

*Districts and institutions*

The Italian case is particularly important in the literature on small firms and districts. However, during the seventies, and in the following decade, similar phenomena were also signaled and described in different contexts: in several European countries, the United States, and Japan. A truly systematic comparative study of these cases has never been carried out, probably because of their variety. All the same, several contributions have attempted to highlight some patterns resulting from the studies on various countries (cf. in particular, Sabel 1988; Pyke and Sengenberger 1992; Bagnasco and Sabel 1994; Storper 1997; Cooke and Morgan 1998). Industrial districts oriented towards flexible production are tied to specific cognitive and normative resources. The following features can be underlined in particular:

- 1 With regard to the cognitive features, two orders of factors influence know-how and entrepreneurship. In many cases, including the Italian one, there were substantial artisan traditions, supported by good technical schools and other training institutions. In others, the cognitive resources mainly derived from the proximity of public and private research institutions (also linked to large firms), and in particular from the presence of important universities developing close exchanges with firms. This factor has been crucial in some of the better known American experiments, as shown by the cases of Silicon Valley, near San Francisco, specializing in the production of semi-conductors, and the area of "route 128" near Boston, specializing in mini-computers (Saxenian 1994). Several other cases, for example, that of Baden-Wurttemberg in Germany, illustrate features typical of both patterns.
- 2 The variability among these experiences is wider in relation to the normative dimension. However, the capacity for cooperation and the existence of trust relations are vital resources and are usually influenced by distinct local identities that persisted over time. In some cases these have a religious matrix, in others their origin may be either political or ethnic. The embeddedness of the district into the context of a local community (Becattini 1990) appears, however, to be a constant pattern. This kind of territorial rootedness allows for more direct and face-to-face interactions, and favors circulation of information and monitoring of behaviors that support trust. Therefore, those who deviate from shared expectations can be rapidly isolated, through mechanisms of social exclusion. Local identity and community relations, in their turn, are linked to a development that has not been shaped by mass-production, with its sociocultural consequences.
- 3 Cognitive and normative resources are not only important to explain the origins of districts, but also for understanding how these reproduce over time. As regards specialized knowledge and know-how, one has to consider the role of institutions that favor the continuous adaptation of the local context to the new problems that emerge over time. Some of these aim, for example, at bridging the gap between the local know-how and the constantly evolving scientific and technical knowledge (centers for technology diffusion, for entrepreneurial and labor training, etc.). In addition, there are also institutions for the production of collective goods (information on markets, export promotion, etc.). It would seem in fact

that it is this resource – the provision of “local collective competition goods” (Crouch et al. 2001) – that characterizes industrial districts most strongly, even if the form it takes can vary widely: private centers, promoted by business associations, public bodies usually promoted by local governments, mixed institutions run jointly by private and public actors.

4 The role of normative resources, particularly for the regulation of labor relations, is subject to stronger variability. Flexibility, in fact, requires a high capacity for cooperation and a strong involvement by workers to increase product quality. Traditional cultural identities are also not sufficient to favor labor cooperation, because traditional ties tend to weaken with economic development. Two ideal-typical solutions seem to emerge, with many intermediate possibilities. In the first there is a lack of institutionalized industrial relations. However, less favorable wage and labor conditions are usually compensated by high chances of individual mobility. Contrary to what happened in mass production, many dependent workers may become self-employed and set up small firms. The second involves more institutionalized but cooperative industrial relations. This favors more negotiated and compensated forms of flexibility as, for instance, in the more consolidated Italian districts, or in the German cases. The Italian experience also shows that a gradual movement from the first to the second pattern may occur over time, as local development proceeds.

Summing up, it is worth underlining that the continuous adjustment of cognitive resources and the social acceptance of the economic model are crucial for industrial districts. The success in adjusting to external challenges is by no means achieved once and for all, nor is it simply grounded in previous historical conditions. It is the result of the continuous capacity of local actors to find new solutions and to produce new collective goods on which the well-being of the local society depends.

