From Industrial Capital to Modern 'Urban Miracle'?

The Political Economy of Governance, Growth and Development in Medellín, Colombia

Thesis submitted for the degree of PhD in ECONOMICS

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ABSTRACT

This thesis provides a political economy analysis of governance, growth and development using the case study of Colombia's second city Medellín. Most conventional explanations consider 'good governance' reforms to be the institutional underpinnings for Medellín's recent developments, arguing that a standard set of institutions and governance capabilities were necessary to achieve an "urban miracle". In contrast, this thesis uses a historical political economy framework to argue that, for a detailed understanding of institutional changes and their respective implications, we need to analyse the interdependency between power and institutions. When interactions of powerful actors and institutions achieve a sustainable level of growth and stability a 'political settlement' emerges. This political settlements approach argues that there are no 'good' or 'bad' institutions per se, but only favourable and less favourable interdependent combinations of power and institutions that affect the capabilities of governance agencies to reduce growth-constraining transaction costs and to maintain political stability. The theoretical originality of this thesis is the analysis of how decentralized governance and globalized economic networks have changed the dynamics of traditional power structures and challenged standard strategies of institutional rent management. In particular, it explores ways in which these processes may expand the political settlements approach.

Challenging conventional analyses of the role of institutions for growth, this thesis applies a mixed methods case study approach using qualitative and quantitative data to illuminate three original contributions to the understanding of Medellín's development. First, it provides an alternative analysis of Medellín's industrialization process, arguing that favourable combinations of power and institutions enhanced growth in light manufacturing industries. Secondly, the thesis explores political economy explanations of how the distribution of power in Medellín's political settlement became largely incompatible with institutional mechanisms needed for the promotion of advanced industrial development. Insufficient governance capacities to create and distribute growth-enhancing rents in the 1970s led to economic slowdown, political instability, and violence. Thirdly, the thesis argues that recent developments in Medellín can be understood in the context of Colombia's radical shift to neoliberalism, which included decentralization reforms and a transnationalization of capitalist elite's interests. These changes have enduring implications. The new combination of power structures and institutions creates limited governance capabilities to incentivize productivity growth. The powerful position of the transnational capitalist elite in the ruling coalition furthermore hinders the enforcement of disciplining mechanisms. While these structures might stabilize the political settlement by gathering different elite factions around the axis of transnational accumulation patterns, they also facilitate Medellín's return to static comparative advantages in labour-intensive industries and low technological services, perpetuating the city's confinement in the low productivity end of global value chains.

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ACRONYMS AND ABBREVIATIONS

ACI	AGENCIA PARA LA COOPERACIÓN INTERNACIONAL DE MEDELLÍN (AGENCY FOR COOPERATION AND INVESTMENT OF MEDELLÍN, ACI)
ANDI	ASOCIACIÓN NACIONAL DE INDUSTRIALES (NATIONAL ASSOCIATION OF INDUSTRIALISTS)
AUC	AUTODEFENSAS UNIDAS DE COLOMBIA (THE UNITED SELF-DEFENCE FORCES OF COLOMBIA)
BANREP	BANCO DE LA REPÚBLICA (COLOMBIAN CENTRAL BANK)
BIC	BANCO INDUSTRIAL COLOMBIANO (INDUSTRIAL BANK OF COLOMBIA)
CCMA	CÁMARA DE COMERCIO DE MEDELLÍN PARA ANTIOQUIA (MEDELLÍN CHAMBER OF COMMERCE FOR ANTIOQUIA)
CEDEZOs	CENTROS DE DESARROLLO EMPRESARIAL ZONAL (ZONAL BUSINESS DEVELOPMENT CENTRES)
CEO	CHIEF EXECUTIVE OFFICER
CEPAL	COMISIÓN ECONÓMICA PARA AMÉRICA LATINA Y EL CARIBE (UNITED NATIONS ECONOMIC COMMISSION FOR LATIN AMERICA AND THE CARIBBEAN)
CINEP	CENTRO DE INVESTIGACIÓN Y EDUCACIÓN POPULAR PROGRAMA POR LA PAZ (CENTRE FOR INVESTIGATION AND POPULAR EDUCATION, PROGRAMME FOR PEACE)
COMFAMA	CAJA DE COMPENSACIÓN DAMILIAR DE ANTIOQUIA
COMFENALCO	CAJA DE COMPENSACIÓN DE LA FEDERACIÓN NACIONAL DE COMERCIANTES
COP	COLOMBIAN PESO
DANE	DEPARTAMENTO ADMINISTRATIVO NACIONAL DE ESTADÍSTICA (NATIONAL ADMINISTRATIVE DEPARTMENT OF STATISTICS)
DAP	DEPARTAMENTO ADMINISTRATIVO DE PLANEACIÓN (ADMINISTRATIVE DEPARTMENT OF PLANNING, MEDELLÍN)
DAS	DEPARTAMENTO ADMINISTRATIVO DE SEGURIDAD (ADMINISTRATIVE DEPARTMENT OF SECURITY)
DNP	DEPARTAMENTO NACIONAL DE PLANEACIÓN (NATIONAL PLANNING DEPARTMENT)
EAM	ENCUESTA ANUAL MANUFACTURERA (ANNUAL POLL OF MANUFACTURING)
ECF	EMPLOYMENT CONCENTRATION FACTOR
EDU	EMPRESA DE DESARROLLO URBANO (ENTERPRISE OF URBAN DEVELOPMENT)
EICE	EMPRESA INDUSTRIAL Y COMERCIAL DEL ESTADO (PUBLIC INDUSTRIAL AND COMMERCIAL COMPANY)
ELN	EJÉRCITO DE LIBERACIÓN NACIONAL (NATIONAL LIBERATION ARMY)
EPL	EJÉRCITO POPULAR DE LIBERACIÓN (POPULAR LIBERATION ARMY)
EPM	EMPRESAS PÚBLICAS DE MEDELLÍN (PUBLIC ENTREPRISES OF MEDELLÍN)
ESP	EMPRESA DE SERVICIOS PÚBLICOS (PUBLIC UTILITIES COMPANY)

FARC	Fuerzas Armadas Revolucionarias de Colombia (Revolutionary Armed Forces of Colombia)
FDI	Foreign Direct Investment
FNC	Federación Nacional de Cafeteros (National Federation of Coffee Growers)
GDP	Gross Domestic Product
GEA	Grupo Empresarial Antioqueño (Antioquian Business Group)
GEIH	Gran Encuesta Integrada de Hogares (Large Integrated Household Survey)
GTC	Growth-Constraining Transaction Costs
HDI	Human Development Index
IDB	Inter-American Development Bank
IFIs	International Financial Institutions
IFInd	Instituto de Fomento Industrial (Institute of Industrial Promotion)
ISI	Import Substitution Industrialization
IT	Information Technology
LDS	Local Developmental State
LPF	Labour Productivity Factor
MEGA	Meta Estratégica Grande y Ambiciosa (Strategy for a Large and Ambitious Goal)
MNE	Multinational Enterprise
NGO	Non-Governmental Organization
NIE	New Institutional Economics
PEPES	Perseguidos por Pablo Escobar (People Persecuted by Pablo Escobar)
PILA	Planilla Integrada de Liquidación de Aportes para Seguridad Social (Integrated Liquidation Accounts for Social Security)
PUI	Proyectos Urbanos Integrales (Integral Urban Projects)
QE	Quantitative Easing
QRs	Quantitative Restrictions
R&D	Research and Development
SIEM	Sistema de Indicadores Estratégicos de Medellín (The System of Strategic Indicators of Medellín)
TSC	Transition Costs
UNCTAD	United Nations Conference for Trade and Development
UNHABITAT	United Nations Human Settlements Programme
UNHCR	United Nations High Commissioner for Refugees

US$	UNITED STATES DOLLAR
VAT	VALUE-ADDED TAX
WTO	WORLD TRADE ORGANIZATION

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CHAPTER ONE: INTRODUCTION

> *"Development should be reconceived not as a national phenomenon, in which what develops is a nation, but in terms of developed, underdeveloped, and intermediate population groups occupying contradictory or unstable locations in a transnational environment"* (Robinson, 2010, p. 46).

> *"The cities in Latin America have something that makes them a kind of summary, a microcosm of the world. The elite… lives in orderly, perfect neighbourhoods, similar to the population of the First World: these places could be Norway or Switzerland. This elite dominates the economy, makes decisions, organizes armies, plans the future. Quite a large mass of people… has to survive in terrible neighbourhoods, in conditions of poverty, overcrowding, despair. They have no water or sewer systems, live with hunger: these places could be in Africa. In the city where I live, Medellín, in only a half hour on the metro, you can move from Sweden to Sudan"* (Abad Faciolince, 2014, pp. 389–390).

These accounts of the relationship between space, interests, and inequality fittingly capture some of the core contributions of this thesis. As Robinson (2010) argues, development today must be conceived as much more than efforts at growth stimulation on the national level. As such, the approach used in this study goes beyond the focus of many institutional theories on the role of institutions for development and includes a political economy analysis of decentralization processes and transnational factors. Further, this thesis provides a detailed political economy discussion of historical and social processes in Colombia that have shaped the institutional environment in which policies can be implemented to achieve political and economic development. The thesis specifically analyses how different institutional processes and governance reforms following the implementation of decentralization and liberalization policies in Colombia and the transnationalization of local elite factions affected developmental outcomes of the country's second city Medellín.

In this context, the thesis addresses the following research questions, from the vantage point of its case study Medellín:

1. How can we frame theories of institutions, governance and development in ways that contextualise institutional change in the historic and social processes that have shaped political and economic environments of transitional societies?

This first theoretical research question departs from conventional institutional approaches that use the 'good governance' framework. By proposing a standard set of institutions and by depoliticizing economic decision-making processes, the 'good governance' agenda discounts the importance of context-specific analyses of the societies in which these institutions are implemented. The research question points towards the need of studying historically evolved power structures in order to understand the impacts of institutional change on actual developmental outcomes. The research question thus provides the entry point for a discussion of a broader theoretical framework that includes the study of political and social processes that shape power structures and impact efficiency and distributive institutional functions.

The second research question highlights that the parallel processes of decentralization and transnationalization change the contexts in which institutions are implemented and enforced. Recognizing that development policies are not exclusively defined nationally, the research question thus stresses the need for institutional approaches to extend beyond the narrow focus on the analysis of national-level institutions, policies and power structures.

2. In which ways do decentralized structures and globalized processes impact the political economy analysis of institutional change in less developed countries? In particular, how does the transnationalization of local factions of the capitalist elite in Latin America affect power structures and institutional mechanisms in ways that have implications for the implementation and enforcement of policies that can achieve sustainable levels of political and economic viability?

Research questions 3-6 relate to the empirical contribution of this thesis. Chapter two contextualises these questions in closer detail, identifying the specific gaps in existing empirical analyses of Medellín's development that this study intends to fill.

3. How did historical and social processes shape the development of the interdependency between power and institutions in Medellín in ways that led to the creation of favourable conditions for industrialization?
4. How can changes in the constellation of power, elite interests, governance capacities of the state, and entrepreneurial capabilities of the city's private sector explain why the regional economy deindustrialized? How did the changing nature of these factors shape developmental outcomes?
5. What are the impacts of elite transnationalization and political decentralization on the distribution of power and the institutional environment in Medellín? What effects did these changes have on the city's development trajectory in recent years?
6. Has Medellín's development resulted in sustainable outcomes that could generate political stability and economic growth in high productivity sectors? Why does Medellín remain the most unequal urban area in Colombia – one of the most unequal countries worldwide?

Before engaging in a detailed analysis of these research questions, the remainder of this introduction provides an overview of the theoretical debate and research area in which this study is embedded (section 1.1). Section 1.2 discusses the relevance of this study and points out the main contributions this thesis provides. Section 1.3, which outlines the structure of the thesis, presents the main arguments of this thesis and previews the findings made in each chapter.

1.1 THEORETICAL DEBATE AND RESEARCH AREA

Discussions of the factors and processes influencing the creation of the "wealth of nations" have been at the core of most debates in the discipline of economics. However, most analyses in the discipline have focused exclusively on *economic* determinants that generate conditions of general equilibrium and market efficiency. Following the rising influence of institutional economics, scholarly contributions have increasingly emphasized the importance of institutions that minimize the costs arising from economic *and* political transactions. This literature analyses the underlying institutions or "rules of the game" that underpin social interaction and influence economic choices and growth outcomes (North, 1990). The large majority of this literature is focused on the analysis of the implications of different institutions for achieving competitive markets in the development of national economies, regardless of the context in which these institutions are implemented. From this theoretical understanding derives the policy agenda of 'good governance', arguably the most prominent agenda for institutional reform, that sees a standard set of governance capabilities as necessary and sufficient conditions for achieving growth and development in less developed countries and regions.

While this thesis is broadly located in the area of institutional economics, it challenges some of the underlying assumptions of the conventional understanding of the role of institutions for development on several levels. Firstly, the thesis argues that institutions have efficiency as well as distributive functions. It studies how these functions shape the context-specific distribution of power that affects the likelihood of implementation and enforcement of a particular institutional change and the ways in which policies affect the economic and political viability of a society. Specifically, this thesis is concerned with the analysis of the relative distribution of power in a particular context and how this affects the conditions that determine successful implementation and enforcement of economic policies (Khan, 2010a). Secondly, and acknowledging that upward and downward transfers of institutions in less developed countries have led to a "hollowing out" of the nation state, this contribution analyses how globalized processes and the movement towards decentralization affect the contexts in which policies can be introduced and enforced (Jessop, 2004; Robinson, 2010). The thesis uses the case study of Medellín to examine the impacts of transnational and local factors on elite interests and power constellation.

This thesis studies the political economy of governance and growth in the politically decentralized and economically liberalized context of Latin America. In the past two decades, most Latin American countries have undergone several transformations in their political economies. Since the late 1980s and following the crisis of the state-interventionist development model that focused on economic growth through import substitution industrialization (ISI), Latin America moved away from its state-centred approach and shifted to implement neoliberal policies. Besides far-reaching liberalization reforms of trade and finance, an extensive privatization of public assets and services, fiscal austerity, as well as a very substantial deregulation of state control over industry, these radical changes also involved the implementation of a wide range of state restructuring reforms that included the decentralization of government (see Faguet and Pöschl, 2015; Falleti, 2010). The main aim of the interconnected policies of economic liberalization and political decentralization was to make government more democratic, transparent, and accountable by reducing the discretionary control of central authority to create rents and by bringing decision making closer to civil society (Cavarozzi, 1992).

This rather radical shift towards neoliberalism in Latin American countries following the region's debt crisis and "lost decade" of the 1980s has substantially changed the contexts in which political and economic policies are introduced and enforced (Khan and Blankenburg, 2009). There is an abundance of academic studies analysing the impacts of these shifts on governance, growth and development. However, most scholarly debates that examine institutional challenges in politically decentralized and economically liberalized Latin America focus on conventional institutional approaches and policies that are linked to the 'good governance' agenda. Hence, in order to achieve the 'right' underpinnings for policies for successful growth and development academic observers, international organizations and policymakers have promoted institutional reforms that focus on achieving better transparency, higher accountability, and less corruption (World Bank, 1992, 2000). The 'good governance' agenda together with the promotion of decentralization has served as a blueprint approach for less developed countries to achieve development. The reforms thus focused on downsizing states to minimize market-distorting interventions that are seen as a source of transaction costs (see Hall and Pfeiffer, 2000; UN-HABITAT, 2015).

However, the decentralization and 'good governance' literature falls short in discussing a variety of different aspects that are important for a comprehensive understanding of governance challenges for less developed countries in general and for urban areas in Latin America in particular. Hence, conventional approaches do not engage with closer institutional analyses of how policies can be implemented in contexts where spatio-economic changes have affected power relations, state capabilities, and political factors in general. There is no reference to capitalist development, local elites, or other powerful agents. There is no political economy analysis of the interests, ideologies, or the roles played by transnational organizations, particularly of financial institutions. The emerging influence of the transnational capitalist elite on institutional mechanisms and governance capabilities is also completely missing from this strand of literature. Regardless of these shortcomings of contemporary institutional explanations of restructuring local governance, there have been only very limited attempts to explore alternative institutional strategies for productive economic development for urban areas in less developed countries. Literature that proposes a "local alternative for decentralization and economic development (in Latin America)" (de la Cruz et al., 2011) or a "productive transformation of cities in Latin America" (UN-HABITAT, 2015b) do not challenge 'good governance' ideas and ideals.

Attempts to explore and develop viable alternative theories on urban governance and policy approaches to achieve high productivity growth and economic development through "urban entrepreneurialism", "Schumpeterian local institutions", or "local developmental institutions" have largely focussed urban governance in *advanced* capitalist countries or in successful *developmental states* that have already achieved a considerable level of economic catching up. However, several political and institutional characteristics and the difficulty of mimicking particular institutional strategies minimize the analytical value of a comparison with urban areas in less developed countries today. Thus, and important for the analysis of urban governance in Latin America, less developed countries today face very different obstacles in attempts to create and enforce urban "entrepreneurial" or "Schumpeterian" institutions.

The theoretical contribution of this thesis contrasts with conventional approaches to institutional analysis. Using the analytical framework of 'political settlements' this thesis argues that there are no 'good' or 'bad' institutions, but only favourable and less favourable interdependent combinations of power and institutions (Khan, 2010a; Di John and Putzel, 2009). A political settlement describes a relatively stable set of institutions, which derive from the balances of power in a society. These institutions, in turn, shape a context so that the net distribution of benefits sustains the specific distribution of power of that society. This means that the distribution of power in a polity or across organizations is an important factor for the understanding of institutional changes and their effects on the implementation and enforcement of particular policies that influence political and economic developmental outcomes. The framework proposed here argues that in order to understand institutional changes and their indeterminate outcomes we need to analyse the compatibility of these changes with the particular power structure in the political settlement. In particular, we are interested in how a political settlement creates conditions for achieving sustainable and inclusive levels of political stability and economic growth. Since the distribution of power changes over time, the political economy analysis of institutional change used here is path-dependent, dynamic and non-linear.

In order to understand how the interdependency between power and institutions affect developmental outcomes, our theoretical approach differentiates between different types of costs that are important in the political economy analysis of institutional change. Unlike the New Institutional Economics (NIE), we find that a general reduction of transaction costs does not automatically lead to positive developmental outcomes. The political settlements approach proposed here does not include all kinds of transaction costs, but only focuses on the costs that hinder changes that are "growth-enhancing" (Khan, 2009). In turn, an institutional change that reduces an irrelevant, non-growth-constraining transaction cost may well lead to negative developmental outcomes, for example by inadvertently strengthening powerful organizations that block growth. Furthermore, we argue that the particular *net* effect of institutional changes can only be understood if we consider costs that occur through resistance to or obstruction of these changes. These "transition costs" are costs that arise depending on the intensity of the resistance against distributive implications of the institutional change in question and they are a function of organizational powers of potential winners and losers of institutional change (Khan, 2009).

This makes the analysis of the distribution of power crucial. However, and again contrasting with the NIE, we understand power not purely as an *economic* measure to hold out and engage in a conflict, but also as the ability to organize support in a society as a whole as well as among and between organizations. The understanding of the distribution of power in a political settlement is important for the analysis of how changes reduce or induce certain costs that can affect growth outcomes. If for example a group of powerful political organizations (i.e. a 'ruling coalition') wants to push through a policy that reduces growth-constraining transaction costs, but faces contestation from organizationally powerful groups that are temporarily or permanently excluded from that coalition, the growth-enhancing institutional change might not be implemented.

The political economy framework adopted here further differs from the NIE in regard to the evaluation of rents. The NIE sees rents as sources of market distortions that lead to market failures. In our approach rents in general, and learning rents in particular can also have positive effects on economic growth and development as they can create incentives and compulsions for investments into efforts of acquiring capacities in medium or high technology sectors[1].

Political settlements in less developed countries largely differ from those in advanced capitalist countries. Political settlements in less developed countries are more strongly characterized by the existence of informal institutions. Hence, the institutional analysis of different costs and sources of power also needs to include informal institutions, such as patron-clientelist networks, mafias, and the like. Consequently, the analysis of the distribution of power needs to include institutions that create informal rents and distribute them to formal or informal organizations. The discussion of informality is of particular relevance as it lets us identify and analyse specific enforceability problems of particular institutions.

The successful implementation and enforcement of a growth-enhancing institutional change depends not only on the ability of the ruling coalition to reduce growth-constraining transaction costs as well as transition costs, but also on several additional factors, such as governance capacities of state agencies to effectively manage rents in ways that create incentives and compulsions for investments in medium to high technology sectors. We particularly focus on learning rents that can incentivize entrepreneurs to invest in efforts to increase productivity or acquire advanced technological capabilities. Hence, the success of a growth-enhancing institutional change also depends on the technological and entrepreneurial capabilities of actors, firms, and sectors.

In sum, a growth-enhancing institutional change depends on the compatibility of this change with the distribution of power, governance capacities of the state and technological capabilities of entrepreneurs in a political settlement. A ruling coalition can achieve growth-enhancing changes if the distribution of power drives the creation and enforcement of a particular institution that facilitates rent management in ways that reduce growth-constraining

[1] In this thesis, high technology growth is understood as value creation in production of goods at vest scales (typically capital goods). The share of value added of the production of such goods tends to be high at all stages of the production process. We recognize that global supply and production chains have altered the ways in which value is added along the value chain. The unbundling of the production process following global capitalist integration has made it possible to offshore some of the stages of production. Baldwin (2013) argues that this has led to a shift in value added away from these offshored stages. By showing that particularly the production process itself has been offshored and thus involves less value creation today than before globalization, the author finds that pre- and post-fabrication services are increasingly important sources of high value added growth. Baldwin’s (2013) so-called “smile curve” depicts how global value chains have changed the understanding of high value added activities in showing that earlier and late stages (in pre- and post production services) more value is added than during the production process (depicted on a smile-like graph in which the y-axis shows share of value added and the x-axis shows the stage of production).

transaction costs and minimize transition costs in order to incentivize minimally capable entrepreneurs to invest in the learning and acquisition of higher technological capabilities.

1.2 Relevance and main contributions

While the political settlements framework has been widely used in analyses of the effects of institutional changes, this thesis further explores this heterodox political economy approach and tries to fill gaps in the academic literature on several levels. Firstly, there exists very little academic literature that applies the theory of political settlements to the empirical realities of Latin America, with the exceptions of some very insightful and important contributions (see Di John, 2009; Khan and Blankenburg, 2009). This thesis provides a comprehensive addition to the theoretical and empirical understanding of Latin America in general and Colombia in particular. Secondly, and as Hickey (2013, p. 19) rightly describes, there is a general gap in the political settlements literature when it comes to analysing the role and influence of transnational factors shaping the different aspects of the political settlements theory. This thesis will thus explore and revise the political settlements framework by including an analysis of globalized networks and processes. We particularly use Robinson's (2010) findings on Latin America's emerging transnational capitalist class to analyse the impacts of these political economy transformations on the different variables of the political settlements approach, particularly the distribution of power, governance capacities and technological capabilities of the local entrepreneurs. Thirdly, this thesis explores how the revised political settlements framework helps in the analysis of local and urban governance challenges following Latin America's radical shift to neoliberalism that included not only a return of its economies to static comparative advantages in low productivity sectors, but also the far-reaching decentralization of political, administrative and fiscal authorities. Hence, and following Robinson (2010, p. 27) who finds that "(t)he movement toward the decentralization of the national state… in Latin America should be seen in light of changes in the state under globalization", for our political economy analysis of political settlements in Colombia we go beyond the narrow focus on national-level actors and factors.

For a further exploration of the revised theoretical framework and in order for us to test its empirical validity, we chose the case study of the city of Medellín. The case study of Medellín was chosen strategically because of the several political, economic and institutional transformations the city has experienced since the early 1900s. After an impressive industrialization phase that spanned much of the first half of the twentieth century the local political settlement became increasingly unstable after several crises resulted in economic slowdown and political violence. In the 1980s and early 1990s Medellín became famous for being the 'most violent city in the world', as the Medellín Cartel, led by Pablo Escobar brought terror to the streets of the city and questioned the political and economic legitimacy of local institutions and the predominant elite structures. Following Escobar's death in 1993 Medellín's political economy only recovered very slowly. And with a severe economic and financial crisis hitting Colombia in 1998/99 the economic and political viability of the city's developmental trajectory was yet again fragile: Medellín's violence rates increased once again, the local economy experienced a recession with negative growth rates of around 5%, and the urban unemployment rate rose over 20%.

However, by the turn of the millennium economic growth and political stability returned. Between 2004 and 2014 violence rates decreased dramatically and GDP growth per capita surpassed the average growth rate of Colombia's economy by large margins. In 2014 Medellín's GDP per capita grew by over 4.2%, making the city's economy the fastest growing urban market in Latin America (Brookings, 2015). This truly remarkable success story and turnaround of Medellín's political economy has recently been subject to many scholarly and non-academic analyses. Most contributions come to the conclusion that the city's transformations are nothing short of a "miracle" and find that 'good governance' policies, combined with urban renewal projects are responsible for these developments.

Motivated by dissatisfaction with and doubts about these rather static institutional approaches that are often context-detached, ahistorical and devoid of politics, this study explores the explanatory value of the theoretical assumptions outlined above for achieving a comprehensive understanding of the case of Medellín. By identifying several gaps in the academic literature on Medellín's development, the theoretical framework adopted in this thesis helps to achieve an improved empirical understanding of Medellín's development. This thesis argues that an in-depth understanding of recent developments and transformations requires a political economy analysis of historical and social processes. Besides setting the stage for a context-specific analysis of recent developments in Medellín, this historical investigation allows us to add explanatory value to the understanding of the industrialization of the regional economy. While regional ISI experiences in Colombia have been analysed extensively in the academic literature, this thesis provides an alternative analysis of Medellín's industrialization process arguing that favourable combinations of power and institutions enhanced growth in light manufacturing industries at specific junctures.

Furthermore, the thesis provides original insights into Medellín's deindustrialization processes. Using the political settlements framework, the thesis provides an original analysis of several crises that affected Medellín in the 1970s, 1980s and 1990s. Most conventional explanations regard general macroeconomic imbalances, the Latin American debt crises, and falling external demand as the main causes of economic and political turbulences in Colombia and Medellín. While this study also analyses these factors, it presents additional political economy explanations of these processes and discusses how the power distribution in the local and national political settlements became largely incompatible with the institutional mechanisms needed for the promotion of advanced industrial development. We find that besides macroeconomic causes, it was insufficient technological capabilities of entrepreneurs and inadequate governance capacities of the state to create and distribute growth-enhancing rents that led to economic slowdown, political instability, and violence.

The main empirical contribution of this thesis lies in the alternative explanation and in-depth discussion of recent economic and political transformations of Medellín. By identifying several formal and informal institutional mechanisms and organizations relevant for the implementation of policies as well as other aspects specific to Medellín's political settlement, this study sheds light on the particular characteristics of Medellín's development since the early 2000s. Thus, the analytical explanations of Medellín's recent development depart from conventional accounts that generally find political decentralization, far-reaching economic liberalization, and "good urban governance" to be the institutional underpinnings of the economic and political transformations that led to an alleged "urban miracle" (see Gilbert, 2006; Gutiérrez et al., 2012). A historical discussion of economic, political and social processes that have influenced Medellín's political settlement provides an entry point to an original analysis of the city's recent development, which deconstructs these "miracle" claims.

1.3 THESIS STRUCTURE AND MAIN ARGUMENTS

The thesis begins with a review of the literature about Medellín's development in chapter 2. The chapter is dedicated to a critical discussion of conventional explanations of several transformations of Medellín, particularly the institutional changes and growth performances since the early 2000s. The chapter introduces the topic and case study in more detail and reveals further gaps in the empirical literature, which helps us contextualise the empirical research questions this thesis tries to answer. Chapter 2 argues that most studies analysing Medellín's recent development do not sufficiently consider the historical processes of economic and social transformation that have shaped the local polity and informed recent developmental changes. This is particularly noticeable in the fact that most contributions use theoretical approaches rooted in the idea that the 'correct' institutional framework helps less developed regions to grow and develop. Furthermore, we argue that most scholarly debates on Medellín fail to look beyond very basic analyses of quantitative data, such as GDP growth rates, unemployment rates, and homicidal violence.

Chapter 3 and 4 provide a discussion of the theoretical literature in general and of the political settlements literature more specifically. Chapter 3 argues that for a comprehensive and contextualized analysis of institutions, governance, and growth we need to include a discussion of certain issues the conventional NIE literature fails to address. A political economy discussion of the interdependency between power and institutions can provide insightful conclusions on how different balances of power in a polity and in organizations can affect governance capacities of state agencies, actual implementation of policies, and developmental outcomes. Chapter 4 argues that current analyses of the political settlements literature need to be explored beyond the influence of national-level actors and factors on the interdependency between power and institutions. The ways in which globalized processes and decentralized structures have shaped political settlements need to be taken into consideration for a more comprehensive understanding of governance and development in urban areas of less developed countries more generally and of Latin American cities in particular. We explore the influence of a powerful transnational capitalist elite on power balances, institutional mechanisms and state capacities in local political settlements in Colombia. Furthermore, chapter 4 discusses how decentralization and subsequent horizontal and vertical fragmentation in Colombia's polity and in political organizations might decrease the likelihood of successful implementation and enforcement of growth-enhancing institutions.

Chapter 5 engages in a historical discussion of political and economic processes that shaped Medellín's society and Colombia's political settlements for much of the twentieth century. The chapter argues that a combination of power balances and institutional mechanisms had implications for governance capacities of the state and technological capabilities of entrepreneurs in ways that affected the successful implementation and enforcement of policies to achieve political stability and growth of light manufacturing industries in Medellín. In an analysis of Medellín's deindustrialization following several political and economic crises in the 1970s and 1980s, chapter 5 furthermore argues that the constellation of power in Medellín's polity became largely incompatible with institutional mechanisms necessary for technologically advanced industrialization. The failure of Medellín's economy to "grow up" had severe implications for economic growth and political stability. The rise of the political elite *clase emergente* (emerging class) and actors such as Pablo Escobar in the 1980s destabilized the elite bargain, bringing Medellín's political settlement close to a collapse. The chapter also analyses several formal and informal institutional responses to these crises, including the decentralization of political, administrative and fiscal authorities, the formation of informal organizations and capitalist networks, as well as the paramiliarization of control. While these mechanisms could temporarily stabilize the political settlement during much of the 1990s, it descended into crisis yet again.

Chapter 6 is dedicated to the analysis of the political and economic development of Medellín since the turn of the millennium. For this analysis we use qualitative data from over 60 interviews the author conducted with actors of different regional elite factions, bureaucrats, members of Non-Governmental Organizations (NGO), media representatives and former and current members of paramilitary and guerrilla organizations during fieldwork for this study.[2] The chapter argues that recent changes in Medellín are by no means a "miracle" but rather result from changing combinations of institutions and balances of power in the society. The particular transformations of Medellín's institutional structure and the implementation of 'good governance' reforms are consequences of the increasing organizational power of a local faction of the transnational capitalist elite that has used the market-enhancing agenda to implement policies that promote Medellín's insertion into globalized processes. The chapter argues that Medellín's powerful transnational capitalist elite is interested in the advancement of global capitalism rather than in the development of medium and high technology sectors in the domestic market. These developments have shaped the local political settlement. This can explain the elite's acceptance of Medellín's return to static comparative advantages in low productivity sectors, such as services and low-wage and labour intensive industries.

Theoretical and qualitative findings are tested in a quantitative empirical analysis provided in chapter 7. For this analysis we use macroeconomic indicators, findings from household surveys, as well as sector-level and firm-level data. The chapter argues that the combination of the particular power constellation and institutions in Medellín's political settlement has resulted in economic growth that is marked by the thriving and very dynamic construction, finance and tourism sectors. While these sectors have been the engines of Medellín's economic turnaround, they are certainly not sources of high productivity growth. With stagnating wages and a capitalist elite that has no incentive to invest in the acquisition of capacities in medium or high technology sectors, Medellín's political settlement has yet to reach sustainable and inclusive levels of economic viability. The low productivity of Medellín's economic growth, combined with a labour market that shows a high degree of gross employment elasticities, are indicators for these developments. However, despite failed attempts to climb up the technology ladder, Medellín's political settlement has become

[2] Informed consent was obtained from all interviewees and participants of focus groups. The author provided the respondents with relevant information about the research project and the use of personal data. Informed consent was captured in conjunction with SOAS' code of practice on using personal data in research as outlined in the School's research ethics policies.

politically resilient. Chapter 7 argues that the high levels of political stability can be explained by the combined interests of most powerful elite factions, including the paramilitary. Central to this discussion is the role of Medellín's native son, Álvaro Uribe Vélez.

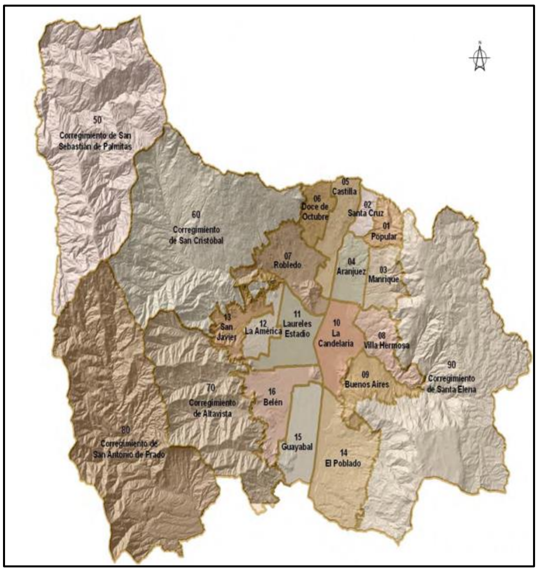
Finally, chapter 8 presents the conclusions of this study by summing up the findings and contributions of the thesis. The chapter concludes by providing implications for policy as well as for future research in this field of study.

Chapter Two: Governance and institutional reform in Medellín: tale of an "Urban Miracle"

Medellín is the second largest city of Colombia and the capital of the department Antioquia (figure 2.1). Medellín is geographically located in the *Valle de Aburrá* (Aburrá Valley) at a height of 1,479 metres above the sea level in the central cordillera of the Andes mountain range. The city is divided into 16 *comunas*, in which a total of 249 neighbourhoods (*barrios*) are located (figure 2.2). Furthermore, Medellín has five so-called *Corregimientos* (Palmitas, San Cristóbal, Altavista, San Antonio de Prado and Santa Elena), which are small towns that administratively belong to the municipality of Medellín. In this chapter and in the remainder of this thesis *Medellín* is used as a synonym for the entire metropolitan area surrounding the city, which includes nine other municipalities[3].

Figure 2.1: Colombia, Antioquia and Medellín

Figure 2.2: Comunas and corregimientos



Sources: Observatorio de Políticas Públicas (2011); Wikimedia (2016)

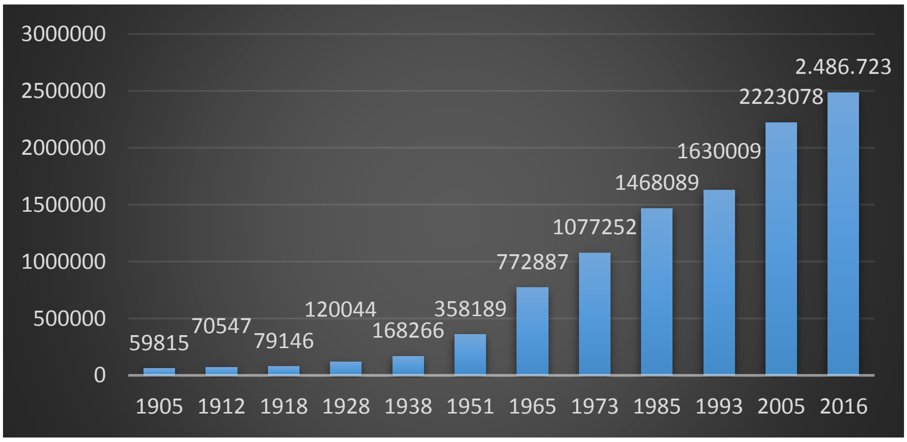
Known for its warm climate as "the city of eternal spring", the *paisa*[4] capital has only recently developed to become a globally important metropolis (DAP Medellín, 2012). As figure 2.3 indicates, Medellín has experienced a considerable increase in its population over the past

[3] Namely, these municipalities are Bello, Copacabana, Girardota and Barbosa in the north of Medellín, and Itagüí, Envigado, Sabaneta, La Estrella and Caldas in the southern parts of the Aburrá Valley.

[4] While *paisa* generally refers to (the people of) the north western region of Colombia, which includes the departments Antioquia, Risaralda, Quindío, and Caldas, *paisa* in this thesis exclusively refers to Antioquia and its population.

century. While in the 1940s the city only had 170,000 inhabitants, it grew exponentially fast and reached a population of 2.48 million in 2016[5]. There are several pull and push factors for Medellín's rapid urbanization that are central to the debate: firstly, and as further discussed in chapter five, Medellín's impressive industrialization and engine of economic and employment growth created incentives for the rural population to migrate to Medellín, which was a blessing for the city's industrial factories that were in need of cheap surplus labour (Farnsworth-Alvear, 2000). Secondly, the rapid increase of the city's population was also a consequence of the violent Colombian political conflict, generally referred to as *La Violencia*. *La Violencia began* in the 1940s as a largely rural dispute over partisanship and political convictions; it has since forcedly displaced 6 million people, who largely moved to urban areas (Albuja and Ceballos, 2010; UNHCR, 2015).

FIGURE 2.3: POPULATION INCREASE MEDELLÍN



SOURCE: DATA FROM SECRETARÍA DE GOBIERNO DE MEDELLÍN, OWN CALCULATIONS

Alongside an impressive population growth, Medellín underwent 100 years of multifaceted political and economic developments. Once known for its industrial growth and development, particularly due to a flourishing textile industry, Medellín achieved dubious fame for the high rise in drug-related violence during the 1980s and 90s. The Medellín Cartel with its leader Pablo Escobar terrorised the city, homicide rates increased, and (legal) economic activity declined (Thoumi, 1995a, 1995b). After the death of Escobar and the dismantling of the Cartel in 1993, Medellín's economy could not regenerate fully, as the Colombian economy was severely hit by an economic crisis in 1998/99 (Torres, 2011). Subsequently, Medellín suffered from negative growth rates – in 2000 it had fallen back to the GDP per capita levels of 1992 (DAP Medellín, 2005). Furthermore, rates of unemployment and informal employment had

[5] In the 2005 census the population of Medellín's *metropolitan area* was 3.8 million.

risen sharply. At the turn of the millennium Medellín was thus suffering from a severe economic and socio-political crisis.

However, in recent years Medellín has yet experienced drastic changes in its urban political, economic, and institutional environment. Since the early 2000s the city's institutional basis and governance structure have transformed, making Medellín an exemplary case for successful urban development in general, and of local governance in particular (Drummond et al., 2012). These institutional changes and subsequent developmental outcomes have caused academic scholars as well as journalists to claim that Medellín has gone "from murder capital to model city" (Brodzinsky, 2014). The New York Times attributed these developments to "Medellín's Nonconformist Mayor (who) Turn[ed] Blight to Beauty" (Romero, 2007). The Economist even declared a "Medellín Miracle" (The Economist, 2014), echoing academic observers who have argued that institutional shifts and the "Medellín Model of Good Governance" are responsible for a "metropolitan miracle" (Gutiérrez et al., 2012, 2009; IDB, 2011). The award as "Innovative City of the Year" in 2012 by the Urban Land Institute, the Wall Street Journal, and Citi Group further increased the buzz about Medellín's development model and reinforced claims of an "urban miracle". As such, the "miracle" discourse continues to be the subject of interdisciplinary academic discussions (Urban Land Institute, 2013).

This chapter reviews the main debates in the literature around Medellín's development. It particularly engages with the "miracle" literature, which argues that 'good governance' reforms and the rise of Mayor Sergio Fajardo were the main factors contributing to successful transformations. We also present empirical evidence of reduced homicide rates and increased GDP growth used in this literature. In addition, the chapter discusses the critical literature that explains Medellín's development not as a miracle, but rather as the consequence of several national and local-level processes that have shaped developmental outcomes in terms of violence reduction as well as economic growth. We conclude by pointing to several weaknesses in all existing strands of literature on Medellín's recent transformation. A common weakness is the failure to contextualise recent developments in a wider historical political economy analysis of changes in Medellín's institutional landscape and constellation of power, including the city's industrialization attempts, the following deindustrialization, and elite developments. Pointing at these gaps in the literature sets the stage for a theoretical unpacking and an empirical re-evaluation of the city's developments through a political economy lens in the remainder of this thesis.

2.1 Background on the "Miracle" claims: some 'stylized facts'

Before engaging with a discussion of the literature addressing the institutional, political, historical and socio-economic underpinnings of the "miracle", this section presents some generalized empirical findings about Medellín's development. These 'stylized facts' are presented across the entire spectrum of academic and non-academic literature and focus mainly on trends in Medellín's homicide rate, changes in poverty and employment, and overall economic growth. While the different interpretations and explanations of these developments will be discussed in sections 2.2 and 2.3, this section presents these empirical data to contextualise the subsequent discussion of the literature and the originality of the theoretical and empirical analysis provided in this thesis.

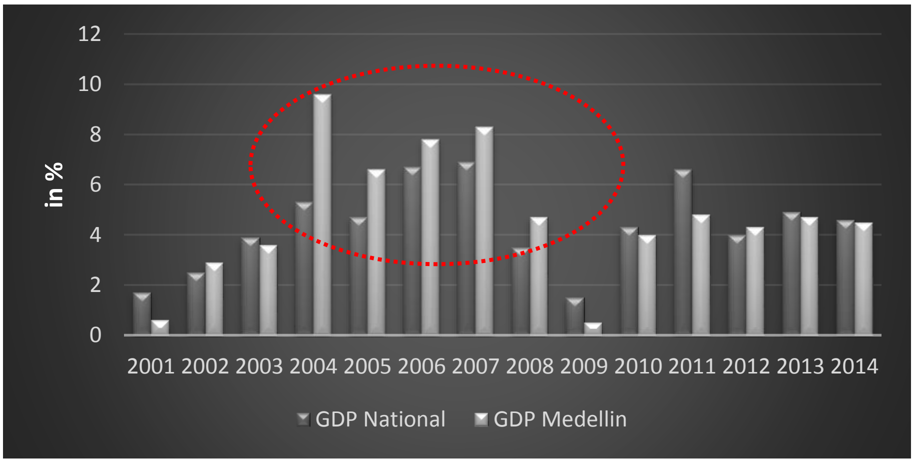
Before the "metropolitan miracle" struck, Medellín and the region of Antioquia had already experienced other impressive development trajectories. Founded as a gold mining and commercial city in 1675, Medellín became Colombia's leading producer of the country's export engine: coffee. Medellín's elite understood the need to diversify the local economy and thus recycled coffee capital to incentivize light industrial manufacturing. In the twentieth century Medellín became the industrial capital of Colombia. Led by the families Restrepo and Echeverría and their textile factories, Medellín embarked on an impressive path of industrialization that catapulted economic growth and employment rates to record heights between the 1940s and 1960s.

Even during the civil war, *La Violencia,* which erupted following the assassination of the populist Liberal leader Jorge Eliécer Gaitán in 1948, Medellín's economy remained untouched and industrial capitalists continued to make record profits. However, due to several political and economic factors and inherent shortcomings of Antioquia's industrial-driven growth, Medellín's economy stagnated in the 1970s. Manufacturing growth never developed from light manufacturing goods into heavy and capital-intensive industrialization. Further, with coffee prices falling in the late 1970s and increased competition from East Asia, industrial growth (heavily reliant on private capital transfers from the coffee sector) plummeted. In the wake of Medellín's deindustrialization the city's economy witnessed a massive increase in urban unemployment, accelerated by the mass exodus of many of Antioquia's population to Medellín due to the on-going violence in rural parts of the country. Besides economic problems such as growth stagnation, growing unemployment, and low investment rates, this period also witnessed a massive increase in urban violence. Chapter five analyses the political economy explanations of these historical phenomena in more detail, however it is important to discuss these dynamics, as Medellín's recovery from them is seen as the basis of the "miracle" claim.

The negative spiral of a stagnating economic growth, increasing urban unemployment and violence resulted in a disastrous situation. The institutional structure was undermined by informal rule of mafias, insurgency movements, and paramilitary groups and Medellín found itself at the brink of complete institutional collapse. In the context of the Colombian economic crisis of the late 1990s, Medellín's economy reached a historic low with negative growth rates of around 5% in 1999. Since labour-intensive industries had been the backbone of job-creating growth throughout much of the twentieth century, the crisis hit the urban labour market particularly hard.

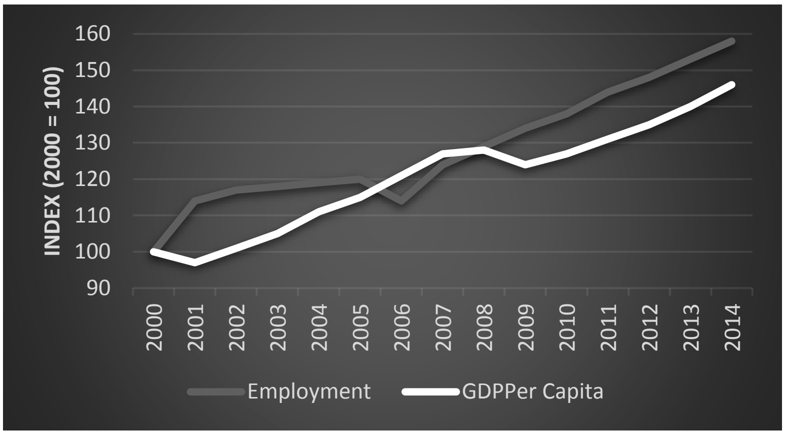
However, since the turn of the millennium, Medellín's economy has been experiencing a remarkable turnaround. Economic growth has returned in a very impressive manner, increasing by 9.6% in 2004, which was much above the average Colombian economic growth of 5.3%. This trend continued until the aftermath of the global financial crisis of 2007/08 started to affect the city's economy (figure 2.4). In recent years however, economic growth has returned. In 2014 Medellín's economy grew by 4.2% per capita, making the city the fastest growing urban economy not just of Colombia but of the entire Latin American region (Brookings, 2015). Changes in the city's employment rates have been similarly positive. While unemployment was at a record high of over 20% in 2000, labour market trends have turned positive since. Medellín's employment numbers have increased substantially, reaching growth rates of just above 3% in 2014. Reflected in figures 2.4 and 2.5, these positive trends are, for many observers, crucial elements in the city's "miraculous" success story.

FIGURE 2.4: GDP GROWTH RATES MEDELLÍN AND COLOMBIA



SOURCE: DATA FROM DEPARTAMENTO ADMINISTRATIVO NACIONAL DE ESTADÍSTICA (DANE), OWN CALCULATIONS

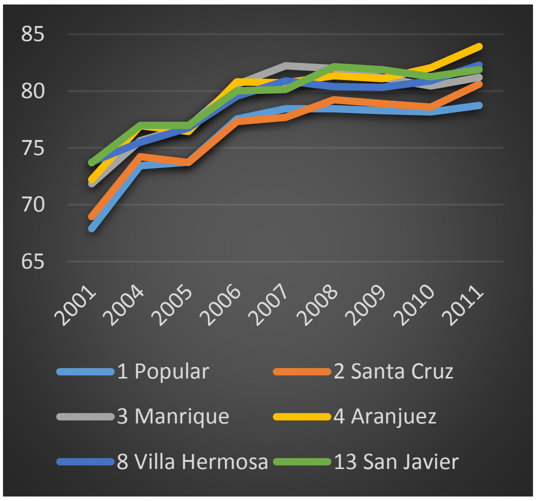
FIGURE 2.5: INDEXED EMPLOYMENT AND GDP PER CAPITA GROWTH RATES MEDELLÍN



SOURCE: OXFORD ECONOMICS DATABANK, BROOKINGS

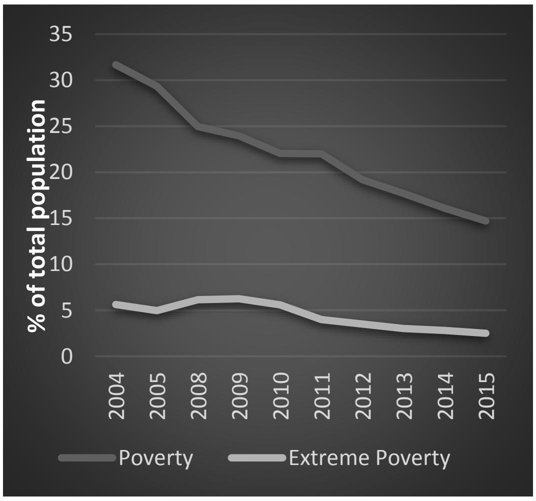
Overall, these developments have had positive impacts on human development and poverty. The human development index (HDI) has improved drastically since 2004, particularly in the poorest areas of the city. As seen in figure 2.6 the North-Western *comunas* 1, 2, 3, 4, and 8 and the Eastern *comuna* 13, which have historically been the most marginalized, deprived and violent-prone areas, made impressive progress. Reductions in poverty and extreme poverty rates are similarly positive. While poverty rates were at an all-time high in the late 1990s, making Medellín's population one of the poorest in the country, this trend has reversed considerably since the early 2000s (figure 2.7).

FIGURE 2.6: HDI IN MOST MARGINALIZED *COMUNAS*



SOURCE: ALCALDÍA DE MEDELLÍN (2012)

FIGURE 2.7: POVERTY AND EXTREME POVERT

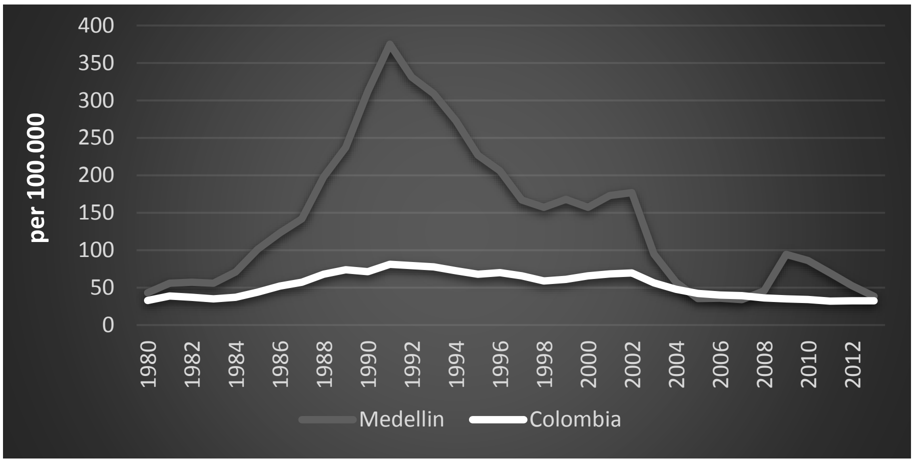


SOURCE: ALCALDÍA DE MEDELLÍN (2012)

Another 'stylized fact' that supports the "miracle" claim is the reduction in violence. Since the late 1970s and coinciding with Medellín's deindustrialization, violence started to increase before it spiralled out of control in the late 1980s and early 1990s. It was during this time that the infamous drug lord Pablo Escobar and his Medellín Cartel ruled the streets of the city, bringing Medellín to fame as the most dangerous urban area and 'murder capital' of the world. Fuelled by conflict over drug-trafficking routes and political territory, Medellín descended in a dark era of open warfare that resulted in a skyrocketing of the city's homicide rates, increasing extortions, forced disappearances, and petty crimes. The most staggering negative trend, however, was the large number of murders: between 1990 and 2002 more than 55,000 people were killed in the streets of Medellín.

However, after 2002 this number decreased six fold and by 2005 Medellín's murder rate was not only below the Colombian average, but even lower than the murder rates of cities such as Baltimore, Detroit or even Washington D.C. The radical decrease of homicidal violence is truly remarkable and the rapid decrease is often presented as proof of a "miracle". Maclean (2015, p. 2) argues that the "Medellín miracle" is represented in the sharp decline in homicides making the city "known for the astonishing decline in violence that has occurred over the last 20 years". Figure 2.8 shows the trends in Medellín's murder rate.

FIGURE 2.8: HOMICIDE RATES MEDELLÍN AND COLOMBIA (PER 100.000)



SOURCE: DATA FROM INSTITUTO NACIONAL DE MEDICINA LEGAL Y CIENCIAS FORENSES, REGIONAL NOROCCIDENTE (MEDELLÍN)

These remarkable developments prompted a series of theoretical and empirical engagements with the case of Medellín, which either describe the phenomenon as a "miracle" or try to explain how and why these transformations happened. The next section reviews and discusses this literature. While the conventional wisdom of the academic debate stresses that the underlying factors of the miracle reside in recent governance and institutional changes as well as in the personification of these transformations in Mayor Sergio Fajardo, we also present more critical strands of the literature that highlight alternative explanations for Medellín's turnaround.

2.2 The foundations of success – a review of the “miracle” literature

As shown above, the putative “rebirth” (Fukuyama and Colby, 2011) of Medellín began around the turn of the millennium. Most academic as well as and non-academic contributions see the starting point of this turnaround in the 2003 electoral victory of Mayor Sergio Fajardo at the head of the political movement *Compromiso Ciudadano* (Citizen’s Commitment). This new coalition introduced institutional reforms in order to overcome the “bastion of old-style policy making” (Devlin and Chaskel, 2010, p. 3). Conventional explanations of the foundations of the “miracle” hence support the idea that a particular reform agenda, supported by what the Inter-American Development Bank (IDB) calls the “Medellín Model of Good Governance” (IDB, 2011), was responsible for taking Medellín “from fear to hope” (Alcaldía de Medellín, 2007a; Gutiérrez et al., 2012).

The analysis of Medellín’s development is dominated by contributions from the academic disciplines of urban planning, geography or architecture. However, the extent to which this particular disciplinary debate has been able to fully explain the city’s institutional and economic transformations is highly limited. Increasingly, contributions from the disciplines of political sciences, history, or institutional economics are weighing in on the topic. The first part of this section discusses a variety of interdisciplinary contributions that focus on the analysis institutional changes through the combination of the ‘Medellín Model of Good Governance’ and physical urban interventions. The second part of the section discusses the literature that engages with the analysis of developmental outcomes of this changed institutionality.

2.2.1 Coalitions, good governance, and urban renovation policies

Between 2004 and 2012 the Fajardo coalition[6] implemented a set of policies known as *urbanismo social* (social urbanism) (Devlin and Chaskel, 2010; Echeverri, 2008). Part of these social urbanism policies were the so-called *Proyectos Urbanos Integrales* (Integral Urban Projects, PUI), which were urban public space projects and infrastructure interventions around specific areas in Medellín. Fajardo’s policy agenda was based on the idea that the creation of public space and the physical upgrading of the poorest neighbourhoods can overcome inequalities and other socioeconomic problems that are deeply rooted in Medellín’s society. The multimillion dollar project *Parque Biblioteca España* (Spain Library Park) in *comuna 1* and the electric escalators in *comuna 13* (both historically marginalized neighbourhoods located in

[6] Sergio Fajardo was elected Mayor in 2003 and ruled the city until 2008 when his political ally and Secretary of Government Alonso Salazar took over after winning the 2007 elections (Fajardo could not run again due to constitutional rules). Salazar continued with the same policy programme and focus on ‘good governance’ reforms. We hence see the years 2004-2012 as period of a continuous policy agenda and talk about the “Fajardo coalition” in a broader sense.

Medellín's hillside areas) are two prime examples, alongside a cable-car system *Metrocable* connecting both of these neighbourhoods to the central metro lines.

The conventional literature on the "miracle" finds that it was the combination of Fajardo's commitment to 'good governance' and his social urbanism policies that lie at the heart of the city's transformative developments (see Dávila, 2013). Brand and Dávila (2013) argue that Medellín's success story is based on the double strategy of the social urbanism reforms and the *Metrocable*. The authors argue that through increased mobility and physical investments around the library parks and the new *Metrocable* stations, the Fajardo administration was effective in improving the living conditions of the urban poor. Dávila and Daste (2011, p. 122) find that Fajardo's policy approach has also had wider impacts on the city's institutional landscape, resulting in increased levels of accountability and confidence in local political actors. Turok (2014) supports these findings, arguing that urban "catalytic projects" were the main drivers of positive institutional change and economic development. The focus of Turok's (2014) contribution on urban planning and social urbanism resonates with the large majority of academic literature that offers geographical or architectural explanations for Medellín's successful turnaround.

Echeverri and Orsini (2010, pp. 16–17) argue that the style of leadership and the governance formula of the Fajardo coalition were responsible for "a public policy focused on the reduction of the profound social debts that were accumulated of the past decades as well as of the violence problems". The Secretary of Government under Fajardo and his successor as Mayor, Alonso Salazar echoed this in an interview with the author: "Sergio (Fajardo) reflected about problems of the city and how to tackle the challenges […] of violence, inequality and the historical social debt we had with the city. And we addressed these problems through the creation of public space" (Salazar, 2014). Cited in Coupé et al. (Coupé et al., 2012, p. 54) Fajardo also emphasizes this redistributive element of the social urbanism strategy: "we carried out wealth distribution without appealing to a discourse of anger or aggression. And in that sense […] we have built library parks" (Sergio Fajardo, interview, Medellín, December 10, 2007). According to this view, the coalition succeeded to implement institutional reforms that helped to achieve improvements in public education, created space for the development of cultural programmes, and most importantly laid the foundations for an improved local entrepreneurship that "changed the skin of the city" (Fajardo, 2008).

In a closer discussion of the coalition-building process, Fajardo and Andrews (2014) present an analysis of the different governance actors. Reviewing the process that led to the election of Sergio Fajardo in 2003, the authors find that the diversity of stakeholders and their ability to engage main business and civil society agents in their governance coalition, was decisive for

Medellín's successful institutional transformation. Fajardo and Andrews (2014) argue that the cornerstone of success was the foundation of the so-called *Grupo de los 50* (Group of 50) in 1999 and the subsequent creation of *Compromiso Ciudadano* in 2001. This diverse coalition of NGO representatives, academics, the business sector, academia, and the media "focused on how to translate their frustration with Medellín's political class into action" (Fajardo and Andrews, 2014, p. 4).

While Fajardo and Andrews (2014) claim that there were formal and informal factors that supported and strengthened the coalition-building processes, the analysis of these issues falls short in explaining the interests of the different stakeholders in these coalition-building processes. In parallel with the literature presented so far, they fail to analyse how the coalition could overcome the heterogeneity of interests. The authors also fall short in analysing the different stages through which the governance model of Medellín emerged to become the dominant developmental approach – both in the context of local-level politics as well as in the wider context of national and global development trends. Many of the contributions to the scholarly literature stressing the importance of institutional changes and governance capabilities of the "miracle" coalition further fail to show conclusive evidence of direct links between the discussed policy changes and developmental outcomes.

Bahl (2012) provides a much more contextualized approach to the question of governance and institutional change over time. He stresses that the social urbanism policy emerged as part of a wider 'good governance' framework in Medellín that made the city "a beacon of urban development innovation" (Bahl, 2012, p. 7). The author thus points out that governance in a transnationalized world needs to look at the role of cities and the capacity of urban actors to shape an institutional agenda for effective urban development. Bahl (2012, p. 7) finds that Medellín, as part of this global trend, has adopted "a model of good governance—one that promotes effectiveness, agency, equitable distribution and interdependence." These processes, however, did not occur without the agency of local actors that shaped a particular brand of 'good governance' agenda that is very much unique to the city of Medellín. Bahl (2012) sees this as a result of how governance and government was understood throughout much of the twentieth century. Since the early 1900s in Medellín there existed a "marginal citizenry" that became embedded into a "sharply segregated and exclusionary" urban fabric (Melguizo and Cronshaw, 2001, p. 114). Bahl (2012) uses this historical analysis to argue that these exclusionary elements gave rise to resistance movements in the 1980s that coincided with the rise of Pablo Escobar's Medellín Cartel. Carvajal (2011) finds that during this period "the logics of narcotrafficking and the associated violence became embedded in the local economy, social and political practices;… indices of corruption and clientelism became elevated… and levels of poverty worsened". It was hence "illicit governance and violence" that became an effective institutional tool in exercising control over capital and power, not only for the drug class but also for the political and economic elites of Medellín (Bahl, 2012, p. 20). Barón and Mond (2001, p. 26) argue that the historical structure of governance in Medellín produced a "negative stalemate" in which the illicit governance actors, alongside formal state institutions were able to fully take control.

It was in this setting in which the 1991 Constitution engendered neoliberal restructuring and the large-scale roll back of the state. Bahl (2012) argues that the resulting "low-intensity democracy" and the retrenchment of the state in Medellín did not create the desired conditions in which increased political and economic competition facilitates the attraction of foreign direct investments (FDI). On the contrary, neoliberal reforms are seen as promoters of privatization of violence that constrained economic activity (Bahl, 2012). Throughout much of this phase of governance in the 1990s, the local government was hence a "weak agent… bargaining as if it were on the same level as other armed groups. It never appear[ed] as the legitimate locus of power with the right to impose its will" (Melguizo and Cronshaw, 2001, p. 127). Bahl (2012, p. 21) finds that this created a "cyclical pattern…in which violence and clientelism exacerbated the weakness of public institutions, and in turn, permitted further violence".

Bahl (2012) links the Fajardo effect to an increased willingness of the municipal state to address these local crises through participatory methods, which he contextualizes in Colombia's wider institutional restructuring following the 1991 Constitution. However, these contextualized analyses of governance changes fall short in discussing historical political economy changes in the productive economic development, Medellín's (failed) industrialization attempts, and elite interests. Furthermore, while Colombia's neoliberal shift is analysed with regards to the general attraction of FDI and the role of the state in security policies, the contributions fail to include a discussion about the impacts of neoliberal restructuring on state capacities in general and capabilities to generate productivity growth and investment.

Gutiérrez et al. (2011) also provide a more contextualized analysis of governance restructuring that led to what the authors call a "metropolitan miracle". Gutiérrez et al. (2011, p. 1) argue that the miracle "was the result of a set of institutional underpinnings basically related to the 1991 constitution". The authors include an analysis of the Constitution of 1991 and its far-reaching implications for local governance structures and discuss how participation and decentralization reforms implemented as a consequence of the Constitution lie at the core of Medellín's success. For Gutiérrez et al. (2011) these underpinnings opened new opportunities for political and economic actors to influence decision making through the formation of coalitions and the focus on a 'good governance' formula. For Gutiérrez et al. (2009, p. 2) "the metropolitan miracle happened because a new, heterogeneous, governing coalition came to power".

In Medellín, this "heterogeneous coalition in which NGOs and the intellectual left were conspicuous, but where entrepreneurs, the Chamber of Commerce, and the media also found a place" (Gutiérrez et al., 2009, p. 6) questioned the values and governing styles of the political class "which governed through longstanding partisan networks… (and) had no incentive to escalate organisational complexity" (Gutiérrez et al., 2009, p. 4). The old political class had interests "to maintain a 'flat and penetrable' set of agencies" (Gutiérrez et al., 2009, p. 4). For the authors, this was incentive enough for the new coalition under Fajardo to question the governing style based on political patron-client relationships that had secured seats and power for traditional politicians (Gutiérrez et al., 2009, p. 8).

The inclusiveness of the discourse of the new, alternative Fajardo coalition "had an idiosyncratic twist to it, claiming to be disentangled from representation" (Gutiérrez et al., 2012, p. 190). For the authors, this was crucial in achieving the miracle, as this anti-particularism could transcend the interests of classes and groups. While the authors find that such a discourse can to some extent be associated with the neoliberal paradigm implemented through the 1991 Constitution, they claim that in Medellín the discourse was not anti-statist, as was typically the case in neoliberal Latin America. Instead the anti-particularistic discourse clearly advocated an increase in state and capacity building. The authors claim that "interest-based bargaining was shunned, and specific social and economic sectors were not privileged" (Gutiérrez et al., 2012, p. 190). However, the authors fail to include discussions on how the limited role of the neoliberalized local state affected governance capacities to implement economic policies to achieve growth and development through direct market interventions.

