OECD Regional Outlook 2014

Regions and Cities: Where Policies and People Meet

October 2014

Regions and cities are on the front lines of the battle for inclusive growth

The crisis has put a halt to the convergence process and in many cases increased inter-regional disparities in income and jobs. In the period prior to the crisis, there were still signs of the poor regions catching up to the richer ones. Since the crisis, that process seems to have stalled. Furthermore, disparities in regional GDP per capita have increased in half of OECD countries. In the other countries where the gap decreased, this is typically due to worsening conditions in the leading region rather than improvements in the lagging region. In 10 countries, more than 40% of the increase in unemployment over the past 5 years was concentrated in one region.

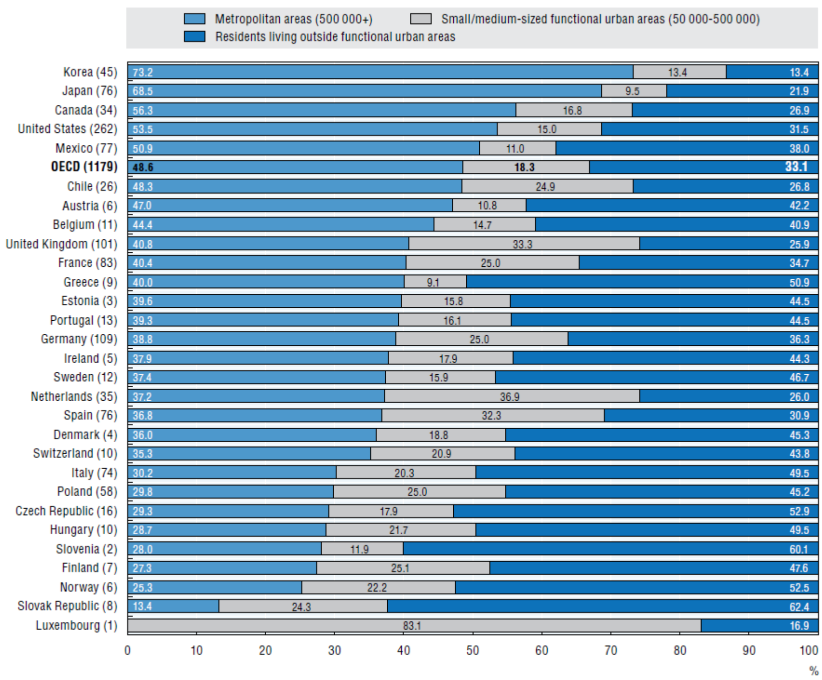
Inequality continues to be observed in other factors that determine well-being, such as health, air quality or safety. In some countries, residents in one region may expect to live several years less than their counterparts in another region. If we want to tackle these and other challenges to promote growth in a form that is inclusive, we need to better target and mobilise efforts in the cities and regions across the OECD.

Getting cities right can have considerable economic, social and environmental benefits

The focus in this edition of the Regional Outlook is on cities of all sizes. Urban areas, as measured by the OECD Metropolitan Database, take into account the realities of our living and working patterns and thus go beyond administrative city limits. There are many reasons for policymakers to take a closer look at cities:

- **Most people live in an urban area**. Two out of three OECD residents live in an urban area of at least 50 000 inhabitants. One out of two OECD residents lives in large cities of 500 000+ (Figure 1).
- **Cities have high levels of productivity and can have far-reaching growth impacts.** They have a significant influence on the growth of the other regions where they are located, as well as on the national growth potential.
- **Better management of cities can reduce many of the disadvantages of urban areas to improve well-being.** Shorter commuting times, safer streets, a lower level of air pollution and access to quality public services depend on more coherent planning at the metropolitan scale.

