customers who want to look different from their peers. In some other U.S. stores, the renewal rhythm is down to one week. From the angle of the retailer this means to move sideways, not upwards. In terms of price, they compete with traditional retailers such as C&A or The Gap, whereas in terms of product differentiation they create a segment of their own. From the angle of suppliers, it implies process upgrading. Lee-Young and Barnett (2001) quote the example of Li & Fung, a supply-chain co-ordination firm located in Hong Kong, "one of the speediest suppliers on Earth".

What does this mean for companies' efforts to upgrade? Essentially, it comes back to the Porter argument: upgrading is not a priori about a direction, such as upwards. It is rather about productive rent-seeking (Kaplinsky 1998). Upgrading means to do things differently, and/or to do different things – not different compared to yesterday's practice in the same company, but compared to competitors.

For locational policy makers, this means that it is difficult to formulate activities to support upgrading activities. Upgrading is much more contradictory and confusing than the Humphrey/Schmitz-typology would suggest – the direction is a priori unclear, and therefore it is difficult, for instance, to assess the necessities in terms of factor conditions resulting from companies' upgrading efforts.

2.3 Territorial upgrading

My reflections on upgrading so far were related to the Humphrey/Schmitz typology. Their consideration of upgrading addresses companies, not locations per se. A different approach to defining types of upgrading, seemingly with an explicit focus at the territorial dimension, has been suggested by Gereffi (1999, 51 f):

"Industrial upgrading is a process of improving the ability of a firm or an economy to move to more profitable and/or technologically sophisticated capital and skill-intensive economic niches. Industrial upgrading operates at several different levels of analysis: (1) *within factories*—upgrading involves moving from cheap to expensive items, from simple to complex products, and from small to large orders; (2) *within inter-firm enterprise networks*—upgrading involves moving from mass production of standardized goods to the flexible production of differentiated merchandise; (3) *within local or national economies*—upgrading involves moving from simple assembly of imported inputs to more integrated forms of OEM and OBM production, involving a greater use of forward and backward linkages at the local or national level; and (4) *within regions*— upgrading involves shifting from bilateral, asymmetrical, inter-regional trade flows to a more fully developed intra-regional division of labor incorporating all phases of the commodity chain from raw material supply, through production, distribution, and consumption."

This typology has two shortcomings. First, Gereffi suggests that regional upgrading is the sum of the upgrading of firms in the region. In a way this is the case, as the companies' success is the ultimate indicator of whatever initiative of locational policy, technology policy, competitiveness policy, etc. But in another sense it is not a useful typology since it says nothing about causalities: Did the firms upgrade because locational factors improved, or despite the fact that they stayed dismal? What was more relevant: intra-firm effort, inter-firm collaboration, locational policy efforts, or overall macro-economic conditions? From a policy angle, Gereffi's typology is not useful, and merely a replication of the 101 of geography.

Second, the typology does not by chance sound like a generalised description of what has happened in East Asia over the last decades; in fact, this is what a lot of Gereffi's work has been about. This line of thinking on upgrading is very much based on the Japanese, Korean and Taiwanese experience, and on the 1960s to 1980s. Japanese and Korean upgrading (and to a lesser extent Taiwanese) occurred in Fordist industries. We have not really thought about the question how the phase of a long cycle affects upgrading. What is quite certain is that today we are in a different phase of the cycle than in the 70s. Perhaps this has grave consequences for upgrading, and perhaps the Japanese etc. experience tells us not really much right now (but will become relevant again in 20 years or so). But so far we do not really know, since this category is not being addressed either by Humphrey/Schmitz or by Gereffi, nor, to my knowledge, by other recent publications which investigate prospects of industrial upgrading in developing countries.

2.4 Upgrading, the industrial life cycle and locational policy

But in fact the implications of the industrial lifecycle on location have been addressed both from a practitioner's and from a researcher's view. Table 1 gives a practitioner's view. Its basic message is simple and straightforward: In the early phase of the lifecycle, companies rely on a sophisticated environment. In the later phases, they will rather move to locations where production factors, in particular real estate and labour, are cheap.

Table 1: Requirements on locations across the industry life-cycle

Start-up phase	Growth phase	Maturity phase	Decline phase
Highly skilled workers Knowledge infrastructure Proximity to customers	Proximity to market (up- and downstream) Specialised workers High skilled workers Real estate	Cheap workers Low location cost Proximity to market	Cheap workers Low location cost Little regulatory cost
Source: Pieper (1994), p 32.			

Interestingly, the practitioner's view, which is mostly based on experience and inductive reasoning, is confirmed by more systematic research, which is summarised in Table 2.

Table 2: A neo-Schumpeterian model of industrial development

Stage of industry Parameter	Innovative	Competitive	Oligopolistic	Decline
Localisation pattern	Close to existing pools of high-skilled labour/ founders residence	Firms are attracted to least cost sites (labour, land, taxes, etc.)	If early: relocation is retarded because market strategies are better implemented from old centres. If late: reorganisation of industry to less unionised labour	Close down operations in old industrial regions. Modernised plants in new regions.
Importance of proximity	Agglomeration economies are high. Attraction point: innovative centres.	Proximity to competitors/ colleagues less important. Proximity to producers of equipment of some importance	Firms operate on larger in- and output markets. Internal division of labour and level of information up.	Low
Growth	High growth rates. Employers from established firms form spin-off firms	High. Minimum optimal scale increases and spin-off becomes rare.	Low. Markets are increasingly organised and negotiated.	Negative
Technological development	Product innovations have primacy. In many cases production equipment is modified by the user	Products are standardised. Process development aimed at economies of scale.	Product differentiation (fashion) and process development dominates	Product development suppressed by short term profit dispositions. Process developments are rare.
Source: Gelsing (1992), p 128.				

