

# Industrial districts, social cohesion and economic decline in Italy

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The economic and social vitality of industrial districts (IDs) depends on the interaction between two major sub-systems: a community of people and a population of firms. A range of circumstances determined inconsistencies between the rationales of these two sub-systems. The emergence of leader firms that substitute the ID as coordinating instances and cost scrapping as a strategy that bypasses quality enhancement undermine the ID as a system. The paper contends that this outcome is not the only possible one. An alternative would require a regulatory—as opposed to merely permissive—action of public actors.

*Key words:* Italy, Decline, Industrial districts, Social cohesion, Public policy  
*JEL classifications:* L25, R11

## 1. Introduction

The paper discusses the role of Italian industrial districts (IDs) in the light of the debate concerning the decline of the nation's economy. It argues that since this debate tends to downplay the specificity of IDs—i.e. that they are made up of two sub-systems, a community of people and a population of firms—it leads to misleading policy conclusions.

The point of departure for the present analysis is the change that IDs are undergoing as a result of a range of domestic and international circumstances. This article contends that the inconsistency between the two sub-systems of IDs is determining the emergence of leader firms that substitute the ID as a coordinating instance. In the pursuit of their goals, some firms are abandoning the 'horizontal' relations that are typical of IDs in favour of more hierarchical ones. In many instances they tend to prefer cost scrapping to quality enhancement. In both cases they tend to undermine the ID as a system. The implication is that an ID-oriented policy would require a regulatory—as opposed to merely permissive—action to change the incentives that enhance short-sighted strategies.

The article is arranged as follows. Section 2 briefly summarises the key issues involved in discussions concerning Italy's dismal economic performance. This concise introduction

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provides a terms of reference to better situate IDs within the overall performance of the Italian economy and to appreciate the theoretical peculiarity of the district-based approach. Section 3 focuses on what allows IDs to be competitive, to achieve economic growth and to reproduce themselves as a socio-economic system. It contends that the key issue is that IDs must comply with stringent requirements for social cohesion. Section 4 discusses some data concerning the performance of IDs on economic and social grounds. It suggests that while economic performance may have some positive traits, these are presumably obtained at the expense of social cohesion. The implication is that the conditions for the persistence of districts may eventually cease to hold, thereby leading to different types of local organisation, such as clusters, which may not provide a solution to the problems outlined. Section 5 discusses two alternative views of the outlined process. According to the prevailing account, it is the somewhat natural outcome of the institutional rigidity of districts. The alternative account focuses on the existence of inconsistencies between the two subsystems of IDs. The institutions that underlie the population of firms lead the latter towards strategies that clash with the institutions that underlie the community of people. Following this perspective, the demise of the ID is possible, albeit avoidable. This leads to an outline of the requirements that public policy must meet.

## 2. Industrial districts and recent trends in the Italian economy

A fairly large amount of Italy's economic literature has recently focused on the country's stagnation. Italy's growth rate has been decreasing over time and it is lower than in most other industrialised countries (Table 1). Some authors have explicitly referred to a downright economic decline (Gallino, 2003; Toniolo and Visco, 2004; Nardozzi, 2004; Rossi, 2006). Based on the claim that this is a long run phenomenon, many scholars suggest that it must be regarded as a supply side issue and argue that the main reason for the decline lies in the slow growth of productivity, which, in their view, is associated with the structural features of the Italian economy.<sup>1</sup> Nardozzi (2004, p. 100) contends that 'the slowdown in the productivity of our manufacturing industry relative to countries, such as France and Germany, [...] is accounted for by two persistent peculiarities: the "dwarfness" of firms and a productive specialisation in traditional sectors'.<sup>2</sup> Following a classification à la Pavitt, Nardozzi argues that traditional sectors are not technology intensive, so that their

**Table 1.** *Gross domestic product (GDP) growth in Italy*

Country/region	Period	Percentage growth in GDP
Italy	1953–1972	5.3
	1973–1982	3.2
	1983–1992	2.3
	1993–2002	1.6
	2003–2008	1.1
Europe	1993–2002	2.4

*Source:* Ciocca (2003). Data for 2003–2008 added by the author; source: ISTAT *Contabilità nazionale. Conti economici nazionali - Anni 1996–2007*, Roma, 2009 ([http://www.istat.it/dati/catalogo/20090604\\_00/ann\\_09\\_12\\_contabilita\\_nazionale.pdf](http://www.istat.it/dati/catalogo/20090604_00/ann_09_12_contabilita_nazionale.pdf)).

<sup>1</sup> Although there is reason to believe that such a distinction is not appropriate—in that, as we shall see further on, the decline in aggregate demand definitely affected the supply side—we will not go into this issue.

<sup>2</sup> Unless otherwise stated all translations from Italian texts are mine.

techniques are hardly subject to any upgrading. They are also easy to establish in less developed countries and their competitiveness ultimately depends on production costs. The small size of firms reinforces the negative consequences of this sectoral bias in two ways. First, precisely because they are small, firms cannot reap the benefits of scale economies in production. Second, independently of production, they do not have the minimum efficient scale to carry out research and development (R&D) or to follow up their productive activity with appropriate marketing strategies. As a result, P. Ciocca (2003, p. 87\*) argues, Italy is ‘squeezed’ between ‘new trade partners (...) who are prone to export consumption goods that Italy produces and to import investment goods that Italy does not produce [and] economies, such as the United States, that can supply products—consumption and instrumental goods and services—characterised by scale economies, R&D, and innovation.”

Nardozzi views the ‘two persistent peculiarities’ as a structural deadweight:

In the Seventies and up to the mid-Eighties the rate of growth of labour productivity in small firms was greater than in large firms. This was the time of decentralised production and of the insurgence of districts. Subsequently, this relation switched and the rise in the productivity of large firms was almost twice as big as in the small ones. [...] The newly established firms of that period remain small, however, and their ‘dwarfness’ is reflected in productivity. (Nardozzi, 2004, p. 96).

Considering that Italian IDs are formed by small and medium sized firms and that they tend to specialise in traditional sectors, views such as those summarised above deny—or, at the very least, downplay—the relevance of districts for economic growth in Italy today. More specifically, Nardozzi’s remarks raise two issues. The first one is theoretical in that he argues that ‘dwarfness’ and specialisation in traditional products are a problem in general. The second one is empirical in that he claims that the time when IDs were the most vital element in the economy has passed. Consequently, in order to appreciate the role that IDs have in the evolution of the Italian economy, we must address both of these levels of inquiry. Let us first consider the theoretical issue.<sup>1</sup> We will discuss the empirical ones in Section 4.