## 2.2 *The transformation of large firms*

After the “discovery” of industrial districts, the investigation extended to large firms, which also began to experiment with models of flexible production, although following diverse patterns. However, some typical features can be identified and described, contrasting them to the traditional model of mass production. The experiences of Germany and Japan are important in this context, because – despite their differences – experimentation with flexible production forms was more widespread and earlier here than elsewhere. In dealing with the variant form of flexible specialization involving large firms, I will use Charles Sabel’s summary (1988). For its institutional correlates, the work by Wolfgang Streeck (1992, ch. 1) on the German case and Ronald Dore (1986, 1987) on the Japanese one are of particular interest.

The starting point is the growing instability and fragmentation of markets. Predictability, which was an essential prerequisite of the Fordist model, declined sharply, as did the possibility of large investments in specialized machinery, since these run the risk of not being profitable, given demand variability and the rapid obsolescence of products. As a result, experimental reorganization was undertaken with the aim of offering a wider range of products (since the success of any of these

could not be guaranteed in advance), as well as rapidly producing what the market demands.

1 For the large firms that want to compete successfully, it became necessary to reduce the Fordist separation between conception and execution of products, since this means that the introduction of any new products is extremely slow and elaborate, and is subject to rigid procedures. To overcome these problems new forms of decentralized authority were experimented with, to reduce the gap between operating units and the market demands, and to favor more rapid productive adjustment. Thus, headquarters shrank and only dealt with strategic decisions. At the same time, the central research and development laboratories and product design structures were dismantled or cut down, and new facilities of this kind were created in the operating units. In this way it is possible to reduce the gap between conception and execution and to gather and process information from the market more quickly. The operating units took on the form of semi-autonomous firms overseeing distinct productions, while from the financial point of view the large firm, often a multinational, was transformed into a holding controlling the firms now specializing in particular products.

2 Internal organization also changed, especially the organization of labor, and the viability of Taylorist models began to be questioned (Kern and Schumann 1984). The possibility of producing differentiated goods in short series, with continuous adjustments to new demands, required a reduction of redundant resources; this trend had been widely practised by the Japanese with what is called the *just-in-time* organizational principle. This involves the reduction of waste, slack, and buffer stocks, synchronizing production as closely as possible with market demand. However, to achieve these results, a high level of collaboration and involvement on the part of labor is necessary. In addition, the use of less specialized machinery, useable for different productions, requires higher labor skills. Workers must acquire broader skills, they must accustom themselves to group work, which are flexibly formed and reshuffled according to changing productive needs, and they must be ready promptly to intervene to avoid production defects, contributing to quality. In other words, the new organization of the firm and labor requires, unlike the Fordist-Taylorist model, a more active participation and greater amount of involvement by labor.

3 The large firm did not only reorganize internally, but also opened its boundaries, strengthening collaboration with subcontractors who are often localized in areas of product specialization. Since the costs of developing new products increase a great deal, while their life cycle tends to shorten, it becomes less possible, even for multinationals, to do everything on their own. They tended, therefore, to concentrate more on the development of several key technologies, on the design and overall assembly of the final product. The complementary parts were instead increasingly produced in collaboration with a network of subsuppliers, which tend in turn to decentralize the production of simpler components to other second or third tier subcontractors. Moreover, for subsuppliers to be more effective and play a role as partners, rather than as mere dependent units, they were increasingly encouraged not to work for the parent company only. By working for more than one purchaser, and being more exposed to the market stimuli, their capacity to

learn may increase. Moreover, they can compensate for decline in certain products with other orders, enhancing productive flexibility and therefore reducing costs for the purchasing firm. In practice, then, on the one hand, the subsuppliers of the first tier are more closely integrated through formal and informal agreements of collaboration with the parent company; on the other, they are encouraged to compete on the market.

4 Like small firms and the districts, for the large firms that moved towards flexible specialization the role played by cultural and institutional factors was extremely important. Once they started this kind of reorganization, they become more dependent on the external environment – to use one of Polanyi's concepts, they became more embedded – than if they had continued relying on the Fordist model. In other words, it is the institutional context that influences the possibility of adapting rapidly to flexible productive models. As with the districts, the variability of institutional factors is, however, high, and it is thus usually more difficult to move from empirical observations to generalizations. I shall try to do so all the same, using the experiences of Germany and Japan during the eighties, since these provide the most successful examples of large firms using flexible specialization methods. In this case too, a distinction between normative and cognitive factors will be made.

