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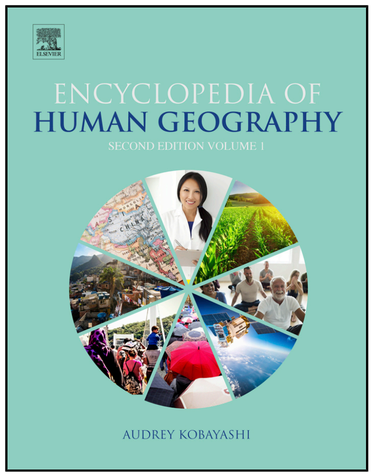

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Regional Development and Noneconomic Factors

Iwan J Azis, Cornell University, Ithaca, NY, United States

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Glossary

Culture is the full range of learned human behavior patterns. It is a complex whole which includes not only knowledge, arts and letters, but also modes of life, fundamental rights of human being, value systems, traditions and beliefs. It gives us the ability to reflect upon ourselves, makes us specifically human, rational beings, endowed with a critical judgement, a sense of moral commitment, and it is also through culture that we discern values, make choices, and create works through which we transcend out limitations. In essence, culture is the knowledge people use to live their lives and the way in which they do so. In this sense, culture reflects a system of economic, religious, and social behaviors, beliefs, and social arrangements. It conveys a kind of academic attention to systematic behavior.

Institution consists of formal and informal types. Formal institution is a large and important organization, whereas informal institution can be intangible such as custom or tradition,enforcement, compliance procedures, and moral and ethical behavioral norms. Hence, it is beyond just property right, good governance, and legal certainty as often described by economists.It defines structures within which people work together in a coordinated way. More often than not, informal institution is more influential than formal institution in affecting regional development performance.

Decentralization is defined as the transfer of authority and responsibility for public functions from central government to subordinate or quasi-independent government organizations (in some cases also to the private sector). It is an important part of broad-based institutional reform aimed at improving governance (hence institution). Decentralization is a complex multifaceted concept. Different types and stages of decentralization can have different characteristics, policy implications, and conditions for successful regional development.

Local capture is a condition whereby public resources are biased for the benefit of a few individuals or groups in detriment to the welfare of the larger population. It is a form of corruption, where elites use public funds, originally intended for either political campaign during local election or investment in goods and services that benefit the larger population. In this sense, local capture is different from embezzlement, misappropriation or other diversion of funds by a public official. Either due to information asymmetry, misallocation of resources, or inefficient regulation, local capture can cause certain segments of the population experience reduced access to the process and outcome of regional development, resulting in increased inequality.

Transaction costs include negotiation and communication charges, legal fees, and coststo acquire information about anything that could help making decision to transact or not. They therefore could influence the quality of the end results, e.g., the quality and other characteristics of goods and services. Incurred during trading or any transactions, these costs are paid by buyersbut not received by sellers, and they are often considered unavoidable. In finance, transaction costs are part of the premium above the current market price (to attract additional sellers), and the discount below the current market price (to attract additional buyers).

New economic geography (NEG) is a new genre of research, emerged in the early 1990s, explaining large-scale agglomeration in termsof pecuniary externalities arising from imperfect competition. Founded by Krugman (1991), the agglomeration arises through the mobility of labor which endogenously generatesvariations in market size promoting further agglomeration.The presence oftransport costs makes firms locate near large markets.Exploitingthe same technical tricks used in the 'new trade' and 'new growth' theories,NEG places spatial analysis squarely in the economic mainstream as it is fully general-equilibrium, deriving the aggregatebehavior from individual maximization. Unlike most traditional spatial analysis, it shows howhistorical accident can shape economic geography, and how gradual changes in underlying parameterscan produce discontinuous change in spatial structure.

What Is Region?

