**Political settlements and economic development – A political economy analysis of institutional change and elites in urban Colombia**

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## 1. Introduction

It is widely accepted in the academic literature that the dynamics of globalization have led to a deterioration of the nation-state. The neoliberal turn of many less developed countries entailed a shift of spatio-economic dynamics in global capitalism that has changed formal and informal institutional settings. This has involved a selective transfer of state capacities upwards to the supranational level (through globalization), but also downwards to the subnational and urban level (decentralization and urbanization). While the critical globalization literature has identified these interventions as strategies in "securing conditions for a smoothly operating world market … in various scales above and below the national level" (Jessop, 2002: 454), scholars working within the discipline of institutional economics have generally not picked this up.

The theoretical debates that do look at the urban as a key analytical dimension for institutional challenges to promote economic development are dominated by analytical approaches that work within New Institutional Economics (NIE) and promote the "Good Governance" reform agenda. However, the "good governance" literature commonly focusses on formal institutions as necessary and sufficient conditions to generate development. It thereby ignores an existing gap between normatively defined formal institutions and how they (informally) operate in practice. Furthermore, the agenda excludes closer institutional analyses of how spatio-economic changes have affected power relations and state capabilities to implement the policies. There is neither a reference to dynamics of capitalist development, nor to the importance of urban elites or other powerful agents. There is no political economy analysis of the interests, ideologies, and roles of transnational organizations, particularly of financial institutions.

Urbanization, decentralization, as well as transnationalization need to be analyzed as interdependent processes that contribute to changes in power distribution. Changes in the distribution of power in a society affect the likelihood of achieving necessary and sufficient institutional mechanisms for productive and inclusive economic development. Different from contributions working within NIE to conceptualize institutions and economic development, this paper uses the theoretical framework of 'political settlement', an historical political economy approach to institutional change brought forward and developed by the economist Mushtaq Khan (1995; 2008; 2010). By definition a "political settlement is a combination of power and institutions that is mutually compatible and also sustainable in terms of economic and political viability" (Khan, 2010: 4). However, most academic contributions using Khan's framework remain focused on the national level as a unit of analysis.

The point of departure of the analysis in this contribution is that the ascent of the urban as a key institutional dimension as well as the rise of a transnational capitalist elite has altered the distribution of power (urban) Colombia. 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 on economic performance and developmental outcomes. The discussed theoretical perspectives are particularly relevant for the analysis of productive and inclusive development in urban Colombia, where static comparative advantages in (speculative) service sectors, unproductivity, and inequality prevail.

The case study of Medellín, the second city of Colombia is in many ways suitable for analyzing institutional change and urban economic development through the theoretical

lens of political settlements. Medellín's economic development is marked by an impressive import substitution industrialization in the in the 20th century, which entailed the rise of a powerful urban industrial elite that formed alliances with the traditional landed oligarchy. The coalition used rents created through infant industry protection, subsidies, tax breaks, and other forms of state-created rents to distribute patronage and keep the settlement politically stable and economically viable. However, with the industrial decline in the 1970s and 80s, standard formal and informal ways of patronage distribution declined. Other actors emerged that contested the traditional elite bargain in the city. The so-called *clase emergente* comprised emerging landed elite factions that had so far been left out from the ruling coalitions, as well as subordinate classes (led by the drug lord Pablo Escobar) that achieved considerable wealth. The following political violence and economic instability made Medellín not only the 'most dangerous city in the world', but also the economically weakest urban area of Colombia.

Since the turn of the millennium, Medellín has gone through remarkable developments. The city's violence rate was reduced drastically and the urban economy grew exceptionally fast. This has motivated scholars and journalists alike to declare a "metropolitan miracle" (see Gutierrez et al., 2011; Economists, 2014). While this article does not engage with the miracle claims in detail, the institutional theoretical framework elaborated here helps to understand the "miracle" from a political economy perspective that looks through the political settlement lens. The discussion of how the transnationalization of the city's elite, as well as several urban dynamics impacted various formal and informal institutional governance mechanisms helps in unpacking the different factors of the supposed 'miracle'.

Following this introduction, section two discusses how spatio-economic dynamics in global capitalism has entailed a selective transfer of state capacities upwards as well as downwards. The urban dimension has become a key arena for institutional challenges to achieve sustainable economic development. The section reviews conventional approaches to urban governance. It concludes that an historical political economy approach to institutional change is needed to understand necessary and sufficient institutional conditions for productive urban economic development. Section three provides an analysis of the theoretical 'political settlements' framework. The framework claims interdependency between institutions and the distribution of power, which is detrimental for political and economic developmental outcomes. Section four expands the 'political settlement framework by discussing how processes of transnationalization and urbanization have affected the interdependency between power and institution. Section five uses the development of Medellín as a case study and applies the theoretical consideration to the city's empirical realities. Section six concludes.

## 2. (Geo-)Economic Institutionalism – Why the Urban Matters

In a response to the failure of the import substitution development industrialization model (ISI) elites in Latin America started to reorganize the basic institutional setup of the dominant post-war nation-state centered settlement. Most Latin American countries (above all Chile, Bolivia, and Colombia) deployed a wide range of neoliberal policies that implemented, inter alia, liberalization of trade and finance, privatization of public assets and services, fiscal austerity, a deregulation of state control over industry, and a flexibilization of labor markets. Khan and Blankenburg (2009: 368) find that this "fairly radical shift towards neoliberalism" 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". Besides the implementation 'Washington Consensus' economic and fiscal reforms (see Williamson, 1990), this market-led development agenda also entailed a political, and administrative restructuring of the state.

Academic debates on how these institutional and economic changes have affected government capabilities to achieve economic development are primarily concerned with institutional changes following the selective transfer of state capacities to the supranational level, making the view of a "hollowing-out" of the nation state through transnational processes widely accepted. However, the impact of these transnationalizing processes on state sovereignty and institutional autonomy also entails an increased importance of the urban as a key arena. Hence, the policy-shift towards neoliberalism also favored administrative and fiscal decentralization, a maximization of local autonomy, and consequently an intensified dynamic of urbanization processes (see Harvey, 2013 for a general discussion of these processes).

Various scholars in contributions to the theory of the state have analyzed spatial impacts for the urban dimension in closer detail. Swyngedouw (2000: 64) sees that "the pre-eminence of the 'global' in much of 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 his analysis of the urban as a key dimension of such a reconfiguration of governance, Swyngedouw (2000) confirms Sassen's (1991) findings that globalization processes have led to the ascendance of "global cities". Urban areas have become important in the re-scaling of strategic territories, leading to a "partial unbundling or at least weakening of the national as a spatial unit" (Sassen, 1991: 27). Castells (1996: 403-04) 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 there is 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: 36). The "urban process" as Harvey refers to the multiple dynamics of urbanization, "also throws up certain institutional arrangements, legal forms, political and administrative systems, hierarchies of power, and the like" (Harvey, 1989: 6). With the selective transfer of state capacities to supranational and subnational forms of *governance* has shifted power relations of local ruling coalitions. These new forms of governance favor private capital and make urban *governments* mere facilitators and bystanders with a role of coordination. Urban governance is focused on making cities "increasingly important geographical targets and institutional laboratories for a variety of neoliberal policy experiments form place-marketing,… local tax abatements,… public-private partnerships,… property-redevelopment schemes" (Brenner and Theodore, 2002: 368). Peck et al. (2009: 57) find that through the insertion of cities into global capitalism, "cities today are embedded within a highly uncertain geo-economic environment, characterized by monetary instability, speculative movements of financial capital, global location strategies by major transnational corporations and intensifying interlocal competition". These processes are seen as a result of increased transnationalization of capital that influences and reconfigures urban and local institutional configurations and vice versa.

Following such understandings of urban governance, policy makers and economists alike promote institutional reforms that mix together state power with private interests and various institutional and organizational forms of 'civil society' to build coalitions to manage

urban economic development. However, there are considerable differences in what policy strategies are promoted.

