

# Planning or doing Local Economic Development?

## Problems with the Orthodox Approach to LED

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Promoting local economic development (LED) has become a growth sector in the international technical assistance industry, both in transformation economies and in developing countries. The experience of the 1990s reinforced the observation that active measures are necessary to promote economic development in low- and middle-income economies. From this perspective, LED is a pragmatic response to a visible need, and there seem to be good reasons to justify its use. However, there are doubts about the efficacy of LED: looking at the experience of industrialised countries, there is surprisingly little evidence of the effectiveness of LED. Thus, it is legitimate to ask whether introducing LED is worth the time and effort. In this paper, we address this question by looking at the conceptual issues that underlie the prevailing approaches to LED. We give an overview of orthodox approaches to LED, before arguing that the orthodox approach to LED suffers from serious flaws. Finally, we draw some conclusions regarding promising approaches to promoting LED in developing countries.

### Introduction

Promoting local economic development (LED) has become a growth sector in the international technical assistance industry, both in transformation economies and in developing countries. With high levels of unemployment and poverty, there is a strong need to promote economic development. Since the 1980s, the multilateral institutions that were the main advocates of the Washington Consensus have discouraged discretionary, targeted approaches to promote economic development, such as industrial policy, and emphasised the importance of creating a stable macro-economic framework and functioning markets.

However, this was not sufficient to unleash entrepreneurial dynamism to the extent that was needed to create a satisfactory level of employment.<sup>1</sup> The experience of the 1990s reinforced the observation that active measures are necessary to promote economic development in low- and middle-income economies.<sup>2</sup>

From this perspective, LED is a pragmatic response to a visible need. More specifically, LED is usually pursued for one or more of the following reasons:

- Local decision makers try to promote economic development to raise their legitimacy with the local electorate, and possibly to improve the income stream for local government;
- National and provincial governments encourage local initiatives since they have neither the information nor the skills and funds to promote active economic development initiatives;
- In some countries, LED has become a mandatory task of local government as part of an extensive decentralisation effort;
- From the perspective of foreign donor organisations, LED is an established practice with a long tradition in their home countries, and there is no doubt that LED is one of the important tasks of local government.

So LED is not only popular because it permits pro-active economic development initiatives that fly below the radar screen of the neo-liberal critics of active government. There also seem to be good reasons to justify it. However, it is not that LED is beyond any doubt. Looking at the experience of industrialised countries, there is surprisingly little evidence of the effectiveness of LED, not to mention its efficiency.<sup>3</sup> Evidence from Latin America indicates that while

there has been a huge effort around LED, especially since the 1990s, the evidence of significant impacts is very limited.<sup>4</sup>

Moreover, there are a number of dilemmas and paradoxes around LED in an era of economic globalisation.<sup>5</sup> Thus, it is legitimate to ask whether introducing LED is worth the time and effort. In this paper, we will address this question by looking at the conceptual issues that underlie the prevailing approaches to LED.

### The Orthodox Approach to LED

What is local economic development? The World Bank suggests the following definition:

Local Economic Development (LED) is the process by which public, business and nongovernmental sector partners work collectively to create better conditions for economic growth and employment generation. The aim is to improve the quality of life for all.<sup>6</sup>

UN-HABITAT uses the following definition:

Local economic development (LED) is a participatory process where local people from all sectors work together to stimulate local commercial activity resulting in a resilient and sustainable economy. It is a tool to help create decent jobs and improve the quality of life for everyone, including the poor and marginalized.<sup>7</sup>

To stimulate LED, various organisations have developed methodologies that guide the design and delivery of LED projects. Though they vary with respect to many details, they share a basic paradigm. All of them are based on the assumption that an LED process needs to be based on careful and detailed planning. The orthodox approach to LED is a planning-driven approach. What do the details of the orthodox approach to introduce LED look like? Let us start by having a look at the World Bank's 'Primer on Local Economic Development'. It states:

Good practice indicates that local economic development should always begin with the formulation of a strategy. A LED strategy is a critical component of any community's planning process. Ideally a LED strategy should form a component of a broader community-wide strategic plan for development, with LED providing a focus on strengthening the local economy. The time horizon for a LED strategy is typically five to ten years with associated short, medium and longer-term deliverables.<sup>8</sup>

Moreover, the Primer suggests that a local economic development strategic planning process typically has five stages: organising the effort; doing the local economy assessment; and then creating, implementing and reviewing the LED strategy.

Stage 1 involves a mobilisation of local stakeholders and the creation of partnerships between public and private sectors and other parts of local society. At stage 2 a

SWOT analysis of the local economy is conducted. Stage 3 involves the elaboration of a comprehensive planning document that balances economic development with environmental and social needs. Stage 4 is based on a plan:

The implementation plan lays out budgetary, human resource and institutional and procedural implications of implementing the LED strategy. It is thus the point of integration of all projects and programs within a LED strategy. The action plan lays out a hierarchy of tasks, responsible parties, realistic time tables, human resource and financial needs, sources of funding, expected impacts, results, performance measures and systems for evaluating progress for each project.

