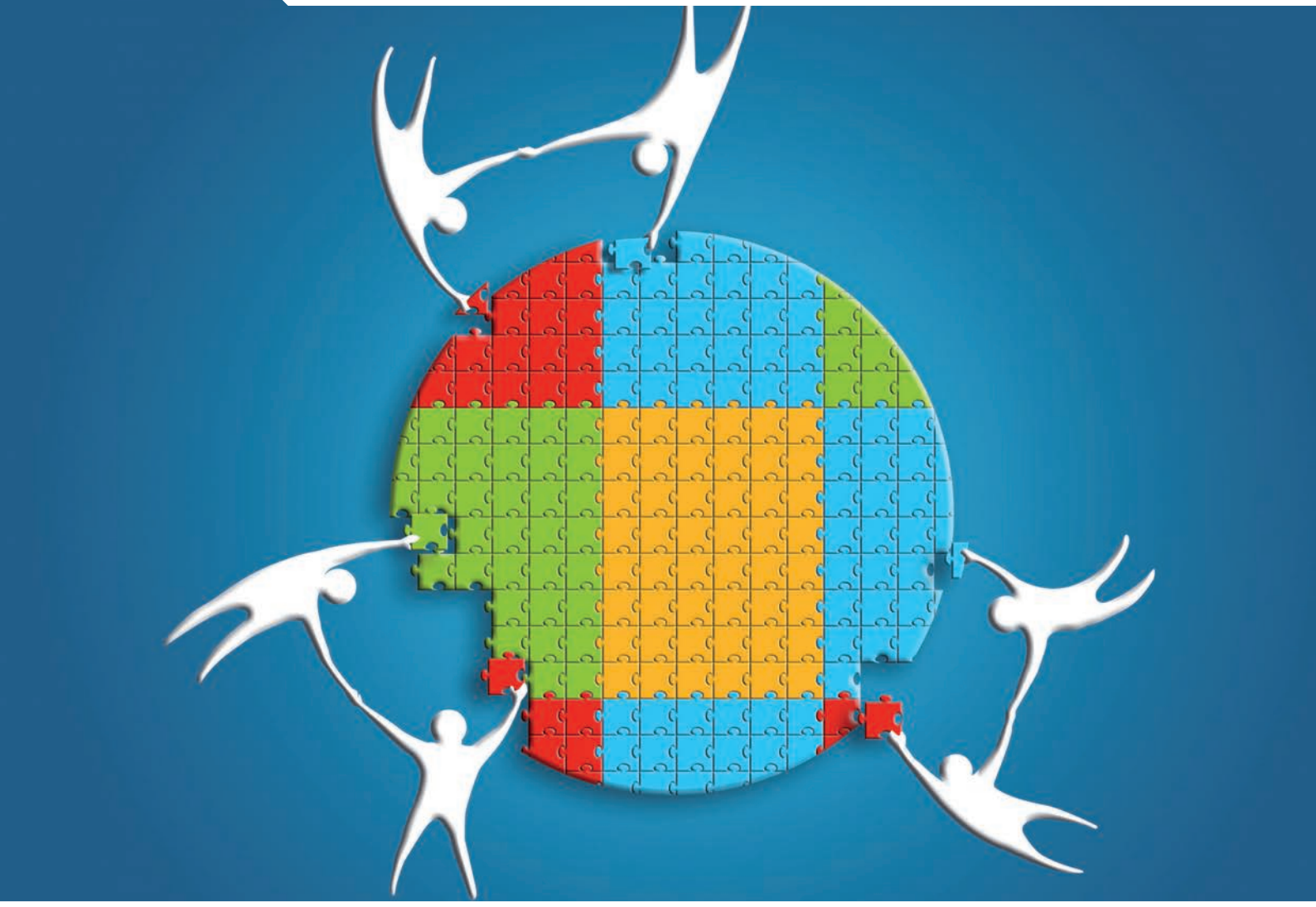
Investing Together

WORKING EFFECTIVELY ACROSS LEVELS OF GOVERNMENT



OECD

Investing Together

WORKING EFFECTIVELY ACROSS LEVELS OF GOVERNMENT



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Foreword

OECD countries devoted over USD 1 trillion to public investment in 2011, financing the provision of a wide range of essential public goods and services, including public transport, schools and hospitals. Such investments are critical to governments' pursuit of growth, well-being, equity and environmental sustainability. Yet they are also under pressure: as OECD governments have moved to consolidate public finances, it has in most places proved far easier to cut investment rather than current expenditure, particularly wages and benefits. Enhancing the efficiency and effectiveness of public investment is thus increasingly important, as governments seek to make the best use of increasingly limited resources.

As this report shows, one way to achieve this is to improve the governance of public investment across all levels of government. It is not merely a question of reducing waste – though that is often the focus of public debate – but of identifying and realising potential complementarities among investments that can enhance their impact. Three challenges stand out. First, since most public investment is managed at regional or local levels, even as it is financed by national or even supra-national authorities, this requires better co-ordination across levels of government. Secondly, exploiting the potential synergies that exist between different investments also implies better mechanisms for co-ordinating policies horizontally across different sectors and for engaging the private sector and civil society. Finally, there is a need for enhanced governance capacities at all levels, to make such horizontal and vertical co-ordination possible. This report explores each of these three challenges, looking at the difficulties OECD governments face and at the solutions they have found.

This report builds on previous work carried out under the aegis of the OECD Territorial Development Policy Committee, as it seeks to articulate a coherent, flexible and effective set of principles for the multi-level governance of public investment. This is a particularly salient issue as OECD governments seek to sustain a still uncertain recovery against a backdrop of fiscal consolidation and, in many economies, limited room for manoeuvre in monetary policy. Their success in making the best possible use of public investment across sectors and levels of government is likely to be a key factor in supporting the recovery in many places. Better governance is a key lever for achieving this end and thus for enhancing economic, social and environmental well-being.

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The report was submitted for comments and approval to the OECD Territorial Development Policy Committee (TDPC) in December 2012. Chapter 1 was drafted by Cathérine Gamper and William Tompson. Important inputs on sub-national financial statistics and trends were provided by Claudia Hulbert and Camila Vammalle. Chapter 2 was drafted by Cathérine Gamper. Chapter 3 was written by Dorothée Allain-Dupré and Lee Mizell. The case study summaries in Annex A were drafted by Elena Celada. The report benefited from valuable and extensive guidance from Claire Charbit and Karen Maguire. The report draws on the written contributions from a number of experts. The OECD Secretariat would particularly like to thank Eric Brousseau of the European University Institute, Marcin Dabrowski of the University of Vienna, Alex Matheson of Oxford Policy Management, Delia Rodrigo of allio|rodrigoconsulting, Andrés Rodrigues-Pose of the London School of Economics, Thierry Senechal of the International Chamber of Commerce and Paul Bernd Spahn of Goethe University Frankfurt. Thanks are also due to Hanna Kleider and Thai-Thanh Dang for statistical analyses. The case studies underlying the report, which are available separately online, were prepared by Dorothée Allain-Dupré, Gregory Bounds, Elena Celada, Claire Charbit, Marcin Dabrowski, Cathérine Gamper, Claudia Hulbert, Hanna Kleider, Lee Mizell, Paul Bernd Spahn, William Tompson, Camila Vammalle and Daniela Venanzi.

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Acronyms and abbreviations

AC	Autonomous communities (Spain)
AUD	Australian dollars
BAF	Building Australia Fund
CAD	Canadian dollars
CBA	Cost-benefit analysis
CG	Central government
CIPE	Committee for Economic Planning (Basilicata, Italy)
COAG	Council of Australian Governments
CPER	State-Region Contract (France) *Contrat de projets État-région*
CSO	Civil society organisation
EC	European Commission
EPCI	Public Establishment for Inter-communal Co-operation (France) *Établissement public de coopération intercommunale*
EPL	Employment-protection legislation
ERDF	European Regional Development Fund
EU	European Union
EUR	Euro
FDI	Foreign direct investment
GAO	Government Accountability Office (United States)
GDP	Gross domestic product
GFCF	Gross fixed capital formation
QoG	Quality of government
HDI	Human Development Index
HVHR	High Value High Risk (Victoria, Australia)
IA	Infrastructure Australia
ICT	Information and communication technology
IGA	Intergovernmental Agreement on Federal Financial Arrangements (Australia)
ILB	Regional Development Bank of Brandenburg (Germany) *Investitionsbank des Landes Brandenburg*
LAA	Local Area Agreements (United Kingdom)
M&E	Monitoring and evaluation
MAA	Multi Area Agreements (United Kingdom)
MFA	Municipal Finance Authority (Canada)
NCP	New Competition Policy (Australia)
NGO	Non-governmental organisation
NPA	National Partnership Agreements (Australia)
NSRF	National Strategic Reference Framework
NVVIP	Public Investment Evaluation Unit (Basilicata, Italy)

O&M	Operations and maintenance
OECD	Organisation for Economic Co-operation and Development
PBC	Partnership British Columbia (Canada)
PLN	Polish zlotys
PPI	Public Procurement for Innovation
PPP	Public-private partnership
PSC	Public Sector Comparator (Australia)
R&D	Research and development
RDA	Regional Development Agencies (England)
RDP	Regional Development Programme (Sweden)
RES	Regional Economic Strategy (England)
RESAH	Buyers' Network of Hospitals in the Ile de France Region (France) *Réseau des Acheteurs Hospitaliers d'Ile-de-France*
RGA	Regional Growth Agreement (Sweden)
RGP	Regional Growth Programme (Sweden)
ROP	Regional operational programme
SET	Stronger Economies Together Initiative (United States)
SHiNE	Shaping Horizons in the North East (England)
SNG	Sub-national governments
SPP	Specific purpose payments (Australia)
TEP	Territorial Employment Pacts (Austria)
UDF	Urban development fund
USD	United States dollar
US EDA	United States Economic Development Administration
WD	Western Economic Diversification Canada

Executive summary

Public investment is an important strategic responsibility, shared across levels of government

OECD governments spent over USD 1 trillion in public investment in 2011, two-thirds of which was carried out by sub-national governments. The financing and implementation of public investment typically takes place across different levels and sectors of government, which makes its management complex. Substantial co-ordination is necessary, and it is critical that sub-national governments have the capacity to work collaboratively in designing and implementing investment projects.

Doing more with less

Sub-national governments benefitted from the initial stimulus measures launched in response to the crisis. However, since then their public investment resource base has been significantly – and in some cases, dramatically – reduced. Given the importance of public investment for regional performance, there is a pressing need to do more with less. Improving the quality of investment governance can help, especially by addressing mechanisms for investment co-ordination and for assessing and building the needed capacity within sub-national governments.

Key findings

The quality of governance has a major influence on public investment outcomes

At the sub-national level, the quality of governance varies as widely within countries as it does between them. The regional variation in quality of governance may explain up to 60% of regional human development outcomes, including a population's health and education indicators. It also appears to be related to the effectiveness of public investment.

OECD countries face a range of common challenges when it comes to managing public investment

More than 75% of countries responding to an OECD survey on public investment governance see information asymmetries at the heart of the problem of sharing responsibilities across levels of government. Insufficient financial resources at sub-national levels and the lack of private sector involvement in financing and implementing public investment are also seen as major obstacles. Two-thirds of the countries responding

to the questionnaire also cited the absence of critical sub-national capacities, such as the ability to engage in strategic planning.

The character of these challenges varies across countries and regions

To some extent, variation in perceptions of the challenges across countries reflects differences in the distribution of competences and autonomy related to investment, in legal frameworks and in the extent and maturity of decentralisation. As a rule, more centralised countries report greater problems for co-financing and integrating sectoral priorities into a complementary policy mix for sub-national development. This mirrors limits to the financial and policy autonomy of sub-national governments in such countries. By contrast, in federal or quasi-federal countries, where sub-national tiers of government are well-established, national governments cite a lack of fiscal discipline at sub-national level as a core challenge.

Key recommendations

Vertical co-ordination

Mechanisms used for vertical co-ordination between central and sub-national levels of government range from informal policy exchange platforms to co-financing arrangements for shared responsibilities to conditionality requirements for receiving central funds.

- Central governments should consult with sub-national governments in the development of national public investment strategies.
- Cross-governmental investment policy forums can help overcome information and policy asymmetries. However, they must be backed by real resources and linked to real decision-making processes, to avoid becoming ineffective "talking shops".
- Co-financing mechanisms enable risk-sharing and policy alignment, especially in a fiscally constrained environment. They need to be adapted to sub-national governments' constraints and should encourage innovative sources of financing.
- The private sector can play an important role in co-financing and bring in valuable expertise (e.g. through public-private partnerships). To work effectively, institutions must be designed to facilitate such collaborations (e.g. making contractual design simple and straightforward for governments to administer).
- Conditions attached to funding can enhance systematic assessments of investment impacts and can clarify roles and accountability, thereby reducing the incidence of "bad" investments. To be effective, conditions must be designed to foster trust and partnership rather than simply to enforce compliance.

Horizontal co-ordination

Horizontal co-ordination is needed not only across sectors, which facilitates an integrated approach to investments in specific locations, but also across jurisdictions, which allows for maximising economies of scale and managing spillover effects of individually driven investments.

- National funding rules should not prevent the pooling of resources across sectors; inter-ministerial collaboration on investment projects should be encouraged. A collaborative approach allows for projects to be better adapted to local needs.

- Leadership is important to solve collective action problems in horizontal co-ordination. Mechanisms are needed to overcome competitive pressures, resource constraints, differing priorities and fears that the distribution of costs or benefits will be unequal.
- Governments may need to provide financial incentives for cross-jurisdictional project propositions or, where useful, require consolidation or mergers of administrative functions in different jurisdictions.
- Barriers to cross-jurisdictional collaboration remain in many places and need to be removed. The legal and regulatory framework should allow bottom-up, cross-jurisdictional collaboration.
- Horizontal co-ordination works best when sub-national governments have the capacity and the desire to work collaboratively with other governmental agents. Fostering a culture of collaboration is crucial.

Contractual arrangements

Inter-governmental contracts are an encompassing, cross-cutting mechanism for co-ordination, distinguished by the fact that they are more formal devices that enable governments across levels to arrange or delegate joint action, as independent entities, and to clarify the complexity of processes and responsibilities.

- To overcome fragmented structures and clarify the assignment of responsibilities across levels of governments, contracts need to embody commitments that are not only credible but also verifiable.
- Contracts should not increase administrative burdens by creating parallel structures. They need to be accompanied by measures that help sub-national governments develop their capacity for such arrangements.

Critical capacities

Limits in sub-national capacities can undermine the outcomes of cross-governmental public investment. Capacities should be built that allow sub-national governments to:

- engage in strategic planning that is tailored, results-oriented, realistic, forward-looking and coherent with national objectives;
- use long-term and comprehensive appraisals for investment selection;
- engage in transparent and competitive procurement with corresponding internal control systems;
- ensure the quality and availability of the technical and managerial expertise necessary for planning and executing public investment;
- produce data at the sub-national level and transform it into actionable evidence for decision makers;
- extend capacity building beyond a focus on workforce improvement to include the development of new institutions and procedures;
- identify the major capacity gaps that exist at various stages of the investment cycle and establish priorities for improving investment outcomes in particular places.

Chapter 1

How to do better with less: Working across levels of government to invest more effectively

This chapter explores the importance of public investment for economic growth, as well as the factors that appear to influence that relationship. It shows why the shared nature of public investment gives sub-national governments an important role, tapping into their comparative advantage of understanding the specific needs of particular places. It also looks at the way in which the economic crisis has compromised sub-national governments' ability to carry out this role. Public investment has become an adjustment variable as governments seek to sustain other critical expenditures in tight fiscal circumstances. This points to the need for governments to do better with less when managing limited investment resources. In many instances, this will require improvements in the quality of governance, an issue explored in the penultimate section of this chapter. Finally, the chapter turns to the two key governance challenges that will constitute the focus of Chapters 2 and 3, namely co-ordination and sub-national capacity, providing evidence from a recent OECD survey that identifies critical challenges that exist with respect to these two aspects of governance.

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Governments across the OECD spent over USD 1 trillion in public investment (capital expenditure) in 2011. Almost two-thirds of this total was spent by sub-national governments (SNGs), though much – and in many cases, most – of the funds came from national or (in the case of the European Union) supranational authorities.[1] Public investment is thus not only a major strategic activity, it is also a shared responsibility across levels of government, in which all levels play an important role. Yet, the ability of SNGs, in particular, to carry out their assigned tasks, has been jeopardised in recent years. The debt-to-GDP ratio of SNGs rose from 9.25% in 2007 to 11.62% in 2010. This has reduced their ability to participate in the financing of public investment projects. Indeed, because governments have sought to protect other sources of expenditure in a time of fiscal austerity, the resources available for public investment fell by 7-8% per annum between 2010 and 2012, with some countries having experienced decreases of up to 30% since 2007. Yet public investment in hard and soft infrastructures and assets is critical to regional development and constitutes a potentially important growth-enhancing form of public expenditure. It is therefore of paramount importance to ensure that, with fewer resources available, public investment measures can be more effective in the future. In short, there is an imperative to "do better with less" (OECD, 2011a).

This report seeks to contribute to the objective of increasing both the efficiency and the effectiveness[2] of public investment, to maximise its returns for regional and therefore national development. It will first demonstrate that enhancing the quality of governance is a key lever for improving public investment outcomes (Chapter 1). Chapter 2 will then look at why the shared responsibility of public investment across levels of governments requires co-ordination mechanisms that facilitate interactions and help to bridge the so-called "governance gaps" identified in previous OECD work (Charbit and Michalun, 2009; Charbit, 2011). Finally, to allow SNGs to carry out their important role in public investment provision, Chapter 3 will investigate the crucial capacities needed to engage in such a multi-level governance context of public investment.

It is worth noting that the findings of this report may have a wider relevance. First, the issues discussed here are particularly relevant in a tight fiscal context, such as prevails across most of the OECD. Even if recent turbulence gives way to a more stable recovery, investment resources will remain constrained for some time to come, so the need to "do better with less" will remain. Secondly, the report's findings are likely to be relevant to non-member countries, in which public investment needs, encompassing both hard and soft infrastructures, are also major challenges. Finally, although the discussion here focuses on public investment, the challenges it addresses are common to many other policy domains: indeed, as Hooghe and Marks (2009) have shown, most areas of domestic policy are now shared responsibilities, requiring varying degrees of multi-level co-ordination. Although many policy domains were exclusively under national jurisdictions in the past, nowadays almost no field of domestic policy has an exclusive national mandate in most countries. Most domestic governance is now multi-level and, to the extent that governments

increasingly seek coherence or even positive synergies among policies, multi-sectoral as well. This implies that capacity issues and co-ordination challenges are omnipresent.

The importance of public investment

Public investment can be a key contributor to economic growth…

The causal linkages between public investment and economic growth have been long and widely discussed, not least owing to the debate about whether, how and to what extent the declining ratio of public capital investment to GDP across the OECD during the 1970s and 1980s (Box 1.1) was linked to productivity and growth performance. Generally speaking, it is not easy to isolate the impact of public investment on growth, which is why the matter has long been the subject of controversy among economists.[3] In recent years, however, a growing body of work has pointed to significant positive effects of public investment on growth (see Romp and de Haan, 2007, for an overview). For example, Bom and Ligthart (2009) find that the short-run impact is rather limited, but in the long run, and after accounting for inter-regional spillovers, it increases substantially. Creel and Poilon (2008) reach similar conclusions for a group of EU countries. Finally, Arslanalp et al. (2010), focusing on public capital rather than public investment, find that increases in public capital stock are positively correlated with growth after controlling for initial levels of public capital.[4]

Sector, time and space affect the impact of public investment on growth. Although the positive effect of transport infrastructure on economic growth has been disputed, evidence has emerged on positive returns to investment in its maintenance (Congressional Budget Office, 1991; Cullison, 1993) and in network infrastructure overall (encompassing energy, water and telecommunications, as well as transport) over and above the addition to the capital stock (Sutherland et al., 2009). Moreover, evidence pointing to higher returns to investment in various forms of infrastructure where *ex ante* supply is lower highlights the importance of addressing bottlenecks, which can be identified even in the most developed countries. Public investment can also contribute to human capital formation (Lucas, 1988; Cullison, 1993; Romer, 1990).[5]

Regional effects of public investment are even harder to identify, owing to a lack of data on capital stocks and very limited data on the composition and scale of public investment by region. Generally speaking, though, work on the drivers of regional growth, many of which are linked directly to patterns of public investment, suggests that what holds for national economies is also true of the regions within them. First, investment in physical infrastructure (especially transport infrastructure) appears to be important for regional performance, particularly when co-ordinated with other strands of policy (OECD, 2009a). However, when undertaken in isolation, it can yield poor results, and it seems to be subject to diminishing returns, which makes effective targeting critical. In Europe, in particular, many regions may have over-invested in this area in recent decades (Crescenzi and Rodriguez-Pose, 2012). Secondly, there is evidence of the importance of investment in human capital and innovation activities for regional growth (OECD, 2009a, 2011b). This points to the importance of investment in soft, as well as hard, infrastructure – and, critically, to the need for public investment processes that are capable of targeting regional needs and potential effectively.

Box 1.1. **Public capital formation: Measurement and trends**

Measuring public investment

Public investment is generally understood as capital expenditure that finances projects for physical infrastructure (such as roads, government buildings, etc.) and soft infrastructure (human capital development, innovation, and research and development) that go beyond the fiscal year. Strictly speaking, it should encompass all spending to increase the stock of fixed public capital. However, the precise definition of public investment varies from country to country. In general, gross fixed capital formation (GFCF) is used as the best available proxy. However, there are differences across countries even here. For example, in some countries private contributions to public investment are accounted for in national accounts, while in others this may not be the case, and there is some variation as to where expenditure on operations and maintenance (O&M) is recorded. Moreover, GFCF is a narrow definition since it does not cover all public spending that could be considered as investment. Indeed, it is sometimes difficult to determine the borderline between GFCF and public consumption. For example, investments in human capital that do not involve the acquisition of fixed assets will be classified as consumption, although they could have long-term repercussions, and the classification of O&M expenditures as intermediate consumption (current expenditure) or GFCF depends on their magnitude. For this study, a pragmatic approach has been taken that relies on government GFCF when making cross-country comparisons (which are relatively few in any case) but allows countries to use their own definitions when responding to the questionnaire on the multi-level governance of public investment.

Trends in public investment across the OECD

Overall, public investment declined slightly as a share of GDP in OECD countries from the early 1980s until the late 2000s (Sutherland et al., 2009). There are a number of underlying factors:

- There has been a general decline in hard infrastructure investment, as most OECD countries already possess well-developed infrastructure and thus have limited scope for new investment. Emphasis rests on financing maintenance and upgrades, and improving efficiency (OECD, 2008). Yet O&M can be classified either as intermediate consumption or GFCF, according to its magnitude. In the United States, for example, O&M costs for transport and water infrastructure have slightly exceeded capital expenditure since the mid-1970s. O&M currently accounts for 52% of public spending in these areas, with sub-national governments accounting for nearly 90% of this spending. By contrast, SNGs account for 60% of public capital expenditures for transport and water infrastructure, and the federal government accounts for the remaining 40% (Congressional Budget Office, 2010).
- The decline can also reflect a shift in investment type, from infrastructure to intangible investment that can appear as current expenditures in government accounts (e.g. software acquisition or training).
- The general decline masks some differences at the country level. Among EU countries, for example, until recently there was an upward trend in public investment as a percentage of GDP in Greece, Ireland, Portugal and Spain (Perée and Välilä, 2007).
- The line between public and private investment has shifted in places as a result of the privatisation or outsourcing of some services and functions that were previously in the public domain and of new forms of private sector involvement in those that remain in the public sector. Public-private partnerships (PPPs), for example, are not necessarily counted as public investment (OECD, 2011b).

Source: Vammalle, C. and C. Hulbert (2013), "Sub-national Finances and Fiscal Consolidation: Walking on Thin Ice", *OECD Regional Development Working Papers*, No. 2013/02, OECD Publishing, doi: 10.1787/5k49m8cqkcf3-en; Sutherland, D., et al. (2009), "Infrastructure Investment: Links to Growth and the Role of Public Policies", *OECD Economics Department Working Papers*, No. 686, OECD Publishing, doi: 10.1787/225678178357; OECD (2008), "Infrastructure to 2030: Policy Brief", OECD Publishing, Paris, *www.oecd.org/dataoecd/24/1/39996026.pdf*; Congressional Budget Office (2010), *Public Spending on Transportation and Water Infrastructure*, Congressional Budget Office, Washington, DC, November; Perée, E. and T. Välilä (2007), "A Primer on Public Investment in Europe, Old and New", *Economic and Financial Reports 2007/1*, European Investment Bank, Luxembourg; OECD (2011), *OECD Regional Outlook 2011: Building Resilient Regions for Stronger Growth*, OECD Publishing, doi: 10.1787/9789264120983-en.

… although its impact depends to a significant extent on how governments manage it

Among the factors that appear to exert an important influence on the impact of public investment on economic performance are the following:

- It is total investment and the capital stock that matter for growth. It is thus important to pay attention to the degree to which a given public investment might "crowd-in" or "crowd-out" private investment. "Crowding-in" occurs when public investment increases the marginal productivity of private capital and labour, or reduces the costs that investing firms occur. Either effect should stimulate private capital formation. "Crowding-out" can occur either directly, when governments take on projects that the private sector would have otherwise undertaken, or indirectly, via the use of distortionary taxes to finance public investments or pressure on interest rates and the exchange rate.[6] Of course, "crowding-in" and "crowding-out" may occur in the same context, as both effects can vary over time and depend to a great extent on the economic environment. Agénor et al. (2005) suggest that crowd-out effects may tend to predominate in the short term, with complementarity effects prevailing over the long term. Atukeren (2006) suggests that the likelihood of crowding-in effects is greater in a more stable macroeconomic environment – a finding with obvious relevance for current debates in some OECD countries, not least those connected with the possible use of macroeconomic conditionalities in the reform of the EU's Cohesion Policy.
- Poorly planned and managed public investment can lead to the creation of expensive "white elephants", which sometimes become a further drain on the public purse owing, for example, to the need for maintenance of facilities that will never yield an adequate return. This is particularly a risk where investment in physical infrastructure is concerned, as there is some evidence that political economy considerations may generate a bias in favour of undertaking more such investment than is efficient (Crescenzi and Rodriguez-Pose, 2012). A number of studies point to the importance of adequate investment in the maintenance of public infrastructure, but such investment, less visible, may be less attractive to elected politicians, resulting in too many new projects being undertaken and too little being allocated to operations and maintenance (Tanzi and Davoodi, 1998; Fedelino and Hemming, 2005; Romp and De Haan, 2007). Sutherland et al. (2009) recommend some policies that can help mitigate the risk of misallocation. Implementing such measures often requires co-ordination across levels of government and between public and private sectors – two of the issues at the heart of this report.
- Closely related is the quality of institutions – a central concern of the present work. Institutional quality, too, appears to affect the expected returns to public investment. In a study of developing countries, Atukeren (2006) underscores the importance of the rule of law, secure property rights and political checks and balances. Everhart and Sumlinski (2001) report that greater corruption is also associated with greater crowd-out effects, while Tanzi and Davoodi (1998) identify four channels through which corruption undermines the effectiveness of public investment: *i)* by increasing public investment while reducing its productivity; *ii)* by increasing public investment that is not accompanied by the necessary recurrent expenditure (i.e. non-wage operation and maintenance spending); *iii)* by reducing the quality of existing infrastructure; and *iv)* by reducing the government revenue needed to finance productive spending.

A final important point to bear in mind is that an exclusive focus on productivity and growth is likely to understate the overall benefits of public investment. A great deal of infrastructure contributes directly to household welfare. Indeed, public amenities like parks and recreational facilities are specifically designed to have direct benefits on households. Such amenities do not have a direct productive function, but they may nevertheless yield indirect benefits for growth, to the extent that they make particular places more attractive for households and firms. Other public services, including transport, water and sewage systems, provide direct consumption benefits to households, in addition to their direct impact on the productive capacity of the economy. Similarly, while the evidence suggests that good health care is growth-enhancing (see e.g. Bloom et al., 2003), the case for public health expenditure does not rest solely on its potential impact on labour productivity. In general, the consumption benefits of public infrastructure have been the focus of few studies, in part because of limitations on the availability of data and the difficulty of measuring quality of life.[7]

A place-based approach is critical to maximising the impact of public investment

The key determinants of regional growth vary according to such factors as population density and levels of development (OECD, 2012c). While certain factors, like human capital, seem to matter everywhere, their relative importance varies from place to place. Not surprisingly, the bottlenecks to growth in rural places differ considerably from the challenges confronting large cities, and the most advanced regions, in terms of productivity, face constraints that are different from those that lagging regions must surmount. This highlights the need for investments that reflect the real needs of specific places.

A number of recent OECD studies of regional growth point to the potential benefits of such an approach, with both quantitative and case study evidence highlighting the ways in which complementarities among different strands of policy can, if exploited, bring about improved performance (Box 1.2). By contrast, a failure to address growth bottlenecks in a co-ordinated fashion can result in otherwise desirable (in principle) policy interventions having unintended and unwanted effects. To encourage regional growth and innovation, and share economic gains as broadly as possible, investments in "soft" and "hard" public infrastructures need to be tailored to specific territorial contexts, adapted on the basis of local knowledge and linkages across places (OECD, 2009a, 2009b, 2011b; Barca, 2009; Barca et al., 2012). Such an approach, by mobilising assets that might otherwise be overlooked or under-utilised, can translate into improved aggregate performance as well (Farole et al., 2011; OECD, 2011b). Finally, it is important to note that there is often a case for a place-based dimension to investment even where growth considerations per se are not paramount: ensuring adequate access to quality public services, such as *health care* and education, often raises different challenges in different kinds of places – in particular, rural service provision can often be a challenge (OECD, 2010).[8]

Although debate over the relative merits and roles of place-based and spatially blind policies continues (see OECD, 2011b, for an overview), the place-based approach has recently grown in popularity not only in the EU, where it lies at the heart of EU regional policies, but also in such countries as Australia (Tomaney, 2010) and the United States (Orszag et al., 2009).

There are nevertheless major challenges associated with implementing a place-based approach. The search for policy complementarities increases the complexity of public

Box 1.2. **Drivers of regional growth and policy complementarities**

Recent OECD work, building on past research (OECD, 2009a, 2011b) and employing both quantitative models and roughly two dozen case studies, has sought to deepen and extend the understanding of how key growth determinants vary across regions. The major findings of this work may be summarised as follows:

- The key drivers of growth vary according to the level of development, although some factors – education and training, above all – appear to be critical for all types of regions. This reinforces the case for policies that are differentiated so as to address the different constraints that bind regions at different levels of development.
- The proportion of the workforce with low skills appears to have a greater impact on growth than the share with tertiary qualifications. Policies to address the plight of the low-skilled may thus be as important for growth as policies aimed at expanding higher education. The regional dimension is critical here, since low-to-medium skilled workers tend to be less mobile than their high-skilled counterparts. Policies aimed at addressing skills gaps thus need to be well adapted to local conditions.
- Infrastructure deficits need to be addressed in conjunction with other policies; when they are tackled in isolation, the results can be disappointing. Moreover, in the great majority of OECD regions, traditional physical infrastructure does not appear to be the binding constraint. This raises important questions about the prominent place of physical infrastructure investments in many regional development strategies. Since investments in "soft" infrastructures, in fields like entrepreneurship- and innovation-promotion, tends to be even more complex than traditional physical infrastructure projects, the importance of effective investment processes is, arguably, all the greater. Policy complementarities matter. While the quantitative findings are suggestive, rather than definitive, the case study evidence presented in OECD (2012c) strongly suggests that interactions among policies can be key and that improving regional performance has less to do with executing a sequence of individual steps than with identifying a feasible strategy for addressing a number of policy challenges in a co-ordinated fashion. The analysis points to the potential drawbacks of isolated interventions and "unbalanced" policy packages.
- Economy-wide policies can have differential effects across space. For example, anti-competitive regulation in "upstream" sectors and strict employment-protection legislation (EPL) are associated with slower regional productivity growth. Moreover, strict EPL and some forms of economy-wide product-market regulation appear to affect regions further from the productivity frontier more than others. These findings reinforce the case for regulatory reform in these areas and suggest that such structural reforms may help to reduce inter-regional disparities, as well as to enhance productivity.