Using Harvey's (1989) theoretical consideration on 'urban entrepreneurialism' Jessop and Sum (2000) provide a "Schumpeterian analysis of entrepreneurial cities" with a detailed discussion regarding a possible growth-enhancing urban governance model. Similar to other discussions about 'urban growth machines' the analysis is mostly focused on how innovative strategies impact wealth creation and the dynamics of property capital. However, the theoretical discussions of 'urban entrepreneurialism' and 'Schumpeterian cities' are exclusively focused on advanced capitalist countries. Both, the likelihood of achieving urban "entrepreneurial" or "Schumpeterian" institutions, as well as impacts of unproductive comparative advantages to which many less developed countries are prescribed to need to be considered in the context of any urban policy recommendations.

Furthermore, most contributions analyzing the implications of the neoliberal turn on urban governance and institutions in advanced countries fail to analyze two central conceptual processes. Fist, many fall short in explaining institutional change within urban governance. Much of the concepts remain focused on institutional change through "strong properties of path-dependency, in which established institutional arrangements significantly constrain the scope and trajectory of reform" (Brenner and Theodore, 2002: 361). Path-dependency is argued to be part of a "policy paradigm" (Hall, 1993) and actors are seen to be dependent on a "cognitive framework that defines the institutional background against which their intentional actions are legitimized" (Torfing, 2001: 287). Such rather vague references are not contextualized in changes in the distribution of power and transaction costs that arise with institutional change. Second, the considerations of neo-liberalization of economic regulation and state spaces lack a focus on institutional mechanisms that could generate productivity growth and inclusive economic development. Closer institutional discussions on how the necessary and sufficient conditions for such strategies can be achieved are missing.

For urban governance approaches in *less developed countries*, the conventional wisdom is focused on reforms promoted by the so-called "good governance" agenda. Good governance policies are the conventionally implemented reform agendas in urban Latin America promoting institutional policies to achieve vague developmental goals such as "accountability", "transparency", "rule of law", and "tax efficiency" (without changing the regressive taxation system or increasing tax on profits). The agenda also suggests reforms of institutional restructuring of the state towards more decentralized forms of governance (see World Bank, 1991, 1994, 1999, 2001, 2009, 2012; UN-HABITAT, 2015; Hall and Pfeiffer, 2000) that are seen as sufficient conditions for the necessary liberalization policies to promote economic development. Good governance is thus an agenda that seeks to overcome market-failures by subscribing to policy solutions that are hoped to produce the institutional underpinning for successful market-driven development and growth. The targeted outcomes of these reforms are an increased international competitiveness, the creation of a favorable "business climate", and to make cities key actors in managing transnational capital flows.

However, good governance policies are implemented without recognition of their shortcomings in Latin America's context of returning to its underlying unproductive comparative advantage. Further, the "good governance" literature excludes closer institutional analyses of how the policies can be implemented considering the spatio-economic changes that affect power relations and state capabilities 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, and roles of transnational organizations, particularly of financial institutions. The emerging influence of the transnational capitalist class on institutional mechanisms and governance capabilities is also completely missing from the good governance agenda, making good governance *seemingly* apolitical. However, the attempt to harmonize the obvious antagonism and contradictions of market-driven development confirms that "[t]he contemporary good governance agenda is based largely on governance capabilities that are required to create the conditions for markets to be efficient" (Khan, 2008: 107).".

Regardless of these apparent shortcomings of contemporary institutional explanations of restructuring urban governance, there has been only a very limited amount of approaches that propose alternative institutional reforms for productive development for urban areas in less developed countries. Proposals of "productive transformation of cities in Africa,… Latin America,… (and) Asia" (UN-Habitat, 2015a) essentially do not depart from "good governance" ideas and ideals.

Urbanization, decentralization, as well as transnationalization need to be analyzed as interdependent processes that contribute to changes in (urban) power distribution. Changes in the distribution of power in a society affect the likelihood of achieving necessary and sufficient institutional mechanisms for productive and inclusive economic development. As changed distribution of power and its impacts on institutionals and economic performance are one of the main results of transformed and re-scaled dynamics in economically liberalized and politically decentralized localities, such theoretical considerations need further scrutiny.

The point of departure of the analysis in this contribution is that the ascent of the urban as a key institutional dimension, presupposed by and contextualized in a transformed spatiality of global capitalism, has altered the distribution of power in less developed countries. 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 on economic performance and developmental outcomes. These theoretical perspectives are particularly relevant for the analysis of productive and inclusive development in urban Latin America, where static comparative advantages in (speculative) service sectors, unproductivity, and inequality prevail.

Different from contributions working within New Institutional Economics (NIE) to conceptualize institutions and economic development, this paper uses the historical political economy theory of 'political settlement' (Khan, 2010). However, most academic contributions using Khan's framework remain bound to the spatio-economic idea of methodological nationalism. After the institutional analysis of Khan's framework, this paper will use the considerations made above and applies the institutional analysis of 'political settlement' to the urban realities shaped by the transnationalizing interests of local elites (see section 4).

## 3. Political Settlements, Institutions and their Importance for Urban Governance

Contemporary approaches to urban governance either ignore power relations all together (this is particularly true for the good governance agenda), or they understand power as a mix of different formal state institutions and organizations (i.e. urban entrepreneurialism has exclusively been applied to advanced capitalist countries where formal institutions are

predominant). Hence, pure institutional analyses to problems of urban governance miss to understand how institutions and policies *actually* work, as they ignore an existing gap between normatively defined formal institutions and how they (informally) operate in practice. This paper proposes a broader framework of how institutions could affect economic performance that goes beyond the conventional approaches that exclusively focus on exogenously given formal institutions, informal institutions and other non-institutional factors such as cognitive capabilities (North, 1995).

An entry point for an alternative theoretical institutional analysis is Khan's (2008, 2010) political settlement framework, which explains different institutional settings and their respective impacts on economic growth and political stability. By definition a "political settlement is a combination of power and institutions that is mutually compatible and also sustainable in terms of economic and political viability" (Khan, 2010: 4). In contrast to the NIE analysis this framework goes beyond the understanding of institutions as primarily formal property rights that make social interaction possible. Khan (2010: 10) distinguishes between impersonal formal institutions and informal institutions, which he defines 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 patron-client networks. Khan (2010) finds interdependency between institutions and the distribution of power that will ultimately lead to the emergence of a political settlement in which the two are compatibly combined. The distribution of power embedded in this political settlement is reproduced and sustained by formal *and* informal institutions, as well as vice versa: enforcement of institutions and their evolution over time depends on the distribution of power. Consequently, it necessary a) to discuss of the organization of power as a determinant of institutional change; and b) to analyze operational outcomes of institutions.

However, there are several enforcement problems with institutions particularly in the context of less developed countries. Enforcement problems do not exclusively arise as a part of transaction costs that occur through or are reduced with institutional changes (i.e. new property rights or the enforcement of existing rights). Enforcement costs are also a result of transition costs, which arise through non-market transactions and political acts such as strikes, and violence. Such costs are ignored by conventional institutional approaches that focus exclusively on transaction costs.

Enforcement costs may vary depending on the nature of the institutional change and the (lack of) resistance to these changes through powerful groups that are outside of the ruling coalition. Institutional changes can have negative impacts if these changes are not divisible with powerful "outsiders" or if political miscalculations were made that might induce transition costs and threaten political stability or hinder economic growth. As formal institutions in less developed countries are often insufficient to provide a distribution of benefits (rents) that is in line with the distribution of power in that society (also because there is a relatively small productive sector), informal institutions play a central role in the reduction of transition costs. Despite that property rights can help to reduce enforcement costs, formal institutions in less developed urban areas have certain cost-reducing limitations. Consequently it is particularly informal institutions, such as patron-client networks that sustain the distribution of net rents for the participants of benefit arrangements. Thus, institutions have distributive implications, which again are closely linked to the (reinforcement of) power in a society. Powerful groups can create rents and manage them according to the distribution of power in the society, so that transition costs of institutional change can be minimized. The combination of (formal and informal)

institutions with the distribution of power makes this framework helpful for a deeper-level analysis of benefits through rent-creation and –distribution for different classes and groups depending on their relative power.

