



**MARIO PEZZINI**

OECD, Head of Territorial Reviews and Governance Division

[Mario.Pezzini@oecd.org](mailto:Mario.Pezzini@oecd.org)

## **CULTIVATING REGIONAL DEVELOPMENT: MAIN TRENDS AND POLICY CHALLENGES IN OECD REGIONS**

### **I. Introduction**

1. The note intents to support 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. Regional success and decline increasingly result from an uneven distribution of and capacity to valorise local collective goods. Examples among others of collective goods with a strong territorial character include robust polarisation effects in metropolitan areas, well-established inter-firms relations within clusters, and accessibility and valorisation of natural and cultural resources so to increase the attractiveness of places and guarantee a sustainable development. 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. The present note a) will summarize the main trends affecting regions in OECD Member countries; b) it will focus on the comparative advantages and the obstacles to development of rural, intermediate and metropolitan regions; c) it will conclude with 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<sup>1</sup>.

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1. In his statement of strategic objectives in 1996, the Secretary-General presented a new triangular paradigm for development based on the principle that a balance has to be achieved between economic growth, social stability and effective governance [ECSS(96)5]. In 1997, the Secretary-General highlighted the role the OECD can play in advising governments on ways to maximise the benefits of economic development, whether local, national or global, and, at the same time, to ensure that economic growth is consistent with global objectives of sustainability [C(97)180].

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

3. The first series of OECD national and regional territorial reviews<sup>2</sup> has contributed to highlight two major “*stylised facts*” about territorial development<sup>3</sup>:

- in OECD countries there are not only important differences among nations; territorial disparities within countries are particularly significant. Actually, income levels, unemployment and poverty rates differ widely across regions, more than between countries. Between 1975 and 1995, on average, regional unemployment rates differed by more than 30% from national ones, in some countries even more than 60%;
- Territorial disparities are relatively persistent: while between OECD countries some convergence is taking place, at the sub-national level the long-term trend towards convergence, if any, is a slow process<sup>4</sup>. In fact, in the large majority of countries total unemployment has decreased while regional disparities in unemployment rates have increased.

4. Regional success and decline seem to result from a different regional capacity to exploit the local financial, natural, physical, social, and human capital to facilitate local as well as foreign direct investments. Opportunities for further development remain concentrated in certain areas, where a peculiar endowment of collective goods is available for endogenous growth. But even exogenous growth has shown to be very sensitive to local conditions. In fact, foreign direct investments have played a crucial role in the economic growth of several countries, but they have often had uneven localisation within countries<sup>5</sup>. As a result, a quarter of national GDP is produced in a single sub-national region, while in certain other areas, sometime bordering with the most successful ones, things have largely worsened and exclusion from mainstream of economy and society has become an increasing concern.

5. However, opportunities related with local collective goods are often unexploited and must struggle with economic, social and environmental obstacles. For example, some of the extremely developed OECD metropolitan areas have experienced a rebirth sparked by the high-tech innovation

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2. OECD is conducting a series of reviews at national level on the territorial policies. The countries reviewed up to now are: Italy, Corea, and Hungari , as Unitarian countries, and Switzerland, Canada and Mexico as federal countries. At the same time, OECD is conducting thematic reviews at regional level. Teruel (Spain), Tzumerka (Greece), Sienna (Italy), and Morevska Trebova (Check Republic) are the rural regions considered. As for intermediate regions they have included: Comarca centrals valentiana (Spain), Champagne-Ardenne (France), and Bergamo (Italy). The on-going metropolitan regional reviews cover the greater Helsinki area, Øresund (Copenhagen and Malmo), Vienna/Bratislava, Melbourne, Montreal, Mexico City.

3. They largely confirm the results of territorial statistics elaborated by the OECD in the last decade.

4. Marked regional disparities persist between the Centre-North and the South of Italy, thus demonstrating one of the widest geographical dualisms among OECD Member countries. Territorial fragmentation remains a major challenge in Hungary with a growing East-West divide, the lack of social cohesion and the need for a better articulation between European assistance and national policy. After World War II, the tremendously rapid pace of economic growth and urbanisation led to significant territorial polarisation and a new process of decentralisation has been launched during the 1990s in Korea.

5. 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, the transition has been especially favourable for Budapest and its surrounding areas, which attracted the largest share of foreign direct investments, while the Northeast and Southwest regions were particularly hit.

spilling over from universities and R&D facilities. Nevertheless, other metropolitan areas are severely hit by structural changes and there is no linear correlation between size of cities and economic performances<sup>6</sup>. Moreover, poverty, crime, homelessness, and drug abuse often characterise metropolitan regions<sup>7</sup>. As for clusters, the reviews conducted<sup>8</sup> provide examples of competitive small firms advantaged in their co-operation by their network relationships. Still, several regions have a continuum of small and medium-sized firms that, although close to each other, are simply juxtaposed, face high transaction costs in business-to-business relationships and are incapable to develop co-operation so to exploit the advantages of networks. Rural regions even when endowed with beautiful natural and cultural amenities that can constitute significant territorial assets for economic regeneration<sup>9</sup> do face particular challenges. In fact, even if farming is still important in shaping rural land use, employment opportunities in primary industries are declining and rural is no more synonymous with agriculture. The same is true for public sector employment. In a climate of fiscal restraint, it is likely to contract. Moreover, out-migration of young people caused by both lack of employment opportunities and inadequate access to educational and leisure facilities, along with in-migration of retirees in some places, has led to the significant ageing of the population. The resulting demographic structure is often not sufficient to support provision of adequate public services including economic services of a general interest.

### **III. Comparative advantages and development challenges in different types of regions**

6. It is worthwhile to analyse more in detail advantages and challenges for regional development. To do that, we will concentrate on different types of regions. We will use a simplified typology, based on broad types of areas mainly identified by density of population. We will distinguish rural, intermediate and metropolitan regions. The reason for such an extreme simplification is to consider a wide range of trends and cases, given the limited availability of territorial statistics. Further statistical progress in building databases with internationally comparable statistics at sub national level will allow for more in-depth work.

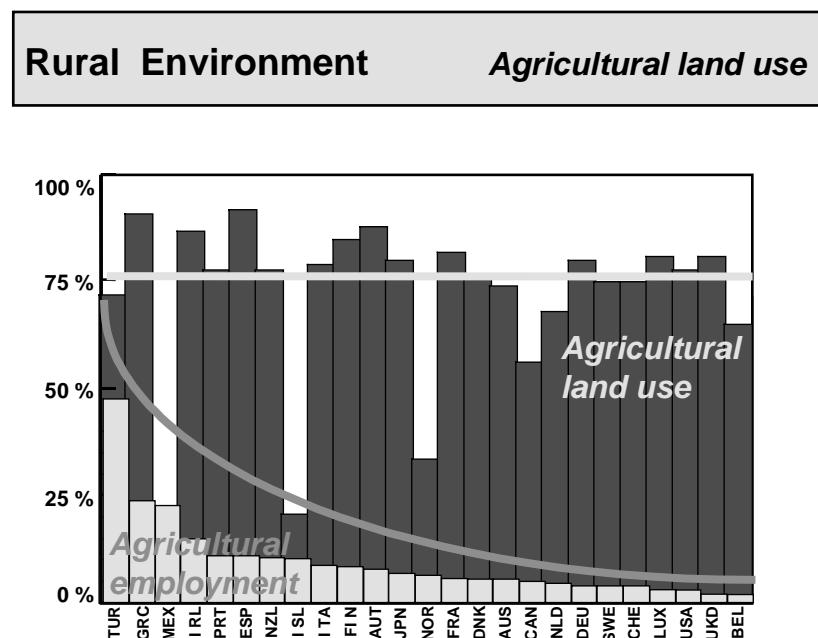
#### **1. Rural regions**

##### *a) Medium term trends for rural regions*

7. According to the results of the reviews in Teruel (Spain), Tzoumerka (Greece) and Sienna (Italy), as well as of the statistical work conducted on rural indicators, rural regions do face significant challenges in comparison to metropolitan and even intermediate areas. Problems are particularly evident in term of employment opportunities, in large part related with the shift in the economic base of rural areas away from primary industries. In fact, even if farming is still important in shaping land use, employment