Source: OECD (2012), *Promoting Growth in All Regions*, OECD Publishing, doi: 10.1787/9789264174634-en; D'Costa, S. et al. (forthcoming), "Structure, Policies, Institutions and Regional Growth", *OECD Regional Development Working Papers*, OECD Publishing; OECD (2009), *How Regions Grow: Trends and Analysis*, OECD Publishing, doi: 10.1787/9789264039469-en; OECD (2011), *OECD Regional Outlook 2011: Building Resilient Regions for Stronger Growth*, OECD Publishing, doi: 10.1787/9789264120983-en.

investment decisions, and the institutions involved often prove reluctant, if not unable, to co-ordinate their interventions to meet the specific needs of individual territories. Even highly decentralised federations often have policy processes in which vertical interactions are deeply sectoral. Cross-sectoral co-ordination often proves weak at the central and sub-national levels, and becomes even more difficult when decisions reach across levels of government as well as across sectors. A place-based approach to public investment for regional development thus makes significant demands on the governance systems at work.

Place-based approaches to investment imply a need for some decentralisation of decision making…

Decentralisation has often been advocated as a way to facilitate a place-based approach by bringing policy making closer to the needs of localities. Theoretical arguments about why some degree of decentralisation of decision making over investment would be more efficient have long been linked to variations in voter preferences from place to place (Oates, 1972), the potential benefits of some forms of inter-jurisdictional competition (Tiebout, 1956) and the existence of information asymmetries (Hayek, 1945). All OECD countries have, to a greater or lesser extent, assigned certain administrative or political functions associated with public investment to the sub-national level in the hope this would lead to better investment outcomes and possibly stronger growth performance. Empirically, research into the link between decentralisation and growth has yielded ambiguous results. While some studies find a positive relationship (Lin and Liu, 2000, for China; Akai and Sakata, 2002, for the United States), others find none (Davoodi and Zou, 1998). The methodological challenges associated with examining this relationship empirically point to a need for more work on identifying the real impact of decentralisation on growth (see Breuss and Eller, 2004, for a review and methodological outlook).

One reason for a degree of decentralised administration of public investment concerns the information asymmetries involved: except in a very small country, it is unlikely to be efficient for national governments to plan and manage infrastructure development across the whole territory. The information they lack, moreover, is not just technical data about local conditions that may be relevant to specific investment projects. As Hooghe and Marks (2009) observe, it can be particularly important in respect to "soft" information, which is not readily communicated in quantitative or other standardised forms. Such information can be expensive to gather, communicate and verify, and the costs of doing so tend to increase with distance. The information that matters often concerns the interactions among various strands of policy, which can be hard for central actors to predict and which may be best observed, understood and managed where they occur – in particular places. In contrast to spatially blind or sectoral approaches, place-based policies thus seek not only to mobilise critical local information about individual decisions or investments, but also to identify synergies or tensions among them that must be managed effectively if their overall policy package is to achieve the best effect (OECD, 2011b).

… but top-down, as well as bottom-up, input is critical

While some degree of decentralisation is needed to allow the kind of bottom-up input that a place-based approach to public investment requires, it would be a mistake to conclude that this is a function that governments can, or should, simply devolve to lower levels. On the contrary, it is striking that, as noted above, public investment across the OECD is virtually everywhere a shared responsibility. A variety of factors, including the presence of spillovers, financing constraints at lower levels of government, the need for the co-ordination of certain forms of investment across space and the potential for economies of scale all point to a role for higher level governments as well. As a result, a very large portion of public investment is typically undertaken as a joint activity, nested in a complex web of central, regional and local financing and decision making. While SNGs manage the largest part of such investment, the financing is most often mixed, involving national, regional and local sources (as well as supranational ones in the case of EU Structural Funds), and the process from planning through execution typically involves multiple

levels, in both very decentralised federations and highly centralised unitary states. This creates particular co-ordination challenges, not least owing to the presence of spillovers and the potential for specific places to effectively "export" the costs of new public investment, leading to inefficient allocation of resources (Haughwout, 2007).

This puts SNGs at the centre of a policy process that, to work well, requires intensive co-ordination across levels of government and among different actors at each level. It also makes significant demands on the capacities of sub-national authorities. Often, regional or local governments may lack the capacity to implement the policies needed to foster regional growth, though their knowledge and preferences remain essential to informing place-based policies (Barca, 2009). That is one reason why higher level governments often act to support public investment even in domains where it makes sense to allow a very high degree of decentralisation of decision making: working across levels of government becomes a way to overcome capacity gaps at lower levels. The structure of this inter-governmental collaboration is often marked, in principle at least, by partnership rather than sub-ordination. To a great extent, the balance of this report is devoted to exploring these co-ordination and capacity challenges and identifying the ways in which they might be overcome.

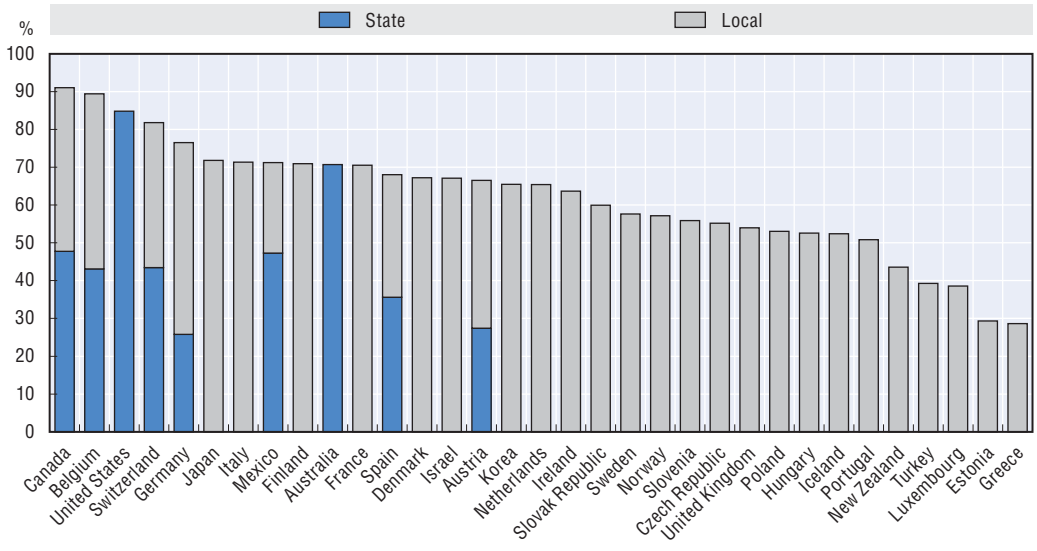
The impact of the crisis on public investment across levels of government

Sub-national governments play a central role when it comes to public investment…

As noted above, SNGs are, on average, responsible for about two-thirds of total public investment, though this figure conceals considerable variation across countries (Figure 1.1). If one considers all spending (current and investment alike), SNGs were responsible for 60% of public spending on education, 40% on health, 30% on economic affairs (i.e. regional development) and 20% on social protection.[9] In general, SNGs' share of public investment is much larger in federations or quasi-federal countries, where it is typically split between local authorities and the intermediate tier of authority (such as regions, states or provinces) constituted by the federal units. Not surprisingly, it is much lower in historically centralised or very small countries (Vammalle and Hulbert, 2013).

The SNG share of public investment has, moreover, been rising slowly but steadily over time (Figure 1.2). This increase may reflect several factors: declines in national spending on public investment, decentralisation trends in some countries and the nature of the competencies transferred, an increase in the number of projects carried out by SNGs, an increase in the cost of the projects carried out,[10] and for EU countries, the impact of European Structural Funds, particularly in new member countries (Vammalle and Hulbert, 2013; Dexia, 2011). Strikingly, though, divergence between more and less centralised countries has widened: the SNG share of public investment has risen in the federal and quasi-federal countries since 2008, while it has declined in the unitary states (Figure 1.2). While the limited time series of data make it hard to assert a trend, this divergence is striking, because, as will be seen, there are other reasons to believe that the crisis has indeed tended to reinforce previous patterns of centralisation and decentralisation, not least owing to concerns about SNG capacities. That said, Figure 1.3 makes clear that there were numerous exceptions to this rule – the SNG share of public investment fell in some federal countries (e.g. Switzerland), while rising in some traditionally centralised ones (e.g. Greece).

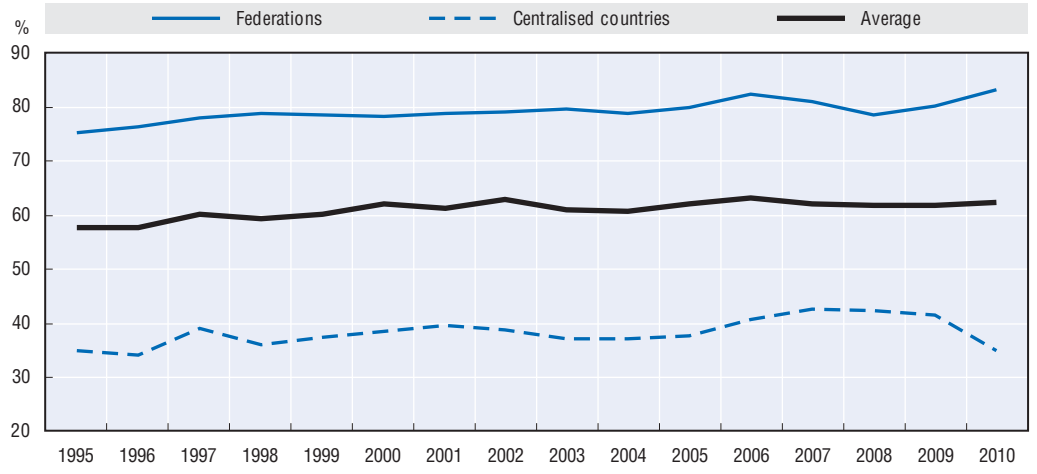
Figure 1.1. **Sub-national government ("local") shares of public investment (2011)**



Source: OECD (2012), *OECD National Accounts Statistics* (database), *www.oecd-ilibrary.org/economics/data/oecd-national-accounts-statistics_na-data-en*, accessed 12 December 2012.

StatLink http://dx.doi.org/10.1787/888932844334

Figure 1.2. **Sub-national government share of total government public investment (1995-2010)**



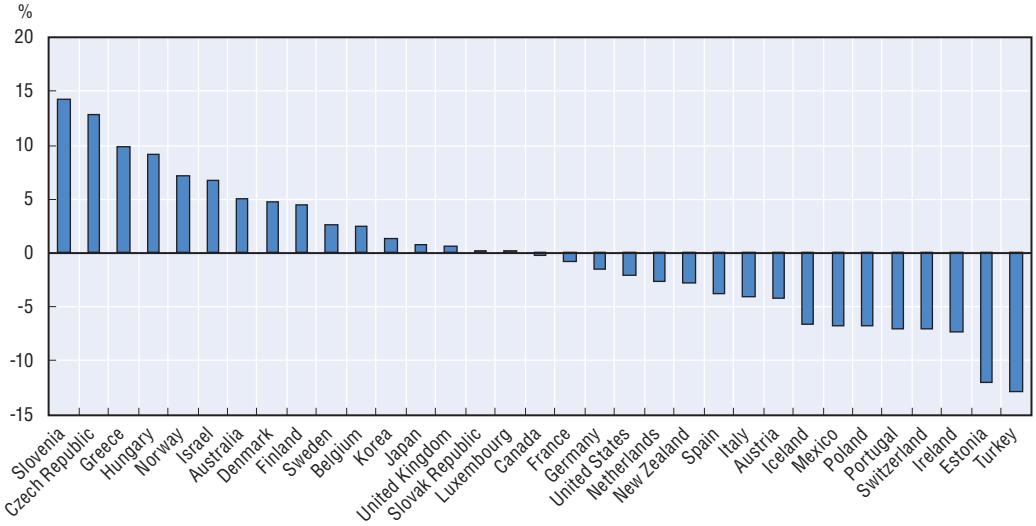
Source: OECD (2012), *OECD National Accounts Statistics* (database), *www.oecd-ilibrary.org/economics/data/oecd-national-accounts-statistics_na-data-en*, accessed 12 December 2012.

StatLink http://dx.doi.org/10.1787/888932844353

... but the crisis and its aftermath have seen public investment become an adjustment variable

Most OECD governments have moved from large-scale stimulus packages in 2008-09 to fiscal consolidation in more recent years. While measurement difficulties make precise cross-country comparisons difficult (Box 1.1), it is clear that public investment has emerged as a key "adjustment variable", in both directions, across the OECD. Stimulus packages adopted at the onset of the crisis included sizeable public investment programmes in a number of OECD countries (OECD, 2011a; Vammalle and Hulbert, 2013). This helped, for a time, to offset some of the fall in private investment that began in 2007.

Figure 1.3. **Changes in sub-national governments' share of total public investment (2007-11)**

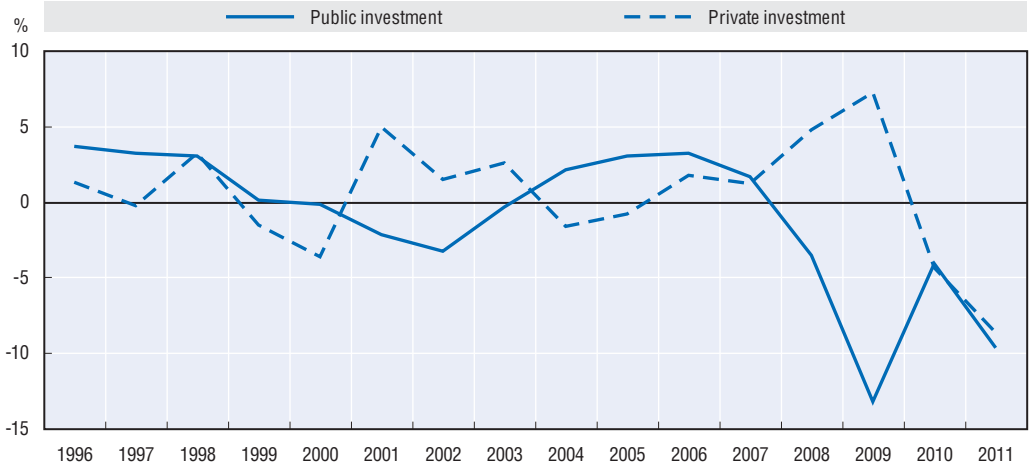


Source: OECD (2012), *OECD National Accounts Statistics* (database), *www.oecd-ilibrary.org/economics/data/oecd-national-accounts-statistics_na-data-en*, accessed 12 December 2012.

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SNGs benefitted from measures to boost investment through subsidies and capital grants, relaxed public procurement procedures, and loosened deficit and debt constraints (Dexia, 2011). Since 2010, however, consolidation strategies have reduced the resources for public investment, putting public investment onto a downward path, even as private investment in many countries has continued to contract (Figure 1.4). This has particularly affected the countries hit hardest by the crisis, including Greece, Ireland and Spain. Indeed, concrete and significant targets for curbing public investment have been set in some countries (OECD, 2012d): Spain planned on reducing infrastructure investments by the

Figure 1.4. **Annual changes in public and private investment (1996-2011)**



Source: Vammalle, C. and C. Hulbert (2013), "Sub-National Finances and Fiscal Consolidation: Walking on Thin Ice", *OECD Regional Development Working Papers*, No. 2013/02, OECD Publishing, doi: *10.1787/5k49m8cqkcf3-en*, based on OECD (2012), *OECD National Accounts Statistics* (database), *www.oecd-ilibrary.org/economics/data/oecd-national-accounts-statistics_na-data-en*, accessed 12 December 2012.

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equivalent of 3% of 2011 GDP, while Greece decided to cut overall public investment by 18% of 2011 GDP. In 2011, direct investment contracted in volume terms by 6.6% in EU member countries, with the greatest decline seen in Spain where direct investment fell by 30% in volume terms (Dexia, 2012). On average, in 2011, public investment measured in terms of government GFCF remained below its 2007 level across the OECD.

Fluctuations in public investment in response to changing circumstances are not entirely surprising. For many governments, it is one of the few major items in the budget that is more or less discretionary. With pensions, entitlements and public sector wages accounting for such a large share of government spending in developed countries, investment seems to be one of the few things that can be cut quickly in a crunch and is potentially less unpopular as the focus of cuts than other expenditure categories. This pattern is, indeed, typical of previous cycles: de Haan et al. (1996) find that in times of fiscal contraction, governments tend to cut investment spending more than other categories of expenditure. OECD (2007) points to evidence that consolidation typically begin with tax hikes and cuts in investment spending, as these can be executed quickly and can signal the government's serious intent, but that governments engaged in fiscal adjustment then move on to a broader strategy aimed at reductions in current spending.

Given that public budgets across the OECD are likely to remain tight for some time to come, the efficiency and effectiveness with which limited public investment resources are deployed are thus likely to be of increasing importance.

… and has undermined the ability of sub-national governments to engage in their key role for public investment

The events of the past five years have had a profound impact on SNGs' financial capacities. The fiscal tightening following the crisis led to a reduction in central government transfers, while own revenues in most cases remained depressed, owing to weak or negative growth. By contrast, upward pressure on social spending remained strong as a result of high unemployment (Blöchliger et al., 2010; Vammalle and Hulbert, 2013). In some countries, consolidation efforts included the introduction of deficit targets or balanced budget requirements at the sub-national level, while in others SNGs were affected by the cascade effect of national level rules.

Box 1.3. **What constitutes good quality in governance and how can it be measured?**

Defining governance as an execution task in terms of a "government's ability to make and enforce rules, and to deliver services", Fukuyama (2013) asserts that governance is about the performance of agents in carrying out the wishes of principals, instead of the goals that principals set. Given the lack of traditional governance indicators to measure the quality of governance, he proposes a preliminary framework, which he bases on the following four measurement categories:

1. Procedural measures. Derived from the principles of the Weberian Bureaucracy model, three qualities of governance measures emerge in this category: recruitment and promotion of bureaucrats on merit instead of political patronage; the level of technical expertise that bureaucrats should possess to carry out their functions; and the overall level of formality in bureaucratic procedure. Since procedures may not correlate with positive outcomes in terms of the performance of governments' tasks, however, the second category is developed: capacity measures.

Box 1.3. **What constitutes good quality in governance and how can it be measured?** *(cont.)*

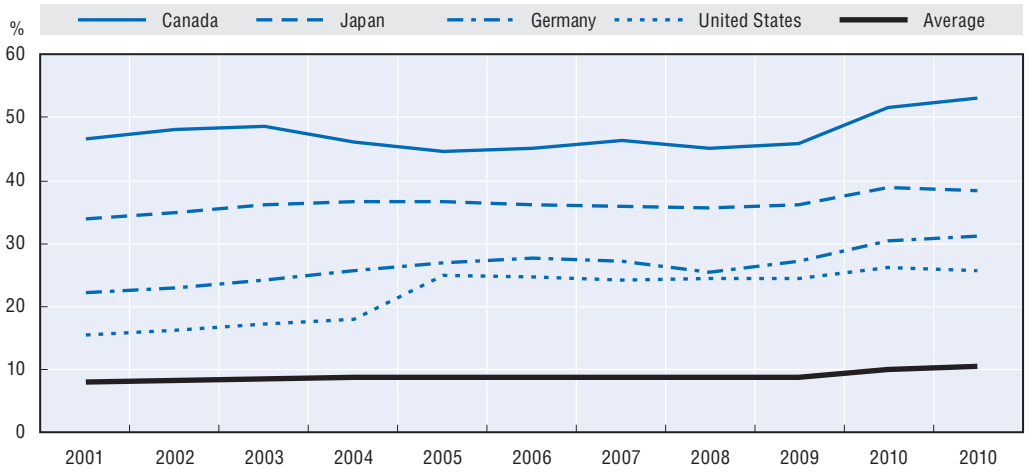
2. Capacity measures. The capacity measurement should measure the ability of the administration to carry out its tasks. Traditional measures, such as tax extraction rates (% of taxes to GDP or nature of taxes), have the advantage that every country has to collect taxes, and data exist for measuring it. In addition to this indicator, the level of education and professionalisation of government officials can be measured. Since capacity is likely to vary across functions, and jurisdictional levels, all major government agencies should be measured, and disaggregated indicators developed.
3. Output measures. In addition to good procedures and strong capacity, government quality needs to be measured in terms of final outputs, such as literacy rates, education test scores, etc. Caution needs to be applied with output measures, as the public sector can only do so much to influence the results. Interventions by the public sector are influenced by the environment and are prone to bad measurement (for example, when teachers start over-tailoring their teaching to reach high test scores). It is proposed to use output measures as independent variables, rather than explanatory ones.
4. Bureaucratic autonomy. Bureaucrats do not determine their general mandates, their political masters (principals) define them. Principals, however, can define very broad mandates (e.g. build a road network) or make them very precise (e.g. procure a construction company that increases the employment of ethnic minority workers coming from a specific area). Mandates are often contradictory and can thereby create dysfunctional bureaucracies (e.g. if local agencies have to report to a chain of command through national ministries, at the same time as to municipal or provincial governments, it may become unclear for the local agency how to resolve conflicts). There needs to be a balance between broad mandates and detailed rules issued by higher government tiers to lower ones. Autonomy is more difficult to measure, even though the author proposes some avenues, including the percentage of political appointments versus the merit-based ones. The provision of autonomy to lower levels of government depends on the level of capacity available: the higher the level of capacity, the more autonomy can be granted.

Source: Fukuyama, F. (2013), "What is Governance?", *Center for Global Development Working Paper*, No. 314, Center for Global Development, Washington, DC, January.

The strains brought on by the crisis pushed many SNG budgets deep into deficit, driving SNG debt from an average of 10% of GDP in 2007 to 13% and rising in 2010 (Vammalle and Hulbert, 2013). This average figure, though relatively low, conceals large disparities among countries. In a number of large OECD countries, it is far higher than the average (Figure 1.5), and in Canada, SNG debt was greater than that of the federal government (Figure 1.6). Moreover, as Vammalle and Hulbert (2013) have shown, the differences within countries are sometimes enormous: where national average figures would in some cases suggest a picture in which most SNGs are struggling but solvent, it appears a few are on the brink of bankruptcy. As events in a number of OECD economies in late 2012 highlighted, SNGs' financial difficulties can quickly create financial and political problems for central governments as well, particularly where markets impute the cost of an expected bail-out into the cost of sovereign debt. Finally, SNGs themselves have faced increasing difficulty in securing access to credit as a consequence of increased borrowing costs and a contraction in the volume of credit given by financial intermediaries in many of the most-affected countries (OECD, 2012d), as well as a reduction in foreign investment inflows (Paulais, 2009).

Limited room for manoeuvre on the revenue side, combined with expenditures that are dominated by items which are difficult, if not impossible, to cut very quickly, has

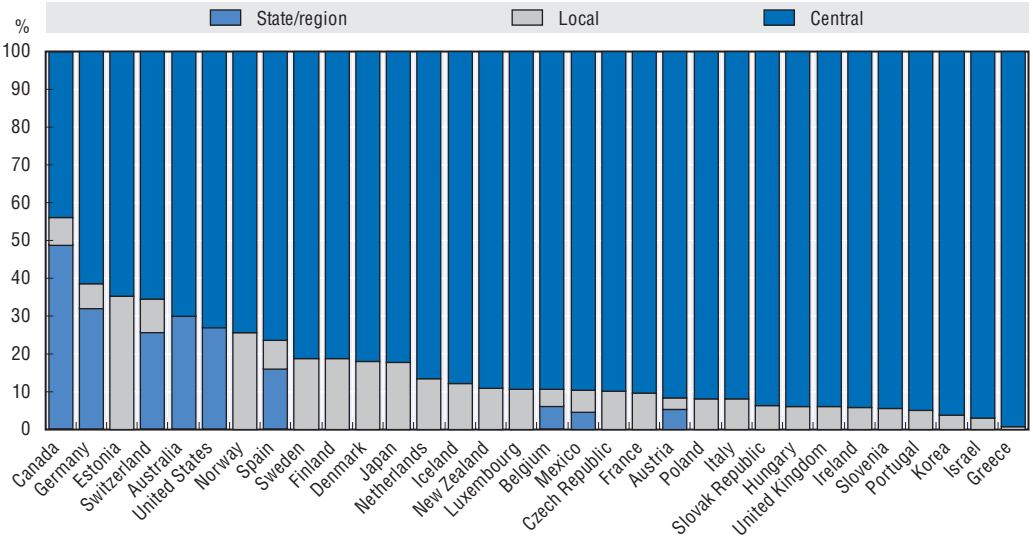
Figure 1.5. **Share of sub-national government debt-to-GDP (2001-10)**



Source: OECD (2012), *OECD National Accounts Statistics* (database), *www.oecd-ilibrary.org/economics/data/oecd-national-accounts-statistics_na-data-en*, accessed 12 December 2012 and OECD (2011), "Fiscal decentralisation ", *OECD Tax Statistics* (database), doi: 10.1787/*data-00580-en*, accessed on 20 November 2012.

StatLink http://dx.doi.org/10.1787/888932844410

Figure 1.6. **Composition of public debt by sector of government (2009)**



Source: Vammalle, C. and C. Hulbert (2013), "Sub-National Finances and Fiscal Consolidation: Walking on Thin Ice", *OECD Regional Development Working Papers*, No. 2013/02, OECD Publishing, doi: 10.1787/5k49m8cqkcf3-*en*, based on OECD (2012), *OECD National Accounts Statistics* (database), *www.oecd-ilibrary.org/economics/data/oecd-national-accounts-statistics_na-data-en*, accessed 12 December 2012.

StatLink http://dx.doi.org/10.1787/888932844429

prompted SNGs to cut public investment spending. This situation is not likely to change soon, even if there is some relaxation of current austerity programmes. All levels of government will therefore have to contribute to "doing more with less", which requires them to develop both their individual and collective capacities to deliver more efficient public investment.

Improving public investment through quality governance

"Doing better with less" requires improving the quality of government…

The quality of government can be defined as the ability of a public administration to carry out the tasks assigned to it (Box 1.3). There has been a great deal of work in recent years on measuring the quality of institutions and the variation across countries (see Kaufmann and Kraay, 2008, for a review), as well as considerable debate about the relationship between institutional quality and economic performance. It is now fairly widely accepted that there is a link between the two (e.g. Woolcock, 1998; North, 1990; Rodrik et al., 2004; Acemoglu et al., 2005), but there remains controversy over whether, how and to what extent one can assert a causal link between them. While some have argued strongly that better institutions contribute to better economic performance, institutional quality may also be a product of economic performance (i.e. it may be endogenous to the economic process) or both may be driven by some third factor, such as human capital. Advocates of the first view emphasise the establishment of stable institutions as a requirement for economic development, suggesting that institutions do affect growth (Acemoglu et al., 2001; Easterly and Levine, 2003; Dollar and Kraay, 2003; Rodrik et al., 2004). A number of identification strategies have been employed in an attempt to overcome the endogeneity problem, i.e. a potential reverse causality, associated with this argument. Mauro (1995), for example, uses ethnolinguistic fractionalisation as an instrumental variable and finds that weak institutions are correlated with lower private investment, reducing economic growth as a consequence. The view that institutions are critical determinants of growth is challenged by research suggesting that initial levels of human capital have a first-order effect on both the establishment of quality institutions and economic performance (Glaeser et al., 2004). A certain level of human and physical capital may need to exist before stable institutions are created.

To date, most of the discussion of these issues has taken place at the level of nation-states. Territorial disparities in terms of socio-economic development, location and other factors suggest that there is likely to be considerable variation in the quality of government within countries, but regional institutional quality has been much less studied and has been largely disregarded as a factor influencing regional economic performance. While a number of qualitative studies have looked at local institutions' impact on growth, empirical attempts to measure this effect have only been undertaken recently. This was in part due to the lack of large data sets with indicators of SNG quality. In addition, this neglect may also have reflected the tendency of traditional regional development policy to be rooted in a top-down approach that neglected the role of institutions, particularly sub-national ones (Rodriguez-Pose, 2010). For Europe, at least, there is now one indicator available (Box 1.4): a perception-based composite indicator of the quality of government (QoG). This has led to renewed interest in the regional dimension of the debate over institutional quality and economic performance. Using this new indicator, Charron et al. (2012) find that there is large variation in the perceived quality of government both within and across countries in Europe. Greece, Italy, and Portugal, in particular, show significant within-country variation (Figure 1.8). More important, they show that 60% of the variation in the regional Human Development Index (HDI) is explained by this quality of governance variation (Figure 1.7). Interestingly, they, like Filipetti and Reggi (2012), find that the degree of political centralisation or decentralisation of a country does not imply more or less variation in the quality of government variation within it.

Box 1.4. **Sub-national quality of government: Using citizens' perceptions as a basis for measurement**

In an attempt to gather data on the sub-national quality of government, Charron et al. (2012) conducted a regional representative survey across 27 EU countries asking respondents about their perceived quality of their sub-national government. The survey data were then used to construct a composite index of the Quality of Government for 172 European regions (see Quality of Government Institute, 2010, for details). The indicator is based on public perceptions of four components of governance: *i)* the rule of law; *ii)* corruption; *iii)* the quality of the bureaucracy; and *iv)* democracy and the strength of electoral institutions. The data were collected in a single survey year (2009) from some 34 000 respondents in 18 EU countries.