5 The ability to learn through a more intense and efficient cooperation between the various structures and subjects working in the firm environment seems favored in those contexts where the role of hierarchy and the diffusion of low labor skills are considerably less than in the Fordist standard. This, for example, happened in the Japanese case, where the firm was traditionally conceived as a community rather than as a network of contracts, and where commitment to the professional training of the labor force was high. It also occurred in Germany as a result of the procedures known as "co-determination," which features a formalized involvement of the workers in company management, as well as stronger commitment to vocational training than was traditionally the case. These examples also show that the extension of cognitive resources through cooperation is favored by particular normative resources, that is, through institutionalized rules providing incentives for workers to behave cooperatively. The concept of jobs for life, the role of cooperative enterprise unionism, the extension of wage incentives tied to firm performance all supported cooperation in Japan. In Germany, highly institutionalized industrial relations at the firm level, even if unions were more integrated at the sectoral and national level on the national scale, played a similar role. In addition, the existence of constraints and rigidity in the use of labor also constituted an incentive for firms to invest more in the vocational training of workers, since they could not easily be dismissed. In addition, firms were also supported by external institutions (jointly run by private and public actors) which provided efficient training for workers, thereby lowering the costs of private investment. Without the legal and union constraints on the use of labor, and without these external institutions, firms would in fact be forced to invest less in training and, above all, to invest in training programs more strictly linked to the immediate needs of the firms, thus reducing the overall level of skill which allows for more rapid and effective forms of adaptation to new production. All this helped to create those "redundant resources" in terms of skills which provided a crucial asset for flexible and quality production.

6 Another important factor that affects the availability of cognitive resources for innovation is the diffusion of external collaborations. Large firms searched for contacts with networks of specialized subcontractors, which are usually quite small and localized in areas of productive specialization or in industrial districts, where they benefit from large external economies. Clearly, the possibilities for large firms to experiment with flexible specialization were conditioned by the availability of such subcontractors. This resource is more easily found where cultural and institutional factors have limited the impact of the Fordist model on economic organization. Among these factors one also has to include public policies which have helped SMEs, for example by fiscal measures or the regulation of labor relations. Moreover, public and private initiatives to strengthen cooperation at the local level should also be taken into account. These measures usually favored the innovative capacity of small specialized firms through the production of collective goods (technology, diffusion, market information, training, etc.). From this point of view, the institutional conditions facilitating the large firm variant of flexible specialization tend to coincide with those that were analyzed in reference to districts. The importance of institutional interventions which, for cultural reasons or political consensus, led to the preservation of a socioeconomic environment that was not eroded by Fordism, is confirmed. This is another aspect of that redundancy of resources that was crucial, in the new conditions, for flexible models.

The tendencies examined so far indicate that experimentation with flexible models leads to a certain amount of convergence between the variant based on districts and that centered on large firms (Sabel 1988; Regini and Sabel 1989). Wolfgang Streeck (1992) has also underlined this trend by introducing the concept of *diversified quality production*. This was realized by both large firms using the new flexible technologies to produce large amounts of non-standard quality goods and by smaller and artisan firms which could now enhance their production of non-standard goods at lower prices. In other words, the boundaries between large and small firms blurred. What should be remembered, however, is that the basis of the new flexible model is not only technological but to a large extent organizational. In both cases – for the large and for the small firms – a network model of organization, based on an extended collaboration between firms, develops. It breaks down the vertical and hierarchical integration of the Fordist model. Districts can be seen as *networks of small and medium-sized firms*, while the large firm transforms into a *networked firm*.