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- 6. That is to say that cities with the same dimension may have completely different performance in term of growth.
  - 7. In ten OECD Member countries with about half the total OECD population, the proportion of people in large cities living in distressed areas varies from 7 to 25 per cent.
  - 8. In Champagne-Ardennes (France), Comarcas Centrales Valencianas (Spain) or in Bergamo (Italy) as well as the case studies in Modena (Italy) and Boras (Sweden).
  - 9. According to the results of the reviews in Teruel (Spain), Tzoumerka (Greece) and Siena (Italy), rural regions are not necessarily synonymous with decline and sustained as well as sustainable development has been observed, based on green tourism, niche marketing of local products, new residents attracted to the area.

opportunities in agriculture are declining, not only in relative, but also in absolute terms<sup>10</sup>. Mainly due to the exceptional increase of its productivity during the last decades, the role of commodity agriculture in rural development has weakened. The modern supply-chain production of commodities includes relatively few farm producers (so to minimise the costs of managing highly integrated business alliances) and lead to a geography based on concentration in relatively few rural places<sup>11</sup>. With few farmers and fewer suppliers where they locate, one is tempted to state that agriculture is no more the backbone of rural regions. Moreover, decline is also affecting public sector employment. In the past this source of jobs had been the main component of rural employment growth, but in a climate of fiscal restraint it is now likely to contract.



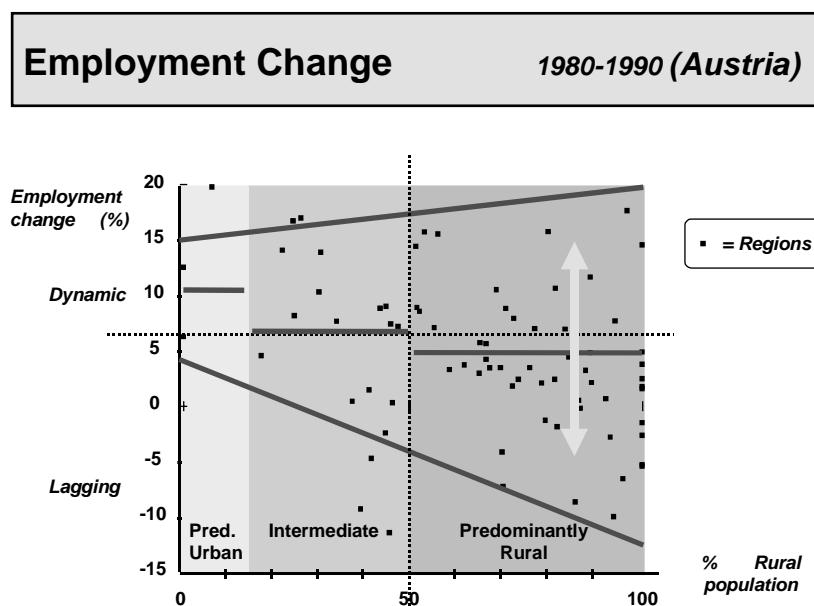
Source: OECD/TSI

8. Although crucial, unemployment is just one of a wider spectrum of problems affecting rural areas. Other issues suggest that economic behaviour in rural areas is connected with social and cultural values and judgements so that sustainable development requires an integrated approach. Out-migration of young people caused by both lack of employment opportunities and inadequate access to educational and leisure facilities, along with in-migration of retirees in some places, has led to the significant ageing of the

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10. Economic forces and changing government policies are speeding up the process of agricultural restructuring in most OECD countries. In effect, most regions have become less dependent on agriculture and resource industries and specialisation in these sectors is risky given the vagaries of international commodity markets and trading regimes. Estimates of the amount of formerly agricultural land that will be converted to other uses range between 30% and 80% (ESDP, p.20). The issue for policy-makers is how to ensure that market-led restructuring does not result in over-cultivation with negative environmental effects in some areas and abandonment of the land in others. Adjustment and transition to new economic sectors and activities is therefore a priority, and the majority of member countries opt for policies of internal and especially, external diversification.
11. 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*.

population. The resulting demographic structure is often not appropriate to support provision of adequate local public services. Moreover, most rural regions have difficulty establishing the necessary critical mass of facilities, producer services and infrastructures to support economic development. Consequently, entrepreneurs face specific obstacles in starting up enterprises 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 locking regions in a sort of permanent under-development.

9. 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. As an example, a text on Austria shows that, although in average rural regions are lagging behind urban and intermediate ones, some rural regions perform very well, even better than urban ones.



Source: OECD/TSI

10. One way of explaining why certain rural economies perform better than others is through analysis of capital endowment (natural, physical, financial, human and social). As a result of location, history, and existing socio-economic structures, each region has different combinations and levels of capital endowment. The following table (tab.1) is the result of an exercise conducted by OECD on growing rural regions. It illustrates different forms of capital and shows which ones may be considered most critical to the success of predominantly rural regions. In order to *explore the paradox*, experts from several Member countries were asked to participate to a survey<sup>12</sup> where they named the three most important factors that

12 . The questions used to structure the interviews were the following:

What activities are the economic engines of the region? Share of total number of jobs? Contribution to total change in jobs number? Annual growth rate?

explain the success of individual leading regions in their own Country. The table presents the absolute frequency of responses. In many cases, the presence of public goods such as rural amenities is the factor that clearly emerges. Transport infrastructures and the existence of towns in the region or the vicinity of a major urban centre were often mentioned as important factors. Still, accessibility did not appear as a sufficient condition. In some cases, the most intangible aspects (entrepreneurship, cultural identity, participation, and partnerships) are the most important in making the difference. Arguably, what really counts for a region is not the availability of one form of capital or another, but the ability to properly exploit it. In other words, the difficulty is to transform stocks into flows: valorise natural and man-made assets, strengthen the economic environment, invest in human resources, improve the institutional capacity, etc.

**Table 1. The factors that make the difference for a rural region to become leading<sup>1</sup>**

Factors	Number of times factor was ranked among top 3
1. Natural endowments	
– Exploitable resources	8
2. Settlement pattern	
– Amenities (natural/man-made)	22
– Urban-adjacent	8
– Presence of towns	0
– High population density	0
3. Infrastructure	
– Transport	16
– Telecommunications	4
– Other	3
4. Production costs	
– Labour	6

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What are the main determinants that make the difference for the growth of the region? Natural, physical, financial, human or social capital?

Has the course of the events in the region been shaped mainly by exogenous (economic, social/political, policy) factors, or by endogenous (local) actions?

If national or other top-down policies influenced the determinants identified above, why were such policies more effective in this region than in lagging regions?

If endogenous factors were predominant, what were the critical actions/strategies undertaken by local authorities and civil society that could be described as the ingredients for the success of the region?

If there has been a significant change in trend (*i.e.*, a leading region starts lagging behind the national average), what was the main reason?

