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## **TRENDS AND POLICY CHALLENGES FOR OECD REGIONS**

### **I. Introduction**

1. By loosening national ties and enforcing international competition, globalisation confronts regions both with development opportunities and with threats not previously known. On balance, it is expected to bring gains to economies in their totality, but it will nonetheless pose severe problems of adjustment to a good number of regions. How to exalt the former without being limited by the latter? Regional success and decline increasingly result from an uneven distribution of and capacity to valorise local collective goods (multicultural integration in metropolitan areas, well-established inter-firms relations within clusters, accessibility of natural and cultural resources, etc.). Still, opportunities related with these collective goods are often unexploited and must struggle with economic, social and environmental challenges. Territorial policies should contribute to building and maintaining growth engines; facilitate individual and organisational learning to up-grade local skills; and supporting diffusion of new technologies and innovations. But in order to do so, a paradigm-shift is required.

2. This paper focuses on OECD Member countries and does not pretend to represent the all spectrum of regional trends and policy challenges, in particular those taking place in developing countries whose singularities would deserve a specific consideration. Within the cases of the most industrialised countries, the paper intends to describe an on-going change of perspective in territorial policies, more focused on the competitiveness of places, than on ensuring a traditional support to sectors or income re-distribution. The paper will first summarize the main trends affecting regions in OECD Member countries and focus on the comparative advantages as well as on the obstacles to development of rural, moderately urbanised and metropolitan regions. Then, the paper will put forward suggestions for designing territorial policy more capable to face the challenges of economic integration and to achieve a balance between economic growth, social cohesion and effective governance.

## II. Main trends affecting regions across the OECD member countries

3. Territorial disparities are significant and persistent<sup>1</sup>. While OECD countries converge, regions converge very slowly or don't. In the medium term, the positive effects of trade seem not to have produced a more balanced development within countries as not only endogenous growth, but also exogenous-led growth is very sensitive to both local conditions and proximity to markets. A large number of opinion-makers have predicted that foreign direct investments would have enhanced convergence. In reality, if foreign direct investments have actually played a crucial role in the economic growth of several countries, they have often had uneven localisations and linkages within countries<sup>2</sup>. As a result, in average, a single sub-national region produces a quarter of national GDP, while other areas, some bordering the most successful ones, are worsening their relative position.

4. However, many analysts and policy-makers are persuaded that several regions could reverse their trends and could better contribute to national wealth by providing additional margins for growth. In turn, such a "development reservoir" would produce more balanced development and better cohesion within countries or macro-regional ensembles, such as the European Union. In fact, unexpected cases of regional success in economic development have renewed "a bias for hope" in regional policies. While some regions have confirmed their role as growth engine and others are still lagging behind, there are regions that have strongly contributed to a change in perception of economic geography, in some cases because they have unexpectedly declined after decades of good economic performance, but in other cases because they emancipated from historical backwardness or recovered from long lasting crisis. Several small and medium-sized cities, supposed to lack the scale for developing a competitive economy, have succeeded by relaying on clusters of small firms. Some rural areas have considerably increased employment by valorising their amenities. Some urban areas, which were severely hit by structural changes, have experienced a rebirth sparked by the high-tech innovation spilling over from universities and R&D facilities.

5. In many cases, local development opportunities seem largely unexploited and policies could help in better promoting local investments as well as attracting external investments. This could take place not only in lagging behind regions; but in a large amount of cases, including successful regions, where development opportunities may remain untapped, too. In order to develop this point, let's make some examples of strengths and weaknesses for regional development by type of regions. For the sake of a synthetic analysis, let's refer to a simplified typology, based on broad types of areas, mainly identified by density of population, and distinguishing rural, moderately urbanised, and metropolitan regions. The reason for such an extreme simplification is due to both considering a wide range of international cases and dealing with the limited availability of internationally comparable sub national statistics.

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1. Among a well-known literature, this result has been highlighted by the OECD work on regional development. OECD is conducting a series of reviews at national level on the territorial policies. The countries reviewed up to now are: Italy, Korea, Hungary and Czech Republic, as Unitarian countries; Switzerland, Canada and Mexico as federal countries. On-going reviews concern Japan, France, Luxembourg and Finland. At the same time, OECD conducted thematic reviews that included regional case studies. Teruel (Spain), Tzumerka (Greece), Sienna (Italy), and Morevska Trebova (Czech Republic) were the rural regions considered. As for moderately urbanised regions they included: Comarca centrals valentiana (Spain), Champagne-Ardenne (France), and Bergamo (Italy). The on-going metropolitan regional reviews cover Athens, Busan, the greater Helsinki area, Øresund (Copenhagen and Malmö), Vienna/Bratislava, Melbourne, Montreal, Mexico City.