What does this mean in terms of upgrading, both for companies and for locations? With respect to locations, the answer seems to be simple and, to some extent, discouraging: There is a lot which can, and indeed should, be done to support the emergence of new industries. But there is little that can be done, in particular on the part of "old" locations, with respect to ma-

ture and declining industries. But also "new" locations, such as greenfield sites in developing countries which cater to relocated plants in mature industries, do not have many options in terms of locational policy. The practitioner's view is straightforward: minimise costs – of infrastructure, of real estate, of labour and skills development. This is exactly what has been going on in locations which were successful in attracting greenfield investments in mature industries (Kanter 1995).

What about cases of companies in mature industries getting involved in elaborate locational policy efforts? An example would be the involvement of Volkswagen in locational development and upgrading in the region around its main facility, Wolfsburg. This, however, is a somewhat special case. The company started as a state enterprise, and it still has state government as an important minority shareholder. This creates a kind of shareholder pressure which is different from the usual, ROI-driven one.

2.5 The lifecycle paradox of locational policy

So one would expect that at least locations with emerging or growing industries are favourable places for locational policy. However, this expectation is based on an analysis which involves economic factors. If we introduce political factors as well, things appear in a different light.

The starting point of this reasoning is the question of the appropriate governance pattern for locational policy. Basically, there are two options: hierarchy and networks. Hierarchy is the traditional pattern of public governance. Government formulates and implements a policy after some amount of fact-finding and probably a lot of interaction with special interest groups. This may be an adequate pattern for areas such as environmental policy, where government should take care of the common good and protect the citizens. However, it is not an adequate pattern when it comes to activities such as industrial policy (at the national level) and locational policy (at the local level). The argument put forward by neo-liberal economists, namely that there is no reason to assume that government co-ordination is superior to market co-ordination when it comes to business promotion is convincing. However, this does not mean that government has to limit itself to facilitating markets. Experience in industrialised countries shows that government actors are involved in policy networks which also include various non-governmental actors, and which may be quite effective in formulating and implementing sectoral policy (Messner 1997). Policy networks are rarely designed and created intentionally. The rather emerge as a spontaneous response to governance necessities, for instance market failures which block rapid adjustment processes in old industrial regions.

So what is the problem with policy networks for locational policy? The problem is that functioning policy networks involve collective actors, rather than a large number of individuals or companies. In order to have functioning policy networks for locational policy it is thus necessary to have effective business organisations. Now, entrepreneurs in emerging industries feel little pressure to organise themselves and to look for political support. Industries and firms are growing rapidly and therefore feel no need to fight for their interests. There is no immediate

logic for collective action under such circumstances. Policy makers may strive to support such industries in order to defend common interests. But they face the problem that it is difficult to establish adequate communication links with new firms exactly because they have not (yet) organised themselves.

At the same time, old industries tend do be well organised for the simple reason that there is a logic of collective action, namely to lobby for defensive measures to slow down the adjustment process. Therefore, for government policy makers it is easy to tap into policy networks with mature and declining industries. But, as I have argued above, this is not the kind of industries which is much interested in locational policy. This is the lifecycle paradox of locational policy: industries which might be interested in locational policy are unlikely to be well organised, so that it is difficult to set up the policy networks necessary for policy formulation. Old industries are well organised, but they are not much interested in locational policy.

3 Globalisation, value chains and locational policy

So far, I have looked at intrinsic problems of locational policy, without looking specifically at the repercussions of globalisation on locations. Globalisation is a major reason why local stakeholders start locational policy initiatives. But, as we will see, it is also a major complicating factor for locational policy.

3.1 Globalisation and location

It is analytically useful to distinguish between five different types of globalisation, each of which is relevant for locations:

- globalisation of companies,
- globalisation of product markets,
- globalisation of capital markets,
- globalisation of labour markets,
- globalisation of innovation systems.

Let us briefly look at the relevance each type of globalisation has for locations. In the following subsections, I will in particular look at the challenges and difficulties the first two types of globalisation create for locational policy.

3.1.1 Companies

The fact that companies, at a certain point in their life-cycle, start to look for locations outside the place where they started their business is one of the starting points for locational policy. In the case of large corporations, one can be sure that whenever they announce to be looking for a location for a new factory, dozens of places will line up to attract this investment.

Globalisation of companies is correlated to two features: the availability of attractive markets and the industrial life-cycle. As companies grow, they look out for additional customers for their product, outside their home market. They initially will export, but at some point they will find that it is preferable to locate production closer to the main target markets. The industrial life-cycle argument is something I have outlined above.

Globalisation of companies affects locations in four different ways:

- Foreign companies may invest in a given location, thus creating jobs and tax income (unless government throws too many fiscal incentives and subsidies at the investor). Further effects of inward investment may be an increase in locational quality, for instance in the case of specialised suppliers, and increased visibility of the location, in particular in the case of highly publicised investments (e.g. Intel in Costa Rica).
- Foreign companies may acquire companies in a given location. This is a natural and frequent phenomenon as industries mature and consolidate.
- Foreign companies may decide to close down a factory in a given location. This is a frequent phenomenon in mature and declining industries, and in particular during industrial downturns, when corporations have to cut costs and reduce capacity, in which case they tend to shut down smaller and more remote factories (Watts and Kirkham 1999).
- Local companies may start to internationalise their operations, possibly including the relocation of key activities to other locations (e.g. the relocation of certain R&D activities to a high-tech cluster elsewhere).

Except for the third type, it is difficult to qualify either of these types of globalisation of companies as undisputedly positive or negative for a given location. Table 3 summarises observations in this respect.

Table 3: Positive and negative impacts of different types of globalisation of companies on locations

Type	*Positive impact*	*Negative impact*
Inward investment	• job-creation • tax income • increased visibility and attractiveness of location	• cost of fiscal incentives and subsidies
Take-over of local company	• access to sales channels, brand name, knowledge of external company	• decreasing commitment of company with location
Close-down of local factory	• (availability of real estate)	• loss of jobs and purchasing power • loss of tax income • negative impact on locational image
Internationalisation of local company	• access to additional markets • access to additional know-how	• decreasing attention for local issues

3.1.2 Product markets

Globalisation of product markets manifests itself through the growth of world trade which is surpassing the growth of the world economy. World trade can be divided into three types.

