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Institutions and the fortunes of territories

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by

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Abstract: Regions and cities face unceasing pressures to adapt in response to processes of globalisation, changes in industrial production, and new patterns of migration and trade. At the same time, the dominant development policies are proving less than capable of providing answers to these challenges. Strategies based on a mix of physical and human capital and technology have not succeeded in dealing with growing territorial inequality and its treacherous economic, social and political consequences. There is thus an urgent need to understand why territorial divergence occurs and why there is what seems to be a growing decline in the returns of public intervention targeting economic development. In search for answers, scholars have turned to the examination of institutions. But despite progress in our grasp of how institutions affect development, crucial knowledge gaps remain. This paper reviews recent progress in our understanding of the role of institutions for development, unveils the most important gaps, and proposes a series of avenues to improve how a better understanding of how institutions shape regional and urban development can lead to more efficient development policies.

Keywords: institutions, government quality, public policies, regions, cities

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The waning role of traditional development policies

Regions and cities have been receiving ever-greater attention as the locus of socio-economic research and, increasingly, as the focus of development practice. Facing unceasing pressures to adapt and change in response to new and uncertain circumstances – including the onset of strong globalisation forces, the spatial re-shifting of industrial production, and new patterns of international migration and trade – territories the world over, as well as the countries and supranational organisations they belong to, have sought to set up development strategies to restructure their economic bases in order to remain both competitive and sustainable.

Most development strategies have been firmly anchored in traditional economic growth theory. According to the dominant theories in economics, economic growth and changes in employment and productivity are the result of a combination of three factors: physical capital, human capital or labour, and innovation. In addition, there is a residual factor or error term, which represents the part behind economic performance that we do not know or cannot explain using the traditional components of physical capital, human capital and innovation. Depending on the chosen approach to economic performance, the weight attributed to each of the components varies. The neoclassical growth strand (Solow, 1956; Swan, 1956) put the emphasis on physical capital. The endogenous growth approach (Romer, 1986: Lucas, 1988) focused on human capital and innovation. In turn, the new economic geography (Krugman, 1991, 2011; Fujita et al., 1999) and urban economics (Glaeser, 2011) stressed the role of agglomeration economies, externalities and density. These three factors – plus agglomeration and density – continue to be the fundamental elements informing theoretical and empirical thinking about economic development policies and, consequently, development strategies across the world often remain anchored in these theoretical frameworks. The European Union's

(EU) Cohesion policy has been no exception. The bulk of cohesion investments have been channelled towards improving infrastructure endowment and accessibility, as well as increasing the availability and quality of human resources, and developing the innovative capacity of individuals and firms across the less developed areas of Europe.

The impact of this type of intervention has been, however, controversial. For some (e.g. Cappelen et al., 2003; Becker et al., 2010, 2018; Pellegrini et al., 2013; Maynou et al., 2014; Ferrara et al., 2017; Cerqua and Pellegrini, 2018; Crescenzi and Giua, 2020), European-wide investment focusing on these three areas of intervention has delivered greater prosperity to those regions that have benefited the most from the policy. For others, in contrast, the returns of European investment on cohesion have been below expectations (Boldrin and Canova, 2001; Dall'erba and Le Gallo, 2008; Mohl and Hagen, 2010) and often conditional on the type of intervention and the characteristics of the receiving region (e.g. Ederveen et al., 2006; Dall'erba and Le Gallo, 2007, 2008; Falk and Sinabell, 2008; Mohl and Hagen, 2010). The stark reality is that while some regions and cities have thrived – frequently becoming highly networked, technology-intensive and creative –, some have endured far bumpier rides, while others have fared much worse and are, in some extreme cases, grappling with strong decline. The presence of highly dynamic winning cities and regions alongside areas that have seen long-term economic decay and are increasingly regarded as places with scarce economic opportunities is creating a 'geography of discontent' (Los et al., 2017; Rodríguez-Pose, 2018; McCann, 2019; Dijkstra et al., 2019). This 'geography of discontent' is currently having significant economic, social and political implications. As indicated by *The Economist* on 17 December 2016, rising subnational inequality "is proving too politically dangerous to ignore". Hence, understanding why these divergences occur is one of the principal dilemmas confronting the social sciences today: why do seemingly identical or very similar regions and cities sometimes perform so differently? Or, put in another way, what are the key factors that affect the economic fortunes of territories?

This paper will look at why our theoretical toolbox is increasingly failing when trying to explain the economic trajectories of regions and cities and how a greater focus on how institutions, governance and government quality shape economic activity may not only allow us to explain better the differences in the economic performances of territories, but also provide the basis for a sounder and more efficient development policy at subnational level.