Some projects will be 'quick wins' that can be implemented in the short term and play an important role in building momentum and trust. Others will be medium to long term. In each case, projects should be 'championed' by individuals or group of stakeholders according to interests, resources and commitment.<sup>9</sup>

Stage 5 involves an annual review of development strategy and action plan. This approach to LED is informed by experiences with urban planning in industrialised countries, especially in old industrial regions that are battling with the decline of their traditional industrial base; the repeated reference to brownfield reclamation bears witness to this. The suggested approach tries to transplant the proven approach with big urban development projects (such as a waterfront development) to LED. It ascribes a leading role to government, yet emphasises the importance of the engagement with other stakeholders. The time horizon is long term.

UN-HABITAT's manual is explicitly titled 'Strategic planning for local economic development', and the first lines of the foreword read "Strategic planning for local economic development is important. It is a cornerstone of sustainable development. It involves wise resource use, integrating values and thinking ahead".<sup>10</sup> Strategic planning for LED in this perspective involves an iterative 10-step-process, pursuing four basic questions: Where are we now? Where do we want to go? How do we get there? Have we arrived?

UN-HABITAT's approach also includes a catalogue of 30 typical practical LED activities.<sup>11</sup> Not surprisingly, given that UN-HABITAT "is mandated by the UN General Assembly to promote socially and environmentally sustainable towns and cities with the goal of providing adequate shelter for all", this approach is also primarily informed by urban planning concepts.<sup>12</sup> However, whereas the World Bank approach to some extent reflects experience from industrialised countries, and especially declining regions, UN-HABITAT's approach is based on experience in developing and transformation countries.

The ECOLOC approach, in turn, was developed by the Club du Sahel and Organisation for Economic Cooperation and Development (OECD), based on experience in francophone Western African countries. Reflecting this reality, it has a strong focus on the interrelationship between urban centres and their rural hinterland. The first phase involves research, while the ground is

prepared for the mobilisation of local stakeholders, which is the main focus of the second phase. Once that is achieved, the third phase of practical activities can start. The main focus of the written documents on ECOLOC, though, is on research methodologies.

Another international organisation that supports the introduction of LED is the International Labour Organisation. Its LED approach involves the following steps:

- Territorial diagnosis and institutional mapping;
- Sensitising;
- Creation of a local forum;
- Design of a LED strategy;
- Coordination/creation of implementation structures;
- Implementation of the LED strategy.<sup>13</sup>

The distinguishing feature of the ILO approach is the creation of implementation structures, i.e. the setting up of local economic development agencies (LEDAs). Another ILO document summarises the features of a LEDA:

LEDAs have their own legal structure and functional autonomy. They are recognised under private law, and their legal form permits participation of local actors from both the public sector (local administrations, decentralised parts of the national government, services) and the private sphere (associations, chambers of commerce, trade unions, producers' organisations, banks).

They are non-profit associations. They bundle together a series of traditionally separate services: financial services, technical assistance, training of potential entrepreneurs, territorial services such as marketing and business support.

Autonomy enables an agency to be simultaneously an institutional entity that plays a role in the local and national political picture, a contractual entity with independent access to funding, to subcontracts and services, to national and international programmes; and an administrative entity able to implement projects and provide services and credit in a simple, non-bureaucratic manner.

Mixed public-private participation and private administrative status have proved to be factors of success. The participation of public institutions and administrations gives the agencies political, institutional and programmatic links with the various institutional expressions of the State at all levels. Representatives of civil society enable them to respond in a practical and adequate fashion to the needs of the population. Finally, the private nature of their management makes for streamlined operations.<sup>14</sup>

### The Problems of the Orthodox Approach

The common thread of the different approaches can be summarised as follows: LED is driven by government, yet needs the involvement of the private sector and civil society. It should be based on participatory processes and a

comprehensive effort in stakeholder consultation. An LED initiative needs to be based on a profound investigation of the local economy. LED also needs a strategy, in the sense of a written document (or in the terminology of Henry Mintzberg, "Strategy as plan"<sup>15</sup>), as well as an institutional basis – an LED section in local government or a LEDA, a business association, and a stakeholder forum.

The orthodox approach to LED is primarily informed by good practice in urban planning and development. Urban planning and development is – in most countries – a mandatory task of government. The governance structure in urban planning is straightforward: local government takes the guiding role in designing and implementing the overall approach. Implementation of individual projects is left to private investors; however, in an ideal world their freedom of action is circumscribed by government-defined design and quality principles.

Urban planning is based on masterplans which describe the final result of urban development, even if full implementation of a given programme may be ten or more years down the road. Urban planning results in blueprints and detailed planning documents that define

**LED is the process by which public, business and nongovernmental sector partners work collectively ... to improve the quality of life for all**

activities for a number of years to come. Urban planning leads, first of all, to built structures. These built structures create latitude and limits for social structures and processes. Yet it is neither the purpose nor the ambition of urban planning to shape social structures in any detailed way.

