

**Organization for Economic Cooperation and Development (OECD)  
Public Governance and Territorial Development Directorate  
Territorial Development Policy Committee**

**Symposium on Regional Policy: Innovation & Green Growth: The Regional Dimension  
2 December 2009  
OECD Conference Centre, Paris**

**Session III Keynote: The Impact of the Crisis on Regional Actors and  
on the Governance of Regional Policy**

Thank you, Minister Gjerkes. Honorable Ministers, Ambassadors, Delegates, other dignitaries and colleagues...

In this session, I have been asked to briefly frame the discussion around four key questions:

- What are the main challenges generated by the financial crisis for the implementation of regional policy, with particular attention to sub-national governments?
- What mechanisms are being used to ensure effective multi-level governance, regarding public spending during this crisis?
- What are the specific U.S. experiences in regard to these dynamics?
- What information-sharing mechanisms between levels of government and the private sector can be identified for post-crisis rebuilding?

*The Challenge to Sub-National Governments*

As you well know, this crisis is having a profound effect on sub-national governments, and these dynamics will have long-term impacts for regional policy, driven by a triage budgetary environment, and calls for consolidation and interoperability, along with the potential for ongoing geographic and sectoral tensions regarding public budgets.

On average, sub-national governments account for 31% of total public spending, 22% of total public revenues, and two-thirds of total public investments in the OECD. In practice, sub-national government spending represents 15% of GDP, on average, in OECD countries. In the U.S., these account for almost 20% of GDP.<sup>1</sup> Furthermore, sub-national governments are often responsible for essential public services, including education, health care, and social services delivery. Consequently, a very difficult "convergence of the twain" is currently unfolding.

While local government revenues continue to fall, spending increases, as sub-national government service needs expand, resulting in a worsening sub-national debt burden. Assuming the jobless recovery continues for at least the next year or two, increased unemployment rates will worsen these burdens,

and some sub-national governments will probably face pressure on interest payments, resulting in increased debt burdens, as well. Returning to the equity/efficiency consideration in Fabrizio Barca's Session I keynote, expenditures on transfer payments to individuals, which currently average around 20% of sub-national budgets, will undoubtedly increase in this period.<sup>2</sup>

Unfortunately, sub-national governments have minimal adjustment mechanisms. They must either reduce expenses, cutting jobs and investments, or increase revenues, through taxing authorities. Some may execute counter-cyclical policies, which also increase debt burden. In addition, in a number of nations, sub-national governments face the statutory challenge of a balanced budget mandate, which usually prevents tax cuts or increased spending, if essential public services are to be continued at or near current levels.

A June 2009 OECD survey, prepared by the OECD Fiscal Network, co-managed by the Public Governance and Territorial Development Directorate, found that most nations have reduced, rather than increased taxes, in response to this crisis. It also found cuts in capital and current expenditures were equally frequent. While half of OECD sub-national governments are increasing spending, despite operational cuts, which does spur public investment, the survey also found that debt levels are increasing at the sub-national level in nine nations.<sup>3</sup> Of course, since this survey was undertaken, conditions have worsened, and the pressure for increasing tax revenues is mounting.

In this environment, while monitoring of stimulative public investment is occurring, there is little evidence of multi-level strategic investment design, across governments. Indeed, while regional policy remains an attractive alternative in most countries, the crisis focus remains primarily on job creation and basic public services, as declining fiscal resources challenge proponents of this more integrative, place-based approach.

### *Mechanisms to Ensure Effective, Multi-Level Governance*

Most national governments have retained control over centralized decision-making during this crisis. However, the OECD study did find a number of encouraging developments, in which central governments have increased support for sub-national participation in recovery strategies. These include increased discretionary granting; an expansion in earmark grants—mainly for capital expenditure financing, although some current expenditure support is becoming evident; incentivizing of sub-national investments, and acceleration in anticipated infrastructure spending; efforts to simplify fund disbursement mechanisms; and facilitation of sub-national borrowing—through direct loans and loan guarantees. In addition, the study found instances where sub-national governments were receiving an increased percentage of shared tax revenue, and some waiving of rules regarding balanced budgets, along with allowances for sub-national borrowing to finance governmental operations.

In general, this survey also found a reinforcement of the importance of multi-level governance tools, combined with continuing support for some regional strategies supporting national priorities. Intergovernmental adjustments are occurring, and a significant potential for further structural reform appears possible, as new fiscal arrangements and financial relationships become necessary. Some increased coordination and vertical dialogue is evident, along with new mechanisms to reinforce or create regional approaches. In addition, a number of nations, and the European Commission, have used regional approaches to co-fund local projects, in response to this crisis.<sup>4</sup>

However, it is also clear that sub-national authorities must concentrate on immediate social welfare concerns, which will worsen over the next year or so. This could result in national governments retaining a longer-term investment focus, as sub-national governments are increasingly forced to focus on immediate human needs. These dynamics continue to evolve, and are very dependent upon local context, so the ultimate outcome remains unclear.