2. For instance, in Mexico, the increase in regional disparities in per capita GDP from 1986 on, largely reflects the diverging trends in the northern Border States, which benefited from major investment from the United States, and the southern states, which are still underdeveloped. In Hungary or in Czech Republic, the transition has been especially favourable for Budapest or Prague and their surrounding areas, which attracted the largest share of foreign direct investments.

## 1. Rural regions

6. Rural problems<sup>3</sup> are particularly evident in term of employment opportunities in agriculture and the public sector. Despite farming is still important in shaping land use, employment opportunities in agriculture are declining, not only in relative, but also in absolute terms, among other things because of the exceptional increase of productivity during the last decades. The modern supply-chain production of commodities includes relatively few farm producers (among other things to minimise the costs of managing business alliances) and lead to concentration of commodity agriculture in relatively few places.<sup>4</sup> One is tempted to state that commodity agriculture is no more the backbone of rural regions. Moreover, in a climate of fiscal constraint, decline is affecting public sector employment that had been the main component of rural employment growth. Transition to new economic sectors and activities is therefore a priority, and many member countries opt for policies of adjustment helping diversifying economic activities, commercialising natural and cultural amenities, finding market niches for local products.

7. Although crucial, unemployment is just one of a wider spectrum of problems affecting rural areas. Closely related is the significant ageing of the population due to a) out-migration of young people as they do not only lack employment opportunities but also adequate access to educational and leisure facilities, and b) in-migration of retirees, at least in some places. Furthermore, the resulting demographic structure is often not appropriate to support provision of local public services. Moreover, most rural regions have difficulty establishing the necessary critical mass of facilities, producer services and infrastructures to support entrepreneurs starting up in rural regions. Finally, in many cases the above problems are related to each other so to produce an additional and crucial obstacle to development: a vicious circle looking regions in a sort of permanent under-development and connecting unemployment, lack of services and rural exodus.

8. However, despite important economic and demographic challenges, rural regions are not necessarily synonymous with decline. Sustained as well as sustainable development has been observed in a remarkable amount of cases. Why? Transport infrastructures or the vicinity of a major urban centre are often mentioned as important factors. For sure they allow containing the consequences of weak economies of agglomeration by providing access to services of larger cities. Moreover, they allow attracting urban dwellers demanding for amenities, as improved transport links make recreation in rural areas feasible. Still, accessibility does not appear as a sufficient condition for rural development and sometime it is more the source of population *leakages* than of economic *linkages*. In many cases, endogenous resources such as financial, human and social capital drive development. In particular, the most intangible aspects (entrepreneurship, cultural endowments, participation, and partnerships) may make the difference. But given that almost each region has different combinations and levels of capital endowment what really counts is as much the availability of one form of capital, as the ability to properly exploit it. In other words, what is difficult is to transform stocks into flows: develop strategies that *valorise* natural and man-made assets, *strengthen* the economic environment, *invest* in human resources, *improve* the institutional capacity, etc.

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3. The session identifies and discusses some of the key trends in rural regions, as they appear from the territorial reviews conducted by the OECD in Teruel (Spain), Tzoumerka (Greece), Moravska-Trebova (Czech Republic), Champagne-Ardennes (France), and Siena (Italy), from the horizontal work conducted by as well as from the statistical work on rural indicators and factors of growth.

4. Of course, some rural places still own their growth to the new ways in which agriculture produces commodities. In some regions, farmers still assure income and even employment development by signing contracts with a major food company to deliver precisely grown products on a pre-set schedule. However, such a successful move to a “supply chain” organisation changes not only *how* agriculture does business but also *who* does business and *where*. In absolute terms, it implies reduction of employment and surface in agriculture.

9. If strategies are key for development, which ones are the most effective? Some of them are more traditional. They have to do with exploiting natural resources or with taking advantage of major public expenditures. Some regions succeed well in exploiting wood, oil, minerals, or hydro-electricity<sup>5</sup>. Other few regions succeed hosting settlements that, although beneficial to society, generate a certain number of nuisances (prisons, dumps, waste recycling plants, etc.): in low population density they affect a smaller number of people. The greatest problem is that these traditional strategies have limited chances to be replicated in other places. More sustainable and forward-looking forms of development deal with valorising rural amenities and strengthening industrialisation in rural hubs. While the latter is a case that has much in common with patterns of development in moderately urbanised regions and will be treated extensively later on, let's concentrate on the former. A large part of successful rural regions has been able to valorise public or quasi-public goods such as a clean environment, attractive landscapes and cultural heritage (including food). Their increasing value has to do with both a growing demand on the part of urban dwellers for rural areas and a local capacity to co-ordinate several economic actors to supply and promote local collective or public goods. Potential economic opportunities range from developing green tourism packages; promoting local products, attract residents (secondary homes) or permanents (active or retired) to the area together with building synergies among all the above factors of growth. This applies not only to old but also to new countries.