In order to do that, I will first look at the 'problem', namely why are we struggling to adequately comprehend the diverse economic trajectories of cities and regions. Then I will identify what I consider to be a number of critical gaps in our knowledge, before turning to the analysis of institutions as a potential solution to the 'problem'. The penultimate section of the paper will outline potential ways forward in order to improve both our understanding of what triggers economic development as well as the design, delivery and implementation of development policies. The conclusions are presented in final section.

The 'problem'

If scientific research has struggled to properly understand why some territories fail while others thrive, the answer may lay in the deficiencies in our theoretical toolbox and how they have affected development policy interventions in cities and regions. In recent years it has become increasingly clear that we are witnessing a decline in the returns of intervention in the three traditional main growth axes. There is, for example, concern about a potential exhaustion of additional investments in transport infrastructure and of improvements in accessibility as drivers of growth (Crescenzi and Rodríguez-Pose, 2012; Crescenzi et al., 2016). There is also growing scepticism about the viability and returns of investing in technology and innovation in areas that are far away from the technological frontier (Acemoglu et al., 2006; Farole et al., 2011; Filippetti and Peyrache, 2015). Furthermore, distance to the technological frontier may also affect the economic impact of investment in human capital (Vandenbussche et al. 2006; Sterlacchini, 2008; Rodríguez-Pose and Ketterer, 2019). Overall, the combination of physical capital, human capital, and technology explains a waning share of the variation in territorial – regional and urban – development. Economic theories that accounted for differences in development performance relatively well two decades ago are becoming less capable of doing so (Rodríguez-Pose, 2013). The residual factor is growing, meaning that, in spite of substantial improvements in growth theory, methods and data availability, we tend to be able to explain less about what determines the fortunes of territories.

This declining explanatory capacity signals that a key ingredient in the growth and development equation has been missing. Especially at the empirical level, "stubbornly high – and often growing – residuals in growth regressions have encouraged many scholars to look for additional factors that impinge on economic development and growth beyond traditional growth theories" (Rodríguez-Pose, 2013: 1036). Most eyes have turned to the role of institutions, in general, and government quality, in particular, for answers (Charron et al., 2014a). Indeed, according to Rodrik et al. (2004), institutions trump traditional factors such as trade, resource endowments, and geography in their significance and influence on economic development.

However, although the literature concerning the role of institutions for development is becoming more voluminous and transcends numerous academic disciplines, scholarly research is labouring to go beyond the idea that ‘institutions matter’. Hence, how institutions shape economic progress still remains the ‘dark matter’ of economic development (Storper, 2010).

There are several areas where the literature on the links between institutions and development has faced considerable stumbling blocks. First and most importantly, work trying to link institutional quality to economic development has been confronted with the issue that defining institutions is difficult and remains fraught with controversy. Concepts about institutions are subjective when not outright contentious (Rodríguez-Pose, 2013). Second, measuring and operationalising the institutional dimension is problematic for several reasons: a) many different types of institutions are context and geography specific and what is an efficient institutional arrangement in one place may not necessarily work in another (Chang, 2003); b) time also affects the returns of specific institutional arrangements (Storper, 2005); c) institutions and development also tend to be endogenous: good institutions promote development and development, in turn, promotes institutional improvements (Rodrik, 2004; Chang, 2011); and d) institutions are also closely connected to the three other determinants of growth and with innovation and education, in particular (Glaeser et al., 2004). These difficulties make measuring and operationalising institutions, especially at the regional and urban level, particularly problematic.

Despite these notable barriers, considerable progress has been made of late in terms of measuring institutions and their impact at subnational level in different parts of the world (e.g. Beer and Lester, 2015, for Australia; Rodríguez-Pose and Zhang, 2019, 2020 and Wang, 2019, for China), but particularly in Europe. The Quality of Government Institute of the University of Gothenburg has made the largest contribution in this respect. The Quality of Government Institute generated, at the request of the European Commission, a comprehensive subjective quality of government (QoG) index for virtually all regions of Europe (Charron et al., 2011, 2014a, and 2014b). This index has now been produced in three waves: 2010, 2013 and 2017. It became an instant hit since its release, with several researchers resorting to it as the main indicator of institutional quality across regions of Europe.