Urban planning and development, especially in developing countries, has seen significant change since the 1990s, stimulated by a fundamental critique of government and planner-driven approaches.<sup>16</sup> Thus, promoting participatory approaches to urban planning, involving various stakeholders and local communities, is good practice in urban development nowadays. However, we will argue that the transplantation of urban development good practice to local economic development is flawed. We look at two issues, namely the role of government and the role of markets.

### Government and governance

The orthodox approach ascribes the leading and central role in LED to government:

A strong argument can be made that the local government should play a leadership role throughout the planning process, ultimately giving final endorsement of the strategy. Why? First, a democratically elected local government is accountable to its citizens, therefore they are in a position to add legitimacy to the LED strategy. Second, the local government is

involved in developing complementary and competing plans for development, and they are better positioned to integrate these plans, including social and environmental objectives.

Third, the local government is already deeply involved in local business activity as suppliers of infrastructure, as tax collectors and as regulators of land, buildings and activities. The increasing trend towards decentralization and local governance underlies the crucial role of local government. A final argument for the local governments to take a leading role is the global consensus and commitment by national governments on poverty reduction as expressed in the millennium development goals and the poverty reduction strategies (PRS) being promoted by the World Bank and other development partners. The implementation of a PRS is questionable without a visible leadership and mobilization role by local governments.<sup>17</sup>

This kind of approach has been criticised by Pritchett and Woolcock. They point out that the implementation of development programmes in developing countries has for decades been based on the assumption that government consists of highly professional, competent and ethical Weberian bureaucracies, which more often than not is an unrealistic assumption.

A standard approach has been tried again and again, sometimes successfully, often failing, which ascribed the main role to government: “need as the problem, supply as the solution, civil service as the instrument”.<sup>18</sup> There have been specific problems that could effectively be addressed in this way, such as mass vaccination against polio.

Pritchett and Woolcock suggest a simple matrix to distinguish key public services. Before we look at it, let us address the term ‘key service’: “Key services are those for which there is a broad consensus that some type of government action is necessary, desirable, and/or inevitable”.<sup>19</sup> More often than not, spatial planning and urban planning are ‘key services’ in this sense. Things are different when it comes to LED. It is not rare to find that

## A democratically elected local government is accountable to its citizens ... and is in a position to add legitimacy to the LED strategy

companies consistently ask for government not to interfere at all in the business sphere, especially not with so-called promotional activities.

Let us come back to the matrix. Its two axes are ‘transaction intensive’ and ‘discretionary’:

Services are discretionary to the extent that their delivery requires decisions by providers to be made on the basis of information that is important but inherently imperfectly specified and incomplete, thereby rendering them unable to be mechanized. As

such, these decisions usually entail extensive professional ... or informal context-specific knowledge.

Transaction intensiveness refers simply to the extent to which the delivery of a service (or an element of a service) requires a large number of transactions, nearly always involving some face-to-face contact.<sup>20</sup>

The resulting matrix looks like this:

	<b>Discretionary</b>	<b>Non-discretionary</b>
Transaction intensive	Practice	Programmes (e.g. vaccinating children against polio)
Non-transaction intensive	Policies (e.g. changing the lead interest rate)	(Procedures, rules)

Pritchett and Woolcock argue that

the provision of those elements of services which are (more or less) discretionary and transaction intensive – ‘practices’ – provide the biggest headache for even the most astute and well-intentioned practitioners, because they are intrinsically incompatible with the logic and imperatives of large-scale, routinized, administrative control.<sup>21</sup>

Where would urban planning and LED figure in the matrix? We argue that urban planning fits into the ‘policies’ quadrant – it is discretionary, but not really transaction intensive; the transaction intensive part comes later, when building permits have to be granted, but that should be non-discretionary. LED, on the other hand, fits squarely into the ‘practice’ quadrant. LED is highly discretionary, i.e. does not involve standardised service delivery. And it is transaction intensive, since it involves ongoing communication and negotiation between various stakeholders – something that all the proponents of the orthodox approach point out in their reference to the need for participatory approaches.

Following the argument of Pritchett and Woolcock, one would thus expect government to battle with the delivery of effective LED. From this angle, the unconvincing track record of government and planning-driven LED is no surprise at all. Ultimately, it is unlikely that LED with government in the driver’s seat can be successful.

Pritchett and Woolcock point at three typical responses to the problem. First, there is intensification, i.e. more of the same, only better and smarter. Second, there is amputation, i.e. getting government out of it altogether. Third, there is policy reform: “continue with the types of reforms that can be implemented by ‘10 smart people’”.<sup>22</sup> They argue that all three responses have failed. ‘Amputation’ might appear to be the obvious response to the failure of LED. However, the result would most likely be no LED at all. Though there are examples of LED that was driven by the private sector, most notably in the by now legendary industrial districts in Italy, most of the available evidence points at the fact that the private sector alone is unlikely to develop a sustained effort of



*Promoting local economic development (LED) has become a growth sector in the international technical assistance industry, both in transformation economies and in developing countries - but is it effective or efficient? (Pic: Guy Stubbs)*

locational upgrading. There is a role for government in LED, both with respect to addressing market failure and introducing a strategic perspective that goes beyond the short-term planning horizon of most businesses, especially small enterprises.