10. In the latter cases and under certain conditions, farming can continue to play a role and remain a tool for rural development. Farmers are often engaged in creating, maintaining and valorising distinctive places and products, ensuring green credentials for marketing or directly contributing to the regional tourism supply. The point is that in all successful cases farmers are actors of a restructuring process that encompass agriculture as one component and not the dominant element of a comprehensive and place-based strategy for rural development. Furthermore, it is important to dispel the outdated notion of the "full-time farm business" with the household wholly dependent upon agricultural income. Multiple income sources for farm households are now widespread. In other terms, the health of the farm and non-farm economies in rural areas is inexorably linked. This is why the established notion of a separate national economic sector seems blurred and farmers should come to be seen and valued for their role as "rural entrepreneurs" and "local environmental managers" as well as for their role as food producers.

11. Prospects for development may not be limited to valorising natural and cultural resources or networking small firms, but cover a much wider set of possibilities. The above notes cannot pretend to be exhaustive. However, they help stressing a crucial point: together with increase connectivity due to information technologies, an increased and diversified **social demand on rural areas** has widened the range of regions considered as having marketable values. This demand has to do with higher disposable incomes, more sophisticated consumer preferences and a growing interest in ecology. Market segmentation has opened up niche opportunities for a variety of agriculture-related, industrial and service activities in rural areas. However, the new demand on rural areas may face a diminishing supply, resulting from rural exodus and the perverse effects of the present sectoral policies. Independently from the original endowment, some areas may face obstacles in capturing new opportunities and require *pro-tempore* policy intervention to facilitate the design and implementation of development projects.<sup>6</sup> In turn, this requires a

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5. As a matter of fact, the rural regions with the fastest employment growth in OECD countries are often remote places that are highly dependent on one of these resources. The discovery of oil in the North Sea was a boost for the economy of the highlands and the islands (Scotland). Sometimes, technological progress changes the fate of regions: new mining techniques allowed a county like Elko (United States) to venture into low-grade gold extraction. In other places, for example Soyn and Fjordane (Norway), the production of hydro-electricity generates sufficient income to ensure high levels of investment in infrastructure and services. The difficulty in all this type of places is to manage the effects of the price fluctuations of the resource (which induce rapid economic booms and declines) and to retain value added.

6. Other areas may have almost pure public goods – the best-known examples being those concerning natural endangered species – for which a real market is and will be difficult or impossible to establish.

re-examining the approach to rural policy. The focus of intervention to promote rural development and employment should be the regional economy (for example as defined on the basis of functional regions) so to develop new and distinctive economic functions. In short, a shift from a sectoral to a territorial policy approach.

## ***2. Moderately urbanised regions or the “urbanised countryside”***

12. Many industrialised countries base a part -- some a considerable part -- of their structure on regions where small towns constitute the main settlement basis and small firms the main economic basis. These regions are often growing at the expense of rural areas, offering a critical mass of services and infrastructures that populations need, while the smaller size of their cities saves them from some typical big-cities nuisances and they may even attract urban citizens. With improved communication and increased personal mobility, small towns are extending their catchments area in a way that bolsters their service industries and makes them more attractive as a place to live. In short, if until the 1960s the policy debate was dominated by larger cities growing fast and population tending towards increasing concentration, a more indistinct pattern has developed subsequently, including urban sprawl<sup>7</sup> as well as dispersal of population down the urban hierarchy to smaller towns<sup>8</sup>.