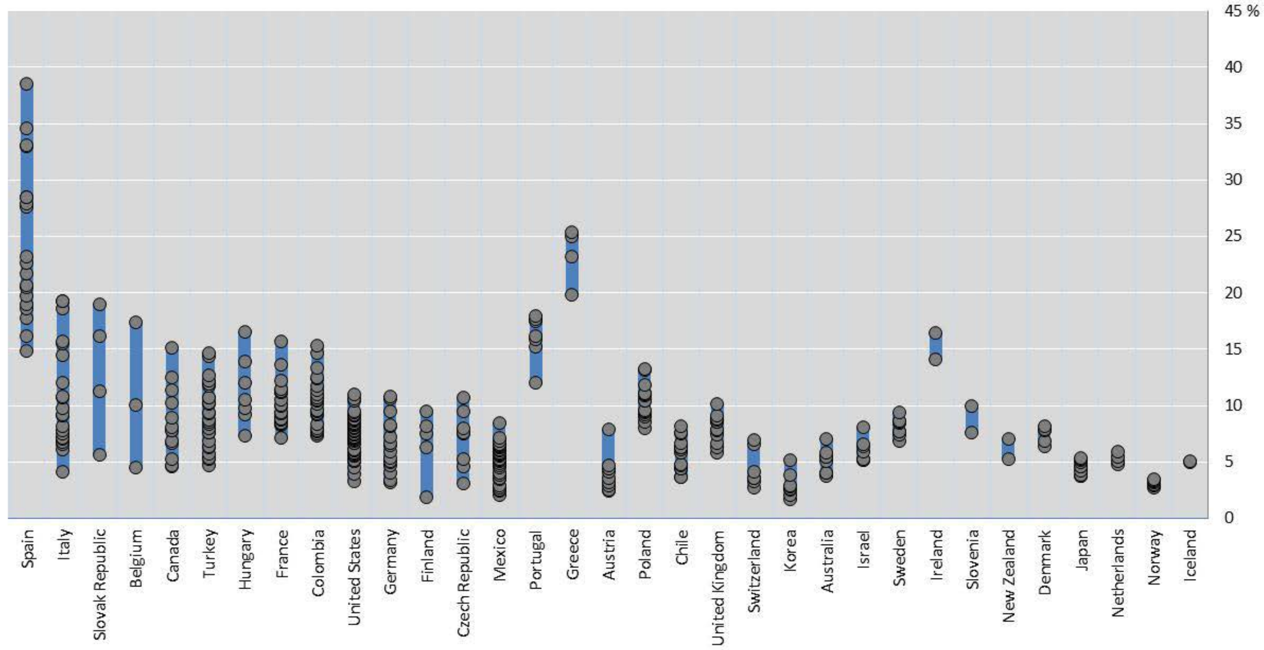
Figure 1. Two out of three people in the OECD live in and around cities



Source: OECD Metropolitan Database

Figure 2. Access to jobs remains highly unequal across regions

Regional variation in the unemployment rate



Source: OECD Regional Database, Territorial Level 2 regions, 2012 data.

Access to jobs depends in part on the region where one lives

Unemployment levels remain one of the biggest regional development challenges. The overall unemployment rate in the OECD area grew from 5.6% in 2007 to 8% in 2013. The youth unemployment rate is around double those figures. The range in rates among regions in the OECD was 32 percentage points, almost twice as high as the difference across OECD countries (18 percentage points) (Figure 2). Inter-regional differences for the most vulnerable unemployed (youth and long-term) are larger than for unemployment more generally. In almost half of OECD regions considered, one third of the unemployed were long-term unemployed, meaning they were looking for work for more than a year.

Urban and rural regions experienced the crisis in different ways

The crisis affected urban and rural regions in different ways. Regions classified by the OECD as predominantly rural experienced a lower decrease in gross domestic product (GDP) per capita than predominantly urban regions (a -0.2% compared to -0.6% decrease per year for the period 2008-10). The growth patterns of rural regions are more varied than those of more urbanized counterparts. Rural areas closer to cities have a greater variability in growth patterns. Their fate is often driven by their economic and demographic linkages with urban areas.