Region has been a central concept of the development of geography as a discipline. While there is no general-accepted definition of it, one can loosely describe region as a complex spatial unit with defined borders. It includes a specific geographic closeness and mutual connection that can be delineated in terms of the degree of internal homogeneity with respect to physical and natural, social, historical, political, cultural, and economic characteristics. Formed by either history (as a collective identity of a spatial entity), natural factors (climate, soil, and physical characteristics), or external division and delimitation, regions can constantly increase

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and develop, but they can also shrink or disappear due to natural and man-made acts. A substantial decrease in the significance of space or region, also known as *deterritorialization*, can occur because of either economic blockade and warfare or the mobilization in cultural, ethnic, and religious terms. The implications of deterritorialization can be a shift in the regulatory power from public to private sector including nonstate organizations, a delinked perception toward a global threat such as global warming, or it could simply transform collective identities facilitating transborder solidarities based on things like class, gender, ethnic origin, and religion. This points to the limitations of most studies and literature on the relative position of regions in globalization that tend to emphasize the geographical dimension at the expense of the sociological aspects and overlook the relations in terms of the political and cultural dimension between global and regional levels. Indeed, from the local and regional perspective, globalization can be seen as a cultural phenomenon, since it invokes cultural processes albeit not likely to lead to complete homogeneity at the local level.

As cohesive geographic and economic entities, regions can also be defined as hierarchical systems of central places or nodes (e.g., cities) in which the availability and diversity of goods and services offered determine their order. Typically, there is a small number of large, higher order central places and a large number of smaller, lower order ones (or peripheries). The interactions and mutual connection among them are reflected in trade transactions and movements of people (labor, consumers, and producers). The dominance of central nodes over the surrounding periphery is attributable to the spatial dependence of workers or goods. This conceptual basis is useful for the purpose of delineating functional (say, economic) areas such as the one used by the United States' Bureau of Economic Analysis. With such a delineation, the correspondence between regional analysis and social welfare can be made clearer, and the human impacts of changes within particular regions can be determined more easily.

Noneconomic factors matter in differentiating regions and regional development as a playing arena for human activities. Things like trust, tradition, habits, familiarity, and conventions of communication and interaction, for which culture plays an important role, will determine the characteristics of a region. So will historical, political, and natural factors.

With this in mind, in what follows, I summarize the role of culture and institutions as noneconomic factors in regional development. The case of regional decentralization presented in the last section should make it clear that integrating economic and noneconomic factors—beyond treating the latter as simply the attribute external to the system—is not only possible but also imperative.

What Is Regional Development

Given those noneconomic factors, the process through which the human activities take place defines what *regional development* is all about. The spatial and territorial boundaries (can be domestic or international) within which regional development is pursued, may evolve. Given the socially determined and normative principles and values, regional development process shapes the geographical diversity and unevenness in terms of economic and social, cultural, political, and environmental concerns. It is commonly observed that globalization and liberalization policy accentuate the gap between skilled and unskilled labor within a country or a region. The unskilled workers also suffer from a lack of mobility. Some even contend that globalization reinforces existing inequalities not only among states but also societies and regions. To the extent, many of regional issues relate to welfare inequality between regions (existed since the beginning of human history), regional development is also seen as the act or process of government providing funds and other assistance to less-developed regions. Indeed, much of the literature on regional development centered around policies aimed at addressing regional disparities by raising the welfare of lagging regions or managing the development of more developed ones. As part of an integrated geographical approach, regional development always aimed at addressing regional problems and issues through development interventions, which are best carried out at the regional level.

The process of regional development in spatial analysis also concerns with the phenomena of regional clustering. The combination of benefits offered by the less competition due to a smaller number of competitors in a smaller spatial unit (region) and the development of technology that lowers the transport costs explains why activities tend to cluster (agglomerate) in that spatial unit, even when those activities need to serve the population in some distant areas. As activities cluster, so do population. This is the reason why this very process is also used to explain the emergence of cities or urban areas. To the extent predicting cluster and agglomeration with a high degree of precision is difficult, as it involves a number of possibilities and alternatives (multiple equilibria) due to the cumulative and self-reinforcing process, the need to select the socially optimum alternative offers room for policy intervention. From this perspective, regional development policy is not only justified but also needed.