13. Some of these regions have specific advantages and can provide useful suggestions to policy-makers. The proportion of moderately urbanised regions with employment gains is greater than the proportion where employment has dropped. Employment gains often correspond to areas where industrialisation and specialisation still represent an asset. Many of these areas rely on conception intensive activities, flexible production processes, and modern technologies to target fairly narrow market segments and capture a particular part of the world market. In these activities, small firms seem not to be disadvantaged as co-operative relationships among them provide both the appropriate scale and the flexibility to respond more nimbly by shifting production to change and instability. Other moderately urbanised regions have succeeded by becoming rural hubs, i.e. small capital of areas with a relevant endowment of natural and cultural amenities. These successful cases suggest development patterns that could inspire a wider set of areas. In fact, several regions do not valorise their natural and cultural resources as they could or have agglomerations of small and medium-sized firms that, although close to each other, are simply juxtaposed and face high transaction costs in business-to-business relationships. They do not fully exploit the advantages of proximity in order to specialise, develop a local pool of skilled labour, attract buyers and suppliers, and reduce costs by sharing activities such as marketing and technical services<sup>9</sup>.

14. However, independently from the capacity to exploit existing comparative advantages for competitiveness, they share some important challenges. One at least deserves close consideration. It is related with globalisation and, in particular, with the effects of the new competition emerging from countries such as the “big players” (such as India, China, Brazil and Russia). In these countries, and differently from what first happened with the small Asian dragon, technological capacities may facilitate impressive increase in productivity without proportional growth in wages, given the unlimited supply of labour ensured by latent unemployment in rural areas. The consequent permanent increase in new countries’ firms competitiveness affects in particular labour intensive or light industries, i.e. the sectors in

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7. Decline of population in the inner cities together with growth of suburbs.

8. Note that 32% of the OECD population lives in moderately urbanised regions, and the proportion rises to 60% when intermediate and predominantly rural regions are combined.

9. In these agglomerations, subcontracting to potential competitors for orders that exceed a firm’s capacity is also rare because of mistrust about reliability and standards.

which the above-mentioned countries have better comparative advantages. As a result, many moderately OECD urbanised regions that are specialised in the same sectors can no longer hope to compete on the basis of prices.

15. In this context, small firms in OECD moderately urbanised regions (as well as in all locations in which they do not depend from large firms for what concern their investments decisions) are compelled to be quicker in innovating than “big players” firms in copying, but they may face obstacles in pursuing a knowledge-based strategy. They are increasingly forced by fierce competition to exploit any possible advantage in terms of quality and design of manufactured products to forge new competitive assets, to refurbish the image of their brand names, and to capture new market niches where quality is the uppermost consideration. However, many regions may face obstacles in reviving their industrial output, promoting innovation, and up grading skills on a permanent basis. Holders of university and post-graduate degrees are proportionately less numerous in moderately urbanised regions than in urban regions. Additionally, the reduced size of most business is not easily conducive to investments in research. Last but not least, the competitiveness of local firms depends as much on individual investments as it depends on the overall capacity to produce and use innovation of the cluster (suppliers, customers, sub-contractors, etc.) to which individual firms belong.

16. In short, there is a need to put in place territorial innovation-led policies. Even when small firms are competitive and able to use and even produce innovations, they require a whole range of skills and incentives for innovation that the market is not always capable to provide. They require that the whole local *filiere* to which they belong has ample access to global knowledge. In order to help small firms doing both developing clusters relationships and adopting innovations, several tools have been put in place. Supporting business training, easing restrictions and regulations that stifle new SMEs investments, providing mutual guarantee systems for bank loans to individual firms<sup>10</sup>, financing business start-up programmes have often played an important role. In particular, business advisory services seem to have had a crucial function to promote co-operation among SMEs in a number of areas, including investment in R&D. Together with encouraging networking, investment in quasi-public business services have helped drawing local firm into high-quality information circuits. However, an appropriate assessment of the respective advantages and disadvantages of these tools still need to be made.

17. Moreover, small and medium-sized towns need to better cooperate in order to be capable to provide the specialised services that their economic fabric requires. Moderately urbanised regions lend themselves to developing specialisation of and horizontal networking between towns located close to each other so to enjoy facilities and services that they would never be able to afford on their own. In reality, these towns are often isolated and cooperation and networking are rare. Co-operation must at least initially focus on a few carefully selected objectives and implies a form of governance where capacities and policies can be shared by several local entities, without the need to create an additional administrative layer. The main transports network often by-pass moderately urbanised regions. This is a problem because while infrastructure alone cannot necessarily create growth, a lack of accessibility can slow it. Development policies should carefully consider secondary systems that provide links to high speed networks.

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10. It is the consortium, and not the bank, which decides whether or not to provide a guaranty for a given company, after examining the loan application and discussing it with the applicant. If the business is not in a position to repay, the co-operative takes over the liability to the bank.