Guerrero (2011) and Devlin and Chaskel (2010) take a closer look at the 'good governance' model that followed Fajardo's victory in 2003. Analysing "the Political Economy of Medellín's Recovery" Guerrero (2011, p. 2) provides qualitative and quantitative evidence "that a quick upgrading in the city's less favored districts, combined with a stronger enforcement of the rule of law, may have successfully raised the traditionally low levels of political and institutional support in the city, breaking the equilibrium of distrust in government". The paper finds that a 'good governance'-style institutional formula and particular institutional spill overs helped to achieve economic and political developmental outcomes that support the miracle claims.

In a similar vein, Gutiérrez et al. (2012, p 194) stress that the new coalition's governance model "was based on guaranteed stability of property rights and reduced corruption". This institutional understanding and governance structure was strongly supported by the urban business elite who were willing "to surrender *direct* access to decision-making through clientelist links to individual politicians (in exchange for) lower transaction costs, better infrastructure, and increased predictability, as well as a sense of contributing to public good" (Gutiérrez et al., 2012, p. 195, emphasis added). In turn, the business elite could establish other channels of influence, which allowed them to be "incorporated… much more strongly into the new municipal government" (Gutiérrez et al., 2012, p. 196). The mechanisms through which these institutions were established, the different interests of the actors in the coalition, as well as how the *new* elite bargain affected power constellations and policy outcomes remain underexplored in this contribution.

Devlin and Chaskel (2010, p. 2) find that Medellín's 'good governance' agenda, implemented by an "independent mayor" who was "fed up with flagrant corruption and betting", was based on the concept of transparency. Citing an interview with Fajardo the authors stress that "transparency is the equivalent of trust, and that is the best political capital you can have" (Devlin and Chaskel, 2010, p. 8). The authors argue that through efforts to decrease corruption and increase government accountability, the city was able to improve its fiscal situation drastically, which in turn is seen as a necessary and sufficient condition for Medellín's improved economic growth. And indeed, while up until 2004 Medellín had to pay obligations of 84.4 billion Colombian Pesos (COP) with a total income of only COP 7 billion (Devlin, 2010: 8), the Fajardo administration was able to "clean up" the balance sheets, and in turn double public investments between 2004 and 2008. Both Guerrero (2011) and Brand (2010) stress that this was particularly due to the improved management of *Empresas Públicas de Medellín* (Public Enterprises of Medellín, EPM), the public utility provider mandated to give 30% of its net profits to the city.

However, all contributions fail to analyse the formal and informal mechanisms through which the new coalition engaged in interest-based bargaining to secure support from the business elite as well as from civil society organizations. The authors do not sufficiently explain how the new coalition gained and maintained power and how particular interests that are very much aligned with neoliberal ideals and ideas dominated the new ruling coalition. Besides analysing the role of the media through which Fajardo was able "to signal his otherness", Gutiérrez et al. (2013, p. 7) also inadequately explain how homogeneity was achieved in order to successfully implement policies despite the "heterogeneous" character of the coalition. Furthermore, the authors fail to analyse what the new governance formula entailed, which interests dominated in implementing policies, and what wider developmental outcomes were achieved.

In a detailed analysis of the actors behind the “miracle”, Maclean (2015, 2014) tries to fill this gap. She provides an insightful contribution to the literature that looks at how interest-based bargaining mechanisms formed the coalition’s governance formula. Similarly to Fukuyama and Colby (2011), who find that the Medellín “miracle” is based on the strong position of a “uniquely civic minded business elite”, Maclean (2015) finds that this business elite and its representative economic group, the *Grupo Empresarial Antioqueño* (Antioquian Business Group, GEA) largely influenced the politics of the miracle. Hence, using their powerful position in the Fajardo coalition through various channels of institutional influence, the business elite was able to “structurally change the economy and, crucially, invest in education, to enable political actors from different perspectives to work together and find common aims” (Maclean, 2014, p. 46). The strong presences of business associations, such as the GEA and its influential think-tank *ProAntioquia*, as well as the large role of the Chamber of Commerce in the coalition have been “necessary conditions for the Medellín miracle” (Maclean, 2014, p. 46). At the same time, however, Maclean (2015) finds that the increased influence of these actors also included a “shoring up” of the business interests in the formation of a governance structure and the implementation of certain policies. Furthermore, the author argues that the ruling coalition was able to “overthrow the Liberal/Conservative duopoly in Medellín and change the political elite” and work with the business class to shape a “political processes of change” (Maclean, 2014, p. 38).

However, Maclean (2015) takes the occurrence of the “miracle” for granted and limits her analysis to the context in which these “miraculous” transformations happened. Questions of power relations remain underexplored, which, particularly in the context of the suggested overthrow of traditional bipartisanship, is a crucial analytical oversight. The author’s uncritical stance towards the increased interest bargaining of the business elite and the underlying implementations of this new power distribution limit the explanatory value of Maclean’s (2015, 2014) contributions. The contributions further fail to analyse the entrepreneurial ability of the GEA and the organizational powers of the ruling coalition vis-à-vis this strengthened business elite to develop governance capabilities necessary for policy implementation. For a conclusive evaluation of developmental outcomes, we need to include discussions of how the domination of the business elite affected Medellín’s ‘good governance’ formula and hence policies that help to achieve sustainable levels of political and economic viability.

2.2.2 MEDELLÍN – A "LOCAL DEVELOPMENTAL STATE"?

The literature analysing the concrete developmental outcomes of the 'Medellín Model of Good Governance' picks up on contributions that find positive effects of an improved management of public institutions on economic performance. Coupé and Cardona (2012) argue that 'good governance' structures and physical interventions helped in incentivizing an increase in private investments, particularly into small businesses along the *Metrocable* lines and around the library parks. The policy programme, the authors argue, incentivized private entrepreneurs to open businesses and fuelled the construction of housing, making "the real estate market in the affected commuas more dynamic than in the rest of the city" (Coupé and Cardona, 2012, p. 93). The authors take these results, the increase in total employment figures, and the improvement of the HDI in Medellín as proxies to conclude that the social urbanism and 'good governance' policies had positive economic developmental impacts (see figure 2.6). Turok (2014) finds that the physical and institutional redevelopments of Medellín under Fajardo have been fundamental in the city's economic transformation that have created and retained jobs through public provision of "generous business support services to micro enterprises… (whose) revenues have helped to finance the city's social and infrastructure programmes and compensate for the low tax rate" (Turok, 2014, p. 577). Turok (2014, p. 578) argues that this "economic and social advancement" has been supported through investments in organizational capacity building "both within the public sector and among non-governmental organisations and social movements". Particularly Medellín's "transformative policies and programmes", backed by the alliance of a variety of stakeholders in the Fajardo coalition, are seen as crucial for the city to overcome the "tough predicament of mass unemployment and deep inequality" (Turok, 2014, p. 578).

Bateman et al. (2011, pp. 1–2) find that Medellín's 'good governance' framework, combined with the state-controlled EPM as a growth driver, was the basis for Medellín to become "the pioneer in developing a new Post-Washington consensus local economic policy model". Taking a variety of local-level institutional interventionist policies into account the authors portray the Fajardo coalition as "pro-active in building the institutional and organisational infrastructures required for growth-oriented micro-, small and medium enterprises to emerge and succeed" (Bateman et al., 2011, p. 2). The authors see these organizational infrastructures as the institutional underpinnings for the emergence of a "local developmental state" (LDS), in which the local-level public utility company EPM plays a crucial role in financing state-led and state-coordinated economic and industrial growth. The authors hence present several "LDS-style interventions". Besides EPM as a state-owned financer of targeted economic policies, Bateman et al. (2011) stress the particular importance of the *Cultura E* programme established in 2004.

This 'culture of entrepreneurship' programme includes the setting up of 14 business support centres for microbusinesses in marginalized areas (*Centros de Desarrollo Empresarial Zonal*, CEDEZOs), as well as a state-owned microcredit institute *Banco de los Oportunidades* (Bank of Opportunities) that provides small loans at low interest rates. According to Bateman et al. (2011, p. 3) these interventions have helped to overcome local demand constraints and to explore and 're-localize' "existing local industrial and state demand patterns".

Bateman et al. (2011) conclude on a cautionary note with regard to the insufficiency of the *Cultura E* programme in sustainably promoting economic development. However, the authors do not sufficiently explore the institutional framework supporting the idea of a supposed local developmental state in Medellín. While an analysis of the role of the local state-owned utility company EPM does indeed provide an interesting point of entry into the discussion of Medellín's policy model, Bateman et al. (2011) do not analyse the particular organizational capacities of EPM or the distribution of power in the city's society affecting the ways in which this model is implemented to achieve development. As the distribution of power and the organizational capacities of actors underlying the institutional environment of a polity is an important variable in understanding possible "LDS-style" developmental approaches and outcomes, a closer analysis of the particular interests that drive EPM's interventions is necessary. With the strong position of the business elite in the Fajardo coalition, EPM's 'state-led' character is also more than questionable. The analysis of a "local developmental state", one would assume, needs to include a closer discussion of state capacities to create incentives and compulsions for technology-driven growth and a climbing-up on the productivity ladder. Such a discussion, however, is missing entirely from this contribution. Furthermore, the contribution fails to analyse how the *Cultura E* programme as part of the 'good governance' model has affected economic developmental outcomes that go beyond small-scale microbusiness development.

Higuita Palacio (2015) takes a closer look at the impacts of Medellín's "miraculous" institutional transformations on technology and innovation-driven economic growth. Inspired by Medellín winning the title of the "most innovative city in the world", the author finds that "Medellín has converted itself into a regional system of innovation, which was led by the local state… until the point at which the city can be categorized as the capital of innovation in the Latin American context" (Higuita Palacio, 2015, p. 41). He finds reasons for this transformation in Fajardo's effort in increasing public investments in education, as well as in science and technology. This, coupled with the coalition's focus on providing entrepreneurial support through the *Cultura E* programme lies at the foundation of the "miracle" (Higuita Palacio, 2015).

However, akin to the analyses of most other contributions, Higuita Palacio's (2015) article falls short in providing sufficient qualitative and quantitative evidence to support the claim that Medellín succeeded in technology and innovation-led economic growth. Furthermore, most analyses of the "Medellín miracle" fail to include historical political economy discussions of the institutional shifts and their respective developmental outcomes. Questions of power and elite interests remain secondary to most academic contributions. Explanations of the institutional change either focus on the ability of new political actors to "signal their radical otherness while at the same time appeasing the economic elites" (Gutiérrez et al., 2013, p. 7), or on the fact that the people of Medellín were simply tired of clientelist political corruption (Devlin and Chaskel, 2010, p. 2). Similarly, while most contributions study the nature of the governance model the city has implemented, they fall short in evaluating the connections between the political and economic factors behind the institutional change, the subsequently introduced policies, and their respective developmental outcomes.

2.3 Countering the conventional wisdom: challenging "miracle" claims to understand urban transformations

In contrast to the vast amount of contributions that find evidence supporting the occurrence of the "miracle" due to the efforts of an "independent mayor" who led a "heterogeneous governance coalition" to achieve "inclusive outcomes", there is very little literature that critically engages with this miracle claim in a structured way. This section reviews the few scholarly contributions that counter the conventional wisdom surrounding Medellín's recent developments. The section also presents remaining shortcomings of these critical contributions and closes with a discussion of the gaps in the literature that this thesis tries to address.

In a critical review of the institutional functioning of the Fajardo government, Moncada (forthcoming) stresses that the administration's interests in changing the city's image stem from the strong position of the business elite and GEA in the ruling coalition. Hence, a changed perception of Medellín would not only increase FDI into GEA-dominated sectors, but would also allow the business elite to re-establish influence within the local government (Londoño, 2004). Countering the findings that the Fajardo coalition is "anti-particularistic" and "anti-corrupt", Moncada (2016) argues that the GEA had a large influence on the policy direction of the local government. Moncada (forthcoming, p. 28) finds that "the private sector also faced particularistic incentives to support infrastructural development. For example, the leader of the GEA, Nicanor Restrepo Santamaría, was also the head of the board of Conconcreto S.A., the construction firm that built the city's first cable car line". Hence, "private interests indirectly profited from the reshaping of the city's image, but also from direct participation in the development of infrastructural projects integral to that revised image" (Moncada, forthcoming, p. 28). While these are valid claims, the author does not engage in a closer analysis of the particular abilities of Medellín's business elite to use its dominant position for the development of possible entrepreneurial and technological capabilities. Moncada (2016) presents little empirical evidence about the developmental impacts of the combination of this power structure with the particular interests of the GEA to develop infrastructural projects.

Some contributions to the academic literature analyse Medellín's recent developments in the context of global processes and networks established since the colonial period. Mendieta (2011) for example discusses how the insertion of Medellín in globalization patterns of formal economic activities and illicit cocaine production has spurred economic growth and development in the city. Brand (2013) takes the insertion of Medellín into global patterns of accumulation as the starting point for his critical evaluation of Fajardo's 'good governance' model and the associated social urbanism policies. He finds that the narrative around the "miracle" has to be renewed due to the increasing social inequalities in Medellín. Brand (2013, p. 11) hence notes that Medellín's governance model "has become increasingly inclined towards the spectacular and its marketing potential, caught up in a dizzy spiral of competition and the short-term logic of capital". These pressures to insert Medellín into global value chains have reinforced Medellín's weak position in "the corporate globalisation agenda, inducing deindustrialisation and increasing economic dependence on primary products and the formal and informal service sector" (Brand, 2013, pp. 11–12).

In a critical analysis of "Medellín's makeover" Hylton (2007, p. 71) finds that "Medellín is a media-saturated, image-conscious city, dominated by advertising and public relations". In a historical analysis of the city's ruling class, Hylon (2010) stresses that the recent changes at the city's institutional level, beginning with the election of Fajardo, are far from being a "miracle". The author explains that the reduction of violence has less to do with the election of the Fajardo, but is rather linked to the 2002 presidential victory of Medellín's native son, Álvaro Uribe Vélez. Uribe Vélez' close ties to "the 'rising class' of traffickers and import-export men" (Hylton, 2007, p. 78) and the subsequent (para-)militarization of Colombia's security are presented as main factors behind the reduction in overall homicides. This development, the author argues, came at the cost of social repression of "students, teachers, journalists, lawyers, and especially trade unionists and peasant activists… (who) were subject to assassination" (Hylton, 2007, p. 81).

Hylton (2010) claims that Fajardo's governance approach promotes market-driven development, contextualized in Colombia's neoliberal policy regime. Besides Uribe Vélez' paramilitarized influence, the author finds that reduced homicide rates can be explained by looking at the parallels between the neoliberal development approach of the Fajardo coalition and paramilitary interests in avoiding to be "left behind by the engine of globalization" and to create the "necessary climate so that investment returns, particularly foreign investment" (Hylton, 2007, p. 81). These power balances in Medellín have created hegemonic interests between the formal and informal institutional operations of the city, which Hylton (2007, p. 88) sees as the underpinnings for "Medellín's model of a dynamic, narcotics-based, finance and service-sector economy". Medellín, as "the beacon of neo-conservatism in Latin America" is hence being controlled by a ruling class that has secured hegemonic power by having turned to narco-capital and paramilitaries (Hylton, 2007, p. 89). Hylton (2010) critically concludes that the recent shift of the ruling class under Fajardo towards securing property rights and profitability is hence based on weak and informal foundations, which "provide little grounds for the new order's legitimacy" (Hylton, 2007, p. 89).

However, like the general "miracle" literature, these critical analyses of recent transformations in Colombia's second city need further exploration of several key issues if they are to add explanatory value to the understanding of Medellín's development. While most contributions mention issues of power regarding the institutional capacities, this is largely underexplored. Hence, the critical approaches to Medellín's development fall short in the analysis of the *distribution* of power. While they provide a critical engagement with the domination of Álvaro Uribe Vélez and the neoliberal-minded business elite, the analyses remain vague on how globalized processes and the changing interest constellation in Medellín's polity have impacted institutional mechanisms and ultimately economic developmental outcomes. Furthermore, there exists no political economy analysis of Medellín's deindustrialization, which is crucial in the understanding of the evolution of power structures, entrepreneurial and technological capabilities of Medellín's firms and sectors, and hence the institutional effectiveness of achieving sustainable levels of economic and political viability.

While many scholarly observers find that Colombia's shift to neoliberalism with the 1991 Constitution has been a major institutional underpinning for Medellín's recent transformation, there is no analysis of how this affected the development of productivity growth of Medellín. Furthermore there is a general lack of analytical engagement with historical and social processes and factors that shaped the power constellation in Medellín's society, the particular interest bargaining between different elite factions, governance capabilities, and entrepreneurial abilities. While Hylton (2007) claims that Medellín has gone from an industrial capital to become a finance- and service-sector based economy, he does not provide conclusive theoretical and empirical evidence that would support this claim.

2.4 Conclusions

The existing literature on Medellín's transformation has been insufficient in providing a conclusive understanding of recent changes in institutional structures and governance and their respective implications for economic growth and development. There is a general lack of a more sophisticated and in-depth approach to questions of economic governance for inclusive and sustainable productivity growth that include a clear theoretical engagement with the role of institutions and empirical evidence that goes beyond simplistic data of increased GDP growth and reduced violence rates. Furthermore, there is a need for a contextualized analytical engagement with historically determined political and economic factors that influence how governance and development are interlinked. Questions of power distribution, elite interests, and governance capabilities of the state are central factors in this debate.

This thesis links Medellín's current development trajectory to wider historical changes in Colombia, such as the development of specific political and economic dynamics during the region's (failed) industrialization attempts and following the implementation of far-reaching neoliberal reforms. While some contributions have engaged in such a contextualized analysis, this thesis presents and elaborates on a theoretical framework that systematically analyses the impacts of Colombia's neoliberal turn on institutional mechanisms capable of creating the conditions for economic growth and political stability. While there exists a wide array of theoretical literature on the role of institutions in economic development, this thesis presents alternative political economy considerations in theorizing and analysing institutional functioning. Hence, we find that institutions and their effectiveness in creating and enforcing particular policies that generate developmental outcomes are interdependently linked to political factors of power distributions. Changes in the Colombian policy environment following neoliberalization of the economy are thus analysed in the context of how they affect the distribution of power, which then drives the creation of institutions and determines political and economic outcomes. Particularly, we look at the impacts of globalized processes such as elite transnationalization on the interdependency between power and institutions. When interactions of powerful actors and institutions achieve a sustainable level of growth and stability a 'political settlement' emerges.

This alternative to institutional approaches that focus on 'good governance' explanations for Medellín's development is also important in conceptualizing other changes in the Colombian society, polity, and economy. Political decentralization in the context of state-weakening liberalization reforms also affected power structures as it weakened the position of an organized state in Colombia further. Besides the upward transfer of state capacities to supranational organizations and transnational actors, decentralization in Colombia fragmented organizational power through considerable downward transfers of administrative, political and fiscal capacities. This can have considerable consequences for the creation and enforcement of particular institutional mechanisms, which in turn impact political and economic developments.

We argue that without a historical understanding of these factors in Medellín's polity any theoretical and empirical analysis of Medellín's current development will have limited explanatory value. This is why this thesis does not only address gaps in the literature regarding recent analyses of Medellín's development. The analysis presented here is also concerned with obtaining a better understanding of Medellín's political settlement in the city's industrialization process. Hence, our research also includes a historical political settlements analysis of how the interdependency between power and institutions can explain why Medellín's industry failed to move on to the use of more advanced technology. Before engaging with the analysis of Medellín's historical and social processes and recent institutional transformation, the next two chapters will set out and develop the theoretical framework that informs our theoretical and empirical discussion of the case of Medellín.

CHAPTER THREE: POLITICAL SETTLEMENTS: FRAMING A POLITICAL ECONOMY APPROACH FOR A THEORETICAL UNDERSTANDING OF POWER, INSTITUTIONAL CHANGE, AND GOVERNANCE

The primary concern of this thesis is to analyse and understand how institutional settings and policies can have developmental outcomes that very much depend on the context in which they are implemented and enforced. The political economy theory of institutions adapted and developed in the next two chapters hence considers context-specific developments of Latin America in general and Colombia in particular. We find that decentralization reforms and a radical economic and financial liberalization agenda in Colombia has impacted the context in which institutional strategies and policies can be implemented and enforced to achieve sustainable levels of political and economic viability. While there are several academic contributions that theorize the "hollowing out" of the nation state through globalized processes (Jessop, 2004), there is a lack of systematic theoretical analyses of how state restructuring in the form of liberalization and decentralization reforms have impacted governance capabilities for local administrations in Latin America.

The review of the literature showed that conventional analyses of Medellín's "makeover" fail to present conclusive explanations of several factors. Similar to most contributions to questions on urban governance the analytical scope of the "miracle literature" remains limited to an application of the core features of New Institutional Economics (NIE). We argue that for an in-depth empirical and analytical engagement with urban development we need to have a more detailed theoretical understanding of how institutions affect the implementation and enforcement of particular policies in ways that influence political stability and economic growth. In this chapter and in chapter four we aim to present a theoretical framework of institutions that can help to provide more comprehensive explanations of Medellín's transformation. However, before we can engage in a systematic theoretical discussion of urban governance in Latin America in chapter four, we need to explore alternative institutional approaches that can add explanatory value to the understanding of governance and growth in less developed countries.

The remainder of the chapter is structured as follows: section 3.1 provides a general discussion of urban governance, local institutional developments, and their implications for growth. The section argues that conventional approaches to urban governance fall short to explain a number of central aspects of local institutional and economic dynamics. The section concludes by pointing out that the explanatory failure of conventional theoretical approaches to urban governance resides in a general misconception and misinterpretation of institutional functionings in less developed countries. We argue that this can be addressed by looking at political economy theories of institutional change and development in general, and Khan's (2010a) political settlements approach in particular. Section 3.2 discusses how the political settlements framework can add analytical value to the theorization of governance in general, and property rights, transaction costs, and conflict in particular. The section argues that NIE theories fall short to distinguish between several types of costs and their implications for developmental outcomes. Section 3.3 discusses how the analysis of interdependencies between distributions of power and institutions can help to mitigate these shortcomings of conventional approaches. Section 3.4 explores how these interdependencies underpin conditions for the creation and distribution of different types of rents and their related implications for development, given the characteristics of a political settlement. Section 3.5 brings the discussions of the different variables together in analysing how this political settlements framework provides an alternative entry point for understanding institutional and policy changes and their effects on growth and stability. The main argument of this section is that in order to understand institutional functionings and developmental outcomes we need to engage in an analytical discussion of the interaction between political factors (e.g. power distributions and governance capacities) and economic factors (i.e. technological capabilities of entrepreneurs) in a political settlement. It is crucial to analyse the compatibility between these factors and institutional strategies to create incentives and compulsions for successful growth-enhancing change. Growth-enhancing institutional strategies need to focus on creating and distributing rents that can overcome principal-agent problems of financing learning. The likelihood of effective governance capabilities to arise that can overcome such appropirability problems (i.e. through ensuring that financing for learning is not misallocated or wasted) depends on the political characteristics of the political settlement. Section 3.6 concludes and argues that the insights from the political settlements framework can be helpful in proposing an alternative institutional approach to urban governance and development.

3.1 Urban governance, institutions, and development

Conventional institutional approaches to urban governance follow the 'good governance' literature in arguing that a standard set of institutions is necessary for less developed countries to achieve the 'right' underpinnings for policies for successful growth and development. This widely supported policy recipe for local economic development has been promoting the decentralization of government, accompanied by other institutional reforms to achieve better transparency, higher accountability, and less corruption (World Bank, 1992, 2000). The 'good governance' agenda together with the promotion of decentralization has served as a blueprint for less developed countries to achieve development. Commonly implemented ‘good governance’ reforms in less developed countries have thus focused on downsizing states to minimize market-distorting interventions that are seen as a source of transaction costs (see Hall and Pfeiffer, 2000; UN-HABITAT, 2015).

However, the decentralization and ‘good governance’ literature does not engage with closer institutional analyses of how policies can be implemented in contexts where spatio-economic changes have affected power relations, state capabilities, and political factors in general. There is no reference to capitalist development, local elites, or other powerful agents. There is no political economy analysis of the interests, ideologies, or the roles played by transnational organizations, particularly of financial institutions. Considerations of the emerging influence of the transnational capitalist elite on institutional mechanisms and governance capabilities is also completely missing. However, a holistic discussion of governance and growth in urban Latin America must also consider how the region’s political decentralization as well as its economic liberalization and the consequent return of many countries’ comparative advantages to low value-added economic activities have affected institutional capacities to achieve growth. These issues are largely ignored in the decentralization and ‘good governance’ literature. The move towards ‘good governance’ strategies can thus be seen as an attempt to create governance capabilities that are required to create market-enhancing conditions building on neoliberal reforms of liberalization and market-driven growth (Khan, 2008, p. 110).

Regardless of the shortcomings of contemporary institutional explanations of restructuring local governance, there have been only very limited attempts to explore alternative institutional strategies for productive economic development for urban areas in less developed countries. Proposals for a “local alternative for decentralization and economic development” (de la Cruz et al., 2011) or a “productive transformation of cities in Latin America” (UN-HABITAT, 2015b) do not depart from ‘good governance’ ideas and ideals. Academic scholars, international organizations, and policy makers alike have thus continued to promote institutional reforms based on recommendations that fail to consider several crucial elements for understanding why nations, regions, or cities have succeeded or failed to climb up the value ladder. This is particularly true for urban Colombia where decentralization and reforms of “good urban governance” (Gilbert, 2006) are the conventional institutional policies used to achieve economic development.

Critical theories of urban governance discussing the impacts of the reorganization of economic and political landscapes under economic liberalization and political decentralization have been dominated by geographers, sociologists, or heterodox economists analysing the transformation of the role of the state. Swyngedouw (2000, p. 64) maintains that “the literature and political rhetoric obfuscates, marginalises and silences an intense ongoing sociospatial struggle in which the reconfiguration of spatial scales of governance takes a central position". In the analysis of the urban as a key arena for such a reconfiguration of governance he confirms Sassen's (1991, p. 27) findings that globalization processes have led to the ascendance of "global cities" as a key spatial dimension in the re-scaling of strategic territories, leading to a "partial unbundling or at least weakening of the national as a spatial unit". Castells (1996, pp. 403–404) finds that major urban areas have become "nodes of the global economy, concentrating the directional, productive, and managerial upper functions all over the planet: the control of the media; the real politics of power; and the symbolic capacity to create and diffuse meanings".

Overall, this literature finds an "enhanced role of regional or local states in economic development" as well as a "development of transnational linkages among regional or local authorities" (Jessop, 1997, p. 36). Brenner and Theodore (2002, p. 368) see regional entities in general and cities in particular as "increasingly important geographical targets and institutional laboratories for a variety of neoliberal policy experiments form place-marketing,… local tax abatements,… public-private partnerships, and new forms of local boostering of workforce policies, property-redevelopment schemes,… and a host of other institutional modifications within the local and regional state apparatuses". Urban areas have thus become territories of "actually existing neoliberalism" (Jessop, 2002, p. 452). Peck et al. (2009, p. 57) find that through their insertion into global capitalism "cities today are embedded within a highly uncertain geo-economic environment, characterised by monetary instability, speculative movements of financial capital, global location strategies by major transnational corporations and intensifying interlocal competition". The 'urban process' thus "throws up certain institutional arrangements, legal forms, political and administrative systems, hierarchies of power, and the like" (Harvey, 1989, p. 6). The selective transfer of state capacities to supranational and subnational forms of governance has reconfigured power relations within local ruling coalitions (Harvey, 2013).

These critical urban theories can also be of value for alternative political economy theories of institutional change and economic development that diverge from the mainstream focus on 'good governance'. However, there are only very few academic contributions that discuss urban governance and policy alternatives to achieve economic development and growth in medium and high productivity sectors. Jessop and Sum (2000) provide a "Schumpeterian analysis of entrepreneurial cities" with a detailed discussion of potentially growth-enhancing urban governance models, particularly for the case of Hong Kong. Nonetheless, and similar to Harvey's (1989) discussions of 'urban entrepreneurialism', the analysis is mostly focused on how institutional strategies impact wealth creation and the dynamics of urban property markets. The theoretical discussions are furthermore focused either on urban governance in *advanced* capitalist countries or on how city governments can influence growth and development in successful *developmental states* that have already achieved a considerable level of economic catching up, such as China, Japan or Korea (Jacobs, 2008; Lee and Shin, 2012; Oi, 1995).

However, the difficulty of mimicking particular institutional strategies, often specific to political and institutional characteristics of successful developmental states, minimizes the analytical value of a comparison with today's transitional or less developed countries. These features include a system of monopolization for productive investments and very high overall investment rates. Furthermore, there were often historically specific state-business relationships between a relatively independent bureaucratic state and technologically capable entrepreneurs that facilitated growth-enhancing rent management strategies in developmental states. The balances of power were thus favourable for the creation and enforcement of incentives and compulsions for productive investments. The power constellations in successful developmental states also allowed the state to credibly sanction in instances of non-performance by recipients of subsidies. As a result, these countries could implement successful technology acquisition strategies that helped their economies climb up the value ladder (Chang, 2002).

Thus, and important for our analysis of urban governance in Colombia, less developed countries today face considerably different obstacles in creating and enforcing urban "entrepreneurial" or "Schumpeterian" institutions. The likelihood of achieving growth-oriented governance varies depending on the context in which the institutional changes are implemented. The context specificities of less developed countries are hence also important distinctions to East Asian "local developmental states" (Zhu, 2004). Similarly to the political factors discussed above, organizational capabilities endogenous to polities and societies have also been crucial for achieving growth-enhancing transformation on the local level through "Schumpeterian urban entrepreneurship" (Jessop and Sum, 2000, p. 2287). These distinctions need to be taken into consideration for a contextualized theoretical and empirical analysis of urban governance in Colombia. In the following chapters we identify several internal as well as external factors that determine whether or not favourable conditions for growth-enhancing change can emerge.

Before we can engage in an analytical discussion about the internal particularities of Colombia's political economy as well as specific exogenous factors affecting urban governance and economic development, we need to review and analyse the literature discussing theories of institutional change and development. However, since theoretical discussions of the role of institutions in economic development are dominated by conventional approaches to institutional economics that claim to have a one-size-fits-all answer to problems of development, we will explore theoretical arguments that challenge this simplistic view. Drawing on critical political economy theoretical literature on institutions in general, and on Khan's (2010a) political settlements framework in particular, the subsequent sections engage in a theoretical discussion of how we can re-evaluate the role of institutions and governance in creating conditions for successful and sustainable development.

3.2 Transaction costs, institutional reform and the role of distributions of power – views from critical political economy theories

Transaction costs are defined as the costs of creating, enforcing, and monitoring outcomes associated with a particular institution (i.e. property rights), or "costs of running the economic system" (Arrow, 1969, p. 48). Standard neoclassical economics assumes transaction costs to be zero or only present at the point of exchange itself and never as part of reaching agreement about or enforcing an exchange. Where they do exist they are modelled into mainstream price theory based on demand and supply equilibria. The costs that determine supply in this approach now include all kinds of production costs, transportation costs, taxes, and the like. Allen (2000) argues that goods with high transaction costs will lead to higher prices for that good, with demand adjusting passively. This means that in the neoclassical theory transaction costs are not seen as an explanatory factor of inefficiency. Market failures thus never arise due to transaction costs, but rather because of missing property rights, which leads to externalities or moral hazard (i.e. public goods, monopolies, principal-agent problem). In turn, for neoclassical economics, property rights only emerge if the gains of internalization of these externalities exceeds the costs of internalization.

Contrary to the neoclassical assumptions, NIE theories acknowledge the existence of transaction costs and attribute market failures to cases in which transaction costs are high. The creation and enforcement of property rights or other "rules of the game" (North, 1990) is usually associated with the need to reduce transaction costs and hence to achieve market efficiency. While North (1984) also discusses the creation of inefficient institutions and property rights like monopolies where the objective is to capture rents, the NIE generally sees the existence and persistence of market failures as a result of missing or insufficiently defined property rights and attributes this to overly high transaction costs of introducing or enforcing such rights or institutions. This creates inefficiency (Acemoglu and Robinson, 2008, 2000), and the persistence of such market failures can lead to the failure of nations (Acemoglu and Robinson, 2012). States can overcome market failures and decrease transaction costs by implementing reforms that create the 'right' institutional framework (Acemoglu et al., 2006) in which property rights and incentive structures induce decision-making processes that result in reduced transaction costs of acquiring information, and of reaching, enforcing and observing agreements. This is the basis for achieving beneficial contracts for everyone involved as well as social welfare gains.

For the NIE, the failure of less developed countries to achieve sustainable development is thus rooted in their failure to create and maintain stable, well-protected property rights (Acemoglu et al., 2004; Kauffman et al., 1999; Krueger, 1974). Due to weak property rights the transaction costs of achieving favourable institutional change are impeding social and economic advancement. The corresponding policy implications focus on the establishment of governance reforms to achieve and maintain stable property rights. This is summed up in the 'good governance' agenda, which arguably constitutes the most prominent policy prescription for less developed countries or regions today. The political economy theory proposed here shows that the focus of NIE theories on the reduction of transaction costs as the determinant variable for functioning formal institutions (i.e. property rights) is misleading. The remainder of this section discusses how and why challenges faced by less developed countries and regions need to be theorized differently from these conventional approaches.

While this thesis recognises the validity of property rights theories regarding the importance of different types and allocations of property rights for economic growth, it adopts different interpretations of several factors important to the understanding of the role of institutions for development. Instead of limiting the focus of property right analysis on market-based efficiency, we also look at the importance of formal and informal institutions for productivity, including the creation of incentive and compulsion structures, as well as the extension of time horizons. Furthermore, the framework of this thesis also includes the analysis of distributive functions of institutions, which conventional discussions on institutions fail to recognize (Khan, 2010a, 2009).

Drawing on Khan (2009), the framework proposed here argues that any institutional change has implications on costs in one way or another. However, different effects of these costs exist. While some institutional changes induce transaction costs that are unimportant for growth-enhancing change, others are growth-constraining. Khan (2009) argues that only such "growth-constraining transaction costs" (GTC) should be considered. Hence, GTC do not include all kinds of transaction costs, but only focus on the costs that hinder growth-enhancing changes. In turn this means that a general reduction of transaction costs does not automatically lead to positive developmental outcomes. A reduction of an irrelevant, non-growth-constraining transaction cost might even lead to negative outcomes, for example by inadvertently strengthening powerful organizations that block growth. While this would not be a problem in the hypothetical case of zero transaction costs, when transaction costs are high, the distribution of transaction costs matters.

This approach to transaction costs departs from the NIE theory. However, the distinction is necessary as some types of property rights and institutions can make growth-enhancing change more difficult. The exclusive focus on GTC allows us to consider growth-constraining cost effects of a specific reform to pre-existing property rights structures, for example when the destruction or change in existing rights leads to an increase in transaction costs. For this analysis, one needs to identify the beneficiaries of any policy that reduces transaction costs as well as the groups that are negatively affected by this change in order to assess their potential to resist or obstruct change to existing property rights structure.

Thus, the particular *net* effect of institutional changes and the indeterminate outcome of this can only be understood once we take into consideration the possibility of costs that occur through resistance to or obstruction of these changes. Khan (2009) calls these costs “transition costs” (TSC). These are costs that arise depending on the intensity of the resistance against distributive implications of the institutional change in question and they are a function of organizational powers of potential winners and losers of institutional change. The extent of political transition costs that arise when contestants impose costs on each other depends on the underlying organizational power of the losing party to resist such changes. Hence, and contrary to the NIE theory that models transition costs as part of transaction costs, Khan (2009) proposes a model in which the *organization* of (negotiated) institutional changes results in costs due to the time and effort put into possible complex negotiations.

In sum, the intensity of the conflict and consequently the level of transition costs depend on the underlying distribution of political power, but also on organizational power among contestants (i.e. their ability to mobilize support for their positions, their links with the state, and the like) (Khan, 2009, p. 53). This makes the analysis of organizational powers so important in the discussion of institutional change and development, as this largely explains why a ruling coalition is able to push through certain property rights or why they fail to do so. If for example the ruling coalition wants to push through growth-enhancing policies but faces transition costs in the form of high-cost resistance by excluded groups with high organizational power, they might not be willing to implement the policy. The ruling coalition might still be willing to do so if they have incentives in the form of rent extraction from this policy that exceeds the political transition costs of implementing the changes. Khan (2009, p. 55) concludes that “(t)he likelihood of any particular growth-enhancing property right transformation being implemented depends on the transition costs they unleash”.

For a conclusive analysis of developmental outcomes of institutional changes, we hence need to expand on our understanding of power. However, conventional NIE approaches to power have largely focused on power as a purely economic measure of how long one side can hold out and engage in a conflict (see Knight, 1992, pp. 41–42 on the concept of holding power). We go beyond this narrowly defined notion of power and expand this economic analysis of power to non-economic aspects, including a discussion of “how the relative power of organizations in that society affects the enforceability of different institutional rules” (Khan, 2011, p. 1). This organizational power further includes considerations regarding capacities of groups and classes to mobilize against imposed costs (i.e. through demonstrations) and to absorb pain (Khan, 2009, p. 55). Hence, power in less developed countries not only depends on a group’s ability to 'hold out' due to their access to economic resources as suggested by Knight (1992), but also includes *other* factors, such as the control of political processes and ability to organize in society as a whole or within a particular group or organization. With this notion of power distribution in mind we can analyse elites, powerful groups, and subordinate classes not only according to their economic power, but also in terms of their *political*, *organizational*, and *ideological* capabilities. The distribution of power is thus one crucial element that helps to explain (the likelihood of) institutional change and the possibilities of achieving positive developmental outcomes.

The distribution of power in less developed countries differs substantially from that in advanced capitalist countries. Often, colonial legacies in less developed countries left behind a distribution of power that can be described as oligarchic where powerful elites can block growth-enhancing changes if they feel these changes would undermine their position in society, their privileged access to assets, and an income distribution that favours them. The oligarchy of many less developed countries thus holds a substantial amount of power and controls the allocation of rents and patronage (Winters, 2011). In their much-cited analysis of institutional change and development, *Why Nations Fail,* Acemoglu and Robinson (2012) take these findings into consideration. They extend their theory that economic development requires ‘good’ institutions and stable property rights (Acemoglu et al., 2002, 2001) to considerations of political power. The stability and disparity of property rights hence also needs a stable and balanced distribution of political power. For Acemoglu and Robinson (2012) this is not necessarily the case in most less developed countries, which the authors take as one explanation of why nations in the ‘Global South’ fail. However, their analysis does not explain why some countries managed to achieve substantial progress despite the absence of the ‘right’ structure of power and property rights. The analysis also fails to discuss how to achieve the transition from a weak state to a strong political foundation that can deliver resource allocation that results in net economic and social benefits. Acemoglu and Robinson (2013, p. 174) furthermore stress that "economic analysis needs to identify, theoretically and empirically, conditions under which politics and economics run into conflict". While the theory elaborated here agrees that politics need to be taken into account, we find that it is much more the historically contingent *compatibility* of political factors with economic growth-enhancing institutional strategies matters, rather than *conflict* between politics and economics (see Rodrik, 2014).

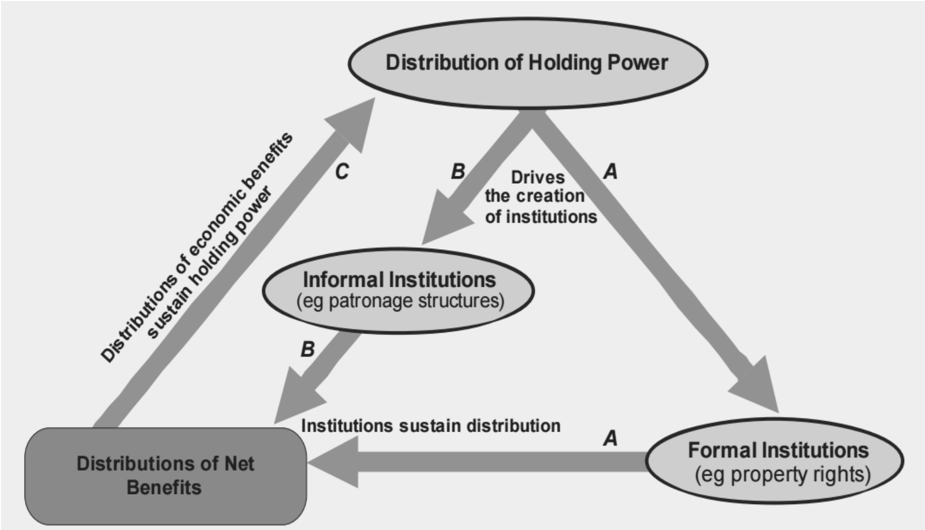
In less developed countries, power is often not aligned with the formal capitalist institutions identified as important for achieving compulsions and incentives for productivity growth, and instead depends on informal institutional mechanisms – especially in 'pre-capitalist' societies. This makes the mimicking of institutional policies of advanced capitalist countries or successful developmental states so difficult. This has prompted scholars like Rodrik (2008) to argue that less developed countries should solve their context-specific market and state failures with "second-best institutions". While some aspects of Rodrik's (2008) argument are useful for our analysis, we focus much more on how informal institutions affect the reduction of GTC and TSC. Thus, for less developed countries we need to take formal *as well as* informal changes to institutions into consideration when analysing institutional enforceability problems as factors that determine political and economic outcomes.

For this, we use Khan's (2010a, p. 10) definition of informal institutions as "patterns of behaviour of individuals who are following internalized norms and values…(and) rules that are not formally written down…but which are nevertheless enforced by third parties" such as patronage structures, mafias, or patron-client networks. The insight from the framework presented here is that in less developed countries informal institutions may be needed alongside formal institutional mechanisms to reduce transaction costs and transition costs. Consequently, studying informal institutions can often provide a better understanding of why developmental outcomes from institutional change differ so largely. Informal institutions are often mechanisms that bring the distribution of benefits into closer alignment with the distribution of organizational power. For the institutional analysis of successful development, we further need to recognize the importance of the creation of (informal) institutions that can incentivize new entrepreneurs and transform property rights so as to create compulsions for a resource allocation that facilitates productivity growth.

The different variables discussed so far are summarized in figure 3.1. The distribution of economic and political holding power drives the creation of formal and informal institutions.

Arrows A and B show how the distribution of power drives the creation and changes of formal and informal institutions as well as how these institutions in turn sustain a certain distribution of benefits. The type and form of the created institution depend on how power is aligned with *formal* institutions. Arrow C shows how this distribution of benefits in turn supports the distribution of power.

FIGURE 3.1: THE INTERDEPENDENCE OF POWER AND INSTITUTIONS



SOURCE: KHAN (2010a, p. 25)

Other than in the NIE analysis which sees informality primarily as cultural difference or as inequality in the access to and distribution of formal rights (North et al., 2009), the approach proposed here considers informality an important mechanism for the creation and distribution of different types of rents. The political economy framework adopted here further differs from the NIE in regard to the evaluation of rents. The NIE sees rents as sources of market distortions that lead to market failures. In our approach rents can also have positive effects on economic growth and development. As figure 3.1 shows, the power structure determines which institutions are created and enforced. Rents created by this institutional change are distributed according to this power structure. If this is compatible with rent-management strategies that incentivize investments into medium or high technology sectors, rents can lead to productivity growth. Some rents are furthermore essential to maintain political stability and prevent violence (North et al., 2009). The next section examines in closer detail the role of rents and rent management in achieving growth-enhancing institutional structures.

3.3 Governance strategies and rent management: institutional challenges of learning and technology acquisition

Another important factor for the institutional analysis of growth and development is the understanding of rents. NIE theories see rents as costly source of inefficiency and corruption. This strand of literature in turn proposes that a standard set of 'good governance' reforms is necessary to reduce corrupt rent-seeking behaviour. The political settlements approach adapted here differs from such conventional understanding of rents. Firstly, we understand rents not purely as costs, but much more broadly as all income flows. Secondly, and depending on the effectiveness of rent-management strategies, rents can result in positive developmental outcomes, as they can be channelled to productive dynamics. Using the findings made so far, we argue that for an understanding of successful rent management strategies, we need to analyse the underlying distribution of power in a society and the organizational power of different groups and organizations.

In standard theoretical literature rent seeking is associated with high costs for individuals or groups who spend resources to influence the state or attempt to create market advantages. Rents result in the deviation from the competitive market equilibrium, which generates social welfare losses. Ultimately, neoclassical economists see rent seeking as a government failure, as rents are created through interventions that create conditions in which the market is inefficient (see McKenzie and Tullock, 2012). Krueger's (1974) model, for example argues that any type of government intervention to create rents leads to welfare losses that are as high as the cost of intervention itself, plus the value of the rents (see Krueger, 1974, p. 301).

NIE economists agree with the neoclassical approach that rent seeking is one of the main constraints on development. However, NIE sees that economic policies to remove rent-creating market restrictions require institutional underpinnings in line with the so-called 'good governance' agenda. As mentioned, this agenda stresses that to achieve economic development it is not sufficient to remove market restrictions in order to obtain an optimal market equilibrium. Reducing rents that hinder market efficiency needs institutional support through changing inefficient private property rights structures. While some proponents of the NIE, such as Stiglitz (1998), correctly argue that rents are endemic in market structures and often necessary for economic dynamism even in advanced capitalist countries, the bulk of the NIE literature stresses that the 'right' or 'good' property right structure is a necessary and sufficient condition to achieve market efficiency and growth. This more rigid strand of NIE theories ignores structural impediments to the effective implementation of reforms that would make property right structures more efficient in less developed countries.

By contrast, Khan (2000a, 2010a, 2010b) suggests that political factors and institutional conditions determine the effects of rents. A positive outcome depends on the types of rents, the policies that create these rents and the enforceability of conditions that would make these policies effective. This again depends on the governance and enforcement capabilities of the state, the overall distribution of power in society, as well as the position of technologically capable entrepreneurs in that context. Rents created through growth-enhancing institutional strategies that are compatible with these factors can achieve positive welfare and productivity gains. Given that in many less developed countries the distribution of power is not aligned with formal institutions, we need to consider rents and off-budget resource allocations that are created and enforced through informal patron-client networks. While such rents can lead to growth-enhancing outcomes and can stabilize the polity, the growth effects of these rents are often indeterminate and they can lead to growth-constraining monopoly rents or disrupt the enforcement of conditions on potentially useful rents (see Khan, 2000a; Khan and Blankenburg, 2009).

Of particular interest for our analysis of an urban region in a less developed country are so-called learning rents. These rents can be created by policies and interventions that support firms in sectors that are targeted as potential growth escalators. Since learning is a lengthy process, transfers, tariffs, or tax breaks can give entrepreneurs time and room to manoeuvre and invest in activities that could otherwise be perceived as too risky. Private and public financing for these sectors may be more forthcoming, as investors have more security of achieving positive returns on their investments. These rents facilitate entrepreneurial learning, and the adoption and adaptation of technologies that can enhance productivity growth (Amsden, 1989). Khan (2000a, p. 21) argues that these strategies can result in the creation of competitive firms and through imitation the creation of clusters that can add up to significant net social benefits.

Governance capabilities are required for the creation and effective allocation of this type of rent. Learning rents can only create incentives and compulsions for growth-enhancing investments if, firstly the state has the governance capabilities to enforce the conditions that are necessary for the achievement of productive outcomes potentially associated with learning; and secondly powerful groups possess the necessary entrepreneurial and technological capabilities in sectors and technologies that are supported. State capabilities are particularly needed to withdraw and re-allocate rents if recipients do not perform in a growth-enhancing manner. These governance capabilities can be undermined if the favoured capitalist groups are very powerful or can make alliances with powerful groups to capture these rents without investing in productivity growth. Governance capabilities are particularly crucial to facilitate the learning process of acquiring tacit knowledge through learning-by-doing. As investors will have periods of financial hardship and loss making while acquiring tacit knowledge, effective management and coordination of learning rents and the enforcement of appropriate conditions are crucially needed governance capabilities.

The most development-constraining market failure in this context is that investors who may be willing to invest in learning processes cannot be sure that they will be able to enforce the levels of effort on the organizations they are supporting that are necessary to make their investment viable (Khan, 2010b, p. 1). The market failure here is “the institutional difficulty of ensuring high levels of effort when learning is being subsidized” (Khan, 2010b, p. 22) but also several so-called appropriability problems that limit future profits of investors and can therefore result in low levels of investment in new sectors. Thus, market failures in the sense of inadequate investment in new sectors and in the acquisition of tacit knowledge stem from formal and informal institutional failures to enforce effort and to address other appropriability problems through the creation and enforcement of the appropriate contracts and property rights. Without these governance capabilities, attempts to address market failures will remain unsuccessful.

While the consequences of failures to ensure effort through contracting have been discussed in the literature, Khan (2010b) points out that important market and governance failures related to technology acquisition and adaptation are linked to limited capacities and/or poor policy design that ignore particular growth-enhancing factors. These market failures include underinvestment in skilled personnel due to possible positive externalities that cause appropriability problems (Dosi, 1988; Khan, 2000b). For example, it is often easier and cheaper to employ workers who have received their tacit knowledge or formal training elsewhere than invest in skills development within the firm, particularly as workers can then leave for other firms. Governance capacities are required to provide subsidies or other forms of support to workers or firms in ways that ensure investments in skills actually take place. Governance capabilities are also required to ensure monitoring and withdrawal of public funding in case of non-compliance.

A different appropriability problem can arise as a result of insufficient protection of intellectual property rights. When no protection is provided, rapid imitation leads to very short-lived technology rents for innovators, which can disincentivize investments. Nonetheless, and this might seem paradoxical, protection mechanisms that are too complex can harm innovation as they slow down the flow of knowledge to new innovators, which underpins the argument of Cimoli et al. (2009) and Stiglitz (2014) that intellectual property rights agreements have slowed down technology transfers to less developed countries. If a sufficient level of appropriability of technology rents is ensured, Multinational Enterprises (MNEs) may be more willing to finance investment in less developed countries that brings in new technologies, which can benefit industrial manufacturing development. However, the less developed country often has little control over the long-term decisions of MNEs regarding their location or other investments into medium or high productivity sectors. In this context a government should primarily be concerned about possible effects on backward and forward linkages of the transferred technology to domestic firms in medium and high technology sectors. Capabilities that make MNEs transfer more and more technologically advanced parts of the production value chain to the developing country are necessary, for example through invoking domestic content as a condition for policy support.

However, the attraction of new technology should not be so advanced that domestic producers cannot imitate and enter these segments relatively quickly, resulting in a technological dependence on a few foreign firms. Policies to prevent this from happening "are predicated on broader governance capabilities to induce technological capability development in other sectors and to ensure that incentives and compulsions exist to ensure high levels of efforts in sectors where learning is being assisted. Without these governance capabilities, dependence on multinational investments may in the long-run constrain developing countries to lower technological trajectories, as well as making them vulnerable to multinational locational decisions" (Khan, 2010b, p. 30).

A third appropriability problem arises with the financing of discovery. Hausmann and Rodrik (2003) argue that less developed countries have comparative advantages that need to be discovered. A country can have a comparative advantage due to innate differences between countries that exist, but are largely unknown until an entrepreneur tries and discovers what works by setting up production. Hence, comparative advantages can be discovered through the organization of production (i.e. discovering-by-doing). Khan (2010b, p. 31) argues that "the appropriability problem is that these pioneering firms cannot appropriate sufficient profits that would justify their investments in the discovery process". This highlights the need for the development of governance capabilities that can enhance the scale of investments for discovery through appropriate financing strategies. However, and since there may also be insufficient efforts to engage in the learning-by-doing that is required to achieve higher productivity in firms, we also need to include an analysis of how success in discovery may implicitly require *effective* learning-by-doing. This is entirely missing in the Hausmann and Rodrik discovery model. For Khan (2010a, p. 32) the problem is "not discovering what you are good at but understanding why there was differential success in learning and then improving the organization of learning-by-doing across more sectors".

In conclusion it can be said that if a state has weak governance capabilities vis-à-vis entrepreneurs with low technological capabilities in a particular society or is captured by an oligarchic elite that controls large parts of economic resources, then rent allocation to solve potential market failures might result in appropriability problems and social welfare losses. If entrepreneurs have considerable monopolistic or oligopolistic powers, the state may not be capable of enforcing growth-enhancing institutional changes that might include disciplining these very same entrepreneurs. Di John (2009) further finds the degree of centralization of political organization in a consolidated state another factor that influences whether the deployment of rents and patronage is likely to promote economic growth. Thus, polities with more centralized political organization "are most likely to promote economic growth… (whereas) in a consolidated state with fragmented political organization… patronage structures are less predictable and coherent because there is either less political party cooperation, or new factions either within the dominant party system or from outside successfully capture part of the state" (Di John, 2009, p. 10). This distinction is particularly important in the analysis of our study of decentralized urban Colombia.

Insufficient protection of innovation or the excessive protection of the technology rents of powerful foreign companies, underinvestment in technology, and a failure to discipline wasteful rent capture in sectors being supported are examples of the types of phenomena that can emerge in these unfavourable contexts. An analysis of governance capabilities and of the institutional structures can therefore help to explain why countries or regions may be stuck at the low productivity end of the value chain. In polities where the state has insufficient governance capabilities to create effective incentives, or where an overly powerful oligarchic elite that generates income in low productivity and low technology sectors is too powerful, the effective targeting of growth-escalating sectors will be difficult.

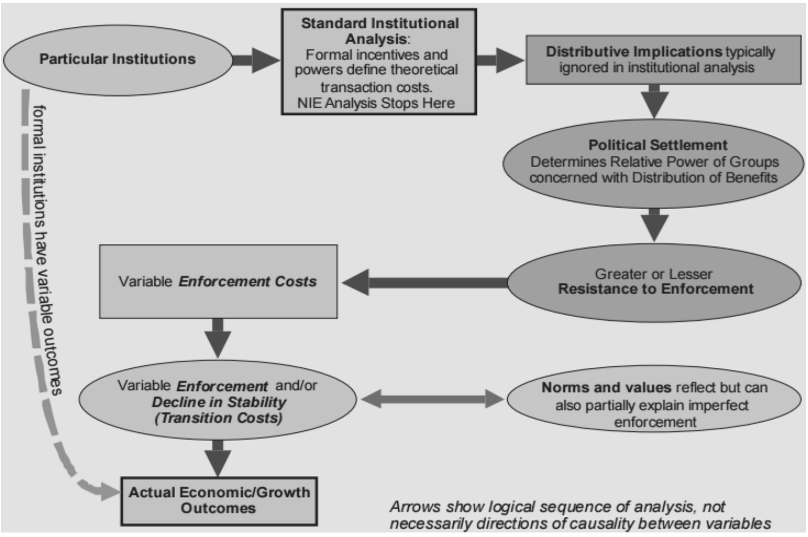
In sum, effective learning strategies and rent deployment require high levels of effort. Khan (2010a) sees effort as a function of four different institutional variables that determine levels of effort interdependently, making the likely effects of policies on effort non-linear in the sense that policy outcomes will depend on other characteristics of the context. The analysis suggests that effort depends on the independence of (a) the design of the financing instruments that are supporting learning; (b) the capabilities of the governance agencies enforcing and monitoring the conditions attached to these financing instruments, (c) the firm structures that are being supported, such as the internal hierarchies of firms, their relationship with the state and the market they operate in; and (d) the political settlement, which describes the relative power of the firms and agencies involved in the implementation of the support policy (Khan, 2010a, p. 4, 2010b, p. 42).

3.4 POLITICAL SETTLEMENTS AND THE GROWTH-STABILITY TRADE-OFF

Recalling figure 3.1, a political settlement describes a relatively stable set of institutions that sustain a distribution of net benefits, which in turn sustains the specific distribution of holding power. This section draws the various elements of the political settlements framework together and argues that the institutional analysis through our particular political economy lens provides a dynamic understanding of institutional change. We furthermore look at how this dynamic framework can add explanatory value to analyses of policy design and implementation in ways that have implications for growth and stability.

Figure 3.2 shows how theories of analysing the developmental effects of a particular institution needs to be expanded beyond the NIE approaches using the concept of political settlements. The NIE only provides an analysis of the efficiency and incentive effects of an institution with regard to the reduction of transaction costs. However, as we have discussed, the assumption that all reductions in transaction costs are efficient can be misleading. A more general analytical approach has to focus on the identification of particular transaction costs that constrain productivity growth and has to go beyond the NIE in identifying and explaining the enforcement costs of particular changes in institutions and policies to address these problems, given the distributive implications of the proposed institutional changes and the distribution of power in the political settlement. Figure 3.2 also shows how enforcement costs can arise either through resistance, which implies economic as well as political costs, or through imperfect or partial enforcement of the institution (Khan, 2010a, p. 36). The actual economic and political outcomes of institutional change can only be determined if we consider all of these variables in the theory of institutional analysis.

FIGURE 3.2: INSTITUTIONAL PERFORMANCE, POLITICAL SETTLEMENT, AND ENFORCEMENT

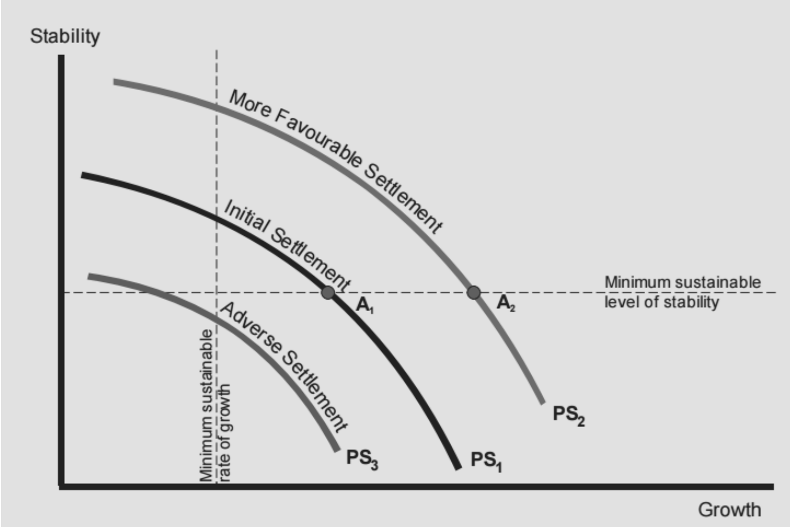


SOURCE: KHAN (2010a, p. 35)

In this framework there are no 'good' or 'bad' institutions per se, but only favourable and less favourable interdependent combinations of power and institutions. With this in mind, Di John and Putzel (2009) find that efficient resource allocation is not bound to a particular institution, which makes a blueprint approach to institutions such as the 'good governance' agenda a largely ahistorical and seemingly apolitical model. According to Di John and Putzel (2009, p. 9) institutions are not intrinsically efficient and cannot be transferred or imitated, as their efficiency, their viability, and their growth-enhancing impact depend on the power distribution in the political settlement. This is why a growth-enhancing institution embedded in one political settlement might not have the same positive results in another political settlement. This makes it crucial to look at the different variables discussed so far to analyse the likelihood of enhancing productivity growth through institutional change.

Enforcing particular institutions that can reduce critical GTC can face what Khan (2009) calls the "growth-stability trade-off". This trade-off depends ceteris paribus on the distribution of power in a society, as this shapes the possible resistance to particular paths of institutional change. Figure 3.3 shows the trade-off between growth and stability, where the vertical axis measures stability and the horizontal axis indicates economic outcomes of incremental changes in the enforcement of potentially growth-enhancing institutions. Let us assume a political settlement (PS_1) with an initial trade-off where growth is sustainably maximized at A_1. The shape of the trade-off curve depends on the institutions in question, the strategies used for improving their enforcement and the effectiveness of governance agencies monitoring and enforcing the appropriate enforcement conditions (i.e. on subsidy recipients). To increase growth a ruling coalition could attempt to implement and enforce a particular institution that might have positive economic and developmental effects. If the strategy to achieve growth-enhancing change is compatible with the power structure, transition costs are low and the cost of enforcing the institution is low. In this scenario, the trade-off curve is relatively flat, and the growth outcomes can be good (the political settlement can move to PS_2 with the minimally stable growth-stability trade-off at A_2). However, if resistance is high due to an incompatibility between the distributive implications of the institutional change and the distribution of power in the political settlement, political stability can decrease rapidly, implying a steep trade-off curve. Growth along this institutional trajectory will be low. In the worst-case scenario of particular trajectories of institutional change the political settlement descends into a crisis, which prevents the achievement of the minimum sustainable level of stability as well as the minimum rate of growth (PS_3). In these extreme cases, new social mobilizations can be triggered that result in changes in the political settlement.

FIGURE 3.3: GROWTH-STABILITY TRADE-OFF AND DIFFERENT POLITICAL SETTLEMENTS

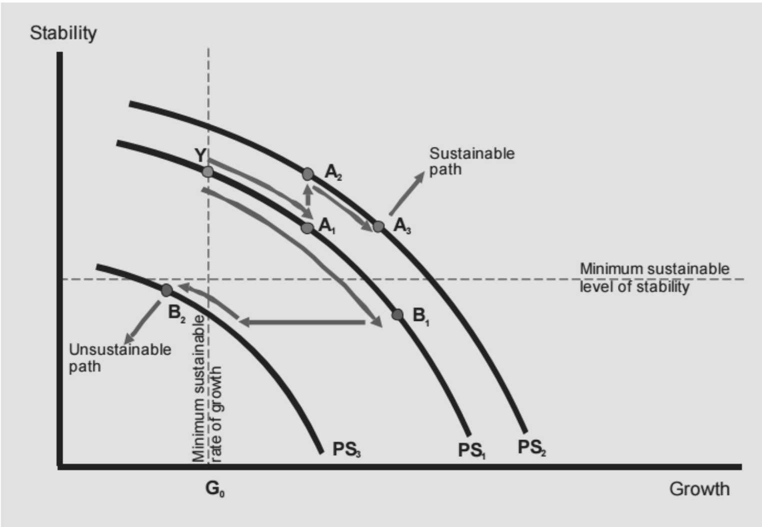


SOURCE: KHAN (2010a, p. 38)

Changes in the distribution of power in a political settlement that can affect the trade-off curve depend on a number of variables. Any significant institutional changes will result in a changed rent-seeking context that will eventually create a new distribution of power and a shift of the trade-off curve. Figure 3.4 shows that a settlement can change in ways that have positive or negative implications for the enforcement of particular institutions. Depending on the institution and the political settlement, a path of institutional improvement may be sustainable and generate positive effects on growth and stability, or lead to a crisis. In the initial settlement PS_1 the trade-off between growth and stability results in an outcome at Y, where G_0 is the minimal growth rate required to sustain the political settlement (see figure 3.4). Assume the ruling coalition then triggers an institutional change to achieve higher growth. The internal mobilizations driving this policy or institutional change could be a variety of 'agency' decisions within the leadership or mobilizations by interested organizations. If the change is compatible with the broader political settlement the growth rate can increase to A_1 with only a minimal decline in stability, as contestation of the change and hence transition costs are low.

This institutional path will enhance income and rent flows to organizations that support this direction of institutional change and as these organizations become stronger, the political settlement changes to reflect the new distribution of power. Diagrammatically, this implies an upward shift of the trade-off curve that looks at the growth-stability trade-off facing the institutional change. If this change in the distribution of power comes about, further improvements in the enforcement of the institution become possible, allowing a shift to say A_3 (see figure 3.4). In contrast to this incremental path of institutional change, some trajectories of institutional change can be rather discontinuous. For example, a strategy of institutional change to increase the growth rate may be pushed too far in the context of particular power constellation in a political settlement like PS_1. This could mean a shift to B_1, where higher growth is achieved but contestation and high transition costs push the political stability beneath the minimum level of sustainability. The resistance and conflict may potentially lead to a destruction of the organizational power of the organizations that supported the change and as a result the political settlement could shift to a new one, PS_3, which implies a more adverse trade-off for these institutional changes. The existing institutional strategy could then push political stability below the minimum level of political as well as economic sustainability and growth may eventually decline to B_2 (see figure 3.4). The new political settlement PS_3 may prevent the joint achievement of minimum levels of political and economic stability and this is a description of a political settlement in crisis, possibly with a high degree of violence. This will persist until a new settlement emerges that can achieve the minimum viability conditions. Overall, the political settlements framework provides dynamic, path-dependent and non-linear approach for the analysis of the impact of different reform trajectories on the levels of political and economic viabilities in particular societies (Khan, 2010a, p. 44).