– Land and premises	4
– Other	0
5. Human resources	
– Skills of work force	5
– Entrepreneurship	6
– Work ethics	1
6. Innovation capacity	
– Research	3
– Training	2
7. Quality of the services	
– Producer services	2
– Consumer services	4
– Financial services	0
8. Local institutions	
– Public/private partnerships	6
– Local leadership	7
– Industrial relations	3
9. Regional identity	
– Political/fiscal autonomy	1
– Cultural identity	12
– Other	0
10. Other	
– Other	2

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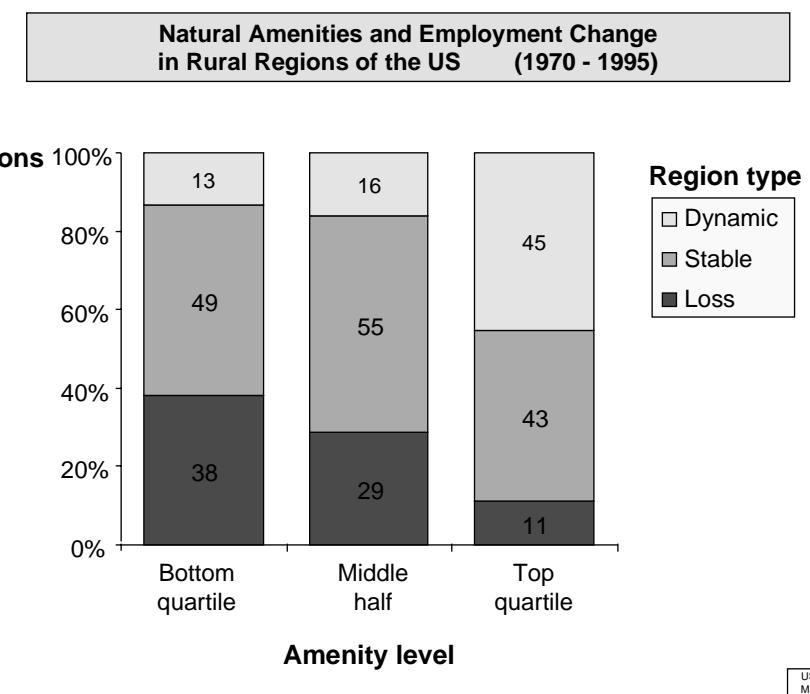
*b) New challenges for rural regions*

11. On the base of this exercise and of the results of the OECD Territorial reviews, it is possible to identify four main trajectories that have been followed successfully since the beginning of the 1980s in numerous regions: amenity-based development, diffuse industrialisation in an “urbanized country-side”, exploitation of natural resources and major public expenditures. Only the first two of the four have been forward looking.

### Amenity-based development

12. In almost all OECD Member countries successful rural regions contain important public or quasi-public goods such as a clean environment, attractive landscapes and cultural heritage (including food). These **amenities** can be the strongest specific asset at hand. Their increasing value is related with the growing demand on the part of urban dwellers for amenities, the improved transport links that make recreation in rural regions increasingly feasible as well as the emphasis on proximity to open countryside and natural amenities in residential location decisions. 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.

13. Relying not exclusively but in large measure on rural amenities, the area of Sienna, for example, has been able to improve its position relative to other Italian provinces in terms of per capita income. Employment creation has also been impressive with the province demonstrating high rates of labour force participation for men and women. But Sienna is far from being an isolated case. Tiroler Oberland (Austria), Mugla (Turkey) and Tasman (New Zealand) are typical regions that thrive on the tourism industry. Other regions, such as Engadina Bassa (Switzerland), Alpes de Haute Provence (France) or Dare County (United States) also attract workers, enterprises or retirees. In some cases (Peloponissos in Greece, Yamanashi-Fujihokuroku in Japan), the accessibility of the regions has been the facilitator of development, in other places remoteness has been turned into an attraction (Notio Aigaio in Greece, or Mie-Iga in Japan). Finally, a recent exercise conducted by David MacGrannan confirms at a more aggregated level the importance of amenities in rural development in the US.



Source: David MacGrannan/USDA

14. In this specific perspective, it is still to be fully recognised that a certain type of farming continues to play an important role in and remain a crucial tool for rural development. This is the case when farmers are engaged in the creation, maintenance and valorisation of distinctive places and products,

for example ensuring green credentials for marketing or directly contributing to the regional tourism supply. Farmers of such a type are far from being rare and isolated; they represent an important part of the farming activity encountered in the three rural reviews accomplished up to now. They witness of entrepreneurial opportunities that may create jobs, but remain often unexploited. The point is that in all successful cases farmers are actors of a restructuring process that encompass agriculture as one component of a comprehensive and space-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 are 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.

#### Diffuse industrialisation

15. Together with amenity-based development, the OECD regional reviews identified another main trajectory that has been followed successfully since the beginning of the 1980s in some regions that receives immigration and have an old tradition of industrial activities. They have been able to remain competitive in industries such as agri-food, clothing, wood transformation, toys or mechanical industries. Examples of rural regions with an old industrial tradition in manufacturing include the Jura (France), Viège (Switzerland), Bardajov (Slovak Republic) and Macon-Rabun (United States). There are also regions that have succeeded in a recent process of industrialisation. The southeast region (Ireland), Luxembourg (Belgium), Oberpfalz (Germany), and Hiroshima-Kamo (Japan) rank among these places. Generally, places with a diffuse industrialisation have benefited in recent years from two facts: *a*) activities such as accounting, software development, or the production and assembling of electronic components less and less require the physical proximity of markets to remain competitive; and *b*) increasingly the attractiveness of places for businesses is not determined by cost only, but also by factors such as availability of skills and quality of life. Still, even if cost is not the only location factor for enterprises, this type of rural regions face a permanent challenge to increase the competitiveness of businesses without the help of agglomeration effects and a well established local fabric of service provision. Thus, strong local initiatives, backed with specific national policy measures are often necessary ingredients.

16. Such a trajectory may orient the development strategies of many areas with already existent agglomeration of small firms. Still, given its basic requirements, a larger diffusion may encounter some obstacles. The above regions are the most similar to intermediate areas, almost sharing the same density of population and type of economic base. As such they differ from *predominantly* rural areas where, if any, industrialisation started much later or even failed to occur. In fact, in spite of some notable exceptions – those linked to industrial districts and clusters – many rural areas record below rather than above average enterprise creation rates. Some of the major constraints that impede the birth and development of new enterprises outside agriculture are well known. They include not only physical inaccessibility to customers and suppliers, but also a restricted occupational structure with limited range of skills and low proportion of educationally qualified individuals as well as difficulty in accessing external training. Some of these constraints may be amenable to policy action, but several are effectively beyond the reach of policy makers.

#### Exploitation of natural resources

17. Even if resource-based industries do not generally constitute an engine of growth for rural economies, there are some regions that succeed well in the exploitation of resources such as wood, oil, minerals, or hydro-electricity. As a matter of fact, the 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 (United Kingdom). 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 in the region.

#### Major public expenditures

18. Low population density can be an advantage for hosting establishments like prisons, dumps, waste recycling plants and nuclear power plants. Indeed, some rural areas specialise in such settlements, that, although beneficial to society, generate a certain number of nuisances. It may be questionable to base a rural development strategy on these types of establishments, but since they will be erected anyway, cost benefit analyses suggest they might as well be placed where the least number of people will be affected. The greatest difficulty with such a strategy is that even when these establishments are properly remunerated, they generate strong conflicts with other forms of development. One of the driving economic forces in the County of Ely (which ranks among the remotest places in the United States) is a federal prison. The province of Sanliurfa (Turkey) has reaped many economic benefits from the construction and development of a large dam. Both are extreme but illustrative examples of how some public investment of controversial nature manages to promote the development of specific regions.