### 3. Metropolitan regions

18. Metropolitan regions are confronted with important opportunities as well as with pressing challenges. Because of their extraordinary fluidity, complexity and diversified economic base, they often enjoy robust comparative advantages linked with polarisation effects and have experienced a rebirth sparked by the high-tech innovation spilling over from universities and R&D facilities. Spill over generates more efficient knowledge transfers, a larger and more specialised workforce, and better markets for high tech goods and services. Nevertheless, there is no linear correlation between size of cities and economic performances, i.e. cities with the same dimension may have completely different results. In fact, some metropolitan areas are severely hit by structural changes, have been exposed to a significant loss of activity, and in the case of some port cities, of maritime commerce as well. Moreover, often unexpectedly the phenomenon of urban distress continues to grow. A mix of poverty, crime, homelessness, and drug abuse is concentrated in some distressed neighbourhoods. In ten countries, with about half the total population of the OECD, the proportion of people in large cities living in distressed areas is approximately 10 percent of the national population.

19. In order to further enhance the competitiveness of metropolitan regions and at the same time address the challenges they face, comprehensive and multi-sectoral strategies should be considered. Among other things, a particular attention should be given to problems of governance. With few exceptions, these areas are fragmented into various administrative jurisdictions. Under certain circumstances, fragmentation may incite competition among multiple jurisdictions, and in turn competition may have a positive impact on welfare as it can provide incentives for municipalities to deliver services cost-efficiently or to diversify their supply. Experiences show however that exacerbated competition among metro-jurisdictions can also result in a complex policy environment in which consensus is difficult to reach on important medium and long-term goals concerning social cohesion and security, environmental quality and appropriate use of land. Moreover, poor coordination among metro-jurisdictions can weaken local actors' capacity to recognise and exploit untapped area-wide development opportunities as this capacity often requires dialogue to combine different forms of knowledge and clarify demands.

20. Policy responses to fragmentation vary throughout OECD countries. Some countries<sup>11</sup> have favoured **municipal mergers** on the grounds that amalgamations should reduce the per capita cost of municipal services through economies of scale and that a unitary tax system should allow a more efficient and equitable sharing of costs within the amalgamated city. On the opposite side of the spectrum, other countries are experimenting strategies such as **redistributive grants and tax-base sharing**, which are fiscal solutions. Equalisation mechanisms have often been supported because, without dismantling current administrative boundaries, they insure a sharing of the costs of public services whose benefit extends to the whole metropolitan area, stem inefficient location choices motivated by differing tax bases, and contribute to an equal ability of municipalities to fund basic public services. An intermediate solution is the creation of **metropolitan co-ordination and planning agencies** (sectoral or multi-sectoral). Agencies devoted to a single public service can take advantage of scale economies in public transport or water while metropolitan bodies perform a wide range of functions such as economic development and co-ordination. Some authorities are composed of directly elected officials while others are appointed. In addition to grants from

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<sup>11</sup> The most significant amalgamations took place relatively recently in Canada (Halifax in 1996, Toronto in 1998, and Montreal in 2002), it is premature to assess thoroughly their real impact. Still, the results obtained so far appear mixed. Cost reduction or quality increases cannot, as yet, be detected, a task made more difficult by persistent transitional cost increases. Moreover, while the amalgamation process could probably lead to reduced fiscal competition and less social segregation along geographical boundaries, groups strongly hostile to amalgamation argue that the process may have a democratic cost. Finally, it is difficult to achieve a perfect match between functional and administrative boundaries simply because functional areas evolve constantly in time and space.

upper-level government, some can levy their own taxes. A main issue for the multi-sectoral metropolitan agency<sup>12</sup> is their accountability especially when the institution has increasing responsibilities and fiscal revenues. No one fits all solution is available between amalgamation, tax sharing and agencies but farther work to identify different scenarios seems promising.

21. The lack of horizontal co-ordination between different local jurisdictions is not the only barrier to the well functioning of metropolitan regions and three additional problems need to be mentioned. First of all, insufficient vertical collaboration among levels of government limits the effectiveness of policies as more coordination could spread the risks of a project among several actors and gain additional financial resources. Secondly, lack of coordination at the central government level between national sectoral ministries limits policies effectiveness as it may put in place conflicting objectives and produce perverse effects. Thirdly, the reform of urban public finance is lagging behind the required institutional changes. At a time when major investments are required to enable metropolitan areas to compete in the global economy, decentralisation of expenditure responsibility has often produced unfunded mandates, *i.e.* upper levels of government demanding certain expenditures from the local level without introducing the corresponding means to finance these expenditures. This may be due partially to a reluctance of national or regional governments to allow municipal governments access to revenue sources other than the property tax (which may have inherent political and social limitations), partially to a reluctance of national governments to increase intergovernmental transfers, or partially to above mentioned problems of metropolitan or intergovernmental co-ordination.