The networks function as “learning systems,” that is, as sets of formal and informal relations reinforcing the capacity for rapid adjustment to market changes. It is no longer the firm as a hierarchy that decides on its productive objectives and imposes them on the market; instead, it is the market, in a new fragmented and unstable form, which requires more rapid and costly adjustments. Networks allow the speed of adjustment and capacity for learning to be reinforced, as well as the costs of the new products to be reduced, by distributing them over a wider range of subjects and thus lowering the risks. Networks are able to carry out these tasks better because collaboration is based on a series of formal and informal links and does not require a detailed definition of contractual clauses between the involved parties (which would in fact be very complex and inevitably incomplete). But at

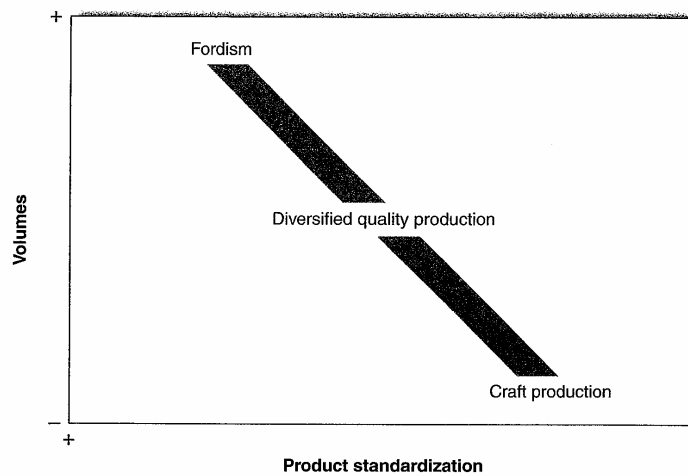


Figure 9.1 *Diversified quality production*

the same time, networks avoid the bureaucratic rigidity and slowness of the hierarchy.

The importance of cooperation for flexible models means that the large and small firms adopting them become more dependent on the social context in which they operate. While the Fordist model can be seen as an organizational device that strengthened the autonomy of the firm from its external environment, in flexible production this relation tends to be reversed. As we have seen, in contexts where trust relations facilitate cooperation, and institutions generate and reproduce them, networks can be constructed more easily and they work better. In Fordism, the institutional conditions influencing the demand management at the central level (composition of governments, system of representation, etc.) are most important; in flexible models, institutional factors influencing the supply side at local and regional levels become crucial.

### 2.3 *The other side of flexibility: the informal economy*

The shortcomings of Fordism and the restructuring of welfare systems also led to different forms of flexibility in the production of goods and services. These were tied to reduced economic dynamism, lower capacity for innovation, and less favorable labor relations. Therefore, interest grew in the *informal economy*, not only as a device for adapting to the new situation, but also as a widespread tendency in

more backward countries and regions. As a first and rough description, this kind of economy can be considered to be the total production and distribution of goods and services that evade the national accounting system either completely or in part. In other words, the informal economy is identified with the invisible, hidden or underground economy. This general definition includes various phenomena, from direct subsistence production on the part of households, to industrial production through non-registered labor, to the criminal economy in drug trafficking or illegal gambling. It is therefore necessary to distinguish analytically the different relations that each one of these forms has with the formal economy if we want to understand the various patterns of development of the informal economy (Bagnasco 1990; Portes 1994).

A more precise definition of the informal economy can therefore be based on three dimensions: the modalities of production of goods and services, which can be legal or not; the type of goods and services produced, which can also be licit or illicit; and, finally, the destination of production to market or to household subsistence. The formal economy is thus constituted by production destined for the market of lawful goods and services, realized through practices that do not violate the law. In contrast, the informal economy is characterized by the lack of one or more of such requirements. In particular:

- 1 goods and services that are themselves illegal and produced by illegal means make up the *criminal economy*;
- 2 goods and services that are themselves legal, but which are produced wholly or partly by illegal means (e.g. with unregistered labor or fiscal evasion) make up the *hidden economy*, or "black" economy, component;
- 3 goods and services that are themselves legal and produced through legal means, but which are not oriented to a household or a community's direct consumption rather than the market, make up the *domestic and communal economy*.