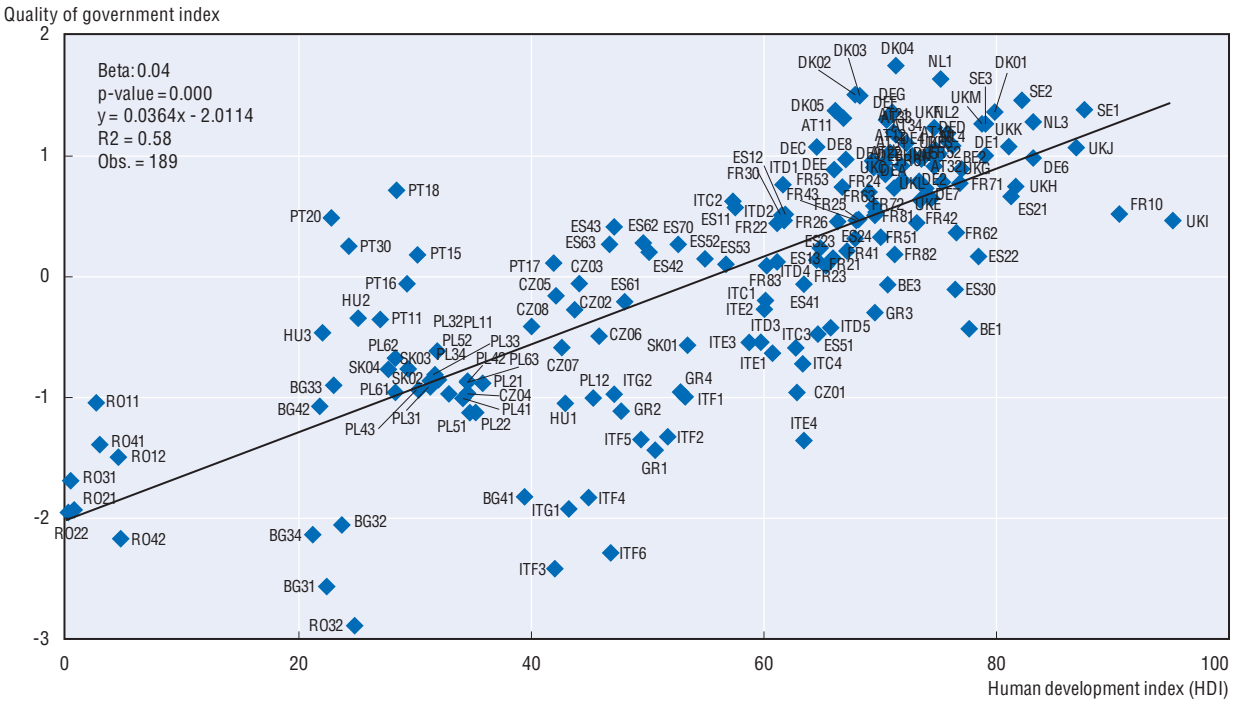
There are two main limitations involved in the use of the indicator to study the link between quality of government and economic performance. The first is simply that it was collected for only one year (2009). No time series are yet available. The second is that the indicator is based entirely on public perceptions, which may be incomplete or inaccurate. There is reason to believe that public perceptions of institutional quality can change rapidly for the worse (e.g. in response to a corruption scandal or the exposure of very poor performance in some part of the public sector), but tend to improve slowly, often lagging changes in actual public sector performance. This is especially true where public sector actors face rising public demands and expectations for services. Nevertheless, public satisfaction data do at least directly tap the ultimate demand for quality administration – the needs of the governed – rather than relying on more synthetic measures, and this must be regarded as a strong point. Moreover, the evidence suggests that measures of public perception may deviate from reality, but only up to a point. Countries with a reputation for corruption, for example, generally do have serious problems with it.*

The use of a perception-based variable makes the problem of endogeneity unavoidable if one aims to link institutional quality to performance (Rodriguez-Pose, 2010; Ugur, 2010). Economic performance is, after all, likely to be one factor shaping perceptions of institutional quality, but it is not the only one, and the link may not necessarily be very strong. Nor is this the only potential source of an endogeneity problem: it is also possible that countries that experience sustained growth are better able to build good institutions (as the link between institutional quality and income might suggest) or that countries with good institutions also benefit from other factors that support better performance (omitted variable bias). The results cited in this chapter should be interpreted with that caveat in mind. Future studies will have to come up with either instrumental variables or alternative specification models (such as a regression discontinuity design) to overcome these methodological shortcomings. It is noteworthy, however, that D'Costa et al. (forthcoming) find little or no correlation between changes in the quality of government variable and changes in economic growth. This suggests that the regression results reported in this chapter are unlikely to be a product of covariation between the two variables.

* For a detailed look at this literature, see Mocan (2004) and Olken (2009).

Source: Charron, N. et al. (2012), "Regional Governance Matters: A Study on Regional Variation in Quality of Government within the EU", WP 01/2012, Directorate-General for Regional Policy, Brussels; Quality of Government Institute (2010), "Measuring the Quality of Government and Subnational Variation", report for the European Commission Directorate-General for Regional Policy, Quality of Government Institute, Department of Political Science, University of Gothenburg, Sweden, December; Rodriguez-Pose, A. (2010), "Do Institutions Matter for Regional Development", *Imdea Working Paper* series, Madrid; Ugur, M. (2010), "Institutions and Economic Performance: A Review of the Theory and Evidence", unpublished, University of Greenwich, October, *http://mpra.ub.uni-muenchen.de/25909/*; D'Costa, S. et al. (forthcoming), "Structure, Policies, Institutions and Regional Growth", *OECD Regional Development Working Papers*, OECD Publishing; Mocan, N. (2004), "What Determines Corruption? International Evidence from Micro Data", *NBER Working Paper*, No. 10 460, National Bureau of Economic Research, Cambridge, MA, May; and Olken, B. (2009), "Corruption Perceptions versus Corruption Reality", *Journal of Public Economics*, No. 93, August.

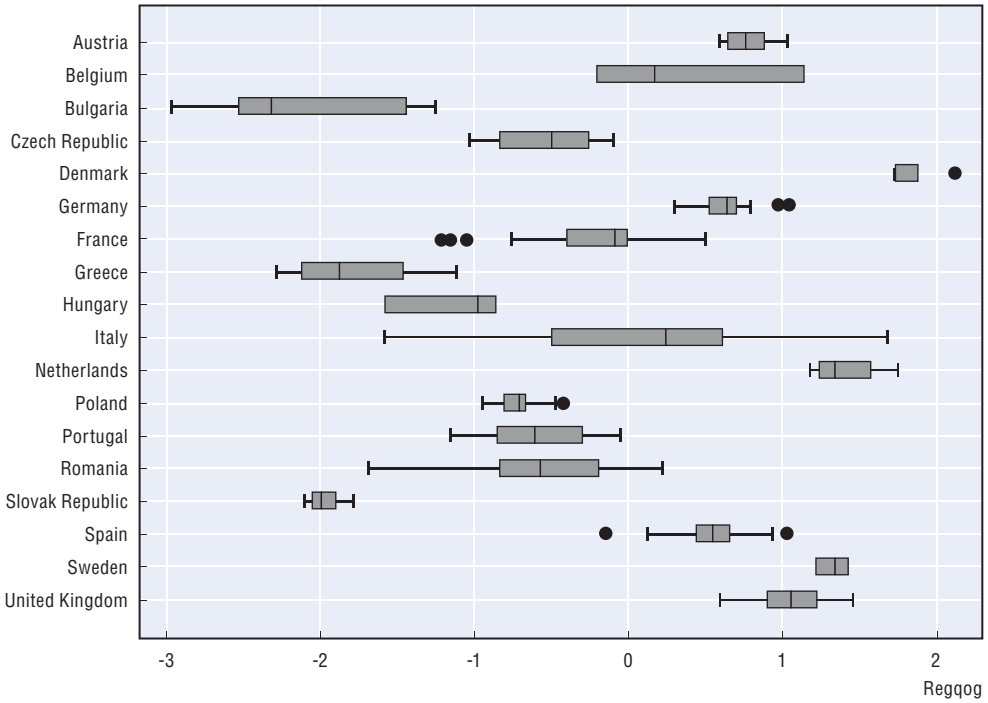
Figure 1.7. **Human Development Index and Quality of Government**



Source: Charron, N. et al. (2012), "Regional Governance Matters: A Study on Regional Variation in Quality of Government within the EU", WP 01/2012, Directorate-General for Regional Policy, Brussels.

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Figure 1.8. **Regional Quality of Government and sub-national variation**



Source: Data from Charron, N. et al. (2012), "Regional Governance Matters: A Study on Regional Variation in Quality of Government within the EU", WP 01/2012, Directorate-General for Regional Policy, Brussels.

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Filipetti and Reggi (2012) go one step further, using the QoG indicator to explore the link between the quality of government and public investment and growth outcomes. They find that the quality of government is positively related to the growth impact of EU cohesion spending. Becker et al. (2011) employ the QoG indicator to study whether absorptive capacity (measured in human capital and quality of government endowment) of EU Objective 1 regions matters for growth performance. Using a regression discontinuity design with heterogeneous treatment effects, they show that the degree of human capital and quality of government endowment have a significant effect on turning EU transfers into economic growth. The results of these analyses should be taken with some caution, in view of the limitation of the analysis to European regions and, in the case of public investment, the reliance on cohesion spending rather than a broader measure of public investment. This last choice likewise reflects data availability: data covering public investments financed by regions and by national governments exist only for a very limited number of countries.

Recent OECD analyses (Rodriguez-Pose and Garcilazo, forthcoming; D'Costa et al., forthcoming) likewise employ the QoG indicator to assess the impact of institutional quality on both economic performance in general (measured in terms of GDP growth) and the returns to public investment, using EU cohesion expenditure as the key investment variable. Although quality of government does not seem to affect the returns to cohesion expenditure across the whole sample of regions considered, it does play a major role in determining whether the cohesion investments are connected to faster growth in those regions receiving the largest sums per capita. For regions receiving an average of more than EUR 80 per capita per year in Cohesion Funds, the quality of government may be a key determinant of whether greater cohesion investment is translated into greater growth. The importance of quality of government appears to increase as the level of cohesion expenditure rises. For regions receiving very high levels of cohesion spending per capita and sharing a similar level of quality of government, greater expenditure does not necessarily translate into greater economic growth – there is a point of diminishing returns for such expenditure that is, in part, dependent on institutional quality.[11]

Rodriguez-Pose and Garcilazo (forthcoming) also introduce an "interaction term" into the analysis – a variable constructed to reflect the degree to which changes in quality of government might affect the impact of changes in cohesion expenditure on growth and investment outcomes and vice versa. Their results further reinforce the importance of the quality of government variable in determining the returns to cohesion expenditure (Rodriguez-Pose and Garcilazo, forthcoming). The introduction of the interaction term[12] not only strengthens the positive and significant coefficients associated with the quality of government variable on its own, it also renders the public expenditure variable positive and significant, with the exception of the regression where the threshold is set at EUR 150. The coefficient of the interaction is always negative, always statistically significant and very close to zero. The results obtained when the interaction term is present suggest several conclusions. First, the returns to European investment in regional cohesion increase as the threshold of investment per capita per annum increases – but only up to a point. The returns are higher at a threshold of EUR 100 than at one of EUR 80. In turn, regions which receive more than EUR 120 per head of Structural and Cohesion Fund expenditure per annum do better in growth terms than those receiving EUR 100. However, there is virtually no difference between the returns experienced by regions receiving more than EUR 120 and those receiving more than EUR 150. Second, in all categories, regions

with a higher quality of government perform significantly better at the same level of cohesion expenditure than those with a lower quality of government. Thirdly, although increasing cohesion expenditure helps to reduce the gap in the returns experienced between regions with a high and low quality of government, this reduction is marginal and does not suffice to overcome the quality of government gap. Above a certain threshold of expenditure, disbursing more funds is likely to be futile (even leading to lower levels of growth), unless there is a significant improvement in the quality of government of the region receiving the funds.

More generally, the negative relationship between quality of government and GDP per capita, which is central to the allocation of Structural Funds, suggests that the interaction term is tapping into a negative relationship between the two independent variables of interest. The correlation between the two is both negative and statistically significant, although when all regions are considered, the relationship is weakened somewhat by the clustering of so many regions close to 0 on per capita annual Cohesion Policy spending. The relationship grows more negative as the threshold values used in the models (EUR 80, 100, 120 and 150) increase. In short, poorer EU regions do indeed have a lower quality of government.

When breaking out the four components of the Quality of Government Index – corruption, the rule of law, voice and accountability, and government effectiveness – the results differ little from those presented for the overall index in the previous paragraphs. However, one variable stands out in these analyses: corruption. Although there is little evidence that corruption levels have much impact on the returns to cohesion expenditure across all regions, this appears to reflect the impact on the results of the very large number of regions with minimal cohesion expenditure: the strength of the interaction between cohesion expenditure and quality of government in regions with high levels of cohesion spending appears to be greatest in the case of corruption. Moreover, when corruption levels are introduced into the analysis by the threshold level of cohesion spending (as above), the drop in the returns to cohesion investment from the EUR 120 to EUR 150 per capita levels is particularly striking. In short, high levels of corruption appear to have a particularly deleterious effect on the returns to cohesion spending in places that receive large Cohesion Funds.

It is common to explain quality of government in terms of political economy variables, like rent-seeking and (weak) accountability. In many instances, the weakness of institutions serves the interests of powerful groups who are capable of looking after their interests in the absence of effective state institutions. Not only do they have no need for better public governance, they might find it threatening, to the extent that it constrained their activities or made it easier for new entrants to compete with them politically or economically. At the extreme, one might think of regimes in some developing countries that have ruled for long periods of time in which the primary aim of the rulers was to appropriate the country's wealth (Wintrobe, 2000; Acemoglu et al., 2003). In post-communist societies, too, there have been episodes in which governing elites have undermined the very state institutions through which they governed in order to facilitate their own rent-seeking (Ganev, 2005). Such examples are hardly typical of OECD countries, but less extreme versions of this phenomenon are widespread, as the literature on, e.g. urban political machines shows (Guterbach, 1980; Reid and Kurth, 1992). Wherever elite cliques and/or entrenched special interests are strong, there is a risk that state action will be diverted from the provision of public goods to the provision, at least in some

spheres of activity, of private goods or "club goods" targeted to specific groups (actual or potential supporters) and withheld from others (actual or potential opponents). The clear implication is that there may be very large constituencies threatened by – or at least sceptical of – reform.[13]

That said, the pronounced correlation between the QoG indicator and such factors as income and education points to a second line of causation, which may well be more important in many lagging OECD regions. Poor quality of government in many cases may also be linked to lower levels of human and physical capital, as well as poorer technology (La Porta et al., 1999; Botero et al., 2012; Chong et al., 2012). Public institutions in some places have low productivity for the same reasons that private firms in those places do. Of course, the two explanations are not mutually exclusive; they may even be mutually reinforcing. First, if institutions are weak, for whatever reason, they may invite rent-seeking and corruption, which will weaken them further. Secondly, the evidence suggests that increasing income and education are also associated with greater demands for voice and accountability and greater capacity for good (public or private) management (Almond and Verba, 1963; Dahl, 1971; Diamond, 1992; Hadenius, 1992; Helliwell, 1994). In short, it would appear that governance and growth are good for each other, and that education is good for both.

These findings raise questions about what can be done to enhance the quality of government to improve public investment outcomes. This is likely to require a complex, multi-level approach, involving both top-down initiatives and collaborative interventions. Where the evidence suggests that the problem is rooted in local elites who profit from poor institutions, part of the solution may lie in establishing greater transparency and inclusivity in local policy making, as well as stricter accountability to both citizens and higher levels of government. Some reforms along these lines (e.g. with respect to public procurement) are discussed in the chapters that follow. Addressing deficits in human capital and technology, by contrast, will probably require collaborative interventions of a different order. As will be seen, these interventions will, in many instances, be connected to better co-ordination across levels of government and capacity building at sub-national levels, the two lines of response that constitute the central concerns of Chapters 2 and 3, respectively.

Key bottlenecks exist in the governance of public investment

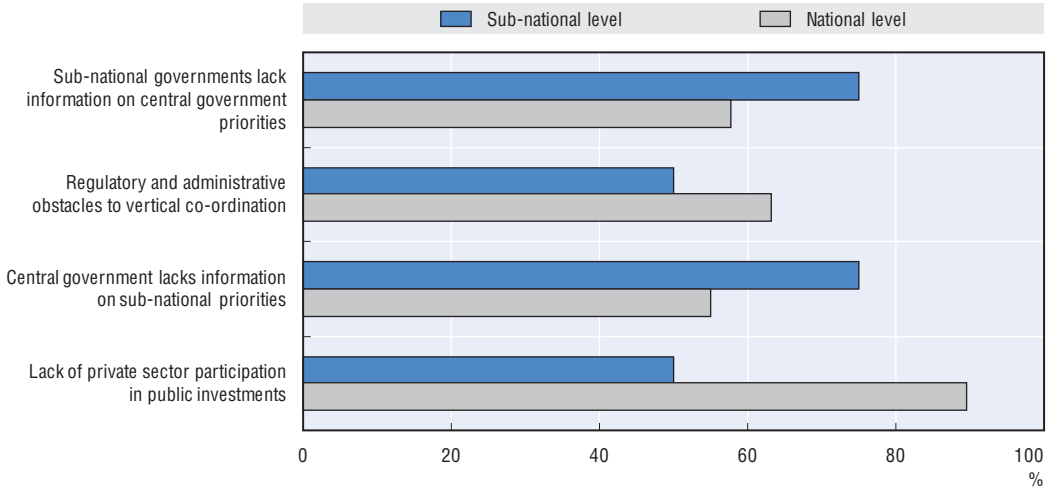
OECD countries struggle to achieve effective inter-governmental co-ordination of investment…

Since public investment is a shared responsibility across levels of government, the constellation of actors involved in public investment in OECD countries is large and complex and, in most, it appears to have grown over time. Policy-making authority has been progressively more distributed across levels of government, both downwards to SNGs and upwards to supranational authorities.[14] Moreover, the private sector's role has grown as a result of the privatisation of many services, shifting redistributive policies and the move from discretionary management to market regulation in many policy domains.[15] Governments have also enlarged the space for the participation of other non-state actors in the policy process, most notably citizens and civil society organisations. In addition, horizontal relations across jurisdictions at the sub-national level also give rise to complex co-ordination requirements and the need for a variety of forms of functional public management. Managing the resulting inter-dependencies across levels of

government and among different stakeholders is therefore a major part of the governance of public investment.

Responses to the OECD survey carried out for this report suggest that significant challenges with respect to managing these interdependencies persist. Figure 1.9 shows that national governments find the limited financial resources (to co-finance public investment) at the sub-national level to be part of the difficulty in making shared responsibilities work. Weaknesses at one level may impede other levels from performing as well.

Figure 1.9. **Cross-governmental co-ordination challenges of public investment**



Source: OECD (2012), "Multi-Level Governance of Public Investment", national and regional case study questionnaires, *www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm.*

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Past OECD work (Charbit and Michalun, 2009) has identified a set of specific co-ordination challenges ("multi-level governance gaps") across levels of government, linked to the kinds of mechanisms that might be used to bridge them (Table 1.1). To be sure, such challenges are not unique to public investment: they arise in respect of the organisation of various public services as well. However, the picture with respect to investment is further complicated by additional factors, including long time horizons or limited information about likely (or feasible) outcomes. Much of the discussion that follows is couched in terms of the ways in which these gaps arise in the design and implementation of public investment, with the aim to help countries and regions identify potential solutions to them.

… and they face shortfalls in sub-national capacities for implementing public investment

Co-ordination mechanisms are important instruments to facilitate co-operation for investment across levels of government. However, where the necessary sub-national capacities are weak or non-existent, co-ordination mechanisms will fail to achieve their objectives, regardless of how well they are designed. For example, if sub-national actors are charged with managing the construction of a bridge, where the national level ensures funding, resources may well be wasted if the sub-national level lacks procurement know-

Table 1.1. **Co-ordination challenges across levels of government**

Governance gap	Description => Potential remedy
Funding	Unstable or insufficient revenues undermining effective implementation of responsibilities at sub-national level or for shared competencies => Need for shared financing mechanisms.
Administrative	Occurs when the administrative scale for investment is not in line with functional relevance as in the case of municipal fragmentation => Need for instruments for reaching "effective size" (co-ordination tools among sub-national units, mergers).
Policy	Results when line ministries take purely vertical approaches to cross-sectoral policies, to be territorially implemented => Need for mechanisms to create multi-dimensional/systemic approaches and to exercise political leadership and commitment.
Information	Asymmetries of information (quantity, quality, type) between different stakeholders, either voluntary or not => Need for instruments for revealing and sharing information.
Capacity	Arises when there is a lack of human, knowledge or infrastructural resources available to carry out tasks => Need for instruments to build local capacity.
Objective	Exists when different rationales among national and sub-national policy makers create obstacles for adopting convergent targets. Can lead to policy coherence problems and contradictory objectives across investment strategies => Need for instruments to align objectives.
Accountability	Reflects difficulties in ensuring the transparency of practices across different constituencies and levels of government. Also concerns possible integrity challenges for policy makers involved in the management of investment => Need for institutional quality instruments => Need for instruments to strengthen the integrity framework at the local level (focus on public procurement) => Need for instruments to enhance citizen's involvement.

Source: Charbit, C. and M. Michalun (2009), "Mind the Gaps: Managing Mutual Dependence in Relations among Levels of Government", *OECD Working Papers on Public Governance*, No. 14, OECD Publishing, doi: *10.1787/221253707200*; Charbit, C. (2011), "Governance of Public Policies in Decentralised Contexts: The Multi-level Approach", *OECD Regional Development Working Papers*, No. 2011/04, OECD Publishing, doi: *10.1787/5kg883pkxkhc-en*.

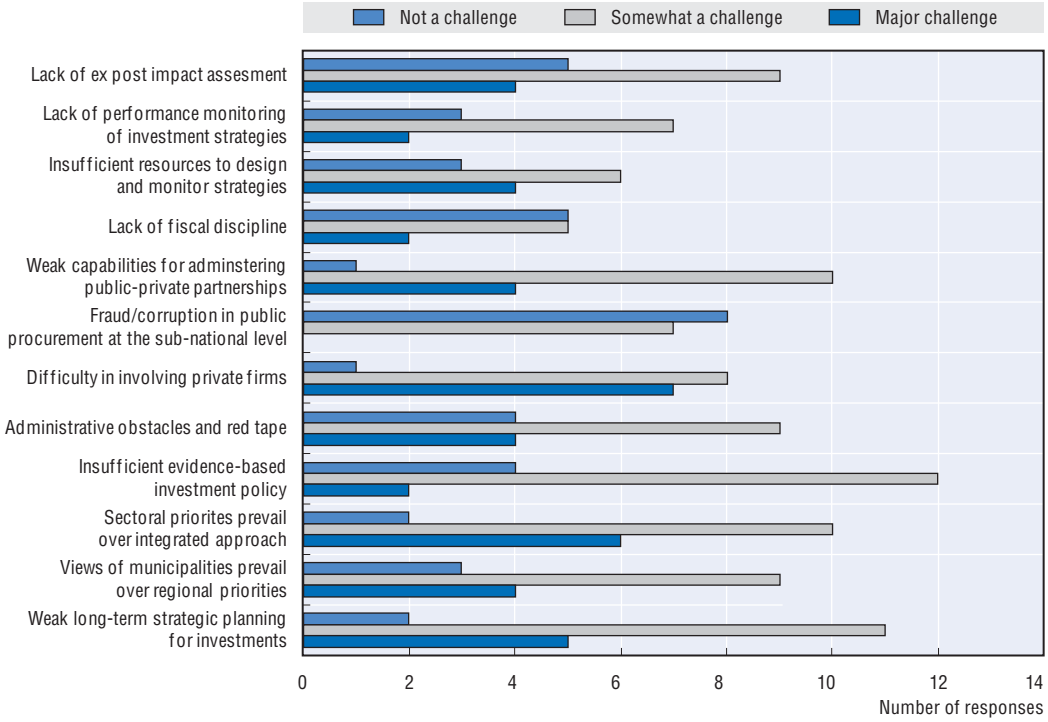
how. SNGs therefore need to have the ability to perform effectively the roles assigned to them. To design, finance and implement public investment projects, SNGs need the capacity not only to carry out the delivery of public investment projects (from project identification to monitoring), but also the ability to engage vertically with actors at higher (or sometimes lower) levels of government and, in many cases, to co-operate horizontally with "peer" jurisdictions on specific public investment programmes. These capabilities cannot be taken for granted.

Significant challenges persist with regard to sub-national capacities (Figure 1.10). From a central government perspective, a key sub-national capacity constraint lies in the difficulty of developing a cross-sectoral view of public investment at the sub-national level, as sectoral priorities prevail over a place-based approach to investments. Difficulty in developing long-term planning horizons when managing public investments are another perceived capacity constraint, and may be connected to the first.

Recent empirical work reinforces these concerns, highlighting the extent to which weaknesses with respect to sub-national capacities and co-ordination across both sectors and levels of government continues to impede the design and implementation of effective, efficient investments. In particular, Allain-Dupré (2011) studies the expansion of public investment during the stimulus phase of the crisis and concludes that the experience of a number of countries in administering stimulus packages crystallised a number of governance challenges that made it difficult to implement investment strategies across levels of government rapidly and effectively:

- the fiscal challenge, most often linked to the difficulty of co-financing investment;
- the capacity challenge, linked to inadequate resources, staffing or processes for the rapid, efficient and transparent implementation of investment projects;

Figure 1.10. **Governance capacity challenges facing sub-national governments in managing public investment (from a national perspective)**



Source: OECD (2012), "Multi-Level Governance of Public Investment", national and regional case study questionnaires, *www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm*.

StatLink http://dx.doi.org/10.1787/888932844505

- the policy challenge, and the difficulty of aligning incentives and objectives so as to exploit potential synergies across different sectors and policy fields; and
- the administrative challenge associated with the fragmentation of investment projects at the local/municipal level.

These findings represent both the point of departure and a major motivation of the present work. The issues of capacity building and co-ordination are, of course, inextricably linked. Many co-ordination mechanisms depend on the presence of capacities at sub-national level that cannot always be taken for granted, while others may be employed precisely in order to "plug" capacity gaps. For example, shared databases or use of performance indicators systems can be valuable capacity-building tools. Likewise, strong sub-national financial and human resources capacities are needed for co-ordination to work. These challenges are common to large and small countries, to federations and to highly centralised polities. Indeed, as will be seen, while the specific solutions applied depend to a great extent on the institutional architecture of the country concerned, many of the basic mechanisms at work are the same. This is worth emphasising since it suggests that even countries with very different economic and political orders can learn much from one another and also that the co-ordination and capacity challenges can be addressed in a wide variety of settings. What matters is not achieving some ideal level of centralisation or decentralisation of power but rather learning to strike the right balance between top-down and bottom-up elements that resolves the problems of information, accountability and consent discussed in Chapter 2.

Methodology and structure of the report

This project is based on a mixed-method approach and essentially encompasses three core pillars: *i)* a national survey of OECD countries (see Annex B) exploring the existing mechanisms and challenges, as well as best practices, with regard to the co-ordination of and sub-national capacity for public investment; *ii)* seven regional case studies (see Annex A), complementing the quantitative data with more in-depth qualitative information; *iii)* a quantitative investigation into the impact of the quality of government on regional economic outcomes and, in particular, on the returns to public investment. The methods employed for the later and the results, summarised in the present chapter, are presented in greater detail in D'Costa et al. (forthcoming) and Rodriguez-Pose and Garcilazo (2013).

Chapter 2 takes up the issues of horizontal and vertical co-ordination. The enormous variety observed in the institutional architectures of OECD member countries, as well as the wide range of co-ordination challenges to be addressed, make it unrealistic to devise any single model. However, this institutional diversity does not alter the fact that the fundamental challenges arise everywhere: aligning agents' incentives, reducing information asymmetries, ensuring adequate accountability, etc. Chapter 2 will first systematically assess the variety of co-ordination mechanisms among levels of government across OECD countries. It will then turn to the discussion and implementation experiences of specific instruments, including contract mechanisms. Chapter 3 focuses on key capacities for SNGs to engage in and implement effective management of public investment, structured around the stages of the investment cycle. It seeks to identify ways for countries and regions to assess capacity needs in specific situations and considers possible ways to address them. Where possible, the analysis identifies the kinds of regions, countries, sectors or projects in which particular issues may be more or less relevant, but its aim is to help regions and countries diagnose their own needs, rather than to present strong recommendations regarding any specific model.

Notes

1. Data are from the OECD National Accounts for all OECD countries, excluding Chile. Data are for 2011 (in 2005 USD PPP), except for Canada, Japan, Korea, Mexico and Turkey (2010); and Australia and New Zealand (2009). As gross fixed capital formation does not include several forms of investment expenditure (see Box 1.1), this figure likely underestimates the true level of public investment.
2. These two dimensions of performance are related but distinct. "Effectiveness" is concerned with performance in respect of the objectives set, without regard to cost. Effectiveness reforms may be cost-increasing, cost-neutral or cost-decreasing. "Efficiency" refers to the relationship between cost and outcome: efficiency reforms aim at better outcomes for any given level of expenditure.
3. For some of the key early contributions to the literature, see Aschauer (1989a, 1989b), Congressional Budget Office (1991) and Gramlich (1994).
4. They do not, however, find that these benefits are guaranteed. Their results suggest that the growth impact of public investment can be negative in certain circumstances, particularly where initial public capital levels are already very high and/or where financing via distortionary taxes or high-cost borrowing reduces the returns to the investment.
5. On human capital and R&D, see also OECD (2009a) and Padoan (2009). See Irmen and Kuehnel (2009) and Del Bo (2009) for recent overviews of the neoclassical literature on public investment, which tends to focus on supply side channels such as those discussed here.
6. The interest rate effect is fairly straightforward if public investment is financed by borrowing. The impact of public investment on the exchange rate is more complex but largely arises from its

potential affect on aggregate demand and domestic prices, particularly of non-tradables. See Romp and Haan (2007).

7. Haughwout (2007), however, produces estimates that suggest that the value of the consumption benefits to households of some central city infrastructure exceeds the benefits to firms.
8. In the long run, such investments can often have important implications for growth, but they are in many cases undertaken on grounds of equity and welfare that would remain valid concerns for policy makers even if there were not any links to productivity or output.
9. The numbers could understate their importance given that a number of public goods and services provided by sub-national levels are not fully accounted for in sub-national public financial indicators (OECD 2011a; Charbit, 2011).
10. Because an important share of SNG spending is on housing and the environment, green regulation may have had an impact on the costs of public investment projects.
11. Other factors may also play a role here, such as higher national spending in lagging regions.
12. For a detailed discussion of the interpretation of the two-way interaction effects for the unstandardised variables, see Rodriguez-Pose and Garcilazo (forthcoming); they use the procedures proposed by Aiken and West (1991) and Dawson and Richter (2006).
13. Incumbent firms, for example, may not welcome institutional rules that make for fairer competition and more open entry.
14. The supranational dimension is, of course, most evident in EU countries, but the impact of supranational rules on domestic policy has grown elsewhere as well, thanks to WTO membership, free-trade agreements in some parts of the OECD area and the proliferation of other forms of hard and soft international law.
15. In some sectors (e.g. water, banking), the post-crisis period has seen a partial reversal of this process, as the role of the state has grown.

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Chapter 2

Co-ordinating investments across levels of government

The financing and implementation of public investment is embedded in a complex set of vertical (across levels of government) and horizontal (across sectors and across the same levels of government) interdependences, which require substantial co-ordination among actors to ensure policy alignment and quality investments. This chapter extends the analysis of the previously identified "multi-level governance gaps" for co-ordination of public investment by systematically investigating the extent to which they are present across OECD countries and the solutions that have been found to address them. It also examines an encompassing instrument that is used to address multiple co-ordination challenges simultaneously, namely inter-governmental contracts. Finally, the chapter identifies policy lessons that emerge from the analysis of these issues and which may assist governments seeking to improve the quality and efficiency of investments.

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Introduction

As noted in Chapter 1, public investment generally entails intensive engagement across levels of government, whereby interactions are not always top-down: while funding most often flows from national or supra-national authorities into projects managed by sub-national governments (SNGs), lower tiers of government often help shape the priorities, and sometimes contribute to the financing, of projects executed by national governments.[1] Frequently, the management of public investment also requires intensive horizontal interaction, involving other jurisdictions and actors (such as the private sector) at the same level, in order to collaborate on specific public investment programmes or projects. Where policy makers seek to realise potential policy complementarities across sectors, a second form of horizontal engagement will also be required – collaboration among the actors and institutions responsible for different sectoral policies from governments at different levels.

The management of the inter-dependencies involved in carrying out investment projects across levels of government can have a considerable impact on the returns to public investment for regional development. This chapter expands on previous OECD work on the co-ordination gaps that can arise in a multi-level governance context (see Table 1.1) to systematically assess the extent to which these gaps exist and potentially pose challenges across OECD countries. It will also look at whether and how countries have identified ways to address these gaps.

After briefly outlining the methodology, this chapter will focus on the different mechanisms that exist for cross-governmental co-ordination. First, it will look at vertical co-ordination mechanisms, including co-financing and conditionality instruments applied across levels of government. This will be followed by an assessment of horizontal co-ordination mechanisms, across sectors as well as jurisdictions. Finally, a more cross-cutting instrument will be presented, namely cross-governmental contracts, which can serve as a framework for addressing multiple co-ordination challenges simultaneously. It may be rational for actors to agree to collaborate across levels of government, or it may not. Therefore, the discussion of possible enforcement devices for policy makers will be discussed before turning to the need for information to make co-ordination work. To conclude, the question of enforcement will be discussed, pointing to a number of considerations for policy makers to ensure that co-ordination mechanisms are designed effectively.