22. In short, fragmentation among metropolitan jurisdiction, lack of vertical and horizontal cooperation among and between levels of governments, and often inappropriate finances and fiscal autonomy for cities may weaken the comparative advantages of crucial regions.

## **II. The emergence of a new paradigm in territorial policies**

23. The trends analysed in the first session have some implications for policy-making. In fact, as territorial disparities within countries are significant and persistent and as their reduction does not seem clearly correlated to growth, it is not surprising that concerns of equity maintain interests for territorial policies. What is more interesting is that the demand for territorial policies comes also from concerns of competitiveness: the persuasion that regional policies can play a major role in a strategy to foster growth by mobilising unused regional resources. Let's analyse more in detail these implications for policy-making concerning as much the strategies as their implementation.

### ***1. Changing strategies***

24. Economic growth alone does not seem sufficient to reduce regional disparities and catching-up has proved a difficult process. Even in a climate of increased economic integration, after years of continuing high growths at the national level and improvement in the macro-economic environment, adjustment in the economic base of regions does not seem to happen spontaneously. Moreover, lowering all labour costs, increasing flexibility through national policies, and implementing regulatory reform to increase competition in product markets, do not seem to be sufficient. Finally, international economic

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Examples of a metropolitan co-ordinating body are the *Montreal Metropolitan Community* (CMM) that the government of Quebec created in 2000 in Canada, the *Metro Council of Portland* (Oregon, US) the *Stuttgart Regional Association* (Germany). In the United Kingdom, the *Greater London Authority* (GLA) is made up of a directly elected mayor and a separately elected assembly that took over control of a number of existing government programmes such as police, fire, transport and economic development.

integration is increasing the interdependence of nations, thereby modifying the traditional policy instruments through which governments influence the process of economic and social change, while simultaneously exposing territories to challenges for which they are often ill prepared. Exchange and interest rates are less and less susceptible to manipulation by administrations. So-called “competitive de-valuations”, already inappropriate, are now impossible, for example within the new European monetary framework. Fiscal policies as well may progressively be bound to converge. In addition, national barriers to competition are being dismantled and regulations homogenised. In short, together with the persuasion that the drivers of national competitiveness have become more local, the limits to policy making explain why signs of increased expectations with regard to territorial policies are not only at the core of OECD activities, they are also evidenced in the World Bank’s World Development Report 1999/2000.

25. These recent expectations renew criticism towards past policy-making in the field of territorial development. Traditional territorial policies, concerned with the centrally managed re-distribution of income to counterbalance less developed regions’ gaps (in fiscal revenue, employment and infrastructures) and bring about geographically balanced economic development have often experienced disappointing outcome and do not seem an appropriate answer to the new conditions engendered by globalisation. In many cases, an originally large amount of subsidies, scattered in a great deal of localities, became too diluted to sustain economic take off and modify the economic geography. A more selective re-distribution, concentrating assistance in a limited number of priority regions, faced obstacles, too. It frequently caused rent seeking wars, and even exhausting competition among regions, without necessarily resulting in as attractive a return as predicted for the winners. Moreover, this policy was exposed to a significant risk of public failure, as the knowledge of central administrations adopting a top-down approach is often incomplete and not sufficient to identify and shape development projects as well as to appropriately select priority regions. Finally, more general doubts about long-term efficacy of subsidies (including lower taxes) have been raised, based on the possibility that income-transfers lead to passive behaviour and stifle entrepreneurship as well as on the likelihood that subsidies may help attracting, but not necessarily to deepening the roots of incoming investments.

26. An increasing number of countries are looking for a paradigm-shift in policy-making, grounded in the analysis of both the failure of policy driven by compensation to correct structural problems and the findings briefly summarised in the first part of this paper. The latter state that the drivers of national competitiveness have become more local. Moreover, they suggest that in many regions there is an unexploited reservoir of development opportunities and suggest that policy could help improving regional capacity to make full use of local immobile assets and to attract mobile resources. In order to do so, a series of factors are required in policy design: a) an emphasis on improving the ‘competitiveness’ of regions, and hence to understand the comparative advantages of each region; b) a switch from sectoral approaches to place-based integrative development strategies; c) attempts to divert resources from programs that focus on subsidies to programs for investments that up-grade human and social capital, and valorise innovation as well as diffusion of new technologies. The aim is to reduce structural hurdles by addressing the problems of the local business environment so to provide a viable basis for growth rather than masking regional disparities with cash transfers. In this perspective, territorial policies should not exclusively address regions lagging behind. Under-developed areas should be helped in exploiting untapped potentials as well as already existing “poles” in preserving and improving their competitive advantages.