Despite the advancement in information technology and globalization, patterns of regional development remain highly diverse between and within countries due to among others the cultural process it invokes without causing a complete homogeneity as noted earlier. This suggests the need for sensitivity to the context of theory, policy, and practice.

The multidimensional concept of regional development is necessitated by the efforts to achieve the goal of stable and balanced multifactor regional potentials and greater access to a set of opportunities available to the population for their satisfactory personal and professional fulfillment (quality of life). The appropriate measures to achieve them and the sources of regional development, however, remain the subject of debate and contention. The concept itself involves complex political, institutional, and cultural factors that shape how decisions are made. For this reason, geographers, economists, sociologists, political scientists, and historians are among those who have contributed to the study of regional development.

The concept of regional development itself emerged from several different intellectual traditions. Since regional development has historically been dominated by economic concerns such as growth, income, and employment, the early thinking on regional development was heavy on economic matters.

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Beginning with the neoclassical and growth theory combined with Alfred Marshall's external scale economies and followed by David Ricardo's concept of comparative advantage, the process of development can produce either interregional convergence or divergence and generate a particular interregional trade pattern where regions export goods intensive in resources they have abundant of. Thus, initial endowment matters, and the resulting trade pattern is known as the interindustry trade. The subsequent Krugman's New Economic Geography (NEG) highlights the effect of a self-reinforcing process of agglomeration by keeping monopolistic competition as the checkerboard, in which trade and incomes are spurred through economies of scale, variety of goods, and skill composition of labor demand, hence not necessarily through the differences in endowment. The resulting trade pattern is known as the intraindustry trade.

In this tradition, however, noneconomic factors such as culture and institutions are treated as autonomous forces shaping the regional development. Yet, regional development has a broad coverage to include economic and social, cultural, political, and environmental concerns, within which institution and geography matter. This explains why the theoretical and conceptual debates about regional development and policies continue to shift. Because of the contemporary economic and social changes, prior to the selection of policies, efforts are made to better understand the issues and problems facing the region within the collaboration of the organizations and institutions. Such efforts too are multidisciplinary or even interdisciplinary. Clearly, regional development reflects not merely the outcome of a process but also the process itself, and it concerns not merely with economic but also with noneconomic factors.

Culture as Noneconomic Factors in Regional Development

The remarks by Gunnar Myrdal went straight to the point about the limitation of economic theory and the importance of noneconomic factors: "Economic theory has disregarded… non-economic factors and kept them outside the analysis. As they are among the main vehicles for the circular causation in the cumulative processes of economic change, this represents one of the principal shortcomings of economic theory." Dissatisfied with strictly mainstream approaches, there has been a strong tendency among regional analysts to focus on the role of institutions, government, and governance in shaping the patterns of regional development. Others question the dominant economic focus of regional development on agents (e.g., firms) in a regional, national, and international economic context. For more practical purposes, regional development has been also shifting toward more local even community level with more socially oriented approaches, where local and regional institutions, development agencies, community associations, and nongovernmental organizations play an important role.

It is hard to deny that almost all undertakings considered as economic activities are socially, culturally, and institutionally situated, as all individuals are part of wider structures of social, cultural, and political rules. A distinctive feature of a region or any spatial unit is the embeddedness of certain noneconomic factors including the social and cultural relations manifested, among others, in social capital, trust and reciprocity, habits, and norms, all of which have a key role to play in regional development. With these social and cultural relations, local actors can share risks and provide tacit or collective knowledge. While culture is what most relevant noneconomic factors are rooted in, the quality of institutions can determine the outcome of regional development. The two are not the same, but they are related.