This distinction between a formal economy and the various components of informal economy shows how the boundaries between the two spheres are uncertain and variable. First, for the distinction to hold, it is necessary that a formal economy can rely on well-defined and enforced legal rules for the regulation of economic activities of the market. Where this is not the case, as, for example, in the Third World or other backward regions, it is difficult to distinguish between the formal and informal spheres. In a certain sense all activities tend to be informal

Table 9.1 *Formal and informal economy*

	<i>Methods of production</i>	<i>Products</i>	<i>Market orientation</i>
<b>Formal economy</b>	legal	legal	yes
<b>Informal economy</b>			
<b>Hidden</b>	illegal	legal	yes
<b>Criminal</b>	illegal	illegal	yes
<b>Domestic-communal</b>	illegal	legal	no

(Portes, Castells, and Benton 1989). Second, the type of relations that single components of the informal economy can hold between them and with sectors of the formal economy should be taken into account. Thus, for example, domestic or communal production can provide additional resources for actors working in the hidden economy who produce for the market under illegal conditions. In turn, this production can increase the flexibility of small or large firms in the formal economy, which decentralize the simpler and more labor-intensive components of their production.

From the mid-seventies on, economic sociology focused increasingly on the informal economy, particularly the domestic and communal forms, and the hidden economy. On the one hand, attitudes towards the spread of these activities in the less-developed areas began to change. They were no longer seen as mere forms of economic backwardness and isolation, bound to be overwhelmed by the growth of modern activities (see chapter 7). Instead, they began to be viewed also as possible tools through which these areas could seize new opportunities opening up in the international division of labor. On the other hand, the diffusion of the informal economy in more-developed areas triggered great interest and opened up new research fields.<sup>2</sup> The approach that economic sociology tends to adopt, using empirical investigations and case studies, led to the discovery of the proportions of hidden or domestic economies, which were not revealed by official statistics. Moreover, in all these cases, as for those of the less-developed areas, the role played by some specific cultural and institutional factors is very important for the origin and operation of the informal economy. This is the field where economic sociology has contributed the most, as will be shown below.

In the absence of information and precise measures, it is difficult to establish with any precision if and to what extent the activities of the informal economy have grown over the last few years. The literature dealing with this problem suggests a reversal of the trend that occurred during the seventies. In the early development of liberal capitalism and successively in its more organized and politically regulated forms, the prevailing tendency seems to have been that of a progressive shift of informal activities towards the sphere of the formal economy. In the field of goods production, this has gone together with the growth of large firms, and with the extension of production for the market. In the field of services there has been a decline in traditional forms of provision, which were previously regulated by mechanisms of reciprocity based on the family, kin and community, and were partly substituted by the welfare state. The reversal of both these trends can be linked to the crisis of Fordist production and welfare systems.

With regard to the first aspect, it has been argued that the problems and transformations of mass production nourished the informal economy, in particular in its hidden or black forms. This may occur directly, as a form of adaptation by workers to growing unemployment,<sup>3</sup> and as a reaction by firms in their attempt to make savings in costs by deregulating labor relations and decentralizing production of goods and services to external firms. In addition, the informal economy can be favored indirectly because the higher variability and fragmentation of markets opens up new spaces for flexible production, which can stimulate some components of the hidden economy. Moreover, the improvement of communication technologies and transport facilitates the strategies of decentralization and delocalizing



of production by large and small firms of the formal economy, contrasting with the search for lower costs which often involves the hidden economy.

It is also possible to distinguish between direct and mediated influences of the difficulties of welfare states. Among the former there is obviously a trend to increase the self-provision of goods and services by households given the retrenching of welfare systems and growing unemployment. The increase in domestic and communal economies, however, frequently reveals new social demands (for example, for care for the elderly, children, the ill or the disabled) that are difficult to satisfy through traditional and over-bureaucratized public services (Paci 1989). This demand is often covered by family and community networks, based on reciprocity. In some cases, the actors involved are motivated by altruistic attitudes, while in others instrumental orientations prevail and actors are more interested in the exchange of services and goods. It is in this way that research on the informal economy tends to link up with that on the self-provisioning of services, on the so-called "third sector," and on the role of the voluntary associations (Ascoli 1987; Gidron, Kramer, and Salamon 1992).

