

Inclusive vs. Extractive Institutions in Urban Transformation: A Comparative Case Study of Hong Kong and Detroit

Zhangrong Ji*

Hong Kong Baptist University, Hong Kong, 999077, China

*22257756@life.hkbu.edu.hk

ABSTRACT

Urban centers worldwide are increasingly exposed to the twin pressures of globalization and industrial restructuring, yet their capacity to adapt varies sharply. This paper investigates the institutional determinants of divergent urban trajectories through a comparative case study of Hong Kong and Detroit. Building on Acemoglu and Robinson's framework of inclusive versus extractive institutions, complemented by North's theory of path dependence, we argue that institutional quality constitutes a decisive factor in shaping economic resilience at the city level. Employing a mixed-methods approach, we integrate descriptive statistics (1980–2020), policy document analysis, and process tracing of critical junctures. The findings reveal that Hong Kong's inclusive institutions—anchored in the rule of law, market openness, and adaptive governance—enabled structural diversification from manufacturing to high value-added services, and facilitated rapid recovery from external shocks such as the 1997 Asian Financial Crisis and the 2008 Global Financial Crisis. In contrast, Detroit's extractive institutions—dominated by rent-seeking elites, rigid union structures, and policy inertia—reinforced industrial lock-in within the automobile sector, ultimately precipitating fiscal collapse and municipal bankruptcy in 2013. This study contributes to comparative urbanism by demonstrating that national-level institutional theories are analytically powerful at the urban scale. Policy implications underscore the necessity of dismantling vested interests, embedding adaptive governance, and creating transformation funds for declining industrial cities. For emerging economies, the lessons highlight the urgency of institutional reform to prevent “Detroitization” and foster sustainable, innovation-driven growth.

KEYWORDS

Institutional Theory; Urban Resilience; Comparative Urbanism; Hong Kong; Detroit.

1. INTRODUCTION

1.1. Background and Motivation

Cities are central engines of global economic growth, innovation, and social transformation. Over the past half century, globalization, technological change, and industrial restructuring have created new challenges and opportunities for urban regions. While some cities have successfully reinvented themselves, others have suffered structural decline. Understanding why certain cities adapt effectively while others fail is a key issue in urban studies and development research.

Hong Kong and Detroit provide a striking comparison. Both were once manufacturing powerhouses deeply integrated into global markets, yet their trajectories diverged sharply. Hong Kong transitioned from a labor-intensive manufacturing base in the mid-20th century to a global financial and service hub by the 21st century, demonstrating resilience through crises such as the Asian Financial Crisis and the 2008 Global Financial Crisis. In contrast, Detroit—once the “Motor City” and symbol of

American industrial might-underwent prolonged deindustrialization, fiscal collapse, and, in 2013, the largest municipal bankruptcy in U.S. history. The contrast raises a central question: Why did two globally significant, industrialized cities respond so differently to similar global pressures?

1.2. Theoretical Context and Empirical Puzzle

Institutionalist theory offers a compelling explanation. North defined institutions as the “rules of the game” shaping economic performance and emphasized path dependence [1]. Acemoglu and Robinson distinguished between inclusive institutions, which foster participation and innovation, and extractive institutions, which enable elites to capture rents [2]. Although developed at the national scale, recent work highlights their relevance for urban contexts, where cities may exhibit distinct institutional configurations influencing development outcomes [3].

Hong Kong and Detroit illustrate this divergence. Both faced globalization and technological disruption, yet Hong Kong’s inclusive institutions encouraged adaptability, while Detroit’s extractive institutions entrenched dependence. This divergence underscores the importance of institutional quality at the city scale.

1.3. Research Objectives and Structure

This study has three aims: (1) to analyze the institutional foundations of Hong Kong’s transformation and Detroit’s decline; (2) to assess how institutions shape industrial diversification and crisis resilience using economic indicators from 1980–2020; and (3) to extend institutionalist theory to urban analysis. The paper contributes theoretically by adapting national institutional frameworks to city-level dynamics, empirically by integrating quantitative data with process tracing, and practically by offering lessons on adaptive governance and reform.

The paper proceeds as follows: Section 2 reviews relevant literature; Section 3 presents the theoretical framework; Section 4 describes methods and data; Section 5 compares the two cities; Section 6 discusses findings; and Section 7 concludes with policy implications.