#### *c) Choosing a strategy*

19. The results of the survey demonstrate that success for rural areas comes in several different forms and that employment creation and GDP growth can still be derived from traditional activities and interventions such as the extraction of natural resources or the location of government agencies and functions. Nevertheless, in terms of formulating policy recommendations for OECD national and regional governments, it is clear that the first two development trajectories -- **amenity-based development** and **industrial clustering and networking**-- offer the best sustainable prospects for the largest number of rural areas<sup>13</sup>. Moreover, work in both policy areas shows that the two are closely linked, with amenity-based development also being linked to adequate levels of entrepreneurship and enterprise creation in the local area, and high rates of enterprise start-up often linked to amenity-based activities such as tourism or environmental protection<sup>14</sup>. However, even when they exist, market forces cannot always grant adequate provision and valorisation of rural amenities or appropriate industrial clustering and networking.

20. In many cases, rural areas have amenities that are not yet, but could easily translate into private goods for which markets could be established. Higher disposable incomes, more sophisticated consumer preferences and a growing interest in ecology have widened the range of local resources considered as having marketable value. In this context, market segmentation, which creates demands for specific

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13. This results were confirmed at the conference organised by OECD in Albarracín (Spain) in 1997 where examples for successful development based on natural and cultural amenities were presented.

14. Over the past few years, the OECD has been collecting best practices in Member countries relating to both policy areas (cf., OECD, 1999d).

products and services, has opened up niche market opportunities that concern a variety of agriculture-related, industrial and service activities in rural areas. These opportunities include attracting visitors, retirees and enterprises by making use of natural beauty that offers good quality of life in combination with an adequate supply of consumer services, and in some cases financial incentives to incomers (*e.g.*, lower taxes or lower property values). It is likely that competition among regions will steer rural economies towards those niche products and services for which rural areas have a strong comparative advantage. However, some areas may face obstacles to overcome in capturing these new opportunities and require *pro-tempore* policy intervention to facilitate the implementation of development projects, remove imperfect knowledge and information as well as restrictions on access to resources. Other areas may be confronted with extreme cases of public goods -- the best known examples being those concerning the natural and cultural heritage -- for which a real market is and will be difficult or impossible to establish<sup>15</sup>. Thus, the arguments are about market failures and the required public intervention for valorisation may be more permanent in nature.

21. Obstacles may equally occur for what concern industrialisation. In spite of some notable exceptions, many rural areas record below rather than above average industrial performance. Some of the major constraints that impede the birth and development of enterprises are well known: the restricted occupational structure focussed on primary sectors and the low proportion of educationally qualified individuals, the difficulty in accessing external training and business support services, the poor communication infrastructure and the relative isolation, etc.. Although extremely complex, some of these constraints may be amenable to policy action in certain areas. Still, even in areas with industrial tradition and already existing agglomeration of small firms, co-operation among firms may be difficult to develop as well as niche products that may allow to be competitive in large domestic and international quality-goods markets. Labelling may provide an important means to develop brand-quality associations among consumers, manufacturing centres may support further diffusion of new technologies towards small firms; loan guarantee consortia may help removing obstacles in the financial system. Still, in the majority of cases these tools require a place-based policy to go with their design and implementation.

*d) Lessons for policy-making*

22. Despite shared challenges, the success of some rural areas is forcing a re-examination of the approach to rural policy. In this respect, the outcomes of the first series of territorial reviews have some important implications. First of all, more robust and versatile local rural economies need to be based on sufficiently diversified income sources. The most pressing problems lie with those localities where the rural economy is dependent upon a narrow economic base, with weak relationships among the actors belonging to the same local productive system. It follows that the focus of intervention to promote rural development and employment should be the regional economy (as defined on the basis of functional regions) so to ensure transformation and the development of new and distinctive economic functions, as rural areas redefine their comparative advantage in a changing world. In short, a shift from a sectoral to a territorial policy approach, including attempts to improve co-ordination and to integrate the various sectoral policies at regional and local levels.

23. Although there seems to be consensus about diversification as a core strategy for rural areas it is difficult to achieve in practice and to make an agreement over what it means for both the local and the national policy-making. The interests of the majority of rural citizens, and even most farm families, seem to be best served by a development strategy based on investments to built local assets such as basic services, to realise village renewal and development, to ensure conservation of rural heritage and to

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15. Because relevant markets do not exist and are difficult or impossible to create and because the 'utilities' involved cannot be considered and measured only in economic terms.

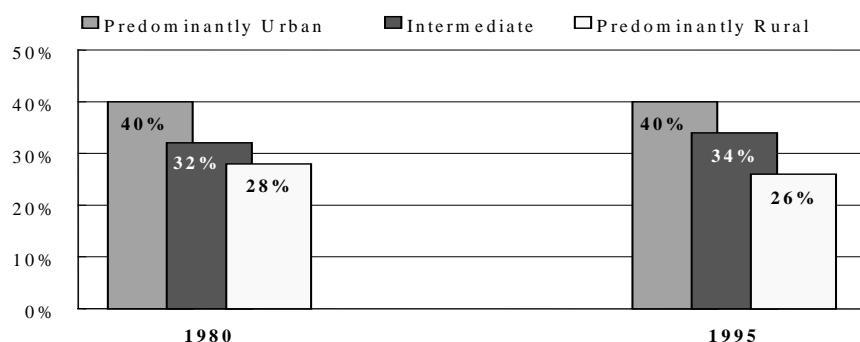
promote a skilled strategy for tourism as well as craft facilities. This is why a second implication derives from the first set of reviews: a shift from an approach based on subsidising sectors to one based on strategic investments to develop new activities and services. A third implication is that the valorisation of rural resources requires to carefully co-ordinate a large number of actors that provide quasi-public goods. Increased use of partnerships between public, private and voluntary sectors in the development and implementation of local and regional policies seems than crucial.

## **2. Intermediate regions**

### *a) Medium term trends for intermediate regions*

24. Many industrialised countries base a part -- some a considerable part -- of their economy and society on intermediate regions, i.e. regions where small firms<sup>16</sup> often constitute the main economic basis and small towns the main settlement basis. Moreover, these regions, both those located close to metropolitan regions and those in more remote areas, are often characterised by positive performance. In 1995, about 34 per cent of the total population lived there and over the last 15 years, they were often the only type regions to see an increase in population. They are often growing at the expense of rural areas, offering a critical mass of services and infrastructures that populations need. Moreover, their smaller size 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>17</sup> as well as dispersal of population down the urban hierarchy to smaller towns and into intermediate and rural regions<sup>18</sup>.

