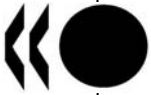


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**PUBLIC GOVERNANCE AND TERRITORIAL DEVELOPMENT DIRECTORATE
TERRITORIAL DEVELOPMENT POLICY COMMITTEE**

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TDPC MEETING AT MINISTERIAL LEVEL (31 March 2009)

POLICY REPORT

**TDPC Enlarged Bureau
6 February 2009
Room CC15, OECD Conference Centre**

This document is submitted to delegates of the Territorial Development Policy Committee (TDPC) for DISCUSSION AND APPROVAL.

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POLICY REPORT

A renewed interest in regional policies

1. Regions are on stage. By loosening national ties and reinforcing international competition, globalisation confronts regions, whether urban or rural, with development opportunities and threats not known previously. Regional policies are on stage as well. They are increasingly tested on their capacity to target regional comparative advantages as to build growth engines and support the diffusion of innovation. Unlocking growth potential in every possible location is essential to generate a positive sum game in which stronger regional growth fuels stronger national growth. Regional policies are also seen as tools to accompany and implement decentralisation and capacity building, shaped in different ways in OECD member countries as well as in developing countries. Finally, regional policies are increasingly considered as possible tools to maximise the long-term impact of the significant counter-cyclical investments in public goods and services planned in recovery packages. In all of the above it appears that regional policies could play a significant role. But in order to do so, a paradigm shift is required, *i.e.* a change of perspective in regional policies, which should focus more on the competitiveness of places and the prioritisation of customised public goods and services than on traditional support to sectors or income redistribution.

... combined with the recognition of past failures...

2. There is shared understanding among OECD countries that traditional regional policies produced disappointing results. Centrally managed redistribution of subsidies scattered through a great number of less developed regions to offset their gaps (in per capita income, fiscal revenue, or employment) became too diluted to sustain economic take-off and too spatially blind to address specific regional assets. Moreover, subsidies and lower taxes often led to a culture of dependency stifling entrepreneurship and distorting trade. More selective redistribution, concentrating assistance in a limited number of large public projects and firms, faced obstacles, too. This frequently caused rent seeking wars without necessarily resulting in as attractive a return as predicted for the winners. This kind of policy was exposed to a significant risk of public failure, as the knowledge of central administrations adopting a top-down approach was in many cases incomplete, not sufficient to identify regional comparative advantages and to target local development opportunities. As a result, the policy often produced “cathedrals in the desert” with meagre backward and forward linkages.

... highlights the need for a new approach.

3. Market forces and local and national public goods built over time have shaped a world that is far from being flat. Geography still matters for growth, despite the impressive improvement in communications, reduction in transport costs, and development in

technologies, often reducing the scale to produce and sell efficiently. Visions about ‘magic carpets’ that would allow for immediate movements of people and goods across space have been replaced with an opposite view of the world economy as an archipelago, in which large cities would be islands in a desert sea or mountains in wide, scarcely populated plains. OECD work points out a more complex geographical picture for metropolitan regions and a more attractive landscape for smaller cities and rural regions that can play a vital role for growth. In both cases, development opportunities remain untapped. Policies can reveal and develop regional comparative advantages, improving the contribution of regions to national wealth by providing additional margins for growth.

Regional policy can help achieve economies of agglomeration in all types of regions,

4. Boosting national growth by tapping comparative advantages will have different policy implications across regions. Large metropolitan areas often enjoy robust comparative advantages linked with the concentration of firms and decision-making bodies. However, cities of the same size may yield fairly different performances. In particular, some large cities seem to reach a point beyond which the correlation between size and GDP per capita becomes negative, most likely due to negative externalities such as traffic congestion, pollution, social distress, price increases, and criminality. Simple concentration of resources in a place does not necessarily translate into economies of agglomeration, which are due to the existence of a pooled labour market, backward and forward linkages among firms, and knowledge spillovers. The key appears to be how assets are used, how different actors interact and how synergies are exploited. Local labour markets need infrastructure to work and agencies to deal with mismatch between demand and supply for labour. Infrastructure investment is most effective when combined with other forms of investment, notably in education and skills. Specialisation and division of labour between firms require trust and cooperation, which in turn call for effective local rules and institutions. For innovation, it is not only the number of researchers or the level of R&D investment that count, but how the innovation system as a whole functions. The market does not appear to achieve this alone.

... including smaller cities and rural areas.