The common the nominator of most of the studies using this index is that institutional quality is a fundamental factor in explaining not only the economic growth trajectories, but also innovation, productivity or employment across regions of Europe. The consensus is that institutional quality matters, and that it matters a lot (e.g. Ketterer and Rodríguez-Pose, 2018), as an explanation of the divergent economic paths of subnational territories in virtually all economic realms. Public institutions are, according to Morgan (2017: 571), “needed to broker connections and nurture novelty”. More specifically, institutional quality determines the capacity of regions and cities to compete in a more economically integrated world (Annoni and Dijkstra, 2013; Huggins et al., 2014). It drives differences in employment growth and social inclusion (Di Cataldo and Rodríguez-Pose, 2017), as well as in entrepreneurship (Nistotskaya et al., 2015; Huggins and Thompson, 2016; Wyrwich et al., 2016; Audretsch and Belitski, 2017; Fritsch and Wyrwich, 2018) and innovation capacity (Sleuwaegen and Boiardi, 2014; Rodríguez-Pose and Di Cataldo, 2015). Local institutional conditions also determine environmental responses to climate challenges (Halkos et al., 2015) and shape the participation of individuals in politics and policy (Sundström and Wängnerud, 2014). As importantly, on top of the above-mentioned direct effects, differences in institutional quality across subnational territories have weighty indirect implications on the effectiveness of other policies. They, for example, shape the returns of development and/or cohesion intervention (Rodríguez-Pose and Garcilazo, 2015; Glückler and Lenz, 2016), influence the choice of public goods – as, for example, the different types of transport infrastructure investments pursued in different places

(Crescenzi et al., 2016). They also condition the economic impact of political processes, such as decentralisation (Muringani et al., 2019) and determine, to a large extent, how attractive a territory is for potential migrants (Ketterer and Rodríguez-Pose, 2015).

Overall, differences in institutional quality across territories can be considered today as important as – if not more important than – variations in physical and human capital endowments and innovation capacity for the economic development of cities and regions (Rodríguez-Pose and Ketterer, 2019).

Gaps in our knowledge

All this recent work on how institutions and government quality affect development strategies and, consequently, the economic performance of territories represents a substantial progress in our understanding of the role of institutions as shapers of economic development at subnational level and, especially, in lagging areas. However – and in spite of the progress made – this research continues to be highly divided (see, for example, the contrasts in Acemoglu and Johnson's (2005) approach vs. that of Chang (2011) – and remains limited on a number of counts.

First, recent work has generally considered institutional conditions as a static factor. The quality of local institutions is considered to be fundamentally a result of history (Charron and Lapuente, 2013). Institutions are built on decades, if not centuries of history, and, therefore, for many they can hardly be changed through policy intervention. They are path dependent and generally assumed to be a permanent feature of a territory. If the South of Italy has underperformed the rest of the country for now several centuries, it is because of the institutional divergence that took place between the North and the South of Italy in the Middle Ages (Putnam, 1993). Hence, institutions are often regarded as permanent features of a territory that facilitate or impede the adequate development of economic activity. Yet, institutional quality does not always remain still. It can change and, under specific circumstances, the transformation can take place swiftly (Rodríguez-Pose and Storper, 2006), often through processes linked to agency (Grillitsch and Sotarauta, 2019). Many Central and Eastern European countries, cities and regions improved their institutional quality rather rapidly after the fall of communism. Others, by contrast, did not. Despite some exceptions (e.g. Rodríguez-Pose and Ketterer, 2019), the capacity for institutions to change and, accordingly, transform the economic potential of a place has been generally neglected by research to date.

Second, most analyses of the role of institutions on economic development have tended to put the emphasis on formal institutions often at the expense of informal institutions. The rule of law or property rights, for example, have featured prominently in most seminal empirical institutional studies (e.g. Rodrik et al., 2004; Acemoglu and Johnson, 2005), while the interest on informal institutions – such as values, culture, trust, openness, networks, tolerance, diversity, creativity or social capital – has considerably lagged behind. This is something that is difficult to understand, especially as the quality of data on values and social capital has kept on improving in recent decades. The few exceptions in this respect (e.g. Beugelsdijk and Klasing, 2016; Cortinovis et al., 2017; Beugelsdijk et al., 2019) provide interesting insights, but still fall far short of the attention that the role of informal institutions for economic development deserves.

Third, most subnational research has limited itself to establishing whether institutions matter or not for economic development. However, limited attention has been paid to the exact transmission mechanisms through which institutions affect economic outcomes. Hence, we know relatively little about the ways in which different types of formal and informal institutions affect the economic development of cities and regions.

Last but not least, there is still a long way to go in order to transform research on the impact of institutions on economic development at subnational level into effective, evidence-based policies. While there is an increasing recognition of the institutional dimension in development policies and of the importance of mitigating and minimising the potential for institutionally-related failures, there is still considerable scope to both incorporate place-sensitive institutional reforms and capacity-building initiatives into the development strategies themselves, based on more detailed research of the dynamics and mechanisms at play between institutional factors and development outcomes.