Methodology

The findings of this and the following chapter are based on a mixed-method approach. First, to assess the presence of existing challenges and the extent to which solutions to co-ordination failures have been implemented, the OECD sent out a national level questionnaire. It consisted of a set of structured and semi-structured questions related to overall and sector-specific vertical and horizontal co-ordination mechanisms for public

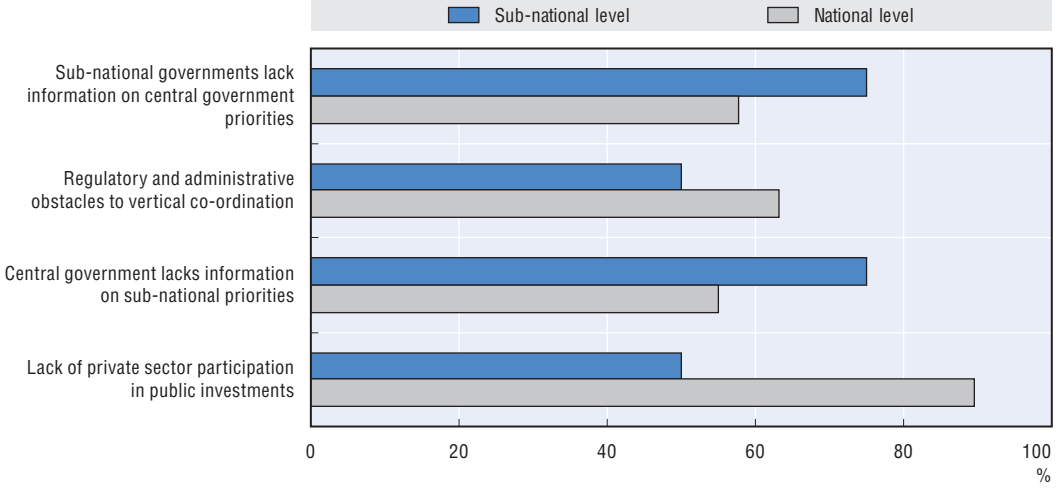
investment assessed from the national level's perspective (the complete questionnaire can be found in Annex B). The findings presented here are based on responses from 22 of the 34 OECD member countries.[2] This has been complemented with regional level questionnaires and in-depth case studies carried out in seven OECD regions, selected so as to include different institutional settings, as well as economically stronger and weaker regions from across the OECD.[3] Whenever applicable, answers from the national and regional level have been compared. However, caution needs to be applied in the interpretation of these comparisons, as the regional sample is limited to only a few observations. A much larger regional sample would have to be obtained in order to make robust comparisons. Finally, other lessons and experiences are drawn from previous OECD country reviews and thematic work carried out on related topics.

The need for co-ordination across levels of government

Challenges to facilitating co-ordination are widespread…

Broadly speaking, the OECD questionnaire to national governments revealed that, although central governments use a wide range of mechanisms to align incentives and goals, and to share information and accountability across levels of government, most respondents did not judge such mechanisms to be effective in improving the outcomes of public investment. While many of the challenges identified concern classic co-ordination failures (see Chapter 1), issues concerning the flow of information in both directions were particularly prominent (Figure 2.1). Others point to capacity issues of the SNGs. They are an important and necessary complement in making public investment work across levels of government. Chapter 3 will provide a thorough assessment and diagnostic toolkit for helping governments self-assess their state of the art when it comes to sub-national capacity issues.

Figure 2.1. **Perceived challenges to vertical co-ordination**



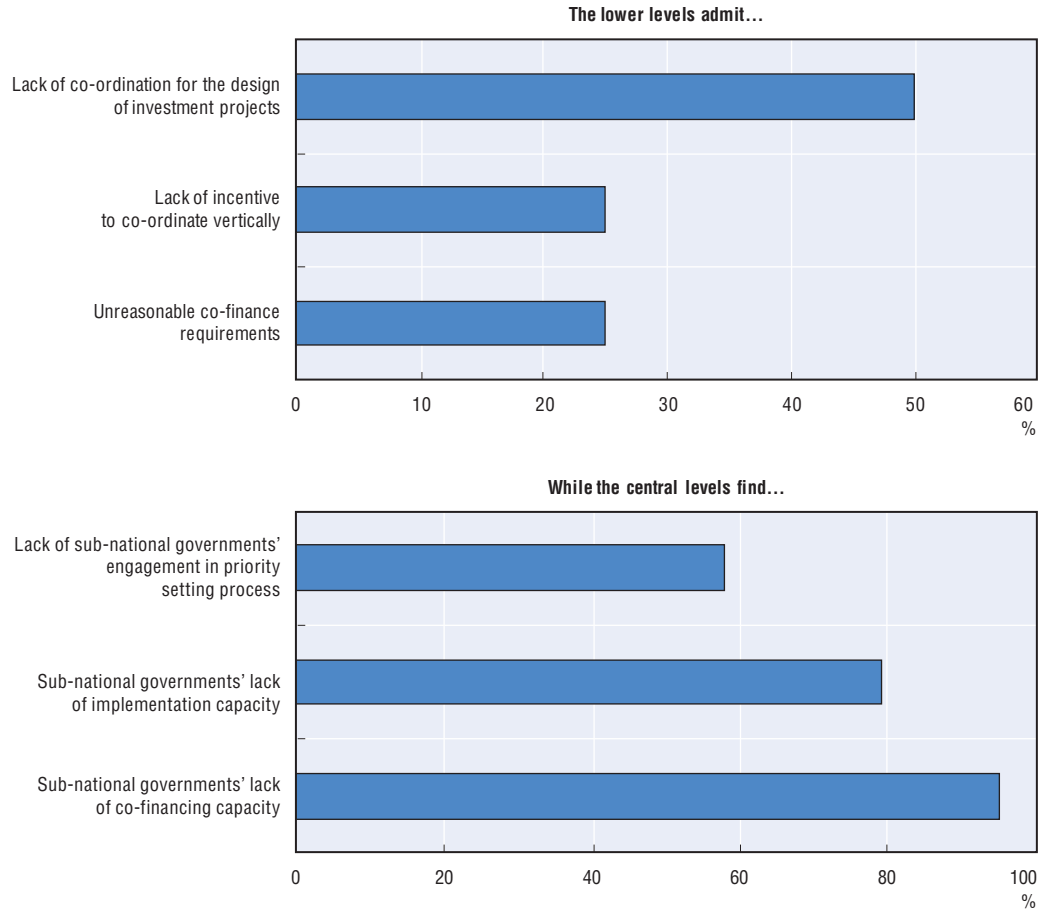
Source: OECD (2012), "Multi-Level Governance of Public Investment", national and regional case study questionnaires, *www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm*.

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… but are quite differently perceived by the central and sub-national levels of government

If the survey responses are indicative of the reality, then central governments are – despite the existence of numerous co-ordinating bodies and channels of inter-governmental communication in most countries – poorly informed about SNGs' needs and objectives, and vice versa (Figure 2.1). More strikingly perhaps, while the central level tends to see a lack of engagement and co-financing capacities to be major obstacles to effective vertical co-ordination, the sub-national levels counter that the incentives for them to engage are small and the conditionalities by the centre are too demanding (Figure 2.2).

Figure 2.2. **Diverging perceptions regarding challenges to co-ordination**



Source: OECD (2012), "Multi-Level Governance of Public Investment", national and regional case study questionnaires, *www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm*.

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The co-ordination mechanisms addressed in the following sections are a product not merely of the range of actors engaged but also of the complexity of many public investment projects. This particularly applies to projects with longer time horizons and higher levels of risk and uncertainty, like investments in "soft" infrastructure or highly technical activities, oriented towards economic development objectives. Moreover, while the various actors involved may all support a given project, they may be pursuing it with distinct

agendas. Reconciling these as efficiently as possible requires effective co-ordination mechanisms.

Co-ordination among actors across different levels of government arguably plays a critical role in each step of the investment project's cycle, from *ex ante* appraisal to *ex post* evaluation. In contrast to Chapter 3, which provides an analytical framework for assessing critical investment capacities at the sub-national level along each step of the investment/project cycle, this chapter explores the range of co-ordination mechanisms available depending on the actors involved. It distinguishes vertical interactions across different levels of government, whereby instruments like co-financing and conditionality will be discussed, from horizontal interactions between actors of different sectors and along the same level of jurisdiction. Contracts will then be presented as an encompassing co-ordination instrument.

Information gaps among levels of government are pervasive…

Central level actors acknowledge that they know very little about sub-national needs and policy preferences, while finding that their sub-national counterparts could be better informed about central level policy priorities as well (Figure 2.1). This stands in contrast to the sub-national level responses to the survey, which reveal that all of the surveyed regions acknowledge being involved or consulted in the process of determining public investment priorities at the national level. Nevertheless, nearly half of the respondents state that they are not well aware of central level policy priorities, and that, even worse, the incentives to engage in this process are limited, which may point to an information gap (Figure 2.2).

… but are less acute if actors have incentives to obtain or share information

SNGs' incentives to engage in policy processes are, to some extent, determined by a country's institutional architecture: the greater the degree to which SNGs need to secure central government support for their investment priorities, the greater their incentive to remain well informed about the agendas of central level policy makers. This can be critical either to obtaining central funds for regional projects or because it makes it easier for the region to influence the development of the central government's own investment projects (e.g. Germany and Sweden). Of course, it is hardly surprising that the level of government with fewer resources has a greater incentive to understand the priorities of the better-resourced tier. The risk, of course, is that the regions' development priorities may be warped by the need to align with central agendas: all regions may end up pursuing the same (central) priorities, whether they are appropriate or not, which defeats the aim of capturing the diverse assets of localities (i.e. the "place-based approach", OECD, 2011c). A related risk lies in the possibility that central actors will focus on those sub-national partners who are politically or administratively more adept at responding to signals about the centre's priorities – i.e. those who best know how to "play the game". This concern is given substance by the survey evidence cited above, which suggests that the degree to which SNGs are informed about central priorities may vary considerably. However, these risks must be set against the fact that some degree of alignment with central goals can help ensure that regional development strategies contribute to aggregate performance and to the achievement of broad policy goals that have a place-based dimension to them (e.g. like those of Europe 2020 in EU member countries).

Vertical co-ordination mechanisms

Aligning public investment policy and implementation across levels of government requires co-ordination throughout the process. To make this co-ordination work, the different levels of government involved need to resolve three sets of issues: information, accountability and consent. These three issues sit at the centre of the discussion that follows. Different governmental institutions need to ensure the efficient exchange of information about their respective challenges, policy preferences and implementation arrangements. At the same time, mechanisms are needed to ensure real commitment to co-operation among partners in public investment and real accountability among them, to one another and to the citizens. Finally, the evidence suggests that these arrangements work better when based upon consent rather than top-down enforcement. This, indeed, is true even where sanction mechanisms are needed. Clearly, the challenge lies in overcoming the tensions that can arise between these three objectives. The potential conflict between accountability and consent is obvious in vertical co-ordination, particularly if the higher level of government operates on a strongly hierarchical basis. Yet tensions can also arise between information and accountability (the former being crucial to the latter), particularly where governments face multiple channels of accountability – to higher levels of government but also to their citizens. This underlies many of the challenges in the use of conditionalities addressed below.

Creating dedicated platforms can facilitate vertical communication

Given the importance and prevalence of information and objective gaps, it is not at all surprising that a wide range of institutions and mechanisms to facilitate communication and the alignment of interests around common policy objectives have evolved across OECD countries. National bodies in charge of sub-national co-ordination and fora in which sub-national representatives gather are the most frequently used instruments for co-ordinating policies for regional development across different levels of government. Most federal countries have created platforms to exchange information on policy objectives between the different levels of government. In Germany, for example, there are so-called "conferences" in specific sectors, like science or regional development, in which different levels of government regularly gather to determine policy priorities. In the United States, several bodies exist, including the White House Rural Council and regional commissions. In addition, national level investment planning relies on investment plans drawn up at the sub-national level. In Canada, there are two instruments: one horizontal and the other vertical. The provinces meet amongst themselves to determine investment priorities, while federal arms of the government are represented in the provinces, via structures such as the regional federal councils or the regional development agencies. Their interests lie not only in representing the central government's priorities in the provinces but also in conveying provincial preferences to the federal authorities. The Council of Australian Governments (COAG) is well known across the OECD as an effective forum for such federal-state policy dialogue. In Italy, political dialogue is ensured through the State-Regions Conference, a permanent negotiating arena.

More centralised countries also create more or less stable mechanisms for consultation. If such bodies do not exist formally, there are still informal discussion fora. In Norway, for example, the Ministry of Local Government and Regional Development gathers with all regional administrations and other relevant regional stakeholders to inform them

about central policies for regional development and to discuss issues important to the regions.

Yet there seem to be limits to the effectiveness of such mechanisms. In Poland, for example, vertical co-ordination committees are in place to increase the exchange of information on policy priorities, although the regions seem to elaborate their regional programmes very much in isolation. Although there are existing committees that integrate stakeholders across levels of government for regional development, Wielkopolska designed the Regional Operational Programme with centrally managed programmes in mind but without really defining them in a joint manner.

Co-financing arrangements are widely employed…

Co-financing arrangements between central and sub-national levels are an extremely common tool in vertical cross-governmental fiscal relations. They are about more than just securing funds for SNGs. They also represent an important co-ordination tool:

- They ensure the commitment of different actors to the success of a project. Those who have invested in it have stronger incentives to choose good projects and offer other forms of support (e.g. technical assistance).
- They are a means of inciting sub-national authorities to engage in projects which generate positive spill-over effects on neighbouring areas or to pool resources with their neighbours: the offer of co-financing from higher levels of government can help overcome the barriers to horizontal collaboration described in the previous section.
- They can help shift the spending priorities of other actors, particularly when linked to new activities (e.g. provision of new services, investment in new infrastructure, etc.). It can also help to protect investment spending when pressures arise to curb investment in favour of spending on public consumption. Yuill et al. (2010), for example, draw attention to the use of national co-financing to ensure that national priorities are reflected in regional development projects. The reverse can also occur: as the Skåne case study shows, regional and municipal participation in financing, even on a modest scale, can help SNGs to ensure that their priorities are also reflected in the design and execution of projects undertaken by the national government.
- They are an important mechanism for risk-sharing, which should, in principle, offer greater latitude for experimentation. However, this is a sensitive point: given the reluctance of public officials to put public money at risk (and the political sensitivity of doing so), risk-sharing may actually lead to less experimentation and risk-taking.[4] In particular, risk-averse donors (usually higher levels of government) may seek to choose only projects with a high probability of success.[5] On the whole, risk-sharing is more attractive when participants are less informed *ex ante* about which outcomes are feasible – which is indeed the case in respect to many facets of regional development.

… but continue to meet challenges in practice

National level answers to the questionnaire show that co-financing by the sub-national level for public investment is widely seen as a challenge to effective cross-governmental public investment. SNGs frequently complain that co-financing requirements are too difficult to meet, exceeding the financial capacity of the sub-national level (Figure 2.2). Governments across all levels admit that in the current fiscal environment, financing investment has become increasingly difficult. This issue is

particularly acute in countries hit the hardest by the crisis. In Spain, for example, uncertainty in funding has undermined the regions' capacity to engage in public investment. Faced with a sharp downturn and a consequent drop in both own revenues and transfers from the central government, Galicia nearly doubled its regional public debt between 2007 and 2012 in an effort to meet its current expenditure commitments. Public investment was cut by 54% between 2008 and 2011. Debt reached 12.8% of regional GDP in 2012. The recent introduction by the central government of strict deficit targets for the regions will put further strain on Galicia's finances in the future. However, Galicia's plight – and that of many other OECD regions and countries – highlights another aspect of co-financing: the degree to which the availability of co-financing may shape choices about where and how to cut spending, something that should be borne in mind when co-financing arrangements are established.

Not surprisingly, fiscal pressures have prompted SNGs across the OECD to think more deeply about alternative financing mechanisms. In many cases, this has led to renewed interest in ways of engaging the private sector, an issue addressed below, but it has also highlighted the degree to which regulatory and political obstacles may impede the use of other sources of finance. The choice is not always between fiscal revenue (taxes and grants) and private finance: options such as tolls and user fees are also increasingly prominent in infrastructure projects in particular, and may even be critical to attracting private participation. Yet, many SNGs seem reluctant to resort to fees, as citizens have deeply ingrained expectations about what infrastructure and services they expect to be free at the point of delivery. Interestingly, these expectations vary – in some countries toll roads may be readily accepted while full cost recovery for water services might not, while in others it is the reverse. Regulatory and legal obstacles can also arise: for example, in the United States, with the exception of a federal pilot programme that allows three states to use tolling to replace worn-out roads, federal regulations ban new tolls on interstate highways (Thomasson, 2012).

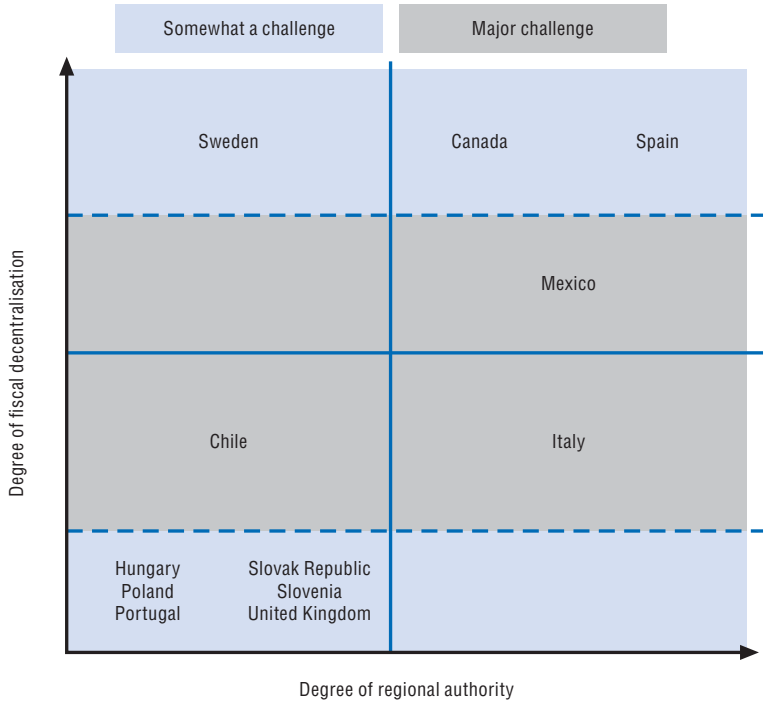
The territorial context plays an important role

Co-financing challenges tend to loom larger in more centralised countries (Figure 2.3). Poland, for example, has implemented an extensive decentralisation reform over the past decade, but it gave its regions very limited financial autonomy (indicated by a low degree of fiscal decentralisation), despite devolving extensive responsibilities to them, including spatial planning, higher education, health care, regional transport and heritage management. Thus, even a relatively strong region like Wielkopolska complains of persistent underfunding and over-reliance on central government resources. In contrast, in countries where the sub-national levels have a comparatively higher degree of autonomy and where fiscal decentralisation is higher, such as in Germany or Switzerland, survey responses show that SNGs' co-financing is not a major challenge.

There remain challenges in incorporating the private sector in co-financing public investment

In response to the national questionnaire, a number of countries express the view that the private sector could play a more prominent role in co-financing public investment across levels of government (Figure 2.1). Sub-national stakeholders also point to the desirability of involving the private sector, albeit to a lesser extent. A lack of awareness of this option and a lack of knowledge about how to involve the private sector in public

Figure 2.3. **Regional authority, decentralisation and co-financing challenges**



Source: OECD (2012), "Multi-Level Governance of Public Investment", national and regional case study questionnaires, *www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm*. Degree of regional authority based on Hooghe, L. et al. 2010. *The Rise of Regional Authority: A Comparative Study of 42 Democracies (1950-2006)*. London: Routledge and degree of decentralisation based on *OECD (2012), OECD Regional Statistics* (database), *http://dx.doi.org/10.1787/region-data-en*, accessed 20 November 2012.

investment projects may partly explain this difference. Successful engagement with the private sector could unlock new sources of finance, while it may also offer other benefits in terms of project design and management. Nevertheless, significant difficulties remain. In Germany, for example, there are strong disincentives to including private sector financing in regional investments. For example, if the private sector participates in financing regional public infrastructure, the share of public funds received from the central government may decrease from 80% to 20%, dramatically increasing the co-financing requirements on the SNG. Typically, therefore, infrastructure is built with public funds, even if it is then operated and maintained (e.g. on a concessionary basis) by private firms. Another difficulty arises in places where the impact of the crisis on the financial system has drastically limited the ability of private firms to secure loans and other finance, and the fiscal position of public authorities has reduced their ability to help firms secure such finance by extending guarantees, etc. This is often cited as one reason for the limited absorption of EU Structural Funds in some regions.

Public-private partnerships (PPPs) are one possible solution to co-financing that comes up frequently in both questionnaire responses and dialogue with regional stakeholders. However, experience with PPPs across the OECD has been decidedly mixed, and many national and sub-national policy makers remain wary of them. While they can, in some situations, deliver better value for money than traditional procurement, they have on occasion been used to finance expenditures that would not otherwise have been approved in a given budgetary situation and they have sometimes been embraced by public

authorities with insufficient understanding of how they work and where the potential pitfalls lie. Some finance ministries dislike them as well, owing to concerns about their long-term impact on future expenditure. In addition, in many places, they have been understood solely as an alternative financing instrument, like a bond or bank loan – albeit one that is burdensome in terms of administration and more expensive than some other financial alternatives (e.g. Germany and Sweden). Extremely low interest rates across a lot of the OECD clearly reduce the appeal of PPPs as sources of finance alone, but there is little awareness of the other potential dimensions of these partnerships. They are more likely to make sense where they help address other issues, including risk sharing, technical expertise, and project design and management. They are also technically demanding in terms of management, suggesting that capacity gaps, especially at sub-national level, can contribute to their slow uptake (see Chapter 3 for a discussion on the capacity of PPPs at sub-national level).

The challenges involved in engaging the private sector effectively are perhaps reflected in one of the more paradoxical findings to emerge from the national level questionnaire. The great majority of respondents (90%) reported that the lack of involvement of private sector firms was a challenge. Yet only 9 of the 22 countries that responded to questions on vertical co-ordination instruments have attempted to require SNGs to engage private sector participation in public investment projects. This may reflect national governments' awareness of the challenges involved in doing so and a reluctance to push SNGs into relationships for which some of them may not be prepared. In some places, they are positively discouraged from entering into PPPs: in Brandenburg (Germany), for example, the permitted level of *Land* co-financing falls from 80% to 20% or 50%, depending on the circumstances; this greatly increases the burden on the municipalities and may be more than sufficient to offset the availability of private funding. Moreover, there is a legislative requirement that even private firms must act in conformity with certain provisions of the Law on Public Procurement when they receive more than EUR 50 000 in assistance from the *Land*'s budget. In the United States, by contrast, private sector participation has been increasingly included as a requirement for federal support.

New models of public-private co-operation are emerging as a result

More innovative models for engaging private participation have evolved in a number of places, not least because SNGs can find co-financing requirements quite demanding. For example, in Canada, significant co-financing requirements have led sub-national actors to engage private partners that were not previously involved in financing public investment, through the provision of matching grants or other in-kind contributions. The matching grants have amounted to as much as 1.5 times the amount transferred from the central government to the sub-national entities. In British Columbia (Canada), the private sector has become a key partner in most large investment projects (e.g. airport, railway or port infrastructure).

Although, as noted above, PPPs have largely been dismissed in some places, they have found wide application in others. In the Australian state of Victoria, for example, PPPs have accounted for 10% of regional infrastructure investment since the state began using them in 2000. PPPs in Victoria are not used simply as a form of investment financing, but rather as a way to procure private sector expertise to design, build, maintain and refurbish the investment asset over the long term. Alliance contracting, also used in Australia, is another form of innovative private sector financing for regional investments (Box 2.1).

Box 2.1. **Alliance contracting**

Alliances are a method of procuring, and sometimes managing, major capital assets. Under an alliance contract, the state agency (as the owner) works collaboratively with the private sector parties to deliver the project. Normally, alliances are used to deliver more complex projects (capital costs exceeding AUD 50 million or around EUR 40 million) where the owner has particular capability to provide skills and expertise, and where the project is, for one reason or another, difficult to specify in advance. Characteristic of alliance contracting is an emphasis on a trusting strategic relationship amongst the parties, and, compared with other contracting methods, there is less focus on competitive pricing. In essence, it represents an attempt to employ relational rather than transactional contracting (OECD, 2007) in public-private co-operation.* In a more traditional contract, or even a PPP, a significant proportion of individual and corporate considerations are set down in the contract itself, which then needs to be administered within the prevailing legal framework. In an alliance, obligations are less specific and enforcement mechanisms far less important: they are based on volition rather than obligation and amount to an agreement that the parties will work together and not sue one another. Differences must be reconciled among the parties, who are committed to collaborating over an extended period – and to learning together, since alliancing is typically used in areas where uncertainty makes it difficult to specify "hard" transactional contracts *ex ante*. Despite its promise, alliancing is not without problems, and there is a growing perception in some quarters that it is being employed in circumstances where more traditional contracting methods could be used and where the parties involved either do not understand the real requirements of an alliance or see an advantage in forming "sham alliances".

* See section on contracts for more on the distinction between transactional and relational contracts.

Sources: Lowe, K. (2012), "The Troubled Rise of Volition – Alliance Dynamics, Alliance Leadership, and the Alliance Advisory Field Perspective", *Alliance Contracting in Focus, www.alliancecontractingiq.com/downloadSecureContent.cfm?ID=224*, Bounds, G. (2012), "Public Investment Across Levels of Government: The Case of Victoria, Australia", report for the 28th OECD Territorial Development Policy Committee, 4-5 December 2012, *www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm* and OECD (2007), *Linking Regions and Central Governments: Contracts for Regional Development*, OECD Publishing, doi: 10.1787/9789264008755-en.

Co-financing will remain a challenge in cross-governmental collaboration for public investment, as tight budgets will likely prevail over the coming years, even if austerity measures are relaxed to some extent. In this context, the private sector will increasingly be looked at as a potential option to bridge that gap and SNGs have to strengthen their capacity for engaging it for investment purposes (see Chapter 3). In many places, co-financing constraints will not be easily resolved, however, and other ways of enhancing public investment efficiency will have to be found.

Conditionality is a well-established policy tool for vertical co-ordination

Conditionality is a type of contractual arrangement whereby a government takes, or promises to take, certain policy or institutional actions, in return for which a higher level government authority or an international institution will provide specified amounts of financial and/or technical assistance. For the most part, conditionality has been used to address such problems as the misalignment of incentives, constraints on the flow of information and weaknesses in accountability. Conditionality has been employed in many inter-governmental relationships, including the co-ordination of investments for regional development. Although the term often generates strong reactions, owing to its association

with the use of financial pressure to impose policy change, many forms of conditionality are more co-operative than coercive. This is an important point, because conditionality is most often analysed through the prism of "principal-agent models", and yet there are strong reasons to question whether this is appropriate. Although some elements of inter-governmental relations are characterised by the logic of principal-agent settings, it is probably not the best model for understanding those relationships (Box 2.2). The analysis that follows considers the application of the full range of such mechanisms, from strict, externally imposed requirements to more co-operative arrangements.

Box 2.2. **From "principal-agent relations" to "mutual dependency" among levels of government**

Most of the existing literature on conditionalities — whether theoretical or applied — focuses on principal-agents relationships. This framework is a hierarchical relationship and does not envisage co-operation among equals. It is generally assumed that the donor/upper level of government has superior objectives and skills as compared to the recipient/lower level. This model tends to assume that the principal's objectives are legitimate, whereas the agent's objectives, if they are not closely aligned with those of the principal, are not. The upper level thus provides means to the lower level that is to act as its agent in implementing policies. The upper level's primary concern is to ensure that the agent pursues the principal's objectives and not its own (i.e. that the agent does not "defect"). Three main issues can be highlighted:

- Asymmetries of information that work to the detriment of the principal. The higher level of government does not systematically know what is needed to reach policy objectives at the lower level, because it has an incomplete or biased understanding of the actual preferences of citizens, of local governance capabilities, and/or of the specific constraints in providing public goods and services, etc. It is these very asymmetries of information that make it efficient for the higher level to delegate some tasks to the lower level, but they also raise the risk of "defection" if the agent's agenda is at odds with the principal's agenda.
- The complexity of setting objectives. Place-based regional development policies are multifaceted and require potential complementarities among policy fields to be identified. Since governments are organised in functional departments and bureaucracies, there are always risks of inconsistent action. In the framework of a multi-level relationship, this raises the risk of the local government (the agent) being strategic, playing the various central actors (in essence, a group of principals) against each other.
- The danger of "defection" in implementation. The central problem relates to the many strategies that the agent may deploy at the implementation stage in order to pursue its own objectives rather than those of the principal. Sub-national governments may, for example, fail to comply with conditions set down before funds were made available to them, especially if the accumulation of conditionalities or programmes results in an inconsistent and opaque set of obligations. They therefore choose to comply with only some conditions and renegotiate others *ex post*.

Relations between levels of government are even more complex because of the additional "principal" in the game: citizens. The relationship between the two levels cannot be understood if the agency relationship between the lower level government and its constituency is ignored. In fact, the lower level of government always balances compliance between its two agency "contracts". It can therefore renege on its commitment *vis-à-vis* the higher authority because it needs to please its citizens (or minimise discontent) or because the local opposition could play on these commitments in an effort to remove the incumbents from office.

Box 2.2. **From "principal-agent relations" to "mutual dependency" among levels of government** *(cont.)*

Ultimately, though, the accountability of lower level governments to citizens calls into question the very utility of the principal-agent model for depicting inter-governmental relationships: regional or local governments may be constitutionally subordinate to national governments and yet, to the extent that they derive legitimacy and authority from their citizens, it is inappropriate to conceive of them chiefly as agents of the central government. Their objectives, after all, may be equally legitimate from a democratic and constitutional perspective, even if they do not fully coincide with those of the centre. Except in cases where their role is explicitly to perform specific delegated functions, the relationship is better conceived as a co-operative one, even if it is not one among equals. In practice, top-down policy impositions that reflect a strong adherence to principal-agent logic often generate resistance or, at best, passivity, at lower levels. This points to a logic of relational contracting and a co-operative approach to the use of conditionality mechanisms.

Note: See section on contracts for more on the distinction between transactional and relational contracts.

Conditionality is relevant for regional development policy because it sits at the heart of inter-governmental fiscal relations. It is an element of any financial transfer that is not a gift. Even general purpose grants that have no specific policy prescription attached to them are extended on the basis that they will be used for legitimate purposes of public policy, however defined.

In order to discuss the application of conditionalities as a mechanism for governing public investment for regional development, it is necessary to distinguish between the different types of conditionalities. Rather than categorising them in terms of a set of modalities, as others have done (see Schüring, 2010), Table 2.1 distinguishes conditionalities first by how and when they are designed in the policy process, and then by how they are embedded and enforced in institutional mechanisms.

Table 2.1. **Types of conditionalities**

Type	Description	Examples in a regional development context
Timing (*ex ante* or *ex post*)	*Ex ante* conditionalitie*:* policies and actions agreed upon in negotiations between donor and recipient before assistance is granted. *Ex post* conditionalities*:* either linked to an agreed process or sequence of steps towards a programme's objectives, or, in the form of performance conditionality, concerned with outcomes.	*Ex ante:* regulatory, strategic, infrastructural planning or institutional conditions to put in place certain policies or institutions; or procedures to ensure monitoring and accountability for the use of funds; for performance-based grants, for example, some minimum *ex ante* conditions may be needed to ensure that the necessary absorptive and administrative capacity is in place to manage the funds. *Ex post:* applies when recipients are rewarded (or sanctioned) based on progress in achieving specified programme objectives.
Explicitness	"Informal" requirements are one of the least-binding forms of conditionality. Advantage: flexibility; Risk: ineffectiveness, if recipients respond to what they believe are tacit conditions in ways the donor had not intended.	Conditions may be more or less tacit, particularly when non-compliance could be punished in future interactions (repeated-play games), independent of the current project or programme context. Inter-governmental fiscal arrangements may include commitments that do not need to be executed prior to the grant nor linked to subsequent donor actions (trigger actions).
Coverage	Conditionality can be confined to a certain geographical area or to a sub-set of target objectives.	Conditionalities that cover only selected policy or geographic areas, instead of whole countries: a national government could condition its transfers to regions with the implementation of certain regional policy changes; supra-national organisations (such as the EU) could require economy-wide structural policies expected to increase the effectiveness of investments financed by regional funds (such as small business regulation or procurement policies or requirements with no particular relevance for regional development goals or the effectiveness of regional policy.