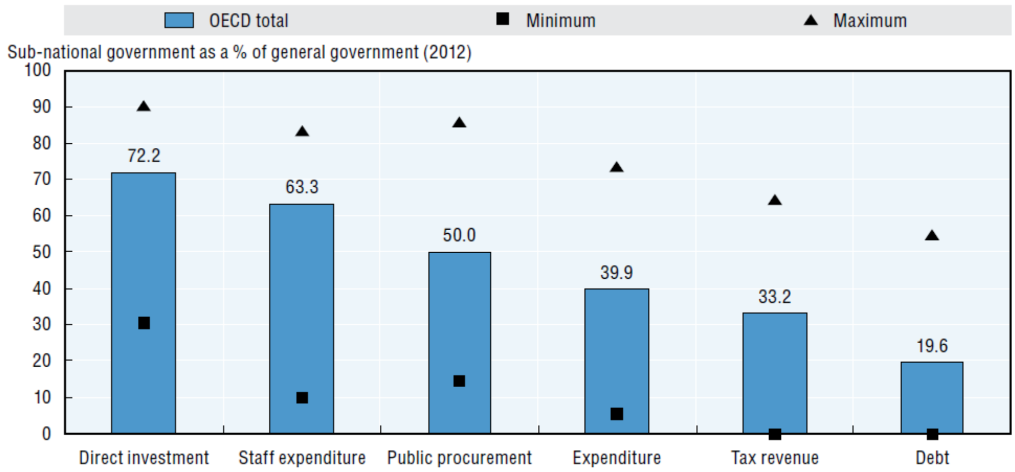
Regional development policies need to recognise the relative importance of growth drivers in each region

Policies to promote regional development over the last several decades have gone through many phases. Such policies began with a focus on subsidies and redistribution, and gradually moved towards efforts to attract companies through financial incentives. Today, there is a focus in many countries on supporting regional growth drivers such as skills and education, business development and innovation. Evidence shows that education is a significant factor for growth in all types of regions, with often the bottleneck being the number of workers with minimal education. Over a third of OECD counties house the regional development policy portfolio in ministries of the economy or commerce given this focus on competitiveness. There is also increasing attention to environmental sustainability and well-being. The capacity of sub-national governments to make the right investments and deliver public services for both growth and inclusion remains a core issue in regional development efforts.

Evidence also calls into question the traditional urban-rural divide in regional development approaches. For rural areas, recognising the links with cities is one important step. Rural-urban partnerships are governance arrangements that make these inter-relationships more explicit. The wider variety of growth drivers in rural areas also calls even more for tailored, place-based approaches than in urban areas, where growth drivers tend to be more similar.

Sub-national government finance and reforms

Figure 3. Sub-national governments play a key role in public finances



Source: Based on data from OECD (2013), "Sub-national governments in OECD countries: Key data and OECD National Accounts.

Finances of regional and local governments continue to be squeezed

Sub-national governments have sought to preserve current expenditures that support basic services such as education and health. Together they account for around 44% of sub-national expenditure across the OECD. Increases in such expenditure have outpaced revenue increases, limiting the fiscal space for sub-national governments to make public investments. Of the almost USD 1.2 trillion in direct public investment across the OECD area, 72.2% was undertaken by sub-national governments in 2012 (Figure 3). The annual volume of sub-national investment declined by 4% in 2012 relative to 2007 in real terms, and by 13% from its peak in 2009. At the same time, sub-national debt has been on the rise, reaching 22% of GDP in 2012. Sub-national gross debt per capita has risen 14% from 2007-12, representing an increase of around USD 1 000 per capita.

Sub-national governance in many countries is fragmented and outdated

There are almost 141 000 general-purpose sub-national governments in OECD countries, alongside tens of thousands additional special-purpose governments. An average municipality in the OECD has 9 115 inhabitants, ranging from 220 285 inhabitants (Korea) to 1 680 (Czech Republic). There are countries with one, two or three government layers below that of the central government.

The boundaries of towns, cities and regions were often set in world very different from today. The boundaries of France's *départements*, for example, were drawn on the basis of travel to and from the administrative centre in one day on horseback. Sweden's counties have had similar boundaries since 1634, albeit there have been some recent mergers. Most of Switzerland's cantons trace their roots back to the Middle Ages.