Forging ahead with institutions as a way to better understand the fortunes of regions and cities

There is, therefore, a need to address the above shortcomings and provide answers that will not only improve our knowledge of what determines development at subnational level, but also to develop viable policy recommendations for institutional intervention at the urban and regional scale, both in the developed and developing worlds. In particular, there is an urge to dig deeper into four areas that can lead to significant improvements in our understanding of the relationship between local institutions and governments and differences in economic outcomes. These areas are the following:

1. ***The dynamics of institutional change:*** Examining the extent to which institutional change influences regional and urban economic performance, focusing, in particular, on the impact of institutional change in lagging and declining areas, is fundamental for the understanding of economic growth. Yet, either because of lack of sound theoretical foundations, lack of adequate data, or problems in operationalising concepts with existing data, most institutional analysis in the development realm has been confined to a static dimension (Zukauskaite et al., 2017). There is very limited work on how institutional dynamics and institutional change impinge on regional and urban economic development paths, leaving a gap in our understanding of the relationship between institutions and the economic fortunes of regions and cities.

2. ***Formal and informal institutions and economic development:*** One of the most basic divisions in the study of institutions is that between formal and informal institutions. Formal institutions basically relate to the powers, quality and competencies of urban and regional authorities, while informal institutions are concerned with how factors such as values, social capital, trust, tolerance, openness, diversity, work ethic types of territories and creativity affect economic performance at the local level. Much more work has been conducted on the former than on the latter, meaning that there is a need to redress this balance in order to get a more complete picture about how local institutions shape economic performance.

3. ***The institutional mechanisms of economic development:*** Studying in detail the mechanisms through which formal and informal institutions impinge on urban and regional economic performance is more necessary today than ever. The ultimate aim should be – by means of carefully designed, in-depth comparative analysis – finding

institutional regularities contributing to the sustainable success or failure of different types of territories, while, at the same time, unveiling institutional differences that affect and determine the economic performance of cities and regions.

4. ***Incorporating institutions into development policy:*** Finally, work needs to be conducted in a more systematic way to transform existing and future analysis on the role of institutions for economic development into viable policy recommendations that could be used in the design and implementation of territorial development policies. A specific focus needs to be placed on the development of precise and workable policy guidelines to help improve the returns of specific development policies.

Each of these areas are developed in turn in the sections below.

The dynamics of institutional change

Institutions are fundamental for the development of economic activities: they are the rules that govern (North, 1990) and promote (Nelson and Nelson, 2002) human interaction and economic change. Recent research has tended to highlight the fact that institutions matter for economic development, but, most of this research has paid more attention to institutional stability[2] and less to the processes of change (Scott, 2013). Indeed, according to Chang (2011) the dominant views on the link between institutions and development have overlooked the importance of institutional change. Hence, whether institutional change affects the economic performance of cities and regions in Europe and elsewhere remains, to a large extent, underexplored. Do

[2] Ha-Joon Chang (2011) is very critical of the dominant discourse on institutions and economic development, especially regarding the widespread belief that free markets and the protection of private property suffice, from an institutional perspective, to promote economic development. He argues that other institutional dimensions that play a fundamental role on the making of economic activity are being disregarded by mainstream research.

institutional improvements affect economic development at subnational level in any significant way? Do poor institutional endowments represent an unsurmountable barrier for economic development, especially in less developed regions and cities as hinted by past research (e.g. Putnam, 1993)?

Dealing with these questions at subnational level implies far more research than the limited analyses conducted to date (e.g. Rodríguez-Pose and Ketterer, 2019). There is a need to assess whether both the initial levels and the degree of institutional change affect regional and urban economic performance in the same way within countries and across different geographies (e.g. Grillitsch, 2015). Particular emphasis is required to determine how institutions co-evolve (Gong and Hassink, 2019) and how institutional change determines economic performance in lagging regions, those that traditionally have a weaker institutional ecosystem. In this respect it is essential to discriminate between the role played by traditional areas in development policy intervention, such as infrastructure, human capital and innovation, relative to that of different formal and informal institutional aspects, such as corruption, openness, social capital, tolerance, the rule of law, government effectiveness and government accountability. The focus has to fall squarely on changes in all these factors. Moreover, the analysis of the dynamics of institutional change needs to rise above considering regions and cities as uniform. It has to start differentiating between territories, using the whole spectrum of cities and regions, in a way that takes into account their unique characteristics (e.g.: European Commission, 2014).