Notoriously difficult to define, culture contains the elements of customary beliefs, social forms, and material traits of a racial, religious, or social group. These elements obviously differ across time, space, or social groups, and they capture the elements of social preferences and beliefs as a reflection of human understanding, shared knowledge, and practice. The human preferences should be learned during the process of cultural transformation, not modeled mechanistically as in economic optimization. The emphasis on learning implies that cultural change is evolutionary in nature. Learning is part of social evolution that is more complex than biological evolution. It occurs more slowly because people, let alone societies, are not easily willing to change due to their realistic appraisal of uncertainties arising from such a change, which is a standard problem in regional development. Among the determining factors, prior beliefs, religions, ethnicities, and trust could play an important role as a coordinating device to make societies in a region play the same "game" to different conditions and focal points. The importance of prior beliefs cannot be overstated, as many decisions—thus the corresponding outcome and performance—are based on such priors (e.g., which local technology to use, what local measures to mitigate the effects of climate change, and how to deal with the region's aging population). Here culture plays a major role in forming individual beliefs even in the new environment and several generations later.

Trust is considered an important component arising from priors. It is a form of social capital, capturing the value and relationships of resources where social networks play a central role in the production of public and common good. The constituent elements of social capital, over which people have more control than over culture, are trust, norms, and networks (the case of welfare gap between north and south Italy by Robert Putnam). The absence of reciprocal trust to produce networks of mutual engagement to create social sanctions for those who defect discouraged productive investment because future income streams are insecure. In the more contemporary era of information technology (IT), priors including trust can be influenced or enhanced by the availability of information ("big data," "internet of things," and all that). Examples of online trade and transactions abound where reviews and reputation may alter the beliefs of people or customers. Even in political elections the use of "big data" combined with complex algorithm has been widespread, and it proves effective.

While the predominant view leans toward accepting that culture is persistent or slow-moving, the question is: how slow is the cultural change? A study has shown how the centuries-old food binding in China, and the long-standing practice of dueling in Europe have gradually disappeared. A massive shift in attitudes toward female labor force participation in the United States is

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another noted example. Central to the analysis is the premise that the younger generation tends to have different understanding, attitudes, and recognition toward local cultural practices and knowledge on how to create a sustainable culture-sensitive environment.

Institutions as Noneconomic Factors in Regional Development

One critical question is about the extent to which a particular system of institutions that produce changes in culture will survive or fail because of such changes. Theoretically, it is the institutional system of legitimacy that will survive and dominate, not the dynamics of power and wealth; without legitimacy neither power nor wealth can be preserved. Institutions are meant to facilitate human interaction by providing patterns that will regulate society's behavior. It is the "rules of the game in a society" by promoting certain behaviors and prohibit other behaviors. There are formal institutions (e.g., bank regulation, tax system, and accounting rules) and informal institutions (e.g., codes of conduct, habits, traditions, and norms). While most analyses focus on the former, the latter can be more important for understanding its role in shaping the regional development performance. Enforcement is another critical component of institutions. Even well-established local rules and regulations can be rendered ineffective if enforcement is weak. Two regions with similar institutions may produce different development performance because of different enforcement.

To the extent formal and informal institutions are shaped by ideas and ideologies, not created in a vacuum, culture enters the equation. Through culture-affected ideas, individuals use their subjective mental constructs to interpret the world around them and make choices. Arguably, institutions determine the extent to which ideas and ideologies (hence culture) matter. It has been argued that the relation between institutions and culture also works in the opposite direction: when individual values are consistent with generalized morality, well-functioning institutions are likely to emerge. Using opinion polls from the World Value Surveys for 1981, 1990, 1995, and 2000 with the coverage of countries that ranges from 21 to 70, it is revealed that distant political institutions left a mark in current attitudes and values. The evidence comes from the results that show a greater trust and respect for others among immigrants who came from countries ruled by democratic system a century ago. It is also revealed from cross-country data that regions or countries that have widespread generalized morality tend to have better governance with well-functioning legal institutions (e.g., voters are more willing to punish misbehaving political incumbents).