Khan (2010) identifies that the distribution of power between different patron-client factions can tell us much about the possible enforcement abilities of the ruling coalition. If the power of an excluded faction is weak (i.e. because all powerful coalitions have been included in the ruling coalition) the ruling coalition can develop interests that are closely aligned with growth. Acknowledging these considerations for the analysis of urban areas in less developed countries, a focus on vague and technocratic "good governance" reforms that promote *formal* institutions might be a waste of opportunities, since they are not sufficient conditions for development in such a particular context.

The institutional strategies of ruling coalitions and their effects depend on yet another dimension implicit in the organization of patron-client networks: the technological and entrepreneurial capabilities of capitalists as well as their relative power and position in the political settlement. Similar to the theoretical consideration brought forward by the urban entrepreneurialism literature, productive entrepreneurs are key actors in processes of capital accumulation and growth. However, with the institutional realities in less developed urban areas the entrepreneurial capabilities of productive entrepreneurs depend on various different variables. First of all, we acknowledge that capabilities are defined by historical processes of accumulation and learning and are changing relatively slowly (path-dependency) and that formal rents and profits of the entrepreneurs increase their holding power. However, the relative power of these entrepreneurs with respect to, or within the ruling coalition also depends on informal rents, grey trading networks, and other sources of income. Depending on the technological-entrepreneurial capabilities of the entrepreneurs, these rents can help generate growth in productive sectors of the economy. The growth-outcome further depends on the position of these entrepreneurs in the ruling coalition (i.e. whether they are powerful or not; and whether they are insiders or outsiders of the ruling coalition). Disciplining of entrepreneurs might be difficult in a settlement where holding power of the entrepreneurs is high. However, such a context can also be helpful in drive of technological acquisition and productivity growth. In contrast, when holding power of productive investors is low these entrepreneurs might be easy to discipline, but it complicates the drive to acquire technologies that enhance productivity growth. This is particularly the case when this is combined with low technological capabilities of these investors. Since entrepreneurs in less developed countries have generally low technological and entrepreneurial capabilities, a concentration of holding power by capitalists can be crippling for development as low-technology and -productivity enterprises persist. This makes it crucial to look at these variables to analyze the likelihood of enhancing productivity growth through institutional change.

Again, the analysis of institutional change through the lens of the political settlement approach goes beyond the good governance debate. The framework does not simply assume that some form of productive sector already exists for which formal property rights are necessary and from which rents can be abstracted. It acknowledges that growth-enhancing capabilities of incentives and compulsion for growth are not common in developing countries, where unproductive capitalists often hold a very powerful position in the political settlement. This creates not only a situation in which rents are extracted from non-formal institutional arrangements but also limits the possibilities of achieving transformations of formal institutions.

The economic focus of the good governance agenda on market efficiency and positive business climate is also misleading in low-productive economies, as it is first and foremost necessary to promote possible productive, growth-enhancing capabilities through formal as well as informal institutions. The institutions for such a development are commonly rules and rights that on one hand incentivize the setting up of new companies, and on the other create compulsions for productivity growth and technology acquisition through learning (Khan 2008, Khan and Blankenburg 2009). However, depending on the power structure and the interest of the entrepreneurs in a society, such institutions might not be effective or might not be implemented in the first place.

In essence, the political settlement framework proposes a non-linear, iterative approach for understanding and assessing institutional performance in the context of particular characteristics of a political settlement. The analysis of the political settlement is crucial to understand the location of productive entrepreneurs (excluded or included in the ruling coalition; patron or client), which determines their power and their ability to coordinate and enforce. Both of these variables again affect the outcomes of particular (informal) institutions regarding political stability and economic growth. With this analysis we can identify the aspects of a political settlement that might have positive growth effects. The changing structure of rents and the capabilities of entrepreneurs are of particular importance in this analysis as this gives an insight to shifts in power and possible changes to enforcement capabilities of particular groups.

However, most contributions using this institutional framework fail to go beyond a scale-based analysis rooted in methodological nationalism. The findings this paper made in the previous section, however, prompts the necessity of re-scaling the political settlement framework to the urban level. Since the urban processes are closely linked with the transnationalization of capital flows and are interdependent with the interests of local capitalist elites, an analysis also demands a closer discussion of the transnational processes and their impacts on power, institutions, and rents in the (urban) political settlement.

The next section will use the discussed theoretical framework and expands this institutional approach with theoretical findings of section two, as well as through new theoretical and empirical insights regarding capitalist elites in Latin America, and more specifically in Colombia.

## 4. The Transnational Capitalist Elites and Urban Governance in Colombia – Political Settlement and Institutions Revised

While the political settlement provides an institutional underpinning for the theoretical framework of this paper, it falls short in considering how the spatio-economic changes affect the interdependent relationship between power and institutions. Khan's (2010) nation-state centric approach to political settlements remains implicit about how global capitalism changes formal and informal institutional settings, not only through upward institutional transfers of power, but also through downward ones. Drawing from the findings made in section two of, the transnational mobility of capital has created new forms of capital accumulation that require (an understanding of) appropriate institutional mechanisms for urban economic development.

Recent academic contributions are attempting to broaden the political settlement framework by acknowledging how global processes challenge the validity of Khan's (2010)

theory. In a conceptual and methodological analysis of underlying power relations in the politics of social protection in Africa Lavers and Hickney (2015) find that "political settlements frameworks tend to downplay the importance of transnational actors in favour of detailed analysis of domestic politics" (26). The process of governance and institutional change "can also be affected by exogenous factors and actors" (Bebbington, 2013: 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: 11). Furthermore, it is necessary to look at the transnationalization of endogenous factors and actors. In such globally exposed and integrated sectors it is important to acknowledge transnational factors more generally "such as policy diffusion and institutional mimicry" (Dressen and Dinnen, 2014: 5). However, a targeted theoretical and conceptual institutional analysis of these processes of a transnationalizing elite in less developed countries, their effects on power, and their implications on rent-creation and –management and likelihood to achieve and implement growth-enhancing institutions is missing in this political settlement literature. As Mohan and Asante (2015) put it, "our understanding of these processes is still quite black-boxed and we have yet to establish causality between international interests, specific coalitions, and outcomes" (4).

Applying Robinson's (2010) theoretical approach of the transnational capitalist elite in Latin America to the political settlement framework could help in filling this gap. Combining conjunctural with more structural approaches to economic transnationalization and elite transformation, the author finds that Latin America's domestic capitalists transformed drastically with the region's neoliberal turn in the 1990s. The transnationalization of the capitalist elite inter alia involved an increase inward and outward FDI, a sharp rise in cross-border mergers and acquisitions that also implied a transnational interlocking of boards of directors, as well as increased transnational ownership of capital shares (Robinson, 2010). Reyes (2003) finds that the neoliberal shock therapy also witnessed a rise of Latin American multinationals, *multilatinas*, which implied an increased concentration of capital and thus power.

For Colombia, the transnationalization of the urban elites and the decentralization of political, fiscal, economic, and administrative decision making after the country's neoliberal turn implemented by the Constitution of 1991 has various interdependently linked implications regarding the *theoretical* understanding of local political settlements, and their respective *empirical* political economic developmental outcomes for urban areas.

*Rent-Creation and Power*

Khan (2010) discusses that domestic capital can shape the position of capitalists in the ruling coalition, depending on the elite's holding power and their technological and entrepreneurial capabilities. A favorable configuration of power and capabilities can lead to resource allocation that favors technology acquisition, leading to an overall enhancement of productivity growth. The creation of these resources inter alia depends on elite rent-creation through economic development and political activities, but also through financing public services (Whitfield and Therkildsen, 2011). However, and considering the discussed dialectic relationship between the global and the local and the entailed hollowing-out of the state, we need to reconsider institutional mechanisms of rent-creation, as well as their impacts on their interdependency with the distribution power.

Colombia's traditional colonial *comprador class* mainly created rents by relying on imperialist capital. After the 1930s and during Colombia's 'golden age' of nation-state capitalism industrial elite factions emerged that relied on state-created rents. Similar to Di John's (2010) findings on elite rent-creation in less developed countries before liberalization, for Colombia's elites during the industrialization phase the "standard ways of distributing patronage were through state-created rents such as infant industry protection (tariff and non-tariff), subsidied credit, high-level jobs in parastatals and marketing boards" (20). In the era of economic transnationalization, dynamics of rent-creation and patronage distribution changed. Elites are no longer able to capture and distribute surpluses and benefits through interventionist mechanisms.

