# Introduction

In the aftermath of the financial crisis, and against the background of a prolonged economic recession, the first priority for policy makers across the OECD and beyond has been to strengthen the world's financial system. The next challenge is to support demand and employment creation during the recession in a manner that helps the subsequent recovery to be swift, smooth and durable, as exemplified by the current emphasis on green growth. Regional policies should contribute to this unfolding policy agenda. With this in mind, this report looks at patterns of regional growth across OECD countries, reviews the rationale for regional policies and explores current policy practice. The objective of the report is to identify ways that regional policies can be made more effective in meeting current and future economic, social and environmental challenges.

Over the past few years, OECD countries have promoted a new approach to regional policy, moving from subsidising businesses and employment in poorer regions to promoting growth in all types of regions. This new approach is more complex and nuanced than earlier versions, and as such it is also potentially more fruitful. Instead of a zero (or even negative) sum game of taxing high-wealth areas to subsidise activities in low-wealth ones, the accent is rather on the positive sum game of mobilising resources, notably by encouraging innovative business (and public sector) practices.

Developing strategies that will have an impact on the competitiveness of a given region involves identifying the sources or potential sources of the region's competitive advantage. A wide range of factors could be targets for policy. Moreover, these advantages are not static but evolve, sometimes rapidly, over time. A region that is at a competitive disadvantage because it is distant from domestic markets can find itself instantly more competitive when trade barriers are reduced with neighbouring countries. In many rural areas, changing lifestyle preferences mean that amenities (natural and cultural public goods such as a clean environment, landscape and cultural heritage) represent an increasingly valuable endowment that can contribute to increasing competitiveness. Potential for economic growth can also be realised through administrative reform. Arbitrary administrative boundaries often inhibit the exploitation of economies of scale, impose additional transaction costs on enterprises and restrict mobility and resource allocation in the labour market. This implies that there is no one-size-fits-all policy: similar regions in different countries will often benefit from different policy approaches.

The capacity of a region to attract and retain mobile resources such as domestic and foreign investment, innovative firms and skilled labour, depends importantly on the quality of services produced or supported by public action (transport and communications infrastructure, research institutions, information for businesses etc.). In certain cases, subsidies and state aids may effectively compensate for market failures by helping new firms to access research and technological innovations. However, excessive direct support distorts competition between regions and may contribute to the emergence of a culture of dependency. There are alternatives to a subsidy-based approach around which a proactive regional strategy can be built. These alternatives involve better use of traditional investment instruments, such as physical infrastructure development; as well as less tangible or soft investments, such as human and social capital. In each area, the objective is that governments at different levels provide collective, locally-targeted public goods, appropriate to the specific needs of rural and urban areas, to encourage and facilitate private initiative and enterprise.

This report argues that regional policies now go beyond a traditional distinction between top-down and bottom-up approaches. Policies to target public investments, both hard and soft, now depend on clear multi-level governance in which each level of government and each actor contributes to the vision and the policy design and, equally importantly, to the implementation of these policies. A multi-level governance approach will address the range of potential areas of public investment: infrastructure and public-goods provision, human capital formation and mobility, as well as business environment and innovation. National governments are best placed to decide on national development strategies. Lower levels of government are better placed to know where the investment priorities lie within their territories, and also better placed to involve private-sector actors in regional development.

This new approach suggests an important role for regional policies in the context of economic recovery and the search for sustainable growth paths. Although responses will vary from country to country, regional policies can play a role in a number of specific ways that are relevant for economic:

- *Accelerating and maximising the impact of public investment.* Territorial development policies often have defined and agreed development strategies for integrating investment projects across economic, social and environmental sectors. Even if governments want to stimulate economic activity through infrastructure development, pushing investment projects forward can be difficult without clear roadmaps based on agreed priorities, needs assessment and stakeholder buy-in. Regional development strategies often represent such an agreed and validated road map that brings together both economic and environmental objectives. Furthermore, integrating regional investment projects into a coherent national strategy can augment their multiplier effects.

- *Combining different types of investment to maximise their impact on sustainable growth.* OECD analytical work confirms that infrastructure investment alone does not produce growth. Many countries are now reviewing their approach to regional investment to give a higher priority to "soft" infrastructure: human capital development and innovation support in particular. In an economic crisis, the temptation to invest heavily in hard infrastructure is strong, but evidence from OECD countries suggests that a more integrated approach will have a better impact on growth.

- *Effectively targeting regions in need.* Regional policies are the natural mechanism for focusing investment on specific regions or communities that face specific economic, social or ecological pressures. In the past, regional policies have been used repeatedly to support restructuring of regions in crisis (modernisation of industries, promoting entrepreneurship, reskilling workforces, redeveloping brownfield sites, promoting preservation of natural amenities, etc.). As such, there is an accumulated experience with policy instruments and approaches that will help address the asymmetric economic and social impacts of the crisis.

- *Ensuring co-ordination at the central level.* Regional policies involve institutions that co-ordinate actions among government ministries – economy and finance, science and technology, education, environment, and so on. In the context of strategic recovery or green growth programmes, such co-ordinating bodies could help to ensure that investment strategies are coherent across sectors.
- *Harnessing the experience of regional development agencies.* Regional agencies and similar bodies responsible for implementing regional investment strategies can be a credible conduit for recovery-related investment programmes. In general, compared to line ministries, these are more private-sector oriented and flexible and can respond more rapidly.
- *Ensuring that local and regional knowledge, funds and capacity are mobilised.* Regional policies often use well-developed mechanisms for co-ordination between the centre and the sub-national level. These mechanisms help to ensure transparency and coherence. In most OECD countries, the sub-national level is responsible for most capital investment. As such, close co-ordination will be required to ensure that local investment and national investment priorities are aligned so that long term, green growth objectives are achieved.

The report is structured as follows: Chapter 1 reviews the evidence behind some key issues in regional policy (such as the role and limits of concentration in generating growth, the role of lagging regions in national economic performance and so on). The report uses a pioneering econometric growth model designed to fit the regional level to explore the sources of economic growth and hence the potential targets for policy intervention. Chapter 2 then discusses recent policy experience in the policy fields that appear to be the most significant for sustainable regional development, namely, infrastructure, human capital development and innovation, as well as looking at the evolution of sustainable urban and rural policy formulation and implementation. Chapter 3 the report looks at how governance of regional policy helps to determine the effectiveness of policy by overcoming problems of asymmetry of information, helping to better mobilise local knowledge and skills and improve the coherence of policy action across levels of government. Finally, Chapter 4 looks in turn at growth patterns in each OECD member country, illustrating on a country-by-country basis the analysis presented in an aggregate form in Chapter 1.