First, there is arms-length trade, intra-firm trade, and value chains. Arms-length trade appears to count for the smallest segment of world trade. It is limited to standardised commodities, such as soybeans or mineral ores. Second, there is intra-firm trade which has increased as a result of the globalisation of companies, and in particular as a result of the increasing segmentation of the production processes within multinational corporations.[6]

Third, there are global value chains. Economics textbooks suggest that international trade involves transactions between anonymous sellers and buyers. In practice, however, quite the opposite is the case. Rauch (1999) finds that what he calls "differentiated products", i.e. products which are not standard commodities and usually involve some degree of direct interaction between producer and buyer to determine product quality and specifications, accounted for 67.1 % of world trade in 1990, up from 56.5 % in 1970. Direct interaction may take different forms; typical examples are international business networks established by ethnic minorities (e.g. overseas Chinese), international networks managed by trading companies (Rauch 2001), or intra-firm trade. Cluster researchers have recently investigated yet another variation of direct interaction, namely the one which has been addressed under the heading of "global commodity chains" (GCC; Gereffi 1996). However, the term chosen by Gereffi is a contradiction in terms. As Humphrey and Schmitz (2000, 10) point out, he investigates commodity chains precisely because they do involve differentiated products, i.e. they are not about standardised commodities. This is one of the reasons why they and other authors prefer the term "value chain".

The work of Gereffi is mostly based on the investigation of networks in the garment industry and trade, mostly involving production in East Asia and Central America and design and distribution in the U.S.,[7] and even though he introduces a distinction between buyer-driven commodity chains (e.g. in garments) and supplier-driven commodity chains (e.g. in cars), his own work is mostly on the buyer-driven apparel chain. Other authors have investigated buyer-driven chains in other industries, such as footwear (Schmitz and Knorringa 1999), horticulture (Dolan, Humphrey and Harris-Pascal 1999), coffee (Fitter and Kaplinsky 2001), and furniture (Kaplinsky and Morris, undated). The common feature of these industries is the dominating position of buyers vis-à-vis producers in developing countries, which is due to a high degree of concentration among buyers in industrialised countries and relatively low barriers to entry for producers in developing countries. So far, there has been little research on global value chains in supplier-driven chains.

Global value chains can have important repercussions on locational policy. For instance, Schmitz (1995, 1998) found that in the case of the footwear cluster in Rio Grande do Sul, Brazil, the specific pattern of integration into international value chains created serious prob-

6 This has been common for quite some time in industries such as textiles and garments, but it is also very important in high-tech industries such as manufacturing of hard-disk drives (Gourevitch, Bohn and McKendrick 2000)

7 As Gibbon (2000) elaborates, the structure of garment retailing, and the sourcing pattern of retailers, in Europe are decidedly different from those in the U.S.

lems for locational policy inside the cluster: Tanneries were happy with the business relationship they had with Italian customers, which demand "wet blue" products, i.e. hides which had gone only through the first, particularly hazardous and pollution-intensive step in the tanning process. Therefore, tanneries had little interest in moving forward into more value-added activities. Big shoe producers relied on one big buyer in the U.S., and they feared that collective action to increase competitiveness might compromise this relationship. Therefore, they did not support the local competitiveness initiative which in the end petered out with little effect.

3.1.3 Capital markets

The globalisation of capital markets affects locations in two distinct ways. First, there are those locations which are nodes in the international capital market, such as New York, London, Frankfurt, Tokyo and Singapore. Despite the increasing technical potential to relocate back-offices and other activities to cheaper locations, the financial districts in these places have kept growing.

Second, there are all other locations. For them, the globalisation of capital markets does not necessarily have the kind impact one might expect. For instance, one would expect that with the increasing sophistication of IT, every financial product is available everywhere anytime. This is not the case, as global players in the banking industry appear to have a bias for large-scale customers. So there are more options for large companies, whereas for SMEs the relevance of local financial institutions is strong and growing. The growing dependence of German SMEs on Sparkassen and Volksbanken is a case in point (Meyer-Stamer and Wältring 2000). However, these local banks see themselves threatened by large commercial banks with more attractive offers for investors, so that even if there is more demand for credit, there may be less deposits to be channelled into the credit business.

3.1.4 Labour markets

It is often assumed that the globalisation of labour markets is progressing at a much slower rate than other types of globalisation. However, this is not necessarily true. Let us take the example of Germany, a country which is mostly trying to deter immigration. Even there, the number of foreigners working in the country is larger than the number of local residents working at the affiliates of multinational corporations (Meyer-Stamer 1997).

As labour markets are getting increasingly globalised, intangible locational factors become more relevant. As highly skilled, specialised professionals find job opportunities in many different countries, they will weigh the wage and career perspectives against intangible factors, such as quality of housing, of schools, and of recreational facilities, as well as the situation regarding security. For instance, local economic development agencies occasionally have conducted polls among spouses of managers of multinational corporations to identify factors which may create a locational differential in terms of intangible factors.

3.1.5 Innovation systems

The discussion on innovation systems is addressing two different issues. First, it is about overall framework conditions which do, or do not, create incentives for innovation (Nelson 1992). Secondly, there is the more technical view which looks at organisations, that is companies, R&D and technology institutes, and training institutions, and the pattern of interaction between them. What is most elaborate so far is the research on national innovation systems (see also Lundvall 1992, OECD 1997) and on subnational regional innovation systems (Cooke 1992, Heidenreich 1997). However, it is important to note that innovation systems, in particular at the sectoral level, are increasingly global in scope. This is particular relevant for developing countries which can less rely on competent national innovation systems (Ernst 2000).

3.2 Value chains and the irony of upgrading

This section addresses some implications of the globalisation of product markets for locations. More specifically, it addresses the implications of global value chains for locational policy making.