Pritchett and Woolcock describe a set of measures to get out of this conundrum, including decentralisation and the participatory approach. Both responses are highly relevant in our context. Decentralisation is one of the *raison d'être* of LED in the first place, and all orthodox approaches to LED advocate participatory processes. The problem is, though, that there are problems linked to decentralisation and participation.

The main problem is that decentralisation of responsibilities is not necessarily accompanied by decentralisation of funds or of taxation. The problem is that local authorities in recently decentralising countries tend to be overwhelmed with new responsibilities, but are underfunded. Both in developing and transformation countries, local authorities tend to focus on immediate, pressing problems, such as lack of physical infrastructure and inadequate social infrastructure.

LED typically costs money, if only for the training courses of local officials and for the consultants who are invariably hired to elaborate the strategic LED plan. However, more often than not no money is left for these activities. LED takes a backseat, since it does not appear as a quick-fix. In fact, the 'strategic' approaches reinforce this perception since they emphasise the need of lengthy mobilisation, research and planning processes before any payback can be expected.

Things are even less appealing in places where local government does not have any tax authority. It is not too difficult to 'sell' the idea of LED to local government by pointing at the increased tax revenue from a more vibrant local business sector. However, if this link does not exist, LED is a very hard sell. But even if local governments are willing to undertake LED, it is by no means certain that they possess the communicative and organisational skills necessary to deliver in an effective way.

Regarding participation, doubts with respect to its effectiveness have increasingly been voiced as participatory approaches moved into the mainstream. Radical academics have denounced participation as a new tyranny,

yet this is a critique that has been refuted.<sup>23</sup> But there are serious issues that participatory approaches are battling with. First, there is the limited attention to power imbalances and elite capture. Platteau has pointed this out as one of the main challenges of decentralised approaches that are supposedly participatory, yet do not have in-built mechanisms to empower those citizens dominated by local elites.<sup>24</sup>

Second, there is the legitimacy problem. Manor argues that “user committees”, i.e. the organisational outcome of participatory approaches, create serious trouble. In his view,

proliferating single-purpose committees are undermining the democratic processes that were presumably institutionalised with the creation and strengthening of elected local governments in Third World countries. This new approach fragments local participation, reducing its coherence and effectiveness; the poor may even be worse off than before. These committees appear to usurp local government functions and deprive local governments of revenues. These myriad problems result in destructive conflicts and the undermining of local government authority.<sup>25</sup>

We argue that LED fora, committees and similar bodies that are recommended by the orthodox approaches to LED suffer from the same problems. They have an unclear mandate, they create inconsistent and unrealistic expectations, and they lead to frustration and cynicism among local stakeholders regarding LED.

Looking at participation from a governance theory perspective, there is yet another problem. The linking of orthodox LED approaches to participation not only reflects the mainstreaming of participation in development, but also experiences in industrialised countries, where governance patterns have evolved from hierarchic to network structures.

But to what extent is this experience relevant for developing and transformation countries? Let us address this question by looking at the term ‘governance’. Governance is an analytical category that has been created to address a changed reality. Governance and networks are key categories in a context where a state that is pursuing the common good needs to closely interact with societal actors to solve problems.

The term ‘cooperative state’ has been created to describe a reality where “the clear distinction between who governs and who is being governed is disappearing”.<sup>26</sup> Renate Mayntz defines governance as follows, referring to a number of political science subdisciplines:

In international relations, governance is a term that describes a pattern of power structures without an overarching sovereign power. The term was adopted by policy research as it fits the specifics of the ‘cooperative state’, i.e. political rule that is based on strong involvement of civil society actors. In both fields, there is no clear distinction between the governing subject and the governed object, because the addressees of

governance are actively involved in the design of rules and their implementation. Looking at a national state, governance thus covers the various different patterns in which issues are ruled and coordinated in the society: from institutionalised self-rule of civil society actors to various types of collaboration between governmental and non-governmental actors to the sovereign acts of government.<sup>27</sup>

In industrialised countries, governance, and more specifically network governance, is an empirical fact. However, it is important to note that governance addresses a pattern where government action pursues problem-solving. As Mayntz has noted elsewhere, this perspective tends to lose sight of other goals of political actors, in particular maximising power for its own sake, as well as securing privileges and serving special interests.<sup>28</sup> The governance discussion emerged from the effort not only to find an adequate description of the political reality in industrialised countries but also to create a sound basis for policy advice.