In a context where the local economy is fully liberalized and integrated in the globalized capitalist market elite rent-creation through economic development as well as through public finances becomes inherently dependent on transnational capital. Powerful transnational actors and a transnationalizing capitalist elite have thus been an essential feature of less developed countries' transition to fully-fledged globalized capitalism. Elite rent-creation in this globalized environment happens through transnationalizing the capitalist portfolio of the local elite or through a brokering (and taxing) of inward FDI.

This has several implications that are not only linked with the issue of rent-creation but also interdependently with each other. Firstly, transnational capital affects social mobilization and transition costs, as well as how (informal) institutions and rent-management can help to minimize these costs (Bebbington, 2013). This changes how transnational capital as a source of rent-creation enables (or constrains) elite agency in the ruling coalition. The exploitation of new sources of rent-creation thus affects the distribution of power in the political settlement. This is not explicitly analyzed in Khan's (2010) theoretical exposition. Secondly, the local faction of the transnational capitalist elite willingly accepts Colombia's static comparative advantage in unproductive sectors as a feature of globalized value creation. The economic interests of the transnational elites no longer reside in the development of national capitalism, but much more in promoting the global capitalist system they participate in and defend (Robinson, 2010: 173). A third factor that needs to be considered is the conceptualization of possible forms of governance that accompany and stimulate such developments. As short-term speculative (capital) investments are an increasingly important source of rent-creation and power, governance reforms will seek to secure this institutional setting. A political settlement where unproductive transnational capitalist elites have concentrated holding power can thus have adverse effects for development. The creation of incentives for addressing structural issues and invest in long-term productive projects is becoming more and more difficult and low-technology and –entrepreneurial enterprises persist. These factors will be discussed in closer detail. Furthermore, it will be analyzed how all of these aspects influence the sectorial and productive development of (urban) Colombia.

*Enforcement, Transition Costs, and Institutions*

As discussed in section three enforcement costs vary depending on the nature of the institutional change and the (lack of) resistance to these changes through powerful "outsiders". Transition costs thus occur with institutional changes that create tensions between factions of the political settlement. These tensions are not exclusively national and internal, but also global and local. The change from nationally-oriented to transnational capitalist development might cause conflicts between old landed oligarchs and nationally-oriented industrial elite on one hand and the transnationalizing local elite faction on the other. As Robinson (2010) finds "(t)he opposing interests and projects of these two groups often underlie the surface political battles among ruling classes and states" (170). Similarly,

informal institutions (i.e. norms, values, rules), which for Khan (2010) are an important mechanism to reduce transition costs, might change with the spatial restructuring and the urban-transnational dynamics.

And indeed, urban political settlements in Colombia are to some extent coined by a competition, politically and economically, between factions of the old landed oligarchy and transnationally oriented elites. However, as suggested by Khan and Blankenburg (2009), Colombia's political settlement has generally been less fragmented then others in the region. There has been a relatively low incidence of redistributive pressure from competing elites, which is also indicated by the historically low inflation rates in comparison to other Latin American countries.[1] Furthermore, the much larger weight of landed elites in the political settlement helped to keep transition costs through redistributive claims low. In turn "the larger role of landed interests in Colombia also meant that the state's capacity to allocate rents to industrialists was more limited by the need to find compromises between industrial and landed interests" (Khan and Blankenburg, 2009: 363).

With this relative low competition in the political settlement, the transnationalization of interests by one faction of the elite did not, in most cases, cause large conflicts with the old landed oligarchy. Robinson (2010: 168) finds "a new axis of class fractionation" helped "(n)ew transnational capitalists and transnationally oriented elites…[to emerge] around globalized circuits of accumulation". In this vein, Rettberg (2005) 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" (38) have formed to become so-called *grupos* (diversified conglomerates). *Grupos* combine the interests of the landed oligarchy and the traditional industrialists with urban transnational elites to concentrate capital and power.

Neither these grupos, nor other forms of patron-client networks between the elite factions are examples for formal institutional mechanisms a la NIE. However, while Khan (2010) acknowledges the political and economic importance of informal networks he remains unclear about the influence of transnational capital on them. Thus, by transnationalizing their assets *grupos* are responding to the penetration of Colombia through transnational capital. These informal patron-client networks are often the answer to the elite's worry of being outcompeted "in the face of globalization and the fear of being invaded on their back yards" (Reyes, 2003: 11). Furthermore, Khan's (2010) considerations on how formal institutions (particularly the ones promoted by the good governance agenda) promote market-led development become increasingly relevant with the inclusion of the transnational and the urban dimension into the political settlement framework. On one hand, and as discussed in section two it is primarily supranational organizations that promote good governance institutions as agents of transnational capital and of the respective market-driven developmental approach. On the other hand these good governance reforms increasingly become a feature of urban governance and affect the economic development of cities. Mohan and Asante (2015) find other formal institutions that become more important with the transnationalization of local capitalist elites, such as marketing boards, central banks, etc. The authors find that such formal "institutions have dualistic functions as intermediaries between transnational companies seeking access to resources and as vehicles for rent capture. As such they are used strategically by elites and are often left relatively autonomous. Hence, it is important to disaggregate 'the state' and to

[1] While some see this is the result of the influence of drug economy (Thoumi, 2003), it is also an indication of a less competition between capitalist-led factions (which might be even translated for the rents created in the drug economy, at least after 1993) that resulted in decreasing transition costs.

examine state agents in the context of transnational capitalist relations" (Mohan and Asante, 2015: 4).

*Governance and Urban State Capabilities*

The disaggregation of the state, both in the context of the urban as well as through processes of transnationalization changed political and the economic interests of most elite factions. Political decentralization and economic liberalization of Colombia combined different elite factions into a broader project of hegemony. Transnational factions of the elite merged with local political managers or developed political capacities as neoliberal actors and technocratic leaders. New forms of urban governance have emerged from this elite bargain, particularly in form of public-private partnerships that encompass many different factions of the capitalist elites through the strong representation of *grupos* and business associations in the ruling coalition.

Ruling coalitions in urban Colombia have promoted economic reforms that on one hand focus on further liberalization of financial and capital markets. And on the other deregulate and felxibilize labor markets to increase the supply of cheap, servile, and low-skilled labor. These economic structural (urban) reforms hope to make metropolitan areas more competitive in the global financial system as well as in the race to the bottom of being attractive for the outsourcing of unproductive service actives vis-à-vis other "global cities" in the less developed world.

However, these economic reforms were soon deemed to be necessary but not sufficient for development. As a result "good governance" reforms are increasingly an indispensable feature of achieving market efficiency (Naim, 1995). These reforms mainly try to create a more transparent and predictable political and economic environment in which market-enhancing economic policies work most effectively. Such market-enhancing governance models not only deepen the hegemony of the transnationalized local elite and concentrate power with the low-technological and –entrepreneurial capitalists, which in turn hinder the development of growth-enhancing state capabilities. The short-termism and possibility of high returns from these processes also gives entrepreneurs incentives to engage in speculative activities as well as in low-tech and low-productive service sectors with rather adverse effects on economic development.

*Sectorial Growth and Developmental Outcomes*

Urban Colombia has experienced a steady expansion of the tertiary sector relative to the primary and secondary sectors of the economy. This "tertiarization" is a part of a broader trend of transnationalized capitalism. It is particularly urban areas that play a key role in Colombia acceptance of the neoliberal diktat of its "naturally given" comparative advantage in service sectors. With industrial and commercial capitals in recession after the failure of the ISI model, and the explosion of speculative and service-based accumulation after liberalization, urban Colombia has seen a rise in sectorial growth service industries, such as hospitality or outsourced communication technology. Furthermore, the urban real estate sector has been growing proportionally fast in urban Colombia. Closely linked to this rise is the growth of financial services in urban economies, since property values are created through various mechanisms of financial intermediation. However, much of the produced profit is often realized without real value, as pre-sales of unbuilt 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 inflow of transnational capital and leads to the transnationalization of mortgage securities.