Before going into the details of interaction between locations and value chains, it is important to note that there are basically two different constellations: locations may be, or may not be, on the radar screen of those who co-ordinate a given value chain. The co-ordinators of value chains are usually global buyers, which are systematically scanning the globe for potential suppliers. This is creating an opportunity for local stakeholders. If the location is not yet on the buyers' radar screen, the conditions for locational policy are probably not bad. This is what a lot of SME promotion is about: to increase the competence of local firms in terms of production, quality, technology, human resources and financial management, so that they can manufacture products of acceptable quality at competitive prices and may appear on the radar screen of global buyers. ISO 9000 seems to play an important role in this respect: apparently, it is mostly relevant as a signalling device, indicating that a local firm may have the potential to become a supplier for a global buyer (Quadros 2001, Nadvi and Wältring 2002).

In the pre-radar screen constellation, upgrading means learning within local markets or elsewhere to improve competitiveness in order to appear on the radar screen of value chain scouts. Government may take an important role, for instance pursuing a carrot-and-stick approach, i.e. both pushing and pressuring firms and supporting them, including dedicated efforts to get them onto the radar screen (missions, presence at fairs, joint marketing etc.).

What are the consequences of appearing on the radar screen? Quite likely, the most immediate consequence is rapid growth. Managing rapid growth keeps firms extremely occupied, so that there is little time for interaction with government. If the money just keeps rolling in, there is also little urgency for collective action. Constellations like this have been observed in the early growth phases of the footwear cluster in Sinos Valley, Brazil (Bazan and Schmitz 1997), and the furniture cluster in São Bento do Sul, Brazil (Meyer-Stamer 1998).

Another detail is that after having been lifted onto the radar screen, the chain governors are unlikely to expect local government to play an active role in day-to-day management. They rather expect government to remove obstacles that stand in the way of day-to-day business (red tape, deficient infrastructure). Government officials find themselves increasingly cut out of communication loops, relying on second hand information on the evolution of the chain.

For local companies, being part of a global value chain may imply four different things:

a) Running to stand still. This implies upgrading jointly with the other participants in the value chain. This is a challenging task, but it involves only a limited risk.

b) Strategic functional upgrading. This would mean to take over functions so far handled by other companies, most probably from other locations, within the same value chain. This is a more risky option, as the to-be-replaced competitors will probably fight back.

c) Improve the competitiveness to move to a different value chain. In a given sector, there are various value chains which cater for different segments of the consumer market. Provided that margins are higher in more sophisticated markets, it may be tempting to switch from one value chain to another one which serves higher-margin markets. This involves the risk of falling between two chairs, in case the old buyer perceives the effort and moves to a different source, whereas the prospective new buyer cannot be persuaded to really buy.

d) Trying to take over the value chain / the main power position in the value chain: This is clearly the most challenging option. It may be viable in cases where the power position of buyers is limited; the ceramic tile industry would be case in point (Meyer-Stamer, Maggi and Seibel 2001).

What is the role of collective action within the private sector in these different scenarios? In all cases there are strong incentives against collective action. In the case of scenario A, one might argue for a positive-sum game which might persuade firms to go for collective efforts to upgrade, in particular in a situation where all the firms in the location are suffering from superior competition from some other location (e.g. the case of the Sinos Valley footwear cluster vs. producers in China in Schmitz 1995). However, it is as likely, if not more likely, that firms will rather think in terms of a zero-sum game, i.e. a firm perceives losses of local competitors as its own gain. This is particularly likely in places where collective action has suffered through easy early export growth.

In the case of scenarios B to D, collective action is even less likely. It is highly unlikely that in a given location all company decision makers display the same level of risk-friendliness. If the degree of risk-friendliness diverges, one may expect that some decision makers would find any of those scenarios plausible, whereas many others would not. It would rather be likely that particularly risk-friendly, strategically oriented firms would go for one of these options, thus creating a split among business executives within the location.

What is the role of government in these different scenarios? Basically, it would try not to stand in the way (i.e. reduce transaction costs) and to excel in the provision of basic and advanced factors; the case study of Halder (2002) on the surgical instruments cluster in Tuttlingen, Germany, illustrates this point. It seems improbable that government can play a major role, in particular with respect to scenarios B to D. It is unlikely that government has the in-depth, up-to-date knowledge which is necessary to assess the viability of these scenarios. The most likely contribution of government may be to contract a specialised consultancy firm to support local businesses and associations in their decision-making process.

So this is the irony of upgrading and entry into value chains: Government can play a very important role in locational policy to help local firms to become so competitive that they appear on the radar screen of global buyers. But as the firms get involved in the value chain, the options in terms of a government role in locational policy decrease substantially, and it is likely that collective action in the private sector will suffer as well.[8]

3.3 The location paradox

This section addresses the implications of globalisation of companies for locational policy. I argue that locational policy makers are confronted with a paradox: Companies are increasingly demanding when it comes to locational quality, but they show a decreasing propensity to get actively involved in locational policy.

Increasing demands in terms of locational quality apply to various locational factors: high quality and low cost of infrastructure, swift execution of licensing and permit processes, low tax burden, substantial effort in workers' training, etc. When talking about companies in this subsection, I address producers which sell a large part of their output elsewhere. I am not addressing local companies such as developers or utilities which will often take a very active role in locational policy. For the latter, locational upgrading is a key element of their business strategy which aims at keeping and attracting customers. But the discussion on the relationship between location and competitiveness is not about developers and utilities, but about industrial manufacturers and service firms which are serving global markets.

The decreasing propensity of companies, in particular large, multi-location companies, to get involved in locational policy has been documented in a few case studies (Heying 1997, Dörre 1999). But why would one expect that companies may get involved in such activities in the first place? This suggestion is based on inductive reasoning: Despite globalisation, companies are usually not footlose, and do not pick locations randomly. Space and location continue to be relevant for globalised manufacturing and service companies. Companies seek specific locational qualities. This, it would appear, implies that companies have an interest in the crea-

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8 This would be an alternative interpretation of the case presented by Leite (2001) about different records of locational policy in the ABC region of Brazil with respect to the car industry and the plastics industry. The way she presents the plastics industry, it appears a lot like an industry which has not yet appeared on the radar screen of external buyers.

tion and improvement of locational qualities, and may thus be willing to take an active role in this respect.