FIGURE 3.4: POLITICAL SETTLEMENTS AND GROWTH-STABILITY TRADE-OFFS



SOURCE: KHAN (2010a, p. 43)

The political settlements approach provides an alternative analytical and theoretical framework to the conventional institutional explanations of *Why Nations Fail* (Acemoglu and Robinson, 2012). Conventional 'good governance' explanations of why some less developed countries, such as Taiwan, South Korea or Malaysia have experienced drastic economic growth since the 1950s stress that these countries were successful in getting the fundamental institutions 'right' (i.e. secure property rights) to achieve market efficiency and macroeconomic stability (World Bank, 1993). Thus, in assuming that any selective state intervention would constrain growth capacities the mainstream analysis of governance focuses on policies that minimize the role of the state, regardless of potential growth-enhancing effects of state intervention.

Besides engaging with institutional theories and NIE analyses of why late-developing countries failed to achieve high levels of economic catching up, this thesis also aims to explore how political economy explanations can provide added explanatory value to our theoretical and empirical understanding of failed industrialization attempts in Latin America in general, and Medellín and Colombia in particular. Many academic explanations of failed attempts of less developed countries to achieve considerable levels of economic catching up either focus on neoclassical explanations of how oil discovery and subsequent "Dutch Disease" effects slow down manufacturing growth, or on policy explanations that focus on macroeconomic policies in the context of trade liberalization.

The "Dutch Disease" literature largely focuses on how a country's resource abundance can have negative effects on manufacturing growth. The increase in oil, gas, or other extractive revenues, it is argued, can alter internal price and production structures of the economy. Thus, rents from "enclave" extractive sectors can result in exchange rate revaluations, which, according to this strand of literature, reduces incentives to invest in manufacturing. The well-above average profit margins and the increased rent from investments in the extractive sectors crowd out manufacturing investments. Hausmann (1990) for example finds that, assuming full employment in an economy exists, increases in inflows from extractive industries in Venezuela resulted in a change in relative prices favouring non-tradable goods, such as services and construction. Non-oil tradable goods from manufacturing and agriculture sectors become less profitable and thus investments are crowded out.

Further, the revalued exchange rate has negative effects on the (export) competitiveness of the productive economy. The decreased competitiveness of manufacturing sectors is further reinforced through wage effects of oil booms. Thus, the increase in aggregate demand for labour as a result of the inflow of extractive rents can lead to an increase in manufacturing wages, making domestic production of manufacturing goods less competitive (see Keynes, 1930; Neary and Van Wijnbergen, 1986).

The common conclusion drawn in this literature is that booms in natural resources lead to negative effects for economic development in productive sectors and the entire structure of the economy (see Corden, 1984). That is, the crowding out of investments and the loss of competitiveness ultimately leads to a deindustrialization of the economy. These "Dutch

Disease" arguments have predominantly been used to explain failures of ISI policies in Latin American countries (see Ross, 1999; Usui, 1997; Van Wijnbergen, 1984). In a critical review of this literature, Di John (2009 p. 38-39) finds that the conventional arguments follow the logic that "an appreciation of the exchange rate leads to a decline in the competitiveness, and hence production and employment, of the traded-goods sector… Thus, the model predicts that oil booms inevitably lead to deindustrialization (see Corden and Neary, 1982; Neary and Van Wijnbergen, 1986)."

The literature, however, does not engage in closer analyses of why the effects of resource booms are so different depending on the particular industry and the context specificities of the economy. Another problem that occurs with the "Dutch Disease" literature is that it assumes full employment and technology to be given. However, and even in an economy where full employment exists, additional export revenues from natural resources can lead to technology-enhancing investments, if accompanied by appropriate industrial policies. This can help a late developing country to successfully catch up in their technology growth. If the policy further promotes incentives for learning, this can lead to productivity growth in manufacturing sectors and can further help in growing up (see Easterly and Serven, 2003). In several empirical studies, Neary and van Wijnbergen (1986, p. 10) find "that a country's economic performance following a resource boom depends on a considerable extend on the policies followed by its government".

Thus, a second and more political economy strand of the "Dutch Disease" literature focuses on why increases in oil revenues are not accompanied by appropriate policies that would balance out the potential negative effects of oil abundance on a country's competitiveness in light of overvalued exchange rates and wage costs. The main arguments of this literature evolves around the analysis of powerful infant industry owners and the urban middle class who oppose devaluations of the exchange rate and a decrease in real wages. However, the degree of urbanization does not necessarily indicate the power or the existence of an urban middle class. Furthermore, even in countries that remain largely urban, we see resistance to or lack of appropriate industrial policies that would counteract on negative effects of an "expensive" exchange rate or high real income levels.

Other authors focus more on the correlations between macroeconomic distortions (i.e. exchange rate revaluations) and microeconomic policies. However, while trade deficits inevitably lead to trade deficits, microeconomic policies, such as trade protection, has indeterminate growth and export outcomes. Thus, the literature that fails to distinguish micro from macro reforms misleadingly associates industrial policy with macroeconomic instability (see Díaz-Alejandro, 1975; Rodrik, 1996). Furthermore, cases exist where high wages can create incentives for productivity growth. In other cases, wages rose considerably, but remained below the levels of productivity growth. The argument of high wages being harmful for productivity growth is further untenable when looking at wage effects following structural reforms in Latin American countries in the 1990s: the decrease in unit wage costs did not have positive effects on manufacturing growth.

Thus, strands of literature that finds that resource rich Latin America fell behind due to "Dutch Disease" effects and macroeconomic distortions are rather inappropriate for the analysis of the very variable and context-specific industrial growth paths and trends of deindustrialization in different Latin American countries. This makes it untenable to generally conclude that deindustrialization of Latin America happened largely due to the continent's oil abundance or imbalances between micro and macro policy reforms (Haber, 1997). This conclusion prompts us to question some of the neoclassical and policy explanations for deindustrialization in Latin America and makes it necessary to analyse growth experiences through the context-specific political economy lens of political settlements.

Other more heterodox analyses of growth experiences of late developers have exclusively focussed on the effects of state interventionist trade policies on productivity growth in manufacturing industries. These alternative explanations constitute the developmental state literature (Amsden, 2001, 1989; Evans, 1995; Rodrik, 1995; Wade, 1990; Woo-Cumings, 1999).

However, the developmental state analysis cannot explain why countries some with similar factor endowments and similar policy strategies failed to develop while others succeeded. Di John (2009) argues that the developmental state literature is inadequate, as it focuses on isolated policy or institutional failures without recognizing the particular context in which they are embedded. He finds the "main problem with them is that they do not consider that governance is an interdependent process of institutional design where such designs are simultaneously specifications of incentives and political power over property rights, policy agenda, and policy implementation" (Di John, 2009, p. 136).

The political settlements framework, by providing a more nuanced explanation of success, can also explain failures despite outward similarities and brings added explanatory value beyond conventional debates on market versus state. Developmental states were successful in catching up because their political settlements had favourable interdependent combinations of power and institutions and they had a supportive informal power structure that could enforce growth-enhancing changes (Khan, 2010a, p. 30). The emergence and success of developmental states is further linked to conditions that include sufficiently centralized political organizations, independent governance capabilities and government leadership, as well as appropriate technological capabilities of supported entrepreneurs. “In other settlements, where clients of state policies were powerfully organized and divided into many factions, ambitious industrial policies failed” (Khan, 2010a, p. 30).

In South Korea, for example, the combination of several critical factors and variables made selective state intervention successful. South Korea had a centralized and relatively independent bureaucratic state with capabilities of establishing and enforcing institutions that could create incentives and compulsions for investments into medium and high productivity sectors. At the same time, the state could effectively discipline sectors or firms that were being supported (Khan, 2009). Private investments were supported by public investments in the form of supportive subsidies and subsidized loans from state-owned banks (Amsden, 1989). At the same time, the historical particularities of the South Korean class structure, where bureaucratic elites maintained a powerful position during capitalist development vis-à-vis the emerging capitalist elites, made growth-enhancing enforcement of learning rents compatible with the distribution of power in the South Korean political settlement. Furthermore, South Korea’s domestic capitalist elite had sufficient entrepreneurial and productive capabilities in technologies that were being supported, which was another important factor in the country’s push from “easy” import substitution industrialization (ISI) to more difficult and technologically advanced strategies.

Khan and Blankenburg (2009) show that Latin America had less successful experiences in moving up the value chain. While state intervention in Venezuela for example was able to generate growth in the early stages of ISI, the state could not provide the institutional framework that could support the development of late industrialization based on technological upgrading and advanced technologies. This was partly due to a combination of technological and institutional strategies that were incompatible with political power constellations. Venezuela had a much more fragmented state and a capitalist elite that – very much influenced by history to be exporters of natural resources – did not have the capabilities needed for big-push industrialization strategies (Di John, 2009). As for most other Latin American countries, these structures “impeded, or at least slowed down, the evolution of a modern and professional state apparatus” (Khan and Blankenburg, 2009, p. 360).

The added explanatory value of this political economy approach is that an analysis through the political settlements lens helps in understanding the success or failure of institutional changes by studying the compatibility of these changes both with particular political conditions (governance capabilities, the organization of the state, the distribution of power across organizations) and economic factors (the technological and entrepreneurial capabilities of firms).

3.5 Conclusions

This chapter argued that in less developed countries the urban scale has become an increasingly important unit of analysis for a theoretical and empirical understanding of the role of institutions in creating and enforcing policies that achieve growth and stability. We pointed out that most analyses of urban institutional changes and development have been focusing on conventional 'good governance' approaches arguing that it is necessary for urban areas in less developed countries to implement a standard set of policies in order to develop. This chapter argued that this simplistic approach to institutional economics ignores several crucial issues in the understanding of governance capabilities in less developed countries.

The chapter engaged with alternative political economy approaches that overcome these shortfalls. We argued that the political settlements framework provides a theoretical understanding of why the transfer, imitation and superimposition of institutional arrangements from a successful late developer to a less developed country are unlikely to work in most cases. The framework proposed here focuses on the compatibility of underlying power configuration such as organizational, administrative and institutional capacities required to implement growth-enhancing development strategies and reforms. It highlights how differences across political economies, in particular the distribution of organizational power, can explain why similar mechanisms of compulsions and incentives were successful in achieving high-productivity development in some countries, while they were less successful in others.

However, despite its validity for an alternative theoretical understanding of institutional change and development, the political settlements framework can be further developed along several dimensions. Decentralization reforms as well as an increased urbanization of Latin America are but two factors in this discussion. Furthermore, the focus of the political settlements approach that balances of power in a society necessarily shape the policy arena in which institutional change can be implemented and developmental outcomes achieved needs to be expanded. The interests of dominant capitalist groups and the influence of ideational change shaping these interests need to be taken into closer consideration. This is particularly true for ideational change through crises and external shocks that followed the insertion of many Latin American countries into global capitalist value and production chains. Hence, the effects of recent changes in the global economy and globalized networks on the organization of different settlements need to be discussed in closer detail. The rise of transnational capitalist interests in Latin American societies following liberalization and decentralization reforms need to be included in the analysis of power, organizational coordination, governance capabilities in rent allocation and the creation of incentives and compulsion for technological transfers and productivity growth, and the evolution of formal and informal institutions. The next chapter will therefore adapt the political settlements approach to discuss the political economy context of economically transnationalized and politically decentralized Latin America.

CHAPTER FOUR: URBAN PROCESSES AND TRANSNATIONAL CAPITAL – THE POLITICAL SETTLEMENTS THEORY REVISITED

The previous chapter discussed that theories of urban governance are dominated by institutional approaches that find a standard set of 'good governance' capabilities necessary and sufficient for achieving economic growth and development. We argued that there is a need to explore alternative political economy understandings of the interaction between institutions and development that go beyond the simplistic and rather static conventional theories. In particular, we discussed the importance of exploring interdependencies between power and institutions to understand factors contributing to successful growth-enhancing economic policies. This chapter specifically focuses on the impact recent developments in the global economy and state restructuring in Latin America have on governance capabilities to achieve a growth-enhancing institutional environment.

As widely discussed, Latin America's shift to neoliberalism in the late 1980s and early 1990s involved the implementation of reforms to promote economic liberalization, deregulation, and privatization (see e.g. Williamson, 1990a). However, and following the neoliberal idea that rent seeking and corruption have been the main obstacles to development, Latin American countries also introduced a wide range of state restructuring reforms that included the decentralization of government (Faguet and Pöschl, 2015; Falleti, 2010). The main aim of the interconnected policies of economic liberalization and political decentralization was to make government more democratic, transparent, and accountable by reducing the discretion of central authorities to create rents and bringing decision making closer to civil society. The main argument for decentralization in this context is to reduce politically motivated rent-seeking behaviour in an overly complex and bureaucratic central state. The conventional argument for decentralization of political and fiscal decision making (inter alia put forward by the international financial institutions, IFIs) is that it serves as a remedy for corruption (Abed and Davoodi, 2000; Abed and Gupta, 2002).

By contrast, the theoretical framework adopted here is more concerned with the effects of economic liberalization and political decentralization on the distribution of power and on consequent governance capabilities to create and enforce institutions that can achieve sustainable productivity growth. The radical roll back of government and the reduced space for discretionary interventionist strategies have weakened the role of the state considerably. The fragmentation of power structures following decentralization can furthermore lead to distributional conflicts. The distributional function of formal and informal institutions becomes more prominent. This chapter argues that the increases in holding power (defined more comprehensively in section 3.2 above) of a particular business elite faction that benefited from neoliberal reforms vis-à-vis a weakened and rolled-back local state makes growth-enhancing institutional strategies less likely. Intensified competition between local decentralized governments, which by the conventional wisdom increases efficiency as it encourages experimentation and innovation in public policy (see Grazzi and Jaramillo, 2015, p. 114), can also have adverse effects on economic development. Competing cities in economically liberalized Latin America can accelerate a race to the bottom by attracting FDI into low-skilled and low-wage activities. In such a context, increased competition between cities can perpetuate differences of uneven productive development at the local level.

Furthermore, and as argued by Rodrik (2014), elites and policymakers of less developed countries are not exclusively driven by vested material interests they seek to maximize through rational-based choices (see Rodrik, 2014). Instead, actors are heavily influenced by ideational changes within a political settlement or as part of exogenous shocks (i.e. paradigm shifts in the global economy). Economic liberalization and globalized structures and processes have substantially changed the political and economic interests and ideas of Latin America's elite factions. Regional business elites, strengthened by the neoliberal reforms of the 1990s, expanded their assets to become local factions of what Robinson (2010) calls the "transnational capitalist class". The transnationalization of capitalist interests through increased inward and outward FDI, mergers and acquisitions had two important effects. First, it made the transnational capitalist elite the natural partners for fiscally constrained local governments who saw the attraction of FDI as a substitute for state-created rents and income flows. Any policy reform by a local government would thus benefit companies most likely to attract and broker FDI, thus strengthening the internal organizational and holding power of these factions through their alliance with foreign investors. Secondly, as the transnational capitalist elite generates most of its income from participating in global value chains it is less motivated to develop the domestic economy instead of promoting global capitalist growth. This is fittingly summarised by Khan and Blankenburg (2009, p. 366) who find that the "fairly radical shift towards neo-liberalism" led to Latin America's "return to its underlying static comparative advantage of natural resources and unskilled labour" that had "detrimental effects on its productivity and growth performance". To understand this shift and its developmental outcomes in urban Colombia, this chapter outlines the need to look at the constellation of political settlements in a contexts where rolled-back local states have low governance capabilities and low organizational power vis-à-vis strong local factions of the transnational capitalist elite with low entrepreneurial and technological capabilities.

This chapter sets out to explore the political settlements approach of analysing institutional performance and its impacts on economic outcomes in a historically specific process of interdependency between power and institutions. More precisely, the exploration of compatibilities between political factors (i.e. a changing distribution of power) and economic-institutional strategies provides a theoretical foundation for a richer understanding of developmental outcomes in the decentralized and liberalized Latin American context. Particular attention will be paid to the role of the region's transnational capitalist elite. The exploration of transnationalized and decentralized Latin America through the political settlements lens can provide answers to the questions set out at the beginning of this thesis.

The first section of this chapter discusses the increased importance of the urban dimension as a spatial unit for political and economic decision-making processes following liberalization and decentralization reforms. Downward transfers of state capacities to local governments have been contributing to a "hollowing out" of the nation state. While policy prescriptions for urban governments in less developed countries mirror conventional policy prescriptions as set out by the 'good governance' agenda, there is a general lack of detailed institutional and economic understanding of how these policy reforms affect the distribution of power and the likelihood of creating and enforcing growth-enhancing institutions and outcomes. Section 4.1 attempts to fill this gap.

Section two of this chapter complements the discussion of the "hollowing out" of the nation state by discussing the effects of the transnationalization of Latin America's business elites. Building on Robinson's (2010) empirical and theoretical findings on Latin America's capitalist class and their impact on economic development in the region, we analyse how changes in the interests of the business elite affect power structures, institutional strategies, and the likelihood of achieving inclusive and sustainable developmental outcomes. While our focus is mainly on the theoretical exploration of Latin America's elites in general, the section also identifies several particularities of elite transformation in Colombia.

Section 4.3 highlights the implications of processes of urbanization, decentralization, and transnationalization on the political settlements framework and its core variables. The section suggests a further exploration of Khan's (2010a) contribution in the light of our findings on the preceding sections. This includes changes in the distribution of power and their effects on institutions, informality, governance capacities, rent-management strategies, entrepreneurial capabilities, and developmental outcomes. This wider understanding of power structures of local political settlements in transnationalized Latin America then provides a revised and extended political settlements framework for the empirical analysis of our case study developed in chapters five, six, and seven. Section four presents the methodology and data used in this thesis.

4.1 Decentralization and urban institutionalism in an economically liberalized context

Academic contributions using historical political economy analyses of institutional change and development have argued that in Latin America it was the incompatibility of technological and institutional strategies with political factors of inner-societal power constellations that impeded a successful catching-up beyond the early stages of ISI (see Di John, 2009; Khan and Blankenburg, 2009). In response to the end of the ISI development model, elites in Latin America started to reorganize the basic institutional setup of the dominant post-war settlement. The 1980s and 1990s saw what Hirschman (1981, p. 155) coined *fracasomania*, that is, an obsession with seeing everything that preceded as a complete failure. During this phase, most Latin American countries (above all Bolivia, Chile, Colombia, Mexico, and Venezuela) deployed a wide range of radical neoliberal policies that implemented, inter alia, far-reaching liberalization reforms of trade and finance, an extensive privatization of public assets and services, fiscal austerity, as well as a very substantial deregulation of state control over industry and flexibilization of labour markets. In addition to the implementation of these 'Washington Consensus' economic reforms (see Williamson, 1990a), this market-led development agenda also involved the political, fiscal, and administrative restructuring of the state. Besides the selective transfer of state capabilities to supranational institutions, such as the IFIs or the World Trade Organization (WTO) as part of Latin America's economic and financial liberalization paradigm, policies also included a wide range of different decentralization reforms, which often coincided with ever increasing dynamics of urbanization processes (Falleti, 2010; Montero and Samuels, 2004).

In the context of Latin America's extensive economic liberalization, reducing the extent of state intervention, and moving towards perceived higher degrees of democratization, decentralization reforms thus became a widely supported set of policies for development (Menocal, 2004). Since the late 1980s and following the crisis of the state-interventionist development model, Latin America moved from its "state-centred matrix" to become the first region worldwide to implement a strategic decentralization process (Cavarozzi, 1992). Since many governments have implemented such reforms, scholars have increasingly turned their attention towards local governments and the impacts of these reforms on the shift of the distribution of power from the centre to the local level (Ames, 1999; Angell et al., 2001; Faguet and Pöschl, 2015).

Discussions of decentralization, however, have been dominated by the a priori adoption of an almost unconditionally supportive stance towards this type of state reform. Support for decentralization reforms spanned almost the entire political and academic spectrum. From a political perspective, decentralization in Latin America is viewed as an institutional tool to bring state services and political legitimacy closer to the people to support and consolidate democratization processes (Faguet and Pöschl, 2015). From a more economic-centric perspective, NIE scholars and neoliberal technocrats have tended to regard decentralization as a kind of magic bullet to promote economic prosperity through increasing economic efficiency, combatting corruption, and improving the use of public financial resources (Grazzi and Jaramillo, 2015). From the latter perspective, "decentralization has been promoted because of the incentives market-preserving federalism is supposed to have on economic development" (Faust, 2006, pp. 164–165). Following fiscal federalism theory, a concept first promoted by Tiebout (1956), scholars argue that fiscal autonomy of subnational entities can improve resource allocation and increase competition between cities to attract investments (see Bennett, 1990; Weingast, 1995). However, the nature of these investments, their effect on productivity growth and the liberalized economic context within which they take place are not taken into consideration by these theories (Falleti, 2010; Faust, 2006).

The political settlements framework set out in the previous chapter can add explanatory value to the study of urban governance as it combines a critical analysis of political factors and power constellations that affect economic factors to achieve productivity growth with theoretical considerations on the role of institutions. The theory explores "institutional performance as a historically specific interactive process between political and economic strategies" (Di John, 2009, p. 13). However, as the context of economically liberalized and politically decentralized Latin America has challenged and changed this interactive process, we need to analyse the implications of the political and economic strategies of state restructuring. The remainder of this section discusses how the processes of liberalization and decentralization in Colombia, and the increasing importance of the urban dimension as a key area of governance analysis, matter for the political settlements framework and the variables discussed in the preceding chapter.

We recognize that the varying degrees and depths of liberalization and decentralization reforms, as well as the contexts in which they are implemented, affect different polities differently. Furthermore, and as Angell et al. (2001, p. 131) point out, we recognize that in the political economy analysis of decentralization and economic development several factors matter that "are partially independent from decentralization, but may strongly affect its outcome". These factors include the underlying resource endowments, physical and economic structures of the region, the industrial base of a country, the macroeconomic context (including tax policies), the social and political context, the strengths of the public sector, and the overall organizational capabilities of organizations to coordinate policy interventions. However, and looking at similarities across Latin America in factor endowments and in general patterns of liberalization, decentralization and urbanization, we can draw valuable theoretical conclusions on how broader processes in the region affect the explanatory value of the political settlements framework for the discussion of urban governance in Colombia.

Decentralization has undoubtedly changed the structures and distribution of power within most Latin American polities. Proponents of decentralization and 'good governance' reforms have suggested that a smaller state has positive effects on discretionary control and can make public spending more effective and efficient. As pointed out earlier, such analyses, according to which a standard set of institutions and governance capabilities are identified as necessary for urban areas in less developed countries to develop, fail to recognize context-specific factors of the societies where they are implemented. For example in Latin America, decentralization has led to increasing uncertainty about the institutional environment and to a decrease in the political and macroeconomic legitimacy of political parties and central governments (Grazzi and Jaramillo, 2015, p. 114). Di John (2009) furthermore argues that decentralization reforms may also contribute to an increasing factionalism and other political and economic conflicts within political organizations as well as in the entire society.

Analysing the case of Venezuela, Di John (2009, pp. 217–218) finds that factionalism, "a growth of multiparty competition and the fragmentation of the party system… reduced the possibility of effective coordination of government policies." Faust (2006, p. 167) argues that "the intensity of conflicts and coordination problems depend to a high degree on the heterogeneity of interests and the varying degree of organizational strength among the political actors involved." While coordination problems and distributive conflicts are endogenous to every process of decentralization (Faust, 2006), decentralization can also leave power structures more fragmented, interests more heterogeneous, and the central ruling coalition with less organizational powers. These coordination problems and distributive conflicts can thus cause political conflicts as they leave room for the rise of new, often populist or violent political actors who polarize and destabilize local political settlements. Following decentralization in many Latin American countries one could witness an increase in civil society tensions and conflict between different regional elites over resources, power and status (see Demmers et al., 2004, pp. 66;115). Informality can increase with these processes, as formal institutions of patronage distribution have become less viable. Since in the framework proposed here both formal as well as informal institutions matter for the allocation of rents, benefits, legitimacy, and policy responsibilities, we need to acknowledge the discretionary powers of clientelist patron-client networks linked to grey markets and illicit economic activities.

In most Latin American countries decentralization coincided with liberalization reforms and neoliberal pressures for fiscal austerity. Central governments were often compelled to implement decentralization reforms so as to pass on fiscal pressures to local governments and to free up resources at the national level (Bird and Vaillancourt, 1998; Bresser Pereira, 1993). These reforms, together with the devolution of political power, have overall strengthened regional elite structures. At the same time, and as discussed in the next chapter, in the case of Colombia the policies led to the fragmentation of central government capacities and the devolution of organizational structures. This resulted in a decline of the powers of national political parties and the central state, as well as in an increase in vertical and horizontal bargaining costs.

However, it would be misleading to assume a priori that decentralization always impedes productivity growth and sustainable development and that there could be no local input to creating and enforcing institutional strategies. "Decentralization for development" (Wiesner Durán, 1992) however, needs to tap into local capacities that focus on economic policies that support the development of medium or high technology sectors. The role of the central government in creating and allocating resources remains critical for the creation of institutions that focus on taxes, research and investment in technology, training programs for technological learning for targeted sectors and employees, infrastructure investment and the like. The likelihood of decentralization reforms leading to growth-enhancing institutional environment that can set political settlements on incremental and sustainable paths also depends on several other political economy factors. This becomes evident in the analysis of the growth-enhancing urban governance reforms that were successfully implemented in many urban areas of so-called late developers in East Asia.

Bae and Sellers (2007, p. 543) for example find that South Korean cities benefited from favourable political economy conditions at the national level that led to the "the emergence of an urban growth politics and business-led growth coalitions". Lan (2009) finds similar explanations for the development of Chinese "local developmental states". He argues that "Shenzhen's local growth political economy is highly embedded in the context of national intention for growth, (and a) biased planning system under growth-oriented urban governance" (Lan, 2009, p. 325). Segal and Thun (2001) also find that the productivity growth successes of Beijing and Shanghai depended very much on broader national structures that were favourable for interventionist growth models at the urban level. They furthermore argue that the centralized and concentrated organizational power of the Communist Party in general were helpful for the creation and enforcement of growth-oriented structures. Similarly, Lee and Shin (2012, p. 1333) argue that the success of Seoul in achieving growth-oriented urban governance capabilities is linked to the fact that the Korean central government "still holds significant institutional power and policies". In the same vein, Jacobs (2008, p. 1) finds that the success of growth-enhancing urban institutions in Saitama City can largely be explained by "its embeddedness in the Japanese Developmental State" and an organizational unified national government with interests in productivity-driven city development.

In the organizational structures of most developmental states, horizontal and vertical fragmentation of power is minimal, which prevents coordination problems. This enabled the emergence of structures for successful allocation of centrally created rents to cities and regions, which incentivized local entrepreneurs to engage in high productivity activities and technologically advanced sectors. That these developmental states succeeded in being late industrializers and late democratizers thus helped growth-enhancing institutional conditions to emerge at the urban level (Bae and Sellers, 2007, p. 543). However, and as the remainder of this thesis points out, the organizational structure of Colombia's political economy is very much different from these successful examples of local governance.

In Colombia we find several *internal* factors that have driven transfers of selective state capacities to subnational governments, and these differ from the factors leading to the devolution of power in East Asian developmental states. Angell et al. (2001, p. 3) argue that "decentralization was adopted almost as an act of desperation in the search for a solution to the political impasse that afflicted the country." Decentralization reforms were implemented as a response to both vertical and horizontal fragmentation of organizational capacities in the main two parties as well as in the entire polity following the end of the *Frente Nacional* in 1974 (Gutiérrez, 2002). Decentralization was seen as a response to the organizational incapacity of the central government to create and enforce institutions that could guarantee sustainable levels of political and economic viability. Due to these generally less favourable conditions, Colombia did not only fail in moving from easy ISI strategies to more advanced technologies for late industrialization. These factors also affect decentralized urban governance until today, as is discussed in more detail in chapters five and six.

In addition to internal factors affecting the political settlement, we identify several *external* factors that determine the effectiveness of achieving growth-oriented urban governance structures. Colombia's economic and financial liberalization reforms were implemented in a political economy context of largely failed late industrialization attempts. The country's return to static comparative advantages in low productivity sectors following the implementation of neoliberal policies needs to be considered in this discussion. This is considerably different from

East Asian developmental states that only engaged in liberalization reforms after they had successfully achieved industrial catching up. Consequently, when local governments in these developmental states were first exposed to specific and powerful globalized networks and processes, the institutional structures of the political settlement in which they were embedded had already put them onto sustainable trajectories of economic and political viability. Combined with the power structures that were compatible with growth-oriented governance capabilities, this had helped their economies achieve competitive advantages in technologically advanced sectors, preventing a return to static low productivity comparative advantages.

The development of Colombia stands in stark contrast. Here, globalized value chains and increased capital mobility in financially liberalized markets have directly contributed to the development of rather low productivity economic sectors. Hence, organizational powers of central as well as decentralized entities in Colombia have been influenced by external changes that can be linked to wider market-oriented policies in the country (Ocampo, 2007, 2001). Alongside Washington Consensus-style structural adjustment programmes, the idea of a rolled-back and weakened local state became the dominant political recommendation in order to decrease the likelihood of interventionist policies that would create market distortions (Garay, 1998, p. 82). Decentralization reforms, it was argued, would facilitate the creation of institutional underpinnings for economic development and macroeconomic equilibrium through economic liberalization and transnationalization of value chains (Restrepo and Cárdenas, 2004). Fiscal decentralization as part of state restructuring reforms targeted potential risks of corruption and free riding, but also had the rationale of reducing public deficits and removing obstacles for private sector development. Besides the use of privatization to reduce public deficits, urban areas in Colombia also used financial liberalization to debt-finance expenditures and to attract investment (Montero and Samuels, 2004, p. 16). Furthermore, in the context of the country's underdeveloped productive sector, these processes have indirect effects on growth trajectories of urban economies in Colombia as they have had considerable impacts on elite interests and power structures. Hence, the underlying distribution of power, the organizational capacity of the state, the productive abilities of the capitalist elite, and overall governance structures for achieving growth-enhancing governance in developmental states differ largely from the capacities and capabilities of powerful organizations in Colombia's political settlement. This again demonstrates the importance of context-specificity in the theoretical discussion of institutions, governance, growth and development.

We further find Di John's (2009) arguments in regard to Venezuela a very useful entry point for an alternative political economy theory for local governance and growth in the economically liberalized context of Latin America. Di John (2009, p. 110) "suggest(s) that economic liberalization and political decentralization has not strengthened the state… The 'good governance paradigm'… downplays the task of reconstructing or building political organizations. This is because of the influence of the rent-seeking and corruption literature in informing policy on state capacity building and the negative view of politics that flows from that analysis." Similarly, our analysis of institutions and governance in economically liberalized and politically decentralized Colombia departs from 'good governance' approaches as it stresses the importance of political factors in urban political settlements, such as the constellations of power and organizational capabilities for achieving positive developmental outcomes.

In sum, the ascent of the urban as a key institutional dimension, presupposed by and contextualised in a transformed spatiality of global capitalism, has altered the distribution of power in Latin America in general and in Colombia in particular. As power relations affect the institutional landscape, and institutional structures affect political and economic outcomes, these spatio-institutional and economic shifts have far-reaching consequences for institutional performance and developmental outcomes.

With these considerations in mind, we need to re-evaluate some of the processes depicted in figure 3.1 and extend our analysis to a political settlement in which decentralization has challenged the centralized context of organizational and holding powers. Formal and informal institutions remain with the functions of enhancing or decreasing efficiency. However, they become increasingly important in terms of their distributive implications. Thus, formal and informal institutions do not only have distributive functions of reducing enforcement costs and centrally maintaining viable political stability at the national level, but also at the local level, including the distribution of benefits, such as rents, patronage, and income resources to regional elites and urban political actors. The institutional processes through which these benefits are distributed include direct elections of mayors, deregulation and privatization reforms, patron-client networks that benefit from reforms and agreements, and the like.

In the decentralized political settlement formal and informal institutions have similar functions. However, with the increase in distributive conflicts within and among regional elite factions following decentralization, (informal) institutional mechanisms to pay off outsiders and to maintain local stability might be more prominent in a decentralized settlement where interest heterogeneity proliferates. Consequently, and particularly in Colombia's context where a) state capabilities are limited and political power structures fragmented, b) regional elites have strengthened their economic powers through benefitting from deregulation and privatization reforms, and c) capitalists have low technological and low entrepreneurial capabilities, formal and informal efforts to create and enforce institutions are less likely to achieve positive productivity growth outcomes. Hence, decentralization and regional fragmentation make the (power) relationship between state and business actors less straightforward as such state reforms add an additional layer of formal and informal relationships that influence the overall distribution of net benefits and the distribution of power in a political settlement (see section 4.3).

The interdependency between power and institutions, however, has not only changed following state restructuring through the rise of the urban dimension as a key arena. Decentralization and liberalization reforms also included adjustments of elite interests that affected the variables of the political settlement discussed above, such as the role of informal institutions of creating rents that reduce GTC and TSC. The next section discusses the phenomenon of elite "transnationalization" in Latin America to set the context for section 4.3, which revises some of the critical aspects of the political settlement analysed thus far.

4.2 The role of ideas and transnational capitalist elites in shaping power and institutions

Of particular interest in the analysis of effective institutional change through the political settlements lens are the powers, interests and position of the capitalist elite (if one exists) in the political settlement, as well as their entrepreneurial and technological capabilities. Decentralization and liberalization have affected the context of Latin American polities. However, these reforms have also had great impacts on the structure of the region's capitalist class and have led to a "transnationalization" of their interests (see Robinson, 2010).

There exists some academic literature on political settlements in a globalized context where changes in elite interests *as well as* ideational change are taking into consideration. However, there is a need for a more in-depth approach to the exploration of the political settlements framework in this changed context, particularly with regards to elite interests, exogenous as well as internal changes of dominant development ideas, the interdependent relationship between power and institutions, and any developmental outcomes. This section analyses several changes in these factors, which is necessary for a systematic exploration of the political settlements framework and its application in a decentralized and liberalized Latin America (further developed in section 4.3).

Recent academic contributions to the political settlements literature actively seek to broaden the framework by stressing that other political economy factors challenge the validity of Khan's (2010) approach. Golooba-Mutebi and Hickey (2013) argue that the standard political settlements approach needs to be extended by including discussions of how globalized structures and ideas impact the character of the political settlement and change institutional complexity (see Levy, 2014). Drawing on Hickey (2013) the authors particularly "emphasise the extent to which political settlements are located within and closely shaped by the globalised context that involves national actors interacting with transnational actors, institutions, processes and also ideas" (Golooba-Mutebi and Hickey, 2013, p. 5). This literature, largely originating from the University of Manchester's Effective States and Inclusive Development Research Centre argues for the incorporation of multi-levelled approaches that move beyond the idea of elites as merely national actors.

Hickey (2013, p. 14), for example, argues that there is a need for a relational approach that compliments frameworks that "operate within a narrow frame of methodological nationalism… (and are) thus unable to capture the broader range of processes and factors that shape the politics of development, particularly in terms of the role of ideas, the agency of subordinate groups and the influence of transnational level factors". In particular, the author finds that that the political economy analysis of power and institutions needs to "treat elites as transnational… who are subject to influence by incentives and ideas that operate at more global levels… Globalisation fundamentally alters the character of bargaining both between elites and between elites and lower-level groupings in ways that are largely ignored within the development mainstream" (Hickey 2013, p. 13; 20).

Lavers and Hickey (2015) use these theoretical considerations in a conceptual and methodological analysis of underlying power relations in the politics of social protection in Africa. The authors find that "political settlements frameworks tend to downplay the importance of transnational actors in favour of detailed analysis of domestic politics" (Lavers and Hickey, 2015, p. 26). The process of governance and institutional change "can also be affected by exogenous factors and actors" (Bebbington, 2013, p. 11). This is especially true for sectors that are "characterized by an important presence of international companies, multilateral agencies, international advocacy networks and transnational nongovernmental organizations, as well as by international commodity price volatility which can also elicit domestic coalitional and institutional change" (Bebbington, 2013, p. 11). In such globally exposed and integrated sectors it is important to acknowledge transnational factors more generally "such as policy diffusion and institutional mimicry" (Dressel and Dinnen, 2014, p. 5). However, and as Mohan and Asante (2015, p. 4) point out, "our understanding of these processes is still quite black-boxed and we have yet to establish causality between international interests, specific coalitions, and outcomes”.

In his contribution, Hickey (2013, p. 22) discusses several transnational factors, such as “the ways in which colonialism helps establish initial conditions, the character and timing of how countries are inserted into the global capitalist political economy, the influence of transnational flows of ideas and also the direct role of international actors in certain policy coalitions” that impact power constellation and institutions. He further explores other critical theories that can offer powerful insights to the political settlements framework in order to move toward “a broad conceptual framework which includes a wide range of variables and processes” (2013, p. 22). Thus, Hickey (2013) clearly maps out a variety of important underlying processes and factors that influence the original political settlements theory.

The approach adopted and developed here builds on these insightful analytical considerations. We aim to theoretically and conceptually explicate how ideas and ideologies as well as transnational factors affect power and governance capabilities, how they impact entrepreneurial and technological capabilities of firms and sectors, and what implications they have for rent creation and rent management as well as achieving and implementing growth-enhancing institutions. Furthermore, and this is generally true for the political settlements literature, there is a need for alternative institutional political economy analyses focusing on the implications of changes in elite structures, power distribution, and institutions on economic and political development in Latin America.

4.2.1 IDEAS AND INTERESTS

As Rodrik (2014, p. 189) rightfully points out, “(i)deas are strangely absent from modern models of political economy”. In part, this is also true for the political settlement framework presented so far. Rodirk’s (2014) main argument is that the neglect of ideas in political economy makes it difficult to account for policy change. This is because the context and the policy space are shaped by how ideas motivate actors to implement policy change. When ideas are put aside due to the dominance of analyzing vested interests in political economy theories, “social science squeezes normative policy analysis out of useful existence” (Rodrik, 2014, p. 209).

Similar to the findings proposed in the Hausmann and Rodrik (2003) model for economic technological discovery, Rodrik (2014) argues that ideas are an important factor for achieving innovative economic policies through “discovery-by-doing”. Furthermore, in the process of discovering policy innovation for a particular context, policymakers, elite groups and other powerful actors often take ideas from other contexts. This policy emulation of so-called “best practices" that prevailed elsewhere can be an attractive source for policy ideas. However, and as argued above, the success of mimicking policies is limited, since the successful implementation and enforcement depends on the particular interdependency of power and institution of a political settlement.

Another source of policy innovation is the existence of crises. Rodrik (2014) uses the findings of Blyth (2007, p. 762) who argues that "(i)n moments of uncertainty, crisis-defining ideas not only tell agents 'what has gone wrong' but also 'what is to be done'." Lavers and Hickey (2015) take this one step further to argue that in moments of instability ideational influence is much stronger than in a stable polity. In this context, ideas can potentially provide "a means of addressing new problems and/or promoting stability" (Lavers and Hickey, 2015, p. 21).

In the discussion of ideational influence on policy reforms Rodrik (2014, p. 193) finds that "ideas may fall on either side of some of the biggest controversies in the history of economic thought", such as questions on an interventionist versus a laissez-faire model, debates on protectionism versus free trade, demand- versus supply-side fiscal policies, and whether monetarism, Keynesianism or Washington Consensus-style neoliberalism creates conditions of macroeconomic stability. All of these debates that have shaped political economies across the world are heavily influenced not just by the vested interests of actors – as usually argued by political economy models – but also by the elites' understanding of reality. In turn, the consequences and outcomes of policies influence the way in which new ideas lead to a paradigm shift in the "conventional wisdom" of economic, political, and social policies (see Gore, 2000). Many of these factors contributing to ideational change and thus driving economic outcomes are exogenous to local or even national processes.

Another weakness related to these issues resides in the assumption of economic frameworks and most political economy models that policy actors have perfect knowledge of their material interests and act rationally according to these interests. However, and as Rodirk (2014, p. 191) argues, "much human behavior is driven by abstract ideals, sacred values, or conceptions of loyalty that cannot be reduced to economic ends." The knowledge about the particular interest and the evolvement of this interest are shaped by the idea about how the world works and about the socially-constructed identity of the policy actors within that world.

This underlines the need to challenge the assumption that policymakers and elites act rationally according to their vested material interests and according to their position within a power equilibrium of a society. A look at political science literature can help contextualize these claims and provide an entry point for including ideas in our political settlements framework. Thus, rather than acting out of their material interests, elites and policy actors "rely on perceptions of… [a] context that are, at best, incomplete and that might often prove to have been inaccurate after the event" (Hay, 2011, p. 67). As such, interests are shaped by more than the aim for material improvement. Rather, interests are socially constructed and arise from ideologies, values, norms and believes and are "irredeemably ideational, reflecting a normative… orientation toward the context in which they will have to be realized" (Hay, 2011, p. 67). Béland and Cox (2011, p. 10) even find that interests are "one form of idea". Thus, elites, powerful actors, and policymakers act according to their interests *as well as* their ideas and worldviews.

These considerations can provide a useful entry point into the adaption of the political settlements framework. Khan (2010b, p. 20; 61) considers ideas largely as an informal tool by elite factions or subordinate groups to mobilize in support of or against an institutional change. Ideas are thus incorporated in considerations of imperfect enforcement of institutions and are seen as important in understanding the organizational capacities of actors to induce or absorb transition costs. However, the political settlements model generally treats ideas as outcomes of incentives and interests, not as factors that shape power constellation and policy space (see Hickey, 2013).

Similar to other political economy models the political settlements theory is based on the analysis of vested interests of elites and policymakers, the distribution of power in a society, and economic institutions or "rules of the game" that influence economic efficiency and political equilibrium (North, 1990). This prompts us to expand Rodrik's (2014, p. 206) criticism of political economy models focusing on vested interests and his "explicit consideration of the role of ideas... for policy analysis". We thus argue that ideas and exogenous factors to a particular political settlement shape the political economy landscape beyond the policy space and influence the distribution of power, relations between powerful groups, and the implementation and enforcement of as well as the resistance to institutional changes.

The relationship between powerful groups in a society and its impact on economic growth is a widely debated topic in political economy models. Acemoglu and Robinson (2013) for example discuss how growth-enhancing policies were not attempted in some contexts (i.e. in 19th century Europe) due to a particular constellation of power. The authors argue that industrial growth and urbanization can adversely affect elites whose traditional base is very much rural (Acemoglu and Robinson, 2013). Potential growth-enhancing reforms are thus not pursued because of unintended consequences for the distribution of power. Hence, and similar to Khan's (2010b) consideration on the distribution of benefits that maintains the political settlement between powerful groups stable (see figure 1), the authors mainly focus on vested interests, which are largely seen as given. However, and reiterating the points made above of taking politics into account, ideas shaped by changes exogenous to a political settlement are an important factor in creating a compatibility between potential growth-enhancing economic policies and the political equilibrium in a political settlement. Well-informed political ideas can lead to growth-enhancing results that are compatible with the underlying distribution of power in a political settlement. Rodrik (2014, p. 197) finds that political ideas can "relax political constraints, enabling those in power to make themselves (and possibly the rest of society) better off without undermining their political power".

However, ideas can also be the reason for changes in the configuration of power. This is particularly true in situations of institutional stability or even 'Knightian uncertainty' (i.e. policy actors are unsure about their own interests), when elites and policy agents question their ideational and ideological paradigms guiding their decision making and look for new approaches and conventional wisdoms (see Blyth, 2002). A focus on ideas in such a period, Lavers and Hickey (2015, p. 14) write, "reinforces previous calls to examine political settlements in historical and dynamic perspective (Di John and Putzel 2009, Khan 2010b, Hickey 2013), given that the paradigmatic ideas underpinning settlements are likely to change".

The dynamism of the different variables shaping the political settlement and the contestation between different elite groups implies some form of instability as the natural order. While institutions are seen as promoters of stability and economic growth (see Khan, 2010; North, 2007), the transition costs they might unleash can also be a source of instability (see above). In a situation where a ruling coalition in a political settlement holds substantial organizational powers, there is very little opportunity for outsiders to influence the ideational paradigm that underpins the political settlement. However, if the distribution of power is widely dispersed, outsiders can take advantage of uncertainty and crisis to challenge a ruling coalition through ideational change. This is particularly true when contesting elites engage in negotiation over future policy trajectory with each other or with subordinate groups. This can lead to a paradigm shift of the conventional wisdom about development strategies and ideas that have thus far underpinned the settlement.

Ideas that can influence the political settlement can arise from conflicts within the ruling coalition, within a powerful organization, or as a result from exogenous shocks, including spatial changes in the political economy (i.e. decentralization, global economic integration, and the like). In the cases of structural reforms in less developed countries it was thus often the implementation of new ideas by the ruling coalition – rather than a transformation in the distribution of power – that was an important factor for change. As Rodrik (2014, p. 206) summarizes, "reform often happens not when vested interests are defeated, but when different strategies are used to pursue those interests, or when interests themselves are redefined". Ideas as an exogenous factor that influence elite interests and reform strategies explicitly need to be taken into consideration when looking at policy change and developmental outcomes.

Looking at the efficiency and distributional functions of institutions, we also need to analyze ideas in their role of potentially reducing transaction costs and minimizing transition costs. As such, we need to consider the role of ideas in compensating potential losers of institutional changes. If, for example, economic liberalization adversely affects some powerful elite faction, these reforms need to be accompanied by compensation to generate efficient outcomes and to minimize political disequilibria (see Rodrik, 2014, p. 196).

We can conclude that the attempts by actors to influence reform processes through innovative policy ideas as well as the impact of ideas in shaping the constellation of power in a society depends on the compatibility of these ideas with the political settlement. Transnational factors and actors increasingly play an important role in shaping ideas and influencing local political settlements through exogenous shocks and paradigmatic ideas (i.e. through the IMF's structural adjustment programs). The next subsection discusses some of these transnational factors and actors, changes in their interests and ideational convictions, and their influence on institutional change and development.

4.2.2 LATIN AMERICA'S TRANSNATIONAL CAPITALIST ELITES

The integration of Latin America into global capitalist dynamics largely followed a paradigm shift towards 'Washington Consensus' and 'post-Washington Consensus' policies. Particularly the latter, which was not only coined by the "substantive differences with earlier approaches, but also the nature of the change in the disciplinary matrix and worldview" (Gore, 2000, p. 790) remains to be a very strong economic development paradigm influencing policy reforms in Latin America and beyond. As such, we need to understand the region's radical shift to neoliberalism as a result of shifts in the vested interests of elite factions and policy actors *as well as* a consequence of changing ideas. We argue that neoliberalism in Latin America – to use Max Weber's words – provided a dialectic relationship between interests, ideas, institutions and social orders (see Weber, 1978, p. 184). Latin America's global economic integration implied not only the introduction of drastic liberalization reforms, the radical privatization of public assets and services, and far-reaching deregulation of state control over industry, but also led to the transnationalization of local capitalist assets and elite interests. We thus understand transnationalization as an important variable strengthening the dialectic relationship between ideas, interests, institutions, social orders (e.g. political settlements) and development outcomes.

In a systematic analysis of economic transnationalization and elite transformation Robinson (2010) finds that Latin America's domestic capitalists transformed drastically and transnationalized their assets after the region's neoliberal turn in the 1980s and early 1990s. Using these insights for our analysis of internal changes within the region's capitalist elite, we identify two general patterns. First the capitalist elite has increasingly concentrated its assets in sectors that have large participation in Foreign Direct Investments (FDI) and are often themselves drivers for capital transnationalization. In urban areas it is mostly the service sectors of finance, telecommunication, real estate, retail, and tourism. Additionally, this elite group also holds majority shares in extractive industries and non-traditional exports – economic activities that are closely linked to the global economy. Secondly, and as Robinson (2010) points out, "the new transnational capitalist groups are not self-made… (They) date their fortunes and class status to the late nineteenth and early twentieth century as capitalism developed in Latin America". While the transnational capitalist elite is qualitatively different from the well-paid junior partners of imperialist capital, it has many of its origins in this old-style *comprador class* (see Reyes, 2003).

With an increasing dynamic of globalization Latin America's elite progressively "integrate their holdings and operations into global production chains if they want to remain competitive… (making it) increasingly difficult to separate local circuits of production and distribution from the globalized circuits that dictate the terms and patterns of accumulation worldwide" (Robinson, 2010, p. 29). Thus, and unlike in nation-state capitalism, the transnational faction of the elite has little interest in developing productive markets domestically, but focus instead on the advancement of specific globalized networks and processes in which they participate and through which they generate incomes from. This pressure on capitalist elites to insert their economies into the global chain of production and value creation while accepting the static and low-productive nature of the comparative advantages of their economies has several implications for Latin America's development that require further discussion.

The first set of implications regards possible allocative and distributional conflicts that arise with the transnationalization of the elites' economic interests. Thus, the "contradictory logic between national and global accumulation" (Robinson, 2010, p. 32) has in many cases led to conflicts between national factions that are declining in power and ascendant transnational factions of local elites. The tensions that arise between these groups are global as well as internal through interregional conflicts. Both have implications for institutional functions and mechanisms. With industrial and traditional exports in crisis, the post-ISI development phase resulted in tensions between elite factions. Traditional industrialist elite factions were losing economic power and hence the ability to distribute benefits to maintain a favourable growth-stability trade-off. Competing elite factions that had been outsiders of the dominant coalition contested fragile power constellations based on traditional rent management, which was reinforced through the dynamics of state fragmentation discussed above.

However, the implementation of neoliberal reforms in Latin America also conjoined with mergers between transnationalizing elite factions and political actors to form new coalitions and projects of hegemony. In many cases these were able to help stabilize the new political settlements, as the transnational capitalists formed coalitions that gathered around "a new axis of class fractionation" and that helped "(n)ew transnational capitalists and transnationally oriented elites…[to emerge] around globalized circuits of accumulation" (Robinson, 2010, p. 168). In this vein, Rettberg (2005, p. 38) finds that in Colombia loose and often informal "networks of legally independent firms, affiliated with one another through mutual shareholding or by direct family ownership" have formed so-called *grupos* (diversified conglomerates). *Grupos* combine the interests of Colombia's landed oligarchy and traditional industrialists with the interests of urban transnational elites to concentrate capital and power. Rettberg (2005) further finds that in Colombia *grupos* have contributed to the weakening of older business associations that were largely linked to industrial capital in their power to influence political decision making. These *grupos* have also led to an increased capital concentration and changed business organization. This is reflected in the elite's "fear of being invaded in their own back yards" (Reyes, 2003, p. 11) by elite factions engaging in interregional or transnational competition.

Robinson (2010, p. 173) finds that Latin America's contingents of transnational capitalists have secured their economic power by developing capacities as political actors and gaining considerable political power. Together with technocratic elites Latin American capitalists have "established new institutional bases from which to develop programs and assemble teams, largely constituted by new private sector associations and elite foundations" (Robinson, 2010, p. 173). Through these institutional bases these agents have used state apparatuses for the promotion of neoliberal polices to advance globalization and to weaken the nation state. This also included "a shift in subsidies that states provide, away from social reproduction and from internal economic agents and towards transnational capital" (Robinson, 2010, p. 33). Thus, the elite factions that managed to assimilate and benefit from processes of transnationalization became dominant in the changing environment of most political settlements in Latin America (see Khan and Blankenburg, 2009).

Linked to the impacts of transnationalization are implications for developmental outcomes of these shifts. The tendency of transnational capitalism to insert the economies of Latin American countries, regions, and cities at the lower value-added end of global value chains reinforces static comparative advantages in sectors marked by low productivity. Latin America's elite still holds major assets in labour-intensive industries, such as textile, food processing, and manufacturing of other non-durable consumer goods. Furthermore, and with some of the industrial capital in recession, Latin America has witnessed an expansion of tertiary economic activities leading to a "tercerization" of their political economies (Robinson, 2010, p. 126). The participation in the global production chain through the transnationalization of assets and interests attracts transnational investments into these labour-intensive industries at the lower end of the value ladder. Hence, the region's transnational elite factions benefit from the acceptance of low productivity comparative advantages.

Beyond the strengthening of a regional elite that has decreasing incentives to invest in potentially growth-enhancing domestic sectors, this development also affects technology-driven growth, labour market dynamics, and wages. Following the logic of global value creation and market-driven resource allocation, Latin America's large pool of unskilled and cheap labour becomes an increasingly natural and unchallenged competitive advantage of the region. However, as pointed out by Khan (2010b, p. 7), less developed countries do not catch up because of their competitiveness in low wages and pools of underemployed labour, as competitiveness also depends on labour productivity, the effective use of inputs, and the quality of a good. As discussed in section 3.3, the process of acquiring tacit knowledge is particularly relevant in this context. In an economy where cheap labour supply is abundant (reinforced by low-wage policies of suppressing real wages), investments and efforts in learning and acquisition of technology to discover higher-value comparative advantages are likely to be marginal, as profits are generated through labour-intensive activities at the lower end of the value ladder. In this situation the appropriability problem of a lack of private investment in training personnel and raising skills arises, as capitalists prefer to generate profits through cheap labour in labour-intensive activities. These processes also reinforce low labour productivity and high gross employment elasticities, as additional GDP growth will lead to job creation in low-waged sectors (i.e. services) rather than to investment in technology-intensive sectors. Economies in which periods of learning-by-doing are absent find it difficult to compete in production higher up the value ladder. Without the capabilities of inducing technological upgrading and with persisting appropriability problems, urban areas in Latin America are not able to create and ensure incentives and compulsions for sectors where tacit learning is needed. This increases dependency on technology transfers through FDI, which makes urban Latin America more vulnerable to multinational locational decisions while at the same time constrains domestic firms to lower technological trajectories.

Further developmental outcomes include the increased participation of the region's transnational capitalist elites in financial services and the intensified financialization of Latin America's economies. Capitalist growth has been largely driven by speculative capital accumulation in the region's financial markets (see UNCTAD, 2015). Through the interconnectivity of Latin America's elite with transnational finance capitalism, FDI linked to financial capital has become one of the main sources of income flows (rents). Closely linked to these speculative developments is the creation of property value through mechanisms of financial intermediation, bolstering growth of 'value-added' in real estate in urban economies. However, many of these accounting profits are not realized, as pre-sales of non-built apartments and houses dominate the urban real estate market. Low interest rate policies facilitate an increase in sub-prime mortgages and incentivize speculative investments, which also generate inflows of transnational capital and lead to the transnationalization of mortgage securities. Financial services and their close connection to transnational capital have thus become lucrative, yet very speculative and fragile substitutes for state-created industrial rents.

Besides attracting global capital investments in real estate and in finance Latin American metropolises have become key arenas for global capital operating in tourism – another sector that is predominantly controlled by the transnational capitalist elite (see Hylton, 2007; Robinson, 2010). While tourism can become a very well-integrated demand-generating sector of the broader urban economy, it is hardly a contributor to inclusive development and sustainable productivity growth. Similar to the more traditional labour-intensive industries the tourist industry might generate employment growth, but it heavily relies on low wages and can have detrimental productivity outcomes. This is reinforced through generating demand in other low-wage service sectors, such as transportation. Tourism furthermore spurs land speculation and real estate development, with the associated speculative risks.

Information technology (IT) is often promoted as an alternative high productivity sector in Latin America's urban areas. However, most IT enterprises operating in the region are far from being sources of high value-added productivity growth, as their production base is mainly characterized by low productivity, low technology and low entrepreneurial skills. This is also due to the fact that these IT firms in Latin America are predominantly outsourced service hubs of transnational companies that "would more accurately be characterized as informational maquiladoras: low wages, long hours, Taylorist discipline, and a hostile anti-union environment" (Robinson, 2010, p. 127).

The transnationalization of Latin America's (urban) elites and the decentralization of political, fiscal, economic, and administrative decision making after the region's neoliberal turn have various related implications regarding developmental outcomes for urban areas. The next section aims to broaden our theoretical understanding of these processes further, by exploring the political settlements framework in the context of decentralized and transnationalized Latin America.

4.3 THE POLITICAL SETTLEMENTS THEORY REVISITED

The arguments made regarding the spatio-economic and institutional changes in Latin America through processes of urbanization and decentralization, as well as the transnationalization prompt us to further explore some of the theoretical considerations of chapter three.

According to the theoretical framework developed in chapter three the ability to influence the agenda setting of the ruling coalition depends inter alia on the political and economic powers of the capitalists and their technological and entrepreneurial capabilities. For Khan (2010a) these capabilities are mainly a product of domestic capital accumulation and of relationships between the capitalist entrepreneurs and the ruling elites. These factors are influenced by the sources of rent creation and the institutions that dominate the distribution of rents (Whitfield and Therkildsen, 2011). As established in the previous sections, several factors related to decentralization and transnationalisation have upset traditional mechanisms of rent management and power structures. The role of ideational change, the ascendance of the transnational capitalist elite, and the increased importance of the urban level affect our understanding and analysis of the interdependency between power and institutions in a political settlement in specific ways.

We find that political settlements at the local level in Latin America do not only drive institutional changes and impact policy spaces for economic development, but are very much affected by a variety of exogenous factors. Besides the presented arguments of Khan (2010b) that contending elite interests define the growth-stability trade-off in a political settlement influencing economic development outcomes, for the local level analysis we also need to include the effects that are exogenous to political settlements at the city level.

Aiming to theoretically expand on the most conventional approaches to the study of institutions and development, we used Khan's (2010b) original insights that indeterminate outcomes of institutional changes are shaped by the compatibility of these changes with the particular power structure in a political settlement. The interdependency between the distribution of power and institutions shape the context in which policies are introduced and enforced. The success of the institutional change is also influenced by the degree to which it can decrease growth-constraining transaction costs and maintain political transition costs low, which again depends on the organizational capacities of different actors in the political settlement.

Using Rodrik's (2014) arguments on the importance of ideas in political economy theories, Robinson's (2010) considerations on Latin America's transnational capitalist elite, and various findings regarding spatio-institutional changes following decentralization, we expanded on Khan's (2010b) theoretical arguments.

We argued that there exists increased influence of ideational paradigms on policy choices by local ruling coalitions embedded in fragmented political settlements that are marked by competition and contestation. The rather short-term time horizon of local policy actors diminishes possibilities of lengthy experimentation and innovation of economic policy implementation, for example through learning-by-doing. Furthermore, we argued that ideas play an important role in influencing policy choices in political settlements in crisis.

In Latin American political settlements, the influence of transnational ideational changes and paradigm shifts towards neoliberalism and post-Washington Consensus institutionalism were particularly strong in the between the late 1980s and the early 2000s when many of the region's economies were in crisis. The debt crisis, macroeconomic disequilibria, financial crises, and ever-increasing dynamics of deindustrialization led many Latin American elites to restructure their political economies. Fuelled by external shocks, such as oil crises and the Volcker shock, the uncertainty over policy and development trajectory opened windows of opportunity for new ideas to influence the framing of policies and perhaps even to alter the distribution of power on which the political settlements were based.

We identified that neoliberalism played an important role in this ideational and ideological shift that substantially changed the ways in which political settlements and their respective policy reforms were set up in many Latin American countries. With traditional growth-enhancing sectors in crisis and the herewith associated decline of legitimacy of prevailing vested interests, Latin American elites and policymakers adapted new ideas and discourse fairly readily. Latin America's resulting implementation of neoliberal reforms included of far-reaching liberalization, privatization, and deregulation.

In this period of crisis, the generally oligarchic and very powerful Latin American elites were thus more open to new ideas and to testing new remedies for economic decline. These included not only the opening of many Latin American economies to foreign capital, but also the transnationalization of local capitalist assets. Following the development paradigm that countries are best-off if they concentrate on their relative comparative advantage rather than on the diversification of their economies, Latin America's capitalist elites started to disinvest in capital goods sectors and concentrated on services and labor-intensive industries (see Khan and Blankenburg, 2009; Robinson, 2010). The shift can be understood not exclusively as a result of following vested elite interests of material self-maximization, but also as an outcome of increased ideational influence on policy choices and development strategies.

The effects of exogenous shocks and internal crises is particularly important for the discussion of the political settlement on the local and city level. It is important to point out that local political settlements do not just drive changes in the policy area and the developmental outcomes at the city level, but are themselves affected by various changes on the national and supranational levels. As discussed above, in times of macroeconomic or financial crises, ideational change can have particularly strong influence on elite interests and investment structures. For a local level political settlement that is integrated into globalized capitalist networks, national macroeconomic crises or global financial crises can lead to ideational changes and substantially affect interests of local elite factions. Further, economic and political policies that are largely a result of dynamics that play out in the national level political settlements, such as trade liberalization or administrative decentralization, heavily influence the local level political settlement. Such changes that can be seen as "exogenous" to a particular local level political settlement thus need to be explicitly added to the analysis of local political settlements driving economic outcomes.

Formal and informal institutions retain their primary functions of reducing growth-constraining transaction costs, as well as their distributive functions in aiming to maintain and sustain holding power. However, the role and types of institutions that derive from this shift in the power structure, as well as the sources and mechanisms of rent-creation and –distribution have changed. Traditional mechanisms of rent creation "such as infant industry protection (tariff and non-tariff), subsidised credit, high-level jobs in parastatals and marketing boards… have become far less salient as a form of rent deployment simply because the state now has less discretionary authority to intervene in markets and create rents" (Di John, 2010, p. 20). This needs to be considered in order to understand actual developmental outcomes of particular institutions driven from and sustaining the changed power structures.

While in the decentralized and transnationalized context of power and institutions GTCs are still important for a comprehensive understanding of the effects of institutional change on transaction costs, the types of institutions that can influence changes along the path of the growth-stability trade-off have transformed and broadened. New formal institutions that promote capitalist development through global production and value chains and that are connected to transnational capitalist actors need to be included in the analysis. These include for example financial institutions, marketing boards, central banks, the Bretton Woods institutions (and their conditionality on loans), the World Trade Organization (WTO) and the institutions promoted by the organization and the governance structures of domestic and foreign companies operating in a specific locality (see Hout, 2013). Such institutions are designed to serve the purposes of increasing global market efficiency by decreasing market and non-market transaction costs that arise through state intervention.

Due to the fact that the interests of Latin America's transnational capitalist elite factions reside less in the development of domestic productive sectors than in the extraction of profit from global capitalist value and finance chains, these structural changes reflect the interests of this elite who become increasingly powerful. In a typical Latin American economy that has low value-added comparative advantages, FDI concentrate on these internationally competitive low productivity sectors, where local factions of the transnational capitalist elites have entrepreneurial capabilities. In this context foreign companies are less likely to transfer technologically advanced parts of the production value chain to the country in question. This makes firms and capitalists in low productivity sectors the main recipients of rents and gives them priority in the allocation of benefits in form of patronage and rents.

As the transnationalizing capitalists control the majority of sectors attractive for foreign capital, such as finance, tourism, and outsourced low-cost (IT) services, these groups of entrepreneurs become powerful agents in determining the creation and enforcement of institutions that coordinate the direction and nature of inward investments. The transnational faction of the domestic elite thus not only benefits through the inflow of FDI into their businesses, but also through influencing institutional mechanisms that distribute rents and tax breaks for increased foreign capital participation. These developments help this ascending elite group augment its economic and political holding powers (see Mohan and Asante, 2015).