Informal institutions come from "socially transmitted information" and are part of the heritage or culture. In the case of formal institutions, they are also linked with the prevailing political system. For example, in federalism markets are fostered through competition for economic organizations at the subnational level. In other systems, the room for pleasing powerful interest group may be more ample. The resulting regional performance under different systems (hence different institutional arrangements) is likely dissimilar. The negotiations required to reach an outcome are also not costless (contrary to the neoclassical model). The problem of information asymmetry can make the observed costs deviate from the true costs, making them more difficult to measure. Even if both parties are honest, there is always something with respect to enforcing the agreement that still needs to be specified either implicitly or explicitly. This is also not costless. When a dispute arises and a settlement (requiring lawyers) is needed, the costs can further multiply.

All the above costs are known as transaction costs. In poor regions and most developing countries, these costs are usually high and not always reported (not internalized). In some cases, personalized transactions are still the rule rather than exception. High transactions costs lead to unfavorable outcome of regional development. Since only at zero transaction costs a better or more efficient outcome can prevail (the well-known "Coase theorem"), attempts to lower transaction costs are preferred, the most common of which is through establishing clear property rights to facilitate the smooth functioning of markets. High transaction costs can also be linked to the size of the unproductive informal sector in a region. Small business operations and poor individuals including poor migrants are "forced" to remain small and informal. The transaction costs for entering the formal sector are too high, that is, getting permits, which also requires paying bribery, and often time consuming. Unsecured assets and a lack of formal documents also diminish their incentives to expand, and bank credits are difficult to get under such circumstances. Thus, informality persists. So do inefficiency and low productivity of regional development.

In a dynamic context, an institutional framework ensuring that technology can be advanced ("creative destruction") is also frequently absent in poor regions. Free entry and free exit hardly prevail. Firms with a privileged access to those in power survive by patronage through monopoly rights, soft budgets, or special concessions. For them no innovation is needed to survive. More seriously, they resent any policy measures intended to enable innovation to raise productivity when those measures threaten their survival. Power influence enables them to do so and to keep away from potential competitors. Thus, culture-influenced institutions can affect transaction costs and, in turn, the regional development performance in a static and a dynamic sense. The latter works through organizations' decisions about technology and innovation. The question is, what kind of institutions that would work favorably for lowering transaction costs and unleash the full potential of the region's citizens to innovate, invest, and develop?

A careful study has shown that nations thrive when they develop "inclusive" political and economic institutions and fail when those institutions become "extractive." The latter is structured to extract resources from the many by the few, and concentrate power and opportunity in those few hands. Thus, not only technology, innovation, and regional growth but also inequality (in political and economic terms) can be determined by culture-influenced institutions. In turn, inequality could also undermine the inclusiveness of institutions; for example, the contribution of Christian missionary in German East Africa was found to have wider impacts than previously acknowledged. In particular, it had deep cultural impact on the current socioeconomic gender

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inequalities. Numerous studies have also shown the effect of Protestant denomination on economic and regional development, particularly in colonial Africa.

Even without subscribing to the neo-Marxists approach, culture could also play a role in obscuring and legitimizing exploitation, leading to persistent regional inequality. Here, culture is treated as an independent causal force that reflects and shapes socioeconomic or material relations, where power structure plays an important role in the process (Weberian premise). For example, in the colonial period, a highly inegalitarian local rule system was formed by reinventing the traditional clientelism into much more authoritarian forms of clientelism. This was found in Latin America and sub-Saharan Africa. Using a different approach for the Indonesian case, the impact of the colonial system on regional inequality has been shown working also through foreign investment. The resulting dualism of the colonial system produced a persisting inequality between and within regions where the central state and elites invested major resources to bring about socioeconomic change in some regions but left much of the governance in other regions in the hands of locally hegemonic elites. The latter derived authority from their powers of distributing projects, jobs, money, and licenses.

In sum, being the key parts of noneconomic factors, culture and institutional factors can determine the extent to which the regional development is able to achieve higher productivity and improve society's welfare.