Many OECD countries are implementing reforms to redraw the map of towns, cities and regions

Reforms of local governments have been planned or completed in half of OECD countries in the last 15 years (see Table 1). They tend to take three forms:

- **Municipal mergers:** to reduce the number of municipalities and increase their scale in terms of geography and population.
- **Inter-municipal co-operation:** to encourage arrangements that allow local jurisdictions to work together for certain common services or investments.
- **Metropolitan governance:** to address the special needs of larger cities and surrounding areas (see later section).

Reforms of sub-national governments may involve top-down decisions or bottom-up choices for merging or associating, either all at once or progressively. The national government may require all municipalities or other levels to merge according to a predetermined plan. Alternatively, national governments may also require mergers but allow individual municipalities, intermediate layers or regions to choose their own partners, sometimes at their own pace and sometimes with a pre-set deadline. Some countries have had successive waves of reforms. However, studies on the actual cost savings associated with municipal mergers offer mixed results, often since the reforms come hand-in-hand with changing responsibilities that take a long time-frame to implement.

Table 1. Municipal and metropolitan reforms: Selected countries

	Municipal mergers		Inter-municipal co-operation	Metropolitan governance	Comments
	One-shot	Prog-ressive			
Denmark	1970 and 2007			Special status given by 2007 reform to Greater Copenhagen	• 1970: from 1 386 boroughs and municipalities to 275 • 2007: from 271 to 98
Estonia	2014-17		X		• A municipal merger policy planned for 2014-17 would merge the current total of 215 municipalities (October 2013) into a total of 30 to 50 municipalities.
Finland	2014	X		Planned reform for Helsinki Metropolitan Area and other urban areas	• 2014: A new municipal merger policy is planned on a bottom-up basis, excluding 10 municipalities in urban areas.
France	1971 and 2010		X	New metropolitan status (2013)	• Failure of the 1971 merger policy (Marcellin law) as well as of the 2010 territorial reform creating the status of "new municipality" (commune nouvelle for the merged entity). • Law December 2013: new metropolitan status for 14 metropolitan areas. • Act III of decentralisation (2014-15) could encourage further municipal mergers.
Germany	Territorial reforms designed and implemented by individual *Länder* (mergers, inter-municipal co-operation).				• Several municipal mergers were carried out by the *Länder* in the 1970s (Baden-Württemberg, Hessen, North Rhine-Westphalia), after 1990 in the former East Germany (e.g. in Brandenburg in 2003) and, more recently, in Saxony-Anhalt (from 1 015 municipalities in 2008 to 222 in 2012). Mergers are planned in Rhineland Palatinate for 2014. • Overall, the number of German municipalities decreased from 16 216 in 1990 to 11 327 in 2012 (a drop of 30%).Inter-municipal co-operation is also strongly encouraged by the *Länder*.
Greece	1997 and 2011			New status for Attica and Thessaloniki.	• 1997 (Capodistrias plan): from 5 825 to 1 033 municipalities and communities • 2011 (Kallikratis reform): from 1 033 municipalities and communities to 325 municipalities and regional status for the metropolitan areas of Attica and Thessaloniki
Japan	1953 and 1999	X (since 2005-06 laws)			• 1953 (Great Shōwa): from 9 868 to 3 232 • 1999 (Heisei no Daigappei): from 3 232 to 2 190 • 2005-2006 (new laws): from 2 190 to 1 719 today • Today: The objective is to reach around 1 000 municipalities, but no timetable has been established.
Nether-lands		X	X	Plan to abolish city-regions	• The current policy framework favours municipal mergers (May 2013). • Inter-municipal co-operation is encouraged, for instance through shared services centres (e.g. for social services). • 2014: Bill abolishing the eight city-regions (WGR+ regions) by January 2015.
Turkey	2008 and 2012			Metropolitan cities status	• 2008: "Scale Reform Act": compulsory amalgamation for municipalities with fewer than 2 000 inhabitants. Reduction from 3 225 to 2 950 municipalities. • 2012: a law published in December 2012 reduced the number of municipalities from 2 950 to 1 395, as of March 2014 elections. • 14 new "metropolitan cities" will be established in addition to the existing 16 after the March 2014 elections, under the 2012 Law.
United States	Territorial reforms designed and implemented by individual states (mergers, inter-municipal co-operation).				• From 1952 to 2012, the number of municipalities (including towns and townships) has increased by 5.5%. Over the same period, the number of local special-purpose entities, e.g. school districts, has decreased by 36%.