We need to know more about whether improving institutional quality by either increasing social capital and tolerance, reducing widespread corruption, cultivating human capital and fostering absorptive capacity, or introducing measures aimed at making government decisions more efficient and transparent represents as important a requisite for territorial development at subnational level as conducting more traditional 'hard' types of regional development investments (Malecki, 2012). We also need to know more about what determines the emergence of able and effective local leaders (Beer and Clower, 2014). Future research, therefore, will have to dig deeper into whether measures aimed at reducing the monopoly power of bureaucrats (Rose-Ackerman, 1978; Bardhan, 1997) or creating a more adequate incentive pay structure for public administration (Bardhan, 1997; Tanzi, 1998) pay off; into whether e-government initiatives and a wider use of ICTs in government can also deliver improvements in government efficiency and transparency (Pina et al., 2007); whether cutting red-tape (Håkanson, 2013), as well as measures aimed at increasing the education levels of civil servants can further redress public sector inefficiencies and promote economic growth (Afonso et al., 2010); or whether increasing tolerance and openness triggers economic development (Florida et al., 2008).

We also need to know more about how can different places break out of current practices and improve their institutional conditions. There is often the perception that local institutional conditions are sticky and take a very long time – often centuries – to change, (e.g. Putnam, 1993). This generates an institutional path dependency, resulting in lock-in in a large number of places. However, changes can also take place in relatively short periods. In the European context, for example, the rapid recent improvements of institutions in a country like Estonia strongly contrast with stasis, rigidity, and reluctance to change in Italy. Hence, there is a need to better comprehend the dynamics of change, taking both into account the starting institutional – both formal and informal – conditions as well as the dynamic of different groups within a society and the balance between bonding and bridging relationships. As indicated by Rodríguez-Pose and Storper (2006: 15), "places with strong groups and strong societies will be characterized by institutional arrangements with problem-solving mechanisms that help to resolve tensions and agency problems". Yet, there is a need to know more and the division between institutional environment, which refers to higher levels institutions such as identity or culture, and institutional arrangements, touching place-specific customs and habits (Martin, 2000; Rodríguez-Pose, 2013).

Likewise, appraising whether institutional progress, such as the enactment of public legislation and implementing policy measures aimed at improving the efficiency of government, enhancing voice and accountability, and/or reducing corruption can lead to better public interventions, characterised by a more efficient use of public expenditure, in general, and public investment, in particular (Afonso and Fernandes, 2006), represents a vital avenue for future research. However, this implies acknowledging that institutional bottlenecks are at the heart of development problems and adequately recognising the role played by institutional quality in development (Tanzi, 1998: 587). Institutional quality must then be raised to the rank of a fundamental factor in growth equations, on a par with transport infrastructure, education and training, and technology and innovation. However, as Persson et al. (2013) stress, awareness of the problem alone is not sufficient and an in-depth knowledge of the mechanisms behind institutional change and how it affects urban and regional economic performance is required as an initial step to be able to formulate solid, evidence-based policies.

Formal and informal institutions and economic development

Formal institutions generally refer to institutions that are defined by "transparent and codified rules" (Rodríguez-Pose and Storper, 2006: 2). As such, they are universal, transferable, and determine human interaction (North, 1990; Rodríguez-Pose, 2013). The quality of formal institutions therefore has the potential to significantly affect economic development (Acemolgu and Robinson; 2005; Rodríguez-Pose, 2013; Charron, et al., 2014).

Informal institutions generally refer “to features of group life, such as norms, traditions and social conventions, interpersonal contacts, relationships, and informal networks” (Rodríguez-Pose and Storper, 2006: 1). In the same way as formal institutions, informal institutions can play a central role in determining economic development (e.g. Putnam, 1993; Florida et al., 2008; Duranton et al., 2009; Tabellini, 2010; Rodríguez-Pose, 2013). However, due to difficulties in defining and operationalising informal institutions (Lee, 2017), the research focusing on how informal institutions influence economic performance at subnational level is much more limited than that dealing with formal institutions. While there is no shortage of academic work on issues such as how differences in the power awarded to subnational governments (e.g. Marks et al., 2008; Rodríguez-Pose and Ezcurra, 2011) or in government quality (e.g. Annoni and Dijkstra, 2013; Charron et al., 2014; Nistotskaya et al., 2015; Rodríguez-Pose and Cataldo, 2015; Rodríguez-Pose and Garcilazo, 2015) shape different aspects of subnational competitiveness in Europe, the focus on the role of informal institutions is still mostly absent.