But let us take a closer look at the connection between company and location. Companies are located in a given place for either of three possible reasons:

a) due to historical accidents (i.e. because they were founded there or because they acquired a firm which happened to be located there),

b) because they are seeking proximity to other firms. A typical example would be an IT company which sets up an affiliate in Silicon Valley.

c) because they are seeking other locational factors. For instance, Renschler (1995) gives a detailed account of the criteria Daimler-Benz applied when it scanned possible locations for its SUV factory in the U.S.

None of these motives necessarily means that a company deliberately contributes to the improvement of locational quality. In particular, both case B and case C are about taking, not about giving. Rather than intentionally, companies will often contribute inadvertently to the improvements of locational quality, as they do something to enhance their competitiveness which creates positive externalities. Conversely, one of the main obstacles to getting companies involved in a locational strategy is the problem of free-riding, i.e. companies' expectation that there is too little appropriable outcome and too much externality.

There are two types of places where one would expect that this problem is less relevant:

- hub-and-spoke-clusters (Markusen 1996) which are essentially dominated by one company (e.g. Toyota City), where the "hub" company can control the external effects,

- extremely cohesive clusters where free-riding is minimised through social control; however, this phenomenon is getting rare as local firms in cohesive clusters get involved in international value chains with the effects elaborated before, and external firms enter into local clusters to benefit from specific locational qualities (Grabher 1993).

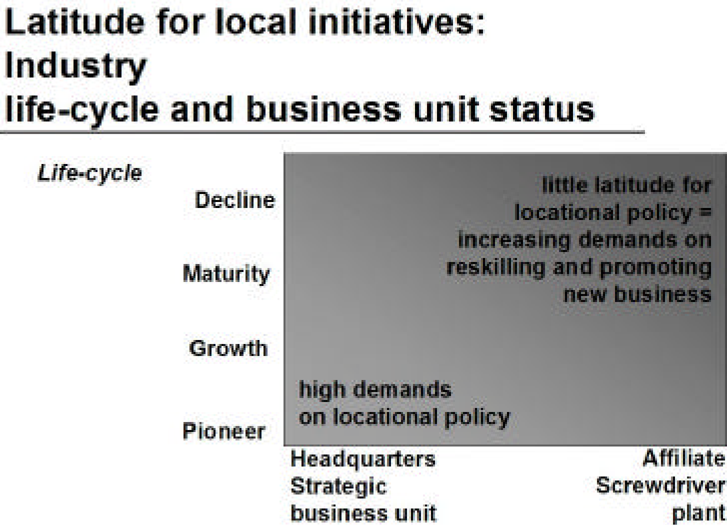
This is not to say that companies do not do anything to the benefit of their location. What they usually opt for is sponsoring – of museums, theaters, other cultural events, sports, etc. For a large corporation, sponsoring has an unbeatable cost-benefit-ratio: the cost is usually low, whereas the visibility is high, and moreover the company can point at the sponsoring activities whenever somebody criticises it for lack of local involvement. Moreover, the cost-benefit-ratio is much more predictable than in cases where companies get involved in locational policy. Understanding the structure of local policy networks, and participating in them, will involve substantial input in terms of time (i.e. high transaction and opportunity costs), whereas the visibility of the outcome is unpredictable. How is a company which is driven by the rationale of shareholder value maximisation supposed to justify this kind of involvement? This logic becomes even more convincing if one considers that companies tend to run operations in dozens, and often hundreds, of different locations, and that in many locations they are

likely to have an exit option which may be particularly attractive in the case of simple screwdriver operations.

The latter point leads us to a factor which qualifies this argument to a certain extent. There is some evidence, not only in the case of Volkswagen that I mentioned above, that locational involvement of company headquarters is different from that of screwdriver plants, thus adding a second dimension to the lifecycle dimension. Figure 2 tries to visualise the interrelationship between lifecycle and status of a location in the respective company's hierarchy.

- The lower left corner matches with the practitioner's and researcher's view elaborated before.
- The upper left corner is populated sparsely, with cases such as Volkswagen and Wolfsburg.
- The lower right corner is probably difficult in terms of illustration; start-up companies tend to stick to one location. It is only as they enter into the growth phase that they diversify their locations. This is where places and locational strategies such as those pursued by Scotland (Raines and Brown 2001) and Costa Rica (Larrain B., Lopez-Calva & Rodriguez-Clare 2000) become relevant.
- The upper right corner addresses a huge number of old industrial locations where local companies are taken over and downsized, or affiliates are close down or downsized.

Figure 2



This figure has some value in orienting locational policy makers in terms of assessing what they realistically can expect in terms of companies' involvement in locational policy initiatives.

4 Perspectives for locational policy

Where does this leave us in terms of locational policy? Addressing this question is more than an academic exercise. The concept of upgrading guides local stakeholders in defining their strategies. If the meaning of upgrading becomes fuzzy or contradictory, this is really bad news for locational policy initiatives. If the upgrading paradox and the location paradox become relevant, this makes things even more complicated.

However, it does not necessarily mean that any proposal to pursue locational policy is point- and hopeless. Even in the most complicated locations, there are always some options for locational policy. For a start, let us distinguish between two types of locational policy: generic locational policy and strategic locational policy.

4.1 Generic locational policy

The goal of generic locational policy is to create favourable overall conditions for business, without specifically targeting companies or sectors. This is something like the functional equivalent to operational effectiveness within companies. And yet it is something which is often highly appreciated by companies, and may, for some time and to some extent, i.e. as long as other locations are too disorganised to do the same, create a locational advantage.