Some scholars have also drawn attention to other factors that can be included together with unemployment and the restructuring of welfare systems. They have pointed out the high cost of final services offered on the market, in particular in the field of maintenance and repairing of goods, such as, for example, home repair or household appliances, or in the field of personal services (caring). On the other hand, the new technologies now offer instruments that facilitate the self-provision of such services by consumers themselves through direct forms such as "do-it-yourself" and through help exchanges that do not go through the market. This trend has further contributed to the growth of the domestic and community economy (Gershuny 1978, 1985; Pahl and Wallace 1985).

As can be seen, the patterns underpinning informal economies are varied and complex. There is, however, one element that strongly characterizes them all – the use of forms of reciprocity as predominant regulatory principle. In other words, the extension of the informal economy in both backward and advanced contemporary societies signals the existence of a wide component of the economy that is – or becomes – less differentiated from the social relations of a family, kin or community type. This is even more clear in the hidden economy.

In the latter case a series of conditions influences the demand side: the search for greater flexibility in the use and cost of labor by firms in the formal economy; new technologies of communication and the improvement of transport, favoring decentralization and delocalization; the fragmentation and variability of markets which, together with flexible technologies, open up spaces for informal production in small firms, and for self-employed and domestic labor. The supply side of informal work is dependent on the growing unemployment and the reduction in welfare protection. However, it should be considered that these conditions do not lead directly to the spread of a hidden economy. For this to occur a crucial role is also played by the institutional context, since it functions as a sort of intervening variable, like a connecting device between demand and supply.

<sup>1</sup> The institutional context involves the role of cognitive resources. Where there is know-how tied to artisan and commercial traditions and to the presence of small

firms and self-employment, or imported through immigration, it is easier to organize autonomous activities. That is to say, a type of entrepreneurship emerges that is capable of creating and managing informal activities.

2 The institutional context also influences normative resources. From this point of view, norms obstructing the demand for informal activities can be distinguished from institutional factors that instead encourage their supply. The level of regulation of economic activities can also be considered. If regulation does not place excessive constraints on formal activities, for example, through fiscal pressure or administrative regulations and industrial relations, the demand for informal activities will be more limited. The same goes for the efficiency of state control over economic activities and the enforcement of regulative norms. If the constraints are very strong, hindering the productivity and profitability of firms, and if law enforcement is weak, the demand for informal activities will be higher.

3 The increase in unemployment, low income, and the reduced coverage of the welfare state are not the only factors affecting the supply of entrepreneurship and labor in the hidden economy. Just as crucial is the role of variables affecting trust relations and shared values, as well as a commitment to hard work. Social networks are essential because the relations of firms with final buyers, with other subcontracting firms, and between entrepreneurs and workers, presuppose a high level of trust. Without this, transactions in the hidden economy could not take place, since it is not possible to refer to legal contracts, enforceable by the state in the case of violation. At the same time it is necessary to minimize the risks of these illegal activities being reported to the authorities. The parties involved must therefore know each other well in order to trust each other. In addition, social networks are essential not only to procure labor but also to supply the necessary credit for starting up and carrying out the activities. Clearly, in these cases it is not possible to refer to the credit structures of the formal economy (banks or stock market). This problem is resolved through the exchange of help within the family or kinship structures, or at the level of the local community, particularly where there are strong ethnic identities, for instance, between immigrants from the same countries.

4 The institutional context is thus an essential mediator between the supply of and demand for goods and services in the hidden economy. Where it is based on a community fabric that is capable of mobilizing the cognitive and normative resources supporting informal activities, these will be more highly developed. It is no accident that territorial links are an essential aspect of these forms of economy, since it is in this type of context that networks of relations can also be fostered, allowing for the mobilization of resources, the monitoring of the subjects involved, and sanctions assigned to those who break trust. This explains why different forms of hidden economies are common within areas of large modern cities, as is clear from the American case with New York, San Francisco, Miami and many other cities characterized by ethnic communities and groups of immigrants with strong internal cohesion (Portes 1994). This is also the case in many backward regions, both in cities and in minor centers where local traditional communities are rooted, and where the family plays a crucial economic role, as in Southern Italy, Spain and other Mediterranean countries (Mingione 1995), or in Latin-American and Asiatic contexts. The growing importance of immigrant communities in developed coun-