Hence, examining how informal institutions impinge on urban and regional performance at a subnational level would address a fundamental gap in our knowledge. Economic interaction and progress is highly dependent on the specific informal institutional conditions of the context in which the economic activity takes place (Tabellini; 2010, Rodríguez-Pose, 2013; Cortinovis et al., 2017; Lee, 2017). Local levels of diversity, openness, trust and tolerance – among other factors – determine to a large extent what type of economic activity occurs in a specific place and affect its innovativeness, creativity, and productivity (Florida et al., 2008; Kemeny and

Cooke, 2017). Yet, the empirical studies that have aimed to assess the link between informal institutions – from family structures to culture – and economic development at a European level (e.g. Duranton et al., 2009; Tabellini, 2010; Cortinovis et al., 2017) remain scarce. Two types of questions require urgent answers. First of all, to what extent do informal institutions shape urban and regional economic development in Europe? Do they do it in a similar way as formal institutions? Or do they follow different paths? Second, it is crucial to understand how do formal and informal institutions interact in specific subnational territories in order to generate economic development, as formal and informal institutions "are mutually influential in shaping a variety of [economic] outcomes" (Storper, 2014: 117).

Answering these two types of questions requires going well beyond the sort of information available at the moment. New sets of informal institutional variables depicting levels of openness, trust, tolerance, diversity, life satisfaction, work organisation and political participation/activism are needed (Westlund and Adam, 2010). So are more accurate depictions of culture (e.g. Tabellini, 2010) or family structures (e.g. Todd, 1990; Duranton et al., 2009). Progress can be achieved now by combining and aggregating at the subnational level individual micro-data stemming from social and value surveys, such as the different waves of the European Social Survey (ESS), and linking the resulting variables to regional and, wherever possible, urban economic performance (e.g. Działek, 2014; Peiró-Palomino and Tortosa-Ausina, 2015; Weckroth and Kemppainen, 2016; Kaasa, 2016). This would require, at a later stage, combining the formal and informal institutional variables, as a way to determine how the co-existence and co-evolution of different forms of formal and informal institutions in diverse subnational spaces contribute to affect subnational economic outcomes.

The institutional mechanisms of economic development

Understanding the institutional mechanisms behind economic development is another of the black boxes in our basic grasp of institutions. Without being able to unpack how institutions work and what are the intricacies that determine how different institutional structures and arrangements affect how economic actors interact in different contexts, we would not be able transcend the catchphrase that 'institutions matter'. This requires methods that go beyond the quantitative and delve in-depth into thoroughly constructed and comparable qualitative case studies (c.f. Peck and Theodore, 2007; Barnes et al., 2007; Boschma and Frenken, 2015). Understanding these mechanisms and intricacies requires being able to fathom "how institutions are produced, reproduced, and change over time, how these institutions exert their influence over economic life, how these processes unfold at different geographical scales, and the difference that geography makes, then much is to be gained by adopting a comparative approach" (Gertler, 2010: 7). This implies identifying the mechanisms through which a place becomes, for example, the conveyor of the dynamic and entrepreneurial character of the migrant even generations after the migrants have gone or have become integrated in society (Rodríguez-Pose and von Berlepsch, 2014, 2019). We are still far away from reaching this point, in spite of the fact that it has perhaps never been more important to do so than now. In recent decades cities and regions have been subject to colossal forces of change as a result of shifting industrial bases, rampant urbanisation, and more pervasive patterns of migration and trade. Much of the resilience of these cities and regions depends on the quality of their own institutional constructs (Simmie and Martin, 2010; Ezcurra and Rios, 2019).

Yet, although institutions are almost unanimously accepted as a major determinant of development (e.g. Amin and Thrift, 1995; Rodrik et al., 2004, Gertler, 2010; Rodríguez-Pose, 2013), their inner workings still very much remain a mystery. New efforts are needed to bring to the fore the mechanisms at play in this relationship (e.g. Huggins and Thompson, 2015; Dawley et al., 2019; Glückler et al., 2019). Comparative research designs involving case studies are perhaps the most effective way of getting to grips with the linkages between urban and regional growth and the influence of institutions (e.g. Safford, 2009; Storper et al., 2015), direct or otherwise, but require strong theoretical underpinnings to arrive at more generalizable conclusions in lieu of large sample studies.

