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Local economic development: Theory, evidence, and implications for policy in Brazil

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ABSTRACT

Local economic development policies have surged in Brazil over the past decade—a major shift in this regionally diverse country of 27 states, over 5000 municipalities, and the largest economy in Latin America. We review the stylized facts, expected patterns and policy recommendations from the foundational studies in regional and urban economics. We then provide a summary of a more recent stream of scholarship focused on local economic development (LED) studies in developed and developing countries that have surged in the last 20 years. Based on this review, we then systemize the findings emerging from studies focused on analyzing local economic development policies in Brazil recognizing the distinctive contributions emerging from both the empirical and the case studies literatures. We identify key lessons for (and from) the Brazilian experience and conclude that Brazil and Latin American countries need a new generation of studies that undertake more rigorous evaluations of these policy experiments. Finally, we recommend steps to advance such research.

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1. Introduction

Local economic development strategies have surged in Brazil over the past decade—a major policy shift in this regionally diverse country of 27 states, over 5000 municipalities, and the largest economy in Latin America. Remarkable changes in economic conditions resulting from macroeconomic stabilization, particularly the drastic reduction in inflation, and government decentralization, have induced governments to direct increased attention to microeconomic reforms including policies to reduce unemployment and generate income in specific geographic regions within Brazil. Though research directed at examining how growth can be ignited at the local level has long occupied the attention of scholars, scholarship on how issues of public administration and policy are impacted in space in the case of Brazil remains an emerging field of research.

Research on regional economic development is particularly important for developing countries such as Brazil, where the uneven spatial distribution of economic activity has been particularly marked and has tended to persist over time. Beginning with the seminal studies by Marshall (1890 (1961)), Weber (1929), Christaller (1966), Lösch (1954), and Isard (1956), a robust tradition of scholarship in regional economics on the relationship between increasing returns to scale, transportation costs and agglomeration advantages stemming from the concentration of economic activity to specific geographic locations has developed. Students of regional development have also long held a preoccupation for the problems posed by unbalanced growth as manifested in the seminal studies of Myrdal (1957) and Hirschman (1958). Scholarship has also advanced on the conditions under which regional policies are merited, as well as why outcomes may not always be as predicted by specific theoretical models. The formalization of models and the increase in empirical studies have contributed to a set of stylized facts; predicted outcomes; and general policy recommendations.

Building on this tradition, more recently, a research stream, largely advanced by urban planners, business economists, geographers and urban sociologists, has focused on examining the development and impact of "local economic development" (LED) initiatives in developed and developing countries. Studies developed following this literature, which we classify and refer to as LED research in this paper, have sought to establish general parameters that characterize strategies for fostering innovation and prosperity in regional economies. Thus far, the vast share of the LED literature has been mainly concerned with local economic development policies in the developed world. Initiatives in developing countries have been documented, but the analysis of the wealth of cases that are found in Asia, Africa and Latin America has been limited.

This paper attempts to partially fill this gap by focusing on Brazil, which is one of the countries where there has been a dramatic and wide set of experiments with LED policies in Latin America. To do so, we first introduce some of the important reasons that help explain why Brazilian economic activity has remained geographi-

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cally concentrated over time and the policy interventions that have been found to circumvent geographic determinism in the regional economic literature. These insights from the literature usually labeled as Regional and Urban Economics or Economic Geography also show the reasons why outcomes may differ from policy goals. Secondly, we then turn to reviewing the LED policy experiments that have been undertaken in developed and developing countries, identifying key lessons for (and from) the Brazilian experience. We summarize findings from LED research on the importance of institutions (organizational forms) and processes in development efforts. Thirdly, we systemize the findings emerging from studies focused on analyzing local economic development policies in Brazil recognizing the distinctive contributions emerging from both the empirical and the case studies literatures. To do so, we gathered and analyzed the Brazilian LED case studies that we could find in the published literature in English, Portuguese and Spanish. To the best of our knowledge these cases have not been summarized before. In the final section, we conclude that Brazil and other developing countries (especially in Latin America) need a new generation of studies that go beyond describing LED experiences and toward evaluating these efforts.