The district-based view stresses that in rich capitalist economies goods should not be classified in terms of their natural (e.g. metal) or technical (e.g. mechanical) characteristics but in terms of the types of customers who are likely to buy them. The nature of modern markets suggests that consumers look for tailored goods, so that diversification and customisation are less the exception than the rule. Rather than reflecting a defensive strategy carried out by those who are unable to compete on the ‘open’ market, niches are what consumer markets are all about. In this perspective, the distinction between shoes and clothing may be misleading, a more appropriate distinction being that between high quality products—e.g. high quality clothes and shoes, which are likely to be sold in the same shop—and cheap ones (Becattini, 2000). The implication is that, in so far as IDs specialise in the former type of goods, they have little to fear from import penetration by less developed countries. Obviously, this is not to say that such a specialisation actually exists. Whether it does or not, however, depends less on the maturity of the industries than on the ability of IDs to ‘choose’ the appropriate strategy to deal with foreign competition.<sup>2</sup>

<sup>1</sup> I will here focus on what is sometimes called the canonical view of Italian industrial districts—as is outlined by authors such as Becattini and Brusco. I will deal with other approaches in Sections 4 and 5.

<sup>2</sup> ‘The present threat that change bears on industrial districts is not, ..., related to the physiological effects of the globalisation process (or of the growing integration in international trade) but only to strategies that lead to a wrong positioning of district firms in the context of the domestic and international economy.’ (Garofoli, 2003B, p. 560).

Another aspect of the district-based view is that firms do not only compete, they also cooperate. Cooperation in production leads to a different division of labour within firms as well as among them, which affects also what and how they learn and innovate. Similar considerations apply to activities such as R&D or marketing: firms can cooperate for these just as for other activities. Thus, what is relevant for economies of scale is not the size of the firm as such but either the size of the single activity that a firm carries out or the size of the set of activities jointly carried out by a group of firms. The critical distinction is not between large and small firms but between large and district firms on the one hand and isolated small firms on the other.

Cooperation among potential competitors is not just a way to make up for the lack of size. Truly small and medium sized firms are not big enough to support R&D laboratories, but the above-depicted features of demand allow them to resort to different kinds of innovative capabilities. They rely less on the application of explicit and codified knowledge to production than on the tacit knowledge that is typical of craftsmanship. This implies that actors must interact in order to identify solutions to problems that have to do with productive linkages.

Tacit knowledge—intended, here, as a range of skills and routines that it is difficult, or even impossible, to codify—is a necessary characteristic of production in IDs. As Storper (1995) points out, however, it is not sufficient in that more is needed to account for the persistence of agglomeration in areas where production costs cease to provide an adequate backing for competitiveness. The explanation Storper suggests is that ‘geographically-constrained untraded interdependencies outlive geographically-constrained input–output linkages’ (1995, p. 209), where the former include institutions (conventions, in Storper’s terms) i.e. ‘taken for granted rules and routines between the partners in different kinds of relations defined by uncertainty’ (1995, p. 208). Morgan (1997) qualifies this claim by stressing that marginal regions can develop appropriate learning abilities only if policy enhances the cooperation among actors and focuses on ‘building a stock of social capital in regions where these invisible assets are thin on the ground’ (Morgan, 1997, p. 497; see also Henderson and Morgan, 2003). Cooperation is therefore important not only because it enhances the diffusion of learning abilities. It also creates an environment where trust enables actors to sidestep the alternative between risky market coordination and rigid hierarchical coordination by overcoming the transaction costs—associated to opportunism—that these organisational setups are supposed to reduce.

Basically what Storper and Morgan point to is a different notion of tacit knowledge, which is what M. Polanyi (1962) actually referred to when he originally introduced the term. It does not refer to specific skills and routines but to the overall background knowledge that actors take for granted when they learn, act and interact. This broader notion of tacit knowledge underlies how actors organise production and how organisation eventually feeds back on their skills and routines. This leads to a different account of technology and technological development in that they cannot be isolated from knowledge as a whole, so that:

The definition of technology may be stretched to include ‘soft’ dimensions of technology such as know-how and organizational rationalities, and this widens the scope of what may be considered a technological trajectory. (Storper, 1995, p. 208).

How does this bear on the debate concerning Italy’s industrial decline? In order to assess the debate between the two approaches outlined above, a common ground would seem to lie in a comparison between the costs and profitability of the two alternative industrial structures. Indeed, two cost structures can be identified and compared on a *coeteris paribus* basis, provided we assume that technology and knowledge, as well as endowments, are

given. If, however, technology and knowledge are assumed to co-evolve with relative prices and to be region-specific, different patterns of development are possible depending on initial conditions and on the path-dependent processes that follow (Garofoli, 2003A). Consequently, although at a given point in time profitability in one of these productive systems may be higher, this may depend less on some intrinsic advantages of that system than on the peculiarities of the pattern of evolution in technology and knowledge that happened to emerge—among several possible others—as a result of some exogenous change in relative prices. Furthermore, even if this static comparison were to point out that one system is definitely preferable, this does not mean that a switch—i.e. the substitution of one setup for the other—would ensure a better cost structure. The required changes would have to involve technology and knowledge, along with endowments, but it is hard to believe that the multifarious features of technology and knowledge outlined above would necessarily evolve in such a way as to match the desired pattern requirements.

These methodological considerations suggest that a great many variables are involved in the pattern of development of Italy's manufacturing sector and they interact in a non simple way. Under these circumstances no system such as an ID can be dismissed on the grounds that it does not meet the requirements of theoretical models that simply assume away such a complexity or because of its performance at some point in time. In so far as an ID is systemically open, because market relations interact with knowledge and institutions, its economic performance also depends on that interaction. It is therefore misleading to assess its vitality—i.e. the possibility for it to materially and socially reproduce itself over time—in terms of only one of the market sub-system alone, as if the other sub-systems only had some sort of secondary function.

Given the importance of institutional elements—including the untraded interdependencies that Storper refers to—for the vitality of IDs, the section that follows situates them in an analysis of social cohesion.

### **3. Industrial districts and the centrality of social cohesion**

Social cohesion is a central feature in all discussions of IDs because it is, at one time, a condition for and a consequence of the vitality of the district.<sup>1</sup> Given the variety of existing definitions (Jenson, 1998), I refer to it as 'the ongoing process of developing a community of shared values, shared challenges and equal opportunity . . . , based on a sense of trust, hope and reciprocity among all [members of that community]'.<sup>2</sup> In the light of the discussion that follows it is worthwhile to stress that, according to this view, social cohesion cannot be reduced to what happens to be only one of its dimensions, i.e. the 'reduction of differences, cleavages and inequalities between groups of people' (Hulse and Stone, 2007, p. 123). More specifically, it is not enough that actors merely renounce social conflict; they must, at least to some extent, feel that the ends they pursue match those of the economic organisations they act in.<sup>3</sup>

<sup>1</sup> This is, arguably, the distinguishing feature between (Marshallian) industrial districts and other types of local production systems such as Porter's (1998) 'clusters'.

<sup>2</sup> The definition is in Policy Research Sub-Committee on Social Cohesion (PRSub-C), Social Cohesion Research Workplan, March, 1997 (cited by Jenson, 1998, p. 29).