As such, engaging in detailed and comparative examinations of the institutional – formal and informal – mechanisms behind urban and regional economic change can unlock the key to not just a better understanding of the processes of economic growth and development, but also to a more effective design and implementation of public investment and development policies. Studying why cities and regions with frequently similar starting points diverge over time needs to rise above glossing over data and extracting correlations or even causalities. It requires deep diving into economic, social, political and cultural processes that interact forming complex local ecosystems and yield considerably different economic returns (Storper, 2018). Only in this way could we comprehend why a city like Madrid has steamed ahead of Barcelona in Spain, when the latter had far better initial conditions. Or why the Bay Area, despite having a weaker starting point and deficits in terms of agglomeration and density, has been able to become more dynamic than Los Angeles in the US (Storper et al., 2015). The same could be said for other pairs of cities and regions such as Milan and Rome (Italy), Lisbon and Porto (Portugal), Leeds and Sheffield (UK), Wrocław and Łódź (Poland), Montréal and Toronto (Canada), or La Paz and Santa Cruz (Bolivia), just to mention a few, in the case of cities. There is a similar need to delve into the mechanisms in the cases of Alsace and Lorraine (France), Hesse and Rhineland-Palatinate (Germany), or Arizona and Utah (US), in the case of regions. This would imply checking for each case study and for each case study pairing the relative economic performance of each case over extended time horizons, before exploring the institutional arrangements comprised of complex interactions between public, private and community groups that give rise to the coming together or pulling apart of growth prone or growth averse institutional arrangements. The overall objective would be to extract policy-relevant insights into the formal and informal institutional nature and mechanisms that shape micro-level incentive structures to conduct economic activity at the local level and influence a territory's capacity to adapt and change.

Incorporating institutions into development policy

The final area where significantly more progress could be made would require incorporating the institutional dimension into development policy. Policy-makers are frequently at a loss in understanding how institutional quality determines economic development and their policies are conspicuously devoid of any institutional dimension. This fault lies not with the decision-makers but with the researchers and advisers that have failed to make politicians aware of the salience of institutional quality for economic development. Among decision-makers, there is a growing demand to include the institutional dimension into development strategies. In preparation of this research, a number of decision-makers in international organisations[3] were approached regarding their views about incorporating institutions into development policies. The minimum common the nominator was that there was a thirst to learn about the policy implications of institutional differences and, more significantly for them, how these differences could derive into usable interventions and policies. A high-ranking EU Commission official,

[3] During the preparation for this research 22 international organisation high-ranking officials in the European Commission, the European Investment Bank, the Council of Europe Development Bank, the World Bank, the Cities Alliance, the ILO, the FAO, the OECD, the Inter-American Development Bank, and the Development Bank of Latin America, agreed to give their testimony about the importance of the institutional dimension for their daily policy-making in the development realm. The majority of those approached agreed to give their candid testimony under the condition of anonymity. Some of their testimonies have been quoted in this section.

for example, highlighted that “research on the impact of regional and local institutions […] is a very important issue for Europe’s economic development, where there are significant gaps in our knowledge. Further research would therefore be highly relevant for our policy and its future development”. Another remarked that “given the relevance of European Structural and Investment Funds for the EU budget, incisive and policy relevant research is needed on the impact of institutional features of the local, regional or national level on the effectiveness of public investment”. Outside the EU, there was a similar call to incorporate the institutional dimension into development strategies. An official at the World Bank stressed that “us practitioners still lack definitive information on *which* institutions are critical for economic development and *how* capacity development should be achieved in order to improve the Bank’s approaches towards institutional support for local economic development around the world”, while another one underlined that “factors such as corruption, lack of transparency and accountability, and inefficient governments, represent significant barriers to improving living standards and eradicate poverty in many parts of the world.”. The overall mood could be summarised by the words of another senior official at the OECD that mentioned that “institutions and governance, despite having a huge influence on policy outcomes, have been largely overlooked”.

Incorporating institutions into development policy is thus considered of paramount importance for those involved in day-to-day development intervention. Hence, providing solid, evidence-based research and, more importantly, translating the research into policy action – e.g. giving clear indications of what exactly policy-makers should prioritise in the design and implementation of strategic actions involving institutions – may prove essential in improving the returns of development policies. The overarching purpose of future research should therefore be precisely that, to extract lessons from the theoretical and empirical analyses conducted on differences in institutional quality and on how these differences affect economic activity and performance and translate them it into policy recommendations. This implies providing a better understanding of the steps that need be taken to increase the likelihood that development interventions substantively improve their contribution to urban and regional economic growth and development in what are often very heterogeneous contexts across the world.

This implies that researchers have to deliver clear advice to practitioners about how to introduce institutional intervention in development policies. For researchers this implies using both quantitative research and specific, evidence-based case studies to overview how local institutions affect specific development policies at work. It may also mean underscoring how an excessive focus on one development axis, overlooking the local institutional dimension, can often lead to, depending on local conditions, what can be called 'strategies of waste', that is development interventions that leave the treated territory in the medium- and long-run in a similar or worse condition than before the intervention took place, despite sometimes having short-term positive effects (Rodríguez-Pose and Wilkie, 2019). The extent to which introducing institutions – and, more specifically, what specific types of institutional intervention depending on context – can help transform 'strategies of waste' into the 'strategies of gain' (i.e. interventions that adapt to the characteristics and needs of each territory and that, as a result, can yield more sustainable, medium- and long-term economic outcomes) is essential for decision-makers. We therefore need to strive to demonstrate which capacity building and technical development-type interventions can provide authorities, and organisations more generally, with the capabilities, knowledge and resources (e.g. Whyte, 2004; OECD, 2006; World Bank, 2010) that may facilitate economic development at the local level. Development strategies are frequently the children of different economic growth and development theories.