In OECD countries, successful territorial development is based on policy networks that consist of various government agencies, the private sector, trade unions, NGOs, and other players. This pattern is linked to the more general emergence of policy networks as the predominant governance pattern. But it also has a more specific reason. LED is only rarely a mandatory role of government. In most countries, LED is a voluntary activity driven by the need of local political actors to improve legitimacy with their constituencies. LED is not an activity where government can enforce compliance. It is inconceivable that, say, the local business chamber is fined because its delegate does not show up at an LED meeting. Network governance is the only way to govern LED.

Unfortunately, in many developing and transformation countries, governance and network governance is not an empirical fact but a normative concept. For instance, looking at Latin America, Haldenwang notes that “political systems in Latin America often feature a lack of focus on the common good”; many regimes have battled with the effort to improve governance.<sup>29</sup>

Corruption, the absence of rule of law, non-transparent decision-making processes, and underdeveloped public services in many countries continue to undermine the

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trust of citizens in their democratic order. In patrimonial societies and in countries whose political system is characterised by clientelism and nepotism, the predominant goal of government is not problem-solving. Without a clear focus at problem-solving, the main reason for the emergence of network governance is missing.

We cannot readily assume that government in developing and transformation countries is predominantly of

the problem-solving variety. States in these countries, while formally democratic, are often of the patrimonial, nepotist, clientelist or paternalist variety. For quite a while, the discussion on the state in these countries has highlighted the need for 'good governance'. The extent to which these states have made progress towards 'good governance' since the 1990s is being debated in the academic literature.

There is no question that state reforms have been going on, often including massive decentralisation processes. Decentralisation is one of the main reasons why LED has come onto the agenda in developing and transformation countries in the first place. However, decentralisation has not necessarily led to the creation of truly democratic, participatory, bottom-up decision making processes. Often, the result has rather been the decentralisation of patrimonialism, nepotism, clientelism and paternalism, not to mention corruption.<sup>30</sup>

This creates a local context where politics affect LED efforts in a different way than they do in industrialised countries. Local governance for LED is frequently not of the network variety, involving various actors, but rather dominated by government, in particular elected officials in executive positions who leverage LED to further their political ambitions and careers.

LED is not driven by a problem-solving orientation but rather follows a political logic of power accumulation. The problem for LED initiatives is not only, as some authors point out, the lack of social capital. The problem lies deeper, rooted in a political structure that is oriented towards specific interests and does not care much about the common good. This issue is not only a local government issue, as LED initiatives driven by the private sector are often about promoting the brand of the firm or protecting the short-term interests and gains of the private sector.

### Market failure and market development

One of the main differences between urban development and LED is this: Urban development is usually a mandatory task of government. LED, defined as business promotion and development, is usually not mandatory. Business development is a voluntary task of government, and it is a task that has seen a paradigm shift in terms of delivery.

For many years and in most developing countries, government was seen as the main provider of business development services to small enterprises. The form of these services varied from place to place, but were often subsidised and supply driven rather than demand driven and commercial.

Even in the First World, government provided subsidised BDS services through state-funded organisations like Scottish Enterprise in Scotland or the Manufacturing Extension Programme in the United States. Often small enterprise support programmes in developing countries were funded by international aid organisations. Although there were exceptions to the rule, most of the state-driven

enterprise promotion programmes did not yield the desired economical and social benefits and often collapsed when donors withdrew or shifted their attention elsewhere.<sup>31</sup>

In the 1990s, evidence mounted to show that the functioning and innovation of existing service markets were often undermined by the provision of subsidised services. Hitchins *et al* explain that existing private sector providers of BDS were often "crowded out" by government or NGO suppliers.<sup>32</sup> Hileman and Tanburn observe that until the mid-1990s small enterprise development practitioners were convinced that state-subsidised business development services should be provided directly to small businesses.<sup>33</sup>

## Decentralisation has not necessarily led to the creation of truly democratic, participatory, bottom-up decision making processes

During the 1990s there was a growing global realisation that governments tend to be poor developers of business and are also not the most suitable delivery vehicles for small enterprise development in terms of reach, impact and sustainability.<sup>34</sup> The realisation that current approaches were unsustainable and not achieving the desired results led to the Committee of Donor Agencies for Small Enterprise Development being tasked to compare experiences between various donor agencies and to establish best practices in small enterprise promotion and the reasons for failure. The committee published its findings in 1996 in a publication called *Business Development Services for Small Enterprises: Principles for Donor Intervention*, also sometimes referred to as the Donor Blue Book. This evolution in thinking of the donor community followed a trajectory similar to the one which took place in the micro-finance sector just a few years earlier.

The Donor Guidelines provide the following definition of BDS: "services that improve the performance of the enterprise, its access to markets, and its ability to compete".<sup>35</sup> Business development services (BDS) are services that improve the performance of the enterprise, its access to markets, and its ability to compete. This includes a wide range of strategic and operational services, such as business advice and mentoring, production advice and quality certification services.