People's Participation in Regional Decentralization and Development

Regional decentralization is a multidimensional phenomenon, encompassing several interconnected aspects. Its theoretical supports originate in the informational advantage and coordination (policy enforcement) capability of local government. Although informational advantage can be secured by adopting a promarket policy, a market system alone may not be sufficient to establish an effective coordination at the local level unless the human decision making is decentralized. A more decentralized system, particularly on fiscal front, is also considered superior for promoting regional growth. The World Bank embraced decentralization as one of the major governance reforms on its agenda.

Yet, the experience in many countries shows that the regional development performance after decentralization has not always been consistent with the promise. Growth can be lower, and the region's overall welfare conditions may not improve, if not worsen. Imperfections in local provision and poorly trained local bureaucrats are among the suggested reasons. Problems due to lack of coordination in extracting bribes at the local level can also lead to "excess" rent extraction, although some argued that corruption should be more difficult to commit under decentralization. The most significant risk of regional decentralization is the spread of local capture, especially in regions having a high degree of income disparity. Although the verdict regarding the relative proneness of local and national governments is still out, in general, the likelihood of capture by elites is greater at the local than at the national level. The possibility of power sharing between contesting parties is typically smaller at the local than at the national level. Some analysts consequently suggest that the justification for decentralization should be based on the political economy explanation and to be successful decentralization should entail democratic, fiscal, and administrative components.

The basic premise of regional decentralization-growth nexus is that local governments are more efficient at providing infrastructure and public services compared with the higher levels of government. Greater efficiency is thus at the center of the relation between decentralization and higher rates of regional growth. However, overall efficiency is not always aligned with private efficiency. With enhanced authority after decentralization, local leaders may put private benefits above social benefits, depending on how they perceive the implication on their probability of staying in power. When private benefit rules, incentives to foster growth become secondary, and when private motives produce a detrimental impact on regional resources, growth falters. Local government can stay in power if they either foster or kill growth by intensifying local capture. The latter could occur because local governments have had few incentives either to resist capture or to rein in competition for rents.

Yet, the ultimate goal of regional development goes beyond growth. The problem is that once a multidimensional goal is considered, various trade-offs emerge, where different institutional factors play different roles in affecting welfare. A further complication appears with respect to the complex relations between local capture and the goal, where institutions including capture interact among themselves as well as with welfare. By using the *Institutional Model of Decentralization* (IMD), an extensive study delineated the interactions between institutions as noneconomic factors and regional development with a more broadly defined welfare. The starting point is to delve into the theoretical concept of regional incentives by way of comparing "rewards" and "punishment" for adopting regional growth-enhancing policy. Subsequently, a variety of institutional factors reflecting human behavior ranging from local capture, people's participation, initial conditions, and the quality of local leaders are used to determine how they affect the regional welfare. The importance of local capture cannot be overemphasized as it is always widespread during local elections. Under such circumstances, people's participation holds the key to the regional development performance.

Indeed, literature on institutional perspectives stresses the importance of participatory process. The degree of political participation differs between countries and regions. One of the most determining factors is the initial welfare condition or social structure, represented among others by the human development index and the level of poverty and income inequality. Greater inequality and larger proportion of the poor imply a smaller fraction of informed voters or lower political awareness, that is, upward mobility at the end tends to raise political awareness more significantly than at the higher end (concavity). When awareness is low, critical voices and the process of check-and-balance are constrained. This can limit the quality of public services and the welfare outcome of decentralization in general. In some cases, the budget size can be positively affected by local capture if local leader is capable of capitalizing the resources contributed by the local elites. Hence, while local capture tends to have a detrimental effect on regional

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development performance, in cases where the local leader is capable of mobilizing people's participation greater local capture can be welfare improving.

Given the diverse outcome of regional development with widespread local capture under decentralization, institutional reforms are generally recommended. The use of IMD clearly shows that noneconomic and economic factors are interlinked and integrated, through which a more comprehensive analysis of regional development can be made.

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