While the argument on the impact of globalization and the interests of local elites in generating incomes through their participation in global value and finance chains also holds for more centralized and less organizationally fragmented states, decentralization and the fragmentation of power can enhance these processes further. This is especially true for Latin America in general and Colombia in particular. We recognize the argument put forward by Angell et al. (2001, pp. 5–6) who stress that the changed contexts with Colombia's decentralization may stimulate local productive activity through allocation of rents and infrastructure to small-scale projects, which can incentivize local entrepreneurs to invest and create employment in higher productivity sectors. However, the challenge of achieving growth-oriented rent allocation for Colombian local states is increasingly difficult. This is linked to the uncertainty of Colombian local states over access to centrally-governed rents, potentially increased transition costs that arise through intensified local-national bargaining, and the generally small allocative capacities of the national government. Further, the minimal capacities and resources of local states in creating and enforcing productive rents might prevent successful growth-enhancing rent management. These factors may well outweigh potentially positive incentivizing effects of decentralization and increased interurban competition.

Consequently, a smaller local state with limited capabilities and urban areas competing over resources can slow down and hinder attempts to create and enforce an institutional structure that is sufficient to incentivize investments into medium and high technology sectors. While Lan (2009, p. 325) argues that for the devolution of power combined with "a political economy of fierce intercity competition" were crucial factors in achieving growth-enhancing urban governance in China, this is hardly the case for countries that have smaller provinces or regions. In his analysis of Vietnam, Khan (2015) finds that despite high governance capacities of the ruling coalition and the absence of fragmentation of organizational power, interregional competition and parallel investments can result in coordination failures that slow down attempts to achieve a minimum efficient scale of investments. Khan (2015, p. 19) finds that in the context of smaller countries or countries with small sub-national administrative units, "greater coordination of infrastructure investments is required across provinces and regions to ensure efficient investments." As smaller countries or smaller provinces often lack sufficient organizational and governance capabilities for effective rent management and coordination, efforts can result in suboptimal outcomes. Khan (2015) further finds that in this context, integrating transition economies into global trade and investment regimes creates additional rent-management problems. Hence, joining the WTO or regional trade agreements limits the scope of possible rent creation through subsidies and tariffs and complicates the negotiation of entry and content requirements for foreign capital. Thus, challenges of inserting learning within global value chains are not necessarily linked to a further fragmentation through decentralization but have in general become increasingly difficult.

The main problem in any context remains that of identifying market failures that hinder the development of growth-enhancing sectors or firms, and the creation of rents for firms operating in these sectors. Other challenges include the enforcement of conditions that are identified as necessary for technology-driven growth, which also depends on the governance capabilities of the state and on the entrepreneurial capabilities of the targeted firms. These capabilities also influence the effective selection of FDI with most advanced technology that can have the biggest potential to support the development of domestic firms in medium and high technology sectors. The failures of effective coordination of investments into growth-enhancing sectors or industrial clusters and to ensure investment into learning capabilities also remain crucial.

However, we find that specifically in the case of Colombia these problems and challenges are difficult to overcome, because of the context-specific political and economic factors related to power constellations, organizational capabilities of governance structures, and the technological abilities of domestic firms. The organized control of Colombia's polity has historically been much weaker than in the discussed successful developmental states, and the country has more dispersed and fragmented institutional structures, both vertically and horizontally. In this context, and combined with the fact that Colombia's provinces (*departamentos*) are rather small, a further fragmentation through decentralization and an increase in interregional competition is unlikely to result in an institutional structure that incentivizes FDI inflow for growth of medium or high technology sectors. Interurban competition and parallel investments can thus lead to an intensification of coordination failures of effective FDI attraction in the context of a fragmented state with little organizational capabilities.

Furthermore, the increased power of regional capitalists with transnationalized interests has several important consequences in the context of effective urban governance in Colombia. The transnational capitalist elites in urban Colombia have low interests and capabilities to invest in higher technologies and higher-waged labour. Local states with little governance capabilities and organizational power vis-à-vis the powerful transnational capitalist elite find it increasingly difficult to develop governance capabilities to identify possible growth-enhancing activities, to create streams of income for these, and to coordinate investments. Contrary to successful "local developmental states" in East Asia, ruling coalitions in Colombian urban areas have faced more difficulties in disciplining non-performing recipients of rents due to their weakened administrative capacities and organizational power. Hence, in such a transnationalized local political settlement institutions have limited abilities to create conditions for efforts in investing in tacit knowledge in growth-enhancing sectors through subsidies or other forms of rent-creating mechanisms. Governance capabilities for the attraction of FDI with more advanced technology and that can facilitate transfer to domestic firms in medium and high technology sectors are limited. Domestic investors are discouraged to invest in "discovering-by-doing" strategies for higher-valued comparative advantages.

Despite Colombia's progress towards liberal democratization, the implementation and enforcement of formal rules and institutions through market-enhancing 'good governance'-style policies are unlikely to be effective due to the limited capacities of weakened urban governments and their relatively limited organizational power. In the absence of enforcement capabilities of state organizations, informal institutions are important in this transnationalized political settlement for Latin American urban areas. Powerful informal organizations or third parties, such as patron-client networks, business associations or grey networks have thus influenced the activities of formal organizations, as well as created and enforced informal institutional structures. These have not only been very important in the transition towards transnationalization and decentralized states but also in sustaining power structures endogenous to the "new" settlement.

Hence, the distributive as well as the efficiency functions of informal institutions that derive from the transnationalized urban political settlements and their associated distribution of power have to be reconsidered. Informal institutions such as patron-client networks with interests in promoting global capitalism can contribute to the reduction of the likelihood of conflict between elite factions to compete over rents and resources. Informal institutions can prevent larger conflicts as they help to homogenize and combine capitalist interests. *Grupos*, for example, can reduce possible transition costs by being inclusive of all or most elite factions and gathering them around new axes of transnational production and accumulation dynamics. However, there still exists interregional competition between *grupos*. Thus, while g*rupos* can potentially reduce transition costs within a region or urban area, negative impacts of interregional allocative conflicts between regional *grupos,* patron-client networks, or even mafia-like structures (i.e. drug cartels) following decentralization might offset these positive effects.

Through the concentration of ownership and capital *grupos* can have cost-reducing effects (i.e. by lowering transaction costs of finding contractual agreements). In attempts to become transnationalized actors themselves, *grupos* acquire or merge with foreign companies to become so-called *multilatinas* (Reyes, 2003). This has potential transaction cost-reducing effects and can help to increase efficiency through the integration of different stages of production as well as through decreased transportation costs. However, the *grupos's* encompassing control of all economic sectors can also lead to the creation of monopoly rents due to the concentration of capital and power in the centralized governance structures of the conglomerates. Their interests in extracting profits from global capitalist value and finance chains can furthermore lead to rent capture in low technological and low productivity sectors. The focus of the *grupos* on such economic sectors might achieve high returns to capital for the *grupos* themselves, but it also further consolidates and reinforces the static and low productivity position of Colombian urban areas in global value chains. This again entails appropriability problems such as those discussed in chapter three. The return to comparative advantages in low productivity sectors deters newcomers with potentially high technological capabilities, since rent distribution will most likely benefit labour-intensive sectors or activities linked to natural resources or construction. Private investment efforts into tacit learning of higher technologies are not likely to materialize in such a context as subsidies for high-quality companies that might be outside of the ruling coalition are unlikely.

The changed institutional context of a transnationalized Latin American capitalist elite and upward and downward institutional transfers have not only affected power structures. These changes also have several implications on state capabilities to create and enforce growth-enhancing institutions. Growth-enhancing rent management and productivity upgrading requires dealing with technological complexities, involves high costs, investment indivisibilities and large economies of scale, which in turn necessitates high investment and well-designed institutional strategies. This includes institutional frameworks to allocate resources to high productivity as well as export-oriented activities, which inter alia require the implementation of appropriate trade and industrial policies. This again depends on state effectiveness which "is associated not just with the ability of the state to create rents, but (much more importantly) [with] its capacity to compel the corporate sector to invest them in productive capacity diversification – i.e., continuously to shift resources towards products that would help to supply-upgrade along the so-called "learning curve", and demand-adapt a country's export productive capacity to an ever-changing international demand" (Palma, 2009, p. 204).

In sum, and particularly in combination with economic liberalization in Latin America, a decentralized regime of rent management can reinforce pressures to maintain minimal technological inventories and static comparative advantages and organizational power in sectors marked by low productivity and unskilled labour. The discussed combination of political factors contributing to insufficient local governance capabilities to allocate resources to learning in high-productivity sectors are further discouraged by the reliance of Colombia on attracting FDI for technology transfers, which also increases vulnerability to locational decision making of MNEs. This also discourages incumbents with innovative and productive potential to invest in high-risk strategies, as returns on investments are not backed by a clear institutional structure. Consequently, local governments in Colombia face pressures to accept the low productivity comparative advantages of their economies, while at the same time maintaining a large supply of unskilled and cheap labour to be able to compete with other similarly endowed cities for the attraction of FDI into activities that are at the low productivity end of the global value chain.

The interest of the transnational capitalist elites in Latin America in maintaining a cheap labour force at home is an indication for the elites' preferences of developing global capitalist modes of accumulation over a technology-driven development of their domestic markets. Investments in labour-intensive industries are less risky and can generate larger and more secure returns in the short-run. However, maintaining competitiveness through low wages reinforces negative developments in labour markets that are marked by an abundance of unskilled labour engaging in low productivity and low value-added activities. These developments generally have negative effects on productivity growth in high technology sectors as compulsions to invest in higher cost manufacturing decrease (see Palma, 2011).

However, the institutional change of increasing casualization and flexibilization in the labour market makes resistance and opposition to institutional changes through organized strategies of the labour force less likely. At the same time, the development of labour-intensive industries – reinforced through FDI into these sectors – has immediate job-creation effects. From a political economy perspective, these two factors serve the ruling coalition as institutional tools to secure support from powerful trade unions and other "outsiders" of the ruling coalition that are affected by a particular change in policy (i.e. casualization and flexibilization) and demand compensation.

Furthermore, 'good governance' policies create and enforce institutional conditions that facilitate such market-led development and distribute rents to actors that have interests in participating in specific globalized networks and processes. The relationship between transnational and domestic capital is a main feature that we need to take into consideration for the analysis of the reproduction of organizational power through particular institutions and mechanisms of rent management. The rent distribution in favour of sectors controlled by transnational capitalists has important implications for the growth-stability trade-off. While Khan's (2010b) analysis suggests that the nature of changes to the growth-stability trade-off is not exogenous, we need to consider these external impacts on the power structure and ultimately on this trade-off. With global dynamics that are exogenous to the political settlement, the main focus of our analysis needs to be on the local elite faction that endogenizes these dynamics through institutional changes linked to processes of decentralization, transnationalization, and 'democratization'. However, it is more than questionable whether these changes to the institutional strategies but also to the power distribution in the political settlement will be sufficient to create incentives and compulsions for investment into higher productivity activities.

Concluding, the fragmented nature of the rent distribution system and "parallel processes of democratization, decentralization and economic liberalization… have overburdened the collective action capacities of Latin American societies" (Faust, 2006, p. 167) making a coordination of much more complex development strategies increasingly difficult to achieve (see Di John, 2009, pp. 177–178 for a discussion of Venezuela). These processes depend on and shape various other factors linked with the transnationalization of interests of Latin America's capitalist elite. These include a weakened state with less capabilities to manage rents and create and enforce growth-enhancing institutions, increasingly powerful regional transnationalizing elites with low technological capabilities, a changing nature of formal and informal institutions that are increasingly focused on minimizing transition costs arising from interregional and local-national bargaining games, and overall developmental outcomes of a politically stabilized and economically low productivity polity that sustains the distribution of holding power in Colombia's transnationalized urban political settlements.

4.4 Methodology

This thesis adopts a case study approach, which can help the researcher to refine and support a theory and to test the consistencies between theoretical considerations and empirical evidence (Odell, 2001). The research design and the primary and secondary data collection through mixed methods of qualitative and quantitative research tailored to the research questions and hypotheses of this dissertation.

A number of recent publications discuss qualitative research methodologies in general (e.g. Cassell and Symon, 1994; Creswell, 2003; Flick et al., 2004; Marshall and Rossman, 2010; Miles et al., 2014) and qualitative research methods through case studies in particular (Eisenhardt, 1989; Gillham, 2000; Gomm et al., 2000; Woodside, 2010; Yin, 2009). Case study research has been defined in numerous ways, with Yin (2009, p. 18) proposing a broad but useful general definition: "A case study is an empirical inquiry that investigates a contemporary phenomenon in depth and within its real life context, especially when the boundaries between phenomenon and context are not clearly evident." The use of a case study approach is particularly appropriate for addressing the research questions and hypotheses of this dissertation, since it allows for a constructive and feasible combination of qualitative and quantitative empirical evidence to answer 'how' and 'why' questions about the institutional changes and their developmental outcomes. As Gummesson (1999, p. 86) argues, "(t)he detailed observations entailed in the case study method enable us to study many different aspects, examine them in relation to each other, view the process within its total environment and also use the researcher's capacity for 'Verstehen'".

The particular usefulness in of the case study methodology is the approach's ability to include theory and conceptual categories to guide data collection, research, and analysis – both in the field as well as from afar. While some of the theoretical findings emerged from existing data, the case study methodology adopted here allowed us to develop a theoretical framework that provides core conceptual reference points geared towards achieving a high degree of explanatory power on the basis of informed theoretical abstraction, thereby avoiding a purely descriptive empirical discussion devoid of any meaning outside a very specific context (see Hartley, 2004). This historically informed understanding of complex theoretical discussions of institutional conditions and socio-economic developments was fundamental for making the empirical research as specific as possible while avoiding unnecessary gathering of basic information.

Researchers' and respondents' biases and the problematic aspects that arise with the non-comparative aspects of a single case study were addressed through choosing multiple units of analysis (see Yin, 2009). The concentration on the analysis of different subunits (i.e. urban governance, elite structure, firm-level, the local labour market, etc.) within our larger case (Medellín) is what can be labelled an "embedded approach" (Baxter and Jack, 2008). The ability to analyse subunits separately, between or across the subunits allows us to contextualize our quantitative and qualitative findings in a much more structured and powerful way. However, we also used a "holistic approach" to analyse our larger case study Medellín in order to reintegrate our findings into a global context of the analysed phenomena. Overall, the single case study approach provided a conclusive narrative, which the context-specific analysis of this thesis requires.

The case of Medellín was selected for its intrinsic usefulness in elaborating the application of our extended theoretical political settlements framework. Roy (2013) points out that the political settlements framework can be used at the national as well as the sub-national level. Thus, the chosen unit of analysis is unproblematic "provided the appropriate distribution of organizational power and institutions are identified" (Roy, 2013, p. 96). Given that we include an embedded as well as a holistic approach for the qualitative and quantitative analyses of the urban political settlement in its transnationalized context, we can explain the performance of institutions relative to the political settlement. This study of relative performance helps in the analysis of particular sectors and policies. Furthermore, we inquire about the absolute performance of institutions within the local economy.

There are two main theoretical claims this thesis makes: one is that standard institutional theories focusing on market-enhancing institutions and 'good governance' reforms are unable to explain developments of urban areas in Latin America. The second is that the heterodox approaches making important contributions to the understanding of a variety of developmental outcomes of institutions in less developed countries need to be explored further to comprehend institutional effects in the politically decentralized and economically transnationalized Latin American context.

In this sense, Medellín is a particularly good case study as the adverse effects of liberalization have been particularly strong here, without underplaying how neoliberal reforms affected the entire country and region. Furthermore, while Medellín was barely affected by the political violence present throughout Colombia for much of the twentieth century, this changed in the 1980s when several factors, such as deindustrialization, a drastic increase of unemployment, and emerging drug cartels made Medellín the most violent city in Colombia. Recent developments, a drastic decrease in violence and above-average economic growth – which some observers titled the "Medellín miracle" – makes this case even more interesting, as most scholars have attributed these shifts to the 'Medellín Model of Good Governance'. When answering why and how questions with our political settlements framework, we engage in discussions of different relevant institutions and organizations at various units of analysis.

However, regardless of the unit of analysis we can identify an overarching issue: how institutions maintain (or fail to maintain) the power distribution within a political settlement. Thus, a thorough historical understanding of the political economy of our case study is necessary for the application of the theoretical framework – which is rooted in a historical political economy analysis of economic, political and social events itself. In the case of Medellín the historical background is particularly important for a comprehensive understanding of contemporary trends and developments, but also recent challenges. This is why chapter five is exclusively dedicated to the historical political economy analysis of institutions, power and development in Medellín and the region of Antioquia. The discussion of changes in power, institutions, rent-creation and rent-management helps to analyse formal and informal strategies of the ruling coalition to sustain a certain distribution of benefits as well as strategies of emerging elite factions to contest that distribution. Using the political settlements framework and applying it to the case study analysis we can explain the reasons for institutional changes and the degree of their enforcement. The discussions of the interdependency between power and institutions help us to understand whether political economy factors of power distribution were compatible with growth-enhancing institutional strategies. This, in turn explains developmental outcomes regarding political stability and economic development.

The aim of the case study is to provide both a discussion of the most important institutional aspects and performances of Medellín's political settlement, as well as a comprehensive analysis of the local economy and its sectoral dimensions. The analysis of the institutional characteristics of the political settlement (chapter six) relies on primary as well as secondary qualitative findings. This was based on a critical literature review, particularly contributions engaging in discussions about historical and contemporary developments, and the evolution of power and political strategies in Medellín, Antioquia and Colombia. To underline and deepen these findings primary research was then conducted in two separate field trips. The first trip (four weeks) was in the context of the research project "Rethinking Urban Fringes in Colombia" to which the author contributed during his time as visiting research fellow at Columbia University, New York, in spring 2013. The second field trip that included stays in Bogotá and Medellín took place in 2014 and lasted seven months. During this second fieldwork trip the author independently conducted semi-structured interviews, in-depth interviews, ran focus groups, and chaired discussions with a broad range of actors. The interviewees are listed in appendix. The majority of the respondents are or have been members of the economic elites, the political elite, the emerging political *clase emergente*, or the local, regional, and national bureaucracies. Many of the interviewees provided insights on the formal and informal working of political and economic institutions. Individuals from the local and national media, academics, NGOs, and community activists provided additional information. The author further went on several visits to Medellín's marginalized and gang-controlled neighbourhoods where he could observe various aspects of institutional and personal behaviour, which is of particular interest for the analysis of institutional enforcement problems and informality. For the analysis of informal institutions, patron-client networks, and mafia structures that remain very powerful in Medellín, the author also conducted several interviews with local human rights activists, former fighters for urban militias and paramilitary groups, and members of the guerrilla *Fuerzas Armadas Revolucionarias de Colombia—Ejército del Pueblo* (Revolutionary Armed Forces of Colombia – People's Army, FARC-EP) in Havana, Cuba.

The main hypotheses guiding this dissertation evolved with the findings made prior to the field trip, as well as during the field research. Different hypotheses were tested in interviews, focus groups and discussions by asking targeted questions and adapting to evolving variants of the core hypothesis, and by gathering responses from a variety of different actors. This helped in the progressive process of refining assumptions, which made it even more critical to get high-profile respondents. The author's knowledge of the locality and his extensive experience of working in Colombia were very useful to build a network of individuals with a broad range of opinions, interests, and perspectives. Overall, the author conducted over 60 semi-structured interviews (some on-record, others off the record), five in-depth interviews, led three focus groups and many other informal discussions. Most of the interviews, discussions, and conversations were recorded and subsequently transcribed and translated by the author. The

450 pages of transcribed material was analysed during fieldwork as well as after the return from Colombia. Follow-up interviews were conducted with some participants on Skype calls.

The sectoral analysis of the local economy used secondary quantitative data from different sources, including the *Departamento Administrativo Nacional de Estadística* (National Administrative Department of Statistics, DANE), the *Banco de la República* (Colombian Central Bank, BANREP), the *Cámara de Comercio de Medellín para Antioquia* (Medellín Chamber of Commerce for Antioquia, CCMA), the *Sistema de Indicadores Estratégicos de Medellín* (The System of Strategic Indicators of Medellín, SIEM) the *Alcaldía De Medellín* (Mayor's Office of Medellín), the historical archives of the City of Medellín, the *Planilla Integrada de Liquidación de Aportes para Seguridad Social* (Integrated Account of Liquidation Settlement to Social Security, PILA), the *Encuesta Anual Manufacturera* (Annual Poll of Manufacturing, EAM), *Medellín Como Vamos* (Medellín How are We Doing), the *Empresa de Desarrollo Urbano* (Enterprise of Urban Development, EDU), and the *Centro de Investigacion y Educacion Popular Programa Por la Paz* (Centre for Investigation and Popular Education, Programme for Peace, CINEP). This quantitative analysis (chapter seven) is designed to provide quantitative empirical backing for core qualitative aspects of the analysis, where appropriate and meaningfully possible. The quantitative methods used have varied, depending of the unit of analysis (firm-level, sector-level, urban, regional, national, global). Chapter seven provides a detailed discussion of the different methodological tools and the different units of analysis used in the quantitative approach.

CHAPTER FIVE: MEDELLÍN: A HISTORICAL POLITICAL ECONOMY ANALYSIS OF POWER, INDUSTRIALIZATION AND CRISES

As pointed out in previous chapters, a discussion of the detailed distribution of power between different groups and organizations is central to the approach adopted in this thesis. As Di John and Putzel (2009, p. 4) note, such a historical analysis is necessary "in exploring the formation and change of institutions such as the process of democratisation (Moore, 1966), the transition from feudalism to capitalism (Brenner, 1976), the effectiveness with which industrial policy is implemented (Khan, 1995; Kohli, 2004), and the closely related effort of historical institutionalists to explain the varied routes to capitalist transformation (Hall and Soskice, 2001)". This chapter therefore analyses the historical evolution of political settlements in our main case study, the city of Medellín. Our analysis focuses on how the formation of an industrial capitalist elite in Medellín shaped the power balances in Colombia's political settlement, which had several institutional implications for the implementation and enforcement of industrial policies.

We will discuss how the shifts in power balances and the resulting institutional mechanisms affected the developmental strategies of Colombia in general and Medellín's economy in particular. In this context we analyse the changing distribution of power, state and institutional capacities, the evolution of Antioquia's manufacturing sector, and the entrepreneurial and technological capabilities of the regional elite factions. This analysis facilitates the assessment of the compatibility (or otherwise) of the evolving political settlements with different developmental strategies throughout Colombia's capitalist transformations from extractive and largely landed growth, via an easy ISI strategy to attempts at heavy industrialization.

The historical analysis covers the period from the first attempts of industrialization in the early 1900s until the emergence of the first signs of deindustrialization and partial liberalization in the 1970s and 1980s. The discussion does not provide a comprehensive analysis of every specific policy intervention, instead focusing on selected core policy reforms to illustrate the interdependency between political factors and institutional as well as economic policy changes.

The main purpose of this historical analysis is to provide a contextualized discussion of the evolution of Medellín's political settlement with all its different features and variables. This allows us to better contextualize recent institutional changes and their economic and political developmental outcomes. The main argument advanced here is that Medellín's impressive industrialization in the twentieth century is a result of favourable conditions present in the local and national structures of the political settlement. The extensive power of an oligarchic elite interested in modernizing and diversifying Medellín's economy was compatible with institutional mechanisms that created and distributed rents for the development of light manufacturing industrial sectors. These power structures, as well as the low entrepreneurial and low technological capabilities of this oligarchic elite are, however, also partially responsible for Medellín's industrial crisis that ultimately led to the city's deindustrialization. We further argue that this crisis and the resulting inability of the dominant elite factions to manage rents successfully and to compensate outsiders of the elite pact destabilized the settlement and led to the rise of actors who contested the existing elite bargain in Medellín. Leftist urban guerrilla movements as well as an emerging new political class threatened the dominant power of the oligarchic elites. Several institutional mechanisms and policy reforms implemented in the 1980s attempted to stabilize Medellín at a sustainable growth-stability trade-off.

The subsequent sections will analyse how political factors of power distribution and organizational capabilities shaped the institutional environment of Medellín's political settlement and thus influenced the development trajectory. Section 5.1 analyses the historical developments of elite structures in Medellín with a particular emphasis on the shift from a landed elite with interests in mining and coffee to an industrial capitalist class. The section analyses the different rent-management strategies that were compatible with these structures and that created institutional conditions for successful ISI development. The emerging elite bargain also helped to stabilize the political settlement in Medellín. Section 5.2 goes on to analyse how structural interdependencies between power and institutional strategies became incompatible with ISI attempts to promote advanced and late industrial development. The power structures impeded or slowed down the creation of incentives and compulsions for a big-push industrialization strategy. Alongside other shortcomings of Colombia's industrialization these incompatibilities add an explanatory context to the understanding of Medellín's numerous economic and political crises after the 1970s. The analysis includes discussions of regional elite structures as well as the evolution of the political settlement at the national level.

Section 5.3 analyses how economic crises challenged the compatibility of power structures with formal institutions that had helped in keeping the political settlement at sustainable and inclusive levels of political and economic viability. The section discusses the impacts of decreasing possibilities to create industrial rents, of several state reformation policies, and of the urbanization of an unemployed rural population on the political settlement. The section argues that these factors, the introduction of a mixed strategy of import substitution and export promotion, and the end of the *Frente Nacional* fragmented organizational structures horizontally and vertically. Inter- and intraregional elite competition following these reforms led to a decrease in governance capabilities and coordination capacities of creating and enforcing growth-enhancing strategies. Medellín's local settlement descended into violent crises, which inter alia resulted from the rise of resistance movements from leftist urban militias, and an emerging political elite, the so-called *clase emergente*, which established themselves as powerful actors alongside the dominant elite faction. The section discusses how the traditional elite responded with the creation of formal and informal institutional mechanisms to this contestation of power, which included wide-ranging decentralization reforms as well as the formation of an (informally) organized group, the so-called *Grupo Empresarial Antioqueño* (GEA).

Section 5.4 discusses the rise of Pablo Escobar and the Medellín Cartel that led Medellín's political settlement into a severe crisis. Violent oppression and the privatization and paramilitarization of control became common strategies to regain organizational authority and to increase political and economic holding powers. Section 5.5 concludes by presenting how the findings of this chapter help in engaging in a conclusive analysis of current capitalist transformations, elite development and other recent changes in Medellín's governance structure.

5.1 Industrialization and the development of regional elite structures: hegemonic power in Medellín's political settlement

Since Colombia's colonial times the structure of Medellín's elite was dominated by a few mining and commerce families, such as the Echeverri, Restrepo, Echavarría, Ospina, Santamaría, and Montoya clans, who established themselves around the realms of political power in the province of Antioquia. However, with the stagnation in the mining sector at the turn of the 1900s this oligarchic elite understood that, if they wanted to increase the profitability of the mining industry and maintain their dominant position of power, they had to adopt new institutional strategies for technology upgrading.

Medellín's elite, which had strong representation in the national ruling coalition, could successfully create and enforce institutions that incentivized and stimulated economic development through investments into infrastructure as well as into efforts in tacit learning through the publically funded elite forge *Escuela de Minas* (Mining School) (see González-Calderón et al., 2012; Mayor Mora, 2002). Public investments supported local private businesses in acquiring new technologies and in introducing innovative methods, which drastically increased productivity and led to a massive expansion of the mining sector. Several tax reforms further incentivized private investments into increasingly diversified economic activities (Restrepo Santamaría, 2011).

Following the years of the Thousand Days' War (1899-1902) a shift of elite interests towards industrial-mercantilist activities became evident. Medellín's elite saw that the path towards increased scale economies required large private investment strategies complemented by an effective management of state-created industrial rents (i.e. reduced electricity and water tariffs for industrial factories). These first attempts at industrialization, what Pombo (2002) calls "Colombia's pioneering industrialization phase", concentrated on technological modernization of the mining sector and the industrialization of the coffee sector, which soon became Colombia's main trading and exporting sector. The state-led strategy of providing rents for importers and manufacturers of particular goods incentivized capital flows targeting imports of machinery (Mayor Mora, 1989; Poveda Ramos, 1976). Private investment efforts were supported through policies that facilitated elite access to state-created rents, creating incentives and compulsions (i.e. through import tariff reductions). Law 63 of 1903, for example guaranteed protectionist measures through the increase of import tariffs and barriers for clothes and fabrics, crockery, shoes, and other light industry; tax benefits for imported capital goods and machinery over three tons further protected and subsidized Medellín's infant industries (Vellinga and Kruijt, 1983).

The beneficial treatment and rent access for Medellín's elite was guaranteed through their continued strong representation in the national ruling coalition, especially during the presidencies of Medellín's natives Carlos Eugenio Restrepo (1910-1914) and Pedro Nel Ospina Vázquez (1922-1926).[7] These favourable political conditions for growth-incentivizing institutional strategies also included rent distribution towards coffee producers. Resulting from this constellation of power, entrepreneurial capabilities of regional industrialists, and the institutional mechanisms implemented during the first half of the twentieth century, Medellín experienced high growth rates that were mainly driven by light manufacturing and coffee production (Restrepo Santamaría, 2011).

The strategy of state-created industrial rents was also successful in incentivizing private lending and borrowing through financial institutions that were set up by the mercantilist-industrialist and coffee families of the Antioquian oligarchy. During the early 1900s investments were primarily channelled towards the coffee sector. Vellinga and Krujit (1983, p. 67) conclude that "[i]n this way a few big families of Antioquia controlled the coffee economy

[7] Restrepo was from a traditional merchant-industrial family while Ospina was son of the largest coffee family in Colombia.

and were able to accumulate capital". The combination of successful state-led rent management strategies with local wealth of Antioquia's oligarchy marked the beginning of Medellín's industrial capitalism.

Coffee was the leading sector of the Antioquian economy in this period and became Colombia's main export with shares rising from 30% in 1908 to 78% in 1925 (see Pombo, 2002, p. 5). The *Federación Nacional de Cafeteros* (National Federation of Coffee Growers, FNC), founded by members of the Antioquian elite in 1927, played a key role maintaining this favourable rent distribution and to coordinating the interests of coffee entrepreneurs. The FNC was a very effective network that combined regional elite interests – from financiers, merchants, large and small land owners, to industrialists – with national political interests of promoting growth-enhancing strategies for the coffee sector. The FNC, a private federation with quasi-state capacities (i.e. through tax-collection capacities) "had a dimension of social control, as the federation built up paternalistic relations with small coffee producers, who in turn both cooperated and depended on the federation and the local government" (Thorp, 1998, pp. 59–62). The FNC could not only reduce growth-constraining transaction costs, but also served as an effective arena for elite bargaining that minimized transition costs and stabilized Colombia's and particularly Antioquia's settlement. It held together several powerful elite interests, while also distributing rents and other benefits to small producers and outsiders of the ruling coalition (Ocampo and Botero, 2000). Overall, during this early industrialization period, "coffee was the link between agriculture and industry; the expansion of coffee generated demand for agricultural machinery […] which was particularly strong in Antioquia" (Restrepo Santamaría, 2011, p. 20).

This complementarity of coffee and industrial interest was not marked by the provision of direct market access for industry, but rather through a fast expansion of infrastructure, general growth of wealth, and urban development. The elite in control of coffee surpluses had entrepreneurial interests and technological capabilities to diversify their own asset portfolio and the entire regional economy. Many semi-industrial coffee-packing plants were founded in Medellín in this period, and became a major source of employment for many of the city's working class (Farnsworth-Alvear, 2000, p. 47). Simultaneously, Medellín's entrepreneurial elite horizontally diversified their assets into woollen mills, chocolate and food processing companies, breweries and distilleries, cigarette factories, a match factory, and other industrial manufacturing of non-durable consumer goods. Through the abundance of primary goods for textile production, such as cotton, the diversification of elite assets particularly benefited the rise of economic activities in the textile industry. Medellín soon became the undisputed textile-driven industrial powerhouse of Colombia, with a regional elite faction that expanded their economic influence also by acquiring textile companies in other regions of Colombia.

The second phase of Antioquia's industrialization took place between 1930 and 1945. This period was marked by the high growth rates of Medellín's light manufacturing sectors, particularly of non-durable labour-intensive consumer goods, such as textile and processed food. In spite of the Great Depression of the 1930s and a slowdown of global demand for coffee as well as a decrease in imported primary goods and machinery, it was a period of economic prosperity for Medellín. Medellín's elite had accumulated considerable wealth and had sophisticated financial capabilities to maintain production in light manufacturing industries. In particular, this elite started to invest in raw material inputs to increase the relative strength of the garment and textile sector. Due to horizontal and vertical diversification and integration, this sector did not heavily rely on imports of primary goods. Medellín's inward-looking non-exporting manufacturing sectors of basic non-durable consumer goods and the increase of domestic consumption of manufacturers, as well as the relative industrial backwardness of the country were the underpinnings for Medellín's success that was reflected in a considerable increase of the share of manufacturing in GDP (Vellinga and Kruijt, 1983).

In this second industrialization phase, Medellín's industrialists continued to receive beneficial access to state-created rents through reduced import tariffs for inputs. Sectors benefitting from this were the cotton weaving industry, textiles manufacturing, and food processing. The tariff reform introduced in Law 62 of 1931 increased import duties on all import-competing goods (Berry, 1983). Colombia's relative isolation from the international markets furthermore served as natural protectionism. Overall, and despite the fall of ad-valorem tariffs from around 50% in 1919 to 32% in 1930 (Ocampo and Montenegro, 1984), Antioquia's GDP growth increased at rates above 3% on average annually while manufacturing value added grew at over 8% per year between 1930 and 1945 (Brew, 1977).

The Medellín-based companies *Coltejer*, *Tejidos Rosellon*, and *Fabricato* played a central role in Colombia's textile-led import substitution industrialization. In particular, *Coltejer* and *Fabicato* experienced large growth rates since their foundations in 1907 and 1920, respectively. The textile industry continued to grow rapidly in the 1940s and 1950s, a period referred to as "'golden era' for a particularly *Antioqueño* brand of welfare capitalism" (Farnsworth-Alvear, 2000, p. 6). Financed by high profits and by the emission of new stocks, *Coltejer* and *Fabricato* acquired other textile companies through various acquisitions and mergers during the 1940s. Between 1947 and 1950 both companies increased their net earnings by 178% and 289%, respectively. The Echavarría family alone, who owned and controlled both companies, accounted for more than 50% of Antioquia's textile production (Farnsworth-Alvear, 2000). Despite the importance of family ownership in the beginnings of manufacturing growth, companies rapidly became corporate entities that started to finance imports of capital-intensive equipment through underwriting shares in the stock market (see Botero Herrera, 2003; Pombo, 2002, p. 6).

Wealth accumulated through the advanced elite capacities in financial speculation was reinvested in capital-intensive import to bolster growth in heavier industrial sectors. These developments did not only mean an increase in the numbers of Antioquian industrial companies from 356 in 1930 to 1,288 in 1945, out of which 789 were based in Medellín (Vellinga and Kruijt, 1983, p. 68). The shift towards more capital-intensive ISI development also marked the beginning of Antioquia's third industrialization phase that took place, roughly, between 1945 and 1967 and was concentrated in the development of so-called late industries, such as plastics, paper, petrochemicals, rubber, basic metals, machinery, transportation equipment, and the like.

With their strong influence in the Colombian government, Medellín's industrialists continued to receive state-created rents for a heavier ISI strategy through strategies such as trade and non-trade barriers, domestic credit and subsidies. During the Presidency of Luis Mariano Ospina, son of one of Medellín most dominant *patrones* Tulio Ospina, import licenses and prior import deposits increased substantially and were primarily given to Antioquian industrialists with the necessary technological capabilities to incentivize heavy manufacturing and capital-intensive growth (Restrepo Santamaría, 2011).

There are three main tariff reforms in this phase worth mentioning. The first is Decree 2218 of 1950, which introduced the ad-valorem system for 80% of the tariff schedule. Decree 1345 of 1959 introduced large-scale tax-breaks for domestic producers of manufacturing goods. Decree 3168 of 1964 abolished the *targeted* tariff system and broadened exemption from custom duties. This resulted in an increase of nominal protection from 40% in 1950 to 65.6% in 1964 (Martínez, 1986). The structure of tariffs and exemptions resulted in an effective protection level for manufacturing at around 53.3% in 1969. However, the specific structure of the system stimulated asymmetries in effective protection, which resulted in negative protection rates for some sectors (see Díaz-Alejandro, 1976).

Between 1946 and 1950, and again later between 1955 and 1956 the gross industrial product of Antioquia grew at an average of over 10% per year, which marks the largest industrial growth in Colombian history (Vellinga and Kruijt, 1983, p. 69). Vertical capital integration through investments in production of durable consumer goods (cement, metallurgic, electric appliances, etc.) as well as horizontal diversification in the production of new consumables (paint, paper, foodstuff, glass, plastics, etc.) resulted in a considerable expansion of *paisa* capital (Restrepo Santamaría, 2011). With the industrial deepening of Antioquia's economy, the manufacturing share of total outputs grew from 14% in 1945 to 22% in 1967, leading to a drastic increase of Medellín's industrial growth.

Economic development in this period was also marked by an increase in the creation of holding companies, incentivizing financial sector development. In the 1950s stock issues became the main financing mechanism for capital accumulation, surpassing the reinvestment of retained profits. It was a period of experimentation with new investment instruments to channel long-term finance in manufacturing industries. Private efforts through the largest industrial investment bank in the country, the Medellín-based *Banco Industrial Colombiano* (Colombian Industrial Bank, BIC), were supported by public investment banks, such as the *Instituto de Fomento Industrial* (Institute of Industrial Promotion, IFInd) and the *Fondo Financiero Industrial* (Industrial Finance Fund) (see Pombo, 2002).

An analysis of the growth of Medellín's manufacturing industry through the political settlements lens helps to understand that it was by no means a marginal endeavour but rather the logical result of favourable political economy conditions in which power structures were compatible with institutional strategies to achieve industrialization through import substitution. It was particularly Medellín's industrial capitalists that benefited from protectionist institutional mechanisms, also due to their leading role in the national ruling coalition. Farnsworth-Alvear (2000) finds that this position of political power and the access to protectionist tariffs was also strengthened through the elite's interests to promote industrialist growth, which at the same time created employment opportunities in labour-intensive sectors. This latter point and the variety of other social benefits that came with employment in Medellín's textile companies, such as secure housing, also served as means to pay off outsiders and subordinate classes, to keep the political settlement stable, and to prevent the rise of trade unions and socialist ideas. In this vein, Farnsworth-Alvear (2000, p. 14) finds that "the self-image of Antioquia's emerging industrial elite – who saw themselves as modernizers of their country – predisposed them to raise real wages and the extend extra-wage benefits. Especially in the case of the different branches of the Echavarría family, owners of *Coltejer* and *Fabricato*, mill-owners' understanding of social-Catholic teachings led them to view the factory as mechanism for preventing the spread of communist agitation in Colombia".

Low compensation costs and the job creation minimized transition costs in the form of resistance from groups excluded from the elite bargain. This helped the ruling coalition to push for growth-enhancing policies that incentivized manufacturing growth through the creation of further industrial rents. The low transition costs and the stability of the local settlement in Medellín were tested during the outbreaks of the civil war *La Violencia* in the 1940s, in which the opposing political parties *Partido Liberal* (Liberal Party) and *Partido Conservador* (Conservative Party) were engaging. However, the distribution of power in the *local* political settlement could be maintained and stabilized, as the well-organized industrial elite continued to distribute rents and benefits to all sectors of the society regardless of political conviction (see Bergquist et al., 1992; Farnsworth-Alvear, 2000). Thus, and despite the general rise of violence, disorder, and massacres throughout Colombia during the 1940s, Medellín's industrialist elites recorded large profits. Roldán (1992) describes this rather well: "Just as individuals were organising into armed popular groups… [and] refugees fleeing violence began their arduous exodus from their towns of residence the president of the (Medellín-based) National Association of Industrialists (ANDI) could coolly declare that Colombia's economy had never been better" (Roldán, 1992, p. 113).

The ANDI is a great example of how coordinated organization of Medellín's elite served as an institutional mechanism for the reduction of growth-constraining transaction costs while at the same time maintaining relatively low transition costs. The ANDI promoted the idea that the industrialists represented modest and democratic owners, despite their famously paternalistic style of management. However, with efforts to distribute benefits to outsiders and with a general anti-union environment in the factories, the ANDI was an institutional tool to "guard against communism, and… [a] movement away from left-wing organizing efforts" (Farnsworth-Alvear, 2000, p. 15), which increased the organizational capacity and power of regional industrialists considerably.

The ANDI also served as a lobbyist apparatus and collective bargaining tool for Medellín's industrial elites to express opinions vis-à-vis the state (see Restrepo Santamaría, 2011; Sáenz Rovner, 2007). The large power of Medellín's industrialist elite secured them access to state-created rents in the form of patronage, resulting in 'revolving door' movements of the industrial elites between key private and public positions (Restrepo Santamaría, 2011, p. 87). Pécaut (1979, p. 334) finds that "political positions were frequently held by industrial leaders… the industrialists frequently had a direct or intermediary influence in the political participation and… sought to convey their economic efficiency efforts to political management". Especially between 1945 and the late 1960s the "sinuous or ambiguous line of demarcation between the public and the private" (Botero Herrera, 2003, p. 62) continued to be very present in Medellín's society. This "entailment of entrepreneurs to senior political positions reflected a strong cohesion of the ruling elite and helped to preserve and strengthen it" (Restrepo Santamaría, 2011, p. 87). Acknowledging the strong influence of Medellín's elites on policy making processes, Alfonso López Pumarejo, President of Colombia between 1934 and 1938 and then again from 1942 to 1945 said that the ANDI "represents the most powerful economic group and the best organized of the country… and they have achieved everything they wanted" (cited in Pécaut, 1979, p. 334).

From the perspective of the political settlements analysis, it was the compatibility between political factors and formal and informal growth-enhancing institutional strategies that were key to Antioquia's successful industrialization from the 1920s until the 1960s. State-created rents thus facilitated import substitution and incentivized stages of easy and heavy import-substituting industrialization in labour-intensive sectors. Institutional rent transfers included guaranteed grants, protectionist measures, state subsidies as well as patronage privileges.

Medellín's match factory *Fábrica Fósforos Olano* is an exemplary case of a *paisa* industry that benefited from a political settlement in which the distribution of power was compatible with growth-enhancing strategies for industrialization. The company was selected as a growth driver and was "promoted… through a contract with the state that guaranteed non-expropriation for 20 years, a protection through custom tariffs and consumption laws, and also an agreement not to implement new taxes for matches" (Restrepo Santamaría, 2011, p. 48). The founder of the match factory Ricardo Olano acknowledges these privileges in transportation for Medellín's industries. In his memoires he notes, "the (public) railway granted a considerable discount for carriages destined for industries (in Medellín)"(Olano, 2004, p. 30;46).

In sum, until 1967 Medellín's ISI industrialization was marked by an elite bargain that was stabilized by a variety of public as well as private-led institutional arrangements and organizations, such as the ANDI or the FNC (see Ross Schneider, 2004). The large holding powers of the industrial elite faction created and maintained a property right structure in which rents were deployed to growth sectors in labour-intensive industries that had low costs of coordination and adaptation. And despite the conflict of *La Violencia,* that generally increased tensions between industrial, landed, and military elite factions, Antioquia's business elite emerged as the main 'patrons', influencing institutional strategies through formal as well as informal forms of influence (see Khan and Blankenburg, 2009, p. 363). The tensions between elite factions in the rest of the country calmed during the early years of the military dictatorship of the *Frente Nacional* (1958-1974). However, and despite the fact that Medellín's industrialists managed, "to maintain a strong position in influencing the orientation of economic policies within the framework of national industrial protectionism" (Restrepo Santamaría, 2011, p. 96), this changed over the course of the dictatorship years.

During the course of the *Frente Nacional* the dominant elite bargain that marked local and national political settlements in which Medellín's industrialists had a powerful position weakened in the 1970s. Successful growth-enhancing institutional strategies turned into failing attempts of moving the industry up the value chain. A political settlement emerged in which capitalists failing to develop further technological capabilities continued to hold powerful positions, reinforced through state-created rents for small-scale accumulation processes and blocking big-push industrialization strategies.

The next section discusses the failures of attempts to 'grow up', the reversal of many of the protectionist mechanisms, and the decline in the political influence of Medellín's industrialists. The section also considers the contribution of external developments to an industrial slowdown and eventually to Medellín's deindustrialization. The section analyses a period of rupture for the political settlement that was dominant during the industrialization phases of most of the twentieth century.

5.2 Deindustrialization and elite fragmentation: Medellín on the path towards an unsustainable growth-stability trade-off?

Between 1967 and the mid-1980s Colombia in general and Medellín specifically experienced drastic political economy changes. An economic slowdown and in particular a stagnation of industrial growth in Antioquia affected the national economy. Attempts to move towards advanced strategies for heavy and capital-intensive industrialization failed. Medellín's industrialists did not manage in continuing the development of capabilities needed for successful late industrialization and export promotion. This section engages in an analysis of the effects of industrial stagnation on economic activities in Medellín. We further use the political settlements framework for a discussion of the reasons behind growth stagnation, which we broadly group into two different areas. Firstly, we argue that particular endogenous factors of the national political settlement impeded or slowed down successful rent management for late industrial growth. The *Frente Nacional*, in which Medellín's industrialists became marginalized vis-à-vis the landed elite factions from Bogotá, resulted in a fragmentation of power structures and weakening of organizational capabilities. This led to incapacities of the state to create and distribute rents for export-oriented and capital-advanced industrial growth. Secondly, we find that exogenous factors, such as external price shocks, debt crises in many Latin American countries, and increased competition from East Asian late developers were harmful for heavy industrialization attempts. This resulted in low incentives for Medellín's industrial elites to invest in high-risk ISI strategies, leading to a concentration on service sector development and capital accumulation through speculative activities.

The year 1967 marks a turning point for Colombia's developmental approach in general and for Medellín's industrially-driven growth in particular. Between the late 1960s and the 1980s, Medellín's economic growth slowed down drastically. This economic slowdown was caused inter alia, by stagnating technological capabilities of Medellín's industrial oligarchy, the organizational incapacities of the state to create incentives and compulsion for heavy and export-oriented industrial growth, and the inability of Medellín's business sector to overcome dependencies on imports of capital goods, which through the highly price-inelastic import demand made the city's economy vulnerable to external shocks. Antioquia's economic vulnerability to volatile global demand, the boom and bust cycles of coffee prices in the 1950s and '60s, and an overvaluation of the peso also contributed to the fragile economic environment.

To counteract on these developments, but also to avoid major devaluations of the peso, the Colombian government implemented stringent controls on capital flows, introduced quantitative restrictions (QRs) on imports, adopted a crawling peg exchange rate regime, and diversified the export strategy. Degree 444 of 1967 effectively shifted the developmental regime from a (very short-lived) heavy industrialization model towards a mixed strategy of import substitution and export promotion. Partial economic liberalization reforms that facilitated mergers and joint ventures with foreign investors were hoped to incentivize technology acquisition (Ocampo, 1994). At the same time, subsidies were reduced drastically and industrial growth was largely funded through loans or the reliance on profits and earnings (see table 5.1). This made entry into high-rent markets more difficult for new industrial incumbents, which can have negative long-term effects on productivity growth.

TABLE 5.1: SOURCES FOR INDUSTRIAL FUNDING (IN %)

	Subsidies	Undistributed earnings	Loans	Total
1950-54	33.5	39.1	27.4	100.0
1955-59	33.1	41.1	25.8	100.0
1960-64	27.8	30.1	42.1	100.0
1965-69	9.9	47.9	42.2	100.0
1970-75	6.5	46.8	46.7	100.0
1976-80	4.8	36.6	58.6	100.0
1981-85	4.9	44.6	50.5	100.0
1986-90	5.2	50.7	44.1	100.0

SOURCES: ECHAVARRÍA AND ZODROW (2005; 1979; 1995)

However, the state continued to play an important role in this mixed strategy development model. Manufacturing exports were promoted through tax rebate certificates, tariff exemptions for imports used for the manufacturing of non-traditional export goods, and pre-financing of exports to minimize risks of exchange rate volatility. Institutional mechanisms of financing exports were handled through the newly created PROEXPO, a development fund administered by the Colombian Central Bank that provided loans for risk capital and working capital (Ocampo and Villar, 1992). Supported by an assembly regime introduced in 1969 this mixed strategy was successful in its primary stages. In Antioquia, between 1967 and 1975 GDP growth rates increased by around 6% annually, value added in manufacturing grew by around 8% and export of manufactured goods grew by almost 30% annually. The effects of Antioquia's shift from an industry dominated by the production of non-durable goods under the second ISI phase towards a regime of capital goods production after 1967 can be seen in table 5.2.

The table shows that during and after the *Frente Nacional* Antioquian industrial capital continued to show some dynamism, particularly in durable consumer and capital goods. This can be explained by looking at the closed and vertically and horizontally integrated structure of Medellín's business elite, which guaranteed continued industrial finance despite the marginalization of this elite faction in the national ruling coalition. The relatively dynamic development of capital goods in Antioquia's economy changed drastically after the 1970s when Colombia embarked on first attempts of economic and financial liberalization. Furthermore, the oil boom in the early 1970s and the increased competition for Medellín's business elite following first liberalization reforms effectively diminished incentives for Medellín's capitalists to finance further growing up of local industrial production. This can be seen in the last column: after 1974 growth rates of all industrial goods stagnated or declined (table 5.2). This decline is largely a result of dynamics in the national level political settlements, where national policy switches impacted industrial interests of Antioquia's elite faction.

TABLE 5.2: GROWTH OF GROSS INDUSTRIAL PRODUCT, ANTIOQUIA, 1958-79 (IN %)

	1958-63	1964-67	1968-73	1974-79
Non-durable consumer goods	6	5	11	2
Intermediate goods	9	10	7	6
Durable consumer goods and capital goods	14	7	16	12

SOURCES: LONDOÑO AND URIBE (1980, P. 27)

Table 5.3 confirms that after 1940 the contribution of non-durable goods in industrial manufacturing decreased slightly, while the contributions of intermediate and capital goods to production outputs experienced increases. The difference in manufacturing of capital goods between the 1950s and the 1960s is particularly noteworthy. However, after 1967 this rather positive development in manufacturing growth reversed. The production of intermediate goods stagnated in the 1970s and capital goods experienced very small increases in its relative contribution to value added. Despite this trend towards a higher-productivity economy in the 1970s, non-durable and intermediate goods remained the main contributors to value added in manufacturing with rates of 48.1% and 38.4% respectively. In sum, a big-push industrialization strategy that could have transformed the entire production base in Colombia failed to achieve its desired outcomes (table 5.3). Similar trends can be observed when looking at the sources of demand for manufactured goods. Prior to the introduction of the mixed development model import substitution made up for around 57% of total demand for manufacturing goods between 1930 and 1967. This changed with the decline in subsidies depicted in table 5.1. This demand created from import substitution went down to 6.2% of total demand between 1967 and 1980. While some of this could be compensated through an increase in internal demand for manufacturing goods from 39.5% before 1967 to 85.5% between 1967 and 1980, the target of moving towards a successful export promotion failed as external demand only increased from around 3% between 1930 and 1967 to 8.3% thereafter (Echavarría and Villamizar, 2006, p. 47).

TABLE 5.3: CONTRIBUTION TO PRODUCTION IN DIFFERENT INDUSTRIAL SECTORS 1940-1979

	1940-49	1950-59	1960-69	1970-79
Non-Durable Consumer Goods	58.0	55.7	50.0	48.1
Food	14.2	12.5	13.4	13.6
Beverages	13.4	13.0	11.0	11.6
Tobacco	6.3	5.3	4.4	3.6
Textiles	16.4	18.1	15.7	14.5
Shoes	5.6	5.0	4.0	3.4
Wood processing	2.1	1.8	1.5	1.4
Intermediate Goods	36.8	37.9	38.8	38.4
Paper	0.6	2.6	3.5	3.7
Printing (and related)	5.8	3.8	2.8	2.8
Leather	0.8	1.0	0.9	0.7
Rubber	0.2	1.0	1.6	2.3
Petrochemicals and pharmaceutical	19.4	13.6	13.1	14.6
Petrol, carbon, and derivatives	1.9	6.0	7.1	5.2
Non-metallic minerals	7.1	6.5	5.5	5.5
Basic metals	1.0	3.4	4.3	3.6
Capital Goods	5.2	6.4	11.2	13.5
Metallic products	1.1	2.0	3.2	4.0
Non-electric machinery	-	0.6	1.8	2.3
Electric machinery	3.9	1.9	2.6	2.7
Transportation material	0.2	1.9	3.6	4.5
Total	100.0	100.0	100.0	100.0

SOURCE: JUNGUITO (1979)

This failure of the Colombian economy to climb up the productivity ladder towards higher value-added production was particularly noticeable in the decline of Antioquia's industry. The traditional industries of Medellín suffered most under the new mixed-strategy developmental regime after the mid-1970s. Table 5.4 confirms the findings so far and shows that contribution to the national aggregated value of Antioquia's stronghold sectors, namely textiles, wood processing, and basic metals were very high in 1953. This decreased drastically with the move away from the ISI development model. The gradual expansion of production in processed foods, and machinery and equipment was insufficient to halt the deindustrialization process of Medellín's economy.

TABLE 5.4: ANTIOQUIA'S CONTRIBUTION TO NATIONAL VALUE ADDED PER SECTOR 1953 AND 2000

	Antioquia	
	1953	2000
Food, Beverages, and Tobacco	12	19
Textiles and Garment	50	42
Wood Processing	17	9
Paper and Printing	13	15
Chemical Products	13	9
Non-metallic Minerals	23	24
Basic Metals	33	18
Machinery and Equipment	21	28
Others	16	13
Total	25	18

SOURCES: UNITED NATIONS (1957, P. 270); ENCUESTA ANUAL MANUFACTURERA

The failure to achieve a successful transformation can be traced back to low levels of efforts by domestic capitalists to acquire new technology and tacit knowledge. Mergers and joint ventures with foreign capital did not achieve the desired outcome of technological upgrading. Table 5.5 shows changes in industrial production and GDP growth between 1930 and 1999. The upper part of the table shows the different factors of production, capital (K) and labour (L), which produce output (Q). Until 1979 growth in industrial output was larger than in the rest of the economy. Similarly, industrial employment was generally higher until the 1960s. Capital stock in Colombia's industry was on average lower than in the rest of the economy, with the exception of the years 1940-59, showing the relative low capital intensity of industrial growth.

Changes in (A), the Solow residual[8] (see Solow, 1956) and in the ratios between factors of production and output are shown in the lower panel. In line with our previous findings this panel shows that while labour productivity (Q/L) and the capital productivity (Q/K) increased since the 1930s, both dynamics slowed down after the 1970s. Labour and factor productivity in the industrial sector have grown at very low rates, indicating that acquisition of technology either through upgrading of domestic production or through joint ventures with foreign investors had only marginal effects on technological upgrading.

TABLE 5.5 TECHNICAL CHANGE AND GROWTH IN COLOMBIA 1930-1999

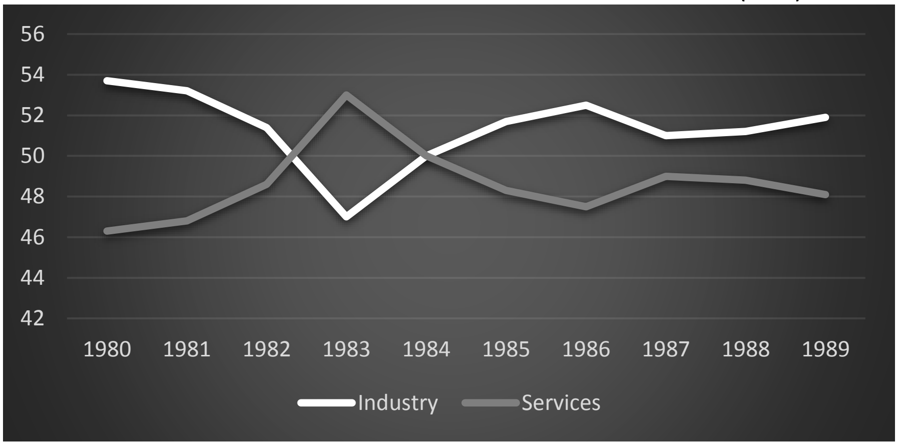
	Industry			Total Economy		
	Q	**L**	**K**	**Q**	**L**	**K**
1930-39	10.7	3.1	0.9	4.3	2.0	1.8
1940-49	8.6	4.1	5.3	4.3	1.6	3.0
1950-59	7.0	4.2	7.0	5.3	2.2	4.3
1960-69	5.8	1.0	3.9	5.1	2.5	5.1
1970-79	6.5	2.7	5.8	5.7	4.6	6.0
1980-89	0.3	-0.2	-0.8	3.3	3.1	6.4
1990-99	0.8	-0.2	-0.3	4.4	2.1	6.4
	A	**Q/L**	**Q/K**	**A**	**Q/L**	**Q/K**
1930-39	8.6	7.6	9.8	2.3	2.2	2.4
1940-49	4.0	4.5	3.3	2.1	2.6	1.2
1950-59	1.6	2.9	0.1	2.2	3.0	1.0
1960-69	3.4	4.7	1.8	1.5	2.5	0.0
1970-79	2.4	3.8	0.7	0.5	1.0	-0.3
1980-89	0.6	0.6	1.2	-0.4	.02	-1.3
1990-99	0.7	1.0	1.1	0.6	0.9	-0.9

SOURCES: ECHAVARRÍA AND VILLAMIZAR (2006, P. 31); UNITED NATIONS (1957); SYRQUIN (1987); ENCUESTA ANUAL MANUFACTURERA

[8] While we are aware of the methodological limitations of the Solow residual, we use is as a rough approximation of technological change or the capacity of achieving rates of technological change.

The low employment rates and the decreasing capital stocks indicate that Colombia's economy was deindustrializing. The industrial crisis was noticeable in Medellín, where services became more dominant and in 1982 for the first time surpassed industrial contribution to GDP growth (figure 5.1). This is partially due to external shocks and the aftermath of decreasing demand for manufactured textile goods, but also shows a general weakening of the entire manufacturing industry in Medellín. While this trend reversed again in 1984, labour and factor productivities in Medellín's industry were stagnating, as the economy failed to upgrade its technological and thus productivity base.

FIGURE 5.1: ECONOMIC SHARE OF INDUSTRY AND SERVICES IN MEDELLÍN (IN %)



SOURCE: DANE, CUENTAS DEPARTAMENTAKES, BASE 1975

TABLE TABLE 5.6: VALUE ADDED PER WORKER AND NUMBER OF WORKERS PER FACTORY, 1953, 1975, 2000

		Value added/Worker			Worker per factory		
ISIC	**Sector**	**1953**	**1975**	**2000**	**1953**	**1975**	**2000**
311	Food manufacturing exc. beverages	81	125	91	10	20	23
312	Food manufacturing exc. beverages	135	209	76	8	21	24
313	Beverage industries	378	347	182	24	102	93
314	Tobacco manufactures	102	250	277	8	19	47
321	Manufacture of textiles	108	71	49	16	38	43
322	Manufacture of wearing apparel, except footwear	43	39	23	3	30	27
323	Manufacture of leather and products of leather	88	60	29	5	30	21
324	Manufacture of footwear, except moulded rubber or plastic footwear	129	54	23	10	21	19
331	Manufacture of wood and wood and cork products, except furniture	49	38	43	3	18	17
332	Manufacture of furniture and fixtures, except primarily of metal	46	28	28	3	19	17
341	Manufacture of paper and paper products	135	133	148	24	39	39
342	Printing, publishing and allied industries	85	79	54	13	19	19
351	Manufacture of industrial chemicals	141	170	364	20	37	31
352	Manufacture of other chemical products	134	161	138	8	32	36
353	Petroleum refineries	178	141	1,974	227	28	16
354	Manufacture of miscellaneous products of petroleum and coal	188	150	265	31	29	19
355	Manufacture of rubber products	352	148	63	26	28	21
356	Manufacture of plastic products not elsewhere classified	166	70	50	21	33	28
361	Manufacture of pottery, china and earthenware	63	46	74	7	35	392
362	Manufacture of glass and glass products	107	78	99	10	67	28
369	Manufacture of other non-metallic mineral products	88	65	105	10	24	27
371	Iron and steel basic industries	116	130	167	10	21	25
372	Non-ferrous metal basic industries	91	102	138	9	18	27
381	Manufacture of fabricated metal products, except machinery and equipment	61	68	42	3	24	19
382	Manufacture of machinery except electrical	58	65	35	2	27	19
383	Manufacture of electrical machinery apparatus, appliances and supplies	81	90	65	4	34	26
384	Manufacture of transport equipment	52	58	155	10	28	30
385	Manufacture of professional and scientific goods	45	51	71	4	32	30
390	Other Manufacturing Industries	66	51	37	3	24	19

SOURCE: ECHAVARRÍA AND VILLAMIZAR (2006); UNITED NATIONS (1957); ENCUESTA ANUAL MANUFACTURERA

Stagnating labour productivity in Medellín's urban economy is reflected in table 5.6. Value added per worker decreased particularly in the city's stronghold industries of food processing (311, 312), textile manufacturing (321), manufactured leather goods and footwear (323, 324), and manufacturing of machinery and equipment (382, 383). At the same time, these sectors experienced an increase in worker per factory, indicating a deepening of labour intensity and a decrease in labour productivity, which is particularly relevant given that the overall contribution of these sectors to national value added decreased (see table 5.4).

Colombia's industrial decline in the 1970s impacted manufacturing growth and value added of Medellín's economy quite drastically. Overall, value added as well as value added in manufacturing stagnated and declined after the 1970s, before these values only slightly recuperated in the second half of the 1980s. The conventional economic explanations for stagnation of Antioquian and Colombian industry largely focus on macroeconomic imbalances from the mid-1970s until 1990. Ocampo and Villar (1992), for example find that these developments can be explained through the volatility of coffee prices, the closure of private foreign credit due to the debt crisis in other Latin American countries, the rise of international interest rates and an increase in external debt service as a result of the Volcker Shock, and the Colombian financial crisis of the early 1980s. As the 1984 macroeconomic adjustment programme of the IMF focused on restoring macroeconomic equilibrium through fiscal control and financing of public investments through FDI, export subsidies were scaled back, as was the role of the public PROEXPO and IFInd. The changes in the developmental strategy and the institutional adjustments that focused on the establishment of macroeconomic equilibrium reflect the emerging dominance of the idea that economic stagnation and crises are the result of 'bad' institutional environments.

And indeed, the discussed decline and stagnation of Medellín's industry reflects several weaknesses inherent to Antioquian industrialization. Similar to many other industrialization attempts in Latin America, Medellín's industry remained with a strong emphasis on production of non-durable consumer goods. With the removal of some protectionist policies, it was particularly Medellín's stronghold textile sector that suffered from external shocks and competitive disadvantages vis-à-vis other emerging industrial economies, such as the South East Asian Tigers. Intermediate goods and capital goods production always had little priority in Medellín's industry and could thus not serve as a substitute of the declining traditional non-durable industry. The linkages of industrial capital to a few families that controlled the productive sectors of consumer goods have also been identified as crippling factors for further effective horizontal diversification and vertical integration (see Vellinga and Kruijt, 1983, p. 114).

Using theoretical arguments of Bruno and Sachs (1979, 1982) and Corden and Nearly (1982), Clavijo et al. (2012) argue that "Dutch Disease" effects following the increased importance of oil, gas, and coal for Colombia's economy in the 1970s were largely responsible for deindustrialization trends. Showing that the increase of oil production in Colombia correlated not only with a substantial revaluation of the exchange rate of the Colombian Peso but also with a decrease of value added in manufacturing as a percentage of GDP, the authors find evidence that deindustrialization in Colombia happened as a consequence of "Dutch Disease" effects. These arguments are resonated by Echavarría and Villamizar (2006) who find that between 1970 and 1979 the importance of oil and coal for Colombia's economy increased, while manufacturing of capital goods decreased in that same period.

These arguments are also supported by Ortíz (2009). The author finds that in addition to "Dutch Disease" effects of a revaluated currency and low wage competitiveness it was macroeconomic mismanagement and misplaced microeconomic policies that were responsible for "economic deceleration in Colombia".