### *The U.S. Experience*

In the U.S., we are in the midst of an enhanced federal commitment to place-based policy. The Obama Administration released a very important "Memorandum for the Heads of Executive Departments and Agencies," in August of this year, framing the new U.S. approach to place-based policies.<sup>5</sup> This White House directive was the first public acknowledgement of an extended and very important internal Administration decision process, and subsequent legislative and administrative actions indicate this approach will be central to future domestic policy efforts of the Obama Administration.

While the guidance outlined in the White House memo was preliminary, it presaged an important interagency process, focused on evaluating existing place-based policies and identifying potential reforms and areas for enhanced interagency coordination. The intent is to create a more effective, multi-level governance framework, to influence how rural and metropolitan regions develop, through streamlining otherwise redundant and disconnected programs, and to identify principles for regional policy that are clear and measurable, to enable vigorous evaluation. In the U.S., this commitment to place-based policy is indeed historic.

As a result, integrated approaches to regional policy have already begun to surface across the federal government. A new program within the U.S. Department of Housing and Urban Development will utilize \$150 million to enhance regional strategic planning and integration, as well as the evaluation of regional programming.<sup>6</sup> The Livable Communities Initiative, a new interdepartmental approach to regional policy, has been introduced in the U.S. Congress. This legislation, and interim administrative actions, will support regional efforts at the Departments of Housing and Urban Development, Commerce, Transportation, Environmental Protection, and USDA. Although the enabling legislation will not be considered until next year, these departments are working daily to integrate regional approaches, and rethink relationships with state and local governments, and the private sector.<sup>7</sup>

While these structural reforms are encouraging, our federal system must now grapple with a very difficult fiscal challenge. During the last decade, the local government share of total U.S. payroll employment has steadily increased, and is now near the historic highs of the mid-1970s. The number of full-time employees in local U.S. governments increased by 16% between 1999 and 2007, and their total wages grew by nearly 40%, topping \$46 billion. In our largest 100 metropolitan areas, local government accounts for 10% of total non-farm employment.<sup>8</sup>

However, the fiscal state of U.S. city and county governments is dire. The National League of Cities recently released a study regarding spending cuts in the FY '09 budget. 67% of cities are now either freezing hiring or initiating layoff programs, and 62% are delaying capital projects.<sup>9</sup> A recent report from the Center on Budget and Policy Priorities indicates new shortfalls have opened in the budgets of 35 states for FY '10. State and local revenues continue to fall short of projections and large gaps appear to be evident in 2011. The study predicts that combined FY 2010 and 2011 state budget deficits will exceed \$350 billion.<sup>10</sup>

The nonmetropolitan, sub-national government challenge may be worse. The National Association of Counties just released a report regarding the status of medium and small-sized county governments. 56% of these counties report a fiscal year shortfall of more than \$10 million, 47% indicate the shortfall has increased significantly since the start of this fiscal year, and 95% expect additional shortfalls next year.<sup>11</sup>

Looking down the road a bit, the pressures on sub-national governments will be further challenged by the \$1.5 trillion in commercial real estate debt, coming due in the next two years. Most analysts believe these properties are currently worth only 30-40% of the stated mortgage value. As these financial instruments are renegotiated, the resultant decline in local tax revenue will be coupled with an exponentially increased human service demand. Ten million Americans have applied for food stamps over the last two years. One in eight are receiving Supplemental Nutrition Assistance Program support, as are one in four children. Currently, twenty thousand Americans are being added to this roll each day.<sup>12</sup>

Against this backdrop, most U.S. sub-national governments face the unique challenge of the balanced budget mandate. These tax dynamics, the onset of the retirement of the baby boomers, and the severe increase in social welfare costs becoming evident will create an unparalleled need for new federal, state, and local partnerships, and most political leaders recognize we must govern differently in the future. These discussions are now beginning. The challenge remains whether a regional policy framework can retain its importance, as well as be made relevant to U.S. equity considerations, in the face of these overwhelming social welfare dynamics.