In the original definition of BDS it was decided to exclude financial services, a decision that was hotly debated for many years. Recently the international community has relaxed its view on whether financial services are part of BDS or not and has shifted its attention to the development of practical approaches to stimulating the demand and supply for BDS in a market context.

Businesses depend on services for a variety of reasons that depend on the nature and the size of the firm. Large firms often use professional business services to gain a competitive edge, or to gain access to specific expertise (e.g. marketing expertise). Small firms often use business

services to make up for areas of weakness, or to overcome specific problems (e.g. accounting services). Bear et al explain that although many practitioners still believe that direct intervention is needed in some cases, there is a worldwide shift towards more systematic interventions concentrating on making service markets work for small enterprises and the poor.<sup>36</sup>

The publication of the Donor Guidelines created a paradigm shift away from direct provision of services to business by governments, donors and NGOs towards the establishment of well-functioning service markets that provided a diverse array of commercially viable business services to enterprises.<sup>37</sup>

The core logic of the BDS market development approach is about addressing causes (rather than symptoms) of underdevelopment. Whereas conventional SME development interventions ask, “what problems does business have and how can I help to solve these?” the market development approach asks, “what problems do businesses have and why isn’t the market environment providing solutions to these?”<sup>38</sup> Bear et al conclude that if the one is about why the business isn’t working then the other is about why the market isn’t working. This conclusion leads to the argument that BDS market development is about systemic change that leads to large-scale meaningful impact.

Bear et al propose that a detailed understanding of markets will shape interventions in two particular ways:

- Assessment of existing market situations, especially to identify underlying constraints, forms a starting point for intervention (answering the question – “what is the current situation?”)
- Developing a detailed picture of how a market might work more effectively in the future – a picture of sustainability – sets a target for an intervention (“What could be?”).<sup>39</sup>

The authors explain that many critical features of functioning markets – information, incentives, values and standards – are determined at a local level. They continue: “the implication here is clear: market economies (and BDS markets within these) only function well when they are embedded in a local context; any comprehensive view of a BDS market must understand this to provide insight into the underlying reasons for market performance and into the capacity for change”.<sup>40</sup>

In a local context, stakeholders are often concerned with the competitiveness of small firms or sub-sectors. Often analysis of a local sub-sector or value chain leads to the identification of obstacles or issues that can be addressed by the provision of commercial business services. Traditionally these obstacles would have been addressed by the formation of an institution or a development agency, but under the market development paradigm the thinking shifts towards a more systemic solution. Lusby and Panlibuton suggest that many problems or obstacles in sub-sectors can be addressed by the provision of commercially viable solutions, often in the form of services.<sup>41</sup>

Hitchins proposes that small enterprise development solutions should move beyond the supply and consump-

tion of services towards the sustained functioning of markets. He suggests that solutions should consider the role of various role players (both public and private), the functions provided and the payment mechanisms involved and the wider context of the market.<sup>42</sup>

Against this background, government’s role in LED is radically different from its role in urban planning. In terms of basic coordination patterns, urban planning involves hierarchy and LED the market. In urban planning, government is the centre of coordination, responsible for the delivery of good urban planning.

In LED, local government should not repeat errors committed by central governments of the past, substituting or distorting the market by becoming a direct provider of BDS or the provider of solutions to business. The key role of local government is to understand market failure and find ways to remedy it. Often the remedy will be in raising awareness about certain obstacles or opportunities but not directly intervening.

### **Alternative Approaches: Conceptualising LED as an evolutionary process**

Evolutionary concepts of economic development argue that economies are not moving from one state of equilibrium to the next, but rather evolve in idiosyncratic ways.<sup>43</sup> Economic actors do not behave in rational ways but rather in a path-dependent manner; the rules that served them well enough yesterday will also guide their behaviour today, with incremental adaptations. Economic development evolves along trajectories, to some extent shaped by coincidence, but more importantly they are the result of cumulative learning-by-doing and learning-by-interacting. This does not only apply to companies but also to much larger aggregates.

Kay observes that the transfer of concepts regarding institutions from developed to developing countries has also failed, since most of these institutions require an evolution rather than an intervention to be relevant and sustainable.<sup>44</sup> Often the result of the evolution (the institution) is copied to a developing country without much consideration for the process that lead to the creation of the institution.

Why is this evolutionary economics relevant for LED? First, we posit that the evolutionary perspective is a more adequate description of economic reality than the neo-classical view, especially since local economies are full of market failure and other idiosyncracies. Second, just like the economic evolution of industrial sectors is driven by the learning processes and innovative behaviour of companies, the economic evolution of territories is driven by learning processes and innovative behaviour not only of the companies based in that territory but also the actions of other actors who, intentionally or not, contribute to an explicit or implicit collective effort to build a territorial competitive advantage.