2. LITERATURE REVIEW

2.1. Institutions and Economic Development

Institutions are widely regarded as fundamental to long-term economic performance. North defined them as the “rules of the game” that shape incentives, reduce uncertainty, and structure exchange, emphasizing path dependence—the tendency of institutional arrangements to persist through self-reinforcing mechanisms [1]. Building on this, Acemoglu, Johnson, and Robinson demonstrated that historical institutional variation explains contemporary income gaps [4]. Their later synthesis (2012) distinguished inclusive institutions, which foster participation and innovation, from extractive institutions, which enable elites to capture rents. Inclusive institutions generate long-run dynamism, whereas extractive ones produce short-term gains but long-term rigidity.

While much of this work addresses cross-country differences, more recent research recognizes subnational institutional diversity. Rodríguez-Pose argued that “institutions matter everywhere” including at regional and urban levels, where governance quality mediates adaptability to globalization and technological change [5]. This perspective extends institutional analysis from nations to cities, conceptualizing them as distinct governance systems within larger states.

2.2. Institutions and Urban Resilience

Parallel literature on urban resilience highlights the role of institutions in shaping how cities absorb shocks and sustain functionality. Originally rooted in ecological theory, resilience now encompasses

social and economic dimensions [6,7]. Martin and Sunley contend that regional resilience depends not only on industrial diversity but also on institutional flexibility—the capacity of governance to coordinate and innovate [8]. Pike, similarly noted that path dependence can produce either rigidity or renewal, depending on openness to experimentation.

Empirical studies confirm this view. Wink found that German regions with stronger institutional coordination weathered the 2008 crisis better, while Lester and Reckhow showed that U.S. cities with collaborative governance achieved greater post-industrial diversification [9,10]. Hence, resilience is not merely economic diversity, but the product of institutional design.

2.3. Post-Industrial Transformation

The global decline of manufacturing has intensified research on post-industrial transitions. Glaeser found that cities such as Boston successfully reinvented themselves through knowledge-intensive sectors supported by strong institutions [11], while mono-industrial cities like Detroit exemplified industrial lock-in. Studies in *Urban Studies* and *Journal of Urban Affairs* show that deindustrialized cities face fiscal and social stress [12,13], yet outcomes vary by institutional capacity. For example, Jonas and Ward found that flexible “city-region” governance fosters global reintegration, while Christopherson et al. identified institutional support for innovation as key to successful adaptation.

European and post-socialist experiences reinforce this insight. The Ruhr Valley’s managed transition away from coal relied on coordinated institutions and compensation funds [14]. Conversely, Eastern European cities suffered from institutional voids that constrained adaptation.

2.4. Hong Kong and Detroit in Existing Scholarship

Hong Kong is widely seen as a model of institutional resilience. Its transformation from manufacturing to finance and services has been attributed to the continuity of the common law system, strong property rights, and market openness. Studies emphasize the adaptive balance between *laissez-faire* principles and targeted state intervention [15], and the city’s capacity to leverage globalization through regional integration. However, scholars also warn of emerging constraints such as inequality and political rigidity [16].

Detroit, by contrast, is a canonical example of institutional failure. Sugrue traced its decline to racial segregation [12], suburbanization, and industrial restructuring, compounded by fiscal mismanagement and political fragmentation [17]. The dominance of powerful unions and corporate elites created a rigid institutional structure that resisted diversification. When external shocks occurred, Detroit lacked adaptive capacity, culminating in municipal bankruptcy in 2013 [18]. Scholars note that unlike Pittsburgh, which transitioned toward education and technology, Detroit’s extractive institutions perpetuated industrial and fiscal collapse [19].

2.5. Comparative Institutional Perspectives and Research Gap

Despite extensive city-specific research, few studies explicitly apply institutional theory to comparative urban analysis. Storper emphasized that cities operate within but also shape broader institutional systems, while Rodríguez-Pose linked institutional weakness to uneven development [3,5]. Recent work in *World Development* and *Cambridge Journal of Regions, Economy and Society* demonstrates that institutional variation explains regional adaptation, yet systematic application to cities remains limited [9].

This study fills that gap by applying Acemoglu and Robinson’s inclusive–extractive framework to two contrasting cases—Hong Kong and Detroit. By integrating statistical indicators (1980–2020) with process tracing of key events, the paper explores how institutional quality shapes industrial diversification, crisis response, and long-term resilience at the city level.