2. Regional development: theory and stylized facts

Research on why economic activity clusters in centers, how new centers develop and the consequences of remoteness are particularly important for countries such as Brazil where the uneven spatial distribution of economic activity has been particularly marked and has tended to persist over time (Krugman, 1999). The uneven spatial distribution of economic activity in Brazil has remained concentrated in a core region centered in São Paulo beginning with the period of industrialization in the early 20th century until the present day. In fact, empirical evidence suggests that the share of Brazil's population and income remained concentrated in the state of São Paulo and its neighbors, the states of Paraná and Minas Gerais, throughout the 20th century. In 1939, 63% of national income was concentrated in three states—São Paulo, Paraná and Minas Gerais—comprising the Southeast region of Brazil (Azzoni, 2001). Table 1 presents the share of income for Brazil's five regions in 1939 and 2000. Relative to 1939, the level of economic activity in the Southeast region had only fallen by 6.8–56.2% by 2000. In contrast, the share of income for the nation's historically poorest region, the Northeast composed of the states of Alagoas, Bahia, Ceará, Maranhão, Paraíba, Pernambuco, Piauí, Rio Grande do Norte and Sergipe, decreased from 16.9% to 12.6% during six decades.

Economic theory has provided some important answers as to why economic activity has continued to be concentrated in Brazil. Building on earlier work on the geographic concentration of economic activity and urban/rural differences, recent research has offered renewed attention to how increasing returns, both at the internal level of the firm and externally with respect to other firms, may contribute to explaining agglomeration forces at the country, regional and city levels (Baldwin et al., 2003; Fujita and Thisse, 2002; Krugman, 1991a,b). In contrast to standard regional convergence theories where income disparities arising from differences in regional capital/labor ratios diminish over time, these models do not predict convergence in growth rates. Instead, these models show that growth may be uneven and tend towards divergence within regions (Aghón et al., 2001; Henderson et al., 2001).

Scholarship has also documented the conditions which drive firms to locate in close proximity to large markets and to each other. Models have emphasized both supply (reduced transport costs, access to immobile factors), as well as demand (namely market access) factors as the determinants of the agglomeration of economic activity with increasing returns (Fujita et al., 1999). And unlike models predicated on constant or diminishing returns, these

Table 1
Regional GDP as a share of national GDP in 1939 and 2000.

Region	1939[a]	2000
North	2.7	4.5
Center-west	2.1	9.5
Northeast	16.9	12.6
South	15.3	17.3
Southeast	63.0	56.2

[a] Data for 1939 reported by Azzoni (2001). *Source:* IPEA.

models show that production, trade and investment patterns evolve in a geographically concentrated, or gravitational, manner which seems to be the very processes observed empirically by those studying development trajectories.

Under different assumptions regarding factor mobility, models predict that different growth performance outcomes are possible. Under conditions where factors are immobile and there are broader linkages between particular industries, Krugman and Venables (1995) show that industrial activity concentrates in the "core" as the benefits from concentration (due to market access or demand driven factors) outweigh the labor cost savings of moving to the "periphery" predicting increased inequality across geographic regions. These predictions contrast with earlier work that argued that the mobility of capital and labor and the closer linkages between industries, would lead to more diffused development patterns with particular cities specializing in particular types of industries (Henderson, 1974).

On the other hand Puga (1998), for instance, argues that urbanization patterns in contemporary less developed economies will follow a reverse trend to that experienced during Europe's expansion in the 19th century where patterns led to more evenly distributed regional growth. With lower costs of spatial interaction, economies of scale, and elastic supply of labor to the urban sector, Puga concludes that the dominant pattern in developing countries will be economic development in which primate cities dominate.

Storper and Walker's (1989) unique contribution is relating regional growth with capitalist cycles. During expansion periods, new industries emerge and create new centers. In an instability phase, new industries de-stabilize the very center that they had created. Finally, as a result of the division of labor, cities become differentiated. Some of their ideas were modeled a decade later in main stream economics. Fujita et al. (1999) summarizes models for new center formation and destruction that could be considered compatible with the expansion period described by Storper and Walker. Regional differentiation is compatible with increasing returns at the firm level, although it is not quite compatible with the increasing returns at the urban level externalities that Jacobs (1969) emphasizes.[1] Furthermore, as expected, the mainstream literature has neglected the instability phase.

3. Policy implications

By shedding light on the concentration of economic activity and spread of development to developing regions, the literature has also provided evidence of cases showing how policy interventions can circumvent geographic determinism (Krugman, 1991a). Specifically, under certain conditions, government policies directed at reducing the costs of remoteness can allow new economic centers to develop. Building on these earlier models, more recent research has begun to focus its attention on how public infrastructure (roads, airports, industrial parks), as well as technology and production subsidies influence location patterns and economic devel-

[1] Storper and Walker (1989) assume returns to scale in center formation explicitly (see pp. 76–77).

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