Financial services and their connection to transnational capital has thus become a lucrative, yet very speculative, unproductive and fragile substitute for state-created industrial rents. Rents based on property-finance have thus been generated by the emergence "of a broader cross-border urban bloc that comprised not only multinational/local banks (in the form of project finance/mortgages) and construction companies (in the form of land/ property assets) but also legal/property professionals (in the form of services), the government (in the form of land and revenues),… and cross-border capital… (in the form of legal and clandestine capital)" (Jessop and Sum, 2000: 2301).

Besides attracting global fixed capital investments in real estate and fictitious capital in finance, Colombian metropolises have become key arenas in creating rents through attracting global circulating capital through tourism (see Hylton, 2007; Paul, 2004). While tourism can become a very well-integrated sector of the broader urban economy that generates demand it is hardly a contributor to inclusive and productive development. The tourist industry relies on cheap wages itself and the sector generates a highly elastic labor market and a demand in low-wage jobs in other service sectors, such as transportation. Tourism further spurs land speculation and real estate development, which entail discussed developmental outcomes.

An intensified activity in information technology is often promoted as alternative high-productivity sector in less developed urban areas. However, most IT enterprises are far from being sources of productivity growth. They are characterized by low-technology development, as they 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: 127).

The combination of the concentration of power with the low-technology capability of the ruling elites cripples any attempt to achieve inclusive, productive, and sustainable development. The implemented neoliberal urban governance model has been unable to create effective demand on the basis of cities' insertion into global markets. In a transnational environment marked by inter-urban competition cities become laboratories for transnational elites that try to make their metropolis attractive for the inflow of foreign capitals (be it through tourism, low-technology outsourcing, or the financial system), which again generates a highly elastic demand for real estate development. These developments in turn serve the transnational elites as another source of rent-creation and deepen their holding power, creating an unproductive vicious cycle of power, institutions, and economic development.

## 5. Case study: Medellín

The city of Medellín is in many ways a suitable case study for analyzing institutional change and urban economic development through the theoretical political settlement lens. While Medellín's elite traditionally comprised a strong landed oligarchy who had hegemonic holding powers throughout much of the city's history, the impressive industrialization of Medellín's in the 20$^{th}$ century also saw a rise of a modern industrial elite. The transition from easy to heavy import-substituting industrialization in the mid-1940s produced some shifts in power balances. However, the regional elite of Medellín managed to successfully establish a relatively stable elite bargain in which domestic capitalists emerged as the main 'patrons'. Medellín's industrialization was marked by rent-seeking processes and technology

acquisition strategies that favored low-value added, labor intensive technologies that implied low enforcement and low adaptation costs. With the creation of various business associations, particularly the industrialist-led *Asociación Nacional de Industriales* (ANDI, National Industrialist Association) Medellín's elite could prevent violent conflicts between landed and industrial elite factions that were common in other parts of Colombia during civil war years of *La Violencia* (Restrepo Santamaría, 2011). Medellín's elite managed to successfully "pay-off" or to include landed oligarchy into the ruling coalition (Ross Schneider, 2004). Transition costs were thus mainly minimized through informal clientelist networks between the different elite factions.

Attempts to "grow up" and to promote more capital-intensive industries in the 1960s through a mix strategy of ISI development and export promotion failed. This was also due to the incompatibility of the holding powers of capitalists that depended on state-created rents through subsidized credits with formal growth-enhancing institutions that could create incentives and compulsions for high-productive, capital intensive industrial development. The relative strong position of low-productive and –technological capitalists in the political settlement limited the capacity of any government to allocate and monitor rents in a way that could facilitate the climbing-up on the value ladder by promoting capital-intensive heavy industries. The high dependence on foreign capital for technology acquisition and the lack of technology spillover through these processes hindered a transfer to more productive, capital-intensive industries even further.

First liberalization reforms in the 1970s brought Medellín's textile-led industrialization to a complete halt and even recession, as disadvantages of the city's textile manufacturing sector vis-à-vis the East Asian Tigers had become too large (Poveda Ramos, 1988). With the fall of the coffee prices in the late 1970s, the elite factions could not create sufficient rents from landed assets to maintain the political settlement stable. Tensions arose as deindustrialization and economic crises in the 1980s prevented mechanisms of patronage-distribution that had kept the political settlement in Medellín relatively stable. Other actors that contested the traditional elite bargain in Medellín emerged. The rise of the so-called *clase emergente*, which comprised landed elite factions that had so far been left out from the ruling coalitions, as well as subordinate classes (led by drug lord Pablo Escobar) changed power dynamics in Medellín's settlement, as the emerging elite achieved considerable wealth, also through rents created in the drug economy (Thoumi, 2003; Franco Restrepo, 2005; Hylton, 2007). Beyond their economic power, the emerging class also strived to achieve political power. As Carvajal (2011) rightly summarizes, "the logics of drug-trafficking and the associated violence became embedded in the local economy, social and cultural practices, and even in sectors of the political ruling class, where […] indices of corruption and clientelism became elevated". Misguided liberalization policies and the slow vanishing of state-created rents in the 1980s increased the relative power of this *clase emergente* dramatically, as politicians were increasingly willing to provide "support" for the illicit economic activities (Bahl, 2012). Medellín's merchant-industrialists also faced contestation of their local power position elite factions from Bogotá, who started with hostile takeovers of many of Medellín's flagship businesses.

The contestation of the traditional elite's hegemonic power caused tensions. Since the elite was increasingly incapable to pay off emerging outsiders due to the drying-up of sources of rent-creation, transition costs occurred in form of violence and a paramilitarization of security. The formerly hegemonic ruling coalition was not able to achieve political stability, which also negatively affected economic growth in this period, making Medellín 'the most dangerous city in the world' with the slowest growing urban economy in Colombia.

As a response to this contestation and unfavorable growth-stability trade-off, the traditional elite of Medellín decided to cross their stake- and shareholding activities of the city's three largest companies to form the *Grupo Empresarial Antioqueño* (Business Group of Antioquia, GEA). This informal network of companies helped to restructure the organization of the city's economy. The creation of the GEA implied a change in the elite's investment structures towards services and a more finance-based portfolio. The GEA transnationalized their assets following the Colombian Constitution and the country's neoliberal turn in the 1990s. During these institutional changes the GEA benefited through privatization of public assets and services (particularly social security) as well as through a flexibilization of the labor market that would make the city more attractive for an inflow of foreign capital into the GEA-controlled service sectors. One of GEA's CEOs confirmed that "globalization requires an offensive and aggressive attitude as one must influence the new rules of the game" (cited Betancur et al., 2001: 210).

The traditional transnationalizing elite also benefited from the inflow of clandestine and illicit capital into the GEA-controlled finance sector and real estate market. In turn, the formerly excluded *clase emergente* also benefits from inflow of transnational capital, since many of the emerging elites are property-owners and speculators (also as a source to launder money). Hence, finance and real estate sectors have become an important source of informal patronage distribution between the competing elite factions, which has guaranteed a more stable political environment and 'business climate' for FDI inflow. The 'miracle' can thus (at least partially) explained by these informal institutional mechanisms that helped to decrease transition costs and stabilize the political settlement.

After the turn of the millennium, the GEA built on its economic power to acquire capacities as political actors in order to achieve a broader project of hegemony. Leading-up to the municipal elections of 2003 the GEA merged with technocratic political managers to form a broader coalition that aimed to include social and political elite foundations, as well as several NGOs. After a landslide victory the coalition implemented several reforms that resemble good governance polices.

Following the electoral victory in 2003 several reforms were implemented that facilitated the participation of both profit and non-profit organizations. With the GEA's position as the leading partner in the ruling coalition the decentralized government of Medellín has increasingly been working through and alongside various public-private partnerships. The reforms of institutional restructuring of this new ruling coalition were based on recommendations by supranational organizations. As one member of the administration told the author, the governance reforms were "sought to be achieved using the World Bank's Results Based Monitoring and Evaluation System as a tool to draft and implement development plans [sic]" (Carlos H. Jaramillo, interview, Medellín, April 24, 2014). The World Bank's handbook for development practitioners (see Kusek and Rist, 2004) promotes policies that are a blueprint of the good governance agenda. Another influential supranational partner for the city's institutional transformation was the Inter-American Development Bank that recently proclaimed the "Medellín Model of Good Governance" (IDB, 2011).