Table 2.1. **Types of conditionalities** *(cont.)*

Type	Description	Examples in a regional development context
Frequency	Conditions can be applied either as a one-off requirement or on a regular basis.	Regular programming over repeated periods (annual tenders or allocation processes, EU programming periods, etc.). Much depends on whether there is any link between performance in one period and outcomes in another.
Expected performance	Performance conditionality conditions funds on the achievement of policy objectives. Advantage: may allow the recipient greater freedom in how to achieve given objectives; the prior consultation that is required between donors and potential recipients is an achievement in and of itself, and contributes to communication and information sharing. Risk: can be costly, as a robust monitoring system is needed to assess performance.	For example, setting regional economic growth rates as an objective would be highly problematic, as growth is not something over which a region has a decisive influence. Yet, if the objectives are more or less within the recipient authority's control, then it may simply learn to "game the system".
Enforcement	"Hard" forms of conditionalities characterised by the presence of sanctions for non-compliance. Inter-governmental fiscal relations are typically characterised by "softer" instruments, which means that conditions are not enforced but remain the responsibility of the recipient; non-compliance could still be punished in future interactions.	"Hard" conditionality: the punishment could entail the withdrawal of all or part of the funds granted by the donor to the recipient, as when the IMF suspends disbursements to a client government for non-performance. "Soft" conditionality: if a lower level of government is seen to waste or misuse funds allocated from a higher level of government, those funds might be cut in the following period.

Source: Bergvall, D. et al. (2006), "Intergovernmental Transfers and Decentralised Public Spending", *OECD Journal on Budgeting*, Vol. 5/4, OECD Publishing, doi: *10.1787/budget-v5-art24-en*; Blöchliger, H . et al. (2010), "Sub-Central Governments and the Economic Crisis: Impact and Policy Responses", *OECD Economics Department Working Papers*, No. 752, OECD Publishing, doi: *10.1787/5kml6xq5bgwc-en*; European Commission (2012), Regulation of the European Parliament and of the Council laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund covered by the Common Strategic Framework and laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Council Regulation (EC) No. 1083/2006, European Commission, Brussels; Roller, E. and P. Berkowitz (2011), "Conditionality: A Sheep in Wolf's Clothing?", presentation to the UK Regional Association conference "What Future for Cohesion Policy? An Academic and Policy Debate", 16-18 March, Bled, Slovenia; Smart, M. and R. Bird (2009), "Earmarked Grants and Accountability in Government", in J. Kim et al. (eds.), *General Grants versus Earmarked Grants: The Copenhagen Workshop 2009*, Korea Institute of Public Finance and Danish Ministry of Interior and Health, Copenhagen; Steffensen, J. (2010), "Performance-Based Grant Systems: Concept and International Experience", United Nations Capital Development Fund, *http://uncdf.org/sites/default/files/Download/pgbs.pdf*, accessed 28 March 2013.

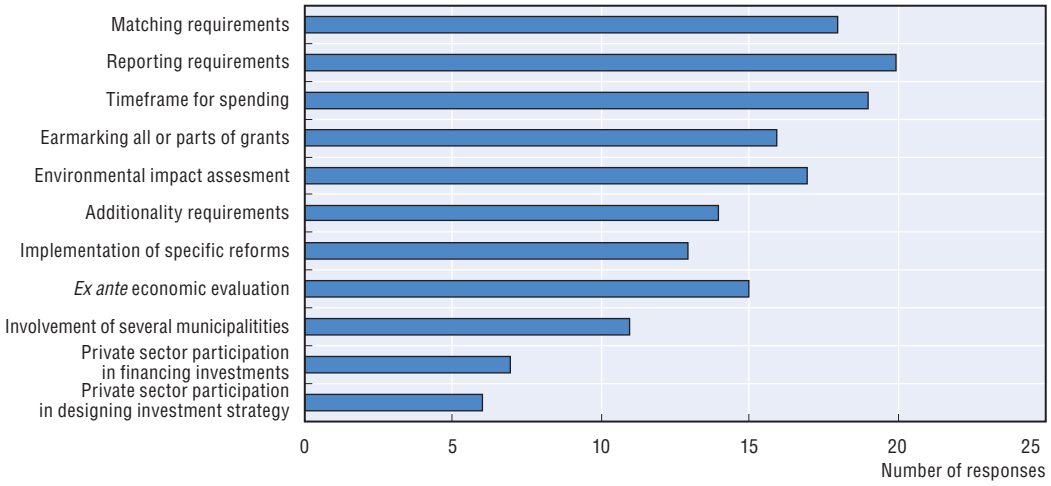
The use of conditionalities varies widely across OECD regions and countries

The majority of countries responding to the OECD questionnaire report that the central government attaches certain conditionalities to inter-governmental transfers for regional development and, in EU countries, the European Commission does as well. The most frequent conditions attached to central funding include matching (co-financing) and reporting requirements, as well as predetermined timeframes for spending investment funds. In most of the respondent countries, earmarking, environmental assessments and additionality requirements are also frequently applied (Figure 2.4).

The use of such requirements poses a challenge in many, but not all, respondent countries, regardless of their territorial organisation (Figure 2.5). Estonia, Norway and Switzerland are examples of countries where requirements do not pose a challenge.

Although national governments responding to the OECD questionnaire acknowledge widespread and significant difficulties, they also see advantages in the use of conditionalities for regional development policy (Figure 2.6). Even though just over half of the respondent countries report that such requirements pose an additional administrative burden, they are not perceived as being very effective in increasing the quality of investment projects. Several countries, though, report having found conditionalities, including those concerning the timeframe for spending, earmarking and matching requirements, as well as *ex ante* assessments, effective tools for framing policies and strategic planning, in that they have enabled the central level to better understand the local

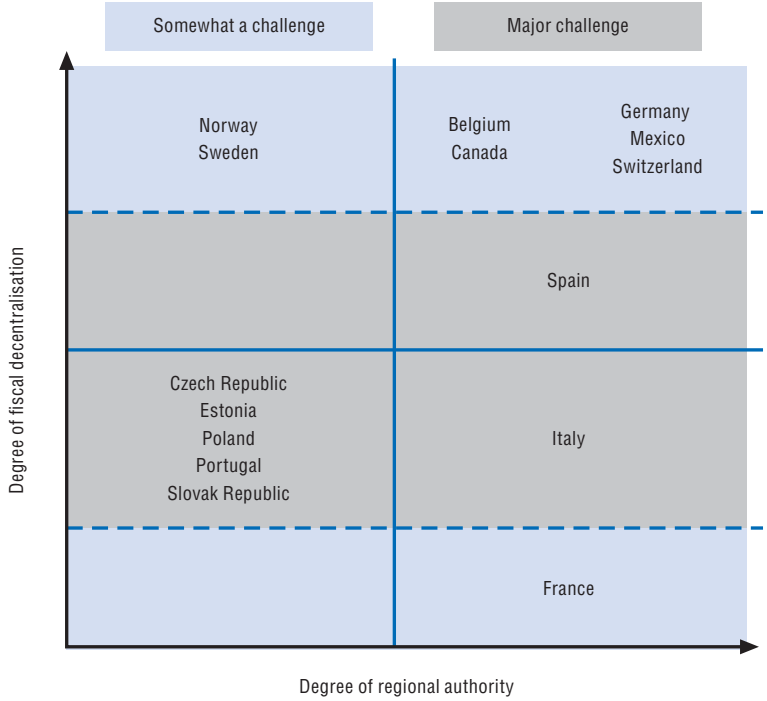
Figure 2.4. **Types of conditionalities attached to public investment funds**



Source: OECD (2012), "Multi-Level Governance of Public Investment", national and regional case study questionnaires, *www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm*.

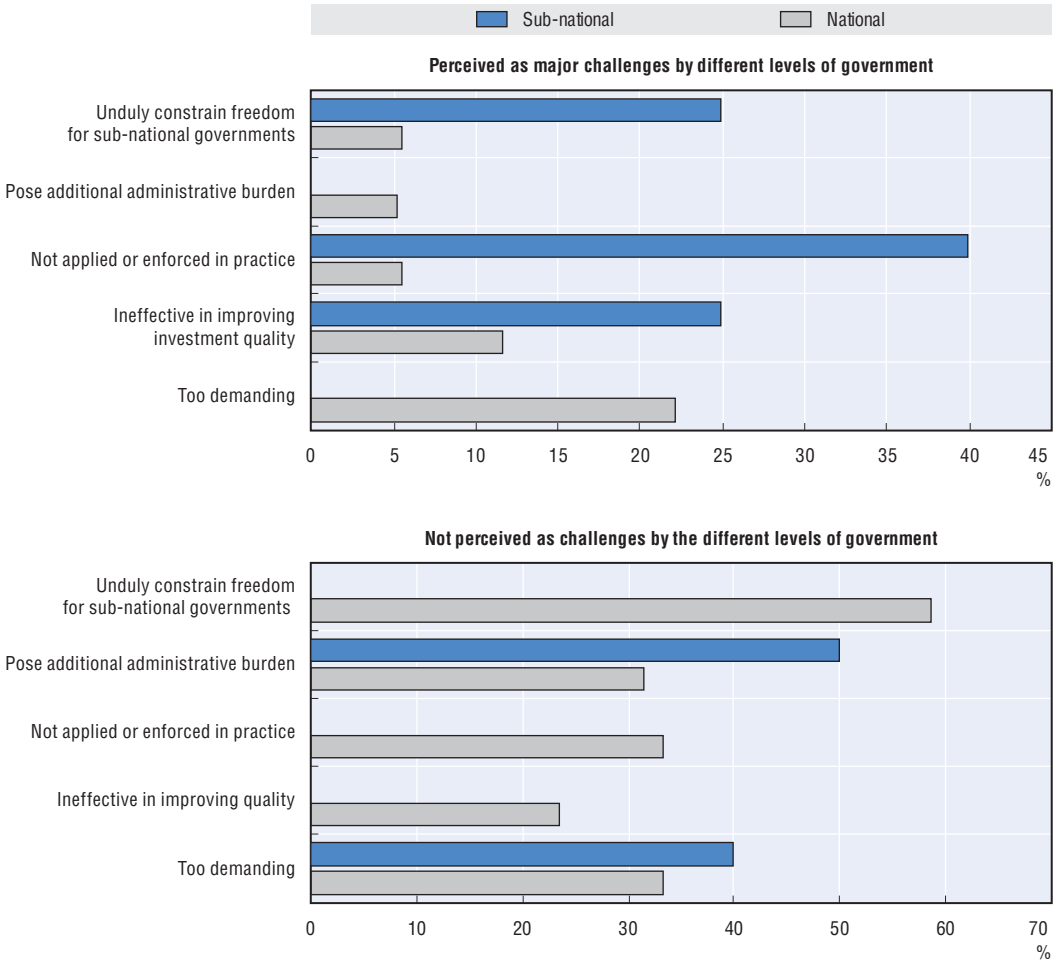
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Figure 2.5. **Level of difficulty in meeting conditionalities**



Source: OECD (2012), "Multi-Level Governance of Public Investment", national and regional case study questionnaires, *www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm*. Degree of regional authority based on Hooghe, L. et al. 2010. *The Rise of Regional Authority: A Comparative Study of 42 Democracies (1950-2006)*. London: Routledge and degree of decentralisation based on *OECD (2012), OECD Regional Statistics* (database), *http://dx.doi.org/10.1787/region-data-en*, accessed 20 November 2012

Figure 2.6. **Challenges in the use of conditionalities: National versus sub-national perspectives**



Source: OECD (2012), "Multi-Level Governance of Public Investment", national and regional case study questionnaires, *www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm*.

StatLink *http://dx.doi.org/10.1787/888932844581*

conditions (e.g. Estonia, Italy, Slovak Republic). In Canada and Estonia, such conditionalities have helped to enhance systematic assessments of likely and actual impacts of investments, thereby reducing the incidence of "bad" investments. In Italy and Norway, conditionality has successfully encouraged the concentration of resources, thereby making it easier to promote and anticipate measures deemed crucial for regional development.

Sub-national authorities have likewise experienced both positive and negative outcomes in the use of conditionalities. The case studies suggest that regions (especially Basilicata in Italy and Wielkopolska in Poland) do recognise that some conditionality requirements have facilitated co-ordination with the central level and rapid design of investment projects. Nevertheless, some regional authorities, including British Columbia (Canada), Victoria (Australia) and Wielkopolska (Poland), view it as a restriction on their freedom in undertaking investment projects.

The use of conditionalities has seen manifold changes in some, but not all, OECD countries since the eruption of the global economic crisis in 2008. During the stimulus phase, some conditions were relaxed in a deliberate effort to accelerate disbursements; in other cases, conditions were made stronger, for the same reason. In Canada, Estonia and the United Kingdom, for example, requirements across levels of governments were streamlined so as to accelerate the achievement of desired investment outcomes (such as economic growth, job creation, etc.). This included reducing the timeframes for the delivery of public investment projects in an effort to disburse funds faster. To accelerate the implementation process further, environmental assessments were dispensed of for some types of investment.

The tightening fiscal situation since 2010 and the concomitant need to improve the efficiency of public investment have reinforced the need to strengthen the links between the design and implementation of policies and their main objectives. Some countries have already taken steps in this direction by, for example, linking project proposals to their economic recovery contributions, such as including a job creation measure. Others have tightened control requirements in an effort to improve the management of investment projects. Greece has accompanied an overhaul of local and regional public administration with the requirement that regions and ministries sign agreements providing for tougher reporting requirements. Failure to comply with this requirement could lead to a reallocation of funding. Similarly, Norway and Portugal have strengthened monitoring requirements as a result of the crisis. Both the Czech Republic and Poland continue to develop their evaluation methodologies and to extend their reach; increasingly, EU evaluation methods are being applied outside of programmes that it finances.

The use of conditionalities by international lenders points to some potential pitfalls …

Before turning to how such conditionalities for regional development have been designed in the past and how they could be designed in the future, lessons will be drawn from other policy arenas that may have relevance for the governance of public investment. At an international level, the use of conditionalities by international financial institutions has generated a number of debates, some of which raise concerns that should be kept in mind when discussing the application of conditionalities in a regional development policy context.

The primary debate concerns effectiveness. Traditional conditionalities applied by international financial institutions like the IMF and the World Bank have frequently been criticised as ineffective, particularly with respect to promoting economic growth and social welfare.[6] However, there is evidence to suggest that they can be useful tools for promoting structural reforms, particularly where domestic forces impede the implementation of policies which nevertheless have government support (Babb and Carruthers, 2008).[7] Often there is also tension between the desire to cover all aspects of policy believed to be essential to a programme's success and the need to minimise intrusion into the recipient authority's decision making. Assessments of the efficacy of IMF and World Bank conditionalities, for example, find that where too many detailed conditions apply, programmes become unwieldy, conflictual, time-consuming to negotiate and administer, and ineffectual (IFIAC, 2000).[8] Such concerns may be particularly relevant in a regional development context, where place-based regional development typically involves the co-ordination of complex policy packages among a large number of autonomous actors.

If conditionality is viewed by recipients as an "outside imposition", domestic agents may be reluctant to press the case for controversial policy or institutional change. The domestic political base for the policy is thereby weakened and incentives to comply are lowered. Instead of building lasting change, the focus shifts to satisfying donor requirements. As a result, conditionalities associated with policy-based lending have in recent years increasingly focused on cultivating country ownership and minimising general policy prescriptions. World Bank (2005) concludes that they are "most effective when [they] complement local development efforts rather than substituting for them". Issues of ownership and accountability are of particular relevance for regional policy since the success of a place-based approach to regional development depends to a great extent on mobilising bottom-up initiative rather than simply imposing discipline from above. This has implications both for the types of conditions applied and for the manner in which they are negotiated and administered. In simplest terms, local ownership is likely to be critical to the success of regional development initiatives, but, as Mold and Zimmerman (2008) argue, the imposition of conditions may run directly counter to the notion of ownership, particularly when more "coercive" conditionality arrangements are being applied. Whatever conditions apply, they need to rest on a very high degree of local consent and need to be seen to do so. This last point underscores the need to avoid the all too common situation in which lower level governments privately acknowledge the need for conditions but find it politically useful to blame higher authorities for any costs involved. Ultimately, the logic of partnership and bottom-up input is central to a place-based approach to regional policy, and the use of conditionalities should be managed carefully, so as to avoid undermining that logic.

Issues of technical legitimacy arise with respect to the content of conditionalities. It has been argued that the content of conditionalities often reflects weakly tested or unproven assumptions rather than scientific knowledge (Babb and Carruthers, 2008; OECD, 2009b). It can be particularly difficult to negotiate strict yet effective (and non- or at least minimally distortive) performance conditionality where there are high levels of uncertainty about the relationships between policy settings and the desired economic outcomes. This point is likely to be particularly relevant when it comes to applying conditionalities in the context of a place-based approach to regional development, for the very simple reason that the need for place-based policies arises precisely because regional specificities do matter and one-size-fits-all solutions are often inappropriate. Such an approach of necessity must leave room for experimentation and trial and error.

... as do the experiences of OECD countries in pursuing regional development

This section provides an assessment of the degree to which conditionality mechanisms have been used to address the co-ordination gaps listed above. It draws on responses to the OECD questionnaire, the case studies undertaken in the context of this project and the secondary literature on fiscal relations across levels of government. Many of the examples come from outside the domain of regional policy, largely because the application of performance-oriented conditionalities to regional policy instruments has, in most countries, been very limited until recently. The traditional "compensatory" approach to regional policy tended not to prioritise performance, so such conditions as applied usually pertained to compliance with reporting and audit requirements. This is changing, however, and there are already some indications that the pace of change is likely to accelerate in the current austere fiscal environment (OECD, 2011a; Allain-Dupré, 2011), as

governments aim at both increasing the effectiveness of public expenditure and using regional policy to help stimulate growth. In Europe, the current overhaul of Cohesion Policy in preparation of the 2014-20 programming period (Box 2.3) more or less ensures that conditionalities will loom rather larger in European regional policy than hitherto.

Box 2.3. **EU proposals for Cohesion Policy 2014-20**

In its proposals for Cohesion Policy in the 2014-20 programming period, the European Commission has proposed a set of changes intended to make its policy better targeted, more results-oriented and more efficient. The measures attempt to balance strengthening top-down control mechanisms (e.g. via greater use of conditionality requirements and indicators) with a degree of managerial decentralisation. The changes envisaged thus include:

- requirements for a greater degree of thematic concentration on competitiveness factors in order to reduce the dispersion of resources across too many competing priorities;
- the introduction of *ex ante* conditionalities linked to both specific policy domains ("thematic conditionalities") and requirements that cut across all domains (e.g. in respect to administrative capacities);
- promoting the use of innovative financing instruments, including a bonus for innovative instruments and community-led development; and
- reducing administrative burden by adopting common rules to govern funds allocated under Cohesion Policy, rural development and maritime and fisheries policies, as well as by introducing limits on Commission audits of individual operations and allowing exemptions from certain reporting requirements for some programmes, particularly low-volume programmes and those that have a consistently good track record.

The strengthening of conditionality requirements has been, by far, the most controversial element of the reform package. The thematic conditionalities, which are linked to interventions in specific policy domains, include such things as the enforcement of the Small Business Act, the transposition into national legislation of EU requirements for energy-efficient buildings and the adoption of comprehensive national transport plans. The general conditionalities, which do not have to be met at the time the Partnership Contract is signed, include reference to aspects of administrative efficiency like the development of quality management systems and of procedures and tools for monitoring and evaluation.

The logic here is, in essence, to attach conditions to the use of European funds that encourage and support "good practice" in regional policy. This requires attention not only to the specific modalities of implementing regional policy but also to assessing how programmes financed by such funds do (or do not) cohere with other policies that countries are pursuing. It also reflects renewed emphasis on certain "minimum conditions" aimed at ensuring that recipient authorities possess the necessary absorptive and administrative capacity to handle the funds efficiently and with the necessary level of accountability.

Source: European Union (2012), "The Partnership Contracts – How to Implement Multilevel Governance and to Guarantee the Flexibility of Cohesion Policy", EU Directorate General for Internal Policies, Brussels; European Commission (2012), Regulation of the European Parliament and of the Council laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund covered by the Common Strategic Framework and laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Council Regulation (EC) No. 1083/2006, European Commission, Brussels.

Conditionalities can help to align objectives across levels of government…

As noted above, conflicting preferences can arise when sub-national actors pursue policy objectives for regional public investment that differ from (even if they do not contradict) the central government's aims. This need not imply opportunistic behaviour on anyone's part. It simply reflects the range of actors engaged and the complexity of many public investment projects. While considerations of efficiency – achieving the best outcome for any given level of expenditure, given the objectives defined – are likely to be relevant to all actors involved, their priority orderings among various objectives may legitimately differ. This is because the various actors involved may be pursuing related but distinct agendas, some of which may have implications for efficiency. To take a simple example, multi-level co-operation for the construction of major new transport infrastructure may be seen by the national government chiefly in terms of relaxing a constraint on trade flows. The key is to build the object quickly and as inexpensively as possible without compromising quality. The region, by contrast, may be more concerned with using its procurement activities associated with the project to promote the development of local SMEs. And local authorities may focus on minimising the noise and other negative local externalities.

Matters are even more complicated when incentives for inter-jurisdictional competition are stronger. For example, local governments may be reluctant to participate in scaling up major infrastructure projects if this would mean locating key facilities (and jobs) in another jurisdiction. Even if there are economies of scale to be realised, individual local authorities may prefer less efficient local provision if scaling up would result in shifting employment or other benefits elsewhere. The central government, on the other hand, may simply wish to provide the investment the most efficiently, implying collaboration among municipalities.[9]

In such instances, conditionality requirements can be used to direct SNGs towards that goal: the central government may insist on cross-municipal participation as a condition for supporting the project. In contrast to an incentive scheme aimed at making the municipality want to co-operate (e.g. by offering additional benefits if multiple jurisdictions are involved), a conditionality mechanism in this situation is more likely to make acceptance of the centre's preference for co-operation a condition of assistance. However, the two are not mutually exclusive and conditionalities set by domestic managing authorities can include positive incentives. For example, the project assessment criteria of Wielkopolska's Regional Operational Programme are designed so as to encourage joint inter-municipal investment projects.

As a way to ensure that objectives are aligned and that donor governments' priorities are kept in view, conditionalities have been applied across OECD countries in the form of performance monitoring. In Italy, for example, this has been positively enforced through a performance reserve which awards well-performing regions with additional grants, based on pre-identified indicators and targets. The Italian system even rewarded local levels, in cases where a region as a whole did not meet identified targets. The Italian scheme has so far been evaluated as a success, despite some shortcomings (Box 2.4). The performance scheme used with England's now defunct regional development agencies, by contrast, was widely viewed as unsuccessful, mostly because the reserve, and therefore the incentive, was small, and the scheme was designed in an overly top-down fashion that failed to ensure real cross-sectoral co-ordination. In 2007, the US Economic Development

Box 2.4. **The case of Italy's performance reserve**

Within the 2007-13 National Strategic Reference Framework (NSRF) budget for the Mezzogiorno, Italy set aside a performance reserve for regional policy (*Obiettivi di servizio*) of EUR 3 billion, almost 3% of the overall budget, to reward well-performing regions.* Similar to the EU performance reserve established for the 2000-06 programming period, the Italian performance reserve intended to bring about lasting improvements in regional governance in "Objective 1" (lagging) regions, as well as to strengthen some administrations operating at the central level of government. The scheme set aside an additional 6% of funds, effectively making access to 10% of regional development policy funds conditional on performance. While the overarching goal of the reserve was to promote institutional capacity building, its specific objectives were to modernise public administration, to promote and anticipate reforms in certain sectors deemed crucial for achieving development objectives, and to mitigate somewhat the incentives for rapid Structural Funds spending implicit in the N+2 de-commitment rule, by creating incentives to select and organise more complex and higher quality projects. The extension of the reserve until 2013 has focused on outcome and equity indicators, ensuring uniform access and quality of public services, especially education, child and elderly care, water, and waste management.

This practice has had different advantages. First, it introduced a programming approach based on results within all levels of governance. This has shifted the logical sequence of programming from expected results to needed actions rather than the other way around. Secondly, it has encouraged decision makers to co-ordinate financial resources, contextual conditions and responsibilities. Thirdly, it strengthened the role of monitoring and evaluation practices. Further, it has provided transparency and accountability rules. Finally, the scheme has not only rewarded the regions: if a region misses a target, its well-performing municipalities could still receive up to 50% of the resources assigned to an indicator, while the remaining would go to better performing regional authorities.

One recent assessment (Anselmo, 2012) suggests a number of lessons from the Italian experience that may have wider relevance. First, financial incentives have been effective because they reinforce reputational incentives in the context of clearer accountability. Financial incentives alone might not induce a results-oriented attitude in all relevant actors. Secondly, the scheme has worked well in part because it was focused on a few policy areas and indicators, excluding domains where the institutional setting is too complex or causality too difficult to assess. Thirdly, it is important that the final results largely depend on the actions of the managing authority subject to the incentives; if outcomes depend too greatly on the actions of others, incentives are likely to have little effect. Fourth, the choice of how to attain the desired results has largely been left to the regional authorities. However, technical assistance from the centre has in some cases been required to support the preparation of the action plans. Finally, revision of milestones/targets during implementation can be challenging, but may be necessary.

The Italian experience has thus far demonstrated satisfying results, indicating that the financial incentives of a performance reserve can be effective for increasing quality and the accountability of involved authorities. However, one needs to ensure that such performance schemes are accompanied by regional methodological capacity building and technical assistance resources to ensure the quality of the indicators and information collection effort.

* Education, child and elderly care, urban waste management, and water services were the four objectives. Within each objective, two to three indicators were designed.

Source: Venanzi, D. and C. Gamper (2012), "Public Investment Across Levels of Government: The Case of Basilicata, Italy", report for the 28th OECD Territorial Development Policy Committee, 4-5 December 2012, *www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm*; Anselmo, I. (2012), "The 2007-2013 Italian Performance Reserve – Measurable Objectives for Public Services Provision in Mezzogiornio", Ministry of Economic Development, Rome; OECD (2009a), *Governing Regional Development Policy: The Use of Performance Indicators*, OECD Publishing, doi: *10.1787/9789264056299-en*; Mizell, L. (2008), "Promoting Performance: Using Indicators to Enhance the Effectiveness of Sub-Central Spending", *Working Papers on Fiscal Federalism*, No. 5, OECD Publishing, doi: *10.1787/5k97b11g190r-en*.

Agency (EDA) introduced a reward for investment recipients whose performance met or beat established targets. Funds previously used as a bonus for grantees who participated in an economic development district were used to reward investment recipients if they completed projects on time and met the targets set in their grant awards for job creation and private sector funds leveraged. These indicators are monitored for all investment recipients through the regional Balanced Scorecard. Investment recipients receive the awards after projects are completed and cannot exceed 10% of the project's total investment (OECD, 2009a). Yet, OECD experience suggests that performance indicators generate incentive effects even in the absence of specific rewards or sanctions: monitoring and reporting performance will in itself tend to generate incentives owing to things like reputational effects. Thus, such indicators, though useful, must be designed and employed with great care.

In EU member countries, central governments sometimes add their own requirements to the distribution and use of EU funding for regional public investment projects, not least in order to ensure that regional operational programmes are consistent with central priorities. In Poland, for example, local authorities' investment projects may be funded on the condition that they are part of the implementation of a multi-annual development strategy. Indeed, the management of development policy based on a mid-term strategic document, such as a regional development strategy, is a statutory obligation for a Polish region. The plan, moreover, is to be "nested" in the higher level strategic plans of the central government and should be broadly consistent with them. However, the conditions attached to grants, such as earmarking according to purpose, are a matter of negotiation, which the region can influence, rather than something laid down unilaterally by the central government. The regional authorities in Wielkopolska report that such conditions have had a positive impact on programme effectiveness and the sustainability of project financing. This experience suggests that conditions around which the two levels agree may work better than those imposed by one side or the other.

In Germany, conditionality has been explicitly attached to central government transfers. However, the regular sectoral conferences held between the centre and the regions are meant to allow regional authorities to discuss and engage in the central governments' policy objectives. This should reduce the information gap on both sides and make central government choices for final regional investments more effective.

The introduction of Australia's New Competition Policy in 1995 (Box 2.5) provided a way for the central government to design a reform programme in collaboration with state governments, and to reinforce its implementation with a suitable conditionality and performance framework attached to central government transfers. The Australian experience suggests that the sums attached to such incentive schemes need not be large, particularly if the conditions are based on a widely accepted negotiated settlement rather than being imposed from above and if reputational incentives are also involved. A similar mechanism, the National Partnership Payments, was introduced under the aegis of the COAG in 2009.

… and can be used to strengthen accountability

At times, conditionality mechanisms may be needed in inter-governmental transfers to reduce the risks posed by elite capture, clientelism, rent-seeking and the insider-outsider problems that arise when those responsible for administering external money are not sufficiently accountable. Accountability goes both ways. SNGs need to be accountable

Box 2.5. **Australia's New Competition Policy**

In April 1995, the commonwealth and state governments agreed to implement a package of measures under the New Competition Policy (NCP) designed to extend pro-competitive policies to sectors of the economy that had previously been exempt from them. The reform package also included three inter-governmental agreements on aspects of competition policy. Under the third of these, the commonwealth agreed to provide payments to states and territories meeting their obligations plus reform commitments in electricity, gas, water and road transport. NCP payments were small relative to state budgets (less than 0.1% of GDP throughout the period), and they were rarely suspended or withheld: in the end, well over 95% of the funds available for NCP payments were paid to state governments between 1997 and 2006. However, they played an important role in reform implementation. First, the publicity associated with the NCP's annual assessments was a source of pressure on state officials to keep to their NCP commitments; no politician wished to be identified as the one who had cost the state millions of dollars, except in those few cases where doing so involved resisting really unpopular measures. Secondly, the sums involved were larger as a share of states' discretionary spending. Thirdly, the lack of penalties in the early years meant that the states came to rely on the funds when budgeting, which made deductions or suspensions more disruptive. Finally, the NCP payments empowered state treasuries and state departments of premier and cabinet, which were usually driving the reforms, *vis-à-vis* other departments. Delays and deductions were often taken from the budgets of the "offending" state departments, something no state minister wished to accept.

Source: Tompson, W. (2009), *The Political Economy of Reform: Lessons from Pensions, Product Markets and Labour Markets in Ten OECD Countries*, OECD Publishing, doi: 10.1787/9789264073111-en.

to higher levels of government in terms of carrying out their assigned tasks, but they also need to be accountable to the citizens who are clients for their investments and services. Matching requirements and performance reserves have been used to enforce accountability, among other reasons. To ensure that sub-national levels are accountable, transfers in some countries are conditioned to certain matching or co-financing requirements by the sub-national level.

To ensure the accountability of SNGs to their citizens, conditions can also be attached to the policy process associated with a project – for example, requiring SNGs to consult their citizens. In Poland, local authorities are obliged by law to prepare local development strategies in consultation with local stakeholders. However, if sub-national actors see the requirement as an administrative burden imposed by the central government (as many do in Poland), the conditioning may be ineffective, and it may encourage pro forma consultation that adds no real value to the policy process.

Horizontal co-ordination mechanisms

As outlined at the beginning of this chapter, co-ordination in a multi-level context is not only crucial vertically, but equally horizontally, across sectors at the central and sub-national level, and across jurisdictions of the same level.