**Figure 1. Population distribution by type of region -- OECD average**



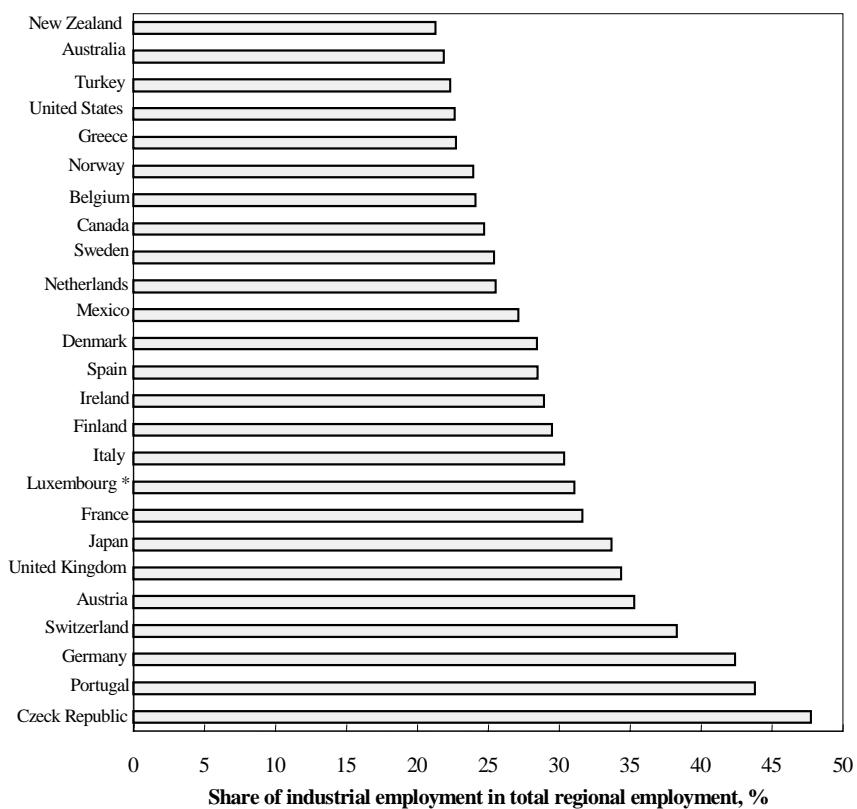
16. In many of the OECD's intermediate regions the proportion of SMEs is higher than at the national level.

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

18. 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.

Source: OECD TDS

25. When it comes to job creation, the picture for intermediate regions is more contrasted. It is not rare to find intermediate regions that have seen their job numbers fall, due to cases of traumatic industrial restructuring, with little capacity for mobility. Group of people have tended to stay behind, for a number of reasons: difficulty in selling their home, highly specialised skills but in sunset productions and low educational levels that make the shift to a new occupation difficult; and the intensity of family and community support networks. At the same time, the proportion of intermediate regions with employment gains is greater than the proportion where employment has dropped. This often correspond to areas were industrialisation and specialisation do represent an asset. Many of these areas relay on conception intensive activities that allow for a permanent up grading of skills and incremental innovation; flexible production processes and modern technologies to target fairly narrow segments and capture a particular part of the world market; small firms and co-operative relationships among firms that have the advantage of flexibility so to respond more nimbly by shifting production to change and instability. Other successful intermediate regions have been capable to play the role of small capital of areas with a relevant endowment of tourist amenities. Thus, at least in part, territorial statistics and reviews contradict the idea that the development strongly depends on the degree of urbanisation. They have shown that, contrary to one widely held view, metropolitan regions are not the only engines of economic growth.

**Figure 2. Industrial employment in intermediate regions in 1995**

\* Luxembourg is considered as a whole as an intermediate

Source: OECD TDS/TSI.

26. The Italian industrial districts (Box 1) are probably the most quoted example of successful intermediate regions<sup>19</sup>. After the Second World War, they greatly contributed to the dramatically structural change and development of North-Central Italy, where some regions, were transformed from bottom-ranked, rural regions into some of the most prosperous ones in Europe. In recent years, they help explaining some of the cases of local development in the South of Italy, as well (Viesti). Although the opinion of some researchers that in recent years have announced generalised signs of decline, several indicators suggest that they generally have kept their promises<sup>20</sup>. Comparative analyses show that in the

19. A crucial role in building the international reputation of industrial districts was played by the International Institute for Labour Studies which embarked on a programme of small firm studies in the mid-1980s. From the beginning the Institute paid special attention to the most developed Italian industrial districts because they demonstrated unusual economic success -- not merely in the Italian domestic market but also in the international market -- and at the same time they seemed to provide decent labour standards compared to other forms of small firm organisation. This prospect motivated the Institute to form in 1987 a network group of pioneer researchers on the field (G. Becattini, S. Brusco, M. Piore, C. Sabel, C. Trigilia, etc.) to examine closely industrial districts in Italy and in a number of other countries. The work of this network resulted in two major conferences at the ILO in Geneva and in Sao Paolo and in two major publications (Pyke F., Becattini G., and Sengenberger W., 1990; Pyke F., and Sengenberger W., 1992).

20 . In Italy, between 1981 and 1991, employment rose by 19,7 per cent, while the increase for the country as a whole was only 5,6 per cent. . This trend was particularly noticeable in business services, which grew by

last decade, districts have increased their weight on the national gross product, the national export, and the national employment. Moreover, they attained higher average wages and a higher rate of participation for women.

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64.4 per cent over the same period. Recent studies show that, even at times of recession, job creation, real wages and returns on investment have all been consistently higher in industrial districts than elsewhere. This record is even more striking when it is recalled that many of these districts are specialised in making goods such as clothing and footwear that are often considered vulnerable to low-cost imports. Sassuolo in Emilia-Romagna, for example, is Europe's largest producer of ceramic tiles. Carpi, where there are 2 068 knitting and clothing establishments with an average of 5 workers, produces sales of US\$1.3 billion. Another well-known textile-producing district, Prato, with 5 990 firms and 38 080 employees, produces 64 per cent of the country's woollen cloth exports. These examples show that even at a time of intensifying international competition it is possible to maintain solid economic health and employment in so-called sunset industries.

### **Box 1. The Italian local productive systems of small firms**

In Italy, since the early 1970s, increasing attention has been given by researchers and, with a certain delay, by policy-makers to a particular type of local development: small towns (from 15 000 to 100 000 people) where hundreds of specialised small firms belonging to the same industrial *filiere*' are concentrated.

Well-known examples in conception-intensive industries include Carpi (described above), Como which specialises in silk fabric, Prato in textile, Montegranaro in footwear, Sassuolo in ceramics, and Poggibonsi in furniture. Similar organisations exist in such industries as micro-mechanics, electro-mechanics, and machine tools, in which Italy has attained a considerable international reputation. Since the Second World War, Cento, Copparo, Guastalla, Sant'Ilario D'Enza as well as for Modena, Reggio Emilia, and Bologna produce a large part of the Italian export volume, and lead the world market. These local productive systems are called "industrial districts" when they have the following characteristics:

- Inside the limited geographic space -- the town or a group of closed small towns -- the economic relationships are particularly dense. (Thus, the socio-economic boundaries do not necessarily coincide with the administrative boundaries, a fact that can give rise to problems of governance).
- One specific industrial activity is largely prevalent in the local economy and the firms that are specialised in this activity are:
  - Mainly small, sometime medium-sized, never large,
  - Specialised in a small number of phases of the same process of production or filiere,
  - Sharing a mix of competitive as well as co-operative inter-firm relationships.
  - The community shares a local culture that is the mix of:
    - socio-cultural conventions: sense of belonging to the local community, trust, work ethics, conventions that run both the social relations among individuals and the economic relations among firms,
    - an "industrial atmosphere": the accumulation and diffusion in the local labour market of technical skills (including the ability to deal with international markets) and knowledge which supports the innovation processes.

A clear implication is that in industrial districts the social structure is weakly polarised.

### Box 2. Types of firms in industrial districts: the example of Carpi

#### *The size of the firms*

An industrial district generally has many micro-firms, a large part of small firms and few medium-sized firms. Their proportion is related -- among other things -- to technology. In the footwear industry, districts have firms with an average size of 9 employees, while in ceramic tale the average size is 50. In the case of Carpi, a well-known knitwear and clothing district, 88 per cent (2 319 firms) have less than 10 employees, 11 per cent have between 10 and 50 employees and just 1 per cent has more than 50 employees.