<sup>3</sup> 'In order to achieve a capacity for invention and innovation, (...) it is essential that many people understand the technology with which they work. This, in turn, requires continual informal interaction in cafés and bars and in the street. In this way, new ideas are formed and transmitted.' (Brusco, 1990, p. 16). The informal interaction Brusco refers to would hardly be possible if all actors were not involved in the general goals of the firms they work for.

Social cohesion involves trust, i.e. the belief that other actors will behave according to shared values, independently of their personal gain. Trust is important in interfirm relations within IDs because it allows actors to maintain cooperative relations in a competitive context. It is also important in intrafirm relations. Mutual trust here implies that workers are willing to do more than is formally required of them because employers are willing to acknowledge this extra-effort.<sup>1</sup> Trust reduces the scope for opportunism, thereby leading to governance and coordination mechanisms that downplay the latter, to the advantage of other priorities. Rather than forcing economic activity within the straight-jacket of control, IDs can enhance the interaction among workers within firms and among different firms. Rather than protecting their knowledge—their skills and their capabilities—in order not to lose their bargaining power, actors can share it. In so far as they do so, they enhance not only the diffusion of existing knowledge: they allow the creation of new knowledge. In this perspective, Charlie Chaplin's parody of the Taylorist division of labour in *Modern Times* would reflect a waste of resources—the actual and potential skills of the worker—at the expense of the capabilities of the firm (Loasby, 1994; Dosi *et al.*, 2000), as well as of the district as a whole.

Social cohesion also involves confidence (Mistri and Solari, 2003; Mistri, 2006). While trust has to do with the behaviour of other actors, confidence has to do with a system's overall performance. From the perspective of entrepreneurs, confidence includes positive expectations in terms of market demand and profit opportunities. It involves reliance on the ID as a buffer: should a firm suffer a downturn, it can always rely on what other firms choose not to produce directly but to subcontract. From the perspective of a worker, it includes a non-decreasing income and the possibility—should she want to—to set up her own business. Here too the ID may act as a buffer: should one's business be unsuccessful, one can always return to one's previous type of job.

Social cohesion allows an ID to operate differently from a large firm, as well as from an undifferentiated set of (small) firms. In so far as this specific organisation and this operational mode provide its firms with a distinctive competitive advantage, they eventually validate the actors' mutual trust and their confidence in the ID. This reinforcement effect, coupled with shared knowledge, allows the ID to act as a firm incubator, thus to reproduce entrepreneurial capabilities over time (Becattini, 2003).

A district may lose its competitive advantage if it does not adapt to two types of change: change coming from outside the ID, such as, for instance, the emergence of India and China in the world economy, technological breakthroughs that affect the competitiveness of its products, or changes in the level of aggregate demand; change within IDs, such as generational changes in expectations. Adaptation to these changes involves a range of possible actions, which result from the purposive conduct of some actor or the spontaneous outcome of a self-organising process. They reflect a (sometimes implicit) choice as to whether it is better to rely on path dependent knowledge in the existing industries or to shift to new industries, to focus on cost scrapping or on qualitative upgrading, to focus on technology or on design, etc. Although in practice these alternatives may not be as clear cut as they are presented here, the issue remains of what the priorities are.

<sup>1</sup> 'Trust and co-operation, so crucial to the successful performance of the district, is helped by an attitude that seeks competitive success not by aggressive cutting of direct labour costs but by general organisational competence, standards and productivity.' (Sengenberger and Pyke, 1992, p. 5, emphasis in the original)

What is important, here, is that these actions must take into account the requirements of two sub-systems: the ID's community of people and its population of firms.<sup>1</sup> This is all but straightforward, since as Bagnasco points out, 'market efficiency, as a matter of principle, tends towards Schumpeter's creative destruction, and the social capital embedded in community relationships is continuously challenged by change and by the strategic use, in the economy, of multiple social relations' (Bagnasco, 2002, p. 279). The risk that Bagnasco envisages is that the networks of the new economy may develop a social capital<sup>2</sup> that is functional to 'systemic integration' but not to 'social integration', thereby undermining the self-organising capabilities of society as a whole.<sup>3</sup> Thus, any action that aims to adapt to the above changes must comply with the constraints of both sub-systems. They must allow the reproduction of the ID's economic environment but they must also be consistent with the reproduction of the ID's social environment. The discussion that follows aims to focus on how these intertwined constraints have affected the vitality of IDs and, possibly, Italy's overall economic performance.

#### **4. Recent trends in economic performance and social costs**

G. Becattini and G. Dei Ottati (2006) address the vitality issue by providing a statistical analysis of the Italian economy during the 1990s. They divide the manufacturing sectors into four groups: heavy manufacturing industries, food processing, light manufacturing industries and consumer goods.<sup>4</sup> The third and fourth groups typically are those that IDs are specialised in. Becattini and Dei Ottati also divide Italian provinces into four classes, according to their prevailing industrial structure: large firm, ID, residual and mixed.<sup>5</sup> The main conclusion they draw—based on data from the 1991, 1996 and 2001 censuses—is that IDs generally outperform other territories and other manufacturing sectors both in strictly economic terms and in terms of quality of life. Let us briefly summarise their results.

The two district-related groups account for a high share of Italian exports (62% in 2001) and a positive trade balance, whereas the other two groups have a negative balance, which, in the case of heavy manufacturing industries, tends to worsen over time. Similarly, district-related provinces export more than large firm ones, both in absolute and per capita terms. Value added rises more in the district-related provinces than elsewhere.

Employment in the private sector rises more in district-related provinces. It rises especially in non-trade service sectors, mostly in business-related services. Employment in

<sup>1</sup> In Becattini's words, an ID is 'a socio-territorial entity which is characterised by the active presence of both a community of people and a population of firms in one naturally and historically bounded area' (Becattini, 1990, p. 38).

<sup>2</sup> Bagnasco (2002) defines social capital as the potential for cooperative interaction that a social organisation affords people.

<sup>3</sup> Bagnasco refers to Lockwood (1976, p. 371): 'Whereas the problem of social integration focuses attention upon the orderly or conflictual relationships between the actors, the problem of system integration focuses on the orderly or conflictual relationships between the parts, of a social system.' Although this demarcation is conceptually useful, the two types of integration are in no way independent of one another, to the point that Lockwood explicitly refers to the distinction as 'wholly artificial' (Lockwood, 1976, p. 371).

<sup>4</sup> Heavy manufacturing industries include: paper and paper products, coke, refined petroleum products, chemicals, rubber and plastic products, vehicles and basic metals. Light manufacturing industries include: metal goods, machinery and mechanical, electrical and electronic equipment. Consumer goods include: textiles, clothing, tanning, leather and footwear, wood, tiles, furniture, jewellery, musical instruments, sporting equipment, toys and not elsewhere classified (Becattini and Dei Ottati, 2006, p. 7, n.4).