Government action for locational policy nowadays is often, explicitly or implicitly, based on Porterian concepts, in particular the development of specialised factors. But it happens that highly competitive firms are beyond that.[9] They focus on a value chain-oriented strategy (e.g. ceramic tiles, see Meyer-Stamer, Maggi and Seibel 2001) and strategic positioning in restructuring/merging markets (e.g. surgical instruments, see Halder 2002). They take the availability of specialised factors for granted, and if they encounter any deficiencies in that respect they will often prefer to buy them somewhere rather than going for a locational policy effort with the unfavourable cost-benefit-ration explained above.

This does not imply a passive role of government. Quite the contrary, local government may develop a business-friendly disposition, and think in all sorts of contexts about ways of making the life of business easier. This reflects real changes, including the decreasing latitude for locational policy due to pressure within value chains and the behaviour of companies with extra-local headquarters. Plus it addresses one of firms' main concerns: to remove government-induced obstacles, in particular in terms of clumsy and complicated licensing and permit processes. And yet it is not just neo-liberal orthodoxy, as it may include a number of proactive initiatives.

In practical terms, a generic locational policy may include the following elements:

9 Apart from that, a number of case studies found it difficult to verify Porter's emphasis on diamond-related factors as the basis of competitiveness; see Davies and Ellis (2000) for an overview.

- a systematic effort to assess the consistency, necessity, effectiveness and efficiency of local rules and regulations, and based on that a streamlining of them;
- an effort to make local and national rules and regulations more transparent and easy to handle, and to make public agencies more aware of the necessities and demands of private companies;
- the creation of first-stop or one-stop agencies;
- the provision of efficient real estate information systems;
- locational marketing efforts.

It is not as if these things were easily implemented from one day to the next. In particular, making public agencies more private sector-friendly involves a protracted effort. For instance, in the state of Northrhine-Westphalia, Germany, local public authorities have been working on this for quite a while. However, their self-assessment differs substantially from the perception of private firms (Table 4).

Table 4: Customer orientation of public agencies in NRW

	Local governments: agree fully or partially	Companies: agree fully or partially
Easily accessible	98 %	56 %
Courteous and customer-oriented	99 %	43 %
Forms and correspondence easy to understand	86 %	40 %
Competent advice	98 %	36 %
Understanding of business‘ concerns	98 %	30 %
Adequate explanation of decisions	93 %	27 %
Sufficient explanation of delays	94 %	23 %
Timely information on delays	90 %	20 %

Source: Kommunal- und Unternehmensbefragung der Mittelstands-Offensive NRW move. Unternehmen und Kommunen - Zwischenbilanz einer schwierigen Beziehung (undated, approx. 2001)

What is the role of other stakeholders in the context of generic locational policy? Essentially, it is important to distinguish between two types of stakeholders here. First, there are Chambers, business associations and other collective actors. They can contribute to locational quality by simply doing a good job, i.e. to be agile, in close contact with member firms and constantly adjusting to new challenges. For instance, in the case of a Chamber it means providing efficient, good quality and constantly updated real services to its member firms, and pursuing effective lobbying.

Second, there are supporting institutions, e.g. in training, ongoing and re-training, technology extension, etc. They have to compete on markets. Preferably, these would be real markets, where the customer pays, e.g. training courses or R&D projects commissioned by firms. But often it will be distorted markets, where a substantial part of the price of the service is paid by a third party, usually government (e.g. as part of employability or technology and innovation programmes).

A more active, but still generic, element of locational policy comes to mind when introducing the issue of local markets. It is frequent to observe market failure at the local level. This is particularly notable in the case of the labour market, which is highly segmented and suffers from serious information problems. For instance, small and medium-sized firms tend not to have explicit human resources planning, including training of employees. This is creating serious problems for local training providers, who can neither count on a defined medium-term perspective of training demands of SMEs nor customise training courses for job seekers in a way that fits with real demands of employers. The result is what Schönfeld (1998) calls "invented demand" or "researched needs", which need to be distinguished from "articulated demand". *Invented demand* refers to training providers who simply guess what the demand in the market may be. *Researched needs* refers to assessments of companies' problems and necessities, usually conducted by third parties (university researchers, consultants), which tend to be "objective" needs which are not necessarily the same as the "subjective" needs a given businessperson would be willing to spend money on. *Articulated demand*, on the other side, refers to a pattern where direct communication is established between training providers, companies and possibly third parties such as governmental employment agencies. The idea is not to plan the evolution of the local labour market, but rather to reduce information asymmetries and to make the local labour market work more effectively.

The same rationale of trying to make markets work better applies for other markets as well. One typical example would be the organisation of formal or quasi-informal events for business contacts to stimulate supply relationships between local firms. Formalised supplier fairs may serve the same purpose, but often at a lower cost-effectiveness-ratio. Another typical example would be to organise local consumer fairs, so that consumers get aware of products and services that are locally produced.

A variety of generic locational policy is the "entrepreneurial city" approach[10] which Wilson (1995) describes as an exercise where "the local growth coalition works with the local public sector to market the city to increasingly footloose land developers, businesses and consumers". It involves public-private partnership, but on the private side it mostly includes local developers and utilities. The idea is not so much to turn a city into what Marx would have called "ideeller Gesamtkapitalist", i.e. an actor which aggregates all business interests, but rather to make a city a business-friendly place.

4.2 Strategic locational policy

Strategic locational policy is a major focus of the cluster discussion (e.g. Knorringa and Meyer-Stamer 1998), and also of the local innovation system discussion (Braczyk, Cooke & Heidenreich 1998). The idea of strategic locational policy is not to leave upgrading to the invisible hand of the market, but to try to define specifically where to upgrade, i.e. agree on a

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10 See, for instance, Center for Civic Innovation (1999) for the "practitioner's guide" and Hall and Hubbard (1998) for some reflection.

direction and a goal. The formulation of a strategic locational policy is the outcome of a process which involves government, firms and other local stakeholders. At the end, there is a decision which defines tasks and responsibilities. Getting there, though, involves an enormous effort and very difficult governance issues.