#### *The role of the firms*

In Carpi there are at least three types of firms:

- Final firms: firms that face the final market and sell mainly to wholesalers (44%), and retailers (38.5%). They purchase raw materials, control the work that is subcontracted, make styling and, often, make the sample preparation internally. They operate in different ways with respect to the market, and two particular cases can be identified:
  - Pre-programmed sample firm: the final firm programmes 12 months before the season and organises the sale of its models;
  - Just in time firm: the final firm produces within a month models at the request of wholesalers or importers who already know which models of other firms are selling well.
- Subcontractors: these are firms that are specialised in only one or a few phases of the process of production: knitting, cutting, assembling, embroidering, ironing, finishing or packaging. They have an average size of 3 employees and different clients (only 14 per cent of subcontractors have just one client).
- complementary firms: firms resulting from backward and forward linkages of the predominant production process. Some examples are: firms that produce containers, or that print labels or insignias on containers, firms that produce machines to be used by the firms of the industry, firms who deliver the products, and so far.

Note that there is no close relation between the size and the role that firms play in the district. 'Final firms' can be micro-firms (74 per cent have less than 10 employees). Note, as well, that the Carpi district exports 74 per cent of its production, thus even smaller firms use to export.

***The relations among firms***

- Concentration is weak. The 15 most important firms produce 30 per cent of the total production of the districts and employ 23 per cent of workers.
- Competition is certainly present. There is a market for almost each phase of the production process -- i.e., in each phase there are many producers but no one can control a significant part of the market. Cases where sub-contractors have only one customer are exceptional. There is little power concentration in the hands of individual clients.
- Co-operation is there as well. It involves some material relations (tools or raw material loans, and alliances for answering immediate orders) and some immaterial relations (exchange of information and knowledge). In general, it means that firms accept a certain degree of obligation in respect of other firms. Richardson compares firms to dancers: in co-operation firms dance together but when the music stops they can change partner. An important condition to permit co-operation is the existence of a common language and a skilled labour force trained in the dominant industry of the district. In turn, the agglomeration in the district assures the circulation of information, the transfer and creation of competencies and, thus, a "learning by living" is established (creation of an industrial atmosphere).

Source: "Il settore tessile abbigliamento - Un confronto tra sistemi produttive", Comune di Carpi, CCIAA di Modena, CEE-Comett.

27. Anyway, independently from their future destiny, they have already witnessed the existence of paths of industrialisation that diverge from those that have been conceived in the past, and modified some of most traditional convictions around industrial development. In fact, industrialisation seems to bear a cultural and institutional more ample variety than it was thought, and, besides, it can follow forms that are more articulate than those of large productive complexes. Moreover, industrial districts and a certain variety of forms of industrial organisation are not an exclusive Italian prerogative and concern a much wider part of OECD economies. Just to limit the list of cases to those encountered in territorial reviews, Alcoy, Ontenient, Castellon, Elda, Elche, Ibi (Spain), Troy, Cholet (France), Boras (Sweden) -- among others -- are examples of intermediate regions with the economy based on a continuum of small and medium-sized firms. As a result, policies should better keep into account industrial diversity and the place-based nature of some of the successful forms of development, but this does not seem always the case. The perception of a mosaic of dynamic non-metropolitan areas with specialised regional economies remains somehow vague. Despite the fact that intermediate regions have a comparable weight in terms of employment, total sales<sup>21</sup> and comparable rates of growth in population and employment, for large firms and metropolitan regions appropriate, and often very expensive, measures of policy have already been designed and implemented -- for example to face the organisational rigidity they may have -- while for local agglomeration of small firms in small towns a coherent framework is still lacking<sup>22</sup>.

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21. Available national statistics tend to limit the lowest size of firms that are counted in inquiries to a level that is higher than the average size of firms in many local productive systems. Moreover, the lack of precise analysis of input/output relations contributes to underestimate the importance of industrial development poles.

22. Somehow, the need for a tailor-made policy may be independent of the consideration as to whether these regions are better or worse than others. It may result from the relevance and specificity of existing cases, and from the hope of strengthening their competitiveness as well as ensuring in for the future the local employment, which already exists.

*b) New challenges for intermediate regions*

28. The lack of specific public policies would not in itself constitute a problem, given in particular the average successful results of intermediate regions. But not all intermediate regions are “in the same boat”. Even if they are not inevitably condemned to decline and some of them are rather displaying remarkable success, the following problems are often reported:

- The “loan gun” approach of the entrepreneurial culture often found in intermediate regions tends to downplay the role of education and management skills and to discourage the dissemination of innovative technologies. In fact, holders of university and post-graduate degrees are proportionately less numerous in intermediate regions than in urban regions. Additionally, the reduced size of most business is not easily conducive to technological research and partnerships among industry, employees and unions are required;
- The main transports network often by-pass intermediate regions and their smaller and medium-sized towns. This is a problem because while infrastructure alone cannot create growth, a lack of accessibility can slow it. Development policies should carefully consider secondary systems that provide links to high speed networks;
- Several regions 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. Consequently, they do not fully exploit the advantages of proximity in order to specialise in the same production chain and develop co-operation (i.e. they do not share the main traits of successful districts). As such they often fail in developing a local pool of skilled labour, in attracting buyers and suppliers, and in reducing unit costs by sharing activities such as marketing and technical services. 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. These features discourage flexible specialisation that might allow for production of differentiated goods with high value added as well as for keeping local wages high and unemployment low;
- Even when clusters of small firms are competitive and able to use and even produce innovations, they require a whole range of producer services that the market is not always able to provide. This is a particularly serious problem given that at a time of rapidly shrinking product lifecycles, swift access to information is a key determinant of economic growth;
- Small and medium-sized towns should co-operate so to build “polycentric metropolitan systems” or “metropoles policefai” and provide citizens with the advantage of a metropolitan quality of life, but cooperation and networking are rare. Equally rare are the efforts to build a common learning based on comparison among different experiences and exchange of best practices among intermediate regions.

29. Together with the will to face the above problems, a demand for specific public policies may be strengthened by the possible effects of the new competition emerging from countries 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 the enormous latent unemployment in their rural areas. The consequent permanent increase in competitiveness will affect in particular labour intensive or light industries, i.e. the traditional specialisation of industrial districts. The latter will be forced by fierce competition to permanently up-grade their processes and exploit any possible advantage in terms of quality, originality, luxury, design and innovation of manufactured products in order to forge new competitive assets and to refurbish the image of their brand names. In this context, policy will be required

to help specialised regions in moving from labour intensive activities into conception intensive productions. In other terms, policy will have to help intermediate regions escaping vulnerability by ensuring that their time for innovations in process and products will be shorter than time for copying in the “new dragons”.

c) *Lessons for policy-making*

30. The situation and trends apparent in many intermediate regions of Member countries raise a number of questions for which there are just preliminary answers.