<sup>5</sup> A prevailing structure of a province is 'large firm' ('district') if the share of employees in large firms (districts) exceeds the national share of those same employees. A 'mixed' province is both 'large firm' and 'district'. A 'residual' is neither one.

manufacturing drops everywhere but less in district-related provinces and sectors. In the heavy manufacturing industries, the drop in employment is paralleled by a rise in local units, thereby leading to a significant decline in the average size of local units.

Activity ratios are higher and unemployment is lower in district-related provinces. In general, per capita income is higher in these same provinces. Migration tends to flow into district-related provinces and out of large firm and residual provinces. This final information is particularly important, according to Becattini and Dei Ottati. They argue that:

it is unlikely that people move from areas where they live better and have better job opportunities (according to the conventional wisdom these are the areas with large firms) towards areas that are less advanced in social terms and where employment ultimately ought to be more precarious (according to the conventional wisdom, these are the areas where small firms prevail, as is the case of district-related provinces). Obviously, something must be wrong with the 'conventional wisdom'. (Becattini and Dei Ottati, 2006, p. 20).

Despite this positive performance, a few problems stand out and should not be disregarded. Becattini and Dei Ottati distinguish two district-related groups of industries but, although they do point out that these groups perform differently, they do not elaborate on these different performances, which substantially lead to a recomposition: the light manufacturing industries (M) tend to become more important as the consumer goods (C) decline. Employment in the latter group dropped by 15.3% from 1991 to 2001 whereas it rose by 73% in M. Local units in C dropped by 13.4% and rose by the same percentage in M over the same period. This recomposition does not lead to any significant (positive) change in the foreign accounts: judging by the trade balances provided by Becattini and Dei Ottati, the net exports of the rising group of industries (M) declined after 1996 and never recovered completely, whereas the net exports of the declining industries (C) basically kept on rising.

Unfortunately, compensation between the two groups of industries has not been complete: during the 1990s, employment in M rose by only 46% (119,857 units) of the corresponding drop in C (281,576 units). Since these two groups of industries are generally based in different provinces, the effects on employment have been rather grievous: in some of the district-related provinces, jobs dropped by 6–8 percentage points from 1995 to 2002. The impression is that this recomposition led to significant social costs. Given the above discussed centrality of social cohesion for IDs, this seems to be a rather important issue.

The share of non-regular employees in total employment complements the above data (Figure 1). While the figures for M are always lower than those of the other industries, the figure for C is systematically higher than those for both M and the heavy mechanical industries (H), and the gap between C and the other two increases over time.<sup>1</sup> This suggests that C is characterised by relatively precarious employment conditions: non-regular employees can be sacked whenever their employer chooses; they are therefore forced—as opposed to willing—to comply with what s/he deems appropriate; finally, they get no (otherwise compulsory) social security contributions. Truly, when market demand is high and growing, the cost of precariousness may be low, as Brusco (1982) argued, but the above data on employment suggest that this is not the case today. In these industries,

<sup>1</sup> Recent changes in Italian labour law make it easier for firms to substitute regular—yet temporary or part time—jobs for irregular jobs. This may account for the decline in irregular jobs over time, although the decline need not be positively associated with social cohesion.

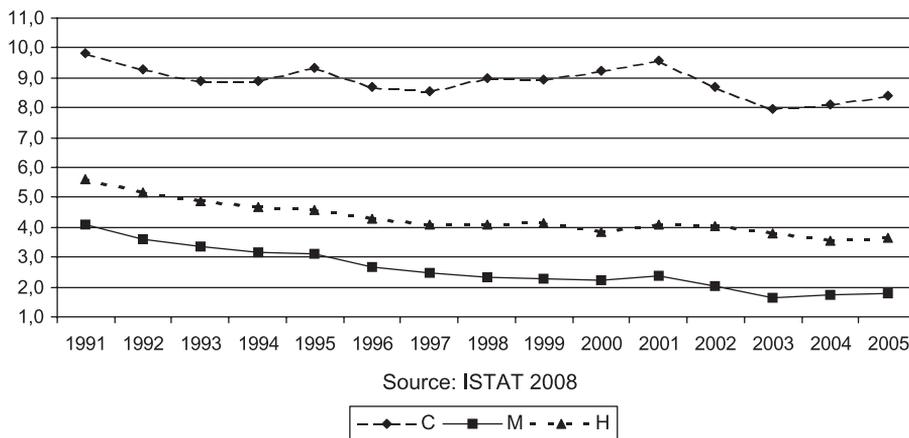


Fig. 1. Share of irregular employees: Italy. C, consumer goods; M, manufacturing industries; H, heavy industries.

firms are shifting their private costs onto workers, thereby bypassing competition through the creation of social costs.<sup>1</sup>

The strong difference between these two groups of district-related industries calls for further inquiry. An account for the different performance could be that C is less subject to technological progress, thus more easily reproducible in low-cost countries. But this would imply that social cohesion in the related IDs either does not exist or it cannot make up for the technological drawbacks. The data that follows focuses on social cohesion. It does not allow for a comparison between the two groups of industries but the aggregate picture is worth taking into account.

Figure 2 provides data on fatal accidents occurring to workers in Italian provinces, classified according to the criteria followed by Becattini and Dei Ottati.<sup>2</sup> The data show that working conditions are more dangerous in district-related provinces than in Italy as a whole. Truly, district-related provinces are not the most dangerous areas and the firms involved may be external to the IDs but it is nonetheless striking that this kind of situation should occur where social cohesion is so important.<sup>3</sup>

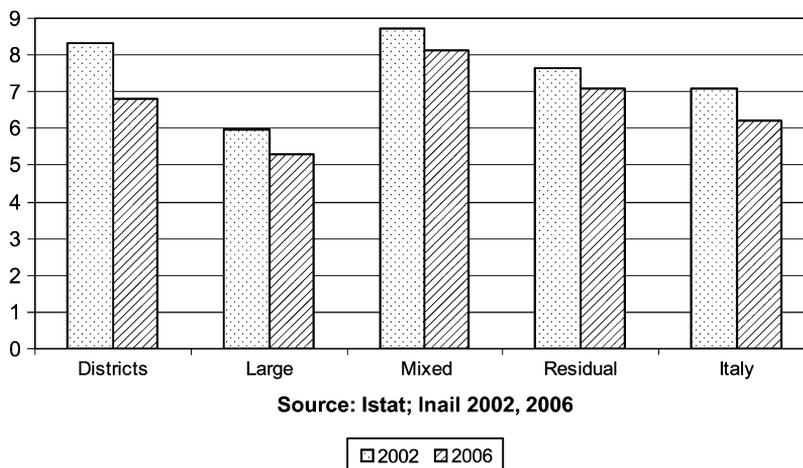
From 2002 to 2006 there was a general reduction in fatal accidents, which is particularly strong in district-related provinces. A possible explanation may be that the industrial recomposition within districts was to the advantage of firms that rely on means other than dangerous working conditions to achieve competitiveness. The data for district provinces nonetheless remains higher than the data for large-firm provinces.<sup>4</sup>

<sup>1</sup> The notion of social cost used here is the one discussed by K.W. Kapp (1978). According to this view, social costs are not externalities associated to market failures but the outcome of business strategies that consist in shifting private costs onto the community or sections of it.