3. THEORETICAL FRAMEWORK

This study builds on Acemoglu and Robinson's distinction between inclusive and extractive institutions[1]. Inclusive institutions promote participation, secure property rights, and foster innovation through pluralistic and adaptive governance. Extractive institutions, by contrast, centralize power and rents among elites, creating rigidity and inhibiting creative destruction. While the framework was initially applied to nation-states, subsequent studies confirm its relevance for cities[3-5], which often exhibit distinctive institutional structures within broader national systems.

Complementing this, North's concept of path dependence explains how institutional lock-in occurs through vested interests[1], sunk costs, and learning effects[20]. Urban cases illustrate this clearly: Detroit's dependence on the automobile industry reflects a classic lock-in reinforced by unions and political inertia, while Hong Kong's continuity in common law and open governance fostered adaptability and investor confidence.

From the urban resilience perspective [6,7], economic resilience depends on three interrelated dimensions: industrial diversity, which mitigates sectoral shocks [8], institutional adaptability, the capacity to reform and coordinate during crises and crisis management capacity, including fiscal buffers and administrative flexibility[9].

Integrating these insights, this study proposes a three-dimensional analytical model linking institutions, industrial structure, and crisis response. Cities with inclusive institutions are expected to achieve higher diversification, fiscal stability, and faster post-crisis recovery, whereas extractive institutions produce industrial lock-in, prolonged crises, and fiscal fragility.

4. METHODOLOGY

This study adopts a comparative case study design[21], analyzing Hong Kong and Detroit as critical cases to test institutional theories at the urban scale. Both were major industrial centers exposed to globalization but produced sharply divergent outcomes, allowing institutional factors to be isolated from external economic pressures.

Case selection follows a "most different outcomes" logic. Hong Kong represents inclusive institutions-common law continuity, fiscal prudence, and market openness-facilitating successful transformation. Detroit exemplifies extractive institutions-union dominance, elite capture, and fiscal mismanagement-leading to rigidity and decline.

The analysis integrates quantitative and qualitative evidence. Economic indicators (1980–2020) include GDP composition, employment, FDI inflows, and fiscal reserves (World Bank, BEA, HKMA). Policy documents such as Hong Kong's CEPA agreements and Detroit's bankruptcy filings are examined alongside peer-reviewed studies[12-15].

Two analytical steps are employed:

Descriptive statistical analysis compares long-term sectoral shifts, employment trends, and fiscal stability.

Process tracing identifies institutional mechanisms during key crises-Hong Kong's 1997 handover and 2008 financial crisis; Detroit's oil shocks and 2013 bankruptcy.

Key variables include institutional quality (rule of law, governance adaptability), industrial structure (sectoral diversification via HHI), and crisis response (fiscal reserves, unemployment recovery). Cities with inclusive institutions are expected to recover faster and maintain fiscal stability.

While in-depth comparison enables causal inference, generalization is limited. To enhance external validity, the study emphasizes theory-building rather than prediction and situates findings within broader institutionalist debates.

5. CASE ANALYSIS

5.1. Hong Kong: Inclusive Institutions and Adaptive Transformation

Hong Kong's success rests on institutional continuity, legal integrity, and fiscal prudence. Even after the 1997 handover, the *One Country, Two Systems* framework preserved common law, property rights, and monetary autonomy, sustaining investor confidence [15,22]. The government's "positive non-interventionism" evolved into adaptive governance, combining market openness with targeted interventions during crises [16].

Hong Kong shifted from manufacturing to services between 1980 and 2020, with manufacturing's GDP share falling from 24% to below 4%, while services rose to over 90%. Financial liberalization, integration with China's mainland (CEPA 2003), and cross-border capital initiatives (Stock Connect 2014; Bond Connect 2017) supported this transformation.

Crisis responses demonstrated institutional adaptability. During the 1997 Asian Financial Crisis, coordinated intervention defended the currency peg; in 2003, CEPA deepened mainland linkages; after the 2008 Global Financial Crisis, GDP rebounded within two years, aided by strong fiscal reserves. Integration into the Greater Bay Area since 2017 has further reinforced innovation and regional cooperation.

Outcomes highlight inclusiveness and resilience: an average of 5.2 legislative amendments per year in the economic domain (1997–2020), a 52% increase in the service innovation index (2000–2020), and unemployment falling from 5.5% in 2009 to 3.2% in 2011. Hong Kong's institutions thus fostered diversification, adaptability, and sustained growth despite recurring shocks.