Of particular priority in Medellín's good governance model is the creation of a transparent and predictable political environment through formal institutions to create 'confidence' (a world commonly found in many of the official documents and development plans). A 'better business climate' was hoped to make Medellín the 'best corner of the Americas' for transnational capital investments (Cámara de Comercio de Medellín et al., 2009. While on

one hand, this strategy underestimates the uncertainty implied in attracting capital investments, it also signals Medellín's adherence to neoliberal good governance reforms and the coalition's commitment to market-driven development.

The growing competition between cities to attract investments in the "comparative advantage" sectors of low-productive services and finance has led to a complete flexibilization of Medellín's labor market. A governmental document that promotes the city as a destination for international capital investments claims that "(t)he minimum wage in Colombia is one of the lowest in Latin America [...] Colombia has one of the most flexible labor 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, [...] the amount of compensation for unreasonable dismissal is very low" (ACI et al., 2006: 65-66, cited Betancur, 2008: 1).

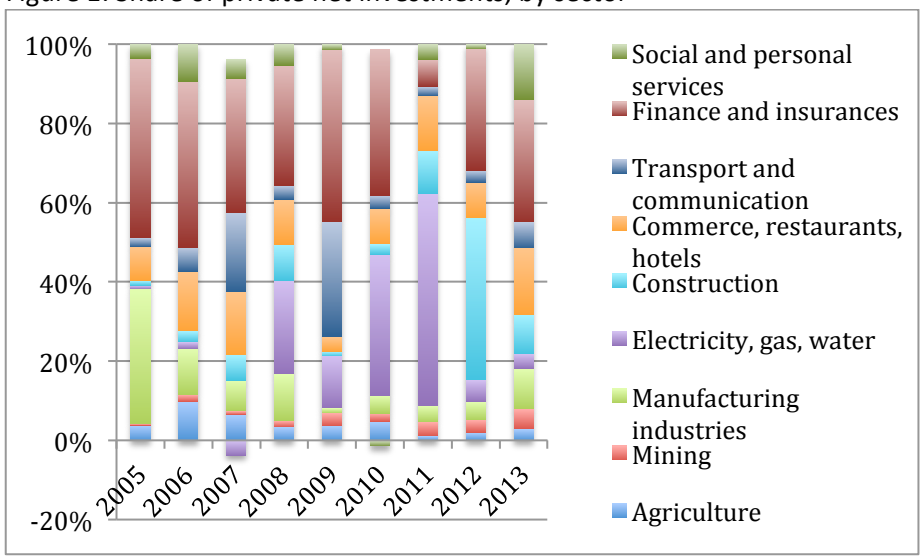
Medellín's transnational capitalist elite acts as main driver of neoliberal policies that help to create market conditions favorable for rent-creation through which their power in the local political settlement is further secured and deepened. The discussed theory suggests that in such a political settlement, where holding power is concentrated with capitalists that have low technological and entrepreneurial capabilities, productive growth outcomes are generally low. The remainder of this section tests whether these theoretical claims can be empirically verified for the case of Medellín.

The analytical approach of this paper follows the one of Palma (2011). In his analysis of economic development in Latin America after the implementation of neoliberal reforms Palma (2011) finds that most of the region has not achieved productive growth and failed to upgrade to high technology and higher-value added processes.

On first sight, the claims that Medellín's economic development is a "miracle" seem to be true. Medellín's economy experienced an impressive growth since the new ruling coalition established its powers in 2003. The growth rates almost doubled in the first year of government and since then the local economy witnessed significantly higher annual growth rates (5.8%) than the Colombian average (4.7%). Furthermore, private net investments in Medellín have risen over 10% annually since 2004. And unemployment rates have gone down drastically (see Franz, forthcoming 2015 for a detailed analysis).

However, the city's economic development is far from being "miraculous". As the disaggregated data reveal, the primary recipient of the private net investments were sectors with low-productive and –technology growth capacities, such as finance and construction. On the other hand, private investments in manufacturing industries decreased from 34% of total net investments in 2005, to only 10.2% in 2013. Figure 1 illustrates this well.

Figure 1: Share of private net investments, by sector

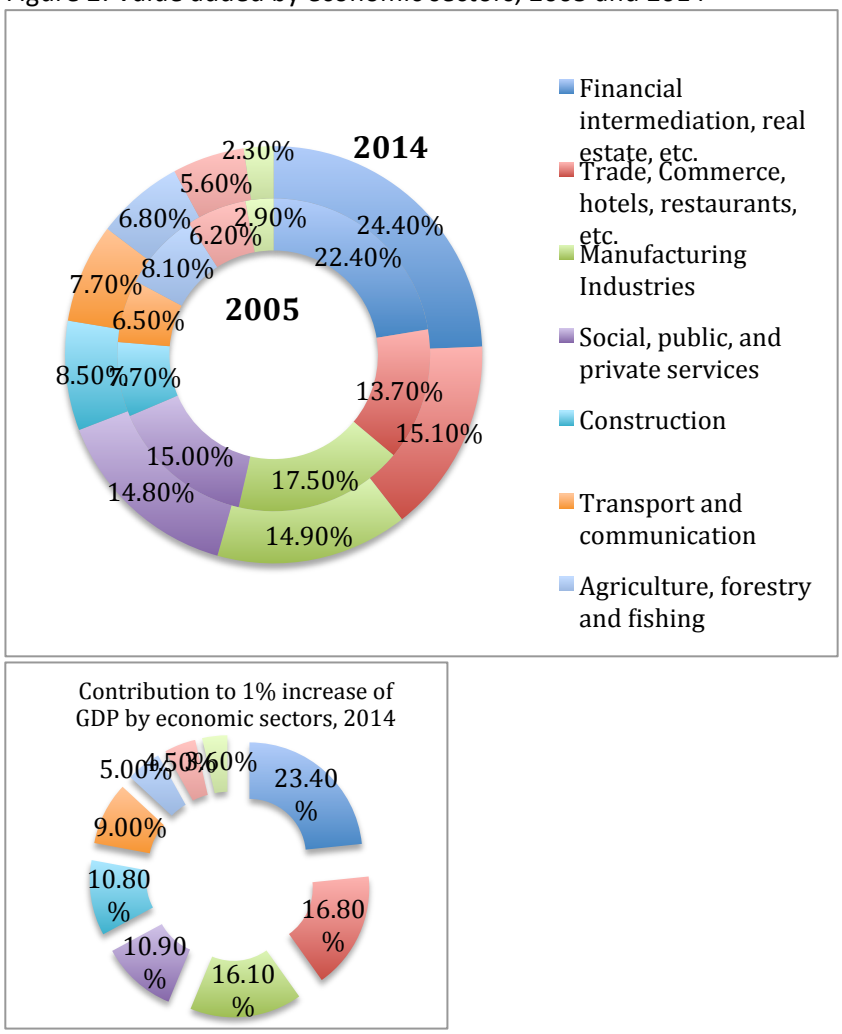



*Source: Cámera de Comercio, 2014, own elaboration*

The composition of private net investments is mirrored by growth rates in rather unproductive sectors. Much of Medellín's economic boom since 2004 was driven by the large expansion of construction activities, a sector marked by very high fluctuations, often due to speculation, and low labor productivity. However, the construction sector is one of the main sources of patronage distribution and pay-off for outsiders of the ruling coalition. Both, the narco-financed *clase emergente*, as well as the traditional elites have vested interests in a well-performing real estate and construction industry. The latter, who are the hegemonic actors in the regional finance industry, profit from the intensified capital flow into real estate and construction through increased financialization of the sector. Overall, financial services have been the main drivers of the local economy. Value added in hospitality services (tourism) also increased by a large margin. Being a "global city" that is integrated into transnational capitalism Medellín is exposed to an intra-urban competition that has forced the local government coalition to apply a very aggressive strategy to sell the city as an investment hot-spot. The government coalition uses urban mega-project (financed through public-private partnerships with loans from GEA financial institutions) to attract global fixed capital investment as well as circulating capital through transport, tourism, conventions and events.