<sup>2</sup> Fatal accidents are more difficult to conceal, so data on deaths is more reliable than data on professional injuries and diseases.

<sup>3</sup> Actually, one might argue that accidents are more likely in IDs precisely because social cohesion is so strong: workers may feel so involved that they are willing to take a risk in order to achieve the firm's goals. This could be true but, much like for irregular employment, it makes sense when achievement of the firm's goals affects workers as well. Social cohesion—in the strong sense outlined above—is unlikely if workers take the risk only because there is no alternative.

<sup>4</sup> There are only two mixed provinces, i.e. provinces where the share of employees in both district firms and large firms exceeds the national share, so the data may not be particularly significant. Nonetheless it is interesting to note that they are the provinces where the share of deadly accidents is highest.



**Fig. 2.** Fatal accidents per 1,000 workers in manufacturing and services by groups of provinces (2002, 2006).

Sources: *INAIL Rapporto Annuale, 2002 and 2006* (see [www.inail.it/](http://www.inail.it/)) and *ISTAT 'La misura dell'occupazione non regolare nelle stime di contabilità nazionale', 6 febbraio 2008* (see [http://www.istat.it/salastampa/comunicati/non\\_calendario/20080206\\_00/testointegrale20080206.pdf](http://www.istat.it/salastampa/comunicati/non_calendario/20080206_00/testointegrale20080206.pdf))

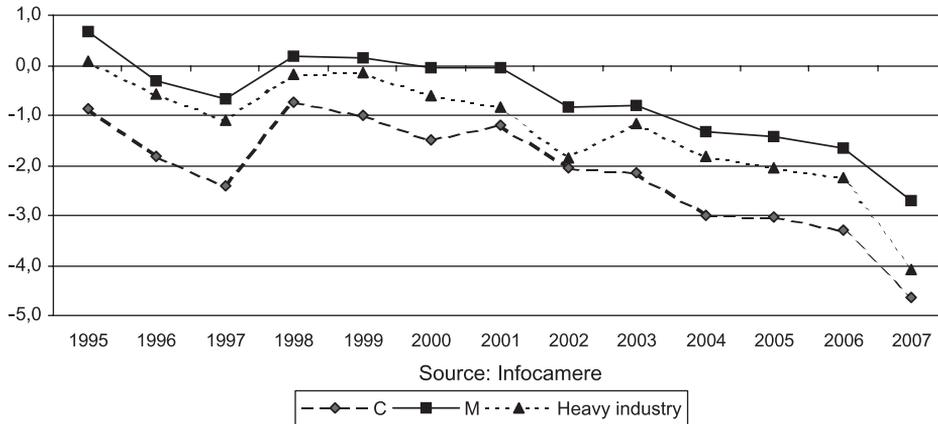
The data considered here have to do with the situation any worker may be in, as a worker. Let us now consider a situation a worker may look forward to, that of setting up his or her own business. Indeed, one might be willing to suffer the social costs depicted above, provided they are the price to pay in order to achieve social mobility. Figure 3 shows that, in the period 1995–2007 more firms were shut down than were set up. Setting up one's own business became ever more difficult. Nor is the turnover of firms such that it provides much opportunity: Figure 4 shows that inceptions have declined until recently and, although there has been a slight rise since the early 2000s, the overall level is definitely lower than in the 1990s.

The data is consistent with the findings of Guelpa and Trenti (2007), who point to a rising and persistent gap between successful and unsuccessful firms throughout the Italian economy, thus also in IDs.<sup>1</sup> According to Guelpa and Trenti, this leads to oligopolistic market structures that are consistent with another recent feature of IDs, the emergence of formal and informal hierarchically organised company groups. In this respect, Carone and Iacobucci conclude their inquiry on Italian SME groups by stressing:

the progressive 'hierarchisation' of inter-firm relations and the consequently increasing importance of medium-sized firms that have focused their competitive strategies on two circumstances: a progressive shift towards high quality market segments (better quality of the product); the control of the final market (through brand-centred strategies and control of distribution). Carone and Iacobucci (1999, p. 347)

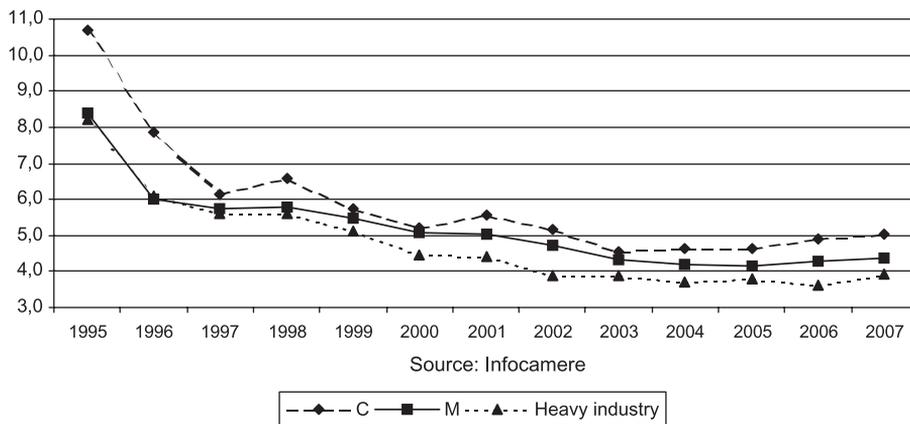
This is somewhat consistent with the account that Dei Ottati (1996A) provides of the Prato district. However, while at the time of her essay Dei Ottati argued that, despite these changes, the Prato district remained 'more a bilateral or multilateral governance structure

<sup>1</sup> 'The divide, deeper and more structural than in the past, between successful firms and firms in dire conditions is ... affecting district-based firms. ... This is particularly relevant since some of the key features of districts involve less heterogeneity and, through the strong imitation opportunity afforded by external economies, less persistence in the performance of firms.' (Guelpa and Trenti, 2007, p. 100).



**Fig. 3.** Firms: inceptions less cessations as a share of active businesses. C, consumer goods; M, manufacturing industries.