However, the authors arguing that Colombia's and Medellín's deindustrialization resulted from "Dutch Disease" effects fail to analyse why some manufacturing sectors did not suffer decreases and why several devaluations of the Colombian Peso in the 1990s and labour market reforms resulting in real wage suppression did not reverse the trends. Further, it remains unclear whether or not increased extractive rents were used to increase technological learning in order to achieve economic growing up. A closer look at the changing nature of local elite interests following these external shocks is also missing from these policy and neoclassical explanations.

Seen through the political settlements lens, the inability of Medellín's economy to continue to climb the technology ladder can be explained by several additional factors that impeded or at least slowed down attempts to upgrade Medellín's economy. Firstly, we argue that the distribution of power in *Colombia's* political settlement is one important factor in understanding these developments. The historically large powers of landed interests vis-à-vis industrial interests can partially explain why advanced ISI strategies were not implemented that may have set Medellín onto a path of "late industrial development". During the years of the *Frente Nacional* this relatively stronger weight of the landed elite made the distribution of power more and more incompatible with an institutional strategy that could allocate benefits to growth-enhancing industries. The need to find compromises between the different elite factions to keep the settlement stable limited the development of state capacities to create and distribute the remaining industrial rents in order to decrease growth-constraining costs. This impeded efforts for lengthy learning of tacit knowledge and risky investments.

Secondly, where industrial rents *were* created they were largely allocated to the oligarchic Antioquian industrial elite that had relative low value-added, low technological, and labour-intensive capabilities. While it did not require very sophisticated coordination and strong planning efforts to reduce risks in Medellín's easy phase of ISI, this changed after the 1950s when Antioquia attempted to push large-scale capital-intensive industrial production. The relatively short-lived experience of advanced ISI development can thus be explained by the limitation of the state to allocate and monitor rents effectively. Hence, the system of compulsion in place during and after the *Frente Nacional* proved to be insufficient for creating and distributing rents to successfully advance to more difficult stages of ISI development, leading to a failure of attempts to develop internationally competitive exporting sectors.

This was reinforced by a third factor: the low levels of competition among Medellín's industrial elites in all phases of ISI development. Whereas the large bargaining power and the extensive coordination capacities of Medellín's industrial oligarchy facilitated growth-enhancing rent management during the easy stage of ISI development, this turned into a disadvantage after 1967. The low competition, which "at least in part, (is) explained by the much larger weight of landed elites and interests in the Colombian (political) settlement" (Khan and Blankenburg, 2009, p. 363), hindered successful allocation of rents as well as disciplining mechanisms in cases of non-performance of rent recipients. Besides the distributive and allocative implications for possible growth-enhancing rents, the very close and tight elite in Antioquia also limited entry for outsiders of the ruling coalition. Again, while the exclusive character of the ANDI and its direct ties to the state had enhanced productivity growth during the first half of the twentieth century, this turned into a disadvantage as it made it almost impossible for industrial newcomers to develop political bargaining power to influence government.

We also identify the relatively low organizational capacity and governance capability of the state as a factor. Despite the introduction of the mixed strategy, the state was not able to create conditions for successful export promotion and for the attraction of FDI with more advanced technology. The lack of governance capability to create conditionalities for MNEs to commit to technology transfers through FDI in medium- or high-productivity activities, which may have facilitated technology upgrading of domestic firms, had adverse effects for long-term productivity growth. Backward and forward linkages could hence not be created, resulting in a continued dependence of Antioquian industry on technology acquisition through FDI.

Khan and Blankenburg (2009, p. 364) discuss yet another factor that reinforces the overall picture of a lack of elite competition and of low state capabilities: "The absence of populism in Colombia and the high degree of exclusion of subaltern and middle classes from the political settlement did not mean that the state was not affected by contestation from outside this settlement. Instead, political contestation by excluded sectors of society took the form of (mostly) rural guerrilla warfare that, while largely confined to remote regions with little government presence, increasingly undermined the political stability of the elitist-clientelist pacts." This shift towards an unstable and unsustainable growth-stability trade-off intensified and urbanized with the decrease in Medellín's industrial growth. Hence, while the labour-intensive character of Medellín's industry had not only incentivized urbanization as to absorb capitalist surpluses through an increased labour supply, it also guaranteed a stabilization of Medellín's political settlement, which changed with the deindustrialization of the city's economy. The next section discusses these trends in further detail and analyses how the growth-stability trade-off in Medellín's political settlement became increasingly unsustainable through contestation from a variety of outsiders of Medellín's elitist pact.

5.3 Political economy explanations of changing elite structures and institutional responses in a destabilizing political settlement

Medellín's industrial elites held considerable power in the local and national political settlements for much of the twentieth century and could influence institutional strategies of creating and distributing rents to facilitate industrial development and maintaining the stability of the political settlement. Low levels of competition among elites, the relatively stronger position of landed interests (particularly of elite factions from Bogotá), a state with limited disciplining and incentivizing capacities, and generally low entrepreneurial capabilities of the industrial elites impeded the implementation of growth-enhancing institutional strategies for advanced industrial development. The consequent economic crisis in Colombia and Medellín's deindustrialization since the late 1970s had several consequences for the interdependency between power and institutions and its developmental effects on economic growth and political stability.

This section engages in a political economy analysis of changes in elite interests and power structures that followed these developments. The first part of this section focuses on how Medellín's industrial elite changed to become a service-sector based capitalist class that developed networks and institutions to maintain economic powers in the changing local and national context. In the second part of this section we discuss how the separation of political and economic elites, and increasing influence of outsiders of the dominant *pacto* undermined and challenged the overall stability and sustainability of the political settlement. We focus on how policy reforms that decentralized the Colombian political landscape responded to these changes. The section will analyse how these decentralization reforms affected the structures of power and hence impacted the likelihood of achieving growth-enhancing institutional change.

5.3.1 Changing elite structures in Medellín – the birth of the GEA

With the industrial decline in the 1970s and the deterioration of state-created industrial rents, Medellín's elite and the entire urban economy stood at "the advent of an irreversible crisis in the productive sector, which witnessed the beginning of the decline of hegemony and the reorganization of the Antioquian industrial faction" (Franco Restrepo, 2005, p. 154). This decline started with and is symbolized by the crisis of the textile industry (Escobar and Hoyos, 1986). The main features of Antioquia's industrial model clearly were no longer viable in the new economic context and Medellín's industrial elite factions recognized the need to restructure their bases of capital accumulation.

The bargaining power of Medellín's industrialists, in particular through the business association ANDI, declined during that phase, as elite factions with landed interests received increasingly favoured treatment in terms of rent allocations. As a result, Medellín's industrialists started to develop informal networks and institutions to protect their interests from Bogotá's landed elite faction as well as from outsiders of Medellín's local elite *pacto*. Using their financial capacities developed throughout the twentieth century, Medellín's industrialists successfully replaced the importance and weight of industrial businesses with economic consortia and organizations that focused on capital accumulation through financial speculation, construction, and mergers and acquisition of several service and light-manufacturing companies.

It was in 1978 after several rival elite factions engineered a hostile takeover of various core *paisa* industrial businesses, that Medellín's industrial elites saw themselves forced to push their informal institutional strategies further and formed the so-called *Sindicato Antioqueño* also known as *Grupo Empresarial Antioqueño* (Entrepreneurial Group of Antioquia, GEA).

The formation of the GEA and the organizational restructuring of Medellín's most powerful capitalist groups can be seen not only as a result of increasing competition between different elite faction in the local political settlement (discussed below), but also as a consequence of factors that were exogenous to Medellín's political settlement. Thus, the ending of the *Frente Nacional* and the introduction of several macroeconomic policies at the national level had several interlinked effects on the balances of power in Medellín and the interests of the

Antioquian elite. The creation of the GEA as an exemplary case for how national level dynamics can affect political settlements at the city level is particularly strong when looking at the influence of elite factions from other regions of Colombia in the national political settlement.

Historically, the biggest regional rivals for the Antioquian elite have been the *Grupo Santo Domingo* and the very powerful *Organización Ardila Lülle*. The implementation of first liberalization reforms, coupled with increased revenue flows from oil and coal production in the 1970s, had substantially strengthened these two *Grupos*, both of which had historically focused on landed rent extraction. The *Grupo Santo Domingo*, for example, used the period of the 1970s when Medellín's industrial capital was crisis to acquire the Medellín-based brewery *Cervunión* and to take many parts of beer production to Colombia's capital Bogotá.

Similarly, other Antioquian manufacturing plants of non-durable and intermediate goods were bought by the *Organización Ardila Lülle*. The beverage producer *Postobón* and the textile giant *Coltejer* are but two examples of how rival regional elite factions took over core sectors of Medellín's industry and took production to other parts of the country. The cases of *Postobón and Coltejer* are particularly noteworthy due to their effects on capital goods production in Medellín. Both companies had not only been the backbone of Medellín's growth in non-durable and intermediate goods manufacturing, but due to their horizontal integration with companies producing machinery and equipment, they had also helped to create a considerable base of capital goods production in Medellín. When the *Organización Ardila Lülle* acquired *Cotejer* and *Postobón* and moved parts of their production to Bogotá and Barranquilla, this also impacted output of capital good production in Medellín. Many machine-producing plants were moved, while assembly and textile production remained in the Antioquian capital.

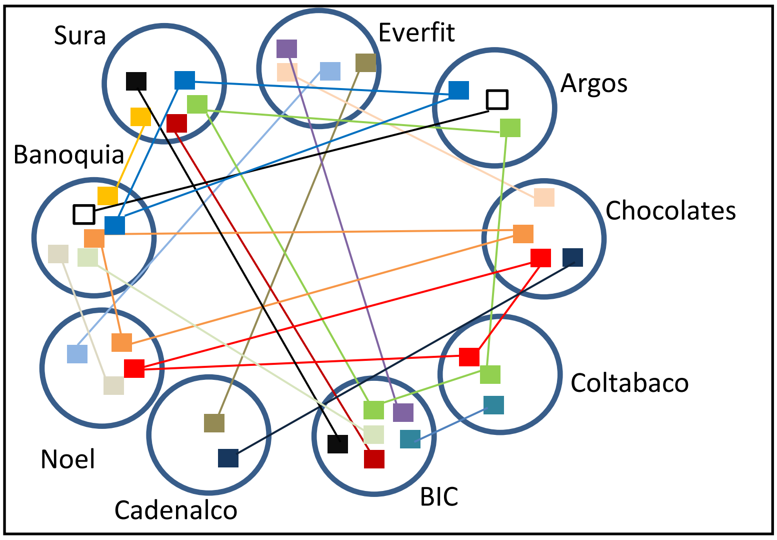
Following this, the GEA integrated several different fractions of Medellín's dominant business elite to compensate for the economic weakening of large traditional corporations following the industrial decline of the late 1970s and to maintain political influence following the marginalization of the ANDI as a powerful lobbying mechanism (Semana, 1997). This informal institutional understanding had several long-lasting impacts, not only in terms of efficiency and economic growth, but in particularly with respect to its distributive functions of allocating economic benefits and political patronage (Franco Restrepo, 2005, pp. 163–164).

Various presidents of Medellín's traditional industrial companies supported the initiative to protect their interests through the GEA as a new informal mechanism to decrease transaction costs, while maintaining economic and political influence. Nicanor Restrepo Santamaría, one of the early leaders of the GEA and arguably the most influential *patrón* in Medellín's recent history, remembers that the GEA resulted from "a process of creation of local organization as an autonomous response" (Restrepo Santamaría, 2011, p. 85). He cites Ricado Ángel, co-founder of the GEA and leader of the regional business elite, who stated that "the centralism and the way they (the *Bogotano* elite), especially the representatives of *Colseguros*, wanted to restructure the management of Antioquian corporations were the reasons that led to the promotion of a bank, an insurance company, and other businesses with the participation of the largest industries of the region" (Ángel, 2005, cited Restrepo Santamaría, 2011, p. 85).

Since its initial phase the GEA has been led by the finance and insurance company *Suramericana de Seguros (Sura)*, its subsidiary bank *Banco Industrial Colombiano (BIC*, or *Bancolombia* after the merger with *Banco de Colombia* in 1997), the cement producer *Argos*, and the food processor *Compañía Nacional de Chocolates* (since 2011 *Nutresa*). All of these companies remain deeply interconnected through a particular type of a cross-share ownership structure: *Sura* holds around 37% of *Argos'* shares and 37% of *Nutresa*, *Argos* controls 36% of *Sura* and around 11% of *Nutresa*, while *Nutresa* owns 10% of *Sura's* shares and 10% of *Argos*. As David Emilio Bojanini, current president of *Sura* and the head of the GEA told the author: "what we are looking for with this particular shareholding structure is to control each other… and to protect us from outsiders and hostile takeovers" (Bojanini, 2014). Santiago Pérez Moreno, vice-president of *Bancolombia* and member of various boards of directors of GEA companies added, "this crossing of shares was done to preserve regional values… but ultimately it was done to preserve the positions and influence of presidents and executives (of GEA companies)" (Pérez Moreno, 2014).

This interconnectivity of the core companies of the GEA is also reflected in the multiple representation in the board of directors (figure 5.2). As seen in figure 5.2, during the initial phase the financial institutions *Sura*, *Bancolombia*, and *Corfinsura* that secured leading roles for themselves in the GEA. The cement producer *Argos* and the food processing company *Compañía Nacional de Chocolates* completed the principle holding groups of the GEA.

FIGURE 5.2: BOARDS OF DIRECTORS OF THE GEA, 1980



SOURCE: FRANCO RESTREPO (2005), OWN ELABORATION

Today, the founding companies remain at the head of this cross-shareholding structure. Their respective CEOs concentrate influence through simultaneous representation in up to five boards of directors. The GEA is thus the main manifestation of a fundamental reorganization of Medellín's business landscape. The adoption of a cross-ownership structure, which replaced the pyramid structure led by dominant families, can be seen as a defensive strategy of Medellín's economic elites against hostile takeovers. However, and as Londoño (2004) and Franco Restrepo (2005) argue, this quantitative concentration of capital also serves as an institutional strategy for maintaining hegemony over capital accumulation, and sustaining and deepening the organizational power in Colombia's political settlement.

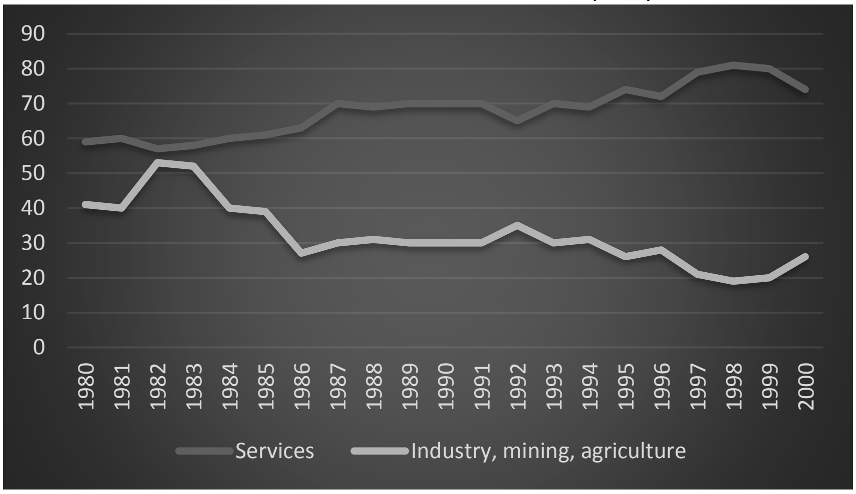
Within this network, and differently from the family-owned industrial companies, the depositories of power are managers and CEOs. However, this does not mean that large influential owners disappeared and were replaced by a democratic ownership structure. On the contrary, the GEA created in the words of the *grupo's* very own Nicanor Restrepo Santamaría "a managerial class that increasingly concentrated the decision-making processes in boards of directors that were nominated behind closed doors" (Restrepo Santamaría, 2011, p. 86). Its CEOs are descendants of the industrial families that dominated ownership and control throughout the twentieth century. Like their ancestors, the 'new' economic capitalist elite is largely privileged through education abroad, high incomes, and inherited access and entitlements.

The creation of the GEA does not only mark a change in the ownership structure of the majority[9] of Medellín's companies, but also embodies the institutionalized shift of interests away from traditional industrial manufacturing towards capitalist service activities. While we discuss the concrete transformation of the GEA towards a service-based transnational capitalist class in the next chapter, figure 5.3 already indicates that since 1980 economic income of the GEA has been dominantly and constantly originating from service activities. This is different from the observations made in figure 5.1 for the entire urban economy and shows that interests of Medellín's elite largely shifted towards services after 1980. One could argue that this was a mere defensive strategy and the capitalist elite of Antioquia was forced to re-orientate their business interests towards service provision (Restrepo Santamaría, 2011, p. 200). However, Betancur et al. (2001) find that with the increased global integration of Colombia's economy the GEA in fact adopted an offensive and even aggressive strategy.

The change in elite interests and balances of power in Medellín's political settlement following creation of the GEA shows that exogenous factors to the local political settlement, such as changes in the dynamics of the national political settlement (i.e. the increased importance of rival elite factions) impact how dominant actors in Medellín's capitalist elite view their interests. The shift in interests from an industrial-based economy towards services can thus not be explained by merely looking at changes in balances of power in the local political settlement, but also by analysing ideational change triggered by factors exogenous to the local political settlement.

[9] Today, the GEA controls companies in Medellín that make up for around 80% of the city's GDP and contributes around 8% to Colombia's GDP. Measured by market valorisation, *Bancolombia* is Colombia's third largest company, while *Sura* is ranked number four. In this national ranking, *Argos* follows on rank six while *Nutresa* is ranked ninth. Together, these core companies of the GEA have a market valorisation of over 26 billion Pounds Sterling (in 2014 constant GBP). Their combined market valorisation makes up for around 25% of the value of all publically traded companies in Colombia (Fradique-Méndez, 2014).

FIGURE 5.3: INCOME OF GEA IN INDUSTRY AND SERVICES (IN %)



SOURCE: ACOSTA AND LONDOÑO (2002)

The creation of the GEA and the implied reorganization of Medellín's industrialists had several effects on the overall power structure, capitalist interests, and the capabilities of implementing strategies for productivity growth and technological change. Concluding our discussion of the GEA, we can summarize that after state-created industrial rents were drying up as a result of several factors discussed in the preceding political economy analysis, Medellín's industrial elite saw the need to establish institutional mechanisms that could sustain their economic power and maintain bargaining and organizational powers vis-à-vis the state. This institutional shift also entailed a reorganization of the *paisa* economy towards services, and construction (cement), and finance, which in turn, affected the existing political settlement. With the concentration of ownership Medellín's capitalists could not only fight off competition through the quasi-protectionist GEA, but could also find a replacement for the ANDI as a bargaining tool.

Alongside the reorganization of Medellín's business elite in the 1980s there were several important policy changes to the political landscape of Colombia. In attempts to stabilize the increasingly fragile elite bargain in the years following the end of the highly centralized administration of the *Frente Nacional* in the 1960s and 1970s, far-reaching decentralization reforms were implemented. In the following we analyse how these reforms functioned as institutional responses to contestations of power from leftist urban guerrillas as well as from an emerging political class.

5.3.2 Elite fragmentation, decentralization and institutional changes in Medellín's political settlement

It was already during the years of the *Frente Nacional* in the 1960s when outsiders of the ruling coalition first contested the traditional industrial elites' self-prescribed role as Medellín's natural representatives in political matters. The hyper-centralization of political power and the quasi one-party rule of the *Frente Nacional* had three important interrelated impacts on the distribution of power in Colombia in general, but more importantly, in Medellín's society (Duque Daza, 2005).

Firstly, Medellín's industrial elite faction lost more and more bargaining power in the *Frente Nacional* to the historically strong landed interests, particularly from Bogotá's elite. This led to a change in resource allocation away from efforts to promote industrial development. Secondly, the efforts to at least secure some access to state-created industrial rents for Medellín's industrialists were concentrated at the national level. Antioquia has historically been the region in Colombia with an elite that subscribed strongly to the idea of regional autonomy (Ocampo, 1984). The fragmentation of organizational capacities and power during the *Frente Nacional* did not only result in a power vacuum in Medellín's society, but also led to a vertical interest fragmentation between the centre and the Antioquian elites. With the rise in the 1960s of a generation of Antioquian regional leaders (*cacicazgos*) not linked to Medellín's traditional elites, these predominant power structures were increasingly challenged resulting in a fragmentation of the main political interests. Thirdly, the concentration of power in the *Frente Nacional* led to an internal horizontal fragmentation of interests within the two main political parties as the organizations failed to manage a distribution of rents to regional political actors as well as the lower rank and file within their parties. The Conservative as well as in the Liberal Party witnessed an increasing heterogeneity of interests within their own organizational structures. These factors left space for alternative actors to challenge hegemonic power both from outside as well as within the two organizations (see Archer and Shugart, 1997).

In addition, these dynamics also led to an alienation of economic from political elite interests and groups (Franco Restrepo, 2005). This became more and more visible during the 1970s with the gradual decline of the *Frente Nacional* and its decreasing political legitimacy. The resulting rise of professional politicians, who articulated their interests independently from the traditional landed and industrial elites, started a process of reorganization of power relations (Duque Daza, 2007). The shift of organizational power away from these traditional elite factions and towards a class of professional political actors is considered by many as the breaking point between the political and economic elites in Medellín (see Dover and Ocampo, 2006; Gouëset, 1998; Leyva, 2014; Restrepo Santamaría, 2011).

Dover and Ocampo (2006) provide an interesting contribution to the literature on the fragmentation of power in Medellín. They argue that prior to the 1970s and the process of a gradual opening up of Colombia's economy, the industrial elites were able to establish themselves as the dominant elite in the political settlement, which was legitimized and maintained through different institutional mechanisms of distributing rents and patronage compatible with this. However, with the economic weakening of the dominant industrial entrepreneurs, this distribution of power was challenged by the rise of "a new elite, the political class, which was formed around a regional bureaucratic apparatus" (Dover and Ocampo, 2006, pp. 263–264). Leyva (2014, p. 126) finds that this endogenous change in economic elites combined with the rise of what he calls *clase emergente* resulted in "a fragmentation of the elite – in singular – into different groups of power".

Duncan (2005) and Palacios (2001) also consider the rise of the *clase emergente* a logical consequence of failing economic dynamics, combined with the massive urbanization waves Medellín experienced from the 1950s until the early 1980s (see figure 2.3). The industrialists had so far been able to accommodate the urban working class through waged employment and housing benefits. Institutional mechanisms and state-created rents – designed to serve the interests of the industrial elite – incentivized both the industrial expansion of labour-intensive industries as well as further rural-urban migration. While the former was largely achieved through formal policies, such as subsidies and tariffs, the latter depended on pull factors (i.e. secure housing) as well as push factors (rural violence). However, and as discussed in previous sections, this positive growth-stability trade-off in the political settlement of Medellín during the ISI phase became increasingly fragile.

Due to the organizational and political factors predominant in the *Frente Nacional* and the economic reforms in 1967, the existing distribution of power became increasingly incompatible with institutional mechanisms that could continue to reduce growth-constraining transaction costs and minimize transition costs through compensating outsiders of the ruling coalition and the urbanized working class. With decreasing political powers of Medellín's industrialists and the slowdown of state-created industrial rent flows, the industrial elite was no longer able to manage enough rents and allocate compensation effectively. Resulting increases in urban unemployment exacerbated rifts among elite factions and strengthened the new political *clase emergente*.

Increasing urban unemployment, the urbanization of the until-then largely rural Colombian conflict, and the decreasing capacity of the state and the elite factions to distribute sufficient rents and benefits to keep the settlement stable also resulted in an increase of urban militia movements in Medellín's marginalized *comunas*. In addition to the growing rifts between the economic and the political elites, the 1970s witnessed the rise of leftist urban guerrillas. While rural guerrillas had been playing an important role in Colombia's political landscape through the FARC, the *Ejército Popular de Liberación* (Popular Liberation Army, EPL) and the *Ejército de Liberación Nacional* (National Liberation Arby, ELN), this was a new phenomenon for Medellín[10]. It was in the 1970s that the city's political settlement started to unsettle as a result of persistent insurgencies, fuelled by an increase in youth unemployment and a growing marginalization of communities and neighbourhoods. This resulted in an intensified contestation of the existing power structures, which was at least in part also a consequence of how the *Frente Nacional* excluded leftist forces from official political representation (Hylton, 2007, p. 77). However, and as discussed in the next section, it was mostly the rise of the political *clase emergente* with its ties to narco-businessmen and traffickers, and Pablo Escobar's Medellín Cartel that severely shook the existing balance of power and the stability of the political settlement.

In attempts to sustain a positive growth-stability trade-off, decentralization reforms were implemented in the hope to provide local political elites that had risen to power in many City Councils across the country, with alternative forms of capital income and control. These reforms were also ratified with the intention to restructure the political, administrative, and fiscal control of the national state, particularly in policy areas of social services, housing and real estate, as well as economic development. Decentralization was furthermore a crucial tool for President Belisario Betancur (1982-86) in his attempts to successfully implement the peace agreements, *Acuerdos de la Uribe,* between his government and the FARC (Cepeda Castro, 2006).

Law 14 of 1983 introduced the first reforms focusing on fiscal decentralization. The emphasis of this reform was on the reorganization of sources of fiscal income for Colombian municipalities and included changes in tax collection. Specifically, the decentralization of the industry and commerce tax, and the urban property tax surplus changed the rules of the game for local administrations. Besides a modernization of the tax-collection system, the reform also

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[10] Besides the most famous left-wing guerrilla movement, the FARC, the ELN, and the EPL, other urban militias are also worth mentioning: *Milicias Populares del Valle de Aburrá* (MPVA), *Armados del Pueblo* (CAP), *Milicias Populares del Pueblo y para el Pueblo*, *Las Milicias Independientes del Valle de Aburrá*, and *Las Milicias Metropolitanas de la Ciudad de Medellín* (see Jaramillo, 1994; Medina Franco, 2006).

created the Value Added Tax (VAT) and implemented rules of fiscal transfers from the centre to the local level, which until today *make up 50% of income for municipalities* (Ospina et al., 2007). Subsequently, Law 12 of 1986 provided the legislative foundations for progressive increases of the percentage of VAT transferred to municipalities. Law 12 of 1986, Decree 1333 of 1986 and Decrees 77 and 81 of 1987 implemented far-reaching administrative decentralization reforms, which transferred a number of core policy competencies to the municipal level, including public construction, water, sanitation, health care, construction and maintenance of public school buildings, care centres, and sports facilities, agricultural and technical assistance to small producers, food security, investment programmes, construction and maintenance of urban infrastructure, urban transportation, the ability of mayors to appoint, transfer and remove staff of public educational institutions, and industrial and commerce policies.

Velázquez (1997) sees these reforms as part of a larger trend aiming to redefine the role of the state in the economy and to achieve market-led private sector development. For example, privatization of the deregulated and decentralized social service sector was facilitated through the devolution of administrative control of the sector in the early 1990s. In addition to restructuring the administrative and fiscal responsibilities in the municipal system, the decentralizing project also introduced changes in the electoral field, entailing far-reaching political decentralizations that involved the popular election of Mayors and Governors (Legislative Act # 1 of January 9 1986). Together, these three areas of policy reform led to a transformation of the structure of state power. These changes were manifest at various levels: a) the re-vitalization of relative power of municipalities and departments, b) the re-legitimization of local authorities, through the adoption of election procedures, and c) the expansion of the powers of local governments via decentralization of administrative responsibilities. Overall decentralization reforms particularly strengthened the role of the mayors of big cities (Iregui et al., 2001; Pening Gavíria, 2003).

Falleti (2010, p. 3) finds that in Colombia "decentralization of government policies has produced the expected effects of increasing the power of subnational governments and officials". The intensification of territorial interests that coincided with the return to pre-nation state agglomerations of highly autonomous cities has led to vertical power shifts that strengthened local political actors and regional elites, and predominantly amongst these the *clase emergente*.

The decentralization reforms of 1983 to 1988 thus constitute a political rupture that started a new phase of the management of institutional strategies to enhance economic efficiency and to distribute rents and patronage. However, decentralization was not only a distributional strategy of allocating rents and benefits in a changed context, but it also heavily affected the capability of the state to create and enforce interventionist policies that can enhance conditions for higher productivity economic development. Angell et al. (2001) find that decentralization in Colombia has had mixed implications for state capabilities to develop innovative institutional strategies. Local clientelism and regionalism flourished, which limited the effectiveness of the centre and increased room for innovation at the local level. However, and fiscal pressures on local governments aside, the lack of a strong national state in Colombia that could rationalize and shape the overall direction of long-term innovative institutional strategies remained a major source of political and technical obstacles for a successful negotiating of potential trade-offs between political stability and productivity growth (Angell et al., 2001).

Decentralization in Colombia has led to increased uncertainty about the institutional environment and to a fall of legitimacy for political parties and the central government. The increased factionalism has negatively impacted the coordination of government policies and, ultimately, for the implementation of successful growth-enhancing institutional strategies. Faust (2006) finds that in Colombia this increased heterogeneity has weakened the state in its capacity to create, enforce, and revoke institutional mechanisms, as political factors of power constellations and governance capacities were no longer compatible with policy strategies for productivity growth and sustainable development. The limitation of governance capabilities to ensure efforts in investments for tacit knowledge in local sectors or firms with medium or high technological capacities had several developmental impacts.

An important *direct* developmental impact of these changes in resource distribution is the increase in regional and urban inequalities (Restrepo, 2004). In the 1960s and 70s rents were distributed from the central government to cities and regions in the form of stimulus packages for economic development in order to close of the gap between different regions and cities and between rural and urban Colombia. Restrepo (2004, p. 88) finds that "the adaption of decentralization process from the 1980s onwards paradoxically buried the regional development policies, in exchange for territorial planning of local public social spending policies." This effectively widened the disparities in growth rates and living standards within and between cities and regions (Restrepo, 2004). Today Colombia is more unequal than ever, a general trend in Latin America to which decentralization policies may have contributed significantly (see Di John, 2009, p. 119). As discussed in the next chapter, decentralization can also be one of the contributing factors to stagnating productivity growth in the context of market liberalization reforms.

As mentioned above, changed power structures and institutional underpinnings did not only impact the economic viability of Medellín's political settlement, but also contributed to an increased contestation of the dominant elite bargain. The next section will focus on an analysis of the *emergentes* as a powerful elite faction that achieved considerable organizational and holding powers, linked to the growing influence of Medellín's narco capitalists.

5.4 The rise of the narcos, the *emergentes*, and the paramilitarization of power

The rise of the *emergentes* did not only establish a *political* counterweight to challenge the traditional elite structures. It also constituted an attempt to increase *economic* influence. In particular, with the powerful GEA controlling over 80% of Medellín's businesses, the economic power of the *emergentes* had remained marginal. The second generation of *emergentes* and their representatives Fabio Valencia Cossio, Luis Alfredo Ramos, Álvaro Uribe Vélez, amongst others were looking for financial resources to enable to strengthen their economic influence (Leyva, 2014).

The *clase emergente* started to develop their capacities as actors who "represented a new economic power and a new societal sector in Medellín" (Dover and Ocampo, 2006, p. 269). While the *emergentes* had originally secured most of their income from landed activities in rural Antioquia, they increasingly became active in urban land speculation and real estate development, thus contesting one of GEA's sources of profit (Gouëset, 1998).

Urban land valuation was modified in Law 14 of 1983, during the presidency of Betancur. The reform augmented the tax-collection capacities of Medellín's City Council, where local actors of the *emergentes* held powerful positions (Franco Restrepo, 2005; Galindo, 2014). These were crucial institutional changes that formally underlined the power of this emerging political class through access to new sources of state-created rents. The *emergentes* could now accumulate additional resources, which "started to give the emerging political class some independence regarding the generation of formal income and capital gains" (Leyva, 2014, p. 127).

Besides the formal institutional consolidation of access to economic and political sources of rent-creation, the *clase emergente* also understood how to use informal networks and grey markets to increase and sustain their position in the changing landscape of Medellín's power distribution. They developed close links with actors that engaged in the smuggling of contraband consumption goods, especially of alcohol, tobacco, textiles, and electric appliances. Through a wide network of asset laundering the *emergentes* were able to increase their wealth further (Duncan, 2013). These grey networks became a growing threat to the economic dominance of the capitalist elite represented by the GEA, as they further undermined tariff protection, jeopardising the economic stability of domestic markets in the formal sector. The increase of foreign exchange earnings from illegal drugs exports and smuggled goods was one of the main causes of a "Dutch Disease" episode in the 1980s (Martin, 2012). This led to a rise of the relative price of non-traded goods and an appreciation of the real exchange rate, resulting in a slow growth of exporting sectors (Kamas, 1986).

The relationship between the capitalist elites of the GEA and the *emergentes* was hence marked by competition (Franco Restrepo, 2005, p. 355). The rising economic power of the *emergentes* in competing with and contesting the ownership of companies that belonged to the sphere of influence of the traditional economic elite was only one aspect of contestation in the 1980s. Even more crucial was that a rising drug elite started to build political capacities and clientelistic networks with political actors of the *emergentes*. The most prominent mafia that established informal ties with the *clase emergente* was the Medellín Cartel under its infamous leader Pablo Escobar. The Medellín Cartel appeared first in the late 1970s and rose to fortune and economic influence during the crisis of the traditional *paisa* economy in the 1980s. Pablo Escobar, together with his *socios* Carlos Lehder, Gonzalo Rodriguez Hacha, and the Ochoa brothers Jorge Luis, Fabio and Juan David, filled much of the *economic* vacuum left behind by the industrial decline of Medellín, generated employment and distributed groceries to the urban poor, making them particularly popular amongst the working class.

Until the mid-1980s Escobar and his Cartel had mainly used their economic fortune to influence policy making through campaign financing and other means of lobbying (i.e. Escobar's financial contributions to *emergentes* such as Senator Alberto Santofimio Botero). However, Escobar increasingly explored ways how to *directly* engage in Colombia's political sphere. John Jairo Velásquez, alias Popeye, hitman and bodyguard of Escobar, remembered a conversation between Escobar and Senator Santofimio. According to Velásquez, Santofimio said: "Pablo… politics does not only bring money but it brings power. Politics is there to have power, with this power you can appoint the directors of the *Unidad Administrativa Especial de Aeronáutica Civil* (Special Administrative Unit of Civil Aeronautics, also known as *Aeronáutica Civil*), so your planes can come and leave as they want; with power you can have the director of customs not to revise your merchandise; you can have the director of the *Departamento Administrativo de Seguridad* (Administrative Department of Security, DAS), generals of the Republic, commanders of the police… This is want politics gives you, Pablo, power" (cited in Legarda Martínez, 2010, p. 161). Despite that there had been "an organic relation between centres of economic power and networks of political power", the ambition of people like

Escobar to engage directly in the political arena contributed to the "gradual separation of political and economic domains" (Franco Restrepo, 2005, p. 29;285).

In Medellín's society and especially within the GEA-led capitalist elite, Escobar's political rise was regarded with increasing suspicion. The decedents of the industrialist families rejected Escobar's application to the prestigious *Club Campestre* and challenged his ambitions of having a permanent place in the city's high society (see García Marquez, cited Labrousse, 1993, p. 295). Salazar (1990) argues that this did not bother *emergentes* like Escobar too much. He finds that "if the snooty Medellín establishment wouldn't accept them as members, (while for many years turning a blind eye to their illegal activities), men like Escobar and Gonzalo Rodriguez Hacha were capable of going ahead and building their own, rival elite" (Salazar, 1990, p. 8). In the interviews conducted in Medellín, a public figure and social researcher with close ties to Medellín's establishment also confirmed this: "Pablo Escobar had great economic power, and the industrialists would not touch him as they were in business with him and they tolerated their own separation from politics. But Pablo wanted more, he wanted real power and he knew that he had to get involved in politics. This was his first big mistake, the beginning of his end. He crossed a line and suddenly became a real threat to the traditional elites" (Durán, 2014).

Escobar's political engagement in the Liberal Party, which had split into two factions in 1979 when Luis Carlos Galán founded the *Nuevo Liberalismo* (New Liberalism), further fragmented and polarized the political landscape. Escobar was expelled from *Nuevo Liberalismo* after which he founded his own political movement, *Alternativa Liberal* (Liberal Alternative). His election to congress in 1982, which coincided with the appointment of Álvaro Uribe Vélez[11] as Mayor of Medellín, was the pinnacle of Escobar's influence over a large part of the political class of *emergentes*. However, and despite his large influence, he was pressured to resign and to give up on the congressional immunity after his involvement in the massacre of Remedios in Antioquia became public (Martin, 2012). Escobar went into temporary exile to Panamá. Negotiations in May 1984 about his return and an end to Escobar's drug business in exchange

[11] Álvaro Uribe Vélez, President of Colombia from 2002-2010, is the son of Alberto Uribe Sierra (wealthy landowner, influential regional politician, and godfather of the Ochoa brothers who was kidnapped and killed by the FARC in 1983). Álvaro Uribe Vélez was director of the *Aeronáutica Civil* from 1980 to 1982 before he was appointed Mayor of Medellín in 1982. After President Belisario Betancur (1982-1986) found out about Uribe Vélez' ties with drug capital and the paramilitaries of Pablo Escobar, Uribe Vélez together with Antioquia's governor Villegas Moreno were removed only a few months after their inauguration. Uribe Vélez' political career, however, continued as Governor of Antioquia (1995-1997) and President of Colombia from 2002 until 2010. While the political figure of Uribe Vélez, alongside the numerous scandals he has been involved in, are subject to many academic contributions and don't need closer attention, we can summarise that Uribe Vélez can be seen as a political figure of the *classe emergente* with close ties to drug capital, the paramilitaries and the GEA.

for non-extradition and other demands by the *Capo*, ended without agreement. Upon failure of the negotiations Escobar commented: “Well, that means that we will have to kill every motherfucker” (Castro Caycedo, 1996, p. 280).

This statement anticipated Escobar’s confrontational war against local and national state apparatuses and the traditional elite that never accepted him as part of their own. The terror Escobar subsequently unleashed, including the bombing of one of the country’s largest newspapers, *El Espectador*, several car bomb attacks on public buildings and an airplane, the kidnapping and assassination of members of Medellín’s political and economic elites, and ultimately the assassination of presidential candidate Luis Galán, are documented in close detail elsewhere (see Bowden, 2002; Martin, 2012; Palacios, 2006; Salazar, 2012). In sum, this war turned Medellín into the most violent city worldwide, with a total number of 6,359 documented killings in 1991 alone, and increase of over 440% of homicides between 1980 and 1991.

As mentioned above, the contestation of power on all fronts was the beginning of the end for Escobar. The *clase emergente* that had been supported by and supportive of Escobar hastened to separate their political interests and economic income from the *Capo’s* violence. Traditional capitalists who had several informal business ties with Escobar also no longer tolerated his economic influence and his threat to their hegemonic role in Medellín’s society. Consequently, the political and economic elites formed a coalition in order to regain control over Medellín’s society. While both dominant elite factions had already co-financed several paramilitary groups to suppress left-wing insurgency movements, the main focus of this paramilitarized control or “corporate mercenarism” (Franco Restrepo, 2002) in the early 1990s became the killing of Pablo Escobar through the so-called *Perseguidos por Pablo Escobar* (People persecuted by Pablo Escobar, PEPES) (O’Donnell, 1998, p. 147).

The PEPES were established through linkages between paramilitary mercenaries and public armed forces. The group was led by three of Escobar’s former hitmen, Diego Murillo Bejarano alias *Don Berna*, Fidel Castaño and Carlos Castaño. The PEPES were recruited and financed by the political and economic elite factions, Colombian and U.S. state organizations, and the competing Cali Cartel to lead the fight against their former *patrón*. The PEPES proved a highly effective mechanism, achieving the persecution and assassination of Pablo Escobar. Moreover, and following the death of Escobar in 1993, this paramilitary group merged into an informal patron-client network between elite factions and the paramilitary to create ‘favourable’ institutional conditions that could stabilize Medellín’s crisis-ridden local settlement. As discussed in subsequent chapters, the *Operación Orión* in 2002 is a prime example of how the employment of structures of corporate mercenaries served as mechanisms facilitating inter-elite cooperation (see Romero and Valencia, 2007).

This paramilitarism, which from the very beginning was organized in close alliance with official Public Forces (Reyes, 1996), acted in the interests of all elite factions and of all traditionally dominant sectors in Medellín's society. In addition to its role as a support structure for an increasingly crumbling state power, paramilitarism played a key role in securing private interests, particularly in the construction and land speculation sectors, infrastructural projects, and economic activities in strategic geo-economic areas (Cubides, 2001). It operated as a decentralized entity of the state monopoly on violence to establish a compromise between the centre of economic power (GEA) and networks of political power (*clase emergente*). Franco Restrepo (2005, pp. 357–358) summarises, "despite being composed of emerging sectors, the military and social strengthening of these illegal power structures, it did not question the establishment". Rather, the mercenaries contributed to the restitution of hegemonic power of the "useful society, the society of owners", and the revival of dominance by the "forces of good" (Franco Restrepo, 2005, p. 358).

However, the competition over economic and political sources of power between the GEA and the *emergentes* remained an inherent feature throughout the 1990s, posing a threat to the stability of Medellín's political settlement. While the paramilitary forces continued to play a central role in maintaining relatively stable power relations in Medellín and the entire region (see Romero and Valencia, 2007), the gradual separation between the economic and political sectors of Medellín's society is an important aspect of the development of Medellín's political settlement until today.

5.5 Conclusions

This chapter has provided a detailed historical analysis of the development of the distribution of power, governance and coordination capacities of the state, and entrepreneurial and technological capabilities of the industrial elites. The discussion of these factors is crucial to a full understanding of the evolution of Medellín's political settlements. We discussed how economic transformations and shifts towards the development of higher productivity industrial sectors can be explained by analysing the interdependencies between power and institutions. The chapter argued that governance capabilities and broader political factors linked to the distribution of power in Medellín and Colombia were compatible with institutional mechanisms that created and enforced rent structures to facilitate growth in light manufacturing industries. We also argued that the same power structures, through which industrialists with low technological capabilities gained large organizational control, became incompatible with strategies for advanced and late industrialization.

The failure of Medellín's economy to 'grow up', first signs of deindustrialization, and an increasing fragmentation of organizational power following the end of the *Frente Nacional* challenged the sustainability of Medellín's growth-stability trade-off, as economic and political viability decreased. While the formation of the GEA and decentralization reforms were institutional attempts of stabilizing the political settlement, the success of these formal and informal institutions was limited. Decentralization reforms actually increased organizational fragmentation and decreased state capabilities for rent creation and the enforcement of growth-enhancing policies. Hence, and despite the economic strength of the GEA, the dominance of this elite faction in Medellín's political settlement was challenged by outsiders of the elite bargain. An urbanization of insurgency, and the rise of the political *clase emergente* and Pablo Escobar's Medellín Cartel brought great instability to Medellín's settlement.

While the paramilitarization of social control could bring partial stability to Medellín's political settlement, the ongoing separation between political and economic elites remains an important feature of power structures in Medellín. This historical analysis of the evolution of elite factions, power structures, and institutional strategies is useful to understand more recent developments. As Leyva (2014, p. 133) rightly concludes, "[t]he rupture that emerged between the political and the economic classes has fundamental implications for thinking about current urban politics in Medellín".

CHAPTER SIX: MEDELLÍN'S POLITICAL SETTLEMENT IN A DECENTRALIZED AND TRANSNATIONALIZED CONTEXT: DECONSTRUCTING THE TALE OF THE "URBAN MIRACLE"

The increasing incompatibility of power constellations in Colombia's political settlement with institutional mechanisms for advanced industrial growth resulted in a relative failure of the state-led development model. This impeded economic growing up to higher levels of technology-driven productivity growth and ultimately led to a variety of political and economic crises in the 1980s. Following these crises, Colombia experienced several changes in its economic and institutional structures. Besides the discussed policies of political, administrative, and fiscal decentralization of government, this also included economic and financial liberalization, market deregulation, and privatization reforms.

Distinct from most contributions to the literature on Medellín's recent institutional, economic and political changes, the analysis put forward in this chapter is embedded in a discussion of how political decentralization and economic liberalization affected the different political and economic factors of the political settlements framework. Using an analysis of Colombia's radical shift to neoliberalism and its return to static comparative advantages in low productivity activities as entry point, we argue that much of Medellín's transformation can be understood and explained by exploring the wider effects of state restructuring on regional power structures, governance capacities of the local state, institutional mechanisms for productive rent creation, and the technological capabilities and interests of local firms and sectors.

The first section of this chapter argues that the Colombian Constitution of 1991 and comprehensive policy changes in the form of liberalization, deregulation and privatization ultimately led to Colombia's return to a static comparative advantage in low productivity sectors. This can be linked to the relatively low technological capabilities of Colombia's firms prior to the liberalization reforms and the increasing specialization on sectoral development in services, agriculture and extractive industries after the 1980s. Furthermore, the state reforms substantially affected the distribution of power. Following the neoliberal logic of limiting market distortions, the state was increasingly rolled back by minimizing discretionary and interventionist powers. At the same time, neoliberal policies and rent opportunities through privatization reforms substantially increased the power of decentralized private actors and local organized business groups. In the course of the 1990s local elites developed capacities as transnational capitalist elites, who are interested in advancing global capitalist processes rather than in the development of domestic markets.

Section 6.2 analyses how these developments changed the character of Medellín's political settlement. We show how the empowered capitalist elite in the form of the GEA transnationalized their assets and started to develop capacities as political actors. By adopting an anti-corruption and political 'good governance' discourse, Medellín's transnational capitalists questioned the political legitimacy and the role of the *clase emergente* by challenging the strategies with which they managed the rents created through the public utility provider EPM. The dispute between the elite factions developed largely over the understanding of EPM's role: while the political elite of *emergentes*, led by Mayor Luis Pérez Gutiérrez, used resources to stimulate local economic and social development, the transnational capitalist elites around the GEA wanted to use EPM as an institutional mechanism and driver for economic transnationalization.

Section 6.3 discusses the particular governance agenda and institutional strategies that followed the election of Mayor Sergio Fajardo in 2003. The section engages in a detailed analysis of how the GEA, which had a powerful position in the Fajardo coalition, substantially increased its organizational powers to influence institutional strategies and local economic policies. Using qualitative evidence, this section explores the 'Medellín Model of Good Governance' and argues that the GEA used this particular political discourse not only to increase its organizational power in the local political settlement, but also to advance Medellín's integration into global capitalist structures. The particular changes in Medellín's political settlement as well as the way in which the capitalist elite transnationalized their assets and developed political capacities can thus explain recent developmental outcomes. The section also engages in an analysis of the effects of implemented rent-management strategies in general, and in particular the implications of changes in the management of rents created through EPM. Section 6.4 summarizes our findings on Medellín's developments and concludes that the city by no means experienced a miracle.

6.1 The 1991 Constitution as institutional underpinning for change: the implications of Colombia's neoliberal shift on state capacity and governance in Medellín

As discussed in chapter five, decentralization reforms had several important implications for the distribution of power, institutions, and governance capabilities of the local state. Political, administrative and fiscal decentralization policies of the 1980s substantially strengthened the role of municipal Mayors, particularly of medium and large cities. The increase in coordination capabilities of local government, however, coincided with an overall decrease of discretionary and interventionist state capacity, as vertical and horizontal fragmentations of organizational structures decreased the likelihood of achieving a growth-enhancing rent management. In this sense, it is crucial to analyse the impacts of Colombia’s economic liberalization processes on Medellín’s political settlement.

While the liberalization reforms central to our analysis were largely implemented between 1990 and 1991, the origins of Colombia’s economic and financial liberalization were in the 1980s. The decrease of internal demand caused by the crises of Colombia’s inward-oriented developmental model, and the decline in foreign demand caused by the massive debt crises of many Latin American countries in the early 1980s had detrimental effects on Colombia’s current account. The large increase in deficit forced the Betancur government (1982-1986) to ask the IMF for a loan. The conditionalities of the IMF agreement included a devaluation of the Colombian Peso (COP) to incentivize private loans from domestic and international banks. This, however, did little to revive growth rates. Ultimately, Colombia “started a process of structural adjustment, which did not only include an orthodox macroeconomic programme, overlooked by the IMF, but also an interference of the World Bank, particularly in sectoral politics” (Ocampo, 1986, p. 230). This interference of the World Bank in form of several adjustment and restructuring projects included loan payments of over 2.7 billion US Dollar between 1985 and 1991 (World Bank, 2016). Consequently, this led to the reversal of many of Colombia’s protectionist measures (López Restrepo, 1995).

The main policy reforms that fundamentally restructured Colombia’s economy were implemented after the election of President César Gaviria in 1990. With the introduction of the *programa de modernización de la economía colombiana* (Colombian economic modernization programme) Gaviria diminished the average tariffs (Documento Conpes 2465 of 1990, see Garay, 1998). This first tariff reform, which for many observers was Colombia’s first step towards a globalized economy (see Dinero, 2013), was followed by an extensive trade reform implemented in December 1990 with Decree 3095, reducing the average tariff from 16.5% in 1991 to 7% in 1994 (López Restrepo, 1995). Complete economic and financial liberalization was implemented with the ratification of the 1991 Colombian Constitution (Ocampo, 2007). Better known today as *apertura* (opening), this entailed a sweeping privatization of public assets and services, extensive deregulation of state control over productive sectors, the introduction of a new foreign investment regime, and the flexibilization of labour markets (Garay, 1998).

The reforms meant a radical transformation of macroeconomic and fiscal policy framework. The Central Bank became independent, the Colombian Peso was further devaluated, and a contractionary fiscal policy regime was introduced to limit government borrowing (Garay, 1998). The *apertura* was thus implemented along the lines of the orthodox and neoliberal reform package of the Washington Consensus (see Williamson, 1990a) and can be seen as part of a tendency to adopt structural adjustment policies that aimed at a redirection of political and economic processes and at a restructuring of the institutional and legal framework of Colombia. The idea behind the restructuring efforts was to minimize the role of the state and its capacity to intervene in economic policy in order to secure and guarantee free market competition (see Constitución Política de Colombia, 1991, articles 333 and 334). The state reduced its role from being a direct employer, service provider, and landlord to become an entity for minimalist regulation.

Colombia's fairly radical liberalization shock had several direct consequences on the country's productive structure and economic development. The relatively low technological capabilities of Colombia's economic sectors prior to the economic liberalization and the specialization on service sector development and on extractive and resource-processing industries after the implementation of the *apertura* reforms led to Colombia's return to static comparative advantages in low productivity activities. While additional resources were freed up through the tariff reduction and the liberalization of Colombia's capital account, the availability of cheaper capital goods through increased import competition led to hardly any increases in productivity growth. Instead, the (premature) integration into global capitalist structures and exposure to increased competition resulted in a decrease of manufacturing in all of the main industrial sectors in the Colombian economy (see Cimoli and Katz, 2004).

Colombia's radical shift to neoliberalism also entailed the strengthening of particular business groups with traditionally large bargaining powers. While the *apertura* diminished possibilities of state rent creation by cutting off many of the capitalist rent recipients from access to traditional sources of rent (i.e. through subsidized credits), the liberalization reforms also created new rent opportunities (i.e. through privatization and deregulation of specific sectors). The *apertura* thus created room for business groups and firms to gain privileged and guaranteed access to a variety of sources of rent creation, making capitalists with large organizational power "the most consistent beneficiaries of some of the reforms' central programs, especially privatization" (Rettberg, 2005, p. 33). While these capitalists in Colombia are linked to traditional capital and have developed their powerful position since before the ISI period, they consolidated their *current* leading market positions after the liberalization reforms (see Fernández Jilberto and Hogenboom, 2004, p. 154). Consequently, pro-liberalization coalitions, in which the dominant capitalist groups had a powerful position, used the *apertura* to become the local faction of the transnational capitalist elite (see Reyes, 2003; Robinson, 2010). Fernández Jilberto and Hogenboom (2004) and Rettberg (2005) argue that this transnationalization mainly happened through mergers between foreign and domestic capital, acquisitions of and by Colombian companies, and generally the linking of foreign investors to local capitalist producers through a massive penetration of FDI in the 1990s.

The transnationalization of Colombia's capitalist elite is marked by a restructuring of their business interests in accordance with the neoliberal logic of comparative advantage. Colombia's transnationalized capitalist business groups, such as the Bogotá-based *Organización Ardilla Lulle*, *Grupo Santo Domingo*, and *Grupo Luis Carlos Sarmiento Angulo* and the Medellín-based *GEA*, have thus focused on the development of capacities in sectors where Colombia has comparative and competitive advantages, such as extractive industries, agriculture and low-wage services. The interests of these business groups hence reside in the development of the global capitalist system in which they participate and extract most of their incomes from. The focus of this elite on low-skilled activities makes Colombia an attractive destination for low productivity FDI. In turn, this presents limited opportunities for spillovers through technology transfers, curtailing the development of high technology sectors and ultimately perpetuating Colombia's position at the lower end of the global value chain.

Besides the implications on elite interests, the *apertura* reforms also affected other factors that are crucial to the analysis of the evolvement of the local political settlement. Most importantly, the *apertura* reforms changed state capabilities to implement and enforce economic policies as they intensified the "hollowing out" of the Colombian nation state. Hence, and following the same logic of decreasing state capacities applied during the decentralization reforms, economic liberalization policies were promoted to reduce sources of market failures that were seen to be part of the legacy of the interventionist state. Weakening state powers and allowing (decentralized) private agents to take control of the productive and social coordination of the economy were seen as solutions to economic stagnation. Colombia thus subscribed to the neoliberal axiom that a minimized state has positive effects on private investments and can make public spending more effective and efficient (see World Bank, 1997).

This resonates with the argument put forward by Angell et al. (2001, pp. 5–6), that decentralization may stimulate local productive activity in Colombia as it increases interurban competition that can incentivize local entrepreneurs to invest in higher technology sectors and create employment. However, and as pointed out in chapter four, in the context of Colombia's decentralized institutional structure, which became highly fragmented and organizationally weakened following the political impasse that led to the end of the *Frente Nacional*, liberalization reforms further challenged the state's organizational capacity and economic viability to create and effectively enforce growth-enhancing institutions. Strict regulation on public expenditure implemented with the *apertura* reforms pressured urban governments to enforce fiscal austerity measures, which often intensified power imbalances as they weakened rent management capacities of local states and increased the power of decentralized capitalist groups even further. This did not lead to an intensified competition between different elite factions, but rather to an increase in organizational power of decentralized business groups with little interests in the development of high-productivity sectors.

The implications of Colombia's shift to neoliberalism need to be included in an analysis of power, institutions and local governance capabilities in Medellín. Franco Restrepo (2005, p. 130) argues that in Medellín the state reforms were part of an institutional project to overcome the political and economic impasse on the local level, "in other words, to limit the state's role as a guarantor of public interest, at a time when it was questioned". The author analyses the 1991 Constitution to argue that besides the neoliberalization of local economies, the constitutional reforms affected state capacities through the implementation of a wide range of "democratization" measures. These included increased opportunities for popular participation and political pluralization reforms, which formally put an end to the traditional two-party system (see Barreto and Sarmiento, 1997). Franco Restrepo (2005, p. 130) concludes that the constitutional processes upset the institutional arrangements of municipal political and economic systems. In Medellín, this altered existing elite bargains, as it increased competition between the *clase emergente* and the GEA over access to new sources of rent creation and intensified the vertical and organizational fragmentation of the local power structures.

Besides impacting Medellín's power structure, the economic liberalization and political decentralization reforms also had important implications for coordination and governance capabilities – particularly in the context of the transnationalization of the local capitalist elites. While the protected and largely closed economy of Colombia had guaranteed a relative stable elite bargain between dominant groups, the neoliberal shift challenged traditional forms of rent management and hence altered the rules of the game for possible creation and enforcement of growth-enhancing policies. Hence, the increased power of local organized businesses and private actors, the decreased power of the decentralized state, and transition costs through increased bargaining between local and national actors can slow down attempts to create and enforce growth-enhancing institutional strategies.

In turn, local investors and newcomers are deterred from investing in "discovering-by-doing" strategies for higher-valued comparative advantages, also due to a decrease in governance capabilities of the local state to ensure high levels of efforts in learning. Furthermore, and following the insertion into the lower end of global value chains, MNEs will most likely decide to invest in sectors marked by low productivity and low-skilled labour, which are perceived to be part of Medellín's comparative advantage. With the discussed distribution of power in Medellín's society, the rolled-back state has limited coordination and governance capabilities for effective selection and coordination of FDI with advanced technology. The urban government has thus become more vulnerable to the locational decisions of foreign companies to bring in high technology industries. The lack of capabilities to invoke domestic content from foreign investors can have detrimental effects on productivity growth and development, which may well outweigh potentially positive incentivizing effects of decentralization and increased interurban competition.

However, in addition to the changed dynamic within the *local* political settlement in Medellín following the *apertura* reforms, other factors *external* to Medellín's political settlement played an important role in shaping elite interests and power constellations. Besides the discussed impacts of external factors, such as the increased influence of other regional business elites, the *apertura* reforms themselves play a crucial role as "exogenous" factors influencing Medellín's political settlement. Trade and financial liberalization and changes to the loaning structure of national development finance (see below) substantially affected the dynamic of the national political settlement in Colombia. Landed business elites and conglomerates with assets in tertiary sectors became the primary ally of governance agencies and state bureaucrats.

These changes greatly influenced elite interests in Medellín's political settlement. Thus, changes within Medellín's local political settlement can not only be explained by looking at the the balances of power of competing elite faction within a local political settlement as drivers for developmental change, but also at external factors. National policy switches through the *apertura* reforms contributed to the changing elite interests, organizational capacities, and power balances at the city level. In our specific case, Rodrik's (2014) theoretical arguments regarding elite interests and ideas as drivers of political and economic results are fitting and add additional value to the standard political settlement considerations.

In sum, and particularly in a politically decentralized and economically liberalized context where a) state capabilities are limited and political power structures fragmented, b) regional capitalist elites with low technological capabilities have strengthened their economic powers benefitting from deregulation and privatization reforms, and c) the local economy has returned to static comparative advantages in low productivity sectors, formal and informal efforts to create and enforce institutions are less likely to achieve positive productivity growth outcomes. While section 6.3 engages in a political economy discussion on what this 'new urban neoliberalism' means in terms of policy, institutions, and development, we can summarize that Colombian cities have transformed to become spaces of economic and institutional restructuring to facilitate market-enhancing growth in accordance with the country's return to static comparative advantages in low productivity and low technology sectors. This has substantially changed the rules of the game and radically affected elite bargains. The next section discusses the development of the elite structure in Medellín's decentralized and neoliberalized political settlement and their compatibility with a particular set of institutional strategies.

6.2 The changing structures of political settlements in Medellín: mapping shifts in power, elite interests, and institutional strategies

The main variable of the political settlements approach that helps to understand institutional effectiveness and resulting developmental outcomes is the distribution of power in a particular society. In the context of Colombia's liberalized economy and decentralized polity, we need to reassess the changes in power structure of Medellín's political settlement. The mechanisms of rent creation, which had secured the holding and organizational powers of the industrial elite and facilitated institutional strategies for Medellín's industrialization, had disappeared. The initial responses to these changes with regard to elite structures, and the division between the capitalist faction of the GEA and the political *clase emergente*, have already been discussed in the preceding chapter.

This section is concerned with the evolvement of this fragmentation in the changed neoliberal decentralized context. It will analyse formal and informal institutional mechanisms adopted by both elite factions to gain organizational powers and to secure access to rent management mechanisms. We discuss the distributional functions of these institutions for maintaining or reshaping the distribution of power, as well as their efficiency impacts.

The first part of the section analyses the restructuring of the GEA with a particular focus on the transnationalization of their assets. We discuss how the transnationalization of Medellín's capitalists implied a shift in elite interests. Drawing on several interviews with GEA executives, we show how the GEA accepted and promoted Colombia's return to comparative advantages at the low productivity end of the value chain by focusing on the development of entrepreneurial capabilities in low technological sectors. The section also analyses how the transnationalization of Medellín's capitalist elite helped this elite faction to regain hegemonic power in the city's decentralized and neoliberalized environment.

The second part of the section analyses the role of Medellín's public utility provider EPM and its rent management capacities in the changed institutional setting. The section argues that while EPM was a formal mechanism which could stabilize the elite bargain in Medellín until the late 1990s, it was also the main reason for renewed tensions between elite factions. The section concludes with the analysis of how the rise of particular actors within the political elites had severe repercussions on the capitalist elites' access to sources and instruments of rent creation.

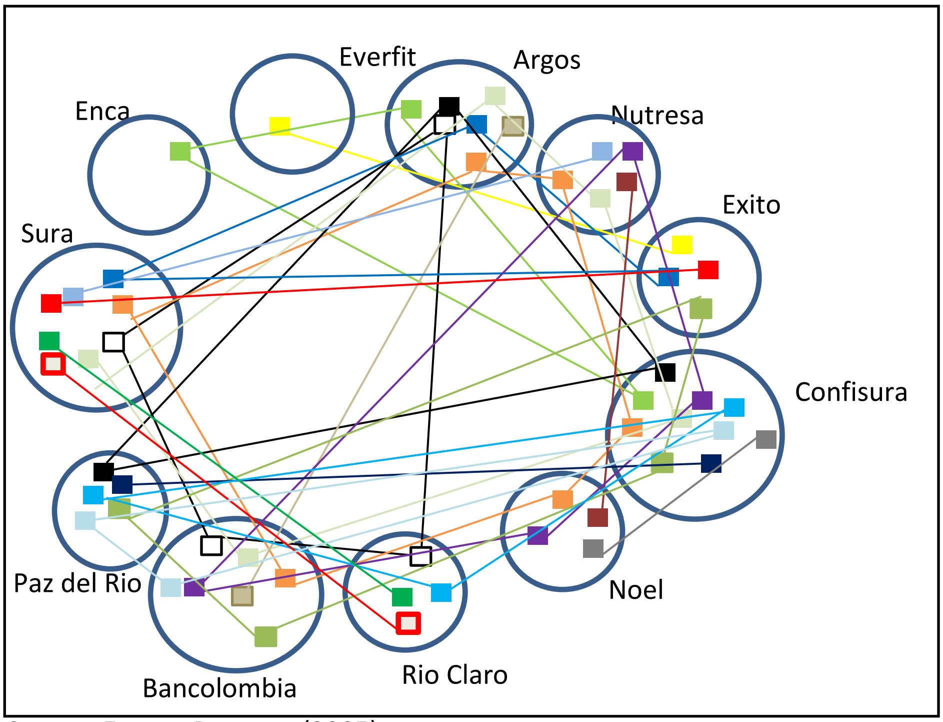
6.2.1 The transnationalization of the GEA

The pressures to integrate Medellín into global capitalist markets did not only impact the discretionary control of the state, but also affected accumulation strategies and entrepreneurial and technological capabilities of the regional capitalist elite. While the creation of the GEA had already implied a shift of elite interests to services and sectors marked by low productivity and low wages, this was a largely defensive strategy to secure the traditional elites' economic power that was threatened by Bogotá's elite as well as the rising *emergentes*. However, with the *apertura* reforms and the gradual disappearance of industrial state-created rents, the GEA used the neoliberal turn of Colombia to deepen capital concentration in its core sectors of finance, services, construction, and food processing. Hence, and in spite of the economic downturn of the late 1990s, the maturity of the domestic markets in some of the GEA's key sectors and the limitation of returns to investments through the high price elasticity in income and demand for some of the GEA's products, the *grupo* was able to benefit largely from liberalization reforms (see Fernández Riva, 1995; Rettberg, 2001a).