- What can intermediate regions do to retain their existing advantages, in terms of competitiveness and the reputation of the specialised niches they now occupy? *Not necessarily to abandon the present specialisation.* The point is rather that intermediate regions in the OECD countries can no longer hope to compete on the basis of costs and prices. Their competitive advantage lies in their knowledge, skills, conception and product quality. To survive, traditional sectors will have to capture new market niches where quality is the uppermost consideration, and adopt policies that promote innovation, organisational flexibility (essential for adapting to shifting demand) and effective commercial techniques. Finally, they will have to adjust to new and innovative technologies. The maintenance of a dynamic industrial sector will itself be of help to the services sector -- some studies have shown that every new industrial job creates several service jobs.
- How can innovative technologies and products be introduced to revive industrial output? Several tools have been put in place, but an appropriate assessment of their respective advantages and disadvantages still need to be made. Supporting business training, easing restrictions and regulations that stifle new SMEs investments, providing mutual guarantee systems for bank loans to individual firms<sup>23</sup>, financing business start-up programmes have often played an important role. However, 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 firms into high-quality information circuits.
- How can locally elected people be persuaded to turn their efforts to intercity networks policies and horizontal co-operation between towns rather than competition? Intermediate regions lend themselves to the development of inter-city networking. Co-operation of this kind benefit from specialisation of SMSTs located close to each other and can allow SMSTs to enjoy facilities and services that they would never be able to afford on their own. What institutional reforms are needed to make the most of these networks and ensure their continuity? Co-operation 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. Realistically, co-operation must at least initially focus on a few carefully selected objectives. Generally speaking, economic development needs to go hand in hand with new methods of governance. Moreover, reforms are needed to transfer decision-making and financial authority from central government to the regional and local level. To be effective, such measures must allow for more independent management of local and regional finances, especially the right to tap into the local revenue base by levying charges and taxes. Regional or central government supervision may be the best way, at least initially, to ensure sound overall management and avoid abuses.

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23. 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.

31. Developing the above answers will require further examination of intermediate regions. Still a concluding point may be stressed by now. Although certain economic and functional characteristics are obviously important assets in determining a region's overall performance, case studies show that much of the explanation relies on intangible factors. Organisational skills, institutional capacity, community participation and democratic local management are all being increasingly recognised as ingredients of success. As Nobel prize-winning economist Douglas North has noted, there is no secret alchemy for converting labour, capital and technology into economic success. Social well-being relies on institutions, formal and informal, explicit and implicit. Social capital is as important as financial capital in promoting economic growth. Italy's industrial districts and some of the "clusters" found in the United States are proof of this. For intermediate regions where local production systems are most firmly entrenched, then, it is important not to overlook the role of civil society in ensuring sound local governance.

### ***3. Metropolitan regions***

32. Because of their extraordinary fluidity, complexity and diversified economic base, metropolitan areas often enjoy robust comparative advantages linked with polarisation effects. In some countries, the majority of the population is concentrated in the capital city and its metropolitan area and produces the bulk of the national economy. For instance, one Hungarian out of 5 lives in Budapest, which represents 34.5% of national GDP. The Central region that encompasses Budapest is responsible for 42.2% of the national GDP<sup>24</sup> and benefits from 65% of total foreign direct investments (FDI). In the capital region of Seoul, there is a concentration of more than 45% of the population, nearly half of the national GDP, 45% of total employment and 56% of FDI. In a federal country, such as Canada, one single metropolitan area is most often the main engine of provincial growth. Toronto, Montreal, Vancouver and Manitoba generate half or more of the GDP of Ontario, Quebec, British Columbia and Winnipeg. Moreover, in recent years some of the OECD metropolitan areas have experienced a rebirth sparked by the high-tech innovation spilling over from universities and R&D facilities. This generates more efficient knowledge transfers, a larger and more specialised workforce, and better markets for high tech goods and services. Finally, metropolitan regions are increasingly active in international policy forums. International networks of cities give rise to cross-border issues (as it is the case for Vienna-Bratislava), and solutions (*e.g.* the creation of a committee for governance in the Copenhagen and Malmo area). Often questions are about how national policies (taxation, labour market regulation, immigration, tariffs, etc.) may be adopted to local needs for mobility of labour and investments as well as for increasing the competitiveness of local enterprises. However, comparative advantages of metropolitan regions increasingly diversify and enlarge the limited opportunities concerning manufacturing. Growing importance of culture, the arts, and leisure (and the blurring of the distinction between leisure and shopping) will not only change metropolitan functions, but will also change the shape of cities.

33. Nevertheless, some metropolitan areas are severely hit by structural changes and there is no linear correlation between size of cities and economic performances. Cities with the same dimension may have completely different results. Some of them have been exposed to a significant loss of activity, and in the case of some port cities, of maritime commerce as well. Moreover, the problems of governance in large metropolitan areas may be more acute and difficult to solve, with public participation more difficult to nurture. Last but not least, poverty, crime, homelessness, and drug abuse often characterise metropolitan regions. Mexico-City is a clear example with 22 million people, many of whom live in extremely underdeveloped conditions. Poverty and other social ills often concern immigrant and minority populations, which are largely represented in cities (*e.g.* immigrants in Vancouver, Toronto, Montreal, Zurich, Geneva; Roma minority in Budapest and Aboriginal minority in Canadian cities). In most of these

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24. In this context GDP is an impressive indicator, but it use raises several concerns given its poor ability to represent the actual production in the city.

cases, social, economic and spatial problems are concentrated in some neighbourhoods. In ten OECD Member countries with about half the total population of the OECD countries, the proportion of people in large cities living in distressed areas varies from 7 to 25 per cent, approximately 10 percent of the national population (about 20 million people). The phenomenon of urban distress was unexpected. It continues to grow and gives rise to concerns about security. It is detrimental to the entire urban economy. These areas represent a loss of vitality and investment, and an accentuation of environmental, economic and social problems with spillover effects that are difficult to measure. In short, the social foundations of cities are perhaps less secure than previously.

34. The ability of cities to manage diversity on large scale calls for new policy measures, greater co-ordination of housing, education, social services and cultural activities, etc. Many large cities have a greater variety of ethnic, religious and immigrant backgrounds than the national average. They have long been distinctive as places where individuals and social groups can enjoy relative anonymity, and therefore greater freedom. The issue is to manage diversity is therefore not new; still it is becoming increasingly important for several reasons: because globalisation increases diversity and weakens homogenisation; because the ageing process (deterioration in dependency ratios) encourages immigration even further; and because urban social problems may interfere with multiethnic issues and give rise to concerns about security, leading to facile racist typing, and to demands for intrusive measures that limit privacy. In general, the problems of governance in large metropolitan areas may be more acute, and more difficult to solve. Public participation may be more difficult to nurture. As a result, there is a need for leadership initiatives to be undertaken by both the public and private sectors to rebuild the foundations of social capital.

35. Urban regeneration should represent an ongoing element of urban policy development in recent decades. New methods and approaches are being introduced which call for a greater role for quasi-public agencies, the private sector, greater community participation, and greater cross-sectoral integration. Area-based solutions involve integrating different parts of the city into the wider metropolitan region. Infrastructure investment is needed, not only to maintain existing facilities, but to modernise and expand them, taking advantage of innovations in construction technology as well as new I.T.. Combined with privatisation, decentralisation and fiscal constraints, there is a need for better public-private partnerships to finance infrastructure, which in turn require public support (social acceptability). The appropriate management and consideration of infrastructures are increasingly linked to sustainable development issues and synchronisation between economic development and environmental protection is becoming a top priority in the urban policy agenda. Problems of air quality, high noise levels, and congestion may encourage businesses and people to leave, but out-migration may only leave cities with high fixed costs, and at the same time, burden other regions with problems they are ill-equipped to manage. Moreover, restructuring and social change combine to release considerable space in cities for redevelopment (brown-fields), but these sites may be contaminated, and in any case, they often have an outdated infrastructure. The re-use of brown-field sites involves inventories, carefully developed projects, community participation, financing, job creation, etc., and progress is slow. Meanwhile, green-field sites are being developed at an accelerating rate, with consequences for wetlands, air quality, congestion, etc., which will be costly for the future.