Source: InfoCamere: Movimprese (see <http://www.infocamere.it/movimprese.htm>; date last accessed 23 January 2009)



**Fig. 4.** Firms: inceptions as a share of active businesses. C, consumer goods; M, manufacturing industries.

Source: InfoCamere: Movimprese (see <http://www.infocamere.it/movimprese.htm>; date last accessed 23 January 2009)

than a hierarchical or unified one’ (Dei Ottati, 1996A, p. 48), Arrighetti and Traù tend to believe that a more general phenomenon is now occurring, namely:

an organisational and dimensional consolidation of existing production units. In particular, this change consists of a rise in the relative weight of middle sized units, the development of ‘quasi-hierarchical’ governance patterns such as company groups, a decline in the demographic growth that for a long time characterised the emergence of the small business sector, and a stop to the deverticalisation of production at least in some dimensional classes of firms. (Arrighetti and Traù, 2006, pp. 44–5).

Cainelli and Iacobucci (2007) qualify this statement by pointing out that company groups in IDs prevail in the mechanical industry whereas traditional industries—thus, consumer goods—are characterised by market relations.

The rationale for this change seems to lie in the changing international competitive environment. Foresti and Trenti contend that:

Since 1996 less favourable exchange rate conditions, together with a competitive context that has become more complex (above all the competitive pressure that China has exerted in sectors where ID typically operate), hindered districts that, from then on were unable to achieve a better performance than non-district areas, in the same industries they are specialised in. (Foresti and Trenti, 2007, p. 63).

According to Chiarvesio and Micelli a new type of firm—a leader firm—acts as an interface between the ID and the global economy:

such a firm, named ‘open-network firm’ here, and labeled ‘district-global firm’ in other studies, is able to become a part of international value chains and take advantage of the stock of local competences and knowledge within the productive and commercial *filieres* that operate at a global level. (Chiarvesio and Micelli, 2007, pp. 104–5).

The changes that the above studies point to call for a reassessment of quite a few theoretical issues, such as the potential persistence and accentuation of oligopolistic market structures in IDs, the relation between oligopoly and size, the relevant size variable (employment, sales, financial consolidation, etc.), the notion of company group and, ultimately, the very notion of the (boundaries of the) firm. Although these issues definitely deserve further inquiries, what is particularly important from the perspective of our discussion, is that leader firms are enhancing the required organisational change within IDs (Ferrucci and Varaldo, 1993), thereby leading to a shift from the ‘invisible mind’ of the ID to ‘more visible minds’ (Lombardi, 2003) and this affects both the systemic and the social integration that Section 3 discussed.

Let us return to the data presented above. Despite the differences between C and M, the overall decline in the turnover of district-based firms, coupled with the drop in employment, suggests that quite a few businesses are having a hard time. The decline implies that it is unlikely that unsuccessful firms can survive through subcontracting. The data concerning irregular employment and accidents does not tell us whether these phenomena date back to the 1970s—the golden age of IDs—or emerged in more recent times, as a response to economic changes. Thus, it is not clear how important they were to the economic vitality of IDs in the 1970s relative to the dynamics of demand and other exogenous circumstances. The data shows, however, that an important way for firms to pursue competitiveness is cost scrapping through employment and income precariousness, as well as through hazardous working conditions.

By shifting their costs onto their workers, firms socialise costs. They ultimately call upon the family to substitute the ID in its role as a social buffer. This redistribution between firms and society is coupled with redistribution within the value chain. The control of the final market that Carone and Iacobucci refer to is not only an (efficient) way to manage a turbulent market: it is the means whereby leader firms may control the distribution of value added within the group and/or the network of firms that they interact with (Ramazzotti, 2004).

The implication is that IDs may well attract migration flows but, contrary to what Becattini and Dei Ottati argue, this is no evidence of social cohesion. It only suggests that IDs provide some opportunity for a living whereas other areas do not: rather than social cohesion, this is more likely to be resignation.

The evidence suggests that neither IDs nor ID firms in Italy are performing in a unique way. M districts perform better than C districts and successful firms remain so over time, possibly because of the market power they have acquired. The overall picture, however, is

all but reassuring. M districts do not make up for the decline in the C districts either in terms of the trade balance or of employment. As for ID firms, rather than taking advantage of the distinctive feature of Italian IDs—i.e. the positive interaction between the technical features of a flexible organisation of production and social cohesion—they are pursuing competitiveness in a way that undermines the quality of life of IDs and, in so doing, probably disrupts social cohesion. If this is the case, the relatively good performance of IDs in Italian manufacturing may quite trivially reflect the mismanagement of large firms and of industrial policy.<sup>1</sup>

## 5. What's wrong?

Three major circumstances affected the competitive environment of the Italian economy and of its IDs over time, leading to a marked change from the mid-1980s onwards: increasing competition from less industrialised economies; technological change, especially associated with information and communication technologies; restrictive macroeconomic policies, thus a lower growth in effective demand. Roughly, three main strategies were available: restructuring, i.e. a quantitative change in capacity and costs; repositioning, i.e. a qualitative change in output; reconversion, i.e. the switch to different industries.<sup>2</sup> Leaving aside the last one, which is the alternative fostered by the authors discussed in Section 2, the first two roughly correspond to what Sengenberger and Pyke refer to as the 'low road' and the 'high road':

[T]he 'low road' to restructuring [...] consists of seeking competitiveness through low labour cost, and a deregulated labour market environment. [...] The principal alternative to such 'destructive' competition is the 'high road' of constructive competition, based on efficiency enhancement and innovation; that is, through economic gains that make wage gains and improvements in social conditions feasible, as well as safeguarding workers' rights and providing adequate standards of social protection. (Sengenberger and Pyke, 1992, pp. 12–13).

The outlook of the previous section is that a great many IDs are following the 'low road'. To some extent this should not come as a surprise. The potential unsustainability of the district model when demand is not high was pointed out by Brusco (1982), who foresaw that a problem of social costs would arise.<sup>3</sup> Brusco (1990) also stressed the difficulties associated with technological change when coordination is decentralised and learning is a widespread process. These difficulties are aggravated by public policy when it enhances cost-centred restructuring rather than innovation-centred policies. The absence of a consistent set of incentives increases uncertainty, to the detriment of long-term investment. Thus, it is no wonder that short-termism has prevailed.<sup>4</sup>

<sup>1</sup> As Signorini and Omiccioli (2005, p. 20) argue, 'the evidence does not suggest that industrial districts are leading Italy's industrial decline. Whatever its causes, it is more visible outside of industrial agglomerations than within them; thus, it is associated less to the specific weakness of the districts than to the general weaknesses of the Italian system, along with the even more marked weaknesses of alternative productive organisations.'

<sup>2</sup> Obviously, these strategies could be combined to some extent.

<sup>3</sup> 'There is only one way to avoid the dilemma of ensuring primary conditions of employment in all Emilian firms and yet preserving the flexibility of the system as a whole in a situation where demand is uncertain. To achieve such a result it would be necessary to construct a new secondary sector of firms and workers outside the region. (...) The internal contradictions of Emilia gradually become in this way external ones, which other regions have to face and resolve.' (Brusco, 1982, p. 177).