The scaling back of horizontal diversification, a focus on financial concentration in services, finance, and construction, and an orientation towards international markets were important strategies for the GEA to face the challenges of economic and financial liberalization and to gain global competitiveness in their core sectors. In interviews with several CEOs of GEA companies, it was repeatedly stressed that in order to be competitive in the global markets the GEA needed to concentrate on economic activities in sectors where Medellín has comparative advantages over other cities with similar factor endowments. A leading figure of the GEA confirmed that "with the *apertura* all of the companies started to have different problems… than in the closed economy of the 1970s. Foreign investors were interested in the GEA… so we needed to specialize to be more efficient and resilient… The *grupo* understood that the world had changed and that it needed to concentrate on three businesses, which were *Sura* in insurance and banking… *Nutresa* for food processing and for cement it was *Argos*" (Sierra, 2014). As another business leader of the GEA confirmed, "in a globalized economy, for a *grupo* like ours, diversification means dispersion… This is why we have chosen to reduce the number of sectors in which we operate… We want to disinvest in textiles, steel, reforestation, wood" (cited Betancur et al., 2001, p. 140). David Emilio Bojanini, CEO of *Sura* also emphasized that the *grupo* in the liberalized context "needed to focus and disinvest in traditional businesses to be able to invest in finance, cement, and light manufacturing because we knew we had to go out and compete not only in Colombia but also outside" (Bojanini, 2014). In particular, the *grupo* concentrated on financial activities, as they "do not require high levels of capital investment but generate capital gains" (Sierra, 2014).

Figure 6.1 shows well how this strategy of disinvestment and financial concentration in the core businesses changed the organizational structure of the GEA compared to its original format organization (see figure 5.3). The core companies *Argos*, *Nutresa* and *Sura* thus have most representatives in other strategic GEA businesses. The weight of financial intermediation in the form of banking and insurance through *Sura's* subsidiaries *Bancolombia* and *Confisura* is particularly noteworthy. The cross-shareholding structure has remained, which secures the continuation of distribution of rents and benefits through intra-organizational synergies. This has reduced transaction costs, as it vertically and horizontally integrated firms in key sectors of Medellín's economy, making the realization of input spillovers more likely through potential cooperation in research and development strategies. Through this new organizational structure, the GEA has furthermore gained control over larger parts of the supply chain, stabilizing demand for the *grupo's* key goods and services. Additionally, the maturity of capital assets held by the GEA firms (particularly in relation to other Colombian conglomerates) made the *grupo* sufficiently resilient against potential threats of hostile takeover following increased competition in a liberalized market.

FIGURE 6.1: BOARDS OF DIRECTORS OF THE GEA, 2000



SOURCE: FRANCO RESTREPO (2005), OWN ELABORATION

Concentration on these three main businesses after the liberalization reforms did not only involve disinvestment and financial deepening strategies, but implied an outward orientation towards other Latin American markets. The CEO of *Argos* confirmed this to the author, stating that "we had to diversify geographically and each company should concentrate on a single sector… With this strategy we gained increased capacity to indebt our companies and to go out and look for opportunities outside of Colombia" (Vélez, 2014). This increased capacity to raise external funding stems from a change in the organization of the GEA in Colombia's financially liberalized economy. Holding companies[12] were formed in order to secure access to new financial resources through increased participation in international credit markets. The integration of the GEA into global financial markets through these holding companies increased its capacity to debt finance, and shows the GEA's transformation strategy from domestic and industrial capital to a transnational group with major assets in finance and services.

In interviews with the CEOs of the GEA, this 'reinvention' was stressed repeatedly. The CEO of Argos "believe(s) that Medellín does not have its vocation in big industry, but rather in light industries and services" (Vélez, 2014). A leader of *ProAntioquia* confirmed that, "Medellín and Antioquia are in a process of transformation that is led by global dynamics. And the big companies (of Medellín) are in the process of reformation towards services…to search for comparative advantages… We have always defended the fact that globalization, the search for comparative advantages, has implied the reinvention of companies" (Tobón, 2014). The former head of the GEA, Ricardo Sierra stated that *Sura*, *Argos* and *Nutresa* play a central role in Medellín's economic reinvention in a globalized market: "The three companies redefine their businesses within (the context of) globalization; and with globalization they needed to become *Multilatinas*" (Sierra, 2014). The transition towards this transnational capitalist elite is noticeable in the increased amount of foreign investors in core GEA sectors, particularly in finance and low-cost services. However, the GEA has also integrated its holdings and

[12] For example, the largest GEA holding company *Suramericana de Inversiones S.A* emerged from the split of *Suramericana de Seguros S.A*. The company was also founded in order to have full control over the construction investor *Compañía Suramericana de Construcciones S.A*., the insurance and investment company *Administradora Suramericana de Inversiones S.A*., the insurer *Servicio de Reparación Integral Automotriz Ltda,* the investment and capitalization firms *Compañía Suramericana de Capitalización S.A., Suleasing Panamá S.A., Corporación Financiera Nacional and Suramericana S.A., Suleasing*, the pension funds *Administradora de Fondos de Pensiones* and *Cesantías Protección S.A,* the insurers *Compañía de Investigaciones Económicas Prospección S.A., Compañía Suramericana de Seguros de Vida S.A.*, inter alia. *Nutresa* and *Argos* followed similar financialization strategies of their asset portfolios.

operations into the dynamics of global capitalism. All companies have subsidiaries in several Latin American countries and beyond[13].

Thus, unlike in the ISI phase of relatively closed domestic markets, the GEA currently has less interest in developing the productive domestic market than in engaging in activities that promote the advancement of the financialized global capitalist system in which they participate. Globalized financial circuits have dictated the strategy of the GEA since the *apertura* reforms, making activities linked to sectors such as finance, real estate, and construction the primary sources of profit. As the head of the GEA proudly declared in the interview: "Today, *Bancolombia* is the number one bank in Colombia, the *Sura* is the number one in insurance and asset management of pension in all of Latin America, *Argos* is the number one producer of cement in Colombia and number two in Latin America, *Nutresa* is the number one in Colombia when it comes to food processing" (Bojanini, 2014).

In an interview with the author, Gabriel Piraquive, director of economic research at the *Departamento Nacional de Planeación* (National Planning Department, DNP) sums up this trend rather well: "the traditional Antioquian economic elite changed from an industrial class to a financial capitalist elite… with interests in the insurance sector and finances… to engage in global capital accumulation" (Piraquive, 2014). Thus, liberalization of trade and finance was the underpinning for this elite faction to expand their stock capital. This made Medellín's capitalist elite more resilient after the *apertura* reforms, and differentiates it at least to some extent from other top business groups in Latin America (see Ross Schneider and Doner, 2010).

These changes in elite interest had important implications for firm-level entrepreneurial and technological capabilities. Hence, with capital concentration in low technology services and speculative sectors, GEA companies are focusing on creating competitive advantages in sectors that are marked by low productivity and low-skilled labour. The shift to sectors that have low returns to scale is likely to result in an unwillingness of private investors to invest in efforts in tacit learning of technologically advanced activities. Furthermore, entrepreneurs are discouraged to dedicate time and financial resources to the discovering of new comparative advantages in medium or high productivity sectors.

While we can conclude that the GEA was, for the most part, able to benefit from integrating its activities into transnational financial markets, the remainder of this chapter and chapter seven

[13] Besides Colombia, *Sura* operates in Chile, Mexico, Peru, Uruguay, Panama, The Dominican Republic and El Salvador; *Nutresa* has international subsidiaries in Chile, Mexico, Nicaragua, Venezuela, Guatemala, Ecuador, Peru, Costa Rica, Panama, El Salvador, Malaysia and the United States. Outside of Colombia *Argos* owns cement factories or has market participation in Panama, Haiti, Honduras, The Dominican Republic and the United States (Vélez, 2014).

discuss the impact of these processes for Medellín's ability to achieve sustainable levels of economic and political viability.

6.2.2 INSTITUTIONAL STRATEGIES AND THE ROLE OF EPM

After the *apertura* reforms and during the political aftermath of decentralization, the elite factions of Medellín were on a way towards achieving a stable elite bargain. While the killing of Pablo Escobar in 1993 and the paramilitarization of governance structures played an important role in this process, other formal and informal institutional mechanisms of rent management also helped in (re-)establishing a stable relationship between the political *clase emergente* and the capitalist elites of the GEA (see Franco Restrepo, 2005, p. 285). This put the local political settlement temporarily back onto a stable growth-stability trade-off curve. However, and due to Colombia's economic crisis of 1998/99 and the discussed transnationalization of the capitalist elite, the rift between the factions became more noticeable by the turn of the millennium, as economic stagnation and political instability began to affect Medellín's settlement once again.

In the preceding chapter we identified the *clase emergente* as a non-traditional elite that obtained much of its income from drug trafficking, real estate development, and landed activities, which made them powerful political and economic agents (see Ambos, 1994, p. 30). Through financing political campaigns and paramilitary activities to fend-off insurgency movements, these "cocaine capitalists" increased their political strength in the 1980s and 1990s (Meschkat et al., 1983; Schulte-Bockholt, 2006). Many senators, governors and mayors that held office in that time have been directly linked with narco capitalists (see Semana, 1994, 1989). After the killing of Pablo Escobar, paramilitarization of governance structures through the PEPES and subsequently through the *Autodefensas Unidas de Colombia* (The United Self-Defence Forces of Colombia, AUC) became an important informal mafia-like institution keeping the settlement relatively stable. While both elite factions continue to have ties with paramilitary groups (see Durán Núñez and Molano Jimeno, 2015 for the case of Argos), it was mainly the second generation of political leaders from the *clase emergente* that formalized the privatization of security (Schulte-Bockholt, 2006).

In order to understand Medellín's return to a relative stable and sustainable growth-stability trade-off during the 1990s, we need to analyse other institutional mechanisms in the city's decentralized and liberalized settlement. As discussed before, under the ISI model Medellín's leading economic companies depended heavily on state-created rents through subsidized credits, contracts, and regulations. During the ISI process Medellín's industrial elite had depended on tangible and intangible state resources and had great incentives to form a close relationship with government and to capture the state apparatus. With market reforms and the fragmentation of elite interests this dependence did not disappear, but changed.

Schamis (2002, 1999) as well as Rettberg (2001b) find that Colombia's transition towards neoliberalism did not entail the immediate disappearance of state-created elite-accessed rent mechanisms. Even though the elimination of import licences and the independence of the central bank limited access to rents (see Revéiz, 1997), the entire conglomerate and particularly GEA's financial institutions *Bancolombia*, *Conavi* and *Confisura*, continued to receive financial subsidies from IFInd[14] (Rettberg, 2001b). These national policy changes to the loan structure of development finance again demonstrate that within the context of a decentralized political settlement discussion, we need to include the analysis of external factors influencing local level political settlement dynamics. The partial privatization and the decreased possibility for elite factions to access state-created rent substantially impacted economic interests, the organizational capacities, as well as the political understanding of the business elite in Medellín.

The interdependencies between the rolled-back (local) state and the GEA created a relationship of mutual constraints. The GEA benefited from guaranteed access to state-created rents, such as the privatization of public assets and contracts. The local as well as the national governments, in turn, depended on the accumulated experiences of the GEA and their "superior endowments of managerial and capital resources… (The *grupo*) became the state's natural partner in the privatization process, consolidating the state's role as a source of contracts and licenses" (Rettberg, 2001b, p. 56). Schamis (1999, p. 238) concludes, that this compromise between the elite factions helped to secure that "the influence of winners and their capacity for collective action… set off that of the losers".

The decentralization, deregulation and partial privatization of social service provision through Law 100 of 1993 is only one example of how the GEA was guaranteed advantages. Following this law, the GEA entered the sector of social security with the creation of insurance and social security companies *Susalud*, *Suratep*, and *Protección* as part of the increased presence of private capital in that sector. The introduction of Law 50 of 1990 that flexibilized local-level labour market regimes led to a decrease in the cost of labour, thereby facilitating capital accumulation for the GEA through cheap wage activities. Furthermore, the local state shifted coordinating and controlling capacities to decentralized private actors of the GEA. So-called

[14] As discussed in chapter five, the IFInd was a financial institution to promote Colombia's ISI process (see Garay, 1998). Despite that IFInd divested public equity holdings and was privatized following a US$ 450 million World Bank "divestiture privatization program" between 1992 and 1997, it continued to provide credit as a market-oriented financial intermediary until the early 2000s (World Bank, 2016).

family compensation funds that provide small credits and micro-subsidies, but also health, education, and recreation services were privatized and are now controlled by the GEA affiliates COMFAMA and COMFENALCO.

Decentralization, deregulation and privatization reforms hence created new sources of rent for both elite factions. On the one hand, the *clase emergente* could extract rents and distribute political patronage through decentralized tax-collection capacities and through budgetary transfers from the national level. On the other hand, the GEA was the natural partner of central and local governments in efforts to privatize public assets and deregulate state control over production (for example through the creation of *zonas francas* east of Medellín).

Medellín's public utility provider EPM was another important player that could stabilize the settlement politically and advance it economically in the context of the changed environment of elite rent management following liberalization and decentralization reforms. With Luis Alfredo Ramos (1992-94), Sergio Gabriel Naranjo Pérez (1994-96) and Luis Pérez Gutiérrez (2000-2003) as Mayors and Álvaro Uribe Vélez (1995-97) and Alberto Builes Ortega (1998-2000) as Governors, the *emergentes* gained considerable organizational power during the 1990s. Initially, after the neoliberal shift of Colombia's economy there were disputes between the *emergentes* and the capitalists of the GEA over the role of public services. The different elite factions debated whether rents generated by EPM "were to be understood, operated, and owned publically or privately" (López, 2003, p. 53).

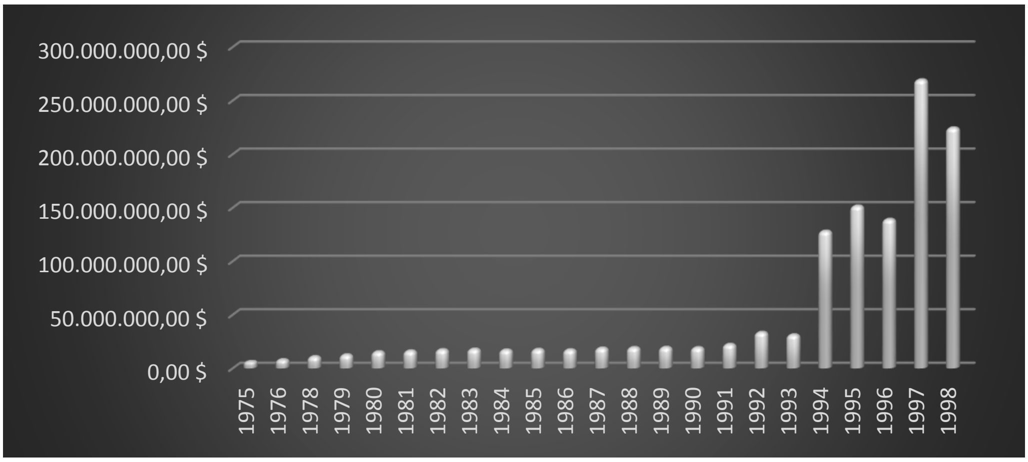
Following Law 142 of 1994 EPM became a for-profit organization to increase budgetary transfers to Medellín's political leadership under the Mayor Alfredo Ramos. Subsequently, Law 489 of 1998 converted EPM from an *Empresa de Servicios Públicos* (Public Utilities Company, ESP) to an *Empresa Industrial y Comercial del Estado* (Public Industrial and Commercial Company, EICE), which entailed a definite rupture of EPM's role as a public utility provider. While ownership of the company remains fully public, EPM is now governed by private as opposed to public law (known as *privatismo organizacional*, see Varela Barrios, 2011, 2010 for a detailed discussion). This duality can be seen as a compromise between the contesting elite factions. On the one hand, the GEA could push through a continuation of EPM's role as a for-profit public entity, while the political power of the *emergentes,* on the other hand, secured increased representation on EPM's governing board (Botero and Villegas, 2005; López, 2005).

Hence, the dual public-private character of EPM enhanced its role as an institutional mechanism for maintaining a relatively stable elite bargain throughout the 1990s. EPM continued to transfer 30% of its dividends to the municipal budget, making the company an important mechanism for additional rent creation. The capacity of the local, state-controlled

EPM to access the international credit market and debt finance its operations furthermore provided opportunities for public administrations to circumvent constitutional limitations on debt finance for municipalities (see Cabrera and Naranjo, 2003). This control of the local state and thus EPM through the political class of the *emergentes* provided large benefits for that elite faction.

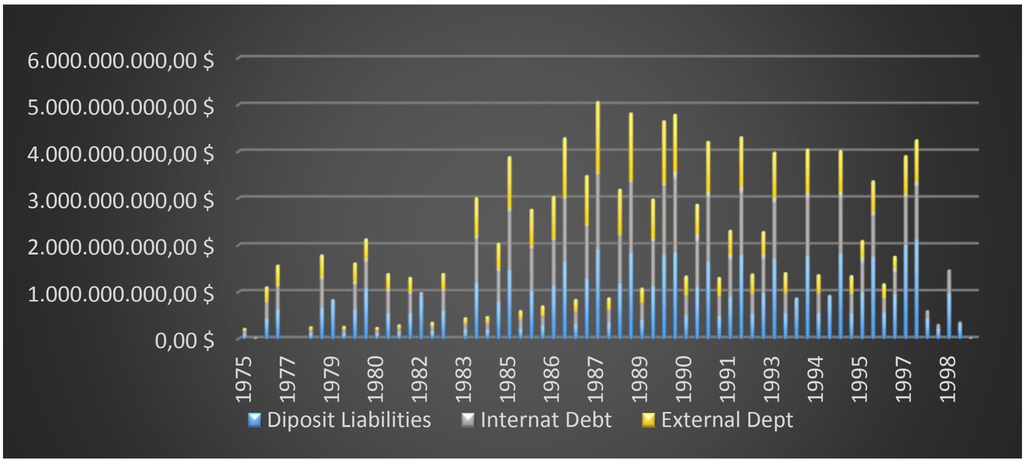
While the access to state-created rents through EPM had always been attractive for local elite factions, the control of EPM became increasingly attractive following dramatic increases of the company's budget subsequent to the discussed reform changes. Furthermore, and particularly with the increased profits, EPM became an important source of state contracting for infrastructural projects. These institutional capacities have made EPM a central mechanism for rent creation and distribution, particularly due to EPM's function as a channel to obtain debt financing. Figures 6.2 and 6.3 show how the increase in internal and external debt of EPM in the 1990s corresponded to a drastic increase in transfers to the public budget.

FIGURE 6.2: TRANSFERS FROM EPM TO THE MUNICIPAL BUDGET IN CURRENT COP



SOURCES: BONILLA ET AL. (2013); BONILLA AND AMADO (2013); CARRANZA AND BONILLA (2013)

FIGURE 6.3: ACCUMULATED DEBT OF EPM IN CURRENT COP



SOURCES: BONILLA ET AL. (2013); BONILLA AND AMADO (2013); CARRANZA AND BONILLA (2013)

The capacity of EPM to create large amounts of additional rents has made the public utility company an important asset for the local state. According to Dover and Ocampo (2006, p. 286) EPM has become increasingly "politically attractive, due to its symbolic capital… as well as due to its transferred financial resources to the Mayor's office". However, securing access to EPM's increased profits started to become a source of new tensions between the elite factions. After the election of Mayor Luis Pérez Gutiérrez in 2000 (another important representative of the *emergentes*) and coinciding with a national economic crisis resulting in a decrease of centrally allocated rents, the political settlement of Medellín was yet again at the brink of collapse with Pérez Gutiérrez fundamentally challenging the leading position of the GEA and the overall configuration of power in Medellín. Self-declared as "the real representative of the people" who was against the "exclusionary tradition of the economic elites", Pérez Gutiérrez adopted a confrontational discourse that departed from the implicit guarantees which originally secured a stable compromise between the transnational capitalists of GEA and the city's political elites (see Dover and Ocampo, 2006, pp. 268–270).

In his first year in office Mayor Pérez Gutiérrez also changed the legal and fiscal structure of EPM. It became a conglomerate with investments and projects in a variety of sectors beyond the core utilities of water, electricity and gas. The Mayor saw EPM as the "*Grupo Económico del Municipio de Medellín*", acting as a counterweight to the GEA. According to Pérez Gutiérrez, "EPM and the municipality of Medellín are the entities that arguably control more business in Colombia… (making) the *Grupo Ecónomico [del Municipio] de Medellín* (known as EPM) the largest *grupo* in Colombia… The GEA is pennyworth compared to the *Grupo Medellín*… and this is what makes it attractive for the people of the GEA who want to take over EPM" (Pérez Gutiérrez cited in Dover and Ocampo, 2006, p. 267). At the same time the administration of Pérez Gutiérrez created the *Fundación EPM* that provides several social services and gives scholarships to students from economically marginalized neighbourhoods.

The Pérez Gutiérrez administration also used public funds to create the *Banco de los Pobres* (Bank of the Poor), a public microfinance institution that provided public loans at cheap rates for the poor. Another policy causing conflict between the different elite factions was Pérez Gutiérrez' introduction of so-called *tarifas justas*, fair tariff that aimed to freeze energy and water prices (Pérez Gutiérrez, 2003). These radical shifts in the management of EPM were viewed with suspicion by the capitalist elites, who claimed that Pérez Gutiérrez' was corrupt and his policy reforms stemmed from populist interests to distribute resources to his electorate. The economic elites of the GEA saw this socialization and politicization of EPM and the increased presence of the public service provider in GEA-controlled sectors as a frontal attack on their interests. Relationships between the GEA and Pérez Gutiérrez remain sour to this day, demonstrated by Ricardo Sierra's (the longstanding CEO of the GEA) view on this: "I hate Luis Pérez, because we know that he is a rat and that he is a thief" (Sierra, 2014).

The GEA-owned media outlets soon accused Pérez Gutiérrez of "diversion of public funds" to secure electoral support (Dinero, 2003). The local capitalist elite faction broadened their strategies of de-legitimization of the administration, which Pérez Gutiérrez in turn regarded as an attack on the political sovereignty of his government: "…they used their international connections to say that all international credits will be cancelled; in Washington they debated with me… and I started to speak, very content, with the illusions of changing this society. The (electricity) rates had been increasing by over 38% annually and I wanted to lower them in line with inflation and introduce *tarifas justas*. As I say this… they accused me that I was going to bankrupt EPM, and that they would close down international loans" (Pérez Gutiérrez cited in Dover and Ocampo, 2006, p. 280). The downgrading of EPM's creditworthiness by the New York-based rating agency and corporate finance advisor Duff & Phelps is evidence of the influence and pressure of the transnationalized capitalist factions on Pérez Gutiérrez (Dinero, 2003). As the rhetoric and tactics between different elite factions over EPM turned into open battles, President Álvaro Uribe Vélez (who had been a core mediator between the economic and political elite interests during his time as Senator, Mayor, and Governor) had to intervene to try and resolve the situation by mediating between the conflicting parties (El Tiempo, 2003; Franco Restrepo, 2005).

Dover and Ocampo (2006, p. 268) conclude that the inter-elite disputes over EPM that caused political fragility are "consequences from the way Pérez Gutiérrez rejected the economic leadership of the city and favoured the political management of the company". The marginalization of the GEA in the ruling coalition and the exclusion from access to locally created rents destabilized the polity that had been marked throughout the 1990s by an "organic relation" between economic and political powers (see Franco Restrepo, 2005, p. 29).

Based on interviews with members of the political and the economic elites, Betancur et al. (2001) confirm this divide between the two elite factions after the turn of the millennium. Thus, despite the GEA representatives stressing that "we need to work together to help each other", the interviews the authors conducted with GEA leaders show growing gaps between the factions. One CEO of a GEA company mentions that "the political class is considered as corrupt" and "the economic class is more representative of the region". The economic elite saw itself to be "on a different side", as it supposedly "integrates more social sectors of society" than the political elite (Betancur et al., 2001, p. 236)

This idea that the political elite was inherently corrupt and an obstacle to development is not only central in considerations regarding the divide between different powerful elite factions and the destabilization of the political settlement in Medellín. It also served as theoretical advocacy for neoliberal governance policies more generally. Furthermore, the rhetoric used by the GEA representative shows that, in Medellín's context of political decentralization and economic liberalization, the transnational capitalist elite was mobilizing to more actively take control over organizational and distributional powers in the urban political settlement. Much of this 'corruption discourse' is hence also reflected in proposals of an alternative decentralized 'good governance' model, which will be discussed in the next section.

While the GEA had been rather passive and less visible in politics and public affairs during much of the 1990s, this changed at the end of the decade with the resurging dispute between the elite factions. Betancur et al. (2001) find that the GEA showed aspirations to permanently occupy public positions. Such aspirations to direct political influence had not previously been part of the GEA's strategy, which separated the *grupo* from most other economic conglomerates in the rest of the country that had been active in taking on a more direct political role since the implementation of the 1991 Constitution (Rettberg, 2001b). Betancur et al. (2001, p. 151) rightly conclude that the shift in the GEA's strategy, "could be hinting at an interest of the *grupo* for more direct involvement in policy decisions in the region". The next section discusses how the GEA developed capacities of direct political involvement and shows that Betancur et al.'s (2001) analysis of the situation at the turn of the millennium was borne out in subsequent years.

6.3 The GEA and the political settlement after 2003: towards the 'Medellín Model of Good Governance'

As discussed, the descendants of the historically dominant elite factions, now represented by the transnationalized capitalist elite of the GEA, were increasingly being excluded from the political realm of organizational and political influence. Consequently, and confronted with these changing power structures in a political settlement that was marked by high competition between different elites, low economic growth, and political instability, the GEA became increasingly interested in establishing a more direct influence in the political sphere. The transnational capitalist elite, according to GEA affiliate Sergio Fajardo hence "realized that politicians are the ones who make important decisions in society whether we like it or not, so we said to ourselves that we have to get into politics. Instead of saying how things should be, we said this is the way it is done" (Fajardo cited in Fukuyama and Colby, 2011).

In contrast to much of the "miracle" literature that attributes Medellín's "turnaround" to Sergio Fajardo and his unconventional style of politics (see Fajardo and Andrews, 2014; Martin, 2012), this section argues that these recent developments are not a miraculous change but rather a logical consequence of an evolving interdependency between the distribution of power in Medellín and the (formal and informal) institutional mechanisms that sustain or challenge these structures. We analyse the rise of Fajardo as part of larger long-term changes linked to Colombia's neoliberalization, and the implementation of Medellín's 'good governance' agenda as an institutional framework that sustains and advances a neoliberal model and favours market-driven development and private capital accumulation.

Central to our analysis is the resurging conflict between the different elite factions and the impact of the transnationalization of the GEA on Medellín's elite bargain, on power configurations in the city, and consequently on the effectiveness of institutional and governance structures in achieving inclusive and sustainable developments. We analyse how the transnational capitalist faction of Medellín's elite created new institutional bases from which they developed capacities as political actors. In this context the section also analyses how Medellín's 'good governance' policy agenda favoured a shift of subsidies away from actors that engage in domestic production towards transnational capital and services. This shift did not occur without distributional conflicts between domestically oriented *emergentes* and the GEA that subscribes to global capital accumulation. We also return to discuss EPM, particularly its role for the transnationalization of state-led rent management.

6.3.1 The GEA as political actor to promote a transnational agenda

As mentioned above, the transnationalization strategy of the capitalist elite was evident in their efforts to concentrate resources in service sector activities, and in the territorial expansions of GEA firms. One of GEA's CEOs confirmed, "globalization requires offensive and aggressive attitudes as one must influence the new rules of the game" (Betancur et al., 2001, p. 210). In the context of changing bargaining power and increased divisions between powerful elite factions these attitudes did not only translate into a transnationalization of the GEA but also resulted in the development of capacities as political actors. Similar to other Latin American *grupos* or large industrial enterprises, the GEA received beneficial treatment during privatization of state-owned enterprises in various sectors (see Baer, 1994; Baer and Maloney, 1997; Peres, 1998). However, during the course of the 1990s these nationally created rents dried up. With the Colombian financial and economic crisis of 1998/99, centrally created and allocated rents further diminished, making the public utility provider EPM the primary source of state-created rents and benefits for the regional elite factions. As Pérez Gutiérrez excluded the GEA from access to these rents, the need to develop political capacities and to (re-)gain control over EPM's rents became a matter of even greater urgency for the *grupo* (see Dover and Ocampo, 2006, p. 256).

The Medellín Chamber of Commerce has been an important arena for the GEA's development of political capacities in the liberalized economy vis-à-vis the local political elites. Throughout the 1990s the GEA used the Chamber as an indirect forum of influence to express concerns about the need for policies to facilitate Medellín's insertion into global value and production chains. The Chamber's 1995 *Reporte Monitor: La ventaja competitiva de Antioquia hacia el siglo XXI* (Monitor Report: The competitive advantage of Antioquia towards the 21st century) was crucial for the capitalist elite's advocacy of a transnational and neoliberal market policy for Medellín (Cámara de Comercio, 1995). The report proposed "strategies such as the change of the productive profile of the region from its traditional industrial setting towards promoting financial, touristic, and medical services" (Betancur et al., 2001, p. 138). The Chamber thus served as an organizational form of public engagement by the GEA that echoed the *grupo's* economic interests of developing a service-based economy.

In its 1999 report entitled *Plan Estratégico de Medellín y el Área Metropolitana 2015* (Strategic Plan of Medellín and the Metropolitan Area 2015) the Chamber advocated further local economic reforms and promoted the development of sectors that were seen as most likely to compete globally with other similarly endowed cities. Furthermore, the 1999 report stressed that in order to implement these reforms a new form of politics was required that departed from the *clase emergente* and its "political-clientelist" way of governance (Cámara de Comercio, 1999). Hence, similar to the GEA representative quoted above, this second report saw the need for a much more offensive strategy that proposed local political change and more proactive strategies to address the "globalization" of Medellín's economy. The report can be interpreted as part of the GEA's institutional strategy for reclaiming organizational power and control. This more direct form of attaining political influence is unsurprising, given the discussed conflict over EPM, and the intensifying Colombian economic crisis of 1998/99 (Franco Restrepo, 2005).

The GEA's strategy also included organizational mechanisms that aimed at further delegitimizing Luis Pérez Gutiérrez and to create informal institutional networks of controlling the Mayor's management of EPM. The so-called *Comité Cívico de Seguimiento de EPM* (The Civil Committee of Monitoring EPM, henceforth *Comité*), a parallel governing board of EPM is particularly noteworthy in this regard. The *Comité* was created and controlled by the GEA "with the end to guarantee the continuity of institutional policies and particularly to measure the now absolute power of the Mayor" (El Colombiano, 2003). One of the main rationales behind the creation of the *Comité* was to ensure EPM's profit-driven character and a close surveillance of how EPM's state-created rents were allocated. The failure of Pérez Gutiérrez to use EPM to generate further transnationalization of Medellín's economy through an international expansion of EPM (particularly to Ecuador and Panama) was only one source of tensions (see Dinero, 2003). Besides criticizing Pérez Gutiérrez for neglecting the internationalization of EPM's assets, and thus of Medellín's economy, the *Comité* focused on monitoring operational and investment decisions by EPM's board of directors. Despite information asymmetries and the limited enforcement capabilities of the *Comité* as an informal institution, it exercised considerable influence over the public discourse and opinion on EPM's development, especially through the GEA-controlled media.

EPM's decision to invest in the domestic telecommunication sector was a particularly contentious issue between the *Comité* and Pérez Gutiérrez, as it was seen as a threat to private capital accumulation through transnational capitalist operations in that very same sector. The entire editorial board of Medellín's largest newspaper, the GEA-owned *El Colombiano,* published an opinion piece in which it warned that EPM would be susceptible to polarization by acquiring assets in telecommunication. It warned that the Mayor would have too much executive power and an even larger public budget, which would have adverse effects on private sector activity (Comité Cívico, 2009). Furthermore, and as mentioned in a contribution to the newspaper *El Tiempo* by Diario Valencia Restrepo, a former member of the *Comité*: "The creation of a telecommunication company under the umbrella of EPM… (entails) high risks that could adversely affect the assets in the two traditional service sectors, water and energy" (Valencia Restrepo, 2005). The adversity to a publically controlled telecommunication sector was reflected in what Juan Felipe Gavíria, former GEA executive and president of EPM under Fajardo told the author: "In the telecommunication sector the risks are much bigger… and public capital is not supposed to be in sectors that have a higher risk than the average risk of economic development. Public capital has to be much more conservative and… has to stay in the low-risk sectors" (Gaviria, 2014).

This political understanding is driven by the conviction that a minimally interventionist state achieves optimal developmental outcomes. The governance framework advocated by local actors in Medellín is thus based on the idea that non-state organizations should have larger influence in shaping and influencing local public policy. A key role in this process, both in regard to financial as well as ideological support, has been played by the GEA-founded business association *ProAntioquia* that for many replaced ANDI's functions as a lobbying instrument (Betancur et al., 2001). *ProAntioquia* serves as GEA's lobbying mechanism that maximises the political influence of the Antioquian capitalist elite (see Semana, 2015). As a policy advisor working for *ProAntioquia* told the author, the association's goal has been to achieve a “greater mobilization and increased public advocacy of the business sector… Companies come to *ProAntioquia*, so that we mobilize, discuss, argue… and move our channels of influence (Tobón, 2014).

While the particularities of this governance model and of the resulting coordination capacities will be discussed in the next subsection, we conclude that Pérez Gutiérrez’ attempts to restructure the main source of rent creation – the public utility company EPM – resulted in increased tensions between different elite factions. The separation of the locally-oriented political class of *emergentes* from the transnationally-focused GEA destabilized the local political settlement. Following Colombia’s radical shift to neoliberalism, the transnational capitalist faction that had relatively low organizational and rent-management capacities throughout much of the 1990s, set up various institutional and organizational mechanisms to influence the political agenda.

The next subsection will analyse how the political interests of the GEA have shaped the political settlement of Medellín. We particularly discuss how the governance agenda implemented after 2003 reflects and reinforces the wider shift to transnationalization and neoliberalization in Medellín. The section discusses the political economy effects of these developments on interdependencies between the changing power constellation and institutional reforms and their likely implications for developmental outcomes.

6.3.2 The ‘Medellín Model of Good Governance’ and the shifting political discourse after 2003

As discussed in chapter two, recent changes in Medellín’s political landscape and its governance model have been described as “metropolitan miracle” (see Gutiérrez et al., 2013). This section will use the discussion of Medellín’s political settlement to provide an alternative explanation of the city’s development since 2003 as well as an analysis of the local governance agenda.

The GEA was determined to influence Medellín’s Mayoral race in 2003 in order to gain more direct control over the municipal budget and over the rent management strategies (of EPM). While in the 1990s the GEA had tentatively begun to develop political capacities to influence municipal political decision making (i.e. with the *Plan Estratégico*), it was Sergio Fajardo’s *Compromiso Ciudadano* and the GEA’s strong position in this coalition that cemented the leading role of Medellín’s transnational capitalist elite in the local political arena. Fajardo, former director of *ProAntioquia* and member of a leading ‘GEA family’ investing in the construction sector, had helped this new political movement to emerge amidst the political and economic reorganization of the GEA during the years of the Pérez Gutiérrez administration. Sergio Fajardo, an academic and regular contributor to the GEA-owned *Dinero* and *El Colombiano,* thus embodied a wider change of strategy based on a new political and strategic understanding that aimed to increase the GEA's influence over organizational governance capacities.

Once in power the Fajardo coalition implemented an ambitious reform agenda. In the first development plan titled *Medellín: Compromiso de Toda la Ciudadanía 2004-2007* (Medellín: Commitment of All Citizens 2004-2007) the coalition emphasized the need for a reform of public institutions to achieve "transparency and good governance" (Alcaldía de Medellín, 2004, p. 41). The plan focused on "fighting corruption and politicking… to achieve confidence… through transparency and institutional developments… that attract and congregates investments and economic activities (for development)" (Alcaldía de Medellín, 2004, pp. 15;99). This would also have the effect of reducing violence, bringing Medellín "from fear to hope" (Alcaldía de Medellín, 2007a, p. 1). The agenda was based on the idea that efficient public management needs as little state intervention as possible to avoid any market distortions and restrictions on private capital movements (see Ramírez Brouchoud, 2012). In interviews with Fajardo's cabinet members the importance of a 'good governance' agenda, led by the IFIs, was repeatedly stressed: "The fact that Sergio (Fajardo) and Alonso (Salazar) implemented 'good governance' reforms using the World Bank's Results Based Monitoring and Evaluation System as a tool to draft and implement the Development Plans was a key factor in achieving an improved institutionality in Medellín" (Jaramillo, 2014).

Another key factor that shaped the governance structure of the Fajardo coalition was the large presence of GEA actors in the cabinet itself as well as in many public-private partnerships that were created during the first months of the Fajardo government. Fajardo's Private Secretary and campaign manager David Escobar Arango mentioned that "the interesting part of our 'good governance' formula is the public-private spirit. We created new public-private partnerships organizations and institutions after I took office" (Escobar Arango, 2014). Carlos H. Jaramillo, Secretary of Planning confirmed that the increase "of the public-private management (of the city) was a very targeted and planned action,… which is now one of the main pillars of transformation" (Jaramillo, 2014).

Hence, much of Medellín's new institutional framework is dominated by various public-private alliances. While such public-private partnerships can be of high importance for productive economic transformation (i.e. South Korean *chaebols*), the success in achieving growth-enhancing developmental outcomes depends on the wider politico-economic environment, including governance capabilities, and the entrepreneurial and technological abilities of the capitalist elite.

Following the election of Fajardo, the transnational elites gained substantial organizational power through the increased presence of public-private partnerships. A prime example of the strengthened influence of the GEA in questions of economic governance is the *Agencia para la Cooperación Internacional de Medellín* (Agency for Cooperation and Investment of Medellín, ACI). The ACI is a public-private entity, in which the GEA has a large presence, and it serves to promote Medellín as an attractive destination for FDI. According to its former director, Juan David Valderrama, the ACI acts as official organization "in all public policy areas concerned with social and economic issues. We look for international companies that want to cooperate with local firms and the Mayor's Office. Simultaneously, we want to incentivize and motivate foreign companies to invest in sectors… that focus on services" (Valderrama, 2014).

The increased influence of private interests in the management of public policy areas is also well reflected in the interviews the author conducted with CEOs of GEA companies. David Emilio Bojanini, current head of the GEA and president of its largest company *Sura* mentioned the increased power of the GEA: "the beauty of this created institutionality has been that the government has invited the private actors so we can help in the public management. We are in governing boards, and we hold patronage in many institutions… But if in the future a Mayor will be elected who is against all this, we will put great pressure on him through all the institutions that the city has, first so he won't steal money, and conductus transparent public management, and then apply all the regulatory measures we have set up" (Bojanini, 2014). José Alberto Vélez, CEO of Argos added: "the boards of directors (of public institutions) are very much dominated by the GEA. This makes it possible to keep political partisan clientelism out" (Vélez, 2014). The vice-president of GEA's *Bancolombia* also stressed that "the GEA can act within the margins of the law…and we have been concerned with supporting who we think would govern best… for example Fajardo… Between us, I tell you, when there will be a mayor who tries to undermine that… we will not let him. Our aim is to guarantee continuity and to shield everything against that" (Pérez Moreno, 2014). Pérez Moreno (2014) continued, stating that the "creation of public-private alliances and other public institutional penetration from the private sector have secured the continuity of our interests regardless who will come to power. We will not accept a Mayor that de-links us from our political interests again".

The capitalist elites' almost absolute sense of entitlement to govern is also reflected in what the current Mayor of Medellín, Federico Gutiérrez told the author in a conversation prior to his victory in the 2015 elections: "I know how things work in this city, and if the GEA is against you there is no way you will be elected Mayor" (Gutiérrez Zuluaga, 2014). Thus, by acquiring detailed legislative and executive capacities the GEA has great influence on the creation and enforcement of institutional mechanisms and a governance framework, which for some observers has resulted in a shift away from direct intervention of government and state power towards a ‘good governance’ framework that facilitates market-driven rent management (Brand, 2013; Hylton, 2010). An analysis of interview material, alongside other official public documentation and policy suggestions, also provides evidence that the particular interdependency of power and institutions in Medellín has resulted in a governance model that concentrates on the promotion of Medellín’s comparative advantage in low productivity service sectors.

Analysing the second Development Plan of the Fajardo coalition, entitled *Medellín ES Solidaria y Competetiva 2008-2011* (Medellín IS Solidary and Competitive 2008-2011) shows that the policies proposed largely focused on strengthening economic sectors with low technological and low productivity capabilities (Alcaldía de Medellín, 2008). Besides further promoting the *Cultura E* and the social urbanism policies discussed in chapter two, the plan established so-called strategic economic clusters. The cluster strategy is a set of reforms channelling a large majority of public economic institutional energy towards the strengthening of Medellín’s perceived comparative advantages. The clusters are focused on communication services, finance, construction, medical and ontological services, tourism, textile and fashion, and energy (EPM). This *Medellín Ciudad Cluster* programme further perpetuates the low productivity character of Medellín’s economy to “achieve a better insertion into global dynamics” (Alcaldía de Medellín, 2008, p. 119). This cluster programme focuses on Medellín’s “local-level competition with other cities and regions for the deployment of economic activities to have the capacity to act in a context of increasing globalization, creating locational advantages to increase the business climate” (Alcaldía de Medellín, 2008, p. 82). The emphasis on achieving a better “business climate” is thus seen as necessary to “improve the attraction of capital” (Alcaldía de Medellín, 2008, p. 85) and to make Medellín “the best corner in the Americas”.

The main rationale behind these policy reforms was thus to focus on low productivity “strategic clusters” in which limited direct public intervention will achieve market efficiency through the insertion of local capital accumulation into global value chains. Suspicion of the state’s role in economic development was highlighted by Jaime Echeverri, long standing member of the GEA and head of Medellín’s Chamber of Commerce: “We know that politics are politics, and if there is the presence of the private sector… this helps with the efficiency of the public entities which are sometimes too much politicized. Private actors understand that thinking about long-term strategy, transparency, sustainability and so on are necessary… and there was a qualitative change in the period of Sergio Fajardo, where a policy of co-responsibility opened a much wider space for collaboration between the public and the private" (Echeverri, 2014). Medellín's 'good governance' agenda fully embraces wider economic ideas and ideals according to which economic growth is based on the city's comparative advantages in service sectors, finance, and construction. The 'good governance' strategy is hence a result of the embeddedness of neoliberal ideology into the urban context of Medellín.

Further interviews and the analysis of other official documents provide additional evidence supporting the claim that the 'Medellín Model of Good Governance' is largely based on the promotion of economic growth in service sectors that are marked by low productivity. This promotion focuses on what many public officials and former members of the Fajardo administration see to be part of the naturally given comparative advantages of the city. Ex-Mayor, former president of EPM, and long-standing member of the GEA Juan Felipe Gaviria highlights that Medellín's geographical location is a "natural handicap to promote industrial growth", which leaves no alternative to the "promotion of economic development based on services that can drive GDP growth" (Gaviria, 2014). Fajardo's successor as Mayor and his close ally Alonso Salazar also stressed that "Medellín is no longer an industrial city and is developing as a city of services" (Salazar, 2014). Iván Mauricio Pérez Salazar, who was Fajardo's Secretary of Social Development, and Secretary of Finance in the second cabinet, reaffirms that "services are, without a doubt, Medellín's vocation. We have very strong and competitive service sectors, such as retail, hotels, finance, which for me are the drivers of Medellín's economy" (Pérez Salazar, 2014). Secretary of Economic Development, Felipe Hoyos Viera takes Medellín's natural comparative advantage in services to make clear that "the strategy of the Mayor's Office is to internationalize the city, which will not happen through the attraction of industrial FDI, but rather through an increased focus on services" (Hoyos Vieira, 2014). Fajardo's Private Secretary and campaign manager highlighted that "for Medellín there is no other way (to develop) than through services and this becomes more evident when you look at what is happening in other cities; all the industries are concentrating in Bogotá, Cartagena and Barranquilla… it is not that we don't want diversification… but I believe what Ricardo Hausmann says is true: 'Rich countries produce rich-country goods'. It sounds silly, but it is true. Here (in Medellín), there will be no exports in steel or cars" (Escobar Arango, 2014).

This policy focus – to outcompete other similarly endowed cities through the development of comparative advantages in services, low wages and low-skilled labour – has driven an institutional agenda that aims to promote Medellín's insertion into the lower end global value chains. A manual by the public-private organization ACI, discussed on page 145, clearly indicates this: "The minimum wage in Colombia is one of the lowest in Latin America… Colombia has one of the most flexible labour regimes in Latin America… A day shift [in

Medellín] is long, from 6am to 10pm, and the employer can sign on two shifts without overtime pay or night surcharges; in the recruitment and employment of apprentices… the employer has no obligation to pay social benefits,… and the amount of compensation for unreasonable dismissal is very low (ACI et al., 2006: 65-66 cited in Betancur, 2008, p. 1). In an interview the director of the ACI confirmed that "a company arrives in Medellín…and seeks to reduce costs… If there is more supply of labour than demand this will lower the price (of labour)… Globalization, in which all of us are embedded, makes companies such as Kimberly Clark or Hewlett Packard come in search for optimizing their resources…and what we do is promote public policies that incentivize and motivate development that makes companies come to Medellín… This is why Medellín focuses on services" (Valderrama, 2014).

A statement by Fajardo's Secretary of Social Development in an interview with the author also reflects this: "To strengthen the service sectors the city was given the task of selling itself abroad as a competitive, innovative, affordable city for foreign investment" (Mejía Martínez, 2014). The Secretary of Economic Development confirmed that "the topic of internationalization of the city and to make it attractive for foreign investors' needs implies that we have to be focused on the service sector and especially on the issue of tourism… a tourism that is oriented towards business meetings and conventions. This is part of the internationalization strategy that seeks to generate economic development through visitors that invest in the city and in the end create employment… in commerce, restaurants, hotels, transportation, etc." (Hoyos Vieira, 2014).

We thus see the implementation of the 'good governance' model following Fajardo's election as an institutional mechanism for market-driven development. The GEA, who had failed to develop economic capabilities in technologically advanced sectors as they concentrated on investments in services following the *apertura* reforms, gained considerable organizational power following the 2003 municipal elections. Medellín's transnationalizing capitalist elite adopted the neoliberal 'good governance' discourse as an opportunity to restore and deepen hegemonic power in the local settlement. The combination of these political and economic factors of Medellín's political settlement enhanced conditions in which rent-management strategies are inherently targeting sectors that are unlikely to be sustainable and inclusive growth escalators for the urban economy in the long run. Ineffective coordination of investments and insufficient governance capabilities can lead to a failure of efforts to ensure the attraction of FDI that can have positive forward and backward linkages for domestic medium or high technology sectors and firms. The GEA's interests in implementing 'good governance' reforms that further push an economic transnationalization agenda is thus an opportunistic institutional mechanism adopted in a larger neoliberal context of Colombia's polity and economic policy agenda.

The composition of this settlement can further slow down the creation of institutions for disciplining of rent recipients and can make entry for outsiders or newcomers into high-rent markets difficult through their low bargaining power vis-à-vis the Fajardo coalition. Capitalists with higher entrepreneurial capabilities, who in contrast to older members of the GEA do not have established ties with the Fajardo coalition, are deterred by such institutional strategies, as their interests are incompatible with the constellation of power.

As we shall see in the following chapter, Medellín's political settlement and 'good governance' agenda have achieved neither necessary nor sufficient conditions for the creation of institutional mechanisms to achieve productivity growth in medium or high technology sectors. This is largely explained by the incompatibilities of such rent management strategies with the power configuration of Medellín's political settlement, in which transnational capitalists with low technological capabilities are now dominant. Medellín's political settlement and Fajardo's 'good governance' reforms have thus complemented economic shifts in the city that effectively meant an increase in activities in the service sector. The expansion of the service sector has been part of a broader characteristic of global capitalism that has implied a trend for cities in Latin American countries to expand service-based accumulation (see Robinson, 2010, p. 126). The extent to which this strategy has driven the development of economic activities in low productivity sectors will be quantitatively analysed in the following chapter. Furthermore, the next chapter analyses that while the governance model might have had adverse effects on productivity growth it was able to stabilize the polity by gathering the dominant elite faction around the shared interests and ideology of neoliberal development.

6.4 Conclusions

In the 1990s Colombia went through comprehensive policy changes in the form of liberalization, deregulation and privatization reforms that marked the country's radical shift to neoliberalism and its return to static comparative advantages in low productivity sectors. While the elite bargain in Medellín was stabilized through formal and informal institutional mechanisms during this period, this changed around the turn of the millennium when the conflict between the political elite faction and the transnationalizing capitalists resurfaced over the management of locally created rents through EPM. Much of the distributive conflict between these factions arose out of disagreements about the use of EPM's rents: while the political elite of *emergentes*, led by Mayor Luis Pérez Gutiérrez, used resources to stimulate local economic and social development, the transnational capitalist elites of the GEA, who became more and more excluded from access to locally as well as centrally created rents, wanted to use EPM as a tool for economic transnationalization.

However, economic liberalization, privatization, and deregulation policies had strengthened the economic position of the GEA in Medellín. After the GEA gained capacities as the transnational faction of Medellín's capitalist elite and coinciding with this inter-elite dispute over public rent management and the role of EPM in promoting developmental outcomes, the GEA increasingly developed political capacities. The 'good governance' agenda as a blueprint model for development resonated well with the GEA's rejection of a 'politicized' interference with rent management (of EPM) and the anti-corruption discourse they had developed during the Pérez Gutiérrez years.

With the victory of the Fajardo coalition, in which the GEA had a strong position, the administration started to promote 'good governance' reforms as drivers for alternative development and as counterbalance to the political elites. These governance reforms, however, can be seen as an opportunistic agenda to promote Medellín's static comparative advantages in service-based and low-wage economic activities. The transnational capitalist elite in the form of the GEA used the acquired discretionary control and organizational power to facilitate the insertion of the city into global value chains, a strategy which was highly aligned with the interests of the GEA in promoting global capitalist growth, from which this transnational capitalist elite generates most of its income.

In this chapter we argued that in order to understand developmental outcomes it is necessary to engage in a political economy analysis of the compatibility of rent management strategies with configurations of power balances in Medellín's political settlements. Applying the political economy framework, we found that the specific characteristics of Medellín's political settlement, such as the distribution of power and entrepreneurial and technological capabilities of capitalist firms, were hindering or at least slowing down the creation of governance capabilities necessary for the implementation of growth-enhancing policies. The large organizational powers of the transnational capitalist elite, a less independent local bureaucracy, and low technological capabilities of the GEA companies, are likely to result in insufficient allocation of rents to sectors that may serve as productivity growth escalators. The lack of coordination of investment and the failure to attract technologically advanced FDI is likely to result in further growth of low productivity activities. This is reinforced by the 'good governance' model and the structure of the ruling coalition, in which the GEA has a dominant position. This political settlement not only disincentivizes investors from engaging in efforts to acquire tacit knowledge and to climb up the technology ladder, but it also results in insufficient governance capabilities for effective targeting and disciplining of rent-receiving firms or sectors. Such market-enhancing conditions limit the potential of achieving positive linkages for the development of domestic firms in medium and high technology sectors.

Using qualitative evidence this chapter has shown that the ‘Medellín Model of Good Governance’ is unlikely to provide the growth-enhancing institutional framework needed for productivity growth, and sustainable and inclusive development of the city. The next chapter provides quantitative evidence for these claims.

Chapter Seven: Empirical evaluation of developmental outcomes of Medellín's political settlement

In the preceding chapters we have argued that the distribution of actual organizational power is a central analytical variable for understanding different paths of institutional change. We argued that the interdependency between power and institutions affect the implementation of policies in ways that have implications for political and economic development outcomes. In chapter six we found that the increase in organizational power of the transnational capitalist elite in the form of the GEA in Medellín's decentralized and liberalized political settlement has driven a particular 'good governance' agenda. We argued that the particular power constellation in Medellín's political settlement can impede or at least slow down attempts to create mechanisms that incentivize investment into acquiring tacit knowledge of medium or high technological activities. The strong position of the GEA in the ruling coalition furthermore creates a situation in which disciplining of rent-receiving firms can be difficult. We also argued that due to the changing economic interests and technological capabilities of the GEA, the policy agenda is likely to result in market-conform changes that enhance Medellín's insertion into the lower end of the global value chain.

This chapter uses the findings on the characteristics of Medellín's political settlement made so far to quantitatively evaluate the implemented 'good governance' policy agenda and assess the developmental outcomes in terms of productivity growth and economic development, as well as with regard to violence indicators. Using different quantitative methods, this evaluation helps to provide statistical evidence that underline our claim that Medellín has by no means experienced a miracle.

In the first section of this chapter, we look at the development of Medellín's public finances over time. The section analyses how the implementation of a particular public policy agenda following Fajardo's election in 2003 affected rent creation and the allocation of public finances in general and of EPM's profits in particular. The analysis of the evolution of public revenues through tax collection and EPM's transfers on the one hand, and of public expenditures and investments on the other, can help in assessing broader governance capabilities of public rent management following the implementation of the 'Medellín Model of Good Governance'. The section also analyses private investment strategies. We particularly look at disaggregated investment data and changes in market capitalization of local companies to identify capitalist interests and capabilities of Medellín's private sector. The section concludes with an analysis of disaggregated growth data, evaluating the impacts of public rent management and private investment strategies on sectoral growth performance.

Section 7.2 focuses on the evaluation of Medellín-based companies. Using firm-level data, we analyse the concentration of employment in different non-agricultural sectors and evaluate productivity capacities of firms based in Medellín. This helps us discover which non-agricultural economic activities are concentrated in Medellín, their respective labour intensity and their impacts on employment creation, as well as the productivity capacities of specific sectors. The section compares companies based in Medellín with economies of other Colombian cities. We find that Medellín's economy is dominated by companies with low productivity capabilities. Furthermore, most employment is created in sectors that are marked by low productivity.

Section 7.3 evaluates the export capacities of the regional economy. We find that while exports per capita have increased dramatically since the early 2000s, exports are dominated by low technology goods. Medium and high technology exports have decreased. We furthermore assess the performance of Medellín's strategic *cluster* sectors. We analyse the productivity capacities of these sectors as well as the level of international competitiveness. By looking at the export capacities of these sectors, we find that the textile and fashion *cluster* contributes to the largest share of industrial exports. However, the sector only contributes to very low GDP growth rates and is marked by high labour intensity and low labour productivity, indicating the low capacities of exports to result in positive backward linkages. This is reflected by the fact that the general growth of exports has not directly contributed to GDP growth rates.

Section 7.4 analyses the impacts of Medellín's economic and productivity development on the city's labour market and income inequality. The section looks at general trends of how labour market variables have developed since the Fajardo coalition came to power. We also take a comparative look at the development of Medellín's labour productivity and the gross employment elasticities of the city's labour market. We find that besides the low productivity characteristics of Medellín's economy, the city's labour market has high levels of gross employment elasticities, indicating that changes in the economy prompt rapid adjustment in gross employment. This indicates that Medellín has a highly flexible labour market dominated by low wage services. The cheap labour supply of Medellín does not only reinforce income inequalities, but is also unlikely to be a source for sustainable productivity growth that can help the local economy in climbing up the technology ladder.

Section 7.5 engages in a detailed analysis of violence indicators. Firstly, we explain the decrease in homicidal violence using the political settlements framework. We argue that the fluctuations in Medellín's murder rate can be explained by looking at the different inter-elite contestations and the role of the paramilitary in these disputes. Recent falls in the homicide rate can be explained by the extensive organizational power of the current ruling coalition and particular paramilitary interests that closely align with the interests of the Fajardo coalition.

Furthermore, the section extends beyond the common approach of exclusive focus on homicide rates. We find that despite the decrease in homicidal violence, there has been an increase in other forms of violence.

The quantitative analysis in this chapter largely concentrates on the period between 2004 and 2012. However, due to limited data availability, we sometimes use different time series. In general, data availability is very scattered for local level indicators, which is also due to the fact that *DANE* only started to publish disaggregated data for municipalities after 2005. Where appropriate we used regional level data to make general observations about Antioquia's growth performances, which can be a valid proxy for Medellín.

7.1 Public policy agenda, private investment and growth

As pointed out in the preceding chapter, the political discourse of the GEA prior to Fajardo's election in 2003 was rooted in the idea that the political class of *emergentes* is inherently corrupt. This anti-corruption discourse, which resonated with a wider neoliberal policy agenda of opposing direct state intervention in market mechanisms, was picked up by the Fajardo collation and their 'Medellín Model of Good Governance'. Central to the 'good governance' framework is the transparent and accountable management of public finances in order to avoid the embezzlement of public funds and increase revenue through the decrease in corruption. Furthermore, this policy agenda hopes to achieve better private property rights structures and to increase confidence in the public administration, which, according to the standard view, not only increases citizen's willingness to pay taxes but also makes companies more inclined to invest.

The first part of this section engages in a quantitative analysis of the evolvement of the management of public resources. We particularly analyse the development of public revenues and expenditures after the election of Mayor Sergio Fajardo and the implementation of the 'Medellín Model of Good Governance'. We furthermore look at the changes in tax collection as well as the management of EPM's profits. The section engages in an analysis of how public policies and an increase in the municipal budget affected public investments. The second part of this section focuses on the investment of private companies. We look at disaggregate changes in net private investments as well as changes in the market capitalization of Medellín's companies at the national stock exchange. The section concludes by analysing Medellín's disaggregated growth performance.

7.1.1 Public policy agenda, taxes and the management of EPM

A closer look at the development of public finances can help identify patterns in Medellín's changing policy agenda for achieving economic growth and political stability. One of the main rationales of the 'good governance' agenda is to achieve a more accountable public administration through the reduction of corruption. Proponents of the agenda argue that more transparent governance will not only decrease the likelihood of a misuse of public revenues, but will also generate general confidence into the authorities, which in turn has positive effects on tax collection and creates incentives for foreign companies and local capitalist actors to invest (Bénassy-Quéré et al., 2007; UNCTAD, 2004).

A central aspect of the economic policy agenda implemented in Medellín was a change in the public rent-management strategy in two areas: firstly, improved tax-collection capacities and secondly a reform of EPM and in particular the management of the resources transferred from it to the municipal budget.

In regard to tax collection, the coalition intended to increase Medellín's tax income not through an increase of the local tax rates, but rather by improving tax collection. This entailed enforcement of correct charging and payment of tax bills, and ensuring that correct amounts were collected by the local state. Furthermore, limiting corruption practices more generally and increasing transparency and accountability of public finance are seen as an important factor that resulted in an increase of citizen's willingness to pay taxes. In a strategy to increase confidence and to create "a culture of paying taxes" (see Alcaldía de Medellín, 2009), the Fajardo administration put up large billboards at every public construction site stating that *¡Aquí están invertidos sus impuestos!* (Your taxes are invested here!) (figure 7.1).

Figure 7.1: Public Infrastructure Project Pajarito, Cumuna 7

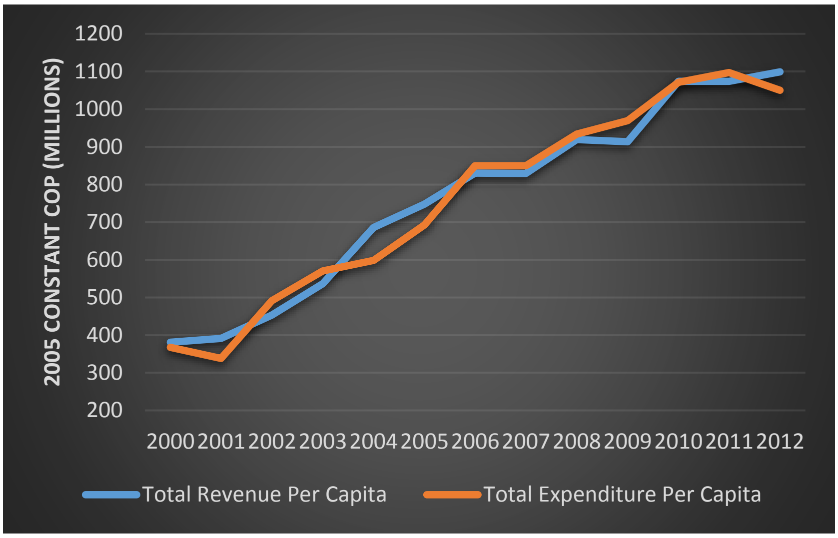
Source: IDB (2011, p. 183)

Iván Mauricio Pérez Salazar, Secretary of Social Development under Fajardo and later Secretary of Finance, confirmed to the author that "[through] the prevention of tax evasion, charging what was owed […], the proper assessment of housing taxes, and the fight of all levels of corruption […] tax income increased threefold" (Pérez Salazar, 2014). One of the primary concerns of the coalition's 'good governance' agenda was to establish and increase business confidence (Alcaldía de Medellín, 2004, p. 35). This need to establish confidence in the public institutions by the business sector was repeatedly stressed in interviews with current and former public officials. Fajardo's Secretary of Planning and former president of EPM Federico Restrepo Posada stressed that due to transparent development policies based on clear statistical evidence and analysis, "the level of subjectivity, which is usually associated with political negotiations, went down drastically" (cited in Devlin and Chaskel, 2010, p. 6). This decrease of 'subjectivity', Restrepo Posada (2014) argues, helped to increase public revenue, thereby allowing also for a considerable increase in public expenditure. Several interviewees argued that these changes, in turn, helped to increase private investments, from other parts of Colombia as well as from abroad (see Valderrama, 2014).

And indeed, as can be seen in figure 7.2, public revenue as well as public expenditure grew substantially from 2000 until 2012. Despite the fact that public revenue per capita as well as total public expenditure per capita had already increased during the Pérez Gutiérrez administration, figure 7.2 shows that there were substantial further increases in both variables after 2003. In particular, the period between 2004 and 2006 saw a relatively larger increase in public revenue per capita. This is also clearly reflected in figure 7.3 that provides an aggregate overview of the sources of the increasing public revenue. Despite there not being any changes to Medellín's tax rates, tax revenue increased. For members of the Fajardo coalition this is the result of increasing efforts in formalizing micro and small enterprises that had until then operated informally, particularly in the more marginalized areas of the city.

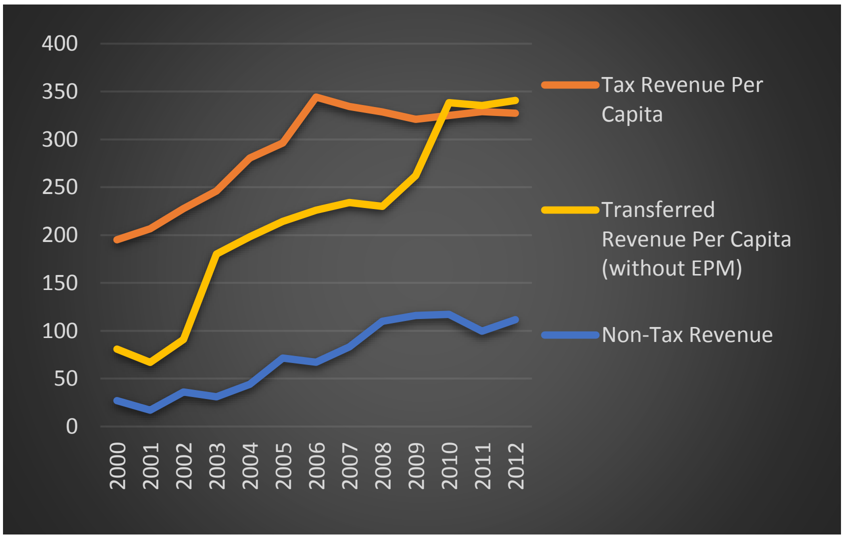
While some claim that the national law 1258 of 2008 helped to increase local tax revenues per capita, the tax revenue per capita of Medellín only increased up until 2006 and then remained stagnant (figure 7.3). While for members of the Fajardo administration the increase of tax revenue is an indicator of decrease in corruption (see Pérez Salazar, 2014), this can certainly be seen as efficiency improvements of the new ruling coalition. Furthermore, the increase of tax collection in the first years of government can be attributed to the coalition's commitment to formalize businesses as part of the *Cultura E* and the social urbanism policies. Hence, besides the construction of the *Metrocable* and the creation of public spaces, the policy entailed the facilitation of business formalization through the creation of the CEDEZOs in the affected neighbourhoods, as discussed in chapter two. Furthermore, we can see that there was a substantial increase in transferred revenue per capita from the central government after 2002. This preceded the Fajardo coalition. In interviews, public officials claimed that the election of Álvaro Uribe Vélez as president played a major role in achieving increase in overall revenues, as he gave Medellín's political actors a beneficial access to centrally created rents (Piraquive, 2014).