Appropriate co-ordination mechanisms can also address government fragmentation

Many of the main challenges for governments concern collaboration for public investment. This is difficult, even in situations where the actors involved recognise the need for it. Transaction costs, competitive pressures, resource constraints, differing priorities and fears that the distribution of costs or benefits from co-operation will be one-sided, can all impede efforts to bring governments together. Collaboration across jurisdictions and levels of government takes time, has a learning curve and has different types of costs, which tend to rise as the number of jurisdictions rises.

Different mechanisms can help limit costs and maximise benefits of co-ordination across policy sectors or levels of government. They include: defining targets of co-ordination upfront, establishing credible co-ordination mechanisms, with incentives and clear political engagement, allowing flexibility in their implementation, and avoiding too many instances of co-ordination, which can be counterproductive. Tools to do so include co-financing, special conditions ("conditionalities"), and inter-governmental contracts, for example. Other important factors include a high degree of transparency and trust among actors, as well as information-sharing mechanisms with citizens, private actors, non-governmental organisations (NGOs) and local actors. Leadership, which can be found at all levels of government, is also critical in resolving the collective problems that co-ordination poses.

Strong framework conditions can improve sub-national government integrity and efficiency

A range of factors shape the environment for sub-national investment decisions. There are risks to integrity throughout the investment cycle that can undermine the effectiveness of sub-national investment. Transparency and strategic use of public procurement is relevant for sub-national governments since they are responsible for half of procurement in the OECD area. However, sub-national governments often lack procurement know-how or specialised personnel. Well-designed and well-implemented regulatory systems at all levels of government can facilitate investment and reduce unnecessary costs. Efforts to reduce the administrative burden for sub-national governments can be helpful – particularly for small ones where the proportion of resources dedicated to administrative functions is greater than for their larger counterparts.

Capacity for good investment decisions at sub-national level needs to be reinforced

Empirical evidence shows that public investment and growth are correlated with the quality of government, including at the sub-national level. Strengthening regional and local governance capacity, from the selection of projects to their execution, enhances the potential of investment, the priority being to address the most binding capacity constraints.

Mobilisation of private actors and financing institutions can diversify sources of funding and strengthen capacities. Private sector actors can play different roles at different stages of the public investment cycle, but risks of capture by specific interest groups need to be managed. Despite the potential benefits, private sector involvement in sub-national public investment remains relatively limited. The selection and implementation of an investment can be more successful if stakeholders are engaged throughout the investment cycle. Involving stakeholders, such as citizens, universities and the private sector, can thus improve the quality of planning efforts.

OECD Principles of Effective Public Investment Across Levels of Government

Pillar I: Co-ordinate public investment across levels of government and policies

- Invest using an integrated strategy tailored to different places.
- Adopt effective instruments for co-ordinating across national and sub-national levels of government.
- Co-ordinate horizontally among sub-national governments to invest at the relevant scale.

Pillar II: Strengthen capacities for public investment and promote policy learning at all levels of government

- Assess upfront long-term impacts and risks of public investment.
- Engage with stakeholders throughout the investment cycle.
- Mobilise private actors and financing institutions to diversify sources of funding and strengthen capacities.
- Reinforce the expertise of public officials and institutions involved in public investment.
- Focus on results and promote learning from experience.

Pillar III: Ensure proper framework conditions for public investment at all levels of government

- Develop a fiscal framework adapted to the investment objectives pursued.
- Require sound and transparent financial management at all levels of government.
- Promote transparency and strategic use of public procurement at all levels of government.
- Strive for quality and consistency in regulatory systems across levels of government.

Note: The Recommendation of the OECD Council was adopted on 12 March 2014.