<sup>4</sup> Garofoli (1999) points out, for instance, that following the devaluation of the Lira in 1992, firms did not reinvest their profit in innovative investment but transformed it into rents by progressively giving up production to smaller firms, who tended to turn from 'district firms' into 'outsourcing firms'. 'Under the previously described circumstances the goal was not innovation or development but only short term viability and the preservation of cost competitiveness and of the lead firm's extra-profit.' (Garofoli, 1999, p. 397).

The ‘low road’ basically violates the conditions for social cohesion in that it undermines both trust and confidence. It precludes an innovative process based on participation as well as the district’s function as an entrepreneurial incubator. It therefore leads the ID away from the canonical model, possibly towards something similar to Porter’s (1998) notion of an industrial cluster. Under these circumstances most of the arguments against the ‘two persistent peculiarities’ of IDs may actually appear to be relevant.

In order to properly assess the above process, let us try to understand what is going on from a broader theoretical perspective. One possible explanation is that the institutional characteristics of IDs prevent them from adapting to changing markets. Basically, the argument goes as follows. IDs consist of institutions that, together with the market, coordinate economic activity. Institutions, however, tend to be resilient. They take time to change, more than the market allows for.<sup>1</sup> The outcome is that firms fail to innovate and to achieve the required competitiveness.

Viewed from this perspective, leader firms appear as the Schumpeterian innovators who break up consolidated views and institutional rigidity, thereby providing breakthroughs in business. The social consequences pointed out above turn out to be the inevitable outcome of change, possibly requiring some compensation by local or national authorities.

In this perspective, the shift of the unit of analysis from the ID as a whole to the district firm (Ferrucci and Varaldo, 1993; Brioschi *et al.*, 2002; Biggiero and Samarra, 2003) apparently reflects not only the empirical evidence about the increasing importance of leader firms but also the internal inconsistency of the ID as a system and the emerging role of a new coordinating instance arising from one of the latter’s sub-systems. Although the authors who follow this approach do not deny that the ID is important, its importance is reduced to that of a context, an environment where externalities enhance the market-related activities of firms. Social cohesion makes (economic) sense, in this perspective, in so far as it reflects the consistency of the institutional setup with market requirements.

Leaving aside the fact that, based on this approach, nothing warrants a satisfactory solution to the competitive and growth requirements of the IDs—in that, in the absence of the institutional setup of a district, single firms may well pursue the redistribution of existing value added at the expense of their workers and of other firms rather than try to increase it through quality enhancing innovation—the novelty that the approach focuses on is that leader firms can afford the economies of scale in areas such as marketing, finance and R&D. We are not that far from the ‘dwarfness’ thesis outlined in Section 2, the key issue being the centrality of scale economies and of hierarchical coordination.

What is important about this approach, however, is that, implicitly drawing on North (1990), institutions are assessed in terms of their effect on growth. Although a great deal of the literature acknowledges that some policy is required, ‘The orientation is towards local and regional growth defined with reference to dominating growth images: high technology production, new producer services, capital intensive cultural *filières*, etc.’ (Moulaert and Sekia, 2003, p. 297). In this perspective, policy makers are expected to assess institutions in relation to growth alone, so that ‘We are confronted here with “institutional instrumentalism”, whose sole endogenous ingredient is the capability to produce the “orgware” and the human resources to accomplish the exogenously imposed or inspired economic growth targets’ (Moulaert and Sekia, 2003, p. 297). This criterion denies the overall theoretical

<sup>1</sup> The ‘rules of interaction are stable and inertial elements [...] and tend to persist even during phases of radical change of the external environment, to the point that they turn into factors that block the system’s innovation.’ (Varaldo *et al.*, 1998, pp. 30–1).

relevance of IDs and of the district-based approach depicted in Sections 2 and 3. The distinctive feature of the latter is precisely that the institutional set-up must ensure not only the material reproduction of a community but the reproduction of a 'socio-territorial entity which is characterised by the active presence of both a community of people and a population of firms'. This implies that, in whatever way one might choose to assess the performance of IDs, one cannot assume away that changes in trust and confidence are likely to feed back on how these local systems of production function.

These considerations lead us to an alternative explanation. The point of departure is precisely that reproduction of the ID as a socio-territorial entity is possible so long as there is social cohesion, in the sense that the institutional setups associated to the population of firms and to the community of people are mutually consistent. The first setup includes what is functional to market performance, thus to competitiveness-enhancing and profitability-enhancing interaction. The second setup involves what affects the quality of peoples' lives: income and occupational stability; safe working conditions; social mobility; etc.

The two sub-systems maintain different rationales. Whenever internal or external circumstances change, these rationales may—at least to some extent—become inconsistent. In some instances this may disrupt the district system. This is precisely what occurs with the 'low road'. It puts internal rivalry (within the firm and within the value chain) before external rivalry (between the ID and other areas). It subordinates the values and institutions concerning the quality of life to the institutions affecting the market. In so doing, it generates an inconsistency between these two sets of institutions, thereby undermining the conditions for district vitality.

The 'low road' strategy is the consequence of an incentive structure that disregards innovation, that favours short-termism, that does not preclude cost shifting and the consequent insurgence of social costs, and that does not consider social cohesion as a priority. It is the outcome of only one out of many possible incentive structures. The alternative strategy we have been discussing—the 'high road'—would reinforce the virtuous cumulative effects of the canonical model. It would require an appropriate public action, however, such as the introduction and enforcement of laws in favour of safe working conditions and against irregular labour, and incentives that make precarious jobs and dangerous working conditions ever more costly.

What is important, however, is not the specific type of intervention but the need for public action that is not merely supplementary to the decisions of the major actors involved in an ID. Doubtless, measures that provide 'real services' (Brusco, 1992) or 'collective goods' (Crouch *et al.*, 2001), and the 'provision of forums for regular exchange and debate among representatives of the various interest groups (...) in order to develop a shared understanding of local problems and to come to commonly-agreed programmes of action' (Dei Ottati, 1996B, p. 62) are important. These policies allow actors to properly choose and carry out their strategies. They are consistent with a situation where IDs are on the high road and where the task of public policy is just to reinforce the existing incentive structure. The data provided above, however, suggest that changes in the economic environment are dramatically affecting incentives, thereby calling for a different approach to public policy.

Viewed from this perspective, the real deadweight is that 'the legacy has been to assume that the artisans and small firms knew their business best, such that the tasks of public policy should be to facilitate access to the factors of production (credit, business services, labour, etc.)' (Amin, 1999, p. 398). What is called for is a switch from the dominant

*adaptive rationality* of IDs to a *strategic rationality* (Lombardi, 1994). From a public policy perspective, this switch involves two issues. First, in order to prevent strategies that are convenient in the short-run (and only to some actors) but not in the long-run (and not to the district as a whole) policy makers must not simply enable actors to choose their best strategies within a given scenario: they must create the appropriate scenario.