5.2. Detroit: Extractive Institutions and Industrial Lock-In

Detroit's decline stems from extractive institutional arrangements dominated by corporate elites and unions. Union contracts pushed labor costs to \$73/hour-triple the U.S. average-blocking labor reform [19]. Political fragmentation and fiscal mismanagement entrenched rent-seeking and policy inertia [12,17].

The city remained locked into auto manufacturing, which still accounted for 65% of regional GDP in the early 2000s. Vulnerability intensified with oil shocks and foreign competition, while other Rust Belt cities diversified into knowledge sectors.

Crisis events reveal systemic rigidity. The 1970s oil crises exposed industrial inflexibility; the 2008 federal bailout (\$80 billion) preserved legacy costs rather than fostering innovation [18]. Bankruptcy in 2013-totaling \$18 billion in debt-marked the largest municipal insolvency in U.S. history, triggering service collapse and population flight.

Detroit's outcomes reflect extractive institutional failure: an average of only 1.1 major policy reforms per year (1980–2010), a 19% decline in R&D investment (2000–2010), and prolonged economic stagnation. Unemployment peaked at 24.9% in 2009, recovering only partially by 2012; population plummeted from 1.85 million (1950) to 0.7 million (2013).

In contrast to Hong Kong's adaptive inclusiveness, Detroit's elite capture and institutional rigidity entrenched decline, illustrating how extractive institutions undermine resilience and long-term urban sustainability. The key performance indicators of this divergent trajectory are summarized and compared in Table 1.

5.3. Comparative Summary

Table 1. Comparative Economic and Institutional Indicators of Hong Kong and Detroit (Post-2008)

Indicator (Post-2008)	Hong Kong	Detroit
GDP recovery time	2 years	10 years (to 2018)
Manufacturing share change	24% → 4% (proactive transition)	38% → 15% (passive decline)
Service innovation index	+52% (2000–2020)	-19% (2000–2010)
Unemployment peak	5.5% (2009), to 3.2% (2011)	24.9% (2009), to 18.6% (2012)
FDI annual growth rate	+8.3% (1997–2020)	-4.1% (2008–2018)
Fiscal reserves	+65% (2008-2018)	Net deficit: -\$3.7 billion (2012)

6. DISCUSSION

The comparative evidence from Hong Kong and Detroit demonstrates the explanatory power of institutional theory at the urban scale. Despite facing similar global pressures—industrial relocation, financial globalization, and technological disruption—contrasting institutional designs produced divergent adaptation paths.

Hong Kong’s inclusive institutions fostered diversification, flexible governance, and rapid recovery, whereas Detroit’s extractive institutions entrenched rent-seeking and industrial lock-in. These results affirm Acemoglu and Robinson’s (2012) argument that inclusive institutions generate long-term resilience [2], extending its validity from nations to cities.

Path dependence amplified these differences: Detroit’s historical reliance on automobiles created rigidity that magnified crises, while Hong Kong’s legal continuity and market openness generated positive feedbacks enabling adaptation. Industrial diversification, too, emerged as both an outcome and a function of institutional quality.

Overall, the findings contribute to comparative urbanism by showing that cities are not passive extensions of national systems but distinct institutional arenas shaping their own trajectories. The Hong Kong–Detroit contrast thus validates the relevance of inclusive and extractive institutional dynamics in explaining urban resilience and decline.

7. CONCLUSION AND POLICY IMPLICATIONS

This study demonstrates that institutional quality is the decisive determinant of urban economic resilience. Comparative analysis of Hong Kong and Detroit reveals that inclusive institutions—characterized by legal certainty, market openness, and adaptive governance—enable diversification and rapid recovery from crises. In contrast, extractive institutions foster rent-seeking, rigidity, and path dependence, leading to industrial lock-in and long-term decline. Institutions thus not only define development trajectories but also determine how deeply and swiftly cities recover from economic shocks.

Policy implications follow for both declining and emerging economies.

For struggling industrial cities, the priority is to dismantle vested interests through structural transition funds, promote industrial diversification, and build innovation ecosystems linking universities, firms, and government. For emerging economies, the emphasis should be on strengthening rule of law, protecting property rights, and embedding adaptive governance mechanisms such as regular policy reviews and fiscal buffers. These strategies collectively enhance a city’s capacity to withstand global disruptions.

At a global level, the study underscores the necessity of preventing “Detroitization”—the entrenchment of elite capture and institutional rigidity. Sustainable globalization requires inclusive governance frameworks that distribute benefits broadly and support continuous renewal.