5. Many analysts and policymakers are persuaded that non-metropolitan regions could also better contribute to national wealth if their growth potential were unlocked. Unexpected cases of success in regional economic development have renewed hope in regional policies. Some regions have contributed strongly to a change in perception of economic maps due to their emancipation from a history of backwardness. In particular, a significant number of OECD rural regions with relatively low levels of concentration are growing faster than their national average and faster than many OECD urban regions. For instance, all Scottish rural regions but two grew faster than the OECD average over the 1995-2005 period, and in Korea three of the four most dynamic regions in terms of GDP per capita growth and levels of productivity are rural regions.

Countries are moving forward with the implementation of a new approach...

6. Over the past few years, OECD countries have promoted a new approach to regional policy that aims at helping each region maximise its specific comparative advantage in a positive sum game that contributes to national objectives (Table 1). Regional policy has evolved from a top-down, subsidy based group of interventions designed to reduce regional disparities into a much broader “family” of long-term development policies designed to improve regional competitiveness via grouping of public goods and services. The new paradigm focuses more on endogenous assets rather than on exogenous investments and transfers; on opportunity rather than on disadvantages; on negotiated governance agreements involving national, regional and local governments, as well as other stakeholders. In this new paradigm, regional policies should help lagging regions to exploit their own potential and already existing “poles” to preserve and extend their comparative advantages.

Table 1. Old and new paradigms of regional policy

	Old paradigm	New paradigm
Objectives	Compensating temporarily for location disadvantages of lagging regions	Tapping under-utilised potential in all regions for enhancing regional competitiveness
Unit of intervention	Administrative units	Functional economic areas
Strategies	Sectoral approach	Integrated development projects
Tools	Subsidies and state aids	Mix of soft and hard capital (capital stock, labour market, business environment, social capital and networks)
Actors	Central government	Different levels of government

... which is based on the capacity to diagnose and mobilise regional comparative advantages and offer a tailored set of public goods and services.

7. The new paradigm calls for a strong capacity to identify and exploit the comparative advantages that will underpin the competitiveness of each region. Solving the challenge of diagnosing regional opportunities and customising the set of public goods and services required for stronger regional competitiveness is largely linked with how different actors pool together their specific knowledge of the assets present in a region, how different sources of investment financing (both public and private) are brought in, and how regional networks of social capital are integrated in development strategies. A critical element of regional policy therefore lies in creating a continuous dialogue to exploit synergies between public, private and social stakeholders at the national and subnational level.

The new regional paradigm entails a new approach to rural development...

8. Despite important economic and demographic challenges, rural regions are not necessarily synonymous with decline. However, even when opportunities exist, market forces do not always grant their adequate and appropriate valorisation. Some areas may face obstacles in capturing new opportunities and require *pro-tempore* policy intervention to facilitate the design and implementation of development projects.

Policies can help rural areas better exploit their own development potential. Distinctive advantages related with higher quality of life and the existence of various natural and cultural amenities have fostered a rural renaissance in some countries, as made visible in recent migration trends from urban to rural areas (*e.g.*, France, UK) or from rural to rural areas (*e.g.*, China). Some small and medium-sized cities were able to seize niche markets and to offer a more attractive living environment than congested urban agglomerations, while the widespread decline of agricultural employment across OECD countries has challenged rural areas to develop alternative sources of growth. Diversification of the rural economy is positively correlated with population growth, higher income and employment growth across OECD countries, which suggests an important avenue to raise the utilisation of resources in rural regions and foster regional development.

... as well as urban development,

9. The new paradigm also endorses a more pragmatic approach to urban development. Ensuring a clean and attractive urban environment is increasingly recognised as an integral aspect of the creation of dynamic cities rather than a mere compensation of their consequences. There are limits to the dynamism that can be sustained by cities with increasing traffic congestion and pollution. The introduction of a congestion charge has generally been perceived as an effective measure to limit traffic and improve the use of public transportation (*e.g.*, London). Exploiting a city's particular cultural assets has also bolstered the development of tourism and creative industries (*e.g.*, Athens and Istanbul). Some metropolises that experienced massive urban sprawl have sometimes undertaken a spectacular urban revolution (*e.g.*, converting a motorway into a water stream via the Cheonggyecheon project in Seoul).

... with an increasing need to facilitate rural-urban linkages.