Failures of cross-sectoral co-ordination remain widespread

The attempt to identify and exploit potential investment policy complementarities across sectors, which are required for place-based regional development, adds to the

complexity of co-ordination. Policy complementarities refer to the mutually reinforcing impact of different actions on a given policy outcome, as exemplified in Table 2.2. In other words, to maximise the outcomes of policies, different sectors have to co-ordinate their policies for specified territories. In Japan, for example, the 2012 Act to Promote the Low Carbon City encourages local governments to develop a place-based, cross-sectoral Low Carbon City Development Plan that is supported by three different line ministries, identifying low-carbon projects across sectors (health, transport, public housing, etc.) to be financed by the central government. Even highly decentralised federal systems have been shown to work in a deeply sectorally entrenched way, making not only central cross-sectoral co-ordination difficult, but inter-governmental and cross-sectoral co-ordination as well, and even more so. Where co-ordination is lacking, the potential benefits of policy interventions may be missed and otherwise desirable investments may have unanticipated and undesirable consequences (OECD, 2011b).

Table 2.2. **Complementarities in selected urban policies**

Policy	Impact		
	Land-use zoning	Transport	Natural resources
Land-use zoning Land-use zoning determines the density, height of buildings and proportion of undeveloped land on each property.	–	Segregation of land uses impacts travel distances and frequency; transit-oriented development zones encourage use of mass transport.	Zoning designates natural resource areas that may be set aside to reduce vulnerability to flooding or urban heat island effects.
Transport Transport policies determine the development and extension of road and mass transport networks.	Transport infrastructure policies shape demand for land and acceptance of density increases.	–	Transport systems impact natural resources and preserved zones.
Natural resources Natural resource policies determine which areas are preserved from development and what uses are acceptable in those areas.	Natural resource policies determine the limits of developed land-use zones and can improve the quality of high-density zones.	Natural resource policies affect the placement of road and mass transport infrastructure.	–

Source: Based on Kamal-Chaoui, L. and A. Robert (2009), "Competitive Cities and Climate Change", *OECD Regional Development Working Papers*, No. 2009/02, OECD Publishing, doi: *10.1787/218830433146*.

Cross-sectoral co-ordination remains weak in many OECD countries. In Poland, for example, information on the government's decisions on investment in various sectors impacting regional spatial planning is dispersed across the sectoral ministries; regional actors have to work hard to find and collect the information necessary for co-ordination with the national plans. This makes it harder to realise potential synergies among a wide range of territorial policies, such as transport, the environment and water. Regional authorities also need to liaise with each of the sectoral ministries when designing their spatial development plans. In Slovenia, a disconnect between spatial planning and regional policy is associated with the lack of strategic management capacity and a concomitant failure to appreciate the strategic role of spatial planning (OECD, 2011d).

Examples of good practice do, however, exist. The White House Council on Strong Cities, Strong Communities is an example of cross-sectoral collaboration to ensure the long-term economic development of cities. The initiative has brought together a significant number of central sectoral ministries to develop the programme in six pilot cities. The

initiative has had a budget of USD 11 million, which it aims to increase by cutting red tape, reducing transaction times and leveraging additional funds from the federal level (US Economic Development Administration, 2012).

In many places, regions work to make up for such failures

In some cases, where policy co-ordination across sectors at the national level has been perceived as lacking, regions have tried to compensate for this. Galicia reports that no multi-sectoral co-ordination exists between the central government and regional authorities. Bilateral agreements between regions and the centre (*convenios de collaboración*), which structure much of their co-operation, tend to be sectoral and are distributed across the central ministries. Nevertheless, Galicia has developed a multi-annual strategic plan that attempts to integrate policies across different sectors and thus to help alleviate this problem at the regional level. This master plan brings together several regional level sectoral plans, including those for road infrastructures, transport, water and innovation, with the aim of avoiding conflicting objectives and improving outcomes.

In Germany, Brandenburg has engaged in an effort to bundle the different sources of funding (such as from the Joint Task,[10] EU funds, etc.) that make up the roughly 10% of its budget over which it has real discretion,[11] so as to ensure maximum coherence between different policies. In addition, it has inter-ministerial working groups involving *Land* ministries. One challenge Brandenburg faces at the moment is that the funding instruments of the Joint Task and the EU have different programming periods. However, a far bigger challenge, namely that of significantly reduced funding from both sources, will have to be confronted in the future. This will require not only finding new financing mechanisms but also new ways of achieving policy coherence for regional development. On the central level, there seems to be an institutionalised approach to co-ordinating between the centre and the *Länder*, but it is largely sectorally driven, with few cross-sectoral co-ordination mechanisms that are as firmly institutionalised as the vertical ones.

In the absence of national cross-sectoral co-ordination, however, regional efforts to realise policy complementarities can be undermined. Region Skåne has both sectoral (e.g. transport, innovation) and cross-sectoral regional development strategies. They are the outcome of an important effort to define a holistic, place-based regional development policy. However, it has only had a limited impact, as the region lacks the resources to finance it and the plan is not tied to resource commitments from local or central sectoral budgets. As long as the regional strategy is not linked to a concrete implementation plan supported by financial commitments, it is unlikely to leverage the expected policy complementarities.

These examples reinforce the idea that, for place-based policies to work, interactions among sectoral policies probably need to be managed where they occur – in specific places. Except in very small countries, central governments are unlikely to be able to achieve the kind of cross-sectoral co-ordination that a place-based approach needs, precisely because conditions vary from region to region. This suggests that overcoming policy gaps that inhibit regional development is likely to pose a particular challenge in highly centralised countries. While it does not follow from this that they need to create a powerful regional tier of government – in some countries that may not be warranted (OECD, 2011d) – it does imply a need to create structures, linked to real resources, which can work towards the effective integration of sectoral policies.

As noted in Chapter 1, the benefits (and/or negative impacts) of public investments are rarely confined to pre-determined administrative boundaries. For example, building a bridge to enhance transport flows in one community may equally benefit other, adjacent, communities – or it may divert flows from other places, reducing their growth. Positive (as well as negative) spillovers may challenge the traditional management of public investment within fixed administrative boundaries, as it creates incentives for localities to free-ride. The other issue concerns economies of scale: it may not be efficient to build and maintain separate sewage systems for two small, adjacent communities, if technology easily has the capacity to serve both at the same time. Indeed, some investments may simply not be possible to undertake on a very small scale – their minimum feasible scale may exceed the size of the jurisdictions involved. Spillovers and efficiencies of scale are therefore key drivers for planning and implementing investment projects co-operatively across jurisdictions, to ensure an approach to policy making that reflects functional economies rather than administrative boundaries (Box 2.6).

Box 2.6. **Defining functional regions**

Functional regions can be defined as the spaces where the bulk of economic and social processes take place or where different economic flows and linkages cluster together. The identification of functional regions can be carried out looking at different kinds of interactions that take place among territorial units, from commuting patterns to housing market dynamics.

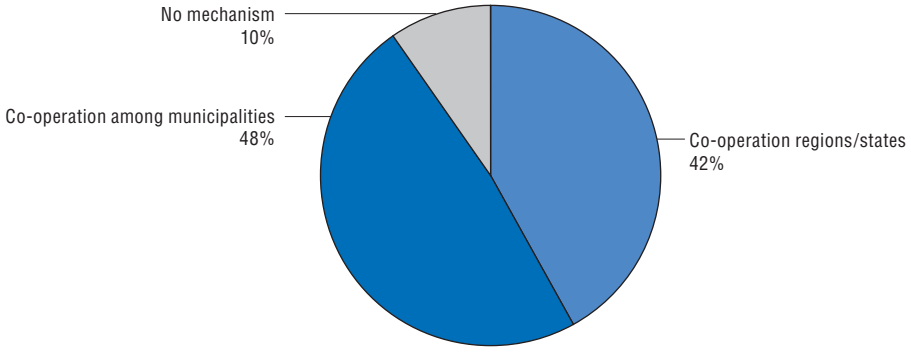
The functional integration between urban and rural regions is generally considered conducive to economic efficiency. However, it may have a different impact on people and territories, requiring an integrated approach to social and economic policies. The attempts to create co-ordination mechanisms, such as, for example, through regional partnerships, representing the interests of citizens of adjacent municipalities, should be tailored to the different spatial and functional forms of urban-rural interactions. In some respects, the extent to which a region carries out its policy-making processes with an integrated vision of the territory, beyond a sectoral and micro-territorial perspective, can characterise the "territorial identity" of a region, which helps define the capacity of regions to provide public goods starting from their endogenous abilities and resources.

Source: Veneri, P. (2011), "Assessing and Monitoring Rural-Urban Linkages in Functional Regions: A Methodological Framework", discussion paper for the Working Party on Territorial Indicators, 22nd Session of the Working Party on Territorial Indicators, 11 December 2011, OECD, Paris.

National governments actively seek to promote cross-jurisdictional co-operation…

Two-thirds of the countries responding to the questionnaire report having mechanisms in place to encourage either cross-regional or cross-local collaboration (Figure 2.7). Some encourage both. Federal or quasi-federal countries virtually all report the existence of such mechanisms across federal units. The survey results suggest that some traditionally centralised countries tend, as a rule, to put less emphasis on horizontal collaboration, although there are some important exceptions, such as Finland and France (Box 2.7). Strengthening such collaboration where it has historically been weak involves certain risks, as there may be a lack of or limited inter-institutional trust on the sub-national level, stemming from a planning tradition (such as has existed in Poland) that orients localities vertically, towards the centre.

Figure 2.7. **Co-operation across levels of government**



Source: OECD (2012), "Multi-Level Governance of Public Investment", national and regional case study questionnaires, *www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm*.

StatLink http://dx.doi.org/10.1787/888932844600

Box 2.7. **Using incentives to promote municipal co-operation: The case of France**

France has more than 36 000 *communes* (the basic unit of local governance), whereas countries of comparative size usually have around 8 000. Nevertheless, France has long resisted municipal mergers. Though many municipalities are too small to be efficient, they are considered an essential component of the French democracy. For more than three decades, the central government has been encouraging co-operation among municipalities, both to allow small rural communes to surpass minimal thresholds necessary to provide public services, and to allow urban areas, which are often fragmented into several municipalities, to be managed coherently. There are approximately 19 000 inter-communal structures aimed specifically at facilitating horizontal co-operation, and some 88% of communes are involved in them. There are three main types of supra-communal structures: communities of communes (groupings of small rural communes), "agglomeration" communities (groupings of 50 000 inhabitants subject to a single business tax) and the urban communities (groupings of 500 000 inhabitants or more). Each grouping of communes constitutes a "public establishment for inter-communal co-operation" (*Établissement public de coopération intercommunale*, EPCI). The EPCIs assume limited, specialised and exclusive powers transferred to them by member communes. Unlike the communes themselves, the EPCI is not governed by elected officials, but by delegates of municipal councils. Although the EPCIs are created by the communes directly, there are two notable roles for the central government. First, EPCIs must be approved by the state in order to exist legally. Second, to encourage municipalities to form an EPCI, the central government provides a basic grant plus an "inter-communality grant" to those communes that accept a single business tax. This is to preclude competition on tax rates among participating municipalities. EPCIs draw on budgetary contributions from member communes (for the syndicates) and/or their own tax revenues (for the EPCIs).

Source: Charbit, C. and C. Vammalle (2010), "Modernising Government", in *Making Reform Happen: Lessons for OECD Countries*, OECD Publishing, doi: 10.1787/9789264086296-9-en; OECD (2006), *OECD Territorial Reviews: France 2006*, OECD Publishing. doi: 10.1787/9789264022669-en.

… but such efforts face significant challenges

Wide-reaching autonomy and varying levels of sub-national capacity across jurisdictions are among the challenges that complicate horizontal collaboration. In Mexico, for example, states have autonomy in their designated fields of competence, which makes it difficult to co-ordinate agendas, priorities and fiscal resources. In addition, a number of respondents point to a perceived lack of capacity for horizontal collaboration at the regional level (e.g. Sweden).[12] A lack of strategic planning capabilities at the local level has impeded inter-municipal collaboration in such diverse countries as Canada and Slovenia. Differences in size, wealth and priorities can make it difficult for neighbouring municipalities to agree on investment decisions together, particularly where very large agglomerations are engaged with much smaller municipalities. Large agglomerations are likely to question how much they need their smaller neighbours and may be wary of carrying their burdens, whereas smaller municipalities often doubt their ability to uphold their interests in such an unequal partnership. Co-operation can also be difficult where there are significant differences in income levels between adjacent jurisdictions. Yet competitive pressures arise even in a partnership of equals.

Inter-jurisdictional competition is another obstacle to fostering horizontal collaboration at the local level in many places. Competition between regions for national funding often tends to trump collaboration incentives (e.g. Germany and Switzerland). In Estonia, municipalities compete to obtain funding from higher levels of government. Where indivisible assets like schools and hospitals are concerned, collaboration can be harder. For example, in low-density places like Slovenia (OECD, 2011d) or south-eastern Sweden, municipalities readily see the scale economies to be realised by collaborating in fields like education and health care, but may fear that their own long-term viability and attractiveness depend in part on ensuring that the key facilities (and related employment) are located within their own jurisdiction. On the opposite side, though, SNGs may have an incentive to collaborate to increase their influence at the central level, as for example in Sweden, where Region Skåne and its smaller neighbours across the larger South Sweden Region have sought to co-operate in pursuit of shared priorities. Their joint weight shapes the negotiations at national level. One such sector where this plays a role is transport infrastructure. The extension of the railway lines to Stockholm is one recent example.

Finally, regulatory impediments may exist. For example, the statutory obligations imposed on municipalities may make it impossible for them to "contract out" certain functions to neighbouring municipalities or joint bodies, even where this is efficient. National legislation may also raise the costs associated with organising joint undertakings among municipalities (OECD, 2011d; 2012b). Officials in Brandenburg stress the inhibiting effect of rules governing some EU Structural Funds. Brandenburg is a convergence region for the purposes of EU Cohesion Policy (giving it access to significantly more funding than Berlin), whereas Berlin – which Brandenburg entirely surrounds – is not. This prevents Brandenburg from using its cohesion resources for joint projects with the capital, despite the fact that they face many common challenges. Finally, Brandenburg sees its interest at risk if joint funding is set up with Berlin, and Brandenburg the potentially subordinate bordering region.

A range of mechanisms have been used to promote horizontal collaboration…

The mechanisms employed to foster inter-jurisdictional collaboration vary widely, from "harder" legal or financial incentives, to "softer" collaborative mechanisms. Among

the "hard" incentives, one finds, for example, legal requirements to collaborate across sub-national levels, such as those enshrined in Mexico's planning law, which explicitly prescribes collaboration across its states. The provision of financial preferences at the national level for joint sub-national public investment proposals, such as practiced in Estonia, Norway and Spain, are another example. In Slovenia, a reimbursement by the central government of 50% of staff costs for joint municipal management bodies has led to a significant increase in the number of such ventures. In Switzerland, one-third of sub-national funding from the central government is reserved for inter-cantonal investment projects. In addition, some 800 inter-cantonal agreements have been created that focus on collaboration in specific fields, such as fishing, *health care* services, inter-cantonal roads and police networks. The fiscal decentralisation reform of 2008 further reinforced these agreements, allowing the central government to forbid cantons from opting out of specific agreements. Hard incentives have frequently been used by supra-national bodies as well, such as the European Commission. In Portugal, grants are provided for the 2007-13 EU programming period to establish and implement territorial development plans among collaborating municipalities. Among the "softer" measures one finds policies to facilitate the exchange and dialogue among municipalities with regards to their investment policies (e.g. Canada or Sweden). Another example is the special purpose cross-border platforms like the Pacific Northwest Economic Region (incorporating both Canadian provinces and US states). Finally, in the United States, the economic development districts and comprehensive economic development strategies encourage counties to work co-operatively on long-term strategic plans, and the Stronger Economies Together (SET) initiative aims to change the "silo culture" that has been prevalent in investment policy in the United States until today.

In a top-down fashion, British Columbia can create inter-municipal institutions, oblige municipalities to adhere to them and review their mandates when it deems this necessary. British Columbia has created a number of institutions in an effort to facilitate co-ordination between municipalities and reach efficient scale for service provision and public investment (regional districts, Trans Link, British Columbia Rail Company, etc.), as well as authorities that run specific public services for the municipalities. Once created, they are administered independently of the province, directed by a board that represents the relevant interests given their mandate (municipalities, regional districts, civil society, etc.). They are funded by specific taxes and fees and are not allowed to run budget deficits, but they may borrow for capital investment. By providing services to a pool of municipalities, they allow for economies of scale and lower prices. The Municipal Finance Authority (MFA) is one such example, financing most of regional districts' and municipalities' long-term debt, and encompassing all local governments in British Columbia except the city of Vancouver.[13]

In Germany, Brandenburg has sought to combine top-down and bottom-up elements in an effort to foster cross-municipal co-ordination. The *Land* government has identified 16 "growth cores" around Brandenburg, chiefly the leading municipalities in various parts of the territory, around which the other municipalities can organise. To tap the resources available to support projects in these growth cores, municipalities must affiliate to one of them and must also be ready to participate in the financing. The *Land* gives priority to projects that are expected to generate positive spillovers across municipal boundaries. This approach not only gives the municipalities an incentive to collaborate, it also requires them to approach the *Land* for support on the basis of growth potential rather than on the

basis of need. Growth cores also enjoy a preferential dialogue with the *Land* on various issues.

… and to achieve scale efficiency

Many OECD countries have aimed at scale efficiency, strengthening municipal capacity and reducing fragmentation at the sub-national level by implementing policies to merge or abolish municipalities. Denmark, for example, reduced the number of municipalities from 271 to 98 and the number of regions from 16 to 5 in a reform that took effect in 2007. Most other countries have preferred to encourage voluntary mergers, albeit with a limited impact in most cases (e.g. Finland). Sweden has been trying to encourage a bottom-up consolidation of its 22 counties, but the outcome of this effort remains unclear (OECD, 2010). France is the OECD country with the greatest fragmentation at municipal level, but it has made extensive use of contracting mechanisms to foster co-operation among its 36 000 municipalities (Box 2.7).

Demographic change has been an important driver for efforts to encourage efficiencies of scale at local level, particularly in low-density regions like Småland, in southern Sweden, where population ageing and out-migration are making it increasingly difficult to sustain service provision. However, co-operation remains patchy and some impediments to inter-municipal collaboration remain (OECD, 2012b). In Germany, after a wave of top-down enforced municipal mergers to downsize local administrations following unification, Brandenburg has had to respond to demographic change in recent years by trying to streamline public service provision at the local level. Demographic change has left some municipalities shrinking, with the per capita costs of investment and service provision growing. Therefore in 2011, the Interior Ministry of Brandenburg published a directive on the financial support for voluntary municipal mergers. By providing financial incentives, the ministry hopes to increase the efficiency and quality of service provision at the municipal level. In 2012, EUR 10 million were allocated to support municipal mergers, with EUR 50 000 offered for municipalities where some administrative functions are merged, and up to EUR 500 000 for entire mergers of municipalities' administrations. Among the first to take up this initiative were cities and their adjacent municipalities.

The bottom line: Horizontal co-ordination often requires a vertical dimension

Evidence suggests that horizontal collaboration, across both policy sectors and jurisdictions, is difficult, even in situations where the actors involved clearly 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 regional or local governments together, even in the face of common problems. Thus, leadership from above is often critical in resolving the collective problems that such co-operation poses. This can be done in a variety of ways, but it is striking that many of them involve financial incentives, which can be applied in a systematic way, by reserving a portion of sub-national funding exclusively for collaborative investments, or on an ad hoc basis. Occasionally, they may even be initiated from the bottom up, as when collaborative investments are proposed to the higher funding government level. Regional policy instruments, in particular, are often devised so as to encourage cross-sectoral and cross-jurisdictional collaboration for investment (e.g. Brandenburg, EU Cohesion Policy). Although the financial incentive mechanism seems a necessary condition, it is not sufficient. Building the capacity of sub-national levels to

engage with other governmental agents as well as building a collaborative culture conducive to cross-jurisdictional engagement are essential for facilitating horizontal and vertical co-ordination (see Chapter 3).

Monitoring and evaluation: The need for information to make co-ordination work

Governments at all levels report that they monitor the performance of their investments…

Information is critical to making co-ordination across levels of government work. It is essential to the alignment of objectives and assessment of projects, as well as mutual accountability and transparency. Information collected from monitoring and evaluating public investment also lies at the heart of efforts to increase the efficiency and effectiveness of sub-national level public investments.

Monitoring has become a standard tool for ensuring the success of an investment project; all national and regional governments answering the questionnaire report that monitoring is carried out in one form or another. In their responses to the survey, a great majority of countries report that some form of performance monitoring of public investment projects is conducted at the central government level. This includes the use of performance indicators as well as the formulation of objectives defined in the form of target values (OECD, 2009a). Strikingly, the exceptions to this rule include both very decentralised federal countries, in which federal level monitoring might transgress on the rights of the federal units, and highly centralised countries, in which the sums available to the regional level for regional development are typically very small (even if larger sums go to local governments, which are monitored).

… and robust ex post evaluations are picking up gradually…

Over half of the regions surveyed report that they conduct *ex post* evaluations. Brandenburg, for example, is currently engaged in analysing the effectiveness of an innovation voucher programme through a beneficiaries' survey with the aim of using the results to inform the design of similar programmes in the future. In addition, a business support programme is being evaluated using a randomised evaluation approach, analysing the effectiveness of the programme by matching recipient enterprises with non-recipient ones along a number of company characteristics. Basilicata offers an example of an institutionalised approach to evaluating policy impacts at the sub-national level. Its regional Public Investment Evaluation Unit, situated within the Department for Structural Funds, is responsible for monitoring and evaluating all public investments in the region and for checking the consistency of strategic projects with respect to the Regional Development Plan and the annual financial plan. The unit also performs impact evaluations of public investment projects, with their effects on regional employment and production.

As will be highlighted in Chapter 3, monitoring and evaluation will only become effective co-ordination tools if the information generated facilitates learning. The fact that evaluations are carried out at the regional tier signals the interest of sub-national authorities to understand, in their own contexts, what works and what does not. This dynamic should be positively reinforced by the centre by providing support in the form of capacity tools and resources (such as a central body providing know-how for regions) if

needed, to help SNGs evaluate their own programmes, making use of existing resources in the region.

The discussion will now turn to an encompassing instrument, namely inter-governmental contracts, which may be applicable for both vertical and horizontal for co-ordination, and incorporate elements of instruments such as co-financing or conditionality.

Contracts as cross-cutting co-ordination mechanisms

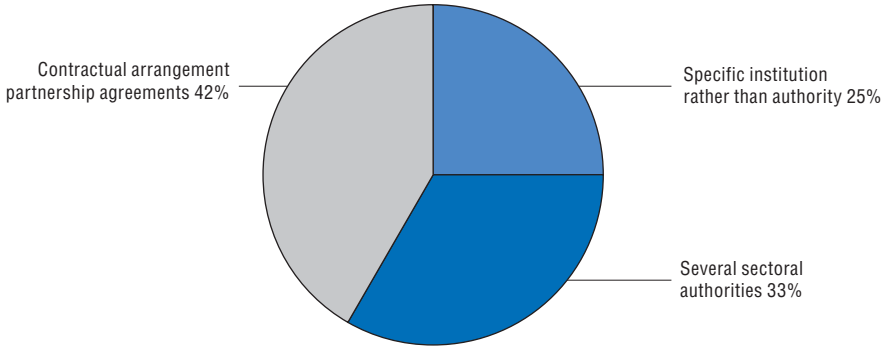
Inter-governmental contracts are an encompassing, cross-cutting mechanism for co-ordination. They can help actors across levels of government to address a number of existing co-ordination challenges simultaneously and they can employ different co-ordination devices together. Mutually designed and agreed upon contracts across levels of government can improve the basis of information on common policy priorities, make objectives clear and transparent and commit all levels to generate and use information on public investment performance outcomes. Contracts can be complementary to other mechanisms, such as conditionality, and in fact, very often are. Contracts take the co-ordination discussion a step further, creating credible partnership arrangements between levels of government to generate a joint commitment for rendering public investment more efficient and effective. They can encompass both specific instruments and projects, from design and implementation through to monitoring and evaluation, as well as agreement on broader objectives and strategies.

Contracts can be a complementary tool that incorporates many other mechanisms

The previous sections have highlighted different mechanisms and instruments that governments at different levels can, and have, used to interact and collaborate for managing public investments. A number of informal arrangements, such as platforms for policy exchange or working groups where policies are discussed informally, and more formal arrangements, such as conditionality, were assessed. It was shown that the relationship of inter-governmental collaboration for regional development should be, and as we have seen frequently already is, based on a principle of "partnership" rather than subordination. This section addresses another encompassing instrument, related to, but different from conditionality, namely inter-governmental contracts for regional development. These are a complementary tool to the formal and informal arrangements discussed thus far, albeit one that can at times encompass some of the others. Contracts are distinguished from other co-ordination instruments by the fact that they are formal devices to enable governments across levels to arrange joint action or to delegate action, as independent entities, and to clarify the complexity of processes and responsibilities for regional public investment. This section looks at how contractual arrangements go beyond what we have seen previously and what we can learn from existing inter-governmental contracts across OECD countries.

Contracts are frequently used as a co-ordination instrument between levels of government for regional development policy in OECD countries (Figure 2.8), in federal as well as unitary countries (e.g. Canada, France, Italy, Portugal, Spain). Half of the regions covered by the case studies have used contractual arrangements. Contracts are quite powerful instruments for cross-governmental co-ordination: they are frequently concluded by high-level political actors and they often include both dedicated budgets to ensure implementation and clearly defined mechanisms to resolve any conflicts that may arise (Figure 2.9).

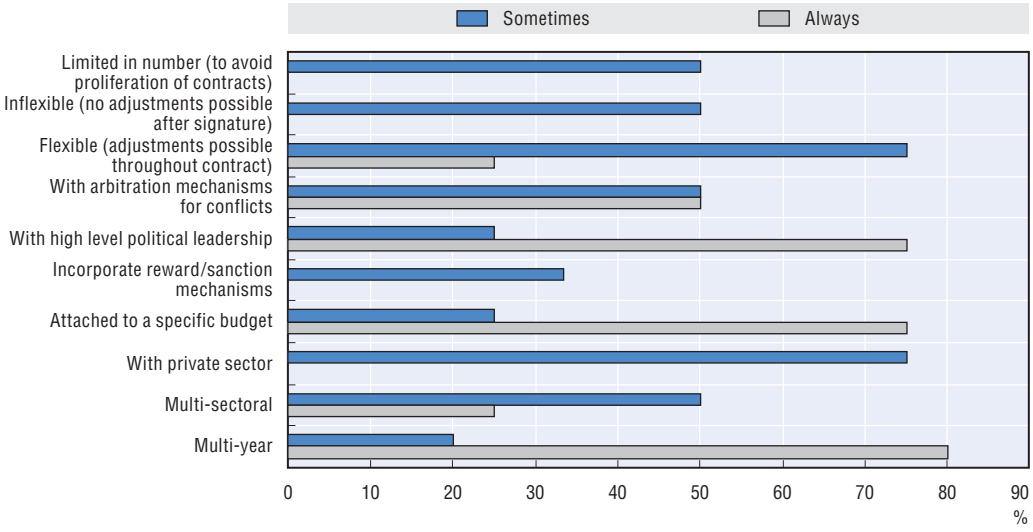
Figure 2.8. **Mechanisms used for cross-governmental co-ordination for regional development**



Source: OECD (2012), "Multi-Level Governance of Public Investment", national and regional case study questionnaires, *www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm.*

StatLink http://dx.doi.org/10.1787/888932844638

Figure 2.9. **Contract characteristics**



Source: OECD (2012), "Multi-Level Governance of Public Investment", national and regional case study questionnaires, *www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm.*

StatLink http://dx.doi.org/10.1787/888932844657

Contracts between levels of government allow for a "tailor-made" and flexible approach for assigning responsibilities across governments for specific aspects of regional policy. This can be useful not only because of the inherent inter-dependencies among levels of government involved in the design and execution of a place-based regional policy, but also because the assignment of responsibilities among levels of government can be "imperfect". There may be overlaps, leading to shared responsibilities and therefore the need for co-operation and clarifying roles. On the other hand, some policy domains may not be specifically assigned to any level of government.

Contracts also allow for adapting regional development policies to different territorial contexts. They present the advantage of avoiding a one-size-fits-all approach and leaving scope for adapting policies to territorial characteristics. They thereby help to address asymmetries of information and potential differences in capacity. Contracts can be useful

in unitary or federal contexts. In unitary countries, contracts are often used in the framework of decentralisation policies, to empower sub-national levels of government or delegate the implementation of public investment tasks. In this context, they tend to be long-term agreements. They can be quite effective for managing policy processes that unfolded in stages over an extended period, particularly where they are innovative or experimental in nature and thus imply a need for periodic feedback and adjustment. In a federal country, contracts are more complementary, specifying co-operation on tasks that are not defined by existing constitutions or legal frameworks. This can often be the case for new or intermittent measures, such as innovation policies or the implementation of stimulus packages (as seen during the economic crisis). Such contracts tend to be focused and short-term (OECD, 2007).

Inter-governmental contracts for regional development tend to be relational, not transactional

Previous OECD work on contracts for regional development has highlighted the distinction between "transactional" and "relational" contracts. "Transactional" contracting involves an *ex ante* determination of the complete set of binding and enforceable rights and duties of the parties, including the co-ordination arrangements. The key challenge concerns the incentives needed to encourage the parties to make good on their obligations. The resulting contracts are contingent, complete (in theory, at least), often complemented by an incentive mechanism and ultimately enforced by third parties, such as the judiciary. By contrast, "relational" contracting involves parties committing to co-operate *ex post* (after the signing of the agreement). Supervision of compliance with the agreement tends to be bilateral, relying on a co-operative spirit. In other words, their primary purpose is not to fix the parties into a complete set of binding and enforceable commitments but rather to serve as a mechanism for collective decision making, which generates trust and facilitates co-operation, information sharing and capacity building. In practice, most contracts fall somewhere on a continuum between transactional and relational (OECD, 2007).

Various factors determine the choice of contract:

- The institutional context is critical. In an inter-governmental context, it is often the case that neither party can really threaten to walk away and negotiate with another potential counterparty (i.e. no regulation by competition). Moreover, central governments and SNGs are typically engaged in a repeated-play game from which neither can easily exit (institutional lock-in). They have little choice but to interact with one another. Finally, where the autonomy of SNGs is strongly entrenched, the absence of any recourse to vertical integration to solve co-ordination problems gives the central authority an incentive to negotiate. All of these factors point to more relational contracts (OECD, 2007).
- The choice of contract depends on the capacities present or absent across levels of government. As Steffensen (2010) observes, weaknesses with respect to administrative capacity frequently undermine the effectiveness of other co-ordination mechanisms, like performance-based grants, and need to be addressed in tandem with co-ordination efforts. In the case of limited sub-national capacity, a contract should be designed on an evolving basis that first empowers the sub-national level and thereby creates the basis for a more optimal contractual design later on. This points to one advantage of more relational contracts. When the central government has capacity limits, contracting

should be used as a way to experiment and learn by encouraging both parties to share knowledge.

- Contract choice is dependent on the degree of complexity of the policy at hand. The more complex and the wider the scope of the challenges to be addressed, the more relational a contract should be, because it is difficult to specify *ex ante* the details of what will be required of the parties. Moreover, where the parties do not know precisely how to deal with a policy issue, they need to co-operate in identifying more clearly how the problem(s) can be addressed. The only certainty is that the parties are involved in a common venture, in which they will share costs and benefits. This, too, points to the relevance of a relational contracting approach for regional development. Where regional growth strategies involve multi-sector policy packages and causal links are difficult to assess *ex ante*, it should be possible to incorporate their key elements into relational contracts for regional development.
- When governments are contracting over prerogatives of both central and local governments, they typically use a co-operative logic and implement a rather incomplete contract. The resulting fuzziness of the duties of each party could be exploited by both sides to escape political accountability. It is therefore essential to make the bilateral commitment as "verifiable" as possible, either by ensuring efficient oversight by the judiciary or some other third party, or by ensuring electoral accountability. The complexity of assessing this type of contract is that it concerns the verifiability of co-operative behaviours rather than fulfilment of precise technical commitments.
- Enforceability of contracts strongly depends both on the organisation of the judiciary (particularly its independence) and on the political accountability of the various levels of government. The contract should be designed anticipating whether these third-party enforcement provisions are necessary (OECD, 2007).