#### *Mechanisms for Post-Crisis Information-Sharing and Rebuilding*

Finally, looking forward, what can be done to create enhanced information sharing for post-crisis rebuilding, across government levels and with the private sector? I would suggest three challenging regional dynamics must first be addressed, if these questions are to ultimately be engaged in a manner which assures sustainable, systemic change. How these are approached and resolved will ultimately determine how, and if, multi-level governmental information-sharing and rebuilding unfolds:

- Given this crisis, place-based policy proponents must confront the efficiency/equity question outlined by Fabrizio Barca in his Session I keynote address.
- In doing so, given the bleak fiscal forecast before us, the relative utility of metropolitan vis a vis nonmetropolitan regional policy investments will become more pivotal. In this environment, the risk of urban political considerations overwhelming collaborative governance approaches in rural areas, and between urban and rural regions, is quite real.
- If this challenge is to be successfully navigated, we must find innovative approaches which better align regional and rural development policy, funding, political champions, and constituencies. This must occur not only at national levels, but also in sub-national contexts.

#### *Summary*

In summary, the place-based policy paradigm no longer faces a theoretical challenge. The relative costs of regional approaches, and the evaluative specificity and rigor employed to assess their impacts, may continue to be questioned, but there remains broad acceptance of the paradigm. However, this current fiscal crisis may well overwhelm the ability of sub-national governments to lead and/or support

such efforts. If subsidiarity considerations are to drive this framework, there must be sufficient local capacity, investment and engagement. Even if additional, stimulus-based national funding is targeted to budget relief for sub-national governments, this will remain a regional policy challenge.

The rural dimension of this question remains the most problematic. Given very difficult fiscal decisions at both the national and sub-national levels, will place-based policy solutions become largely metropolitan policy constructs? If we are to avoid this outcome, metropolitan champions must support rural regional efforts, and we must still grapple with the policy and programmatic chasm which continues to exist between regional and rural development.

There are hopeful indications that each of these issues is moving toward appropriate and positive resolution. However, political champions, as well as committed sub-national governments and wise public administrators, remain key. In this regard, this Territorial Development Policy Committee must continue to provide leadership for the ongoing international dialogue regarding these questions. I would argue your work has never been more relevant, nor more critical!

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- 1 *Sub-National Dimension and Policy Responses to the Crisis*. Centre for Tax Policy & Administration, Economics Department, Public Governance Territorial Development Directorate, OECD Network on Fiscal Relations Across Levels of Government. 9 June 2009.
  - 2 Ibid.
  - 3 Ibid.
  - 4 Ibid.
  - 5 Office of Management and Budget. Memorandum for the Heads of Executive Departments and Agencies Re: Developing Effective Place-Based Policies for the FY 2011 Budget. No. M-09-28. 11 August 2009. Online at [http://www.whitehouse.gov/omb/assets/memoranda\\_fy2009/m09-28.pdf](http://www.whitehouse.gov/omb/assets/memoranda_fy2009/m09-28.pdf)
  - 6 FY 2010 Transportation, Housing, and Urban Development, and Related Agencies Appropriation Bill. Approved by U.S. House & Senate Appropriations Committees (H.R. 3288). Online at <http://thomas.loc.gov/cgi-bin/query/z?c111:H.R.3288>:
  - 7 *The Livable Communities Act of 2009*. U.S. Senate (S. 1619). Online at <http://thomas.loc.gov/cgi-bin/query/z?c111:S.1619>:
  - 8 Muro, Mark & Christopher Hoene. "Fiscal Challenges Facing Cities: Implications for Recovery." National League of Cities/Brookings Institution Metropolitan Policy Program. November 2009. Online at [http://www.brookings.edu/~media/Files/rc/papers/2009/1118\\_cities\\_fiscal\\_challenges\\_muro\\_hoene/1118\\_cities\\_fiscal\\_challenges\\_paper.pdf](http://www.brookings.edu/~media/Files/rc/papers/2009/1118_cities_fiscal_challenges_muro_hoene/1118_cities_fiscal_challenges_paper.pdf)
  - 9 Ibid.
  - 10 McNichol, Elizabeth and Nicholas Johnson. *Recession Continues to Batter State Budgets; State Responses Could Slow Recovery*. Center on Budget & Policy Priorities. 19 November 2009. Online at <http://www.cbpp.org/files/9-8-08sfp.pdf>
  - 11 Byers, Jacqueline. *How Are Counties Doing? An Economic Status Survey*. National Association of Counties. November 2009. Online at [http://www.naco.org/Template.cfm?Section=Media\\_Center&template=/ContentManagement/ContentDisplay.cfm&ContentID=32326](http://www.naco.org/Template.cfm?Section=Media_Center&template=/ContentManagement/ContentDisplay.cfm&ContentID=32326)
  - 12 DeParle, Jason and Robert Gebeloff. "The Safety Net: Food Stamp Use Soars, and Stigma Fades." *The New York Times*. 28 November 2009. Online at <http://www.nytimes.com/2009/11/29/us/29foodstamps.html>