Normally, development interventions have been informed and structured by development strands that have put the emphasis, as indicated in the state-of-the-art section and depending on the dominant strand, on infrastructure building, growth poles, skills and innovation, or clusters and agglomeration. However, most development interventions remain firmly embedded in one approach and rarely consider the institutional dimension. Whenever they do so, they tend to subjugate institutions to the main development axis promoted by the chosen theory. The result is generally highly unbalanced forms of development intervention, which stress one development axis above all others, including institutions, as the key driver for economic growth and employment generation.

This will also imply delving into the analysis of what types of skills and competencies are needed at the urban and regional level to implement efficient development strategies. As indicated by past research (e.g. OECD, 2006; Cárdenas, 2010; Sanghvi et al., 2011; Haque et al., 2015), it should never be taken for granted that local authorities have the competencies needed to initiate and enact development strategies. Capacity constrains are not uncommon, especially in less developed cities and regions. How to integrate these sorts of actions and instruments into development approaches through specific case analyses of what works and what does not work in terms of capacity building measures will help provide a clearer picture of how development intervention can lead to more viable, sustainable, and dynamic cities and regions.

Towards a better understanding of the role of institutions for development

Over the last five to six decades economics, regional science and geography have made crucial theoretical, methodological and empirical advances in the path to understanding what determines the changing economic fortunes of regions and cities. We undoubtedly have better theories, more sophisticated methods, and clearly more extensive and detailed data than one or two generations ago. Yet, despite better theories, methods and data, we are still far away from understanding why some places perform better than others. The residuals in growth regressions have been growing, implying that economic development and growth analyses have been missing something from the growth equation. That something is precisely the role of institutions, in general, and institutional quality, in particular, on the economic fortunes of territories.

Institutions had been overlooked because they are difficult to define and measure. Achieving consensus on these issues is tricky. But, luckily, over the last few years measurements of institutional quality of the subnational level have substantially improved (Charron et al. 2014a and 2014b) and, equally importantly, these measurements have become more accepted by large swaths of the scholarly community. By plugging the institutional dimension into economic analysis it is becoming evident that the quality of institutions varies enormously not just across countries, but also within countries and that this variation has both direct and indirect implications for the economic development of places. Directly, institutions affect the capacity of economic actors to interact in a particular place, impinging on local economic growth, employment and productivity, among other economic factors (Ganau and Rodríguez-Pose, 2019). They can also attract or repel "the industries and activities that generate high growth in output and employment, especially during epochal technological shifts" (Storper, 2018: 260). Indirectly, the returns of virtually every public policy and, principally, the returns of any type of development intervention, are strongly affected by the institutional context in which they are applied.

It is increasingly clear that no development policy should overlook the institutional dimension. However, this is the very point from where more progress is necessary. We as researchers are still puzzled by how to intervene in order to improve institutional quality. This implies more, better and better-targeted research into the dynamics of institutional change; into improving our understanding of the link between formal and informal institutions and economic development; into better grasping the institutional mechanisms of economic development; and into incorporating all the lessons extracted from institutional research into development policy.

Some ground has already been covered in this respect. The development of the scholarly literature on the topic, both from a theoretical and a more empirical side, has been phenomenal in the last decade. However, there is still a need to make further progress if we are going to be able to improve the economic growth and employment generation prospects of different territories. There is still need for more research to make sure that we can devise the institutional mechanisms that will not only deliver greater growth and employment, but also make our cities and regions more sustainable and resilient and their inhabitants happier. But this is something that none of us can do alone. It is a collective endeavour for the whole regional science community to engage with this topic in order to make sure that our research goes the extra mile to achieve better targeted and more efficient policies that work for all territories and for all. The stakes are phenomenally high as discontent and resentment with the economic system is rapidly on the rise across the world. Much of this discontent and resentment has to do with territorial issues and with the failure of development policy intervention to maximise the potential of every territory (Rodríguez-Pose, 2018). The territories left behind, those that have been repeatedly told that they 'don't matter' in the new, more globalised and networked economy, require solutions that are much more capable of mobilising their true potential than through the sort of interventions in place until now. Bringing institutions into the fray and putting them at the centre of more integrated and balanced revamped development strategies may mean that, if done adequately, we can make an important contribution to revive and improve the economic fortunes of all territories.

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