FIGURE 7.2: MEDELLÍN: TOTAL REVENUE AND EXPENDITURE PER CAPITA



SOURCE: DATA FROM BANCO DE LA REPÚBLICA, OWN CALCULATIONS

FIGURE 7.3: MEDELLÍN: SOURCES OF PUBLIC REVENUE



SOURCE: DATA FROM BANCO DE LA REPÚBLICA, OWN CALCULATIONS

There are several important implications of increased local tax collection in Medellín. The first concerns the fact that liberalization and deindustrialization have changed the forms of rent deployment and thus affected the actual organizational power of the dominant elites. As mentioned, the conventional mechanisms of rent management and patronage distribution in a protected economy (through tariff and non-tariff measures) had fallen away with economic liberalization (see Di John, 2010). Through their strengthened organizational power, the GEA and the Fajardo coalition were able to use urban tax collection as a rent-creating instrument. With the social urbanism reforms that largely focused on construction of public spaces, transportation infrastructure and housing, the Fajardo coalition, first, incentivized economic growth through increased activity in the construction sector. Moreover, an increasingly dynamic urban real estate market also helped to increase tax revenues. Increased collection of taxation on property has further strengthened synergies between taxation and Fajardo's urban planning and social urbanism policies through the creation of transparent and comprehensive property databases (Pérez Salazar, 2014). Social urbanism, however, was not focused on productivity-enhancing infrastructure, but rather on megaprojects, such as the construction of library parks and convention centres to stimulate tourism (see Brand, 2013).

Property taxes are furthermore easy to collect for public authorities, as the visibility of property makes it difficult for property owners to evade this tax. Furthermore, these taxes generally do not have a direct adverse effect on economic growth due to their marginal impact on investment decisions by economic agents. Di John (2010, p. 14) argues that this links to the fact that urban property taxes "do not affect the decisions of economic agents to supply labour, to invest in human capital, to produce, invest and innovate to the same extent as some other taxes".

The second aspect of Medellín's changed rent-management strategy focused on EPM's profits in general and the public company's transfers to the municipal budget more specifically. Since the early 2000s the total amount of EPM's transfers to the municipality of Medellín grew significantly as a result of EPM's changed investment strategy and the territorial expansion of the company following Fajardo's victory. The primary objective of EPM was to increase Medellín's presence in transnational markets, especially in Central America. A crucial part of this internationalization strategy has been the investment fund *EPM Inversiones S.A.*, set up in 2004, as a limited liability corporation. The principal objective of this company is "investing capital in domestic or foreign companies, including utility providers of energy, water, sewage, combustibles, gas,… and telecommunications services" (EPM, 2016). In an interview with the author, the president of EPM under Fajardo and former CEO of several GEA companies, Juan Felipe Gaviria, confirmed that the larger presence of EPM in international markets and the privatization of the company's investment strategy are crucial drivers of Medellín's economic development (Gaviria, 2014).

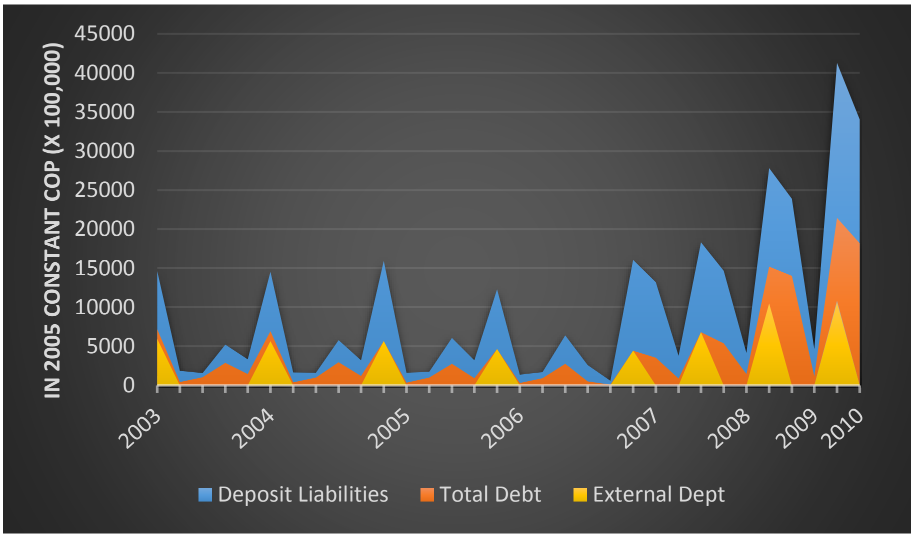
EPM's internationalization strategy was officially finalized with the *Meta Estratégica Grande y Ambiciosa* (Strategy for a Large and Ambitious Goal, *La Mega*) in 2005. Dover and Ocampo

(2006) find that with the implementation of *La Mega* EPM has become truly transnationalized. The core target of *La Mega* was to internationalize 40% of EPM's activities by 2015 (Furlong, 2015). And indeed, of EPM's annual profits of 1.5 billion COP generated in 2015, 36% were earned in foreign markets (El Colombiano, 2015).

EPM's growth strategy also included the re-privatization of its assets in telecommunication in 2014 (Semana, 2014). However, the company has been increasingly active in participating in the domestic and international credit market, which led to a significant rise of total debt and deposit liabilities between 2005 and 2010[15] (see figure 7.4; Bonilla et al., 2013). Since EPM's transfers make up around 40% of the entire municipal budget (Maya Muñoz, 2013). This was part of the institutional strategy of the Fajardo coalition to increase the rent-management capabilities of the local state, also in order to circumvent fiscal restrictions on local governments in Colombia (Pérez Salazar, 2014). Between 2003 and 2010 transfers of EPM to the municipal budget of Medellín increased by over 1000% (see figure 7.5). This has particularly been the result of a massive increase in so-called "extraordinary transfers" in recent years. While these extraordinary transfers have been operational since the mid-1990s, making up for around 45% of total transfers between 1994 and 2008, they only became legalized in 2007 (Alcaldía de Medellín, 2007b). In the latest available data for 2009 and 2010, these transfers have drastically increased. For Furlong (2015, p. 202) the increase in extraordinary transfers is an indicator that "capitalist production is enmeshed with public dividends and social reproduction". As figure 7.5 indicates, EPM's indebtedness has certainly served as an institutional strategy to expand Medellín's public budget. Following this logic, Iván Mauricio Pérez Salazar who served as finance secretary in the Fajardo administration told the author: "EPM is a massive cashbox for Medellín" (Pérez Salazar, 2014).

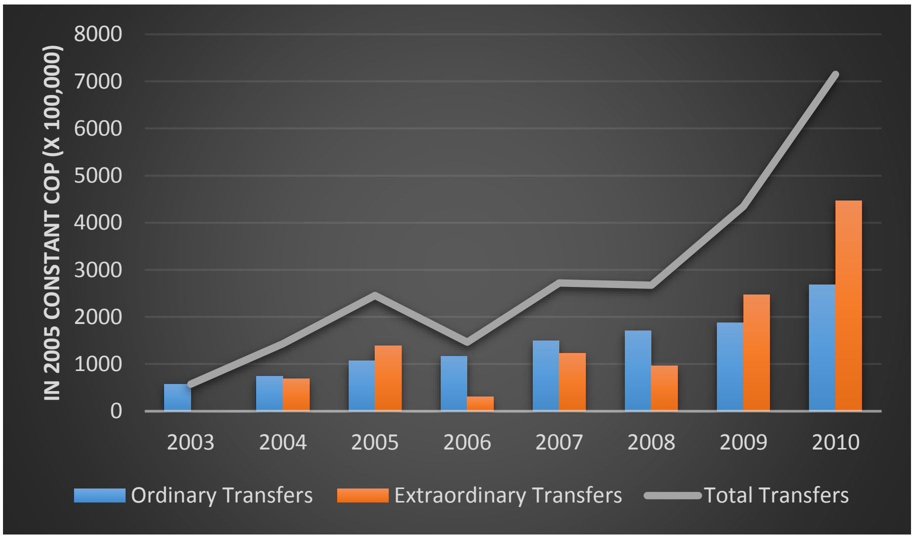
[15] These developments of EPM closely correspond to general trends of increased corporate debt in less developed countries since 2008. Some observers find links between these developments and the Quantitative Easing (QE) policy of the US Federal Reserve, implemented between 2008 and 2014. QE provided longer-term private sector credits at low interest rates, which aimed at incentivizing private investment for the recovery of post-crisis developed economies. However, the majority of the funds – after being leveraged by hedge funds – resulted in an expansion of debt on corporate balance sheets in less developed countries. Analysing the links between this policy and dollar credit, McCauley et al. (2015) find that between 2009 and 2014 bonds and bank loans to non-bank borrowers outside of the US increased from US$6 trillion to US$9 trillion. Palma (2015) finds that for Latin America, this flood of cheap US dollar credits had negative impacts for the balance sheets of non-bank corporations.

FIGURE 7.4: DEBT AND LIABILITIES OF EPM 2003-2010



SOURCES: BONILLA ET AL. (2013); BONILLA AND AMADO (2013); CARRANZA AND BONILLA (2013)

FIGURE 7.5: EPM'S TRANSFERS TO MEDELLÍN'S BUDGET



SOURCES: BONILLA ET AL. (2013); BONILLA AND AMADO (2013); CARRANZA AND BONILLA (2013)

With EPM as a public utility company which now operates transnationally as a private corporation, the Fajardo administration was able to include transnational capitalist interests in the publically managed strategy of resource creation and allocation. This agenda substantially increased the influence of the GEA in matters regarding Medellín's transnationalization strategies, particularly through the control of EPM's capacity in managing rents and distributing patronage through state employment. With the power distribution in Medellín's political settlement and the prominent and very powerful positions of the GEA, a large majority of rent is allocated to sectors in which the GEA has vested interests (see Veeduría, 2014). Furthermore, former CEOs of the GEA have consistently occupied the post of the President of EPM (Zuluaga, 2004), a position in which in mayoral elections is considered to be as important as the actual candidate (Restrepo Posada, 2014). In an interview a public official from the national government also reaffirmed the beneficial treatment of the GEA in receiving rents and benefits, particularly due to the *grupo's* control over EPM's budget: "they (the GEA) can use the public balance sheets as a driver of private investments" (Piraquive, 2014).

The "cashbox" EPM has become of crucial importance for rent distribution to potential growth sectors. EPM is the primary source for state-created rents through local government hiring and contracting procedures. However, and despite the emphasis of the Fajardo coalition and the GEA on the importance of transparency and 'good governance' style public resource management, the vast majority of EPM's projects are contracted out without formal bidding procedures (Veeduría, 2014). Analysing all of EPM's contracting procedures revealed that 67% of all of EPM-financed and publically procured projects were contracted out without fulfilling formally required procedures (see El Tiempo, 2015). A recent report on the public procurement processes of Medellín's public institutions finds similar results. It claims "that both the municipality of Medellín and its decentralized entities may be abusing their public mandate generating undesirable situations politically, legally and socially" (Veeduría, 2014, p. 22). In an interview Luis Pérez Gutiérrez, former Mayor and long-standing arch enemy of Medellín's transnational capitalist elite faction, mentioned that this is particularly due to the style of public resource management the GEA-led Fajardo coalition perceives to be efficient: "the GEA has large interests in EPM due to its capacity to contract out. The power of the GEA disrupts democracy as it converts EPM into an institution that serves for particular interests of the GEA" (Pérez Gutiérrez, 2016).

While a larger municipal budget through both the increases in tax revenue and in transfers (of EPM) can have positive implications for state capacity building, the particular structure of Medellín's political settlement is likely to impede the development of growth-enhancing rent management. The GEA's dominant organizational position in the ruling coalition is more likely to result in the development of a policy agenda that a) further increases the holding power of the transnational capitalist elite; b) is unable to create incentives and compulsions for investment in medium- to high technology sectors; and c) is ineffective in enforcing effective disciplining measures. The developmental outcomes of Medellín's governance structures on private investments, productivity growth, labour markets and political stability will be discussed in the subsequent sections of this chapter.

7.1.2 Private investments and economic growth

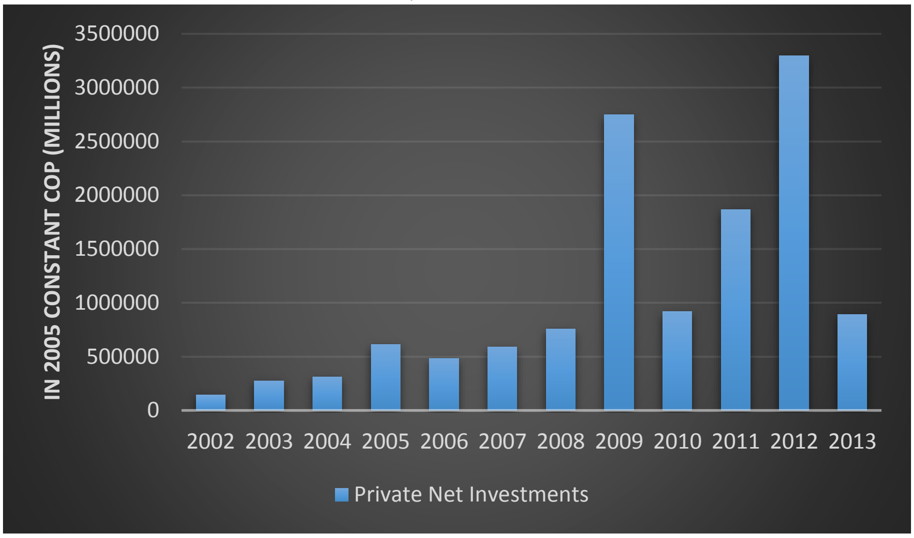
The characteristics of Medellín's political settlement do not only have implications for the policy agenda and hence the management of public finances. They also affect the investment strategies of private actors and capitalist organizations. To analyse this we return to some considerations raised in chapters three and four. There, we argued that the dominant position and entrepreneurial capabilities of capitalists in a political settlement are important factors determining the capacities of a state to create and enforce a growth-enhancing institutional framework, which again affects growth outcomes. In chapter six, we showed that the power of the GEA increased with the inauguration of Sergio Fajardo. The capture of political organizations through public-private alliances gave the transnational capitalist elites a considerable degree of certainty over the long-term access to economic rents.

In conventional theory, certainty over long-term access to rents should encourage private investment into potential high-risk sectors. Analysing net private investments[16] of Medellín's entrepreneurs, at first sight such theoretical claims seem to hold. We find that there has been an impressive growth of net private investments between 2003 and 2013. However, the private investment dynamics only significantly increased after 2008. Figure 7.6 shows an increase of over 10% annually between 2005 and 2013, with large increases of net investments in 2009, 2011 and 2012, showing that private investment patterns are rather volatile[17]. Looking exclusively at the aggregated data for net private investment underlines the claims of the 'good governance' agenda that an improved management of public resources increases private investment.

[16] Local level net private investments were calculated by subtracting the adjustment of capital consumption from gross private investment of Medellín's companies. Net private investments measure changes in the capital stock resulting from investment and is thus the amount of depreciated capital used for productive activities in Medellín.

[17] The rather unusual composition of investment in 2009 can be explained by the capital stock reforms and extraordinary investment of the transportation company *Imbocar S.A.*, as well as the change of EPM's financial structure with establishing a private company *EPM Inversiones S.A.* while at the same time investing into the construction of the dam project *Hidroeléctrica Ituango S.A. E.S.P*. This partial privatization of EPM's assets was net worth 1.5 trillion COP, which explains the 2009 increase. The large increase in 2011 is due to the foundation of the limited company *EPM Ituango S.A*. This partial privatization of EPM's assets over 235 billion Pesos and capital stock changes of EPM's *Aguas Nacionales* that included an extraordinary investment into water and electricity of 350 billion Pesos. The massive increase of financial sector investment in 2012 is due to a further financialization of EPM. The EPM subsidiaries *EPM Ituango S.A.* and *Aguas Nacionales EPM S.A.* increased investments into construction and financial services by 806 billion Pesos (all values in 2005 constant COP) (Cámara de Comercio, 2014, 2011).

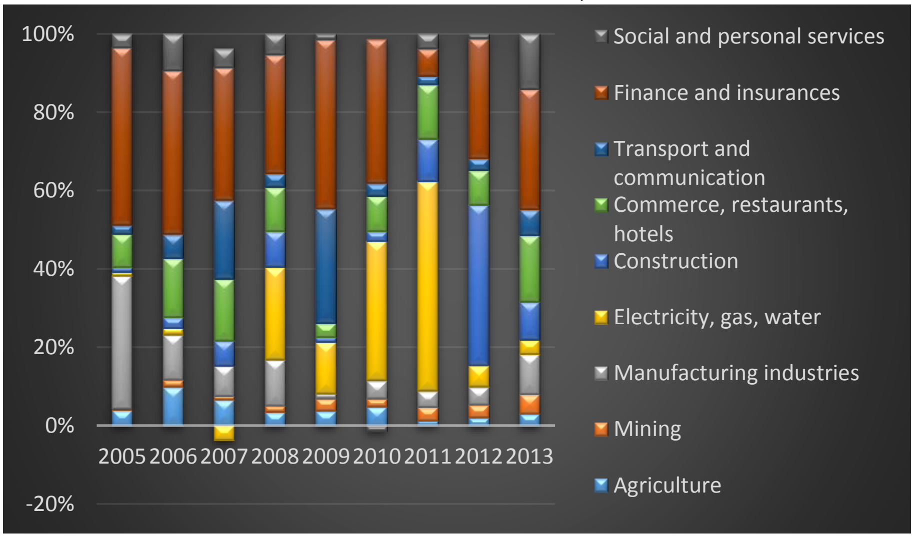
FIGURE 7.6: NET PRIVATE INVESTMENTS, MEDELLÍN 2003-2013



SOURCE: DATA FROM CAMARA DE COMERCIO, OWN CALCULATIONS

The aggregated data, however, do not explain which economic sectors were the primary recipients of the net private investments, and thus have only limited analytical value for the discussion of capabilities for investment in medium or high productivity activities. Looking at the disaggregated data we find that the increases in net private investment were particularly strong in the construction, finance and insurance sectors (figure 7.7). While net private investment in manufacturing industries still represented around 34% of total net investments in 2005, this decreased to only 7% in 2014 (figure 7.8).

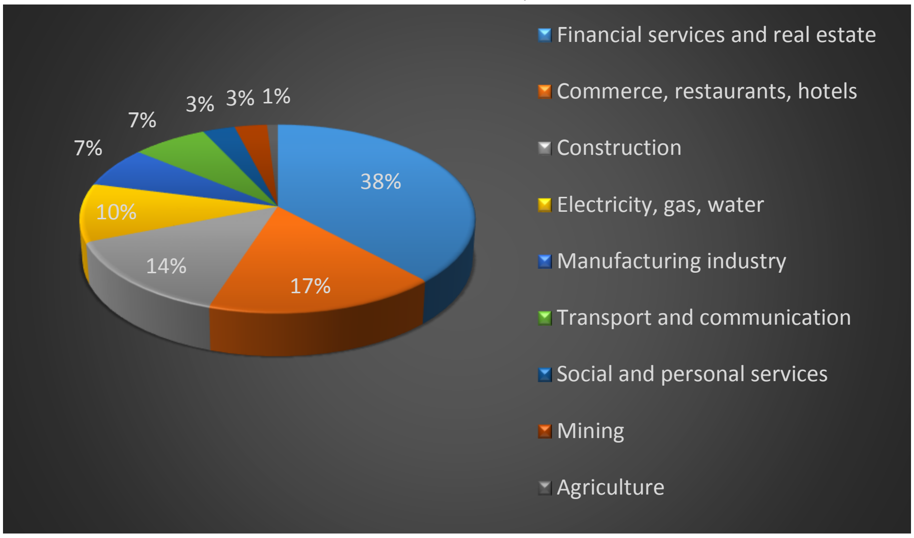
FIGURE 7.7: COMPOSITION OF NET PRIVATE INVESTMENT, BY SECTOR[18]



SOURCE: DATA FROM CAMARA DE COMERCIO, OWN CALCULATION

[18] While gross capital investment usually exceeds depreciation, the negative net investment in the sector of electricity, gas and water in 2007 means that depreciation exceeded gross private investment.

FIGURE 7.8: NET PRIVATE INVESTMENT PER SECTOR, 2014



SOURCE: CAMARA DE COMERCIO (2015)

Similarly, the core features of Medellín's political settlement demonstrate that Medellín's capitalists are not competing with each other in the market and are, therefore, not disciplined to make investments into technologically advanced sectors that are marked by high productivity. Instead, most investments have gone into the financialization of Medellín's companies. As shown in table 7.1, the market capitalization of Medellín-based companies traded on Colombia's stock exchange has increased by 1568% between 2000 and 2015, which is substantially higher than GDP growth during that period (see BVC, 2015; Superintendencia Financiera, 2015). The ratio of the stock of financial assets to GDP thus jumped from around 150% in 2000 to over 300% in 2015.

Table 7.1 shows that this financialization was largely driven by the increase in the market capitalization of financial institutions as well as of construction companies. The massive increase of the market capitalization of electricity, water and gas companies can be explained by EPM's investment strategy. As noted in footnote 17, the public company has invested large amounts of public assets into its private subsidiary companies *EPM Inversiones S.A, EPM Ituango S.A.* and *Aguas Nacionales EPM S.A.* This high financialization of local companies has provided liquidity for local capitalist actors. While this can be positive for incentivizing investments, the characteristics of Medellín's political settlement are likely to lead to a situation where additional liquidity is invested in economic activities which do not enhance productive capacities.

TABLE 7.1: MARKET CAPITALIZATION OF MEDELLÍN'S PUBLICALLY TRADED COMPANIES

Economic Sector	Market capitalization 2000-2015 (in %)
Financial institutions and insurances	2035.03%
Manufacturing	787.68%
Construction	2322.05%
Commerce	901.77%
Electricity, water, gas	2306.68%
Transport and communication	7.97%

SOURCES: BVC (2015); SUPERINTENDENCIA FINANCIERA (2015); OWN CALCULATIONS

Another important variable for the assessment of Medellín's political settlement and its 'good governance' agenda is the ratio of net private investments to the income share of the top 10% of income receivers. Thus, despite the huge share of income of Medellín's top earners[19] and the supposedly well-defined property right structures implemented through 'good governance' reforms, the share of private investment as a percentage of the income share of the top 10% income receivers remains very low. On average, the ratio between private net investments and the income of the top 10% over the period between 2005 and 2014 was only around 8.9% annually[20], which is extremely low, even compared to other less developed regions or other Latin American countries (see Palma, 2011, pp. 19–20). That Medellín's elite can appropriate large amounts of income, while investments into medium or high technology sectors and high productivity activities remain low (see figure 7.7), places a serious question mark over the legitimacy of the neoliberal settlement that encourages such patterns.

Our results are in line with Palma's (2011) findings on Latin American elites. We find that the hegemonic power and the low technological capacities of the transnational capitalist elites have hindered or slowed down resource allocation strategies that create compulsions and incentives for private investments in medium or high technology and productivity sectors. Furthermore, the local state has increasingly become incapable of disciplining the capitalist elites to reinvest a large bulk of their income into productive activities. The evolution of

[19] Due to lack of data for local-level income shares we took the average income share of Colombia's top earners (which is around 50% of all income, measured by tax returns) as a proxy for Medellín's top ten percent. Given the larger degree of inequality of Medellín's society, the income share of the city's capitalist elites is likely to be even higher.

[20] Due to lack of local data, we calculated this ratio using data for total private income in Colombia, the national share of the top 10% of Colombia and the private net investment in Medellín's economy. We adjusted the total national private income to Medellín's top 10% by dividing the average national private income between 2005 and 2014 with the average ratio of local GDP/national GDP. This has obvious limitation but is still a valid proxy that informs the empirical analysis.

Medellín's elites has shaped policy making in the city through embracing a neoliberal ideology that reinforces Medellín's 'new urban neoliberalism'. These trends confirm our assumption that the local state, captured by a transnational capitalist elite with low entrepreneurial capabilities, has been unable to create and enforce an institutional environment that incentivizes high productivity investments due to the incompatibility between such rent management strategies and the structures of power in Medellín's settlement.

The question we need to ask, however, is how Medellín's policy agenda, the increased fiscal capacity of the municipal government as well as the changes in net private investments, affected economic growth. As discussed in chapter two and depicted in figure 2.4 Medellín's economy has grown exceptionally fast. Since the first year of the Fajardo administration and the implementation of the local market-driven policy reforms, the urban economy of Medellín grew rapidly, at almost double the growth rate of the rest of the country in 2004. Some academic observers, NGOs and particularly public officials and business actors in Medellín see this large increase in economic activity as a result of an increase in public expenditure and net private investment over the same period. Various public and private organizations stress the importance of the 'good governance' agenda for achieving this increased dynamic of private sector involvement, which is seen to underpin the "metropolitan miracle" (see Cámara de Comercio, 2011). Hence, the aggregated growth data of Medellín shows that the institutional changes and the implementation of 'good governance' reforms might have had positive developmental outcomes.

However, a closer look at the disaggregated data reveals that Medellín's growth data very much correlates with the findings regarding disaggregated investment. Thus, the composition of political, institutional and economic factors in Medellín's political settlement has incentivized economic growth driven by a large expansion of activities in sectors that are marked by low productivity. The financial sector of Medellín's economy has been one of the main drivers of economic growth, despite a small contraction in its dynamism following the global financial crisis (table 7.2). Furthermore, the urban economy has experienced large growth rates in real estate, (residential) construction, tourism, and business services. While these sectors have experienced stable growth rates at around 5-8% annually, in general we can identify a tendency for fluctuations in activity. The steep contraction of the construction sector in 2007 and 2011 for example, says much about the lack of commitment to the continuity of private and public investments. It further underlines the unsustainable nature of Medellín's economic boom (see table 7.12).

TABLE 7.2: GDP GROWTH IN MEDELLÍN BY SECTOR (IN %)

	2005	2006	2007	2008	2009	2010	2011	2012
Agriculture	13.2%	11.6%	8.8%	-0.4%	3.3%	14.2%	9.9%	5.1%
Mining and quarrying	25.3%	17.0%	-6.6%	-9.2%	1.9%	20.0%	-33.3%	21.7%
Manufacturing Industries	6.7%	4.4%	0.8%	6.2%	5.1%	4.3%	5.9%	1.5%
Electricity, gas and water	1.8%	5.5%	0.8%	1.5%	3.1%	1.3%	1.5%	3.2%
Construction	11.8%	17.9%	-17.5%	-4.0%	-3.4%	19.9%	-20.4%	-2.0%
Retail	10.8%	11.3%	3.1%	4.4%	8.0%	10.0%	6.4%	2.0%
Hotels and Restaurants	5.6%	6.2%	5.7%	4.5%	3.3%	6.1%	7.9%	4.1%
Transport and Communication	12.8%	15.2%	11.8%	2.7%	4.6%	9.8%	3.9%	1.8%
Financial intermediation	8.2%	12.2%	11.6%	-5.9%	9.6%	17.3%	9.7%	8.8%
Real estate and rental	6.0%	6.1%	5.3%	2.8%	4.9%	5.1%	4.7%	3.2%
Activities of business services	9.9%	7.0%	7.1%	7.5%	3.8%	7.7%	8.2%	4.5%
Social and Communal Services	6.2%	4.6%	5.6%	6.3%	4.5%	2.7%	6.2%	5.0%
Total	**6.6%**	**7.8%**	**8.4%**	**4.7%**	**0.5%**	**4%**	**4.8%**	**4.3%**

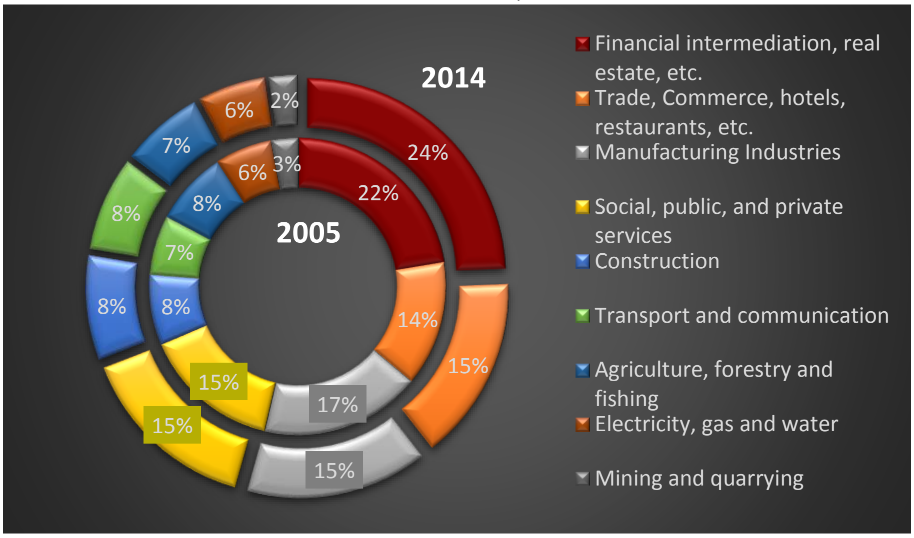
SOURCE: SISTEMA DE INDICADORES ESTRATÉGICOS DE MEDELLÍN – SIEM, OWN CALCULATIONS[21]

The speculative, finance-driven, and low productivity type of growth that we halve already observed when disaggregating net private investments is further illustrated in figures 7.9 and 7.10. While the value-added share of manufacturing industries has consistently decreased since 2005, the financial sector as well as hospitality services (tourism) and construction increased by large margins. In fact, in 2014 these three economic sectors were responsible for over 50% of value added and GDP growth (figure 7.10). Hence, the gap between manufacturing and non-manufacturing growth of GDP is widening. With valued-added growth of over 53% between 2005 and 2014 the non-manufacturing sectors have become the leading drivers of economic growth. While the manufacturing sector has experienced growth rates of up to 6% (see table 7.2), the sector has become increasingly marginalized as it now only contributes 11% to GDP growth (figure 7.10). Furthermore, and as discussed below, the

[21] Data availability for Medellín is limited. Disaggregated data for the municipal level is only available after 2005. The growth rates of each sector was calculated using the available data for sectoral GDP values, in 2005 constant COP.

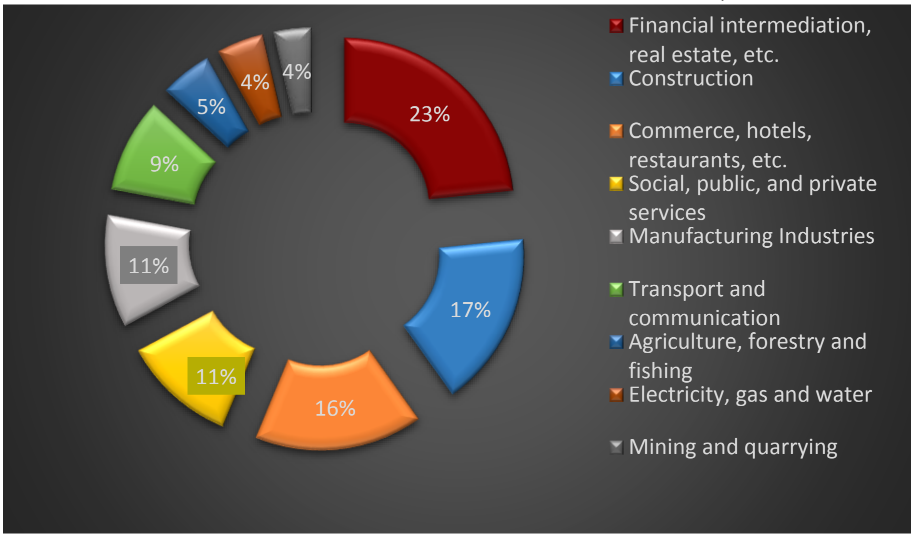
manufacturing activities remaining in Medellín are marked by low productivity and high labour intensity. The combination of remarkably low rates of investments into medium and high productivity sectors with the lack of upward diversification of economic growth patterns seems to be at the core of the city's productivity problem, which will be analysed further in the following sections.

FIGURE 7.9: VALUE ADDED BY ECONOMIC SECTORS, 2005 AND 2014



SOURCES: CAMARA DE COMERCIO (2015), WITH DATA FROM DANE

FIGURE 7.10: CONTRIBUTION TO GDP GROWTH BY ECONOMIC SECTOR, 2014



SOURCES: CAMARA DE COMERCIO (2015), WITH DATA FROM DANE

Another driver of economic growth in the analysed period was tourism, reflected in the growth rates of commerce, restaurants, and hotels (table 7.2, figures 7.9 and 7.10). The focus on developing a tourist industry is compatible with broader global economic transformation patterns elsewhere in Latin America (Robinson, 2010). However, tourism depends on highly price- and income-elastic and unstable demand. In Medellín, despite authorities seeking "to sell the city" in a very aggressive manner, as a host locality the local government has very little control over this demand and thus over possible labour market impacts. Tourist infrastructure has played a particular role in Medellín's development strategy, consisting mainly of increased investment in megaprojects. The cable car system *Metrocable,* for example, has served as a platform for Medellín to market itself to domestic and foreign investors. In an interview the former Territorial Secretary of Fajardo underlined the importance of the cable car system in attracting FDI. However, his comments also indicate that there are problems in creating sufficient backward linkages for technology growth in local productive sectors: "The French, who sold us the technology (for the *Metrocable*) consider us as their strategic ally to sell their products… the cable was not a means of public transportation but of tourist transportation… and they sold us the technology… Today they (the French) say that the way in which to sell it is through Medellín. France is not able to go to Peru to sell this on their own… and we help them indirectly to do so… When we talk about innovation (in Medellín) we don't mean that we invented I don't know what, but that we plan very specific ways to solve urban problems that have nothing to do with the technology itself" (Lopera Pérez, 2014).

7.2 Economic productivity

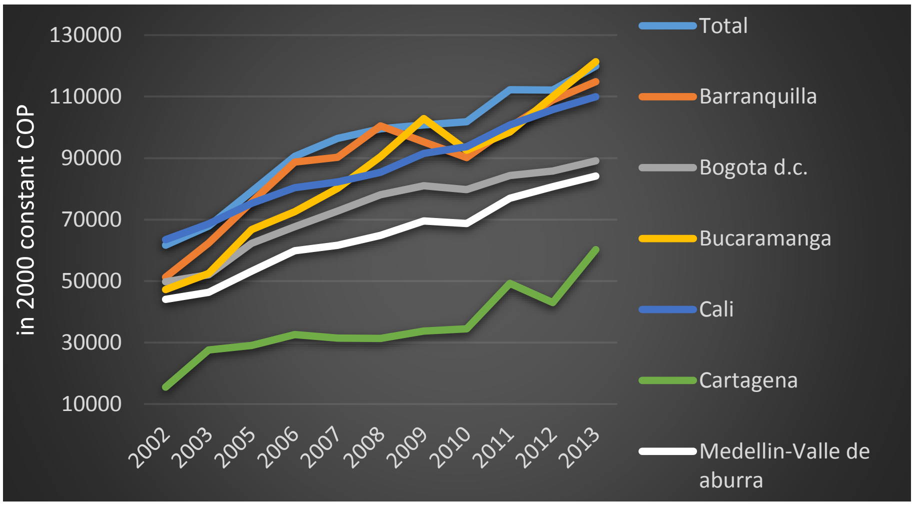
In chapter three we established that particular combinations of power structures and institutional mechanisms can lead to different types of appropriability problems. Many of these problems are linked to insufficient investment in efforts for tacit learning. In a political settlement where capitalists with relatively low entrepreneurial and low technological capabilities and with an interest in labour-intensive industries and services have considerable organizational power, investment in learning-by-doing is likely to remain insignificant. This can lead to adverse productivity outcomes and can slow down technology acquisition.

Recalling the findings regarding the sectorial data in table 7.2 and figures 7.9 and 7.10 one might be tempted to argue that these assumptions do not hold for Medellín, as the city experienced industrial growth and the manufacturing industry contributes around 11% of GDP growth. This, however, would be misleading, not only due to the drastic decline of the industrial share of GDP growth since 2005. A more rounded discussion of Medellín's industrial performance requires scrutiny of how Medellín's public policy agenda and private investment strategy translated into productivity growth and technological development.

A comparative analysis of growth data of Colombian cities helps us identify several characteristics of Medellín's productivity performance. Furthermore, and analysing firm-level data, this analysis allows us to compare the potential of regional companies to develop capacities for growth in medium and high technology sectors. For this analysis, we first look at several factors contributing to GDP growth in different Colombian cities. In particular, we analyse how growth rates in GDP per capita were influenced by changes in labour productivity, changes in labour intensity (measured in hours worked per worker), changes in the employment rate, and labour supply. Secondly, and in order to measure the potential of regionally agglomerated firms, we look at the concentration of traded industries in Medellín and their relative productivity.

The disaggregated analysis of regional growth data shows that Medellín has experienced high growth rates between 2004 and 2012 (table 7.3). The high growth rate of Medellín's economy is in line with our findings presented so far. However, the analysis of the characteristics of Medellín's economy shows that the city has experienced a very small increase in labour productivity rates, indicating that the high GDP per capita growth has not been accompanied by increases in activities of high productivity sectors (table 7.3). Rather, we see that the strong economic performance of Medellín is a result of an increase in labour intensity as well as an overall growth in the employment rate. This underlines the findings that large parts of Medellín's economic activities are located in low productivity and labour-intensive sectors that respond to economic growth with increases in employment rather than in labour productivity. Overall Medellín has shown a relative weak performance in labour productivity growth and is one of the cities with the smallest increase in value added per worker. This is depicted in figure 7.11, where we calculated value added per worker based on output in all productive sectors in the 13 largest Colombian cities. We used 2000 Colombian Pesos (COP) as our base currency to calculate the changes from 2002 until 2013.

FIGURE 7.11: LARGEST COLOMBIAN CITIES: VALUE ADDED PER WORKER



SOURCE: DATA FROM DANE, OWN CALCULATIONS

TABLE 7.3: GDP, PRODUCTIVITY, LABOUR INTENSITY, EMPLOYMENT AND LABOUR SUPPLY: COLOMBIAN CITIES[22]

	GDP per capita [1]	Labour productivity[2]	Hours worked per worker[3]	Employment rate[4]	Labour supply[5]
Bucaramanga	4.97%	2.38%	0.16%	1.97%	0.46%
Pereira	4.91%	3.11%	0.80%	-0.34%	0.44%
Bogotá	4.07%	0.40%	0.80%	1.38%	0.49%
Medellín	**3.56%**	**0.84%**	**0.78%**	**1.48%**	**0.49%**
Cartagena	3.41%	1.51%	0.30%	1.23%	0.37%
Cali	3.01%	2.19%	0%	0.46%	0.36%
Manizales	2.87%	1.95%	0.99%	-0.46%	0.34%
Pasto	2.87%	1.98%	0.18%	0.18%	0.52%
Barranquilla	2.84%	1.03%	0.47%	1.20%	0.33%
Ibagué	2.26%	0.50%	1.22%	0.16%	0.38%
Montería	2.21%	-0.54%	2.22%	0.12%	0.41%
Cúcuta	1.97%	1.07%	0.86%	-0.40%	0.50%
Villavicencio	-1.24%	-2.68%	0.96%	0.06%	0.42%
Total	3%	1%	0.61%	0.94%	0.44%

SOURCE: DATA FROM DANE, OWN CALCULATIONS FOLLOWING RAMÍREZ ET AL. (2014). [1]GDP OVER TOTAL POPULATION; [2]GDP GROWTH PER HOUR OF LABOUR; [3]HOURS WORKED DIVIDED BY NUMBER OF TOTAL EMPLOYED; [4]NUMBER OF TOTAL EMPLOYED DIVIDED BY WORKING-AGE POPULATION; [5]WORKING-AGE POPULATION DIVIDED BY TOTAL POPULATION.

While the differences between Medellín's relatively high GDP per capita growth and the city's low labour productivity is striking, table 7.3 also shows a significant gap between output and productivity growth performances of different regions in Colombia (see differences between Bogotá's and Medellín's productivity growth). The table further confirms claims that Latin American economies have failed to achieve structural change that contributes to increased labour productivity growth.

As such, the findings depicted in table 7.3 regarding the relative failure of economic growth to translate into higher productivity output to some extend contrast with the microeconomic studies of Eslava et al. (2009) and Fernandes (2007). The authors argue that intensified import competition has led to an increase in manufacturing productivity on the plant level in Colombia, since it has forced firms to rationalize their operations (see Eslava et al., 2009; Fernandes, 2007). However, and using the theoretical model and empirical findings of McMillan and Rodrik (2011), we argue that the lack of labour productivity growth across the entire economy as well as the economy-wide gaps in labour productivity can be explained by looking at the effects of workers' displacement from firms that achieved technological growing up.

[22] For Medellín we calculated the variables using data from DANE's *Gran Encuesta Integrada de Hogares* (Large Integrated Household Survey, GEIH) between 2004 and 2012. The results for other Colombian cities is taken from Ramírez et al. (2014), for the years 2002-2010.

The productivity-reducing structural change in Colombia and the productivity gaps between different regions are the costs and consequences of the country's premature deindustrialization. Thus, and following Colombia's *apertura* reforms, increased import competition and productivity growth in top tier firms that managed to close the gap with the technology frontier have led to a displacement of many workers from manufacturing industries to less productive activities. For the regional context in Colombia this means that while some plants (many of them located in Bogotá) managed to catch up technologically, workers that were released from these plants were displaced to a majority of low-productive sectors in labour intensive industries or services. This explains the low gains in labour productivity growth in Bogotá (see table 7.3). For Medellín, and despite the historical importance of mining and manufacturing for the region al economy, the majority of jobs in the Antioquian capital are now provided by companies in non-tradable services – a direct consequence of the region's premature deindustrialization.

In conclusion, we argue that the low increases in labour productivity growth and the regional and inter-economy gaps in labour productivity depicted in table 7.3 are largely an outcome of the way in which local governments as well as the national government in Colombia responded to the country's integration into global capitalist dynamics. The local circumstances before the *apertura* reforms, as well as the choices made and growth strategies implemented by local and national policy makers largely impacted the way in which Colombian regions benefited or not from trends of globalization.

Following Porter (2003) and Ramírez et al. (2014), who argue that regional productivity potential is determined by the presence of traded industries as well as the relative productivity of these industries, we analyse employment concentration and productivity growth of non-agricultural firms based in Medellín. This provides empirical grounds for a broader analysis of productivity growth in Medellín. The data we use are from different years of the *Encuesta Anual Manufacturera* (Annual Manufacturing Survey, EAM) of the *Departamento Administrativo Nacional de Estadistica* (DANE), as well as the *Planilla Integrada de Liquidación de Aportes para Seguridad Social* (Integrated Liquidation Accounts for Social Security, PILA)[23].

More specifically, we look at two factors that determine the entrepreneurial capacities of firms in Medellín to achieve growth high productivity sectors. Firstly, we look at the concentration of employment in non-agricultural sectors of Medellín relative to other cities. This Employment Concentration Factor (ECF) provides insight into the concentration of employment in each sector in Medellín relative to similar activities in other parts of the country. It is calculated as

[23] The access to PILA data is restricted. Available data was taken from Ramírez et al. (2014).

the relation of local employment in a specific sector in Medellín (e_{sM}) with the total employment of Medellín (e_M), divided by the relationship between national employment in that sector (E_{sT}) and total employment nationally (E_T).

$$ECF_{sM} = \frac{\left(\frac{e_{sM}}{e_M}\right)}{\left(\frac{E_{sT}}{E_T}\right)}$$

An $ECF_{sM}>1$ means that a specific industry is concentrated in Medellín, relative to the rest of the country. This can indicate that this sector does not only have employment capacities but also trading capacities (at least compared to other regions of Colombia), as it is not only limited to the local market. Following the rationale of Porter (2003) and Ramírez et al. (2014), the relative employment concentration of a local sector can indicate the traded capacities of that sector. An $ECF_{sM} = 1$ or <1 shows that economic activities of the analysed sector are geared towards the local market needs and can be described as 'local sectors' (see Ramírez et al., 2014).

The second variable we use in the analysis of Medellín's non-agricultural firms is the Labour Productivity Factor (LPF), which serves as a proxy for Medellín's productivity performance. For the calculation of the LPF and in order to determine this proxy for relative productivity of local and tradable industries we take the model proposed by Ramírez et al. (2014, p. 25). This model estimates the LPF variable by comparing the salaries of workers in a particular sector of Medellín's industry with the average salary that is paid across Medellín's economy (LPF_1). With the assumption that workers that have higher skills in higher productivity sectors are better remunerated than low-skilled workers in sectors with lower productivity, this variable can help us determine relative regional productivity of a particular sector.

$$LPF_1 = \frac{Salary_{sM}}{Salary_M}$$

Depending on data availability, we calculated LPF comparing the salaries of a particular industrial sector in Medellín with the average salary paid in that sector nationally (LPF_2).

$$LPF_2 = \frac{Salary_{sM}}{Salary_{sT}}$$

Due to limited availability of data on salaries in the EAM data, we also calculated the LPF using the relationship between value added per worker in a particular industrial sector of Medellín with value added per worker in the entire local economy (LPF_3), or value added per worker in a specific local industry over value added per worker in that industry on the national level (LPF_4).

$$LPF_3 = \frac{Value\ Added_{sM}}{Value\ Added_M}$$

$$LPF_4 = \frac{Value\ Added_{sM}}{Value\ Added_{sT}}$$

We recognize that there are several problems with equating average salary or average value added per worker in a particular industrial sector with the productivity performance of that sector. For example, price distortions caused by particular market power of a firm in a particular sector can affect wages in ways that have little relation to changes in productivity. However, the variable LFP reflects the most accurate and valid proxy for local productivity performance available, also given the limited availability of data for our case study.

Using ECF to examine the concentration of employment in a particular sector in Medellín relative to total employment in that sector and LPF as a proxy for productivity of Medellín's industries, Ramírez et al. (2014) construct a matrix of four quadrants that helps to classify the degree of productivity of different economic activities (see figure 7.12). The matrix shows four different types of sectors classified as 1) tradable high productivity industries; 2) local non-tradable industries with high productivity; 3) local low productivity industries; and 4) low productivity tradable industries.

FIGURE 7.12: PRODUCTIVITY MATRIX

FP ↑		
	2) Local high productivity sectors	**1) High productivity tradable sectors**
	3) Local low productivity sectors	**4) Low productivity tradable sectors**

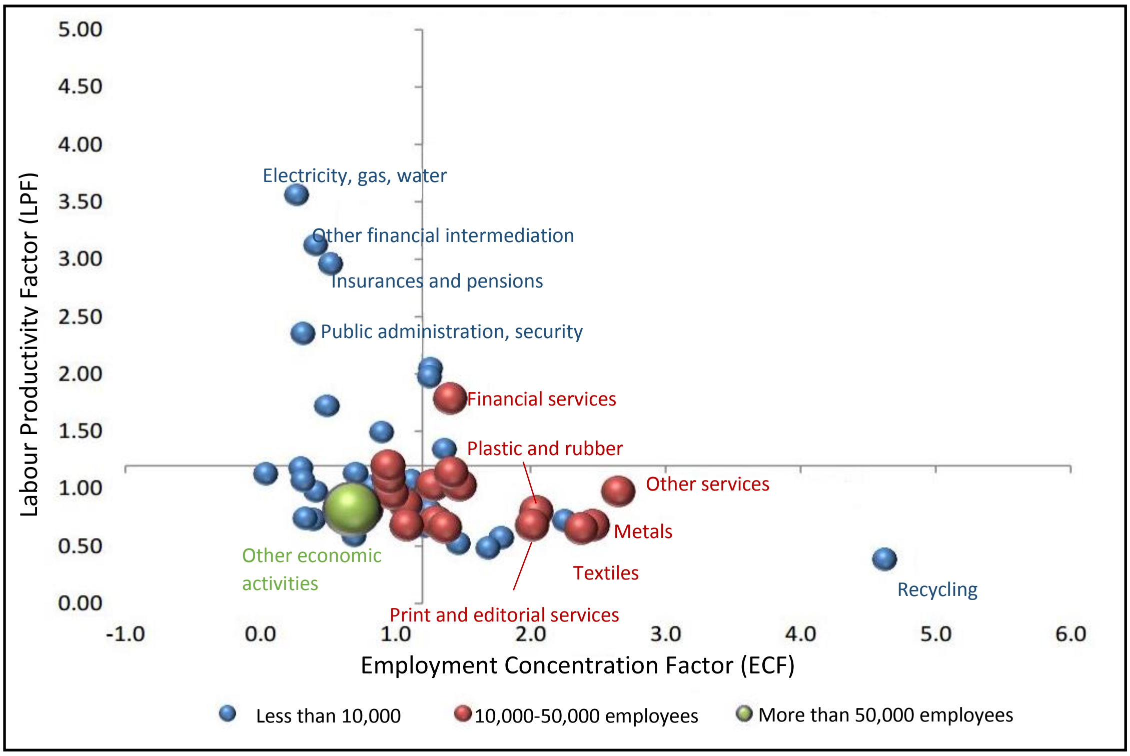
ECF →

SOURCE: RAMÍREZ ET AL. (2014, P. 26)

For Bogotá, Ramírez et al. (2014) find that the most tradable sectors that show high productivity potential generate very little employment. The only high productivity tradable sector in Bogotá that serves as a generator for high employment rates is the capital's financial sector, including insurances and pensions. Most of Bogotá's employment is concentrated in sectors that are characterized by relative low productivity and their non-tradable character such as retail and services (see Ramírez et al., 2014, p. 29). However, when looking at Bogotá's manufacturing sector using the information of the EAM, Ramírez et al. (2014) observe a concentration of industrial sectors marked by high productivity rates, including aircraft manufacturing and manufacturing of electrical cables and wires.

While the situation in Medellín is similar in some sectors (i.e. finance), an analysis of the Antioquian capital also reveals differences, especially in relation to medium and high productivity industrial sectors. The findings for Medellín show that there is a large absence of tradable and high productivity economic activities. The companies that have concentrated in Medellín largely engage in services and low productivity industries. The only tradable sector that shows high productivity potential and concentrates more than 10,000 employees is Medellín's financial sector. This underlines the trend of the finance-driven and possibly speculative development of the city's economy. The PILA data also reveals that the tradable industries of textile, metal and plastic show low productivity capabilities in relation to other economic activities, while at the same time these sectors concentrate a large proportion of local employment (see figure 7.13). The relatively high productivity of the electricity, gas and water sector can be explained by the presence of EPM and its role as one of Colombia's largest utility providers. However, most economic activities are concentrated in quadrant three (see figure 7.13). The low productivity and the lack of trading capacities of these sectors clearly indicates that economic growth in Medellín over the past decade or so is largely built on weak foundations.

FIGURE 7.13: EMPLOYMENT CONCENTRATION AND PRODUCTIVITY OF SECTORS IN MEDELLÍN

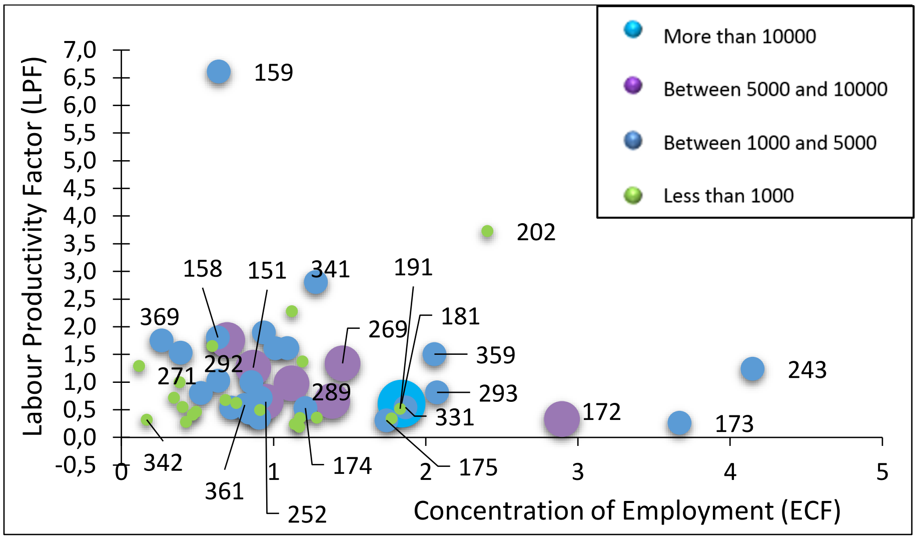


SOURCE: RAMÍREZ ET AL. (2014), WITH DATA FROM PILA

Looking exclusively at the EAM data for an analysis of Medellín's manufacturing industry we find that Medellín's industry is dominated by the manufacturing of non-durable goods, such as textile and furniture (see figure 7.14). Hence, most employment is concentrated in these sectors, where ECF is relatively high. However, and as already established, these sectors have low productivity capabilities.

This becomes further visible in figure 7.14, where the low productivity of these sectors is measured by the generation of value added per worker in comparison to general economic activities in industrial sectors in Medellín's economy. The only non-agricultural sector that shows high productivity capabilities is the beverage industry, which at the same time seems to be concentrated on domestic markets. The inward relationship between ECF and LPF depicted in figure 7.14 clearly shows that sectors marked by high productivity in Medellín are limited to the domestic economy and do not concentrate large parts of the labour force. In turn, this means that Medellín's industry is dominated by labour-intensive activities in sectors marked by low productivity.

FIGURE 7.14: EMPLOYMENT CONCENTRATION AND PRODUCTIVITY OF MEDELLÍN'S MANUFACTURING INDUSTRY



SOURCE: DATA FROM EAM[24], OWN CALCULATION

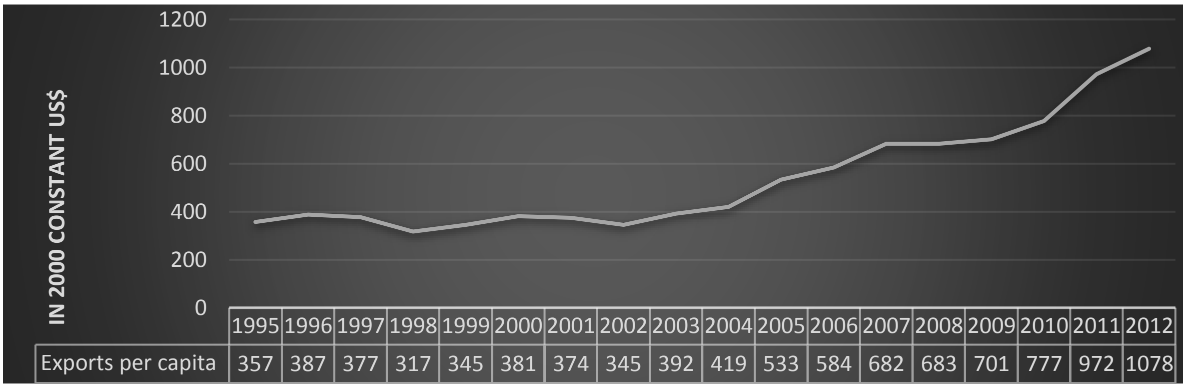
[24] Classification codes: 151: Production and procession of meat and fish; 158: Other foodstuff; 159: Beverages; 172: Weaving of textiles; 173: Finishing of textiles; 174: Other textile products; 175: Textile and knitwear; 181: Wearing apparel, except fur; 191: Leather; 202: Veneer sheets; 243: Millwood, Veneer, Plywood, and Structural Wood Members; 252: Rubber products; 271: Basic iron and steel; 289: Fabricated metal products and service activities related to metalworking; 292: Machinery of special purpose; 293: Household appliances; 331: Medical appliances; 341: Manufacture of paper and paper products; 342: Printing, publishing and allied industries; 359: Other transportation equipment; 361: Furniture; 369: Other manufacturing industries.

In sum, a very large part of Medellín's economic development is based on growth in service sectors, particularly in financial services. Industrial employment is concentrated in low productivity sectors that focus on the manufacturing of non-durable consumer goods. The low capacity of sectors marked by higher productivity to generate employment is limited. These local developments resemble the overall trends of labour productivity growth in post-1991 Colombia, where Washington Consensus-style financial and trade liberalization of Colombia have not resulted in high productivity growth.

7.3 EXPORTS AND TECHNOLOGY TRANSFERS

Similar to the trends in Medellín's GDP growth, export rates have increased substantially since 2004. Per capita rates of Antioquia's exports have experienced very positive developments. Exports per capita reached over 1,000 US$ per capita in 2012, after having grown by over 200% between 2002 and 2012 (figure 7.15). This makes Antioquia the strongest exporting region of Colombia, contributing to 9.3% of total exports. This figure is even higher and rises above 20% if we only look at industrial exports, excluding Colombia's largest exporting sector petroleum and its derivatives (figure 7.16).

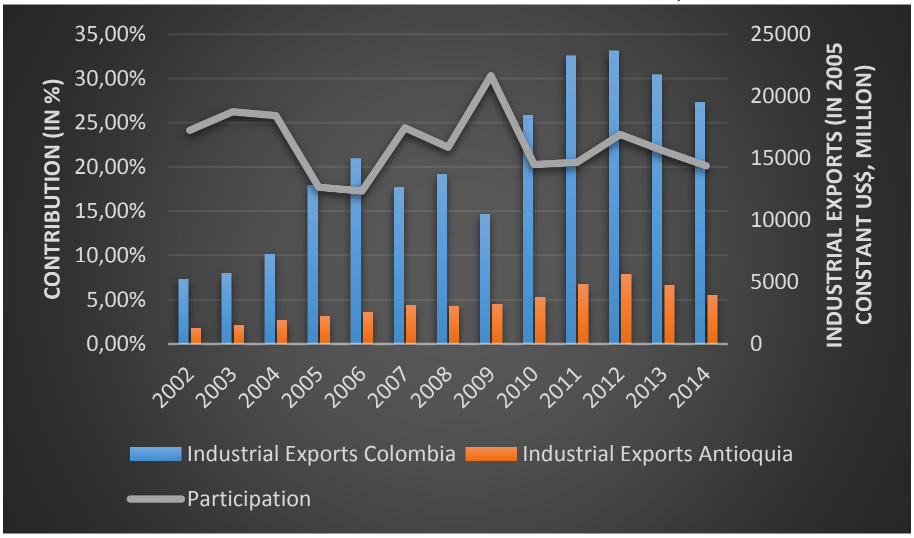
FIGURE 7.15: ANTIOQUIAN EXPORTS PER CAPITA



	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Exports per capita	357	387	377	317	345	381	374	345	392	419	533	584	682	683	701	777	972	1078

SOURCE: CAMARA DE COMMERCIO (2014)

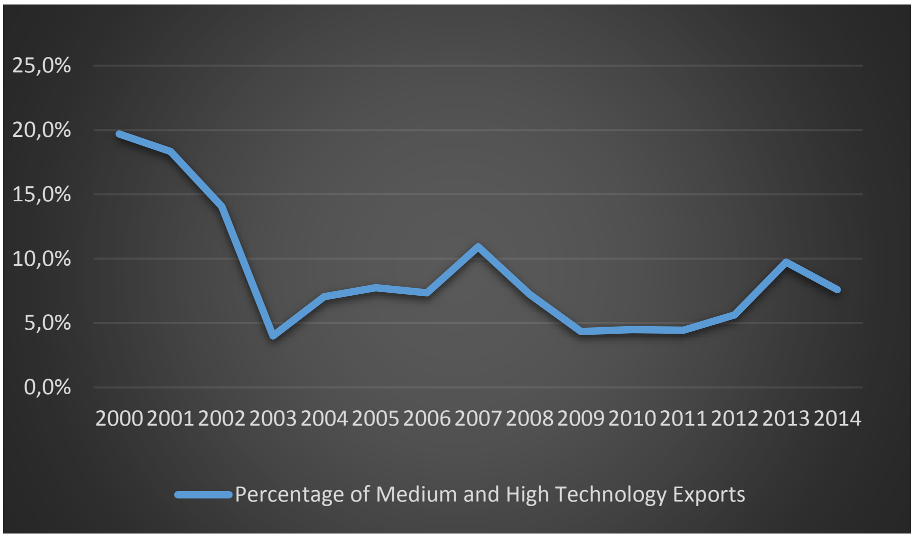
FIGURE 7.16: TOTAL EXPORTS AND CONTRIBUTION OF ANTIOQUIA, EXCLUDING PETROLEUM



SOURCE: DATA FROM DANE, OWN CALCULATIONS

However, despite these positive trends, the export growth rates and the large contribution to Colombia's exports have failed to significantly impact productivity growth and technology transfer in the local economy. This is mainly due to the fact that the region mostly exports primary commodities, reflecting the deindustrialization of Antioquia as discussed in chapter five. Analysing industrial exports, we find that in the past 15 years there has been a constant fall in the share of medium and high technology goods as a percentage of overall exports. We analysed export data looking at the share of exports of medium and high technology goods, such as aircraft materials, office machinery and computers, radio and television equipment, pharmaceuticals, medical and optical instruments, motor vehicles, chemicals, mechanical equipment, electrical appliances, and railway material and other transport equipment. Recent figures indicate that only around 8% of Medellín's total exports fall into this category of medium and high technology goods, which is a significant drop from almost 20% in 2000 (figure 7.17). The very low contribution to the region's exports of these higher value-added industrial products underlines that medium and high productivity sectors have insufficient export capacities. Hence, exports from Antioquia and Medellín have failed to translate into backward linkages for technologically advanced sector development and high productivity employment.

FIGURE 7.17: EXPORTS OF MEDIUM AND HIGH TECHNOLOGY AS A PERCENTAGE OF TOTAL EXPORTS

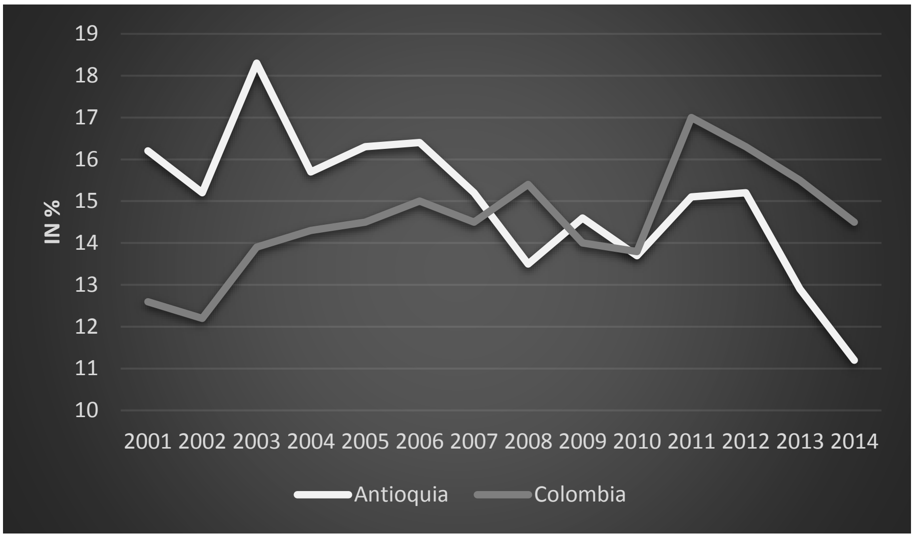


SOURCE: DANE, OWN CALCULATIONS

The relatively low productivity nature of Medellín's export sector is also reflected in figure 7.18, where we can see that exports have not been effective in serving as an engine of growth for Medellín's economy. Despite that the remarkable export expansion of the regional economy has generated increasing incomes for Medellín (see figures 7.15 and 7.16), the local economy has been unable to harness that power generated through the increased exports (figure 7.18). As seen in figure 7.18, Antioquia's share of exports in GDP has decreased from 18.3% in 2003 to 11.25% in 2014, while Colombia's share of exports as a percentage of GDP increased slightly.