An ironic way to define strategic locational policy would be this: It is a consolation for those academics who find it hard to accept the demise of strategic industrial policy, who are still mourning the end of the glorious days of the Race to the Moon, the Airbus, and the VLSI Programme, and who think that a functional equivalent is necessary. Just like in the case of industrial policy, there is a landscape which is not exclusively littered with ruins but also a few beautiful constructions, i.e. vibrant locations which owe their dynamism to a relevant degree to the strategic behaviour of local stakeholders.

But this is not a fair way of dealing with strategic locational policy. It is not just a creative interpretation of reality by researchers, even though one may come across cases of "fuzzy concepts and scanty evidence" (Markusen 1999). There seems to be an – albeit limited – number of cases where strategic locational policy is actually happening,[11] though there seems to be hardly evidence that it actually works (Buss 1999).

One might construct two different scenarios to explain why strategic locational policy sometimes occurs. The first would go like this: A local community has a long tradition of collective action and strong social capital. It never went through disruptive external shocks, positive or negative, which erode social capital.[12] It has a consistent history of strong economic performance which can be linked to collective action to constantly improve the locational quality. For stakeholders in a location like this, strategic locational policy might be business as usual.

The second scenario would go like this: It happens because a local community is going through a deep, disruptive process of radical structural change, for instance due to the closure of the largest local employer or the decline of the locally dominating industry. Strategic locational policy is the only alternative to economic decadence and social decay. This has been a motive for strategic locational policy in several parts of the Ruhr Valley in Germany (Maggi 2000) and in many different places in Latin America (Aghón, Alburquerque and Cortés 2001).

It is difficult to plausibly suggest other constellations. Why would a local community where the economy is thriving as a result of decentral, market-based activities go for a massive collective effort to improve locational conditions? This may be the kind of suggestion academics

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11 In the case of Germany, locations such as the city of Dortmund and the Aachen region would probably qualify (Meyer-Stamer 2000). In the case of the UK, one might think of Wales (Cooke 1998). In the U.S., Pittsburgh may be an example (Parks 1999). In Brazil, the Greater ABC region would be a candidate (Cocco, Silva & Sperotto 2001, Klink 2001).

12 The latter happened in the case analysed by Bazan and Schmitz (1997), namely small communities in the footwear cluster in Sinos Valley, Brazil, where traditional social capital decreased rapidly during the phase of the easy export boom, i.e. a positive external shock.

would make, but from the consultant's perspective it is obvious that this is not the place where many hours can be billed, as in the real world of locations the rule goes *The good is the enemy of the better*, and not the other way around.

How does this reasoning fit with the life-cycle argument elaborated above? The second scenario describes either locations where dominating industries are moving from maturity to decline, and where stimulating emerging industries appears as the only promising option, or locations which have not gone through industrial development so far. The first scenario is less obviously linked to the life-cycle, but there is a link, and it is very important. As a matter of fact, most industries are segmented when it comes to the industrial life-cycle. Take, for instance, the computer industry. Some parts of the industry have already gone through the entire life-cycle, such as the manufacturing of mini-computers. Companies which did not manage the transition to PCs or services were wiped out or taken over; the big names (DEC, Data General, Wang, Norsk Data, Nixdorf) are all gone. Several of these firms were clustered in the east of the U.S., along Route 128 (Saxenian 1994), so that the decline of the industry also implied regional decline. So to say that a given location has a strong base in the computer industry does not a priori tell the observer whether this is a base in an emerging, growing, mature or declining industry. This leads us back to the first argument: there are locations where local firms manage to stay on the emerging and growing side all the time, by constantly coming up with innovations, and where the local milieu stimulates the creation of new businesses which reinforce this pattern. This appears to be one explanation why several industrial districts in Italy are still thriving (Belussi 1999), even though the relative importance of collective action to strengthen the locational quality is not clear; in any case, the relevance of governmental business promotion agencies seems to decrease (Whitford 2001).

It is important to note that there is also something like a surrogate strategic locational policy, where diagnostic, planning and implementation is driven by local government due a preoccupation with the long-term economic health of the location. However, this will often lead to ineffective locational policy, as it is unlikely to meet with the real problems and options of the private sector, even if smart young people from McKinsey or Arthur D Little run around to interview private firms. It may lead to improved communication and co-ordination within the government sector, which often is highly fragmented. But then again, it may turn into an exercise where mostly government representatives meet other government representatives and even less time is left for direct contact with businesses. To some extent, this seems to have been a major feature of the so-called Regional Conferences, i.e. regional-level stakeholder fora involving mostly government representatives in 15 regions of Northrhine-Westphalia, Germany (Kremer 1999, Potratz 1999).

Why is effective strategic locational policy, based on a broad alliance, such a difficult venture, and why does it occur not very often? Apart from the reasons mentioned in the earlier sections, it is important to note two further points. First, there are problems of network governance. The formulation of a strategic locational policy would involve a huge policy network, and the usual paradoxes and dilemmas of network governance would apply, in particular

- a decision-making blockade due to build-up of veto positions, inter alia related to power asymmetries;
- structurally conservative action orientation; trend toward agreement on the "smallest common denominator;“ functional and cognitive blockade; collective conservatism;
- unresolved tension between too weak and too strong ties;
- problems in defining distributive criteria;
- intended externalisation of costs at the expense of the network environment, or unintended externalisation due to exaggerated inward orientation of network actors (Messner 1997).

These problems of network governance can be exacerbated if administrative boundaries are not congruent with the boundaries of economically functional spaces (Cheshire 2001).

Second, there is yet another reason why local firms may hesitate to get involved in locational policy, in particular if it involves locational marketing and investment promotion. The resistance of local firms to external investment which Tendler (2001) observed in Brazil’s Northeast is not a peculiar feature of that region, nor is the motivation behind it, namely the expectation that external investors would drive the wage rate up. Neither is this a new phenomenon. When GM and Ford wanted to set-up factories in the Ruhr Valley more than 40 years ago, they met with fierce resistance. GM succeeded basically because the city mayor of Bochum kept the whole project a secret, and Ford failed because it could not get hold of the necessary real estate which was owned by the old industries (Gaigalat & Kania 2000).