A spotlight on cities

OECD countries have different networks of urban areas

Some countries have a large share of their population living in urban areas, such as Korea (87%), Luxembourg (83%), or Japan (78%). A few countries have half or less of their population in urban areas, like Greece (49%), Norway (48%) or several Eastern European countries. However, the urban experience is not the same in a city of 50 000 or one of over 2 million. For example, in both Chile and the Netherlands, around 70% of the national population lives in urban areas. In Chile, around 70% of the urban population lives in cities of 500 000 or more, while in the Netherlands, only 50% of the urban population lives in these larger metropolitan areas. And while only half of the population of Greece is in an urban area, 64% of them live in a large urban area (over 1.5 million).

Larger cities tend to have higher productivity levels

In many OECD countries, labour productivity (measured in terms of GDP per worker and wages) can be observed to increase with city size. There are some variations in this trend in certain countries, for example in Japan, Korea and Mexico where the relationship is not as clear. Stronger productivity levels are a reflection of a bonus intrinsic to being in a city, known as the "agglomeration benefit". On average, a worker's wage increases with the size of the city where he/she works, even after controlling for worker attributes such as education level. OECD estimates suggest that the agglomeration benefit in the form of a wage premium rises by 2%-5% for a doubling of city population size.

Higher productivity is due in part to the quality of the workforce and the industrial mix. Larger cities on average have a more educated population, with the shares of both very high-skilled and low-skilled workers increasing with city size. A 10 percentage-point increase in the share of university-educated workers in a city raises the productivity of other workers in that city by 3%-4%.

But recent contributions to national growth are attributable mainly to population increases

Metropolitan areas are major contributors to national GDP growth. They accounted for 50% of national GDP growth between 2000 and 2010 in the 23 OECD countries with data. That figure rises to more than 70% of growth in Greece, Japan, France and Hungary.

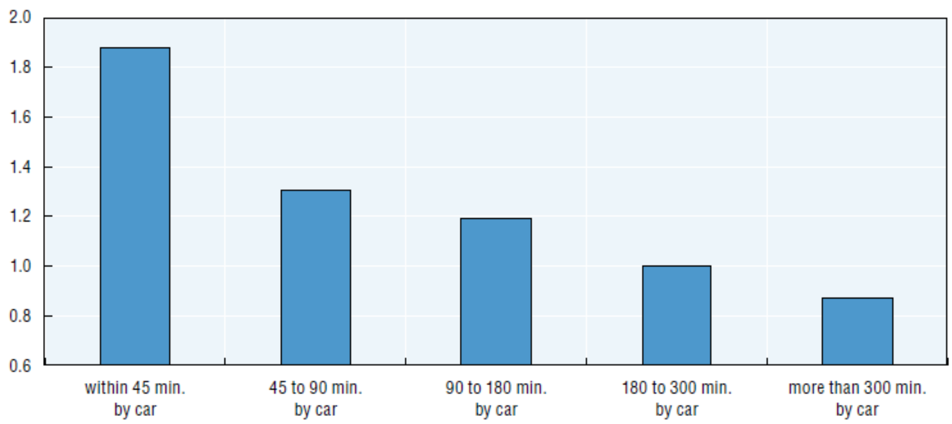
Contributions to national growth by metropolitan areas have been driven more by population growth than productivity growth. While city performance certainly depends on many factors unique to a particular city, there are some general trends. First, economic convergence (i.e. initially less productive cities growing faster than more productive ones) is observed for metropolitan areas with over 500 000 inhabitants. Second, mirroring economic convergence across countries, metropolitan areas in richer countries experienced slower GDP per capita growth than those in less rich countries.

Large cities also contribute to growth in rural areas

The economic health of large cities reaches far into the hinterland. Regions that include large metropolitan areas of more than half a million inhabitants grew roughly a quarter of a percentage point faster per year between 1995 and 2010, compared with regions lacking such metropolitan areas. The largest cities (over 2 million) have a net positive growth effect on locations of significant time-distance by car, which can be the equivalent of over 200 kilometres (Figure 4).

Figure 4. Economic growth increases with proximity to large cities

Yearly growth rates of GDP per capita and driving time to the closest large metropolitan area of over 2 million inhabitants



Source: Calculations from the OECD Regional Database and other sources Yearly growth rates in TL3 regions (1995-2010) controlling for country fixed effects and initial GDP, 18 OECD countries.