36. Last, but not least there is a call for change in the governance of metropolitan areas and scope for policy dialogue and exchange of experience in this field. There are several issues that are of an increasing importance starting with the fragmentation of administrative jurisdictions within metropolitan areas, which results in lack of correspondence between administrative and functional territories. This situation results in area-wide consensus difficult to reach on important goals such as economic development, environment quality and social cohesion across the metro-region. Another important issue is the financial and fiscal ability of local authorities within the region, which face additional charges at a time when economic and social conditions have deteriorated and when major investments are undertaken to enable metro-region to

compete. Without mentioning the lack of a transparent, accountable decision making process. Despite the unique problems that must be faced, a clear definition of roles and responsibilities of the different level of government involved in the metropolitan areas is crucial and requires analysis in the future reviews at both national and regional level.

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

37. Together with first results concerning trends at sub-national level, the outcomes of the first OECD territorial reviews allow for important considerations about territorial policies. As reported above, territorial disparities within countries are significant and persistent; the opportunities for further development remain concentrated in certain areas; and even in-coming investments have had uneven localisation. In these circumstances it is not surprising that, in the countries assessed up to now, the lack of spontaneous cohesion raises concerns of equity and renews the interest for territorial policies. What is more interesting is that the demand for territorial policies tends often to come with the request for changing the traditional strategies and addressing new implementation problems.

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

38. 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 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, 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.

39. 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 balance 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 an equitable way 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.

40. An increasing number of countries are looking for a paradigm-shift in policy-making, grounded in the analysis of the failure of policy driven by compensation to correct structural problems. Such a paradigm-shift requires re-defining the main component of the policy:

- **Strategy:** efforts are oriented toward a switch from sectoral approaches to place-based integrative development strategies. Keeping into account the challenges of sustainable development, policies should focus on local assets that have remained untapped. They should support the competitiveness of places, by valorising their capacity to innovate, by exalting entrepreneurship and by permanently upgrading human and social capital. The aim is to reduce structural hurdles by addressing the problems of the local business environment (infrastructure, access to capital, training/education) so to provide a viable basis for growth rather than masking regional disparities with cash transfers;
- **Targets:** territorial policies should not exclusively address regions lagging behind. Under-developed areas should be helped in exploiting potentials as well as already existing “poles” in preserving their competitive advantages.
- **Tools:** Subsidies, by themselves, are not able to trigger long lasting development and may have even hampered it by creating distortions. In order to stimulate the local economy and help attracting investments, they need to be coherent with a public investment competitive strategy, valorising endogenous resources and providing the conditions for self-sustaining growth at the local level. Direct payments should be transformed into investments and measure to improve the quality of the local environment. Specific targets of a public investment competitive strategy include the promotion of services provided by research institutes, science and technology parks, technological centres, as well as traditional infrastructures (airports, highways and the like).
- **Actors:** governance (that relates to conditions needed to design, implement and monitor policies, including public participation and accountability) should abandon a rigid top-down perspective in order to adopt a combination of fiscal federalism and partnerships.

## ***2. Implementing the new paradigm***

41. Together with changes in the main component of policies, the efforts of countries engaged in reshaping territorial policies increasingly explore some solutions for problem solving. Two issues in particular appear to be crucial: enhancing spatial planning and designing and implementing a governance reform.

### *Rethinking spatial analysis and planning*

42. In many cases, policy-making continue 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. 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.

43. Some examples may help clarifying the above point. Italy when detected through statistical analysis at the adequate territorial level provides an unexpected picture for some of its less developed areas. Many observers know that most of the Italian southern regions were able to catch up with the more advanced North during the 1950s and the 1960s. On the contrary, from the 1970s Southern regions appeared to have diverged not only from the “industrial triangle” (Turin, Milan, Genoa), but also from the so-called “Third Italy” (the centre and north-east of the Country), which have been shown spectacular growth. As a consequence, researchers and practitioners have often concluded that Italy was condemned to a permanent dualism, with little margin for territorial policies. Recently, a trend analysis based on local labour market areas reveals 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.

44. 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. In both cases, the functional organisation of the countries overlaps with their politico-territorial structure that dates decades or even centuries back, creating various gaps and inconsistencies in policy-making. 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.

#### *Designing and implementing a governance reform*

45. 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 from the first reviews 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 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.

46. 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. However, decentralization does not so much transfer responsibility away from the national government as alter its responsibilities and require a *Governance reforms*. 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 design and implementation. Thus, the capacity to involve all relevant actors 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*.

47. 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. 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. This could bring to produce new tools such as contracts, 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. But it also 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.

## V. To sum up

48. The first general conclusion from the recent work conducted by OECD is that competitive or winning regions exist in all types of regions. Still, the world economy is often regarded as taking on the territorial form of an archipelago, in which large cities would be the islands<sup>25</sup>, the essential spatial nodes of the global economy. The on-going systematic approach to territorial benchmarking and the territorial reviews in metropolitan regions will certainly provide a contribution, discussing this assumption in greater detail. Still the accomplished territorial reviews at both national and regional level, as well as the work on

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25. This metaphor was suggested originally by P. Veltz (1966) and has been taken up by a large number of researchers. It masks a finer and subtler inter/intra-regional pattern of settlement than the one adopted by its followers. In it, large cities are merely the visible elements and, in functional terms, the major hubs of a reach and dense global system.

territorial statistics, point out a more complex picture for metropolitan regions and at the same time they show that intermediate and rural regions, as well, play a vital role across the OECD countries.

49. Some of the extremely developed OECD metropolitan areas have experienced a rebirth sparked by the high-tech innovation spilling over from universities and R&D facilities. Nevertheless, other metropolitan areas are severely hit by structural changes and there is no linear correlation between size of cities and economic performances. Moreover, poverty, crime, homelessness, and drug abuse often characterise metropolitan regions. As for clusters, the reviews conducted<sup>26</sup> provide examples of competitive small firms advantaged in their co-operation by their network relationships. Still, several regions have a continuum of small and medium-sized firms that, although close to each other, are simply juxtaposed, face high transaction costs in business-to-business relationships and are incapable to develop co-operation so to exploit the advantages of networks. Rural regions even when endowed with beautiful natural and cultural amenities that can constitute significant territorial assets for economic regeneration do face particular challenges. In fact, even if farming is still important in shaping rural land use, employment opportunities in primary industries are declining and rural is no more synonymous with agriculture. The same is true for public sector employment. In a climate of fiscal restraint, it is likely to contract. Moreover, out-migration of young people caused by both lack of employment opportunities and inadequate access to educational and leisure facilities, along with in-migration of retirees in some places, has led to the significant ageing of the population. The resulting demographic structure is often not sufficient to support provision of adequate public services including economic services of a general interest

50. In order to face the above problems and opportunities a shift has been noted relating to territorial policy. In particular, a new focus on trying to improve the ‘competitiveness’ of regions, and hence to understand the key elements which appear to be ‘performing’ well from those which are not. This implies attempts to divert resources from programs that focus on subsidies to programs that focus on support for investment in human and social capital, diversification of economic activity and the related creation of new enterprises, key infrastructure, the environment, and innovation. There are important consequences for the choice of policy instruments with an emphasis on business assistance and infrastructure, networks of knowledge and expertise, diffusion of new technologies and R&D, inter-regional and international business networks, vocational training, (including an important emphasis on entrepreneurial skills). One of the most important targets is capacity building for policy actors at the local level, including the increasing use of programme monitoring and evaluation procedures both as a control and a learning mechanism. In fact, these refinements and innovations are recent and limited in scope to certain OECD countries.

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26. In Champagne-Ardennes (France), Comarcas Centrales Valencianas (Spain) or in Bergamo (Italy) as well as the case studies in Modena (Italy) and Boras (Sweden).