LED is to a large extent about learning – not only how to produce better products, and produce them in a more efficient way. LED is also about various local stakeholders learning about each other’s existence and goals, learning about the structure and evolutionary pattern of the local



economy, learning about opportunities to stimulate upgrading in the local economy, and the tools necessary to do that.<sup>45</sup>

### Sequencing of LED initiatives

Evolutionary thinking is crucial for the conceptualisation of the sequencing of LED initiatives. There are two dimensions to the sequencing of LED. The first is LED as radical innovation: In many developing and transformation countries, local governments do not have past experience in LED. It was due to decentralisation processes since the 1990s that LED became a task of local government. For them, LED is a radical innovation. They will tend to cope with this radical innovation in a Schumpeterian way, i.e. by recombination. They will take existing institutions and procedures and try to combine them in a new way to address LED.

This approach involves a high degree of risk if inadequate institutions and procedures are used; the transfer of institutions and procedures from urban planning is a case in point. The orthodox approach often involves attempts at co-ordination and control and requires large amounts of resources to manage the process. Local stakeholders are often spectators while a small team drives the process using a 'mandate'. Rather than suggesting a one-size-fits-all methodological approach, from an evolutionary perspective one would recommend setting the stage and defining the boundaries for a learning process.

Secondly, LED as incremental innovation: In locations with a certain degree of experience in LED, there will be constant incremental innovation, i.e. new activities that respond to new challenges or opportunities. In this kind of setting, the main challenge is to introduce mechanisms that stimulate constant reflection and adjustment. The connectivity and discussion between various local stakeholders becomes a priority.

Instead of trying to define a common vision, and coordinate everybody's activities, attention is focused on joint analysis, innovation and reaching a joint understanding of the real issues at hand. In this approach to LED the idea is to get various stakeholders, competitors and institutions involved in separate but often related upgrading activities.

Social networking, interaction and discussion are often the main activities, which are less visible than a planning approach. Instead of focusing the attention on one or several flagship projects, efforts are targeted at several common themes or issues, for example the creation of a local comparative advantage or the improved interaction between a cluster of firms. This may be accompanied by several longer term projects, but in most cases there are several parallel improvement processes.

Planners and politicians are often uncomfortable with this approach because it appears to be risky, uncontrolled and uncoordinated. In many cases success is not dependent on the abilities of politicians, but is dependent on 'out of the box' thinking of business people, bureaucrats and associations. Pragmatic individuals and entrepreneurs thrive in this kind of environment. There are examples of

visionary planners and politicians that have adopted this kind of approach.

The previous section may make it sound as if one approach is better than the other, but in fact it is more an issue of sequencing. This would require that local stakeholders first embark on an open-minded learning process that may lead to radical innovation. The learning process will lay a strong foundation and mutual understanding for the radical change that is required. At a certain stage, after learning, institution-building and the creation of social capital, local stakeholders will usually target more ambitious activities which necessarily involve a comprehensive planning effort.

### Content of LED initiatives

Why is it that territorial development appears to be so driven by fads? Fiscal incentives, special economic zones, technology incubators, cluster promotion and other trends come and go, and often they do not make much difference.<sup>46</sup> To some extent this phenomenon is driven by the public sector variety of the "innovator's dilemma".<sup>47</sup> To the extent that LED activities involve local government, there will be resistance to radical innovation, i.e. using a tool that has not shown its efficacy in a number of other places. Since their political opponents are constantly on the prowl for ammunition, politicians in charge will usually avoid anything that is not tested and thus risky and unpredictable. That is the reason why decision makers

**Getting quick wins in an efficient way makes resources available for catalytic projects, i.e. interventions that make a difference in the long term**

prefer to copy approaches and tools that have been successfully employed elsewhere.

Underlying an imitation-driven approach to LED is the misconception that there are silver bullets. The most promising approach to LED is not guided by a belief in silver bullets but rather the insight that for successful LED two elements need to be combined, namely an effort to remedy market and government failure and a light touch.

The evolution of entrepreneurship and the growth of the local economy is usually to a significant extent due to market failure. Barriers to entry due to anti-competitive behaviour, lack of information and market intelligence, indivisibilities and other factors, deter potential entrepreneurs and hamper the growth of existing companies. Unclear property rights imply, among other things, a lack of access to capital. In successful locations, LED has a strong focus on market failure. Networking events address information failure, while collective action and associations address free riding. Inter-company collaboration addresses issues of indivisibility and lack of scale.

In many locations, local government is creating all sorts of obstacles to business; its business promotion activities do not even start to compensate for that, never mind

that they lack credibility. Cumbersome registration and permit processes place high transaction and opportunity costs on business, and they effectively create an incentive to stay informal, a factor that creates an additional obstacle to business cooperation and collective action. Addressing government failure, i.e. making government more efficient and business-friendly, has become a key element in LED.

Moreover, it is essential that LED interventions address the cause of a problem rather than its symptoms. In this way, problems are fixed for good so that LED actors can move on to the next issue without running out of capacity, time and money. Remedying a market failure such as a specific barrier to entry instead of endlessly running a subsidy programme to compensate for the effects of the market failure would be a typical example.