Not surprisingly in view of the foregoing considerations, contracts aimed at addressing public investment for regional development tend to be relational, emphasising co-operation, rather than transactional. Regional development policy is a shared responsibility between central and regional levels of government. The nature of this sharing varies but tends to be characterised by strong inter-dependencies between levels of government in terms of decisions to be taken, tasks to be implemented and the implications of policy success (or failure). Consequently, regional development policy, which requires *ex ante* co-ordination among levels of government, often employs contractual mechanisms for dealing with co-ordination needs. Regional development policies are complex, due to limited information and a notable degree of uncertainty about the best options to be selected, the targets to be reached and the best strategies to be applied. This suggests the need to use relational instead of transactional types of contracts. While general contracts for regional development tend to be relational, they often encompass tasks to be fulfilled that have a more transactional nature (OECD, 2007).

Relational contracts may be flexible, while still providing strong compliance mechanisms

Although relational contracts may appear "weak" given the lack of emphasis on binding and enforceable constraints, OECD (2007) finds that they can help sustain a dynamic of co-operation among levels of government over the long run. Bachtler and Ferry (2011) observe that they can also contribute to local capacity building. Moreover,

although necessarily flexible, an approach based on relational contracts need not be devoid of strong obligations, and certainly does not preclude agreement on specific binding conditionalities or engagements linked to specified performance indicators (OECD, 2009a). The conditions attached to resource transfers, for example, would still have to be obligatory and enforceable. Owing to the need for a bottom-up approach that allows for flexibility and experimentation, the strictest obligations would probably need to pertain to procedures rather than to the content of policy. Indeed, the greater the weight attached to flexibility and discretion in regional policy, the more important it is to ensure that decision-making (and dispute-resolution) procedures are well specified, transparent and robust. This is particularly important for their legitimacy. Since a place-based approach implies that a single set of standards, definitions and targets cannot (for good reasons) be applied across all regions, then the best guarantee of equity in the treatment of different places is likely to be a transparent decision-making procedures.

A number of regional development contracts can provide valuable lessons…

Previous OECD work looked at specific cross-governmental contracts for regional development in Canada, France, Germany, Italy and Spain (OECD, 2007). It focused on understanding the rationale of contracting, as well as the type and implications of the different levels of government. Since then, the use of such contracts has spread (Table 2.3 has selected cases). This section thus builds on that earlier work to see what has been learnt about their achievements and the challenges they pose.

The examples in Table 2.3 do not give a complete picture of all of the existing contracts across levels of government, but they do suggest some important lessons that can inform the future development of cross-governmental contracts for regional development:

- The Territorial employment pacts (TEPs) in **Austria** have been found effective in bringing all labour market actors across levels of government together to tackle local employment challenges and policy (Committee of the Regions, 2012). The TEPs thereby aim at implementing the National Reform Plan for Growth and Jobs that seeks to co-ordinate across relevant policy areas, including employment, education, regional economic and structural policies, using an integrated, place-based approach.
- The new government in the **United Kingdom** abolished England's local and multi area agreements (LAA and MAA) and replaced them with local enterprise partnerships. Nevertheless a number of lessons can be learnt from the previous contracts. Contracts across levels of government in the United Kingdom have tended to remain relational and non-binding, leaving substantial discretion to sub-national authorities. Although the LAAs succeeded in fostering a partnership approach among local actors, they were unsuccessful in promoting local accountability. Instead, they reinforced the accountability of local actors to their central level departments. This resulted in an ambiguous responsibility for the delivery of outcomes (*Department for Communities and Local Government, 2011*). An evaluation of the MAAs found similar challenges. The persisting centralisation, and thereby fragmentation, of funding mechanisms at the local level (a number of separate funding streams) undermined central and local level co-ordination across sectors. Fragmented funding was accompanied by separate targeting mechanisms, albeit in the context of an integrated local strategy. This further undermined co-ordination at the local level. Furthermore, the MAAs posed a serious capacity challenge for national and local actors in terms of time and resources as well as

Table 2.3. **Inter-governmental contractual arrangements for regional policy across OECD countries**

	Austria	Belgium	Finland	Netherlands	Poland	Sweden	United Kingdom
Contract name (year established)	Territorial Employment Contracts (1997)	Flanders 2020 Pact	Oulu Growth Agreement (2002)	Rural Contracts (2006)	Regional Contracts (2001)	Regional Growth Agreements (2000)	Local Strategic Partnerships
Why this case study is interesting	"Model" relational contracts focused on a given policy area applied in a federal setting	Horizontal contractual arrangements at the sub-national level, Co-operation mostly on a strategic level, but also an emphasis on quantifiable targets and performance assessment	Contractual arrangement in a highly fragmented institutional setting, key role played by municipalities rather than regional authorities, example of innovation policy and partnership	Rare example of a transactional contract, focused on rural policy which operates in the context of the Netherlands, where strong interdependencies exist between rural and urban areas	Contracts modelled on the French *Contrat de projets État-région* (CPER) applied in a decentralised setting (however, with strong centralisation traditions); example from Central and Eastern Europe where regionalisation and regional policy are still a relative novelty and where most EU Cohesion Funds are allocated	Contractual arrangements applied in a bottom-up setting, experimental and ongoing regionalisation in traditionally centralised Sweden	Example of loose relational contracts implemented in the context of devolution institutional flux
Type of contract	Relational	Relational	Relational	Closed, transactional	Relational, with transactional elements	Relational, with transactional elements	Relational
Government actors (lead co-ordinating unit in bold)	• National government (Federal Ministry of Economy and Labor) • Federal states • Local/district authorities • EU Social Fund • Social and economic partners (including the Chamber of Agriculture, trade unions, etc.)	• Flemish government • Social Economic Council of Flanders (representing the key social and economic partners) • United Associations (umbrella organisation for civic organisations)	• Municipality of Oulu • Municipalities of the Oulu Region • Oulu Region Centre for Expertise • Regional Management Committee of Northern Ostrobothnia • Regional partners: local industrial clusters • Higher education institutions	• National government • Provincial authorities	• Regional governments • Central government • EU (indirectly)	• Regional authorities • County administrative boards • Central government (Ministry of Trade and Industry)	• Local councils • Central government (various departments) • Public, private, voluntary and community stakeholders
Contract objective	Increase the co-ordination of employment policies across levels of government to enhance labour market performance	Provide a framework for co-operation and assessment of progress towards Flanders' strategic priorities and Europe 2020	Increase co-ordination at the regional level to deliver more effective industrial and innovation policy and ensure the efficient use of EU Structural Funds	Increase the co-ordination of rural policy between levels of government by shifting competencies to the provincial level	In theory, a tool for co-ordinating regional development policy across levels of government. In practice, however, it is a legal framework for inter-governmental transfers for the implementation of regional operational programmes (ROPs)	Increase cross-level co-ordination while stimulating reflection on regional priorities at the sub-national level and introducing "regional lens" for a range of sectoral policies of the central government	Increase co-ordination for local development priorities through the design of a Sustainable Community Strategy (and local/multi area agreements)

Table 2.3. **Inter-governmental contractual arrangements for regional policy across OECD countries**

	Austria	Belgium	Finland	Netherlands	Poland	Sweden	United Kingdom
Contract description	Co-ordinate co-operation between labour policy actors: improve the flow of information and harmonise strategic and operative labour market policies between the federal, *Land* and district authorities; includes the development of a strategy as well as joint programme development and financial co-ordination	A partnership-based instrument operationalising and translating the region's broad strategic goals into measurable targets, while providing a framework for monitoring progress towards those targets	Instrument based on broad partnership intended to co-ordinate the strategies of municipalities, regional authorities and the key business and education actors; sets qualitative and quantitative targets as well as a system for monitoring progress; closely linked to EU Structural Funds – sets conditionalities concerning the projects to receive EU funding	Instrument for translating the goals of the central government's Agenda for a Living Countryside into measurable targets to achieve at the provincial level; negotiating financial allocations for rural policy interventions by provincial authorities. Strong monitoring of compliance with the targets based on negative sanctions rather than performance rewards	Instrument for co-ordinating regional policy and regional public investment across levels of government, with a strong bias towards the use of EU Structural Funds	Instrument for enhancing horizontal and cross-level co-ordination, by aligning the priorities of the regional strategic programmes to the central government's overarching goals; aligned with the EU Structural Funds framework; emphasis on strategic co-ordination; little attention paid to implementation and monitoring	Local strategies and agreements for implementation should consolidate efforts at the local level through the development of joint priorities, as well as targets and indicators against which they are measured – and subsequently rewarded based on performance

Source: Austria: Huber, P. (2001), "Territorial Employment Pacts in Austria", Austrian Institute for Economic Research (WIFO), discussion paper; Committee of the Regions (2012), "Third CoR Monitoring Report on Europe 2020", final report, Committee of the Regions, Brussels; United Kingdom: Bailey, N. (2003), "Local Strategic Partnerships in England: The Continuing Search for Collaborative Advantage, Leadership and Strategy in Urban Governance", *Planning Theory & Practice*, Vol. 4, No. 4; Russell, H. (2010), *Research into Multi-area Agreements: Long-term Evaluation of LAAs and LSPs*, Department for Communities and Local Government, London; *Department for Communities and Local Government (2011), Long Term Evaluation of Local Area Agreements and Local Strategic Partnerships 2007-2010: Final Report*, Department for Communities and Local Government, London; Poland: Regulski, A. et al. (2012), *Kontrakty terytorialne jako instrument polityki rozwoju. Optymalizacja kontraktów terytorialnych w kontekście wdrażania Krajowej Strategii Rozwoju Regionalnego 2010-2020*, Instytut Badań Strukturalnych, Warsaw; *Ferry, M. (2003)*, "The EU and Recent Regional Reform in Poland", *Europe-Asia Studies*, Vol. 55; Svensson, B. and A. Östhol (2001), "From Government to Governance: Regional Partnerships in Sweden", *Regional & Federal Studies*, Vol. 11, No. 2.

in the development of a culture of collaboration and a better understanding of each other's language (*Russell, 2010*).

- The initial regional contracts in **Poland** served as a learning device preparing the regional authorities for the management of the EU Structural Funds in a multi-level setting (OECD, 2008). These contracts created a stable and multi-annual framework for vertical co-ordination, allowing regional authorities to complete long-term investment plans. Nonetheless, it has been argued that the contracts remained stuck in what was previously a centralised framework, rather than putting the regions at the centre of regional development policy making. Instead of introducing a co-ordinated, place-based approach, the contracts served as a tool for the local implementation of national programmes, the need for which arose because fiscal decentralisation did not match the regions' assigned responsibilities. This reinforced their financial dependence on the central government. The centre's approach to managing EU Structural Funds further undermined the regions' role, making the regional contracts simply an instrument of the EU-funded programmes instead of instruments for regional policy planning and co-ordination (Ferry, 2003; Regulski et al., 2012). The National Regional Development Strategy for 2010-20,[14] which replaces the existing contracts, aims at introducing a more integrated and place-based approach to create synergies between all regional policy instruments with a territorial dimension across levels of government, especially by specifying the sources of funding for the strategy's envisioned interventions.
- The experiment with the regional growth agreements (RGAs) (OECD, 2010) created scope for the emergence of new forms of governance in **Sweden**'s regions, drawing on the country's strong traditions of co-operation and inclusiveness. Nonetheless, the scheme suffered from blurred accountability and conflict, due to the lack of settled and institutionalised authorities at the regional level (Svensson and Östhol, 2001; Svensson, 2001) as well as the fact that the central government retained strong control over the priorities of the RGAs, which ultimately failed to recognise the regional needs and requests. As a result, the scheme has been discontinued and replaced by regional development programmes (RDPs), strategic documents designed at the regional level and backed by regional growth programmes (RGPs) serving the purpose of a voluntary operational sub-programmes specifying in more detail the priorities and measures outlined in the RDPs. While the RDPs have the advantage of being genuinely bottom-up and designed by the regional actors, they hardly fit the definition of a contract because there are no strong enforcement mechanisms in place and little in the way of dedicated resources. Instruments other than contracts have thus been required for co-ordination.

The above examples of the cross-governmental contracts for regional (local) development point to three common lessons. First, contracts seem to be an effective instrument for introducing a co-ordinated approach to regional (local) integrated development policies. They seem to succeed in bringing actors together to form a joint policy strategy. Secondly, however, many contracts remain largely unsuccessful in changing existing fragmented and compartmentalised structures, because the relevant competences that go along with the strategies often remain unchanged. In addition, contracts may not be sufficiently integrated with budgetary processes, so that financing – and thus implementation – are not assured (OECD, forthcoming). Thirdly, while contractual arrangements can be employed as a capacity building device, they sometimes also limit existing capacity, both at the local and the national level. They can create "parallel" structures to existing administrative processes, which increase the administrative burden

and also the need for "know-how" at the local and higher levels to engage in these new structures. Therefore, it is crucial to ensure that contractual arrangements are, as much as possible, aligned with existing ways of "doing business" and are accompanied by training for all levels of government in how to implement them.

… which are of relevance for the development of EU partnership contracts

Plans for the future EU partnership contracts demonstrate awareness of lessons learnt from previous contractual arrangements. The ongoing development of these contracts for the next funding period 2014-20, replacing the former NSRFs (Box 2.8), reflects the lessons outlined above. First, the contracts will take into account the often constrained position of local and regional authorities. Second, the Commission proposes to introduce accompanying capacity building measures across levels of government for effective implementation of the contracts. Third, the contracts, as currently envisaged, will be designed around a core integrated approach to territorial development, with a strong focus on cross-sectoral co-ordination and financial commitments to the evolving contracts.

Box 2.8. **The role of the EU's partnership contracts**

The draft legislation for EU Cohesion Policy in 2014-20 proposes that partnership contracts be prepared at national level with close involvement of partners and then agreed between the Commission and the member country. While in the current framework member countries and the Commission agree on the NSRFs, outlining how the EU funds are to be used, partnership contracts will go further by including conditionalities and targets based on agreed indicators. According to the Commission's proposal, the partnership contracts would include:

- the contribution of EU funds towards the National Reform Programme and the achievement of thematic objectives chosen by the member country from a list of 11 objectives in line with Europe 2020;
- investment priorities for each of those objectives;
- the targets to reach by the end of the programming period as well as performance indicators and milestones for assessing progress;
- arrangements for effective implementation: involvement of partners, *ex ante* conditionalities, performance framework (indicators, annual reports on progress, sanctions), additionality, etc.; and
- arrangements for efficient implementation: administrative capacity, reducing administrative burdens.

Partnership contracts are intended to provide an effective "commitment device" concerning the use of funds and performance. If progress is not made towards the targets set out in the contract, there may be severe sanctions: suspension or withdrawal of funding.

Source: European Union (2012), "The Partnership Contracts – How to Implement Multilevel Governance and to Guarantee the Flexibility of Cohesion Policy", EU Directorate General for Internal Policies, Brussels.

Assuring the effectiveness of co-ordination mechanisms

Actors across levels of government may, perfectly rationally, choose not to co-ordinate with actors of either higher or lower levels of government, or across jurisdictions at the same

level. The co-ordination mechanisms discussed above may thereby fail to deliver their proclaimed objectives. If actors can benefit from other actors engaging in a certain investment, without contributing to it, they have an incentive to free-ride. At the same time, if actors do not trust one another or perceive a certain risk that others may defect, there may be potential non co-operation on their part as well. This, in turn, may lead to co-ordination failures and strategic non co-operative behaviour may appear that leads to sub-optimal or undesirable outcomes, and inefficiency in public investment provision. Behavioural economics offers a lens to better understand such strategic co-operative interactions as may arise in investment policy settings across levels of government (Box 2.9). Policy makers therefore need to understand the incentives and uncertainties that are at stake for different government actors and ensure the design of co-ordination mechanisms to overcome them.

Trust plays an important role in making co-ordination work. Trust is likely to reduce the risks associated with co-operation, as players have greater confidence that others will co-operate. The other bottleneck to co-ordination, namely the incentive to free-ride, is more difficult to be overcome, even in a high-trust environment.

Contractual arrangements can offer some insurance against the risk of deviating from collaborative action, but much depends on their verifiability (by a third party) and completeness. The risk of non co-operation can be reduced by the information included in contracts. Contracts are less effective if incentives to free-ride are very high. Finally, the commitments made through a contract must be credible or else the contract will be rendered worthless. Two policy conclusions can be drawn from this. First, if incentives to free-ride prevail, a contract should be designed around credibility and verifiability. Second, if the risk of free-riding is low, contracts act more like a flexible instrument to exchange information and facilitate collaboration between players (Bartolini, 2013). The degree to which "relational" as opposed to "transactional" elements prevail in an inter-governmental contract (and both may be present) thus depends on the parties' assessment of this risk. Where it is high, credible sanctions and enforcement mechanisms will be more important.

Financial incentives or conditional transfers are an effective instrument to reduce the risk of co-operation. As long as incentives to free-ride are relatively low, financial incentives can be effective instruments to induce co-operation. On the contrary, if the incentive to free-ride is high, the reduced risk of co-operation may be not enough to overcome the gains of deviating from the co-operative strategy (Bartolini, 2013). For example, if it is more costly for a commune to apply for central level funding and act on centrally imposed requirements for the implementation of the investment project, then it might be rational to let the neighbouring municipality benefit from its use. In this case, the financial incentive may be rendered useless That said, the costs of co-operation with the centre may in some situations act as a screening device, at least up to a certain point: localities that can bear those costs and still profit from the investment are likely to be better locations for the project than others, and their neighbours may still benefit. If, however, all local authorities in an area perceive the cost of compliance as very high, then all of them will prefer to leave the investment to others – and none will undertake it.

Conclusions

This chapter has discussed, and systematically assessed, the extent to which previously identified co-ordination challenges across levels of government persist across OECD countries. Although a number of mechanisms have already been employed by supra-

Box 2.9. **Getting actors to co-ordinate: Behavioural analytical insights from game theory**

The interaction of different actors in economics can be modelled according to a game-theoretic approach. In their most basic features, game-theoretic models offer rewards (payoffs) to actors (players) as a result of interactions with other players that are guided by a set of rules. Incentives to co-operate therefore depend on the expected payoffs each individual receives. Game-theoretic approaches go beyond analysing the impact of the institutional environment on an actor's decisions, modelling actors' decisions based on other actors' behaviour or willingness to co-operate. Accordingly, the following strategic situations (or games) can be distinguished:

- Pure co-ordination games: situations in which the highest payoff is associated with all players choosing to collaborate. However, a potential failure to collaborate may arise from the uncertainty actors have about other actors' behaviour, i.e. their choice to collaborate or not to collaborate. There is no conflict between their preferred outcomes, but it is crucial that they co-ordinate those choices to achieve the best outcomes. A trivial example might concern traffic rules: agents might not care whether cars are required to drive on the left or the right, but it is critical that everyone adheres to the same rule of stopping at a red light. These games are relevant in situations of high complementarity, for example, the mutually reinforcing positive effects of aligning complementary policies to maximise their positive impact at the sub-national level.
- Battle of the sexes: likewise ascribes the highest payoff to players if they choose to co-operate with each other. In contrast to the pure co-ordination games, though, players in this setting would like to co-operate in different ways. The game takes its name from the situation of a couple planning to go out on Friday night: one wishes to go to the cinema, the other to go dancing, but each prefers the other's choice to the option of staying home and doing nothing; they thus have strong incentives to find some way to co-operate. A similar dynamic may be observed when different actors agree to an investment project but have different preferences with respect to how they should implement it. This could potentially lead to a failure in collaboration.
- Prisoner's dilemma: the most frequent problematic strategic interactions found are characterised by this game-theoretic setting, in which players are better off if they themselves choose non co-operative action, while others try to co-operate. However, if all actors refuse to co-operate, then the outcome is worse for everyone. Thus, each individual party has an incentive to try to free-ride. A classic policy example concerns environmental protection. Policies to reduce harmful effects of CO_2 emissions benefit other countries at the same time, and if a country benefits more from the emissions reduction activity of another country than it would if it had itself engaged in an activity, countries will choose to free-ride. This can result in non co-operative strategies producing inefficient outcomes.

Each of these dynamics points to rising difficulties for co-ordination. If, in the first instance, one only needs to ensure communication and agreement on a common standard, the second requires compromise, particularly if the interaction is repeated. Where there are elements of a "prisoner's dilemma" dynamic in a relationship, the actors may learn to co-operate if the interaction is repeated, because reputational incentives come into play and agents are able to react to non co-operation on the part of others (sanctions). Nevertheless, it may be faster, easier and more efficient if there are devices that allow the actors to commit to co-operation and render defection difficult (contracts, third-party enforcement, etc.).

Source: Bartolini, D. (2013), "The Role of Incentives in co-ordination Failures", unpublished draft, Regional Development Policy Division, OECD, Paris.

national, national and sub-national governments, they do not appear to work as well as governments would like.

Despite the existing difficulties in co-ordinating effectively across levels of government for public investment, this chapter also highlighted a number of good practices that could help overcome co-ordination challenges in the future. Table 2.4

summarises the recommendations that emerge for policy makers seeking to improve public investment outcomes through better co-ordination.

Table 2.4. **Preliminary guidelines for implementing co-ordination mechanisms across levels of government**

Type of co-ordination mechanism	Policy recommendation
	Vertical co-ordination
Policy alignment across levels of government	✓ The national government should implicate lower levels of government in devising national public investment strategies. ✓ Platforms or national bodies can facilitate, in a structured way, the exchange of information between levels of government on public investment policies. ✓ It is important for SNGs to consult amongst themselves beforehand, as this can strengthen leverage at the national policy-making level.
Co-financing	✓ Co-financing requirements should be tailored to the SNGs' constraints. SNGs should gain the capacity to tap into innovative sources of financing. ✓ The central government can encourage sub-national actors to find innovative ways of engaging the private sector, not just in maintaining and operating services, but in co-financing public investment as well. ✓ PPPs should be viewed not simply as an alternative, possibly more expensive source of co-financing, but as a way to procure private sector expertise. ✓ For PPPs to succeed, substantial investment in new public sector capacities may be required. Not all SNGs possess the necessary technical and financial expertise.
Conditionality	✓ Conditionalities must not be overly prescriptive, given the need for bottom-up input into the design of Cohesion Policy interventions. ✓ Conditionalities should, to the extent possible, reflect a consensus among stakeholders, emerging from negotiations across multiple levels of public authority. ✓ Conditionalities should be evidence-based, observable, allowing for process and *ex post* verification. ✓ Any enforcement mechanisms must be credible, taking due account of the political and institutional realities of the situation.
	Horizontal co-ordination
Cross-sectoral co-ordination	✓ National funding rules should not prevent the pooling of resources due to ministry catchment areas, and should encourage inter-ministerial collaboration. ✓ Regions can compensate for entrenched sectoral approaches at the national level; however, if budgets are not aligned with these priorities, these efforts risk being a failure. ✓ If higher levels of government wish to foster a place-based approach, they need to commit resources to it accordingly.
Cross-jurisdictional co-ordination	✓ Leadership is important to solve collective action problems in horizontal co-ordination. Mechanisms should work to overcome competitive pressures, resource constraints, differing priorities and fears that the distribution of costs or benefits will be unequal. ✓ Provide financial incentives or, where useful, require cross-jurisdictional mergers. ✓ Remove barriers and offer a legal and regulatory framework to allow bottom-up cross-jurisdictional collaboration. ✓ Developing the capacity of SNGs to engage with other governmental agents and building a collaborative culture are essential factors for facilitating horizontal co-ordination.
	Encompassing co-ordination instruments
Contracts	✓ Contracts need to be designed with clear accompanying measures allowing for financial capacity at sub-national level to fulfil the contract's obligations. ✓ The complementary nature of contractual arrangements can exceed the limits of the existing administrative capacity, both at the local and the national level. Therefore, it is crucial to ensure that contractual arrangements are aligned, as much as possible, with existing ways of "doing business", and are accompanied by training for all levels of government in how to implement the contractual arrangements. ✓ To overcome fragmented structures and to clarify the assignment of responsibilities across levels of governments, contracts need to be not only credible, but verifiable commitments.

Notes

1. For example, see the discussion of transport investment in the Skåne case study.
2. The following countries responded to the survey: Australia, Belgium, Canada, Chile, Czech Republic, Estonia, France, Germany, Greece, Hungary, Italy, Mexico, Norway, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, United Kingdom, United States.
3. Case studies were carried out on Basilicata (Italy), Brandenburg (Germany), British Columbia (Canada), Galicia (Spain), Skåne (Sweden), Victoria (Australia), Wielkopolska (Poland). The case studies can be found at: *www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm*.
4. Officials of Canadian regional development bodies view this as one of the major constraints on greater reliance on repayable loans as a policy instrument: if borrowing firms fail and non-repayments mount, the lending agency will face criticism. But a very conservative lending policy may fall short of addressing the market failures it is supposed to resolve. The irony is that such a policy may be associated with fewer failures than a similar intervention organised around grants, but the expectation of repayment means that failures are more visible and may be identified sooner than inefficiently allocated grants.
5. Entrepreneurs in the Russian Federation, for example, complain about such selectivity on the part of public bodies created to stimulate venture capital development (see OECD, 2011c).
6. See Babb and Carruthers (2008), Dreher (2008) and Chapter 4 of OECD (2009b) on IMF conditionalities imposed on national governments. The evidence here is somewhat mixed, due perhaps to the fact that countries subject to IMF conditionalities are generally in severe difficulties at the outset of the loan.
7. Indeed, Kapur (2005) draws attention to evidence that aid recipients may demand more conditionality in order to increase their domestic bargaining leverage and, if their tenure in power is insecure, to limit the options of those might succeed them.
8. "As the number of conditions, particularly structural conditions, increased gradually during the [19]80s and rapidly during the [19]90s, the rate of member country compliance with Fund-supported programmes showed a parallel and no less remarkable decline. Successfully completed programmes or programmes in compliance fell from rates of over one half in the late [1970s] and early [19]80s to below thirty percent in the [1990s], when compliance is defined as that which permitted the disbursement of over 75 percent of the loan and to rates of only sixteen percent if the test of compliance is the full disbursement of the loan". (Buira, 2003)
9. This presumes that the centre's decision is not affected by political considerations (such as the desire to channel investment to a particular electoral district) or by other policy objectives, such as a desire to channel investment to a depressed region.
10. The Joint Tasks includes funding by the federal government and the *Länder* for certain shared responsibilities, such as regional development.
11. Most of the *Land* budget consists of transfers, salaries and other expenditures dictated by law. Though the *Land* administers them, it has little control over them in practice, especially in the short term.
12. See Chapter 3 for more discussion.
13. The city does not borrow through the MFA, but remains part of the joint guarantee, as it belongs to the Greater Vancouver Regional District.
14. Development of the strategy is ongoing and subject to change.

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Chapter 3

Sub-national capacities for effective public investment

Investing together across levels of government requires equipping sub-national authorities with the necessary capacity to engage with other levels of government and to carry out public investment programmes and projects effectively. This chapter identifies the key governance capacities across the investment cycle that sub-national governments need to have if they are to design and implement sound public investment strategies for regional development. It also explores some of the ways in which capacity needs at the sub-national level differ, not only across OECD countries, but especially also within them. It then provides practical guidance for assessing and strengthening these capacities. A diagnostic assessment framework is presented at the end of the chapter to serve as a first step in helping sub-national governments assess their capacity needs and develop a tailored set of actions to strengthen them.

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

The importance of sub-national capacities for public investment

Improving co-ordination mechanisms across levels of government for public investment is a necessary, but not sufficient, condition for quality public investment. To complement this, governance capacities are needed not only to engage in the interactions that co-ordination necessitates (as seen in Chapter 2), but to adhere to good quality standards of public investment throughout the investment cycle. The implementation of recovery packages across the OECD revealed that both national and sub-national actors may lack the appropriate tools and governance capacities to make the best use of public investment funds (Allain-Dupré, 2011; OECD, 2011b). Contrary to a widespread perception, improving governance capacities for public investment should be a priority for all countries and types of regions, not only lagging ones. Even in economically well-performing regions, there may still be scope for strengthening capacities.

The term "capacity" can have different meanings in different contexts. Here it refers to the ability to adhere to good practices in the design and implementation of public investment. More specifically, it refers to good practices in terms of the institutional arrangements, technical capabilities, financial resources and policy practices that can help sub-national governments (SNGs) achieve important goals at different stages of the investment cycle. Although the focus here is on the capacity of SNGs, this does not imply that these capacity challenges only apply to lower tiers of government. SNG capacity has been studied less than national capacity bottlenecks, and there has been a particular challenge to evaluate and address capacity challenges at the sub-national level, which is why it is focused on here.

This chapter will address two issues. First, it will identify the governance capacities that enable SNGs to design and implement sound public investment strategies, including engaging with other jurisdictions to co-ordinate public investment policy and implementation. Secondly, it will provide practical guidance for assessing and strengthening these capacities. To do so, it draws on multiple sources of information: the surveys and regional case studies carried out for this study (see the methodological overview in Chapter 2),[1] OECD territorial reviews, a review of relevant literature and material presented at two OECD expert workshops. Indeed, each of the capacities discussed here merit their own chapters. However, the purpose of this chapter is to provide an analytical framework to understand the overall capacity requirements, based on which future, more in-depth investigations can be carried out.

Identifying key sub-national capacities for public investment

This section examines sub-national governance capacities that have the potential to strengthen public investment, as well as the challenges currently being confronted in these areas. To narrow the field of important capacities, specific attention is given to those that facilitate the design and implementation of an investment portfolio that promotes regional development, reflect the multi-level governance or co-ordination context of sub-national

public investment, represent good practices in public investment management and OECD principles for good governance, and are generally applicable, but allow for setting priorities in regions with differing characteristics. The following discussion will address 15 governance capacities (Table 3.1), organised around the following 5 goals:

1. designing an investment portfolio that encourages regional development;
2. ensuring adequate resources;
3. ensuring accountability for public resources;
4. promoting results and learning;
5. supporting all stages of the investment cycle.

Table 3.1. **Sub-national capacities for effective management of public investment**

Goal	Stage of the investment cycle	Capacity
1. To design an investment portfolio that encourages regional development	Planning and project selection	1. To engage in strategic planning that is tailored, results-oriented, realistic, forward-looking and coherent with national objectives ★ 2. To co-ordinate across sectors to achieve an integrated place-based approach 3. To co-ordinate with other jurisdictions to ensure complementarities and achieve economies of scale across boundaries 4. To involve stakeholders in planning to enhance the quality and support for investment choices – while preventing risks of capture by specific interest groups 5. To conduct rigorous *ex ante* appraisal ★
2. To ensure adequate resources	Financing and budgeting	6. To link strategic plans to multi-annual budgets 7. To tap traditional and innovative sources of financing for public investment ★ 8. To mobilise private sector financing, without compromising the long-term financial sustainability of public investment projects
3. To ensure accountability for public resources and	Implementation	9. To engage in transparent, competitive public procurement processes with corresponding internal control systems ★
4. To promote results and learning	Evaluation	10. To design and use monitoring indicator systems with realistic, performance promoting targets ★ 11. To conduct regular and rigorous *ex post* evaluation 12. To use monitoring and evaluation information to enhance decision making
5. To support all stages of the investment cycle	Throughout	13. To monitor and manage risks to integrity and accountability throughout the investment cycle 14. To engage in "better regulation" at sub-national levels, with coherence across levels of government 15. To ensure the quality and availability of technical and managerial expertise necessary for planning and executing public investment ★

Note: ★ Critical capacity across all types of regions (see below).
Sources: Mizell, L. and D. Allain-Dupré (2013), "Creating Conditions for Effective Public Investment: Sub-national Capacities in a Multi-Level Governance Context", *OECD Regional Development Working Papers*, No. 2013/04, OECD Publishing, doi: 10.1787/5k49j2cjv5mq-en; and based on a review of Rajaram, A., et al. (2010), "Framework for Reviewing Public Investment Efficiency", *World Bank Policy Working Paper*, No. 5 397, World Bank, Washington, DC, *www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2010/08/09/000158349_20100809092806/Rendered/PDF/WPS5397.pdf*; Dabla-Norris, E., et al. (2011), "Investing in Public Investment: An Index of Public Investment Efficiency", *IMF Working Paper*, No. 11/37, International Monetary Fund, *www.imf.org/external/pubs/ft/wp/2011/wp1137.pdf*; and Milio, S. (2007), "Can Administrative Capacity Explain Differences in Implantation Performances?", *Regional Studies*, Vol. 41, No. 4, in particular.