Addressing urban “costs” improves well-being and access to jobs

While productivity, wages and the availability of many amenities generally increase with city size, so do what are generally referred to as agglomeration costs. Some agglomeration costs are financial: for example, housing prices/rents and, more generally, price levels are typically higher in larger cities. In addition, a number of non-pecuniary costs, such as pollution, congestion, inequality and crime, typically also increase with city size. Trust and similar measures of social capital often decline with city size. Survey data from European cities confirm that citizens in larger cities – despite valuing the increased amenities – are generally less satisfied with the other aspects mentioned, notably air pollution. In a local labour market, workers’ access to jobs is also highly dependent on the city structure and transport networks.

More compact cities have important environmental benefits

The environmental consequences of the way cities are organised are considerable. Compact cities can make intra-urban trips shorter, contributing to lower pollution from automobiles and fewer CO_2 emissions, an indicator that is important not only for the residents of the urban area in question, but also for global performance. Unfortunately urban sprawl is on the rise in most OECD countries. In comparison with national rates, some cities emit much more CO_2 per capita than others. In the United States, Baton Rouge emits over five times more than Raleigh. In cities such as Cleveland (United States) or Mexico City (Mexico), the transport sector accounts for half of CO_2 emissions. In other locations, such as Cincinnati (United States) or Cologne (Germany), it is the energy sector that contributes around half of CO_2 emissions. Different CO_2 sources imply different city mitigation strategies.

Better metropolitan governance supports growth and reduces urban disadvantages

Among the reforms of sub-national governments, metropolitan reforms are of growing importance. Some metropolitan span literally hundreds of municipalities: 1 375 in Paris, 540 in Chicago or 435 in Prague. OECD work shows that metropolitan areas in OECD countries with a higher level of governmental fragmentation experienced lower growth of gross domestic product (GDP) per capita over the last decade. An analysis of five countries (Germany, Mexico, Spain, United Kingdom and the United States) shows that for a given population size, a metropolitan area with twice the number of municipalities is associated with 6% lower productivity.

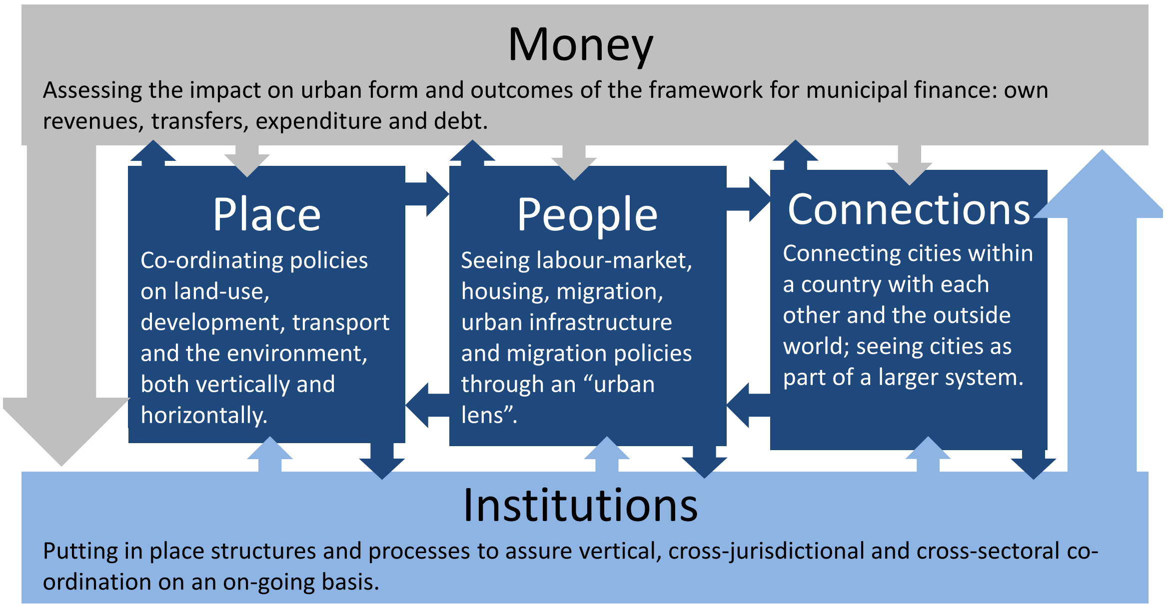
Metropolitan governance bodies of different forms exist in around two-thirds of OECD metropolitan areas. Of those, 49 were created in the 2000s, and at least 15 more have been created in the last three years. A 10% increase in population is associated with a 0.8% increase in the likelihood of having a metropolitan governance body. Four common approaches to metropolitan governance are: informal co-ordination, inter-municipal authorities, supra municipal authorities and “metropolitan cities”. Over half of existing metropolitan governance bodies use informal/soft co-ordination arrangements. Over 80% of metropolitan governance bodies address regional development, over 70% address transport and over 60% address spatial planning. Evidence shows that urban areas with a metropolitan authority of any form had lower rates of sprawl. Metropolitan areas with a transportation authority showed greater levels of resident satisfaction with public transport.