Second, the scenario must ensure that economic growth goes along with the reproduction of social cohesion, that is, mutual trust among the actors of the ID and confidence in the opportunities provided by the district. In this perspective, measures against economic and health precariousness would involve a change in the incentive structure that would presumably favour a ‘high road’ scenario, thereby changing expectations, strategies and the very frameworks for ‘commonly-agreed programmes of action’.

Let us look at the issue from a more abstract theoretical perspective. Sections 2 and 3, pointed out that an ID is a subsystem of a market system, which in turn is a subsystem of a social system. This systemic openness of the ID implies that its regulation depends on elements that are generated within it as well as outside of it. Lane (2002) refers to these institutions as ‘scaffolds’.

Even when ‘scaffolds’ arise to make single sub-systems work, they must operate so as to make them work in a mutually compatible way. Macro-regulation involves all sub-systems, not only markets. As Bagnasco (2002, p. 290) argues: ‘The great regulative systems must be thought of as market mechanisms, political regulation and social self-organisation.’ This involves dealing with all types of scaffolds and considering all of society as a terms of reference. Rather than taking growth to be a constraint, what is required is a redefinition of development priorities.<sup>1</sup> In this perspective IDs are a special type of organisation. Like all organisations, their self-organising characteristics do not ensure the solution to all conflicts. As March and Simon (1958) taught us half a century ago, a solution may require not only persuasion and bargaining but also politics, i.e. the establishment and management of appropriate power relations. When the balance between the two subsystems of a district is dubious, explicit public action may be better than ‘spontaneous’ adjustments.

This is not to say that policy makers are able to envisage what the overall outcome of these policies will be. They must play the role they are assigned by the community: to interact with other social and economic actors in order to avoid social disruption and to enhance development. In the absence of optimal strategies, all actors—including policy makers—deal with an uncertain environment, and no unique outcome can be envisaged. As Sabel (2006) suggests, they put together the pieces of a social and economic puzzle, but there is no picture to show them what will come out. What is important is less what the actual picture will be than the guidelines underlying public action.<sup>2</sup>

## 6. Conclusions

The available data suggests that business reactions to changes in aggregate demand, in technology and in international trade are transforming Italian IDs. This raises the question whether the canonical view of IDs is a matter of the past or not. This paper argues that the canonical view stresses an issue that present discussions concerning both the decline of

<sup>1</sup> Lovering (2001) correctly distinguishes between development *in* a region and development *of* a region.

<sup>2</sup> A discussion of what the latter should consist of lies beyond the scope of this paper but approaches to development that do not use strictly economic goals abound, a prominent example being A. Sen (1988, 1999).

Italy's economy and present changes in Italian districts tend to disregard. The issue is that the vitality of IDs depended on the interdependence between the strictly economic and the social dimensions of districts. Any change in the former would feedback on the latter in such a way that it could prevent both its economic and social reproduction.

Business reactions to recent economic change include the emergence of leader firms and the reorganisation of firms within company-groups. In terms of economic performance of industries, the mechanical industry tends to substitute consumer goods, although employment as whole drops. As for firms, there is a widening gap between successful and unsuccessful firms and the turnover of firms drops along with employment. It is most likely that the gap is associated with the emergence of leader firms and to the related asymmetry—in terms of bargaining power—that is likely to exist within the vertical supply chain.

Setting up a firm is ever more difficult, so industrial districts fail to function as firm incubators. If someone sets up a firm and is not successful it is unlikely that she will easily find another job. These circumstances undermine the potential for social mobility. Furthermore, since it is less easy to find a job than in the past, workers have less wage-related bargaining power than before.

On-job mortality is relatively high in industrial districts. Coupled with the rise in unemployment, this is evidence that firms are shifting their private costs onto workers and that families have to take on the role of social buffers that districts previously had. Given the available data, it is not possible to see whether these social costs prevail in the less dynamic consumer goods industries rather than in the mechanical. The distribution of non-regular jobs suggests that this may actually be the case.

This information may not be conclusive but there is reason to believe that the above changes affect trust relationships and confidence in the performance of districts. In other words, social cohesion in IDs—a crucial requirement for the vitality of these socio-economic setups, at least in their (canonical) configuration—may be declining. Thus, the relatively positive economic performance of IDs seems to occur at the expense of their long-term social and economic viability. This need not mean that they are going to disappear: they are changing into something else—possibly industrial clusters—with less stringent requirements in terms of social cohesion. The literature cited in Section 2 suggests that IDs should become similar to big business. The above discussion of ID performance suggests that this is what is probably going on.

This change raises a few issues. First, how can we judge it? The substitution of leader firms for the social and economic interaction that characterised IDs is associated with high social costs to the point that the fairly good performance of IDs seems to depend less on their specific characteristics than on the bad performance of large industry and big business in general. People may eventually adapt to unpleasant circumstances, at the very least because they wish to avoid the cognitive dissonance between their desires and the status quo, but this has little to do with what Section 3 referred to as 'a community of shared values, shared challenges and equal opportunity . . . based on a sense of trust, hope and reciprocity'. Under these circumstances, compliance with the status quo may not be the best strategy.

Second, what can be done? If we accept the above remarks, whereby strictly economic goals should not prevail over social integration, a strategy is called for that goes beyond the canonical view. Public policy is required because the choice context that private ID actors are faced with does not allow them to choose how to overcome this situation: when profit priorities prevail over social needs, firms substitute the—fairly demanding—social

coordination of economic activity within the ID with the definitely less demanding coordination carried out by relative prices and the profit motive. Social needs become constraints rather than goals and the ensuing action and institutions tend to enter a path-dependent process that leads IDs astray.

Any action that aims to increase the competitiveness of IDs and their contribution to economic growth while it maintains social cohesion must re-establish a balance between the requirements of the two subsystems that comprise them, i.e. the social requirements of the community of people and the market-related requirements of the population of firms. This is what I referred to as the 'high road'. In order to pursue it, public policy cannot play a merely ancillary role, favouring appropriate choices within that path. It must change the incentive structure and the institutional and choice contexts so as to change that very path. Another way to look at the same issue is that policy makers must try to re-establish the synergy between the subsystems of IDs. When that synergy fails to occur, the alternative does not consist in some trade off between profit and social requirements: it is either a new synergy—such as some of the authors mentioned in Section 5 foresee—or *overall* decline, something that the strictly *economic* decline discussed in Section 2 is just a part of. This leads us to a third issue. As Section 2 argues, major contributions concerning Italy's industrial structure and possible economic decline are generally based on the assumption that the division of labour is determined by technological specificities and relative prices. In this perspective, institutions tend to be assessed exclusively in terms of whether they are consistent with the resulting market conditions. The approach followed here suggests that this institutional instrumentalism does not allow a proper understanding of current changes and prevents the identification of appropriate strategies to deal with change. A more convincing approach was suggested here, based on a macro-regulation perspective that takes account of both economic and social requirements.

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