So strategic locational policy is rather an unlikely occurrence. But this does not necessarily mean that generic locational policy is the only option left. I suggest that there is also the option of reflexive locational policy.[13]

4.3 Reflexive locational policy

Reflexive locational policy is located in between generic and strategic locational policy. It involves the organisation of a collective reflection effort on tendencies and structural change in the industries, clusters and value chains which are relevant for the location. Unlike strategic locational policy, it does not involve negotiation of a joint strategy and action plan with a clear definition of responsibilities for various actors. It rather provides a basis for decentral strategy formulation inside companies and government agencies. This variety of locational policy is something we have observed in the ceramic tile cluster of Castellón, Spain (Meyer-Stamer, Maggi & Seibel 2001).

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13 This relates to the concept of reflexivity as formulated by Giddens (1984, 3): “... it is useful to speak of reflexivity as grounded in the continuous monitoring of action which human beings display and expect others to display”.

The justification for reflexive locational policy lies in the existence of dynamic uncertainty. Camagni (1991, 218) introduced two types of dynamic uncertainty:

- “dynamic uncertainty coming from the so-called ‘C-D gap’ (competence-decision gap); uncertainty regards, in this case, the impossibility of precisely assessing the outcomes of – alternative actions, even in presence of full and free information on past events, due to the complexity of the decision problems themselves and inherently imperfect foresight. The probability of choosing a wrong or inferior technology is therefore large;

- dynamic uncertainty coming from a ‘control gap’; the outcomes of present actions depend in fact on the dynamic interaction among independent decisions of many actors, on which the firm has by definition a minimum control”.

Camagni argues that the “local milieu” plays a very important role in firms’ effort to deal with dynamic uncertainty, “through a collective and socialized process allowing cost reductions and enhancing the effectiveness of the dynamic decision-making process of local firms” (ibid., 223). However, one may argue that globalisation, structural change and accelerated technological change overwhelm the individual analytical capabilities of numerous local actors and their informal communication. On top of the learning processes and exchange of information which characterise a local milieu, an organised analytical effort becomes necessary. This effort may be organised, individually or jointly, by local government, business associations, lead firms, universities or research institutes. It may have an academic bias, if it strongly relies on university researchers, or a demand-generation bias, if it strongly relies on consultancy firms. But in any case, it is based on a deliberate effort to gather intelligence which would not come about spontaneously, through the effort of decentral actors, and on an organised reflection exercise based on seminars, workshops and presentations and involving government actors, business representatives and researchers.

Regarding practical activities based on the reflection exercise, government focuses at generic locational activities, but it can achieve a better level of effectiveness and efficiency since its action is based on improved information. Companies pursue individual strategies, but their internal strategy formulation process is likewise based on improved information.

What do you actually do if you want to go for reflexive locational policy? There are two options. One of them is an ironic one: You start a strategic locational policy initiative, but then stakeholders cannot even agree on a problem definition, let alone on a shared goal and practical proposals to achieve that goal. But until you get to the point that everybody understands that this strategic locational policy initiative is stillborn, there will be a lot of discussions, possibly also a large amount of research, and all this will provide local decision-makers in companies and institutions with additional information so that the quality of their respective inhouse decision-making may improve.

The other option is to sell a reflexive locational policy effort as what it is, i.e. try to convince local stakeholders to spend some time in seminars, workshops and presentations. Which of the two options is the more promising one? In fact, this is a tricky question. There is a certain

probability that many local stakeholders find the proposal of an explicit reflexive locational policy initiative not very convincing, in particular as the "product" is not tangible and fuzzy. The advantage of a strategic locational policy initiative is that it aims at a tangible product, namely a formulated strategy which is written down in a document, even if the process never reaches this point.

5 Conclusion

In the past years there has been an increasing degree of excitement about the potential benefits of local economic development efforts, both in industrialised countries (European Commission 1998, OECD 2000) and in developing countries.[14] The purpose of this paper is not to destroy that excitement, on the contrary. I spend a substantial part of my time as a consultant on local economic development, and usually this involves extremely exciting missions to various countries. But it is important, despite all the excitement, to get to a realistic assessment of the latitude of locational policy, and the typical obstacles every locational policy initiative will have to deal with.

Basically, the question of latitude for locational policy is closely connected to the question how contemporary societies can shape the process of economic development, or have to restrict themselves to making the market work as efficiently as possible. As there is always market failure, and as market failures are particularly strong in developing and transformation countries, relying exclusively on market governance is not a very promising option. However, countries with weak governments and little governance capability have little choice. For them, assuring the functioning of markets is already quite a challenge.

This kind of reasoning applies not only to nation states but also to the local and regional level. Local governments which want to foster economic development but suffer from limited resources and capabilities may still try to implement a generic locational policy. Other places, where the governance capability is stronger, may opt for reflexive or strategic locational policy.

It is important to point out that the three types of locational policy cannot easily be ranked in terms of relevance or effectiveness, and that there is also not necessarily a ladder, i.e. where local stakeholders go through a learning process which starts with a generic locational policy and leads them via a reflexive to a strategic locational policy. It is highly location- and phase-dependent which type of locational policy is most adequate for a given location. A location which is thriving due to dynamic firms and market processes is probably well served with a generic locational policy. Actors in a location with a highly diversified economic structure will probably find it difficult to start a reflexive locational policy; this kind of approach ap-

14 On the World Bank's activities see http://www.worldbank.org/urban/led/index.html. Also very active is the ILO, see http://www.ilo.org/public/english/employment/led/about/index.htm and http://www.itcilo.it/delnet/english/index.htm.

pears more promising in locations with a somewhat narrower specialisation profile, in particular industrial clusters. Strategic locational policy is a very difficult approach, which is most likely to happen in places suffering from profound crises. Every location ought to pursue a generic locational policy, some may find it useful and viable to pursue a reflexive locational policy, and very few will succeed in formulating and implementing a strategic locational policy.

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