Since 2004 the non-manufacturing industry has steadily become the leading driver of economic growth as it grew by over 50%. This unproductive growth of the city's economy is reflected by the large weight of the economic sectors of construction, finance, and tourism. These three sectors alone were responsible for over 50% of GDP growth in 2014 (figure 2). On the other hand, the value-added share of manufacturing industries decreased dramatically from 2005 to 2014 (see figure 2).

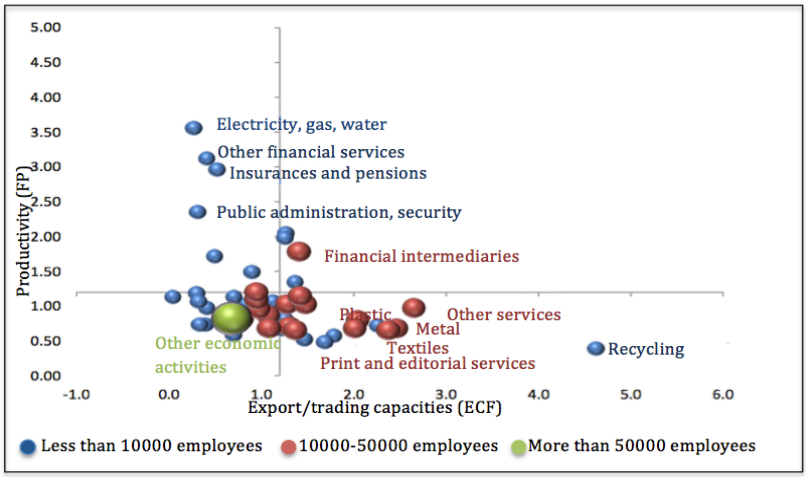
Figure 2: Value added by economic sectors, 2005 and 2014




*Source: DANE, 2013, Camera de Comercio, 2015*

Looking at spatial concentration of specific sectorial employment and at the relationship between labor productivity growth and employment elasticities provides further empirical evidence for the claims that Medellín's growth is largely unproductive. Following the descriptive empirical analysis of Ramírez et al. (2014) we use data from different years of the *Encuesta Anual Manufacturera* (EAM) as well as the *Planilla Integrada de Liquidación de Aportes para Seguridad Social* (PILA). Financial services constitute the only sector that shows high productivity as well as competitiveness compared to its counterparts in other regions of the country. Other companies that agglomerated in Medellín are dominated by low-competitive and low-productive services. While the traditional industrial sectors of textile, metal and plastic show relatively high competitiveness vis-à-vis their counterparts, they have low productivity relative to other sectors and have thus relatively little capacities to be growth- and productivity-escalators for the city's economy (see figure 3).

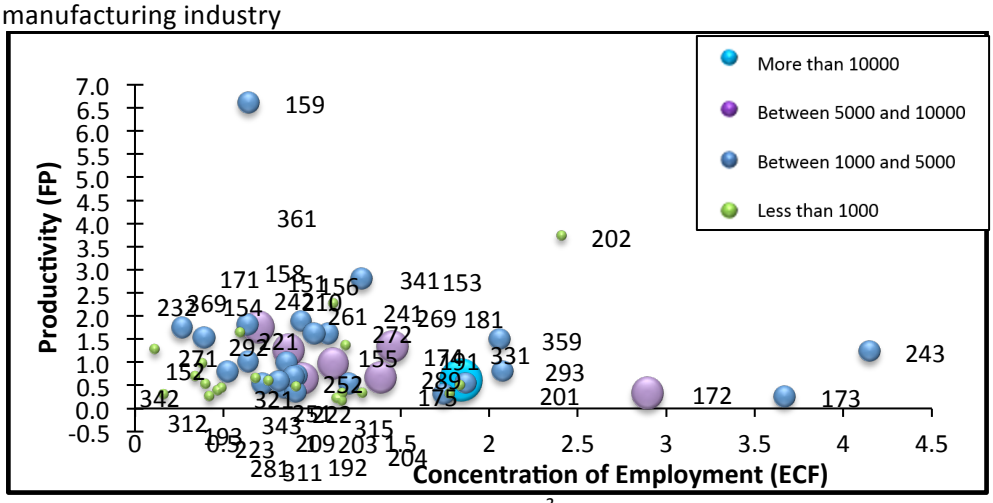
Figure 3: Employment concentration and relative productivity in Medellín




*Source: Ramírez et al. (2014), using PILA data*

A disaggregated look at Medellín's manufacturing industry that served as the city's powerhouse during the ISI development phase shows that the industry is largely concentrated in the manufacturing of non-durable goods (figure 4). Textiles and wood production are the largest and most employment-concentrated sectors, despite their relative low factor productivity (see figure 3). The most dynamic sectors in terms of factor productivity are the ones that have the lowest employment concentration. This is shown by the inward relationship between factor productivity and employment concentration in figure 4.

Figure 4: Employment concentration and relative factor productivity of Medellín's manufacturing industry




*Source: Ramírez et al. (2014), using EAM data*[2]

[2] Codes to classify industries and economic activities: 151: Production and procession of meat and fish; 152: Processing of fruit and vegetables; 153: Processing of dairy products; 154: Grain, starches, animal food; 155: Baked goods, noodles, etc.; 156: Coffee processing; 158: Other foodstuff; 159: Beverages; 172: Weaving of textiles; 173: Finishing of textiles; 174: Other textile products; 175: Textile and knitwear; 181: Textiles and apparel, except fur; 191: Leather; 192: Shoemaking; 193: Luggage, handbags and the like; 202: Veneer sheets; 209: Other wooden products; 210: Paper, carton, and the like; 221: Editing; 222: Printing; 223: Printing services; 232: Refined petroleum products; 242: Other chemical products; 243: Man-made fibers; 251: Rubber products; 261: Glass; 269: non-metallic mineral products; 271: Basic iron and steel; 272: basic precious and non-ferrous metals; 281:

Medellín's local developments resemble the overall trends of labor productivity growth in Colombia since the implementation of liberalization reforms. In contrast to the Heckscher-Ohlin-Samuelson model, Colombia's shift to neoliberalism has not resulted in productivity and employment growth. With an average annual rate 0.86% Medellín even has an even lower productivity growth than Colombia's small increase of 1% annually (Ramírez et al., 2010).

An analysis of Medellín's gross employment elasticities[3] and productivity shows a negative relationship between the two variables. This is an indicator that the high employment elasticities may very well affect GDP and investment growth negatively. Following Palma (2011) figure 5 shows that Medellín, similar to Colombia and Latin America in general, has higher employment elasticities than the rest of the world, which can be a result of the city's focus on sectorial growth in services. These findings are in line with Cano and Ochoa (2008) and Vélez Cardona (2001), who find that Medellín has comparably higher employment elasticity than the rest of the country.

The particularities of Medellín's labor market often limit the amount of productivity growth and high-productive formal employment that can be generated with additional GDP growth. Thus, in times of economic growth, the city is relatively less successful in capturing unemployed than other major cities in Colombia. The relatively lower sensitivity of Medellín's employment to output growth results in employment elasticities that are structurally above the national average.

The political economy of labor market reforms that were adopted in Medellín have intensified employment elasticities and have resulted in growth of low productivity sectors. The excessive flexibilization of the labor market has thus impeded a positive impact of Medellín's GDP growth on the city's productivity. The relationship between elasticity and productivity is even more significant when employment elasticity is the explanatory variable (see figure 5).

Figure 5 indicates that the while productivity growth of Medellín is below the national average, employment elasticity is above average. Combining these findings with the previous ones, we see that the traditional manufacturing sector might still generate employment for Medellín's labor force, but the relative unproductivity of these sectors combined with the large growth in informal employment does not put sufficient pressure on the large elasticity of labor supply. This can also result in very little upward effects on wages. In fact, wages in Medellín have increased remarkable slow vis-à-vis its Colombian counterparts (see Ramírez et al., 2014). Overall this has relatively little impact on productivity growth, which explains why much of the formal sector of Medellín's economy remains in low-productive activities.