10. There is a growing recognition that urban and rural areas are more strongly interlinked than has been thought in the past. For example, rural areas in close proximity to urban areas provide a flow of environmental and recreational services to urban areas. Rural households are better connected to urban society through modern communication and transport links, including the internet, television and high-speed roads. In some OECD countries, virtually the entire rural territory is within easy reach of urban residents who increasingly own second homes in rural communities, or commute to work on a daily basis. Because of such economic connections, it is clear that an effective regional development strategy needs to take into account the cascading effects of policy decisions that link rural and urban regions.

Progress has been achieved in the reorientation of policy focus towards competitiveness and growth in several countries,

11. Recent policies in both OECD and non-Member countries are going through a complex process of transformation towards more selective public investment targeting regional comparative advantages. Over the past decade, many countries have created or reformed regional development programmes oriented towards competitiveness and growth objectives. Some examples include Finland's Regional Development Acts (2002, 2007); regional growth agreements and a new regional governance architecture in Sweden; a new regional development law in Switzerland (2008); building or strengthening of regional development agencies in Chile and Canada; development of regional plans and

devolution of powers to regions in Italy; RDA-led regional strategies in England and specific strategies in Scotland, Wales and Northern Ireland; Peaks in the Delta in the Netherlands; EDA-led regional competitiveness programmes in the US; area agreements and regional partnerships in Australia; and EU-sponsored regional development strategies in its members supported through the 2007-2013 Structural Funds.

***... with policy implications
both in urban regions...***

12. This new approach has led to some significant reorientations in both urban and rural policies. For example, OECD Member countries such as France, Korea, Japan, and the United Kingdom that used to apply anti-concentration measures are starting to push for more competitive metropolitan areas. Non-member countries such as China, which used to pursue explicit urban containment, now emphasise the development of metropolitan economies, an orientation mentioned for the first time in its Eleventh Five Year Plan (2006-2010). At the same time, some countries have successfully tried to ensure that supporting ‘champion’ cities did not compromise the development of other urban areas. For example, the Regional Centre Programme launched in Finland in 2004 aimed at establishing a co-operative network of small and medium-sized cities covering every region and province in the country. In order to provide the linkages often missing between firms and universities, some OECD countries have identified scope for better targeted action in support of firms’ existing, market-based strategies (*e.g.*, emphasis on SMEs in Japan’s new approach to innovation policy, building up universities as strategic hubs in the Danish-Swedish region of Öresund).

... and rural regions.

13. Many countries have also developed a clearer grasp of the different nuances of rural areas and have adopted a more sophisticated rural typology. There have been major initiatives to support rural development by better connecting various levers of policy, including public service delivery (*e.g.*, Citizen Service Offices in Finland, tele-medicine in Norway, Rural Development Programme launched in 2007 in Japan), SME development in rural tourism (*e.g.*, the Bregenzerwald “cheese route” in Austria, rural museum networks in Siena, Italy), manufacturing cluster policies (*e.g.*, successful furniture manufactures in rural areas of North Carolina in the US and Quebec in Canada), and education (*e.g.*, tele-education facilities in Norway, improved rural school bus routes in Australia, teacher-parent partnerships in Canada). The creation of new employment opportunities has been promoted by valorising specific local resources in rural areas (*e.g.*, biomass in the Biomass Nippon Strategy set up in 2002 in Japan, and specific agricultural, natural and cultural resources in 300 model project areas designated across Japan in 2008). Such experiences of the new rural paradigm yields valuable policy inspiration for non-Member countries such as China and South Africa that are confronted with tremendous challenges and opportunities in terms of rural development.

***Efforts have been made to
better integrate sectoral
programmes in functional
economic regions ...***

14. Adjusting the set of sectoral programmes available to the specific needs of a labour market has helped increase the visibility of overall policy objectives in the region, reduce duplication of efforts, create more strategic focus and avoid costly remedial action at a later stage. For example, the Micro-regions strategy in Mexico launched in

2001 has overcome policy fragmentation by integrating programmes and initiatives from 12 different ministries in 263 highly marginalised rural areas around micro-poles of development. The Danish/Swedish region of Öresund has also built a successful labour market by combining the construction of a cross-border bridge with joint efforts to bring universities, research institutions and firms together in the Medicion Valley project.

... through improved collaboration at the horizontal level...