National policies can influence urban development, notably urban finances

Many policies with major implications for cities are never really seen through an “urban lens”. National level actions are required because there are policies where a degree of national government involvement is necessary (e.g. environmental policies or national transport infrastructure planning). There are also policy domains that could, in principle, be left entirely to cities or other sub-national governments but in which national governments in virtually all countries do intervene, usually for reasons of efficiency and/or equity (e.g. housing).

To a great extent, national governments establish the ground rules for cities. National (and in some federal systems, state/provincial) legislation typically defines cities’ responsibilities, powers and, crucially, revenue sources. Attention to the basic legislative framework for cities is essential, but it is too often overlooked. Tax and budgetary frameworks may create powerful incentives that contradict other national policy priorities, such as promoting urban sprawl. Fiscal frameworks can also reinforce urban inequalities. National policies also largely define the terms on which inter-jurisdictional competition takes place. Some forms of competition are healthy and can drive cities to improve services and amenities, but other forms of “race-to-the-bottom” competition that don't create value are still common.

Figure 5: Five areas for assessing urban policy



Many policies actually work at cross-purposes in cities

In practice, many policies and levels of government work at cross-purposes, making policy coherence for cities extremely difficult. For example, property tax systems in much of the OECD still favour single-family homes over multi-occupancy dwellings or owner-occupied housing over rental accommodation. The preference for single-family units constitutes stimulus to sprawl, and privileging home ownership tends to reduce labour-market efficiency. Yet, such tax arrangements coexist with national and city-level policies to curb sprawl, improve labour mobility and reduce interpersonal inequalities. Similarly, efforts to reduce congestion in many places meet resistance because transport and land-use policies are not aligned.

A comprehensive urban policy framework cuts across different ministries for greater policy coherence

OECD countries typically lack a comprehensive approach to urban policy, in part due to the wide range of policies and institutions involved. The average government had 6.7 ministries or national-level departments or agencies with explicit urban policy functions in mid-2013; many had 8 or more. As a consequence, some 20 OECD countries had clearly designated "lead" ministries for urban policies. Fourteen had some sort of national-level co-ordinating body for urban issues, though the remits, composition and powers of such bodies varied widely. However, there was some overlap between these groups: 11 countries had both co-ordinating organs and lead ministries, but a further 11 had neither. Identifying and promoting links between economic, environmental and social goals is crucial to building cities that work. Countries should therefore consider five areas for policy coherence in improving their urban policies: money; places; connectivity; people and institutions (Figure 5).

For more information

For more information on these subjects, see www.oecd.org/regional or contact gov.contact@oecd.org.

For further reading

OECD (2014) *The Metropolitan Century (forthcoming).*

OECD (2014) *How's Life in Your Region?*

OECD (2013) *Regions at a Glance.*

OECD (2013) *Promoting Growth in All Regions.*

OECD (2013) *Investing Together: Working Effectively Across Levels of Government.*

OECD (2012) *Redefining Urban: A New Way to Measure Metropolitan Areas.*