| PARADIGM SHIFT IN REGIONAL POLICIES |   |   |
|-------------------------------------|---|---|
|                                     | Traditional territorial policies  | New trends  |
| <b>Objectives</b>                   | Balancing economic performances by temporarily compensating for disparities | Tapping under-utilised regional potential for competitiveness   |
| <b>Strategies</b>                   | Sectoral approach   | Integrated development projects                                 |
| <b>Tools</b>                        | Subsidies and state aids  | Soft and hard infrastructures                                   |
| <b>Actors</b>                       | Central government  | Different levels of government, including private sector & NGOs |

27. Two elements of the above strategy merit being underlined. First of all, the conviction that subsidies and state-aids are not able to trigger long lasting development and may even hamper it by creating distortions and a possible rent-seeking war (particularly in the framework of the European enlargement<sup>13</sup>). In order to stimulate the local economy and help attracting investments, it is better to build local public and collective goods that address market failures and improve quality of life, valorising endogenous resources and providing the conditions for self-sustaining growth at the local level. Specific targets of a public investment competitive strategy include i) the development of agglomeration economies, and in particular of clusters that provide means to increase productivity and achieve critical mass for small firms development; ii) efforts to link university with local economic actors in the context of regional strategies for innovation (including the promotion of services provided by research institutes, science and technology parks, technological centres, etc.); iii) the support for local immobile resources in rural economies and for positive rural urban linkages. The second element concerns the conditions needed to design, implement and monitor policies, including public participation and accountability. Governance should abandon a rigid top-down perspective in order to adopt a combination of fiscal federalism and partnerships and involve different actors national/local as well as public/private.

## 2. Implementing the new paradigm

28. Together with changes in the main component of policies, the efforts of countries engaged in re-shaping territorial policies increasingly explore some solutions for problem solving. In fact, although

<sup>13</sup> Countries could try to compensate advantages of new members in terms not only of wages and labour and environment legislation, but also of state aids, by increasing subsidies to prevent national firms from migrating. The results would be large public expenditures with no welfare increase.

certain economic and functional characteristics are obviously important assets in determining a region's overall performance, much of the explanation relies on intangible factors. For OECD regions it is important not to overlook the role of civil society in ensuring sound local governance. Two issues in particular appear to be crucial: enhancing spatial planning and designing and implementing a governance reform. Organisational skills, institutional capacity, community participation and democratic local management are all being increasingly recognised as ingredients of success.

### *Rethinking spatial analysis and planning*

29. In many cases, policy-making continues to focus on administrative or macro-regions, which no longer reflects the present local nature of territorial development opportunities. Dividing the country along functional instead of administrative lines often reveals territorial dynamics and problems that were unknown before or hidden by inadequate statistical analysis. The functional organization of the countries overlaps with their administrative-territorial structure that dates decades or even centuries back, creating various gaps and inconsistencies in political decision-making. Even the traditional distinctions between people living in cities or in the countryside needs to be re-defined. Daily commuters from scarcely populated municipalities in suburban areas of Toronto or Zurich have values and behaviours that are much closer to those of inner cities residents than the values and behaviours of resident in small and medium sized towns in predominantly rural regions. In this context too, the crucial unit of analysis and intervention is a functional region, defined in terms of its local labour market or commuting zone<sup>14</sup>. Spatial planning, particularly when built on the basis of functional areas, helps establishing a coherent vision to structure policies affecting location of population and economic activities, relations between urban and rural areas, infrastructure development and polycentrism as well as appropriate forms of governance, in particular between different local jurisdictions or trans-border regions.