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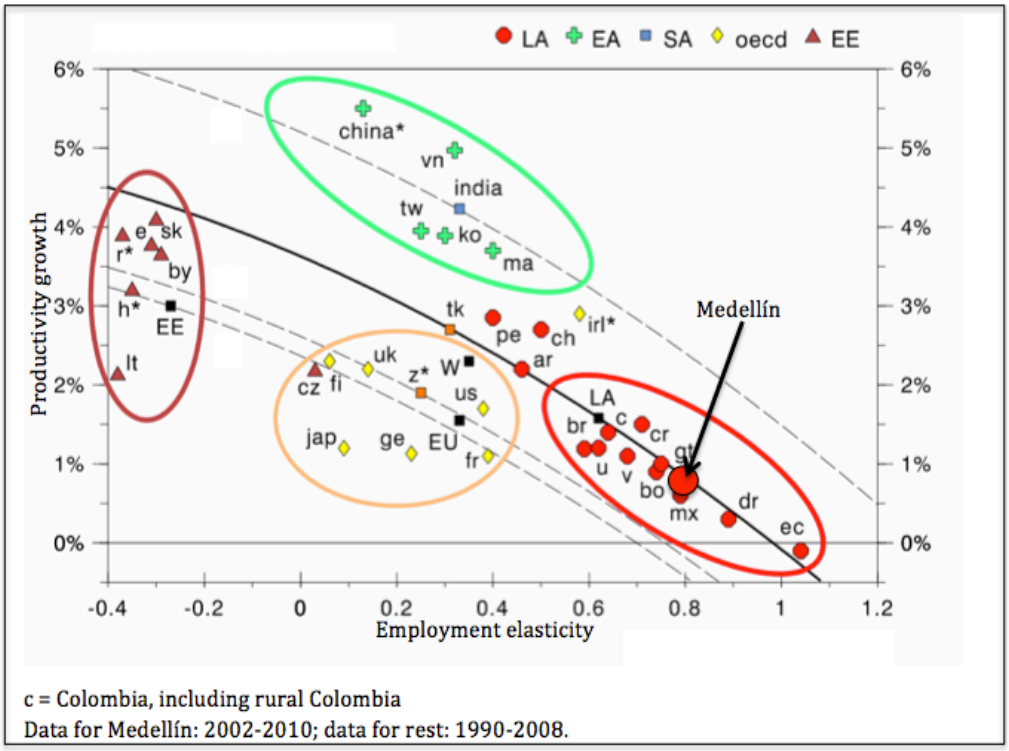
structural metal products; 289: Fabricated metal products and service activities related to metalworking; 291: Machinery of general purpose; 292: Machinery of special purpose; 293: Household appliances; 311: Electric motors, generators and transformers; 331: Medical appliances; 341: Car and engine manufacturing; 343: car parts and accessories; 359: Other transportation equipment; 361: Furniture; 369: Other manufacturing industries.

[3] Gross employment elasticities are understood as the ratio between employment growth and GDP growth. The degree of employment elasticity of a country (or this case a city) is indicative of the degree of flexibility of the national (or urban) labor market. A higher elasticity thus shows a larger degree of labor flexibilization.

Figure 5: Productivity growth and employment elasticity: Medellín's flexible labor market




*Source: Palma (2011: 29), own elaboration for Medellín*[4]

The empirical discussion of Medellín's economic development shows that the theoretical approach of the transnational political settlement framework is fitting for the analysis of urban institutional development and their developmental outcomes. Economic liberalization and political decentralization have established a political economy environment in Colombia that is marked by a static comparative advantage in unproductive services. Access to traditional state-created rents for the industrial elite disappeared with the "hollowing out" of the nation state. Market-enhancing institutions, implemented through good governance reforms, have provided the transnational capitalist elite with unproductive and often speculative rent-creation opportunities. As a result of including competing factions and strong "outsiders" into the settlement (inter alia through the use of informal mechanisms for patronage distribution), holding power has been concentrated. The hegemonic holding power of the low-technological and –entrepreneurial elite has not only prevented productive competition between different elite factions, but also left the local government with low capacities to enforce institutions that help productivity growth. This has created an economic context in which the urban economy of Medellín is growing relatively fast despite the absence of compulsions or incentives for productivity growth, also thanks to its 'flexible' labor market.

[4] Due to limited data availability, the arc elasticity of Medellín's labor market was calculated using the time period between 2002 and 2010, while the rest of the data is taken from Palma (2010) whose time series calculations are for the period 1990-2008. For the calculation of arc elasticity of employment in Medellín we use: $= \frac{\Delta L/L}{\Delta YY}$, 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 percent change of employment for every percent change of GDP between 2002 and 2010.

## 6. Conclusion

The reciprocatory dynamics of economic transnationalization and political decentralization that coin developments of global capitalism have led to an institutional hollowing-out of the nation state. The selective transfer of state capacities to supra- and subnational levels has thus two interlinked results: on one hand processes of transnational capital are central in political economic analysis on institutions; on the other hand, the urban dimension has become a key arena for institutional challenges to achieve sustainable economic development. However, while contemporary approaches that look at urban governance in less developed countries acknowledge these dynamics, they often fall short in including changes in power distribution or ignore power as an important variable for institutions altogether. The importance of informal institution is also widely neglected.

This gap in the academic literature prompts an expansion of the theoretical political settlement framework to include transnational capital as an important variable as well as urban processes. Applying Robinson's (2010) theoretical approach of the transnational capitalist elite in Latin America to the political settlement framework could help filling this gap. A historical political economic approach of transnationalizing urban political settlements could be useful to analyze how changes in interests of powerful actors in less developed urban areas have changed following economic transnationalization.

Looking at the development of Colombia's economy we find that the transnationalization of the country's urban capitalist elite has had several interdependently linked consequences for the theoretical and methodological considerations as well as for the empirical findings. Firstly, sources for elite rent-creation have shifted from state-created rents (such as subsidies, tariff protection, tax-exemptions) to rents that depend on transnational capital circulation, either through brokering of FDI or the transnationalization of domestic capitalist assets. Secondly, this impacts social mobilization and transition costs, as well as how (informal) institutions and rent-management can help to minimize these costs. This in turn affects how rent-creation enables (or constrains) elite agency, which is detrimental for possible distribution of power in a society. Thirdly, with a transnationalizing local capitalist elite that creates rents through transnational capital, urban Colombia is stuck with a static comparative advantage in unproductive sectors as a feature of the global capitalist system, which these powerful elite factions participate in and defend. A fourth aspect that needs to be considered is the conceptualization of possible governance capabilities that accompany and stimulate such developments. The creation of governance institutions that create incentives or compulsions for addressing structural issues and invest in long-term productive projects is crucial. However, the elite's access to sources of unproductive rents has created urban political settlements where transnational capitalist elite with low-technological and –entrepreneurial capabilities have concentrated holding power. This can have adverse effects for productive development as low-technology and –entrepreneurial enterprises persist.

The findings drawn from the case of Medellín show that the theoretical framework of transnational political settlements helps in understanding the city's political and economic development in closer detail. Institutional changes of economic liberalization and political decentralization have affected access to traditional sources rent-creation for the elite. This has shifted power distributions as well as institutional mechanisms to achieve economic development. The dominant elite faction in the ruling coalition that had secured access to transnationalized sources of rent could implement governance policies that favor unproductive market-driven development. Formal and informal institutions for patronage distribution have helped to include competing factions and strong "outsiders" into the

settlement (inter alia through the GEA, but also through the use of the financial sector and the real estate market). This has deepened the power of the transnational capitalist elite in Medellín and promoted the inflow of transnational capital into unproductive service sectors (also due to the flexibilization of the city's labor market). The hegemonic holding power of the low-technological and –entrepreneurial elite has prevented productive competition between different elite factions and left the local government with low capacities to enforce institutions that help productivity growth. This has created an economic context in which the urban economy of Medellín is growing relatively fast despite the absence of compulsions or incentives for productivity growth.

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