A light touch is the opposite of a heavy-handed approach. The orthodox approach tends to put a massive burden not only on local government but also on various other stakeholders, for instance in terms of the time they have to spend in workshops and meetings. The light touch principle suggests that LED is preferably done through brief and focused interventions by the stakeholders closest to the problem or solution. In this manner, learning and innovation become central and stimulates local experience in solving problems and exploring opportunities.

A significant part of LED consists of quick-win activities that may appear trivial and unspectacular. But over time they add up and make a location a much better place to do business. Focusing on quick-win activities reinforces the motivation of the actors involved and builds social capital.

Getting quick wins in an efficient way makes resources available for catalytic projects, i.e. interventions that make a difference for the local economy in the long term. This does not imply that there is no space for more structured or planned interventions, as most interventions that require funding need some level of planning. The emphasis is on exploring and exploiting local energy, social capital and resourcefulness, and not on the funding of interventions.

### Strategy vs. strategic plan

Our scepticism with regard to strategic plans must not be confused with a rejection of strategy. In fact, it is crucial for a location to have a strategy. What should be the concept of strategy applied in the context of LED? Mintzberg distinguishes five different concepts of strategy:

- Strategy as plan: consciously intended course of action;
- Strategy as ploy: manoeuvre intended to outwit an opponent or competitor;
- Strategy as pattern: strategy as consistency of behaviour, whether or not intended;
- Strategy as position: strategy is a means of locating an organisation in a competitive market or environment;
- Strategy as perspective: strategy as an ingrained way of perceiving the world.<sup>48</sup>

In our view, concept 3 is most appropriate, particularly in an early phase of LED. During the early phase, the crucial

point is to undertake LED by implementing small, practical projects which immediately improve the environment and opportunities for business, rather than to strategise. Only after local actors have, through the implementation of practical activities, learnt what LED is all about, do the other concepts of strategy become relevant. The next 'p' to become relevant is most likely number 4, i.e. a shared understanding among the relevant stakeholders how to position the own location in the market, i.e. how and where to build a local competitive advantage.

Another way of defining the meaning of strategy at the early stages of LED might relate to systemic competitiveness.<sup>49</sup> With this concept, we argue that the factors determining successful industrial development can be found at four different analytical levels: the micro-level of companies and markets, the meso-level of specific policies and specialised business support organisations, the macro-level of generic economic framework conditions, and the meta-level with slow variables such as the basic economic model, a society's capacity to learn and to adjust, collective memory, and the social status of entrepreneurship.

From this perspective, the orthodox approach to LED mostly focuses on the micro- and meso-level. It is about selecting business sectors to be preferentially promoted, and targeting specific sectors through the creation of dedicated meso-institutions. Opportunity-driven, business-oriented LED, on the other hand, would not bother with this type of micro-management. It would rather address macro- and meta-level factors: remove unnecessary regulatory obstacles, streamline licensing procedures, create a setting which encourages entrepreneurship, and negotiate a consensus about the necessity of doing LED among local stakeholders.

Over time, though, LED needs to move from incremental improvements to catalytic projects. A catalytic project is an intervention that has a strong leverage and/or multiplier effect by addressing a critical market failure, or by creating a strong leverage factor. A catalytic project addresses the root cause of obstacles to development, rather than symptoms.

It unlocks resources and business opportunities. It addresses issues that will not be addressed through business entrepreneurship because the risk is too high, the amortisation period too long or the immediate profit too low. In other words, it addresses market failures that stand in the way of growth. Catalytic projects can have different characteristics and prerequisites:

- Major financial resources needed and hence the requirement for appropriate planning (e.g. investment and infrastructure projects like rehabilitating an abandoned industrial estate into a small business estate);
- High commitment to cooperation needed (e.g. closing niches in skills development, linking BDS providers and SMEs);
- Very specific know-how needed (e.g. certification, standards, R+D connection with SMEs).

A focus on catalytic projects adapts the principles formulated by Rodrik to LED.<sup>50</sup> A location, in particular in a latecomer country or a peripheral region, is unlikely to

move onto a dynamic growth trajectory through market forces alone. Dynamic development requires a certain amount of intervention and coordination.

The identification of catalytic projects does not require a multi-year comprehensive development plan. But it does require an aligned understanding of the strategic intent of a given location, i.e. the relevant stakeholders need to have similar views on the most promising way to create a local competitive advantage.

This does not mean that they have to be taken through a series of workshops until everybody agrees. In

fact, one of the ideas behind the catalytic project approach is that this does not require the lengthy and painful elaboration of a 'consensus'. Instead, the selection of catalytic projects is based on a participatory scenario writing process and prioritisation exercise.

As catalytic projects are implemented, they then pave the way for individual entrepreneurship. The local upgrading process is not based on a detailed blueprint but rather on individual efforts that are aligned but not coordinated in an active way – in other words, a genuine evolutionary process. □

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