### *Designing and implementing a governance reform*

30. Across OECD there is a wide variety of institutional arrangements depending on the size, the geography, the institutional architecture of countries. Still a common feature that emerges is that local and regional governments have been brought more strongly into the picture. In several countries a number of responsibilities have been transferred to the regional and local level. Together with the empowerment of

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Some examples may help clarifying the above point. Many observers have often stated that Italy is condemned to a permanent dualism, with little margin for territorial policies. Recently, a trend analysis based on local labour market areas has revealed signs of economic and social dynamism in southern areas, especially along the Adriatic coast and in a few parts of Campania and Basilicata. In most cases, good performances are associated with the presence of manufacturing small towns and non-metropolitan areas where small and medium-sized firms are specialised in light industries and mechanics. In these, as well as in many other cases, the traditional administrative regions are often inappropriate to register such crucial phenomena as clusters. In Canada, while disparities at the provincial level are declining, they are persisting among different types of regions, *e.g.* between metropolitan areas and non-metro-adjacent rural areas. This has been revealed by the use of data on Communities. Most of the economic growth has occurred in the urban fringe along the US border, especially Central Canada (Ontario and Quebec) that has been the prime beneficiary of international trade by developing significant industrial clusters. Even in Switzerland where territorial disparities between cantons are relatively stable, the use of functional, rather than administrative, units of analysis suggests that metropolitan areas have slightly higher growth than other parts of the Country. This, again, not only poses problems for the analysis, it requires the design of appropriate forms of governance, and in particular of co-operation between different local jurisdictions.

local communities, devolution is often multiplying the number of actors and contributing to recognise the complexity of regional and local systems. In many European countries there are up to five levels of government and one should add to them the private sector, unions, trade associations, NGOs and the various partnerships. Increasing the level of institutional fragmentation also increases the need for governing structures to establish new forms of co-operation. At the same time, local institutions become more aware that the production of public goods and services can benefit from economies of scale and scope and that many of the externalities produced have an impact beyond the local context.

31. However, institutional flexibility and adaptation does not only concern local authorities. Local and regional policy-makers are increasingly invested with new mandates (policy design for economic development, regional planning, design and provision of producers' services, etc.) and have to cope with a wide range of issues. In particular, a capacity spending more inspired by subsidiarity principles, the reduction of the fiscal gap and a better matching of responsibilities, powers and resources, as well as an appropriate place-based fiscal equalization mechanism. The well known idea is that delegation of competencies, power and financial resources to local and regional authorities can increase their capacity to deal adequately with local development issues. However, decentralization does not so much transfer responsibility away from the national government as alter its responsibilities and require a *Governance reforms*. The role of the central government is to simplify financial and regulatory procedures, to ensure transparency, coherence, and guarantee equalisation of fiscal capacities among territorial units. Moreover, central government should integrate sectoral policies that are aimed at an impact at the territorial level. This implies efforts to improve central co-ordination of a wide range of policies through institutional arrangements for inter-departmental and inter-ministerial co-ordination, including 'policy proofing' to ensure that all such policies contribute to the over-arching goals, and that actual or potential conflicts are minimised.

32. But a crucial aspect needs to be underlined to explain the governance reform that is required. Most of the knowledge needed to devise and to deliver local or locally relevant public goods is dispersed among many different local and national agents. This asymmetrical distribution of information and knowledge requires a high degree of co-ordination among administrations and improved co-operation between public and private bodies in policy identification, design and implementation. Thus, the capacity to involve all relevant actors, to mobilise all stakeholders affects the impact of policies. In other terms, good governance is not only a matter of *efficient* use of resources. It contributes to *effective* policies too, including *in particular* territorial development policies. Questions about *what* policies should be adopted cannot be answered without addressing at the same time questions about *who* should design and implement these policies and *how*.

33. Traditional policy-making is less and less capable to cope with the complexity of regional and local systems. Instead of pulling together all relevant actors so to share as much as possible the knowledge they have, the traditional methods assumes that everything is transparent, that policy-makers can decide in isolation, and that public officials in central administrations can implement decisions through hierarchical communication and rigid command. In this context, if something does not work it is explained by general arguments against the public sector or about the heavy burden of bureaucracy, rather than by the need to design a new policy approach.

34. The multi-level governance resulting from the process of decentralisation requires relations among actors less based on the old command/control approach, which for several reasons has revealed itself ineffective for regional development, and more oriented by vertical and/or horizontal co-operation where different levels of government have an equal base in committees, forum, monitoring bodies that are in charge for the implementation of joint projects. This could bring to produce new tools such as

contracts<sup>15</sup>, incentives (as in the so-called *new public management approach*) as well as enhanced vertical and horizontal partnership across level of governments. That in turn gives emphasis to increasing use of programme monitoring and evaluation procedures, both as a control and a learning mechanism. In short, new territorial development policies involve strengthening the technical and administrative abilities of personnel and processes in administrations. Conditional grants can create incentives for local governments to improve their policy making capacities.

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<sup>15</sup> Countries like France and Italy have created contractual policy tools for the central government to have public action demands ascribed into subnational governments' local pool of knowledge and capacity.