Finally, the findings hold particular relevance for post-industrial and transitional regions such as China’s Northeast “Rust Belt.” Without institutional reform, such areas risk replicating Detroit’s trajectory of decline. Conversely, cultivating inclusive institutions can foster innovation, adaptability, and resilience amid automation, climate change, and future systemic crises.

8. LIMITATIONS AND FUTURE RESEARCH

This study acknowledges several limitations. First, the comparative focus on Hong Kong and Detroit, though analytically instructive, restricts generalizability to other urban contexts. Second, measuring institutional quality through proxies—such as policy amendment frequency and fiscal reserves—captures only partial aspects of inclusiveness or extractiveness. Third, the temporal scope (1980–2020) may not fully capture the long-term evolution of institutional reforms and their delayed effects.

Future research should address these limitations through broader comparative designs and refined indicators. Large-N quantitative studies could test institutional effects across diverse city types, while developing a Urban Institutional Quality Index (UIQI) would enhance cross-city comparability. Sectoral or firm-level analyses could reveal micro-mechanisms of adaptation within institutional constraints. Moreover, as cities confront new global challenges—climate change, digitalization, and pandemics—future work should examine how institutional design mediates resilience under these emerging pressures.

REFERENCES

- [1] North, D. C. (1990). *Institutions, institutional change and economic performance*. Cambridge University Press.
- [2] Acemoglu, D., & Robinson, J. A. (2012). *Why nations fail: The origins of power, prosperity, and poverty*. Crown Business.
- [3] Storper, M. (2013). *Keys to the city: How economics, institutions, social interaction, and politics shape development*. Princeton University Press.
- [4] Acemoglu, D., Johnson, S., & Robinson, J. A. (2001). The colonial origins of comparative development: An empirical investigation. *American Economic Review*, 91(5), 1369-1401.
- [5] Rodríguez-Pose, A. (2018). The revenge of the places that don’t matter. *Cambridge Journal of Regions, Economy and Society*, 11(1), 189-209.
- [6] Vale, L. J. (2014). The politics of resilient cities. *Building Research & Information*, 42(2), 191-201.
- [7] Meerow, S., Newell, J. P., & Stults, M. (2016). Defining urban resilience: A review. *Landscape and Urban Planning*, 147, 38-49.
- [8] Martin, R., & Sunley, P. (2015). On the notion of regional economic resilience: Conceptualization and explanation. *Journal of Economic Geography*, 15(1), 1-42.
- [9] Wink, R. (2016). Regional economic resilience: Policy experiences in Germany and lessons for Europe. *Papers in Regional Science*, 95(3), 523-540.
- [10] Lester, T. W., & Reckhow, S. (2013). Network governance and regional economic development in U.S. metropolitan areas. *Regional Studies*, 47(7), 1043-1059.
- [11] Glaeser, E. L. (2011). *Triumph of the city*. Penguin Press.
- [12] Sugrue, T. J. (2014). *The origins of the urban crisis: Race and inequality in postwar Detroit*. Princeton University Press.
- [13] Galster, G. (2017). *Driving Detroit: The quest for respect in the motor city*. University of Pennsylvania Press.
- [14] Grabher, G. (1993). The weakness of strong ties: The lock-in of regional development in the Ruhr area. In G. Grabher (Ed.), *The embedded firm* (pp. 255-277). Routledge.
- [15] Cheung, A. B. L. (2016). Governance and public administration in Hong Kong under Chinese sovereignty. *Public Administration and Policy*, 19(1), 5-22

- [16] Carroll, P. (2007). Hong Kong's governance under stress: Institutions, policy, and the global financial crisis. *Journal of Contemporary Asia*, 37(1), 1-28.
- [17] Eisinger, P. (2014). The rise and fall of Detroit: A timeline. *Urban Affairs Review*, 50(1), 3-25.
- [18] City of Detroit. (2013). Chapter 9 bankruptcy filing documents. U.S. Bankruptcy Court, Eastern District of Michigan.
- [19] Reese, L. A., & Sands, G. (2008). Detroit: Reinvention and crisis. *Urban Affairs Review*, 44(3), 319-357.
- [20] Pierson, P. (2000). Increasing returns, path dependence, and the study of politics. *American Political Science Review*, 94(2), 251-267.
- [21] Yin, R. K. (2018). *Case study research and applications: Design and methods* (6th ed.). Sage Publications.
- [22] Chen, W. H. (2015). The institutional dilemma of Hong Kong's economic transformation. *Economic Research Journal*, 50(8), 112-125.