15. Increasing pressure to achieve both regional economic development and high quality public services has led many OECD countries to establish various forms of horizontal collaboration at the subnational level. At the one end of the spectrum, amalgamation of municipalities has been put forward as an efficient way to reap economies of scale and internalise spillover effects (*e.g.*, one extraordinary case was found in Denmark, where 270 municipalities were merged into just 98 in 2007). At the other end of the spectrum, intermunicipal co-operative arrangements were established, most often on a voluntary basis and guided by financial incentives (*e.g.*, in France, the majority of the 36 000 communes are involved in some 19 000 intermunicipal collaboration structures). Urban areas have either interposed an additional layer of government (*e.g.*, London, Stuttgart, Portland), established specialised or multifunctional joint bodies (*e.g.*, Montreal, Lyon), or developed deliberative collaboration mechanisms (*e.g.*, Regio Randstad). In rural areas where low density and geographic distance often make it difficult to identify clear gains from municipal amalgamation, policymakers have attempted to link territories into a small functional region following a variety of socioeconomic indicators (*e.g.*, *pays* in France, Micro-regions in Mexico). Such knowledge and resource sharing helps overcome the recurrent mismatch between administrative and functional geography and build regional capacities, which are lacking in a vast number of areas.

... and at the vertical level,

16. Closely linked both with decentralisation and horizontal collaboration issues, vertical collaboration between central and subnational levels of government to foster effective regional development has increasingly moved towards contractual approaches in OECD countries. Contracts among levels of government are an implementation tool of coordinated public investment strategies. Whether they are used in federal countries (*e.g.*, urban development agreements in Canada) or unitary countries (*e.g.*, *contrats de projet Etat-région* in France, *accordi di programma quadro* in Italy), contractual mechanisms are unavoidable for a customised management of vertical interdependencies. Beyond their role in the practical management of co-funded public policies, they have offered a valuable tool for dialogue, experimentation, and learning.

... with increasing initiatives to reform the governance of the central government itself.

17. Regional development contracts have also often made clear the need for stronger coherence between line ministries. Countries have therefore opted for a variety of arrangements in terms of coordination at the central government, ranging from informal consensus building (*e.g.*, Austria) to interministerial bodies (*e.g.*, France, Switzerland) and full-fledged ministries or units in ministries (*e.g.*, Norway, Portugal, Poland). In the case of rural policy, many OECD countries have navigated between the two extremes of a broad rural policy (a sort of

“grand plan” aiming at integrating all sectoral policies in an ideally coherent strategy, often unachievable in imperfect markets) and a narrow rural policy (a niche policy, frequently limited in scope and budget). A credible midway solution has been found in “proofing” the impact of sectoral policies on rural areas and adapting the policy content to specific rural needs.

However, the implementation of the paradigm shift runs into a series of roadblocks and needs to be pursued over time.

18. Regional policy reforms remain an ongoing agenda. In certain countries, traditional regional aid schemes have not disappeared completely, although they have usually undergone a relative cutback in terms of budget, aid ceilings and population coverage along with a more selective regime. The political and social commitment to compensate for permanent structural handicaps in sparsely populated regions also remains strong in several countries, despite rising concerns about fiscal sustainability. Some countries continue to rely substantially on sectoral policies, for instance by continuing to give stronger support to agriculture than would be expected given the reduced relative contribution of agriculture to local economy. Fostering innovation for rural competitiveness remains a challenging task in several cases. Regional strategies can sometimes remain a juxtaposition of sectoral projects. Functional regions often lack an appropriate governance structure for coordinating public goods and services. For example, local authorities within large metropolitan areas do not necessarily co-operate at the appropriate scale. In some cases, the new approach to regional policy has generated resistance, and the “political economy of reform” remains a critical issue to be addressed over time. Two main axes are considered essential for further progress in regional policy: innovation and governance.

First, regional policy can further support innovation processes,

19. Globalisation has increased the pressure on countries to move up the value chain and engage in a continuous process of innovation. The main policy issue is how inputs are transformed into successful innovation and why some places seem to do it better than others. While location is not a lock-in condition for innovation performance, the regions that have progressed have tried to build regional innovation systems to capture positive externalities by improving the efficiency with which partners interact and share their knowledge. The underlying understanding is that not only the creation but also the diffusion of knowledge determines innovation. The gap between knowledge generation (research and education institutions) and knowledge application (firms linked with their customers and contractors) can be bridged by a range of actors such as technology brokers, technology centres, business innovation centres, high-education institutions, innovation-financing actors, etc.

... through a series of policy instruments to be further explored...