Despite of the increase in Medellín's total exports since 2003, this did not result in a similarly positive trend for GDP growth, which may explain the sharp decline of the share of exports in GDP (figure 7.18). Another explanation for the fall in the export share can be traced back to the domination of Medellín's and Antioquia's exports by goods from sectors marked by low productivity. The large share of natural resources (gold) and low-value added content of the exported industrial goods (see figure 7.17) explains much of the trend depicted in figure 7.18. Additionally, the focus on a market-enhancing policy environment that does not actively create incentives and compulsions for an export-led model of goods from medium and high technology sectors further slows down attempts to climb up the value ladder.

FIGURE 7.18: EXPORTS AS A PERCENTAGE OF GDP



SOURCES: CAMARA DE COMMERCIO (2014); DANE

In sum, alongside Medellín's deindustrialization trends and Colombia's shift towards neoliberalism, the institutional changes in Medellín facilitated the city's return to static comparative advantages in industrial and service sectors that are marked by labour intensity and low wages, and have insufficient exporting capacities.

The low productivity growth of Medellín's economy becomes further evident in the analysis of the growth performances of Antioquia's strategic *clusters* discussed in chapter six. Put forward by the Fajardo coalition as a promotion of sectors in which the regional economy was perceived to have comparative advantages, the cluster sectors received a considerable amount of institutional attention and public investment. This incentivized the creation of many new businesses in these sectors, leading to increases in overall numbers of companies as well as in their share of GDP growth (table 7.4).

However, as shown in table 7.4, the *cluster* sectors have low productivity outputs, and more importantly they fail to serve as an engine of growth for the regional economy. Technology transfers and sustainable productivity growth are unlikely to result from these trends. Of the strategic sectors identified by the Fajardo coalition, the labour-intensive textile sector still contributes most to industrial exports, despite it being the smallest contributor to GDP growth. Construction (including cement) is by far the largest industrial contributor to GDP growth (19.5%), but it only contributes around 8.8% to the city's exports. The overall contribution of the tourist *cluster* to GDP growth of only 3.4% confirms our earlier findings that the sector is unlikely to serve as growth escalator for productivity growth and development of medium or high technology sectors. The inability of the local economy to climb up the technology ladder becomes further visible in the analysis of the IT and communication sector. Being one of the few sectors with potential to generate productivity growth in medium or high technology activities, this sector contributes only a very small proportion of overall exports.

TABLE 7.4: ECONOMIC CLUSTERS: GROWTH AND EXPORT CAPACITIES OF THE STRATEGIC SECTORS

Cluster	Number of companies in 2013[1]	Share of total companies in 2013 (in %)[2]	Exports in 2014 (in 2005 constant US$, thousand)[3]	Share of total industrial exports in 2014 (in %)	Contribution to GDP in 2013[4]
Energy	2311	1.7%	238.9	10.6	3.9%
Textile	16104	11.5%	517.4	22.9%	2.4%
Construction	17241	12.3%	199.3	8.8%	19.5%
Tourism	14750	10.5%	N/A	N/A	3.4%
Medical goods and services	5447	3.9%	31.4	1.4%	2.4%
Information technology and communication	4151	3.0%	4.7	0.2%	3.1%
Total	59959	42.8%	991.7	43.9%	34.7%

SOURCES: DATA FROM: [1]REGISTRO PÚBLICO MERCANTIL – CAMARA DE COMERCIO (2013); [2]ESTIMATIONS, BASED ON CALCULATIONS OF REGISTRO PÚBLICO MERCANTIL DATA; [3]DANE, CÁLCULOS INVESTIGACIONES ECONÓMICAS, CCMA; [4]DANE – CUENTAS DEPARTAMENTALES 2012

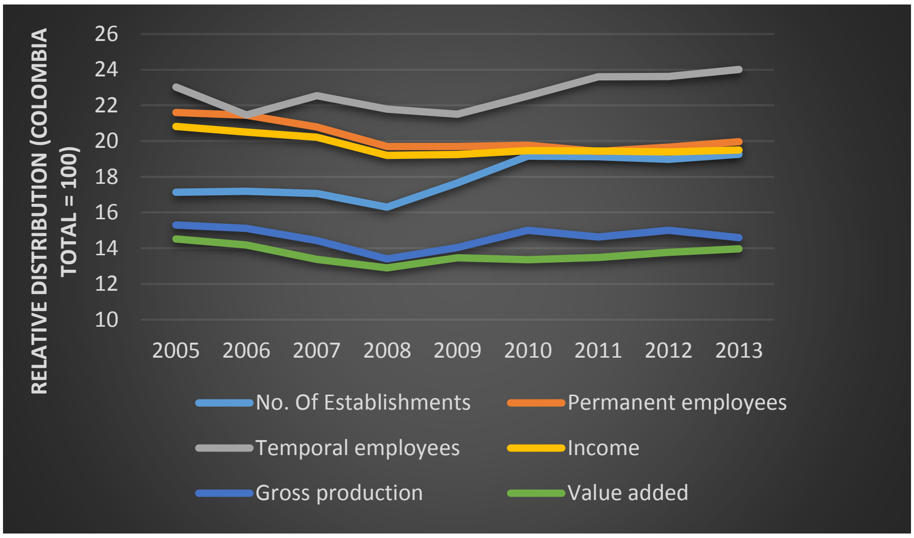
The analysis has shown that from a developmental perspective Medellín has clearly experienced negative trends with regard to productivity growth and technological capabilities. The findings of this section indicate that despite the relatively high growth rates and the comparatively high employment rates in Medellín, these have failed to translate into productivity growth in medium or high technology sectors with the potential of ensuring a sustainable growth path in the longer term.

7.4 THE LABOUR MARKET AND INCOME INEQUALITY

The lack of competitiveness of Medellín's medium to high technological industries and the inability of the city's economy to harness the power generated by the expansion of regional exports has hindered local companies from climbing up the value and technology ladder. This trend of low productivity growth and the failure to translate economic growth into technology acquisitions and transfers is also reflected in urban labour market developments. In figure 7.19 negative or at least questionable trends of Medellín's labour market become visible.

Compared to the rest of the country, the overall number of established companies increased, while value added and gross production of Medellín's economy decreased. Figure 7.19 furthermore shows that the increase in employment was largely absorbed by an increase in temporal employees, while real wages (income) and permanent employment stagnated or even decreased. This provides initial evidence that the labour market in Medellín is highly flexible and experiences high gross employment elasticities.

FIGURE 7.19: RELATIVE DISTRIBUTION OF MEDELLÍN'S LABOUR MARKET VARIABLES



SOURCE: DANE, OWN CALCULATIONS

To gain further insights into the characteristics of Medellín's economy and its capacities to serve as a generator of growth in sectors marked by high productivity and high-skilled labour, we need to take a closer look at the relationship between the local gross employment elasticities and the development of labour productivity. Gross employment elasticity is defined as the ratio between employment growth and GDP growth. The degree of employment elasticity of a country (or in our case a city) is indicative of the degree of flexibility of the national (or local) labour market. A higher elasticity indicates a higher degree of labour market flexibility.

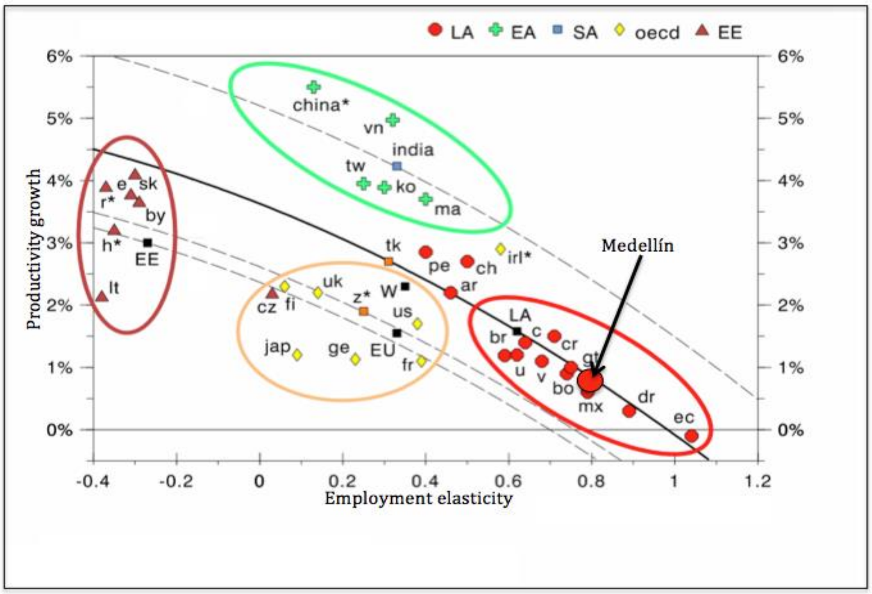
General trends in Latin America show that employment elasticities are much higher than in the rest of the world. Palma (2011) finds explanations for this in the region's focus on economic growth based on services. The labour market of Colombia in general and Medellín in particular is not an exception to this. Quite the contrary: the particularities of Medellín's labour market, characterized by its structurally low productivity and high gross employment elasticities, often limit the amount of productivity growth and high-wage employment that can be generated with additional GDP growth. Cano and Ochoa (2008) as well as Vélez Cardona (2001) find that

Medellín has comparably higher gross employment elasticities than the rest of the country, which results from the relatively higher sensitivity of Medellín's employment to output growth.

The highly flexible labour market regime in Medellín undermines potential productivity growth in periods of high economic growth. In such periods, additional growth is absorbed by an increase in employment. Using the findings of Palma (2011), figure 7.20 shows the relationship between gross employment elasticity and productivity growth in Latin America (including Medellín) compared to the rest of the world. The negative relationship between the two variables indicates that the high gross employment elasticities may very well affect GDP and investment growth negatively.

The analysis of Medellín in comparison to these general trends shows that the local developments are fairly negative. The liberalization of the country's economy, and the implementation of market-enhancing institutional structures have in many ways affected the productivity potential of industrial and service activities negatively, a trend local 'good governance' reforms did not challenge (see figures 7.13 and 7.14). Medellín's growth strategy and particularly the labour market reforms that were adopted in this context have increased gross employment elasticities and have resulted in the concentration of growth in low productivity sectors. The flexibilization of the labour market has thus impeded a positive impact of Medellín's GDP growth on the city's productivity performance (see figure 7.20).

FIGURE 7.20: PRODUCTIVITY GROWTH AND EMPLOYMENT ELASTICITY: MEDELLÍN LABOUR MARKET



SOURCE: PALMA (2011, P. 29), OWN ELABORATION FOR MEDELLÍN[25]

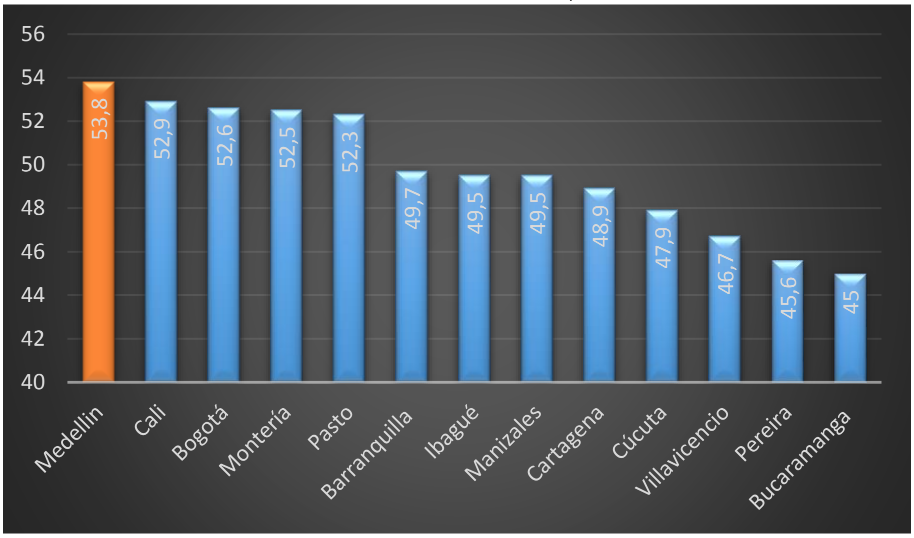
Figure 7.20 indicates that while Medellín's productivity growth of 0.84% is below the national average, the city's gross employment elasticity of 0.79 is above Colombia's average. Combining these findings with those presented in sections 7.2 and 7.3, we see that the labour-intensive manufacturing sectors as well as the tourist sector might generate employment for Medellín's labour force. However, the low capacities of these activities to generate high productivity growth translate to insufficient pressure on the large elasticity of labour supply. This has also resulted in very little upward effects on wages (see figure 7.19), which stands in contrast to the development of income indicators in other Colombian cities (see Ramírez et al., 2014).

Overall, these trends have had little impact on productivity growth, which explains why much of the formal sector of Medellín's economy remains in such activities that require low technology and low-skilled labour. Palma's (2011, p. 30) conclusion for Latin America aligns closely with our findings for Medellín: "In other words, this bulk of the economy can operate with few *compulsions* for productivity growth thanks to 'flexible' labour markets,… and a (typically) high degree of oligopolistic concentration". The modern sector of 'the most innovative city in the world' is thus based on low productivity manufacturing of non-durable

[25] Due to limited data availability, the arc elasticity of Medellín's labour market was calculated using the time period between 2004 and 2012, while the rest of the data is taken from Palma (2011) whose time series calculations are for the period 1990-2008. For the calculation of arc elasticity of employment in Medellín we use: $\varepsilon = \frac{\Delta L/L}{\Delta YY}$, where L denotes employment and Y stands for GDP for the local economy as a whole. The numerator is the percentage change of employment; the denominator refers to the growth rate of GDP. The arc elasticity ε describes the per cent change of employment for every per cent change of GDP between 2004 and 2012.

commodities, a low technology service sector that has low productivity growth rates, and the abundance of cheap (informal) labour supply. It is therefore not surprising that Medellín remains the most unequal city in one of the most unequal countries worldwide (see figure 7.21)

FIGURE 7.21: INEQUALITY IN MAJOR COLOMBIAN CITIES, GINI LEVELS FOR 2010



SOURCE: DANE, OWN ELABORATION

The incorporation of the neoliberal paradigm in Medellín has not only hindered the creation of opportunities for high productivity growth, but has also crippled possibilities of creating market compulsions in which these opportunities can be taken up. Again, using the analysis of Latin America by Palma (2011, p. 50) we can conclude that the neoliberal brand of Medellín's capitalism "is characterised as much by its capacity to generate market opportunities as by its ability to waste them". Furthermore, the very particularity of Medellín's economy is that it has served as a very effective tool for the transnationalized capitalist elite to perpetuate structural tendencies of unequal distributional outcomes in the city's society. The hegemonic nature of the organizational power of actors that promote market-driven development – reinforced and perpetuated through 'good governance' reforms – makes it close to impossible for outsiders of the ruling coalition to challenge this strategy.

The institutional and governance reforms that were compatible with the power structures in Medellín's transnationalized local political settlement promoted developmental outcomes that underline Medellín's return to static comparative advantages in labour-intensive industries and low technology services. Medellín's 'good governance' model does not challenge the city's insertion into the low productivity end of global production. Rather these reforms are perpetuating Medellín's situation.

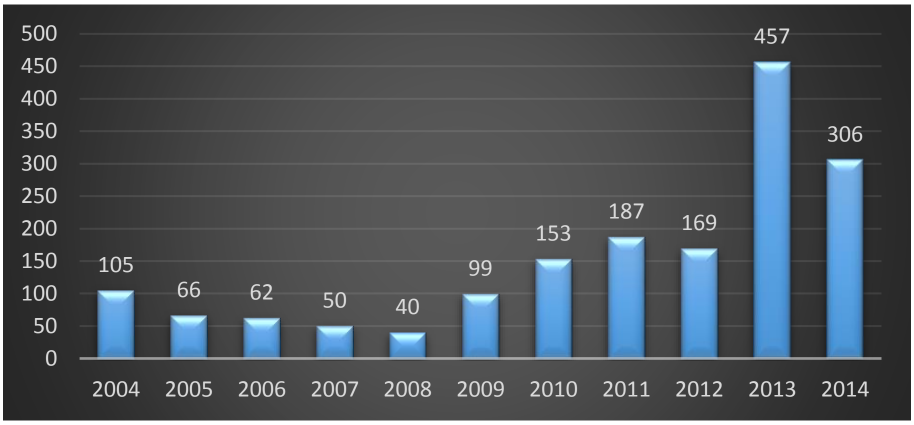
Besides providing explanations of these findings regarding the low productivity character of Medellín's economic development, the political settlements approach can help us in understanding outcomes regarding political stability and violence. The next section discusses how the ruling coalition was an important factor in stabilizing Medellín's political settlement. While most contributions have attributed the stabilization of Medellín's polity and the decrease in violence to 'good governance' reforms, the next section engages in a political economy analysis of the factors behind these changes.

7.5 Political stability, violence and development

Besides Medellín's economic turnaround, the main argument in favour of a "miracle" having taken place in Medellín is the city's success in reducing violence (see figure 2.8). Indeed, since the homicide rate peaked at 375 per 100,000 in 1991, the city has experienced a dramatic reduction of murders to 177 per 100,000 in 2002, before Fajardo came to power, and a further steep reduction to 52 per 100,000 in 2012, the year the second tenure of the Fajardo coalition government ended. This development is undoubtedly remarkable. However, to claim a "miracle" effectuated by the Fajardo coalition is an oversimplified explanation which not only ignores wider national developments and trends of legitimization of paramilitary control over the main geo-political and geo-economic areas of the country. It also fails to include more nuanced considerations about shifts in the distribution of power in Colombia's and Medellín's political settlement, which would inform a fuller understanding of these developments.

Furthermore, we also find an increase in other violence-related variables. For example, the number of extortions of businesses has increased dramatically since 2004 (figure 7.22). This shows that businesses in Medellín have increasingly paid protection fees, so-called *vacunas* ('vaccinations'). In a situation where private investment in Medellín increased (also as a result of the perceived higher security), paramilitary forces have more investment to protect. In certain parts of the city the paramilitary has established a monopoly on violence as well as significant 'tax'-collection capacities, which are tolerated by the local authorities. In visits to the paramilitary-controlled north eastern and north western *comunas* the author observed a complete absence of any state enforcement of the rule of law. In conversations with local members of paramilitary organizations as well as with ex-members of urban militias it was furthermore stressed that the *bandas* exercise control over local businesses and the movement of people (Quijano, 2014). The authorities evaluate these 'petty crimes' as the lesser of two evils and thus tolerate paramilitarized control in *comunas* far away from the tourist activities (Román, 2014).

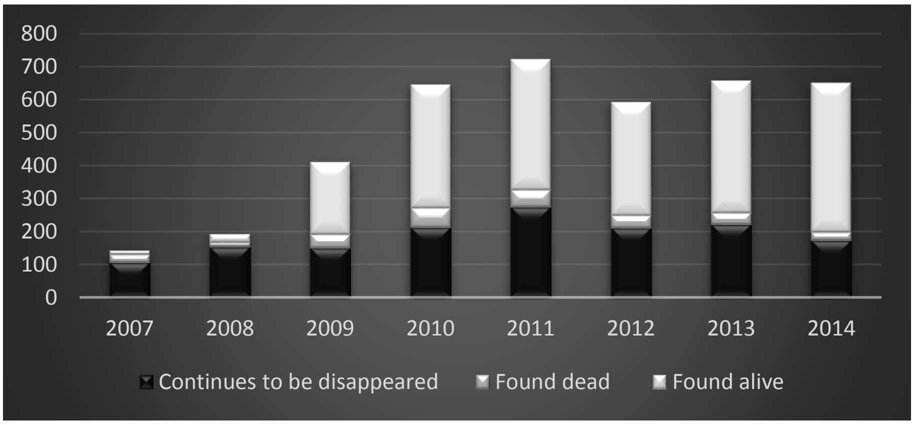
FIGURE 7.22: EXTORTIONS OF BUSINESSES IN MEDELLÍN



SOURCE: MEDELLÍN COMO VAMOS (2015)

The character of violence and tactics of war have also drastically changed since the turn of the millennium. Since then the paramilitary seem to have taken on board that a high homicide rate is harmful to the image of the city for attracting investment, particularly from abroad – after all, the national and international press are exclusively focused on the development of the city's homicide rate (Quijano, 2014). In an interview a community leader denounced that instead of killing someone and leaving the body in the streets to display their strength, local gangs increasingly make people and bodies disappear (Pérez Zapata, 2014). These forced disappearances (seen in figure 7.23) do not affect the homicide rates.

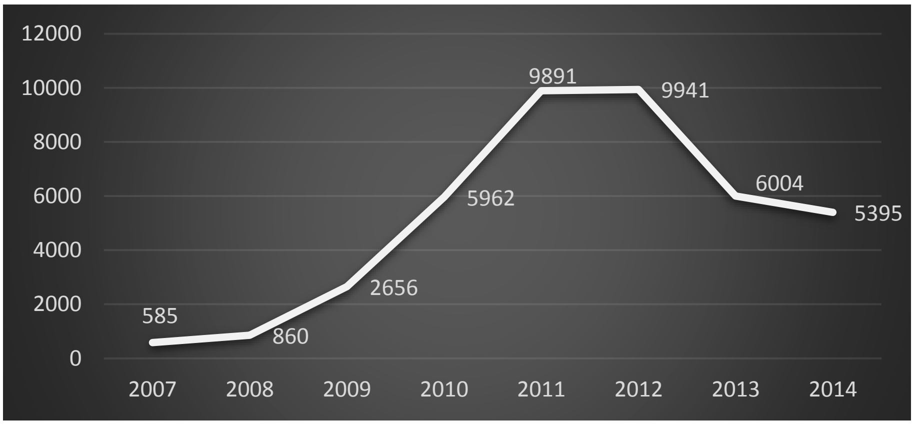
FIGURE 7.23: FORCED DISAPPEARANCES



SOURCE: MEDELLÍN COMO VAMOS (2015)

A related feature of violence worth discussing in this context is the changing nature of interurban forced displacement. As discussed in chapters two and six, Medellín's policy agenda since 2004 places great emphasis on the construction of megaprojects as part of social urbanism and urban planning strategies. While the Fajardo administration claimed that since these projects are carried out in the least developed *comunas* they achieve "wealth distribution without appealing to a discourse of anger or aggression" (Fajardo cited in Coupé et al., 2012, p. 54), the social impact of these projects is far from redistributive. These projects have in fact played an important role in interurban forced displacement. Alongside the tracks of the two main lines of the *Metrocable*, as well as in the residential zones in and around the library parks, the administration has forcibly displaced a large number of poor residents that are further pushed to the fringes of the urban borders (Pérez Zapata, 2014). Figure 7.24 shows these trends.

FIGURE 7.24: INTERURBAN FORCED DISPLACEMENT: MEDELLÍN



SOURCE: MEDELLÍN COMO VAMOS (2015)

However, most analyses of Medellín's transformation focus on the reduction of the city's homicide rate. A political economy analysis of these trends can provide specific explanations, making claims regarding the occurrence of a "miracle" rather inappropriate. The first decrease in the city's homicide rate in the 1990s can be explained by the elite bargain based on the agreement between the different elite factions over a paramilitarized control of the city. This filled the vacuum left by Pablo Escobar's Medellín Cartel, and also prevented the further rise of insurgent urban militias. Unlike the drug lord Escobar, the paramilitary forces were not interested in political control, but solely concentrated on the extraction of rents through private security contracts with all elite factions as well as through illicit drug income and extortions (Franco Restrepo, 2005). Hence, the paramilitary did *not* challenge the economic and political power balance, which continued to be dominated by the GEA on the one hand and the political elites on the other (both of which directly and indirectly benefited through coalitions with the paramilitary).

In the wake of what today is known as *parapolitica* the *emergentes*, led by Senator Álvaro Uribe Vélez pushed through Law 356 of 1994 that legalised paramilitary control through establishing the private security forces *Convivir*[26]. With the creation of *Convivir*, the paramilitary had legal access to state-created rents and could operate as a legitimized force of social control. At the time, the legalization of private control through paramilitary forces was met with great enthusiasm, including by the GEA. As a leader of the *grupo* remarks: “The paramilitaries and *Convivir* are cooperatives that bind good people from the region to protect themselves, they are the result of institutions in difficulty and in decline... Fortunately, the *Convivir* have been given approval to continue operating... They are natural institutions in a society of this kind, and I think these institutions have to continue to exist” (cited in Betancur et al., 2001, p. 227). The *Convivir* thus became powerful organizations with considerable enforcement powers over a variety of different state functions, including the enforcement of property rights (Hylton, 2007). The paramilitarization of control can thus be seen as an institutional mechanism that stabilized the elite bargain between the *emergentes* and the GEA as both factions benefited, be it through a shared interest in extracting rent and income from the drug economy or through the enforcement of property right structures favourable for private capital accumulation.

However, and coinciding with distributive conflicts over state-created rents and the role of EPM, in the late 1990s there was an increase in the homicide rate (see figure 2.8). Luis Pérez Gutiérrez’ opposition to the existing settlement between the political and economic elites at the time is one explanatory factor in this destabilization and increase in violence in Medellín. Subsequently the settlement came close to collapse. The rise in homicides can also be explained by the more politicized role of the paramilitary after the 1990s. However, and not least due to the election of Álvaro Uribe Vélez as President of Colombia in 2002, the conflict did not spiral out of control.

For the analysis of the changing dynamics of violence *after* the turn of the millennium, we can thus conclude that several factors contributed to the stabilization of Medellín’s political settlement.

Firstly, we see the presidency of Álvaro Uribe Vélez as important variable. Since the mid-1990s Uribe Vélez had played a core role in stabilizing the political settlement in Medellín. The *emergente* Uribe Vélez, with his close ties to the paramilitary as well as to the main *paisa* capitalists of the GEA, re-established the synergies between the different elite factions by pushing a national agenda of counter-insurgency for Medellín. Uribe Vélez’ ‘pacification’

[26] Convivir is the acronym for the neighbourhood watch groups *Servicios Especiales de Vigilancia y Seguridad Privada* (Special vigilance and private security services). Convivir (ironically) translates into “coexist” or “live together”.

strategy included a confrontational war against leftist urban guerrillas in Medellín that culminated with the *Operación Orión* in 2002. *Operación Orión* was a military operation led by President Uribe Vélez in which local and national public forces together with Medellín's ever more powerful paramilitary and *Convivir* brutally cleansed the guerrilla stronghold sectors in the Eastern hillside *comuna San Javier*. Resistance by left-wing urban guerrillas was violently oppressed. Despite massive human rights violations, the Colombian government as well as some academic observers deem Uribe Vélez' tactics, and particularly *Orión,* as main factors in the 'pacification' of Medellín. Certainly, increased access to formal and informal rents for the paramilitary calmed tensions and stabilized Medellín's society. These developments preceded the 'good governance' reforms of the Fajardo coalition. Fajardo took office in a situation where the paramilitary in Medellín had near total control over most of the city's marginalized *comunas* and of the drug economy that remains very much alive until today (Durán, 2014). As a political observer told the author: "Fajardo arrived to *faits acomplis* and all he needed to do is implement reforms" (Urán, 2014).

Secondly, we find that the governance structures that evolved from the changed context of power and the distribution of rents through EPM also stabilized the bargaining between the different elite factions. Following Fajardo's victory, the ruling coalition focused on public investments targeting the construction of several megaprojects. The social urbanism policies, combined with the *Metrocable* project generated large demand for cement and are largely responsible for subsequent growth of the construction sector. Incidentally, the increased dynamics of the construction sector also benefited the sectors of financial intermediation and real estate activities. As shown above, these sectors have a high participation of all elite factions: the GEA controls the cement production and finance industry, and the *emergentes* as well as the remaining drug elites/paramilitary have vested interests in the construction and real estate sectors.

Thirdly, we identified shared interests between the different elite factions in maintaining the balance of power of Medellín's political settlement. The promotion of the 'good governance' agenda and a particular pattern of sectoral growth through the institutional structures has served as a way of ensuring access to rents for all elite factions. We find evidence that the particular strategy of achieving economic development through inserting the city into global circuits of capital accumulation helped to stabilize the settlement. Analysing a communiqué of Medellín's most influential paramilitary leader of the 2000s, Diego Murillo Bejarano alias *Don Berna*, we find that the overlapping of paramilitary interests with the dominant interest of the different elite factions in a neoliberal development strategy stabilized the elite bargain further. *Don Berna* explains that there is a need to create the "necessary climate so that investment returns, particularly foreign investment, which is fundamental if we do not want to be left behind by the engine of globalization" (Amnesty International, 2005). Considering this statement, Hylton (2007, p. 88) concludes that Fajardo and *Don Berna's* "major area of agreement… remains the necessity of adapting the city to the needs and security of foreign capital. Don Berna's concern to create a favourable climate for overseas investors... Fajardo echoes the need to 'project' the image of a 'vibrant city, once again taking its place as a business hub and tourist destination'". While for the paramilitary an increase in investments means that there are more resources to protect, translating into more rents and income for the paramilitary (see Holmes et al., 2008, p. 131), the transnational capitalists benefit in several ways. As explained, FDI to Medellín are most likely to target sectors in which Medellín is perceived to have comparative advantages. As these advantages are largely in low productivity sectors with low wages and a low participation of high technological activities, this perpetuates Medellín's position at the lower end of global value chains. Medellín's neoliberal development agenda promotes and advances these global capitalist processes, which most powerful elite factions participate in and extract most of their incomes from.

We can summarise that while the 'good governance' strategy might have established a relatively stable equilibrium in Medellín's political settlement through a particular kind of rent distribution, this is by no means a miraculous development. Medellín's particular form of neoliberal urban governance has served as an institutional mechanism to include a large amount of the political elite factions and the paramilitary actors in the transnationalized circuits of accumulation. The political settlement could thus be stabilized by gathering the different elite factions around the axis of transnational accumulation patterns through the endorsement of neoliberal development strategies. However, this market-enhancing growth strategy has had detrimental effects on productivity, sustainability, and inclusiveness, as it has resulted in low productivity growth. This has created a situation in which higher productivity investments from older incumbents as well as from industrial newcomers are not being incentivized. The developmental outcomes of this neoliberal strategy of inserting Medellín into the global capitalist market are evident in the low productivity character of Medellín's economy, insufficient export capacities which failed to achieve backward linkages on productivity growth and technological transfers, high employment elasticities, and high inequality in income distribution.

CHAPTER EIGHT: CONCLUSIONS

The main objective of this thesis was to theoretically investigate and explore institutional approaches that can help in achieving a more detailed understanding of recent institutional and policy evolution and associated outcomes in Medellín, Colombia. By challenging some of the underlying assumptions of the conventional theoretical understanding of the role of institutions for development, this thesis provided a detailed discussion of the 'political settlements' theory. This approach challenges conventional theories of institutions and development, in particular by adopting a historically well-informed and context-specific focus on how substantial interdependency between power structures, institutional frameworks and policy agendas influence developmental trajectories and economic performances. The thesis explored how recent politico-economic changes in Colombia and in the global economy have challenged dominant power structures and the institutional landscape of Medellín. It extended the political settlements framework to include local as well as transnational factors of the analysis, for the case of Medellín.

The remainder of this concluding chapter is structured as follows: section 8.1 summarizes main arguments and key findings in relation to the research questions this study set out to answer. Section 8.2 highlights important policy implications. Section 8.3 reflects on future research opportunities in our field of study.

8.1 KEY FINDINGS AND MAIN CONTRIBUTIONS

While each chapter addressed specific research questions emerging from the discussion of the literature, the main findings and key contributions of this study evolve around several core themes analysed across the entire thesis.

In a review of the literature on Medellín's development in chapter two we found that conventional approaches analysing the city's transformation use the context-detached and seemingly apolitical 'good governance' framework. The failure of this literature to convincingly explain recent institutional changes and developmental outcomes in Medellín prompted the need to frame an alternative theoretical approach. Furthermore, the largely ahistorical analysis of empirical evidence and the failure of the conventional literature to take into account any other than very aggregate and fairly rough quantitative and qualitative data, such as increases in GDP growth, lower unemployment and improved homicide rates motivated a more detailed and less aggregate empirical contribution to the debate on Medellín's 'urban miracle'.

In the *theoretical* analysis of institutional change, governance, and development we engaged with the broader question of how theories of institutions, governance and development can be framed in ways that contextualise institutional change in the historical, social and economic context of contemporary transition processes.

Our starting point was the observation that conventional approaches to the study of the role of institutions in the economy generally adopt a mechanical view according to which harmful transaction costs, associated with specific types of institutions, reduce economic efficiency. In addition to the efficiency function of reducing transaction costs, institutional changes prompt resistance and contestation, to a greater or lesser degree, particularly in the context of structural transformation processes or economic development. Such processes, therefore, cannot be reduced to static-comparative analyses of which sets of regulations and institutional arrangements may maximise efficient resource allocation in existing market economies. Instead the costs of transition – of moving from substantially non-market based societies to largely market-based ones, have to be taken into account. While historically and contextually specific factors will be relevant also to the reform of regulatory apparatuses in advanced market economies, they loom much larger in transitional economies that undergo long-term structural and societal change. In particular, the viability of specific institutional reform agenda will be much more sensitive to often fragile compatibilities between the distribution of power in a society, the governance and rent-management capacities of state agencies and the technological capabilities of emerging classes of entrepreneurs. The theoretical point of departure of the framework of this thesis is thus one where such political and economic factors are included in the analysis of institutional change and economic development.

Under circumstances of developmental transformation, when institutions manage to sustain a distribution of net economic benefits amongst different players, organizations and interest groups that is compatible with political stability as well as sustainable economic efficiency and growth, a political settlement emerges. In this sense, there are no 'good' or 'bad' institutions, only favourable and less favourable interdependent combinations of inherited and evolving power configurations, institutions and organizational as well as administrative capacities. This makes a blueprint approach to institutions, such as the 'good governance' agenda, unsuitable for a coherent understanding of the institutional impacts on development and growth.

In most less developed economies or regions, and the case of Medellín is no exception, entrepreneurs with low technological and low productivity capabilities hold large organizational powers vis-à-vis the state. In such a settlement the emergence of an institutional structure that creates conditions for productivity growth is unlikely, as the state has limited governance capabilities to create incentives or compulsions for technology acquisition that result in growth-enhancing outcomes. The (local and/or national) state, rather than being in a position to incentivize and discipline emerging entrepreneurs to learn and climb up the technology ladder, is hampered by weak bargaining power. Furthermore, informality is part and parcel of transformational processes and can go either way: It can help channel learning rents to receptive entrepreneurial groups, or it can reinforce low productivity tendencies.

While these features of catching-up development and transformational processes are well established by now, this thesis has, in particular, taken note of the fact that the political settlements literature tends to underplay transnational factors and movements towards decentralization that increasingly shape the societies and economies of less developed countries. The main theoretical contribution of this thesis is therefore based on a further exploration of the political settlements framework beyond the narrow focus on national-level power structures, institutional frameworks, and economic policies. We found that processes of political decentralization and economic liberalization in Latin America have major implications for several aspects of the political settlements analysis. In particular, following Latin America's neoliberal shift in the 1980s balances of power in many societies shifted and institutional mechanisms to create and distribute rents changed. Parallel processes of decentralization and economic liberalization have increased the power of local capitalist elites. At the same time, these changes effectively weakened the governance capacities of states to centrally create rents and allocate resources in ways that can achieve growth-enhancing developmental outcomes. The implications for the creation of traditional growth-enhancing institutions are particularly visible with the example of subsidies, which experienced a shift away from internal industrial agents towards transnational capital.

Our theoretical analysis of Colombia's experience showed that these processes have led to a shift of power away from the central state authorities towards local factions of the capitalist elite. Resulting changes in rent management and the integration of Colombia's economy into globalized markets have facilitated the country's return to static comparative advantages in low productivity sectors. We found that a decentralized regime of rent management in a context of economic liberalization can reinforce pressures to maintain low technological capabilities and static comparative advantages in low productivity and unskilled labour sectors. A range of political factors and constellations, such as those described for the case of Medellín in the context of wider decentralization policy in Colombia, meant that local governance capabilities to allocate resources to learning in medium or high productivity sectors were severely hampered. This was further reinforced by reliance on attracting FDI for technology transfers and the locational decision-making rationales of MNEs. Together, this largely discouraged local incumbents with potential technological and productivity capabilities to invest in high-risk strategies, as returns on investments were not backed by a clear institutional structure or policy agenda. In sum, local governments in Colombia face growing pressures to accept the low productivity comparative advantages of their economies, while at the same time maintaining a large supply of unskilled and cheap labour to be able to compete with other similarly endowed cities for the attraction of FDI into sectors that are at the low productivity end of the global value chain.

Using Robinson's (2010) framework, we found that these processes have also led to an increase in the power of Latin America's emerging "transnational capitalist class". The rise of the transnational capitalist elite in Colombia has thus affected power structures and institutional mechanisms in ways that have implications for the implementation and enforcement of policies that can achieve sustainable levels of political and economic viability. We found that this elite faction, which holds most of its assets in low productivity services, low-wage industries, or extractive sectors has challenged and changed the political settlements that favoured ISI development, which were predominant in most countries in post-war Latin America. Thus, and unlike in nation-state capitalism, the transnational faction of the elite has little intention to develop productive domestic markets and internal effective demand, but rather has an interest in the advancement of the global capitalist system in which they participate and from which they extract most of their income.

The transnational capitalist elites in Latin America have underpinned their economic power by achieving considerable organizational power and developing capacities as political actors. With the powerful position of this elite in local ruling coalitions, any change in institutional structures is likely to reinforce the low productivity development of Latin American markets in general and of Colombian urban economies in particular. Implemented and enforced policy agendas that are closely linked to 'good governance' reforms promote market-driven development and a further economic integration that helps in the promotion of global capitalism. The combination of a powerful transnational capitalist elite that has low entrepreneurial and low technological capabilities with a rolled-back decentralized state with limited discretionary power in a liberalized economy leads to a situation in which formal and informal institutions are unlikely to incentivize the development of growth-escalating sectors. Such a political settlement is unlikely to result in the creation of incentives and compulsions for investments in efforts for acquiring tacit knowledge in medium and high technology activities. Furthermore, the combination of power and institutions has limited governance capacities to discipline the powerful transnational capitalists.

The key *empirical* contributions of this thesis consists of the findings we made in the analysis of Medellín's development experience. The findings were based on the originality of our historical, context-specific theoretical framework and on the application of a mixed methods case study approach using qualitative and quantitative data gathered during fieldwork for this research. This methodology helped in refining and supporting our theory, to test the consistencies between theoretical considerations and empirical evidence, and to identify specific policy responses.

The first empirical contribution of this thesis consists of a historical analysis of political settlements in Medellín and Colombia. We analysed how historical and social processes shaped the development of the interdependency between power and institutions in Medellín in ways that led to the creation of favourable conditions for industrialization. We found that purely quantitative and economic analyses of Medellín's industrialization need to be expanded by exploring how the historically developed combination of power and institutions became favourable for the implementation and enforcement of policies that incentivized growth in light manufacturing industries. For much of the twentieth century Medellín's political settlement was marked by a power distribution that was compatible with institutional mechanisms that created incentives and compulsions for productivity growth and ISI development. The powerful position of entrepreneurs with interests and capabilities in developing labour-intensive industrial sectors facilitated the emergence of growth-enhancing rent management structures for successful easy industrialization.

The second main empirical contribution of this thesis evolves around the analysis of how changes in the constellation of power, elite interests, governance capacities of the state, and entrepreneurial capabilities of the regional private sector can explain why the city's economy deindustrialized. In analysing how the changing nature of the political settlement shaped developmental outcomes, we found that the distribution of power in Medellín's and Colombia'S political settlements became largely incompatible with institutional mechanisms needed for the promotion of advanced industrial development. Various political economy changes during and after the *Frente Nacional* (i.e. the introduction of a mixed strategy of import-substitution and export-promotion, and an organizational fragmentation of elite interests) limited governance capacities to create and distribute growth-enhancing rents. This led to economic slowdown and political instability.

We analysed how institutional responses to these changes in the form of decentralization reforms affected organizational power in Colombia more generally and in Medellín in particular. While these reforms were intended to pay-off outsiders of the dominant ruling coalition (also as a result from the rise of the new political elite – the *clase emergente*), they also fragmented Colombia's political settlement further. This made it even more difficult to implement and enforce growth-enhancing policies.

Furthermore, we analysed the responses of the dominant industrial elite faction to these changes. We found that with the creation of the *Grupo Empresarial Antioqueño* (GEA), Medellín's capitalists developed capacities in services, finance, and construction. The structures of the GEA protected the capitalists' dominant economic position from the increasingly powerful *emergentes*. However, in the 1980s Medellín's fragmented political settlement destabilized, as organizational power was increasingly contested from drug cartels and leftist urban militia movements. The levels of political and economic viability decreased rapidly and the city descended into chaos and violence.

We found that a compromise over rent management, the paramilitarization of control and violent oppression of leftist insurgent movements temporarily stabilized the settlement in the 1990s. However, a new conflict emerged between the political elite of *emergentes* and the capitalist elite over the use of locally state-created rents through the public utility company EPM. In combination with a general slowdown of economic growth in Colombia this conflict made the compromised bargaining of Medellín's settlement increasingly fragile. At the turn of the millennium Medellín was yet again at the brink of becoming an urban society in crisis. We found that this was due to the fact that the distribution of power was no longer formally aligned to institutional mechanisms that could keep the political settlement politically stable and economically viable.

The analysis of Medellín's recent development through the lens of the political settlements approach helped in gaining a more nuanced understanding of how elite transnationalization and political decentralization affected the distribution of power and the institutional environment in Medellín in ways that had several implications for city's development. We found that Colombia's fairly radical shift to neoliberalism in the early 1990s strengthened particular capitalist business groups. At the same time, the further devolution of state powers to decentralized governments, increased fiscal pressure on city administrations, and the privatization of locally state-owned businesses decreased the discretionary power of the state.

The Medellín-based GEA particularly benefited through the implemented economic and financial liberalization reforms. Besides securing access to rents created through privatization and deregulation of specific sectors, the GEA developed capacities as transnational actors in the now liberalized Colombian economy. The transnationalization of Medellín's capitalist elite is marked by a restructuring of their business interests. The GEA thus focused on the development of capacities in low-wage services, finance, and construction, which has reinforced the return of the city's economy to static comparative advantages in low-skilled and low productivity activities.

Besides impacting Medellín's power structure, the economic liberalization and political decentralization reforms also had important implications for coordination and governance capabilities – particularly in the context of the transnationalization of the local capitalist elites. While Colombia's protected and largely closed economy had guaranteed a relative stable elite bargain between dominant groups, the neoliberal shift challenged traditional forms of rent management and hence altered the rules of the game for possible creation and enforcement of growth-enhancing policies. The increased power of transnationalized local businesses and organized actors and the decreased power of the decentralized state can lead to the reduction of attempts in creating and enforce growth-enhancing institutional strategies.

We further explored how Medellín's faction of the transnational capitalist elite developed capacities as political actors to gain organizational powers over local rent management. We found that with the election of Mayor Sergio Fajardo in 2003 the transnational capitalist elite gained organizational power over local state-created rents through EPM's profits and tax incomes. We argued that these changes have enduring implications. In a local political settlement where a transnational capitalist elite with low technological capabilities has considerable organizational capacities, the emergence of institutions that incentivize productivity growth is unlikely. The increasingly weakened local state has limited capacities that could create and enforce incentives and compulsions for investments into medium or high technology sectors. Through the strong position of this transnational capitalist elite, rent management in Medellín inherently targets sectors unlikely to be sustainable productivity growth escalators for the urban economy. The powerful position of the transnational capitalist elite in the ruling coalition furthermore hinders the enforcement of disciplining mechanisms in case of non-performance.

We found that Medellín's 'good governance' strategies are likely to result in the creation of governance capabilities required to create market-enhancing conditions in a broader context of neoliberal reforms. The GEA, which had reconfigured its businesses as well as its asset and investment structure following economic liberalization, uses its newly gained organizational control to establish an institutional structure that deepens its powers economically as well as politically. The GEA's interest in implementing 'good governance' reforms that further push an economic transnationalization agenda is thus an opportunistic institutional mechanism adopted in the larger neoliberal context of Colombia's polity. The governance model of Medellín thus promotes economic growth labour-intensive sectors marked by low productivity in which the GEA has vested interests. The incompatibility between the present power structure with advanced and growth-enhancing institutions is reinforced through the balances of power in Medellín's society. The composition of this political settlement makes entry for outsiders or newcomers into high-rent markets difficult through their disadvantageous bargaining power vis-à-vis the ruling coalition. Capitalists with higher entrepreneurial capabilities, who in contrast to older incumbents of the GEA do not have established ties with the Fajardo coalition, are deterred by such institutional strategies, as their interests are incompatible with the constellation of power.

In a quantitative analysis of the theoretical and qualitative findings we discussed the implications of Medellín's changed political settlements on public policies and private investment patterns. Using different quantitative methods we found that the particular combination of power and institutions in Medellín has largely facilitated public and private investments into sectors with low productivity growth, such as tourism, financial services, and construction. The volatility and speculative nature of these sectors further hindered productivity growth in Medellín's economy. Hence, Medellín's large GDP growth rates can be explained by a drastic increase in economic activities that in the long run will not serve the urban economy as sustainable growth escalators. The analysis also showed that most of the employment in Medellín's non-agricultural sectors is concentrated in low productivity sectors. The analysis of labour market effects of this development revealed that there are large gross employment elasticities in Medellín's very low productivity economy. The inability of additional GDP per capita growth to create productivity gains and to incentivize the acquisition of advanced technology shows that much of the economic growth is based on growth in low-wage sectors, as Medellín's cheap labour force makes labour supply highly elastic to GDP growth. This shows the underlying incapacity of Medellín's governance model to create forward or backward linkages for productivity growth. This also becomes clear in the analysis of Medellín's exports, which firstly have decreased over GDP growth and secondly have been dominated by low technology goods. These developments had a disastrous impact on wages and inequality. Real wages have been stagnating along with permanent employment. Unsurprisingly, Medellín remains the most unequal city in one of the most unequal countries worldwide.

In analysing the developmental outcomes in terms of political stability and violence we found that the transformed power structures and institutional environment have helped in stabilizing the city's political settlement by gathering different elite factions around the axis of transnational accumulation patterns. The dominant elite factions and the paramilitaries share similar interests in participating in globalized markets. We also found that the interests of all elite factions – including the paramilitary and informal organizations – in attracting (foreign) investments had implications on the tactics of war and forms of violence. Hence, while homicide rates decreased, we could identify an increase in other forms of violence, such as forced disappearances, extortions and forced displacement.

8.2 Policy implications

We have argued that the implementation and enforcement of policies that can create conditions for achieving successful developmental outcomes depend on a variety of different context-specific factors. The political settlements approach enables us to identify important variables that play important roles in bringing a society to inclusive and sustainable levels of political and economic viability. As these different variables are interdependent and are likely to have non-linear effects, the targeting of market failures through specific policy reforms is not always straightforward. Our analysis has found that this is particularly true in a context where state powers have been decentralized and transnational factors play an increasingly influential role.

However, we can start by differentiating between variables that are relatively susceptible to be influenced by policy changes, and variables that would need longer term policy commitment in order to achieve significant changes. The variables that are usually the easiest target for policy change are capabilities of state agencies and governance actors. However, and different from the ‘good governance’ prescription, the policy change should prioritize a strengthening of governance capabilities to first identify potential growth-escalating sectors and secondly to implement financing instruments that can create and distribute rents to these sectors. Learning needs to be incentivized first and foremost through a governance agency that has the capabilities to create the conditions for a targeted sector to achieve growth-enhancing outcomes.

The success of such a policy change also depends on the structure and capabilities of the targeted firm or sector. Changing the structure of firms and sectors might be more difficult than the change in the governance capacity of a state agency. But the targeted selection of a particular group of firms for support can help in developing their entrepreneurial capabilities in order to use rent benefits for investments into efforts in learning and acquiring higher technology activities. However, both the governance agency as well as the particular financing instrument need to target the specific appropriability problems different types of firms face in their processes of learning. This also includes a targeting of financing needs through FDI that can help domestic firms in improving learning processes for higher technology activities.

The discussion of the political settlements framework, however, suggests that these easier policy changes that can be achieved in the short to medium term are only feasible if we identify some constraints that are determined by other variables often exogenous to the policy change. This includes the interests and ideas of power elite faction that can influence the direction of policy change and thus development outcomes. The discussion of a political settlements framework for local-level analysis furthermore points to the importance of looking at changes and dynamics at the national level, which are often exogenous to the local level political settlement but nevertheless drive local developmental outcomes.

The analysis of balances of power in a society are not to be neglected in this revisited political settlement framework. As the political settlement also defines the bargaining power between the state agency and the different types of firms, attempts at policy changes need to take these conditions as given. This can make short term changes difficult to achieve. A change of the political settlement itself can be achieved but this requires the political and organizational commitment of internally organized political movements in the medium to long term.

The balances of power and the position of minimally capable entrepreneurs in the ruling coalition can affect the likelihood of implementing or enforcing a policy that intends to improve the governance capacities of a state agency, financing instruments that create and distribute rents, and the structure of firms or sectors that receive rent benefits. This also means that any policy that aims to achieve institutional change will fail to lead to positive outcomes if the different variables are treated as separate policy domains. It is impossible to achieve an 'efficient governance agency', an 'effective financing instrument', or a 'good firm structure' if they are taken out of context of a political economy analysis of how the different variables are interdependently connected in a political settlement with a particular distribution of power.

The further theoretical exploration of the political settlements approach showed how movements towards decentralization and transnational factors affect the distribution of power in political settlements. However, the analysis of these processes through the political settlements lens also helps us in identifying further issues related to the implementation and enforcement of policies that can affect any of the discussed variables in a number of different ways.

Political, administrative, and fiscal decentralization, for example have various implications for policy making. The downward transfer of state capacities might complicate policy coordination, which can slow down policy processes that have positive implications for governance agencies, financing instruments, and entrepreneurial capabilities of firms. The increased complexity of the policy arena can thus add additional constraints for achieving growth-enhancing institutional changes. This is not to say that decentralization policies necessarily have negative consequences for developmental outcomes, but the effects of decentralization are not as straightforward and unambiguous as they are commonly presented by policy makers and academic scholars who take an unconditionally supportive stance towards decentralization. Even in a context where a 'local developmental state' has substantial governance capabilities, the national policy space remains an important sphere for rent management.

For a comprehensive discussion of the implications of state restructuring on policy making we need to take the processes and impacts of transnationalization into further account. Besides that elite transnationalization substantially affect the power balances of a society, other transnational factors, such as the upward transfers of institutional capacities to supranational levels, complicate policy coordination further. The additional layer of the policy arena in general and influences of WTO, World Bank and the IMF in particular can hinder attempts to implement policies that would lead to growth-enhancing changes of governance agencies and financing instruments. The ever-increasing integration of the Colombian economy into global trade and investments regimes has reduced the scope of local and national governance agencies to implement financing instruments, such as tariffs and subsidies and has constrained the negotiating capacities of state agencies vis-à-vis foreign investors. Hence, while in pre-transnationalized economies policy support to foreign investors was able to invoke a transfer of technological and organizational capabilities to domestic firms, these policy instruments have disappeared. Despite that the support of local firms remains important, transnationalized factors have complicated the design of policies that support local capability development. Local governance agencies need to develop capacities in order to create other financing measures and policy instruments to support local firms in learning and acquiring medium and high technological capabilities. However, in addition to these factors, the transnationalization of the capitalist interests of local capitalist elite factions might diminish possibilities of enforcing policies that would change the structure of firms or sectors in ways that could have positive effects on efforts of developing their technological capabilities. Economic integration and the participation of local capitalist elite factions in the global economy has not resulted in the development of medium and high technological capabilities. The persistence of comparative advantages in low productivity sectors hence hinders the development of capitalist interests in medium or high technology sectors.

In sum, we find that the increased complexity of the policy arena through these additional layers have made effective implementation and enforcement of growth-enhancing policies more complicated. Contrary to the 'good governance' reform prescriptions that generally imply market-led development, we find that more rather than less policy coordination is needed.

Transposing these general findings into context-specific policy implications for Medellín proves difficult, particularly given the combinations of power constellation and institutions in the local political settlement. However, we find that there is a need to improve governance capabilities of state agencies to implement finance strategies that target domestic firms for support in developing technological capabilities. This is particularly true for rent created through the operations of EPM. Such policy measures of local capability development can also include the implementation of policies that support foreign investors. This could make MNEs commit to transferring more and more technologically advanced parts of the production value chain to targeted local sectors. The potential positive effects on productivity could increase demand for higher skilled labour, which would increase wages. Labour market reforms could furthermore target wage conditions that perpetuate conditions of high gross employment elasticities and high inequality.

A globally integrated local economy also means that governance agencies in Medellín need to develop capacities to generate conditions that could facilitate the development of pre- and post-production services that are higher up on the value chain. As suggested by Baldwin (2013), for globally integrated local and regional economies to achieve high value added growth, industrialization becomes less significant. As such, for Medellín to achieve economic dynamism in sectors with high shares of value added, local entrepreneurs do not necessarily need to focus on developing capabilities in manufacturing of capital goods. Rather, and particularly in a context where the "vocation" of Medellín's economy is seen in service sectors, local policy actors and governance agencies may want to focus on creating incentives for the development of high value added pre- and post-production services. These can include IT services, design of goods for production, marketing of goods, and the like. Policies that focus on wage convergence, rather than on specialization driven by low wages could help in boosting Medellín's position as a player in the global supply chain trade. As Baldwin (2013, p. 50) suggests, "income convergence will boost supply chain trade in that the extra horizontal specialization will more than compensate any reduction in wage-driven, vertical specialization".

Examples for successful transition to horizontal specialization in high value added services can be found in Dubai, where pre-production activities (R&D, design, commercialization) and post-production activities (marketing, advertising, specialized logistics) for global production and supply chains dominate the share of value added of GDP. Other plant-level examples include

Brazil’s flip-flop brand *Havaianas*. Started with the production of a basic model available in only four different colours, the relatively low-technology production process did not generate particularly high shares of value added. However, by focussing on product innovation and design, research and development of new materials, as well as on marketing, brand management and advertisement, the parent company *Alpargatas* could build *Havaianas* to become a global brand with net revenues going through the roof (see FT, 2013). While the company made a net revenue of R$1.9 billion in 2009, this increased to R$3.4 billion in 2013 (49% of which came from the business branch of sandals) (see Alpargatas, 2013). Despite the seemingly low-technology production of a non-durable good, the flip-flop brand *Havaianas* provides a useful case showing how pre- and post-production services have become an important source for high value added growth in a globalized economy. Medellín’s local governance agencies as well as the local entrepreneurial elite could draw valuable lessons from these examples of successful horizontal diversification and specialization. Economic growth strategies and efforts for achieving high value added output could focus on developing governance capacities and entrepreneurial capabilities in high value added pre- and post-production activities.

8.3 Avenues for future research

A general suggestion for future avenues of research stems from the insights offered by the use of the political settlements approach and in particular by the original application of the political settlements framework to a politically decentralized and economically transnationalized context. This allowed us to illuminate and overcome some limitations of studies that are embedded in conventional theories of institutional change and helped us to further explore the validity of our alternative political economy approach.

Further research needs to critically test the political settlements approach discussed and explored in this thesis. This would entail a thorough study of how local and transnational factors impact power structures, institutional environments, governance capacities, and entrepreneurial capabilities in other decentralized and liberalized contexts. Any future research that aims to test the political settlements approach would also help in the process of theoretical refinement of the framework, making it a superior institutional theory for the analysis of developmental experience to the context-detached approaches that argue for one-size-fits all solutions.

Further comparative case study research is also needed. A comparative analysis of developmental experiences using our explored political settlements framework could help in testing the approach across different geographical contexts. Such an empirical testing of the approach could not only help in theoretical refining, but also in achieving clearer understanding of policy challenges for the different layers of policy making (local, national, transnational). The exact impacts of possible opportunities and constraints in the transformed policy arena require careful study of how the different layers of policy making – including the national level – can achieve a successful policy coordination.

For the particular issue of policy implications, further research is needed that analyses the actual processes and impacts of transnationalization in its great varieties. While this thesis provided a clear discussion of how the transnational capitalist elite in Latin America affects power constellation, governance structures, and technological capabilities, future research could focus on the implications of changes in trade relations. Of particular interest could be a discussion of particular production processes that are integrated into global chains of commodity production.

In the Colombian context such an analysis would need to include the effects of a recent trade agreement between the country and the United States and a trade agreement between Colombia and the European Union, which came into effect in 2012 and 2013 respectively. Both agreements significantly change the policy space of local governments in Colombia, as they reduce the scope of tariffs and subsidies. These agreements furthermore weaken the bargaining power of local authorities in Colombia vis-à-vis foreign investors to transfer technology for domestic content requirements. Beyond the impacts on policy scope, the agreements also affect the participation of Colombian companies in the global production chain. Further research is needed on the actual impacts of these changes.

We conclude by underlining the importance of the contributions of this thesis for a complete and rigorous understanding of institutional performance in achieving growth and development. The application of an alternative historical political economy framework to the locality of Medellín provided comprehensive analytical and empirical evidence demonstrating the wider validity of the political settlements approach. Our findings provided highly original insight on how broader political economy trends impact context-specific developments in a decentralized locality.

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APPENDIX

TABLE A1: LIST OF PEOPLE INTERVIEWED

Name	Organization	Position
Arias, Desmond	New York University	Professor
Álbanez Mesa, Adiella Maria	Mesa de derrechos humanos, Comuna 7	Community Leader
Angel, Andrés	Sofía Pérez Foundation, Foundation close to GEA	Chairman
Arboldea, Guillermo	Confederacion de Cooperativas Antioquia (CONFECOOP Antioquia)	President
Arcila, Carlos	Mesa de derechos humanos de Medellín	Community Leader
Bateman, Milford	Juraj Dobrila University	Lecturer
Berdugo López, Álvaro Iván	Mayor's Office	Deputy Mayor and Secretary of Territorial Development (2012-2016)
Betancur, María Soledad	Instituto Popular de Capacitación (IPC)	Researcher/Economist
Bojanini Garcia, David Emilio	Grupo Sura	CEO
Brand, Peter	National University Colombia	Professor
Canavire Bacarreza, Gustavo	EAFIT University	Lecturer
Diez, Jorge Ivan	Confederación General de Trabajo Antioquia (CGT Antioquia)	President
Duncan, Gustavo	Northwestern and EAFIT University	Lecturer
Duran Ortiz, Juan Pablo	International Bureau for Social and Economic Research (IBSER)	Researcher/Economist
Echeverri, Jaime	Medellín Chamber of Commerce	President

Escobar Arango, David	Mayor's Office	Private Secretary (2004-2008)
Fernández Correa, Patricia	NGO Viva la Ciudadanía	Director
Garcia Molina, Mario	National University Colombia	Professor
Gaviria Gutiérrez, Juan Felipe	Empresas Publicas de Medellín (EPM), Mayor's office	President of EPM (2004-2008), Mayor (1983-1984)
Giraldo Ramirez, Jorge Alberto	EAFIT University	Professor
Guarin, Weimar	Mesa Por La Vida	Community Leader
Gutierrez, Federico	Mayor's Office	Mayor (2016-2020)
Gutierrez, Fransisco	National University Colombia	Professor
Henao, Alberto	Mayor's Office	Economist at DAP
Hoyos Vieira, Luis Felipe	Mayor's Office	Deputy Mayor and Secretary of Economic Development (2012-2016)
Hylton, Forrest	Northwestern University	Professor
Ibanez, Sergio	Fuerzas Revolucionarias de Colombia (FARC)	Member of Peace Delegation
Jaramillo, Carlos Hernando	Mayor's Office	Director of Planning (2004-2009)
Loaiza García, Rodrigo	Mayor's Office	Deputy Secretary of Administration (2004-2008) and Deputy Secretary of Planning (2012-2016)
Lopera Pérez, Juan Diego	Mayor's Office; Governor's Office	Co-director of Territorial Planning (2004-2008);
MacLean, Kate	Birkbek	Lecturer
Martinez Roldan, Luis Esteban	Mayor's Office	Economist at DAP
Maya, Guillermo	National University Colombia	Professor
Mejía Martinez, Jorge	Mayor's Office	Secretary of Government (2012-2016)

Mejia Mejia, Juan Felipe	EAFIT University	Professor
Munevar, Daniel	National Finance Ministry	Macroeconomic Advisor
Niño, Eduard	Convivamos Comuna 1	Community Leader
Ojeda, Tomas	Fuerzas Revolucionarias de Colombia (FARC)	Member of Peace Delegation
Ortíz Arciniegas, Catalina	National University Colombia	Professor
Osorio, Sergio	Grupo Argos	Vice-President
Paris, Andres	Fuerzas Revolucionarias de Colombia (FARC)	Member of Peace Delegation
Patiño Marín, Juan Manuel	Mayor's Office	Co-Director of Planning Department (DAP)
Pérez Jaramillo, Jorge	Mayor's Office	Director of Planning Department (DAP) (2012-2016)
Pérez Moreno, Santiago	Bancolombia	Vice-President
Pérez Salazar, Iván Mauricio	Mayor's Office; Instituto para el Desarrollo de Antioquia (IDEA)	Secretary of Social Development (2004-2008); Finance Secretary (2008-2012); President of IDEA (2012-2016)
Pérez Zapata, Elkin de Jesus	Corporación Con-Vivamos	Community Leader
Pérez, Oscar Dario	Asociación Mutual La 1	Community Leader
Piraquive, Gabriel	National Planning Department, DNP	Director of Economic Studies
Quijano, Fernando	Corporación para la Paz y el Desarrollo Social (Corpades)	President
Quintero, Juan Camilo	Ruta N, Mayor's Office	Director
Quintero, Rafael	Confederación General de Trabajo Antioquia (CGT Antioquia)	President

Ramírez Brouchoud, María Fernanda	EAFIT University	Lecturer
Ramírez, Ivan Dario	NGO Paz y Democracia	President
Ramos Villa, María Eugenia	Mayor's Office,; Governor's Office	Secretary of Administrative Services (2004-2008), Empresa de Desarrollo Urbano (2008-2012); Director of Antioquia Planning Department (2012-2016)
Rendón, Andrés Julian	Governor's office Luis Alfredo Ramos (2008-2011)	Secretary of Government (Governor, 2008-2012)
Restrepo Posada, Federico	Empresas Publicas de Medellín (EPM), Mayor's office, Now Instituto para el Desarrollo de Antioquia (IDEA)	Director of Planning (2004-2008), President of EPM (2008-2012), Vice-President of IDEA (2012-2016)
Restrepo, Magdalena	Fraternidad, Foundation of GEA	Chairwoman
Rios, Norberto	Escuela Sindical Nacional (ESN)	President
Roman, Martin	NGO Veeduria	President
Romero Vidal, Mauricio	Javeriana University	Professor
Ruiz, Olmedo (aka. Ómar de Jesús Restrepo Correa)	Fuerzas Revolucionarias de Colombia (FARC)	Member of Peace Delegation
Salazar, Alonso	Mayor's Office	Mayor (2008-2012)
Sierra, Juan Carlos	Mesa de derechos humanos de Medellín; Mesa metropolitana	Community Leader
Sierra, Ricardo	Distrihogar	CEO
Tobón, Sergio	Proantioquia	Coordinator Social Thinking
Torres Garcia, Alejandro	EAFIT University	Lecturer
Uran, Omar	Instituto Popular de Capacitación (IPC)	Researcher

Valderrama, Juan David	Agencia de Cooperacion e Inversion (ACI), Mayor's Office	Director
Velásquez, Karlos	Mesa Interbarrial Comuna 8	Community Leader
Vélez Cadavid, José Alberto	Grupo Argos	CEO