20. Despite a certain level of “cluster fatigue”, policies using a cluster model have been revised and often provide a bridge between regional policy, science and technology policy, and/or industrial policy. Such instruments aim at improving firms’ absorption capacity, for example via business mentoring programmes, one-stop advice centres for firms, skills training programmes, and specialised network building support programmes. Other instruments can also help transfer

technologies from a core sector to new applications (e.g., mix of ICT and biotechnology in bioinformatics, use of ICT to develop intelligent textiles, etc.), which offers an important means by which a region can avoid over-dependence on single industries and better use accumulated skills. The effectiveness of such policies in different types of regions and in a context of rapidly evolving economic environment needs to be further explored and understood.

... and effective interaction between actors.

21. Broad-based innovation policy at the national level is relatively new and still involves internal restructuring in order to move from a narrow focus on science and technology policy to a broader-based innovation policy. At the same time, regional authorities have often developed closer interaction with their enterprise base and in-depth knowledge about region-specific conditions for the circulation of people and knowledge, the generation of innovative ideas and the development of new products and processes. In a policy environment which is both nationally defined and region-specific, choices in the governance of innovation policy can make regions play the role of “stages” (on which policy is enacted) and agents for policy delivery (according to centrally conceived priorities), or the role of more proactive partners (with increasing influence over policy formulation) and independent policymakers (setting their own agenda and using their own financial resources).

Second, regional policy can help build a coherent and flexible governance framework,

22. Regional policy can help build a coherent and flexible framework that extends across sectors, builds on urban and rural considerations, and provides a call for action to public, private and social actors. The following actions are particularly crucial:

- Creating a single “gate-keeper” for regional policy at the national level. The complexity associated with regional policy requires that the responsibility for defining strategic priorities, providing incentives for action, and enforcing the “rules of the game” lie in an identifiable authority with strong political endorsement and backed by sufficient resources.
- Using contractual approaches to set conditionalities. Regional development requires the combination of various sources of knowledge (national/subnational, public/private). An effective use of knowledge in the policymaking process requires appropriate mechanisms for dialogue and co ordination within and across levels of government as well as across public and private spheres.
- Ensuring a unified, co-financed, and multi-year funding for regional policy. Ideally, a single fund would help clarify how much is currently spent on regional development and what financial incentives are available. In the absence of a single fund, a unified presentation of funding should be created. Co-financing can help enhance the commitment and accountability of policymakers. Multi-year budgeting reduces uncertainty in the planning process and ensures continuity over

the medium- and long-term.

- Promoting the recruitment, retention and training of a professional civil service at all levels of government. Actions that can facilitate the professionalisation of civil servants and avoid risks of politicisation include: the adoption of a professional career system by law, increased use of partnerships with academic institutions to provide technical assistance, implementation of professional exchange programmes between different levels of government and the public and private sectors.
- Strengthening a culture of learning by monitoring and evaluation. Monitoring and evaluation mechanisms need to be established to promote the visibility of accomplished progress, identify room for improvement, and trigger motivation for further improvement.

... and constant efforts towards capacity building.

23. Regional policy requires constant efforts to build capacities at all levels, particularly at the subnational level if the country has a short history of decentralisation. Subnational capacity in a broad sense encompasses various skills that are not easy to measure, and central governments have tended to focus on monitoring subnational public service delivery via performance indicator systems. For example, the EU created the “performance reserve” to monitor the implementation of Structural Funds during the 2000-2006 period. Italy extended this logic into a national performance reserve, and several other countries (e.g., Austria, Japan, Korea, Norway, US, UK) developed their own performance indicator systems. Although performance indicator systems provide effective tools for increasing accountability, they offer only one among multiple sources of information that can be used to guide strategic decisions in regional policy and further research needs to be conducted to support regional capacity building.

In the long run, regional policy is becoming a fundamental tool in addressing global challenges.

24. In the long run, regional policy is increasingly challenged to achieve broader national or even global objectives. In particular, regional policy is gaining a new role in addressing global challenges such as climate change. Many regions are already under the threat of flooding, coastal erosion and drought, especially coastal and arid regions, and must therefore renew their infrastructure. Sub-national governments also have a key role to play in curbing greenhouse gas emissions. In many countries, they have primary authority over environment-related issues, including building codes, energy, public transport, waste and water management, planning and land use. Equally important, climate change policies can provide economic opportunities for regions to strengthen their competitiveness, foster innovation and create jobs in the green economy. Regional policy can help resolve such complex challenges in a way that aligns multiple policies and builds richer knowledge networks.