In many ways, the capacities in Table 3.1 represent an ideal. In practice, SNGs experience important challenges in various areas – although national governments and SNGs differ in their views of the relative importance of the different challenges (Table 3.2). National governments' responses to the OECD questionnaire emphasise difficulties in planning and co-ordination. By contrast, regions tend to emphasise implementation challenges involving financial and human resources. Both draw attention to the specific challenges involved in engaging the private sector. The remainder of this section describes each of the 15 capacities with the potential to strengthen sub-national public investment, while presenting the challenges that are confronted and good practices in each area.

Table 3.2. **Main public investment capacity challenges for sub-national governments**

As seen by national governments	As seen by regional governments
• Sectoral priorities dominate over an integrated approach	• Lack of involvement of the private sector
• Weak long-term strategic planning for public investment; a focus on short-term priorities	• Reduced fiscal capacity for public investment
• Difficulty of involving the private sector	• Lack of capability to administer public procurement
• Weak capacities for administering public-private partnerships	• Excess of administrative procedures and red tape
	• Public employees' salaries not competitive with the private sector

Source: OECD (2012) "Multi-Level Governance of Public Investment", national and regional case study questionnaires, *www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm*.

Goal 1: Designing an investment portfolio that encourages regional development

An SNG's ability to assess needs and select an appropriate investment portfolio is an essential capacity – both for ensuring adequate provision of basic services and for encouraging growth. The planning phase for investment is among the most critical aspects of public investment management due to the long-term nature of project implementation and the long life of the resulting assets (Dorotinsky, 2008). Effective planning sets the stage for sound project selection, budgeting, partnership-building and monitoring. Five capabilities related to the planning phase are included in this stage of the investment cycle: strategic planning, cross-sectoral co-ordination, cross-jurisdictional co-ordination, stakeholder involvement and *ex ante* appraisal.

Capacity 1: Strategic planning

Strategic and capital planning for public investment should lead to an investment mix that ensures adequate public services and promotes growth. Although the path to growth differs among regions, the planning process should lead to an investment mix that adheres to some common principles. First, the portfolio should be tailored and linked to a development strategy based on an assessment of regional (or local) characteristics and specific competitiveness factors.[2] Not only is this important for developing a coherent approach to service delivery and economic growth, but it signals to potential private investors that investment opportunities reflect real needs and, as such, are more likely to receive public and political support.[3] Second, the portfolio should be results-oriented: designed with attention to national and sub-national development goals, complementarities and potential conflicts among sectoral investments. Third, investment priorities should be realistic and well-informed: thoroughly assessed, properly prioritised and funded with a multi-year budget envelope. Attention should be given to ensure that priority-setting is not driven by the inertia of out-of-date previous plans and assumptions, or by narrow political considerations (World Bank, 2008). Finally, the investment mix should be forward-looking, with investments that can position regions to be competitive in the global economy.

Despite their importance, sub-national capacities for strategic planning of investment appear to need bolstering. The great majority (89%) of central governments responding to the OECD questionnaire view the most important capacity challenges for regions/municipalities to be related to strategic planning (see also Chapter 1).

Strengthening strategic/capital planning skills can have positive effects for other dimensions of capacity discussed here. Good strategic planning is not only about the plans themselves, but about the process as well: the stakeholders it brings together, the

knowledge generated and the basis it can provide for managing risks over the course of the investment cycle. This is demonstrated by the case of Wielkopolska in Poland or the English regional development agencies, where regional development strategies must elaborated between authorities and sub-national stakeholders, including citizens.

Capacity 2: Cross-sectoral co-ordination

Capacity is needed to address policy complementarities for regional public investment. The previous chapters have shown that policy complementarities for regional public investment are critical. Sub-national actors are often best placed to identify local needs and exploit synergies across investment priorities. If a region is to benefit from a new road, school or any other type of public investment, certain conditions in terms of complementary local infrastructure or services need to be fulfilled (OECD, 2011b). Infrastructure investment alone has little impact on regional growth unless it is associated with human capital and innovation (OECD, 2009b).

Complementarities across sectors can be sought at both the macro level (aligning investments in housing and transport) and the micro/project level (constructing a technology centre in a region with skilled researchers and/or firms ready to tap innovation support). While the enabling environment set by the (supra)national level for cross-sectoral co-ordination is a key facilitating factor (e.g. by allocating funds by strategic priority rather than solely on the basis of sectoral programme, see Chapter 2), the capacity to engage in cross-sectoral co-ordination can represent an important challenge for SNGs. At the regional level, the presence of an overarching investment strategy or joint committees across sectors can facilitate this co-ordination. SNGs can also draw on external support, such as regional development agencies, to help facilitate an integrated approach to regional development planning.

Among the surveyed regions, most have a regional level strategic investment plan setting out investment priorities in the region, although in most cases it is not binding. In the European Union (EU), regions have been asked to allocate funding in a balanced way across hard (physical) and soft (human capital) infrastructure priorities. In Poland, for example, in the 2007-13 programming period, regions must allocate at least 40% of the funding to Lisbon innovation-related objectives. Most regions in Western Europe allocate more than 60% of their funding to Lisbon objectives.

Capacity 3: Cross-jurisdictional co-ordination

As discussed in Chapter 2, issues of scale and spillovers make public investment an important cross-jurisdictional undertaking, which requires adequate attention especially during the planning phase. While higher levels of government have an important role to play to encourage scale efficiency and avoid the potential incentive for free-riding (see Chapter 2), it is also important for sub-national levels to have the capacity to engage across boundaries and to enhance the synergies with neighbouring (or otherwise linked) jurisdictions' policies. Such cross-jurisdictional co-ordination particularly deserves attention in view of recent empirical findings which suggest that in some settings, public investment externalities, which spill across administrative borders, are more relevant for regional growth than direct public investment in each region (Rodríguez-Pose et al., 2012). It is critical for physical infrastructure provision where the efficient scale of projects transcends boundaries of individual regions. It can also pay dividends in areas like human

capital development and innovation in conditions where functional economies cross administrative borders.

SNGs can cultivate specific capabilities to help facilitate cross-jurisdictional co-ordination. There is a need, for example, to identify and assess possible areas for collaboration, estimate the value of collaborating, and the pros and cons of an appropriate model for doing so. Benchmarking other cases of cross-jurisdictional co-ordination for public investment in the same sector or in similar regions can be helpful in this regard. Gauging and mobilising political support can also be critical to move such projects forward (Oftelie, 2010). That said, the willingness of SNGs to collaborate is likely to vary with the type of investment(s) being considered. It is likely to be easier, for example, to collaborate around investments in basic infrastructure and service provision (e.g. water, sewage) and more difficult around "strategic" investments where SNGs might find themselves competing (e.g. higher education, innovation). Despite hurdles, capacity for collaborative investment projects have emerged.

Issues of scale can be particularly problematic in countries with high levels of administrative fragmentation. Substantial fragmentation, particularly at the local level, affects the type of investments that are prioritised, which tend to be smaller-scale projects with a lower return on investment. Investments that generate a payback across a much larger area (i.e. where there are positive externalities to be realised) may be underdeveloped. This was noticeable in the implementation of investment stimulus packages in 2008-09, when municipalities, rather than higher tiers of government, were the main implementers of investment stimulus funding in France and Spain. In Spain, although the State Fund for Local Investment allowed for joint applications, only 6 of 1 022 municipality associations applied for joint project funding. In France, where instruments for co-operation among the 36 000 municipalities exist, they have not been greatly mobilised in the aftermath of the crisis (OECD, 2011b).

Capacity 4: Stakeholder involvement

Involving stakeholders such as citizens, universities and the private sector, can improve the quality of planning efforts. Stakeholder involvement can establish a shared vision for development, improve the assessment of investment needs, reveal the importance of cross-border linkages, strengthen trust in government and cultivate support for specific investment projects. It can also lead to demand-driven improvements in public investment management capacity. In practical terms, this means that SNGs should have the capacity to engage in processes of stakeholder involvement in policy development and needs assessment in the early stages of the investment cycle, and feedback and evaluation in later stages. Capacities for effective stakeholder involvement include, but are not limited to: *i)* identifying stakeholders, understanding their "stake" and their right to and capacity for engagement; *ii)* designing outreach to and consultation opportunities for stakeholder groups; *iii)* selecting the right technique to involve stakeholders; *iv)* developing a stakeholder communication strategy (e.g. accessible public reporting of investment plans, implementation progress and results); and *v)* managing grievances[4] (OECD, 2004; International Finance Corporation, 2007).

Data from surveyed regions suggest that involvement in investment planning could be bolstered among certain groups of stakeholders. For most case study regions, consulting municipalities for the elaboration of a regional development strategy is common practice. However, involving citizens, academics and NGOs in the design of regional investment

strategies is less common, and banks and private actors are the least involved in the design of these strategies. Sharing good practices and experiences could be helpful in this regard. In the United States, it is not uncommon for local and regional transport planning to include public engagement plans that outline a process for involving stakeholders.[5] Box 3.1 presents an example of public participation in regional economic planning in England.

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. In many surveyed regions, the private sector is involved in the design of public investment in

Box 3.1. **Engaging citizens and firms in regional economic planning**

As part of an effort to decentralise in England in the late 1990s, the central government created nine regional development agencies (RDAs) whose goals included enhancing regional economic development and competitiveness. The RDAs did so, in part, by leading the development of a three-year Regional Economic Strategy (RES) in co operation with partners in their regions. The RES laid out the region's main economic development priorities, offered a strategic assessment of the challenges and opportunities it was facing, and provided a framework within which stakeholders could act.

In 2003, the RDA for North East England, launched SHiNE (Shaping Horizons in the North East), a 14 month futures-scenario building project to take advantage of local knowledge and create buy-in for the 2006 RES. The previous RES had been developed using more traditional planning strategies, and SHiNE represented a new approach intended to capture a broader spectrum of views than in the past. The project – which cost an estimated GBP 250 000 – engaged over 1 000 stakeholders in interviews, workshops and presentations regarding the issues and drivers impacting the region and its economic development. SHiNE engaged or reached the private, public and voluntary sectors, as well as academics, students, faith communities and others. No specific mechanisms were put in place to gather opinions from individual citizens, although the project website listed a toll-free phone number that linked the public with the project team.

According to an ex post evaluation, SHiNE influenced the 2006 RES in a number of ways. First, it highlighted areas where the previous strategy fell short. The lack of attention to the issue of leadership, the inward-looking focus, the lack of definition of clear priorities and lack of emphasis on distinct regional assets and opportunities in the first RES were subsequently addressed in the 2006 strategy. Second, eight priority areas identified by SHiNE contributed to the structure of the revised RES. Credit was given to SHiNE for revealing the importance of "Business, People and Place" – the themes around which the RES and related documents were organised. Some proposals emerging from SHiNE were deemed too radical to include in the RES, suggesting the process pushed the boundaries of thinking about regional economic development in the region. The usefulness of SHiNE was further reflected in the references to the process and outcomes in multiple One North East (which was the RDA for the North East England region) strategy documents, such as its 2005 08 Corporate Plan. Finally, the evaluation pointed to positive effects on strategic thinking and the value of bringing together diverse stakeholders to exchange ideas.

In 2012, English RDAs were abolished and replaced with local enterprise partnerships as a cost-saving measure. SHiNE, however, remains an ambitious example of engaging regional stakeholders in economic planning.

Source: Excerpted with slight modifications from Mizell, L. (2009), "Building Future Scenarios for Regional Development in Northeast England, United Kingdom", in OECD (2009), *Focus on Citizens: Public Engagement for Better Policy and Services*, OECD Publishing, doi: *10.1787/9789264048874-10-en*.

their region, especially in the transport and environment sectors, and to a lesser extent, in innovation and regional development. In some regions, the private sector is involved in investment projects related to hospitals, schools, information and communication technology (ICT) infrastructure, and culture. As stakeholders in public investment decisions, private actors can contribute important information to regional development planning and the implementation of investment strategies. However, capture can be an issue, particularly where firms prioritise the creation of future markets for themselves rather than the best strategies for the particular region (OECD, 2009c). Once private contracts have been awarded, private partners can also contribute to strategies for communicating and consulting with the public. Public authorities can encourage them to adopt a high degree of transparency, provide comprehensive information regarding the project's parameters and the state of infrastructure operations, and actively engage around the environmental and social impacts of their activities (OECD, 2007).

Capacity 5: Ex ante appraisal

Ex ante appraisal is critical for sound project selection, as it drives investment decisions. Appraisals should therefore be technically sound, with larger projects requiring more rigorous analysis (Dabla-Norris et al., 2011). They should also enable a selection of investments based on economic value, after considering alternatives to investment for attaining particular goals (Posner, 2009; Laursen and Myers, 2009). *Ex ante* appraisal should also take account of possible policy and project complementarities. High-quality *ex ante* assessments offer considerable benefits as part of the decision-making process. As Florio and Myles (2011) note, "serious scrutiny of investment decisions can counteract distortions induced by budget constraints and poor institutional environment."*Ex ante* assessment tools for investment projects include cost-benefit analysis (CBA), economic impact assessment, cost-effectiveness analysis and risk assessment. Most case study regions use CBA based on their own initiative rather than because it is required by the central government or supra-national organisations.

Unfortunately, even when *ex ante* appraisals are conducted, they are not necessarily systematically used by SNGs for decision making, nor are they necessarily of sufficient quality. In the United States, for example, the Government Accountability Office (GAO) reports that although some assessment of costs and/or benefits is generally undertaken, "many state and local transportation agencies are not consistently using formal economic analysis as part of their investment decision-making process to evaluate project alternatives [for highway and transit investments]" (US General Accountability Office, 2005). Even within the EU where regulations require CBAs of major investment projects financed with Cohesion Funds, the incentives to initiate new projects or to absorb EU funds can overshadow the incentives to achieve value for money in public investment. The quality of *ex ante* analysis is not necessarily high, and countries may face the incentive to finance projects which are sub-optimal but ready-to-go in order to avoid losing funds. Independent review of *ex ante* assessment can, and should, be employed in order to improve quality assurance (World Bank, 2008; Rajaram et al., 2010; Dabla-Norris et al., 2011).

The challenge of *ex ante* appraisal is likely to be uncertainty about the factors affecting returns on investment. CBA is most effective where there is a great deal of information about the project, the context and the risks involved over the investment cycle. For example, it might be relatively straightforward to assess the potential gains from relaxing a transport constraint on a well-travelled route. By contrast, far greater analysis is required for major new

infrastructure, altering existing traffic flows or generating new ones. The state of Victoria in Australia has developed an innovative "High Value High Risk" process which reflects the importance (and difficulty) of sound *ex ante* appraisal for certain investments (Box 3.2).

Box 3.2. **The "High Value High Risk" process in Victoria, Australia**

The Department of Treasury and Finance in the state of Victoria has more direct accountability for assuring the quality of major public investment proposals. The Victorian government recently established a "High Value High Risk" (HVHR) process. Under this process, for investment projects which have a value above a defined threshold, or which are deemed to be high risk even if they fall under the monetary threshold, the Treasurer (i.e. the minister) must personally verify and approve the investment proposal at crucial points before it is presented for final decision. In contrast with its former role of *ex post* review of spending proposals, this process engages the Department of Treasury and Finance in the decision-making process directly and "in real time". The focus of the new central quality assurance arrangements is on enhanced *ex ante* control – improving the business cases for major investments. These now require much more effort and expertise from the ministry responsible, and are subjected to rigorous scrutiny both at a technical level and in terms of their wider assumptions. The HVHR process has reduced one important source of investment failure – the tendency for the scope of investment projects to increase as they are developed, without express approval.

Source: Bounds, G. (2012), "Public Investment across Levels of Government: The Case of Victoria, Australia", report for the 28th OECD Territorial Development Policy Committee, 4 5 December 2012, *www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm*.

Because the utility of *ex ante* assessments depends on the technical capacity of the organisations and individuals undertaking them (Rajaram et al., 2010), it is valuable to assess and strengthen the presence of such competencies at the sub-national level. Assessing the availability of in-house technical skills among public servants can be helpful in this regard, as well as formal guidance such as provided by the EU's "Guide to Cost-Benefit Analysis of Investment Projects".[6] For major projects where appraisal is particularly complex, it is also important to assess the availability of technical expertise in organisations or units (public or private) with independence and experience. This is one factor that encourages governments to establish special purpose arm's-length public bodies outside the core public service.

Goal 2: Ensuring adequate resources

Ensuring adequate resources for public investment projects is one of the major challenges for SNGs in OECD countries. In the current constrained fiscal environment, public investment has become an adjustment variable (see Chapter 1). As a short-term response, some retrenchment on the investment side is normal and probably unavoidable; other items of expenditure are more difficult to adjust quickly. However, the prospect of an extended period of austerity in many OECD countries risks significant under-investment, with deleterious long-term consequences for both growth and service provision. Regions in the coming years will need to be resourceful in identifying ways of sustaining needed investments in areas where capital requirements are substantial and payback times are long, like transport and communications infrastructures. This section will review the three capacities that have been identified as important to ensure adequate resources for public investment projects: multi-year budgeting, traditional and innovative financing, and private sector financing.

Capacity 6: Multi-year budgeting

Budgeting is the critical link between planning and resources. It is crucial that public investment plans be accurately costed[7] for the intended investment period and that those costs be reflected in the SNGs budget strategy and allocation process. The absence of discipline around costing and budgeting undermines a government's capacity to prioritise its investment programme. It can also lead to chronic underfunding of individual investment projects. Fitting public investment plans into a medium-term budget framework helps provide visibility regarding resource availability and predictability (Rajaram et al., 2010; World Bank, 2009). This is particularly true for long-term projects which may need to survive changes of government. Multi-year budgeting requires *inter alia*, stable, predictable revenue streams and expenditure obligations, which may depend on the national budget system. In the United States, most states use some form of biennial budgeting which establishes revenues and expenditures for two years. Local governments often use multi-annual projections as part of the budgeting process (Boex et al., 1998). In the EU, the seven-year programming cycle of Structural and Cohesion Funds has been a major incentive for European regions to move to more multi-year budgeting. Among the surveyed regions, investment expenditures are planned over a multi-year period in the regional annual budget.

Capacity 7: Traditional and innovative financing

SNGs need capacity to tap both traditional and innovative financing sources for public investment. Traditional sources of financing – own revenue, inter-governmental transfers and borrowing – will continue to be critical for SNGs. Own revenue is important not only for self-financing and co-financing of investments, but Kappeler et al. (2012) find that revenue decentralisation encourages regional governments to spend more on growth-enhancing (economic) infrastructure as compared to redistributive (social) infrastructure – an incentive potentially undermined by capital grants. Inter-governmental grants play a crucial role in sub-national public investment, but in some countries the financial crisis has caused a contraction in transfers. Even in good times, however, capacity issues can emerge. Accessing such grants can require substantial administrative capacity in SNGs, potentially leaving some of the neediest governments the least able to access funds. Finally, fiscal capacity can be enhanced through borrowing, although borrowing may be constrained by fiscal rules and the general economic situation. In addition to limits placed on borrowing by SNGs, factors including a SNGs own strengths and weaknesses, the country where it is located (i.e. its general economic situation, its credit rating) and the general health of banks and the financial sector affect access to credit. Presently, even fiscally sound, top-rated SNGs encounter difficulty acquiring bank loans because of the weak state of the banking system in a number of countries (e.g. Spain, among others).

At present, tapping traditional financing mechanisms for public investment is a major challenge in some OECD regions. With fiscal tightening occurring on the revenue side, SNGs may look to create fiscal space on the expenditure side. Practices such as performance-based budgeting and "strategic reviews" can help to identify savings and create more fiscal space to meet investment priorities. Such fiscal space may be limited, however, by significant, non-discretionary current spending obligations of SNGs.

Innovative solutions to finance investment are needed but their complexity may require capacities that some governments lack. Sub-national capacity needs to be able to make the most of traditional instruments (e.g. collection efficiency, technical skills for accessing grants, sufficient regulatory authority and political will to raise rates/fees), as

well as newer forms of financing (such the use of technologies to improve user fees (see, for example, Wachs, 2010), value-capture taxes or carbon financing for green investments). Some newer financing instruments require SNGs to have specific capacities to be able to use them. An understanding of the pros and cons of different financing vehicles and what they require in terms of the local financial situation, risk management, transaction costs and the market is important (Chan et al., 2009). Thus, to some extent, new tools can open the door to new capacity challenges. A kind of vicious cycle is at risk, with the regions in greatest difficulty being least able to use these new financial instruments.

Capacity 8: Private sector financing

While public sector financing is expected to remain a centrepiece of investment efforts (OECD, 2008b), the need for private financing is undeniable (World Economic Forum, 2010). The capacity to understand, secure and maximise the value of private financing is therefore integral for governments in general, and in particular for sub-national ones managing an investment portfolio with commercial appeal. SNGs need the capacity to assess the worth of and best approach to private sector involvement. Private sector participation should be undertaken after careful consideration of alternative modes of financing and delivery, and risk allocation should be based on an assessment of the public interest. This includes the capacity to demonstrate that public-private partnerships, for example, provide greater benefit than purely public investment (World Bank, 2009).

Public-private partnerships (PPPs) represent one important approach to involving private sector actors (see Chapter 2) and to securing private financing. PPPs are long-term contractual agreements between private actors and a public entity used to finance investment, share risk and improve the efficiency of investment (Box 3.3). The varying types of PPPs differ in the roles and responsibilities of public and private partners, ranging from build-transfer models (where the public sector retains responsibility) to divestiture, where the government transfers all or part of an asset to the private sector. Hybrid models have also emerged in response to challenges faced in different sectors (Deloitte Research, 2007). Different forms of PPPs can have different financial implications for government and consumers. Thus, decisions regarding PPPs should be co-ordinated with the budget process and be consistent with an overall policy regarding the types of investment best undertaken via the public budget, through PPPs and through purely private investment (World Bank, 2009).

PPPs can be particularly complex and SNGs may fall short of the technical capacities needed to assess, design and manage them. The weak capabilities of SNGs to manage PPPs have been highlighted as a "challenge" or "key challenge" by 16 countries (out of 19 which responded to the question) in the OECD national questionnaire. Benchmarking, targeted training, creation of dedicated PPP units and promulgation of good practices can strengthen sub-national capacity. National governments can also support sub-national capacities through training and dedicated PPP units (such as those that exist in Australia, Belgium, Canada and Germany, which have PPP units at the state/provincial level; see OECD, 2010a). SNGs can also be invited to review and adopt the recent OECD Council Recommendation on Principles for Public Governance of Public-Private Partnerships (OECD, 2012c).

Despite the potential benefits, OECD questionnaire data suggest that private sector involvement in sub-national public investment remains relatively limited. Involving private actors in public investment projects is viewed as a challenge by most case study regions and by 84% of the national governments. Difficulties may arise, in part, from the financial

Box 3.3. **Good practices and challenges of using public-private partnerships in three regions**

State of Victoria (Australia)

Victoria has been a pioneer in PPPs, and its processes have been a model for the Commonwealth and for other states. Since 2000, when the first PPPs were created in Victoria, they have comprised approximately 10% of infrastructure investment. There are currently 22 PPP projects representing a total investment of AUD 11.5 billion. The Department of Treasury and Finance has established a unit called Partnerships Victoria as a source of standards guidance and policy development. A feature of the PPP business case development process is the requirement in each project to establish a "Public Sector Comparator" (PSC) – an independently verified cost estimation of the project assuming conventional contracting. The PSC then serves as a benchmark for assessing the value for money of the PPP proposal. Over the past ten years, government departments have had to acquire a deeper understanding of the private sector in each area in order to better calibrate contract incentives.

The Victorian government's policy and philosophy around PPPs are in the public domain. This provides transparency to the private sector on the objectives, policies and processes for the application of PPPs, broadens market confidence and reduces the time and cost associated with private sector engagement. The government has noted, however, that as PPP contracts are output-based, identifying the appropriate output measures and performance levels is a substantial challenge. Additionally, the public interest generated by some of the more complex PPP projects in the water sector, such as the construction of a desalination facility to secure Melbourne's water supply in the event of continuous prolonged drought, has also required the management of significant political risk.

Wielkopolska (Poland)

SMEs in the region of Wielkopolska are keen to take advantage of the funding offered as part of EU programmes (as of April 2012, 1 208 projects by SMEs were funded under regional operational programme measures). However, in the vast majority of cases, SMEs acquire funds for projects they implement themselves. Projects implemented as PPPs remain rare. In fact, PPPs have been a challenge in Poland due to the lack of an adequate legal framework and low levels of trust between the public and private sectors. Some examples do exist, however. One example is the "Galeria Goplana" project, which is being funded as a PPP. It involves the revitalisation of a decaying post-industrial area in the centre of Leszno with the aim of converting it into a commercial centre. The private investor will make one of the revitalised buildings available to the municipality, free of charge, for the establishment of a public multimedia library or tourist information centre. The total value of the project is PLN 178 million, while the loan amounts to PLN 50 million. Another example is support for the reconversion of a post-industrial building into an office space (Office Centre "Podwale" in Pozna). The private investor will offer venues for free training courses and workshops for the local community. The value of the investment amounts to PLN 30 million, while the loan offered by the Urban Development Fund amounts to PLN 22.5 million.

Galicia (Spain)

PPPs in Galicia are relatively limited, having only been used so far for large-scale projects. Currently, two PPP projects are being implemented and three are operational. The financial crisis has made PPPs more difficult to launch because access to funding by private companies has become complicated and more expensive. Galicia recently made two calls for tender but was unable to find companies with which to contract. No other PPPs are planned for the moment.

Source: Excerpted with slight modifications from Bounds, G. (2012), "Public Investment across Levels of Government: The Case of Victoria, Australia", report for the 28th OECD Territorial Development Policy Committee, 4-5 December 2012, *www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm*; Dabrowski, M. and D. Allain-Dupré (2012), "Public Investment across Levels of Government: The Case of Wiekopolska, Poland", report for the 28th OECD Territorial Development Policy Committee, 4-5 December 2012, *www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm* and Hulbert, C. (2012), "Public Investment across Levels of Government: The Case of Galicia, Spain", report for the OECD Territorial Development Policy Committee, 4-5 December 2012, *www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm*.

constraints currently facing potential private sector partners, as well as the limited capacity of some sub-national actors to evaluate the role of and engage the private sector. SNGs can consider a number of important factors when crafting an environment conducive to attracting private financing. These include clear investment policy, transparent and competitive procurement policy, a pipeline of opportunities, a well-crafted regulatory environment, pathfinder projects, sizeable opportunities, credible project timetables, political support and sufficient administrative capacity (World Economic Forum, 2010).

Goal 3: Ensuring accountability for public resources through procurement

Capacity 9: Transparent, competitive public procurement

Accountability for the use of public resources is a core responsibility at all levels of government (see Chapter 1). The focus here is on the importance of sound procurement processes at sub-national levels. Such processes matter because procurement is both critical for public investment and yet also the "government activity most vulnerable to waste, fraud and corruption" (OECD, n.d.). Weak capacity and corrupt practices (Table 3.3) at sub-national levels can reduce trust, deter external investment, increase the costs of borrowing and investment, potentially compromise quality, and disrupt the utilisation of funds. For example, the principal errors for the absorption of EU funds are associated with public procurement (41% of cumulative quantifiable errors in 2006-09) and they are concentrated in a relatively small number of (regional) programmes in a

Table 3.3. **Red flags of corruption in procurement**

Red flag	Description
Complaints from bidders	Complaints from bidders and other parties may indicate a need to investigate potential underlying misconduct, even if it is not noted in the complaint.
Multiple contracts fall just below procurement thresholds	Public officials may tailor a contract to fall just under the procurement threshold, or split one contract into several smaller ones in order to keep them under the procurement threshold (contract splitting). This can eliminate the need for competitive bidding or higher level review while steering contracts to particular firms.
Unusual bid patterns	Collusion in bidding can be indicated by unusual bid patterns, such as (but not limited to) bids which differ from each other by a systematic percentage, losing bidders becoming subcontractors, rotation of winning bidders or bid prices that are significantly above government estimates.
Seemingly inflated agent fees	Unnecessary middlemen may be used to prepare or carry out a contract. Their fees may hide bribes, kick-backs, etc.
Suspicious bidder	Individuals may submit bids through fictitious or shell companies. Due diligence may reveal a lack of permanent business facilities, an official listing or business assets.
Lowest bidder not selected	Bid rigging may be indicated when the lowest evaluated bid is unjustifiably declared non-responsive by a bid evaluation committee.
Repeat awards to same contractor	Requests for an exception to an approved procurement plan in order to award multiple contracts to a single contractor which cannot be well-justified may suggest awards that are being made on the basis of false justifications, or contract splitting.
Change in contract terms and value	Changes to a contract that occur after a contractor is selected but prior to signing the contract may indicate an effort to increase profitability by altering the scope, quality (e.g. personnel), unit rates or other terms of the contract.
Multiple contract change orders	Changes occurring after a contract has been signed or during its implementation may be justified, but may also signal an attempt to increase the contract value without changing the product or services delivered.
Poor quality works/services	Poor quality or undelivered goods or services may indicate a contractor has tried to recover the cost of bribes, kick-backs or collusion with other firms by lowering the quality of goods/services produced or by delivering less than originally specified.

Note: In the source below, these red flags refer to indicators of fraud and corruption in World Bank financed projects. However, the "red flags" are a useful reference for procurement generally.
Source: World Bank (n.d.), "Most Common Red Flags of Fraud and Corruption in Procurement", pamphlet, Operations Policy and Country Services, Integrity Vice Presidency, Washington, DC, *http://siteresources.worldbank.org/INTDOII/Resources/Red_flags_reader_friendly.pdf*.

limited number of member countries (European Commission, 2011). Good practices should exist throughout the procurement cycle – from project design through contract award until contract management. Comprehensible and transparent procurement processes, conducted in a timely and efficient manner, are an important factor for attracting private finance (World Economic Forum, 2010).

For four of the regions studied, a lack of sub-national procurement capacity is perceived as a major obstacle to effective public investment strategies. A lack of capabilities for public procurement can be more challenging in small regions/ municipalities, with only a small or no specific office in charge of procurement or a lack of trained officials for procurement issues. Procurement is all too often viewed as an administrative task, instead of a strategic one. This has led to administrations repeating award procedures across subject matters, creating risks of collusion of economic operators and restricting sub-national markets. At the sub-national level, small procurement units may not be equipped with the necessary specialisation or the legal, economical and technical skills needed for procurement.

Procurement can also be problematic for SNGs with weak internal control systems, due in some cases to decentralisation that has outpaced improvements in administrative capacity. Surveyed regions highlight other obstacles to procurement as well: three point to an excess of administrative procedures (Box 3.4), two note time constraints and one underscores the obstacle posed by overly restrictive bid specifications, creating red tape.

Box 3.4. **Public procurement challenges in Wielkopolska, Poland**

Public procurement is a challenge for the implementation of the Regional Operational Programme (the regional strategy with all co-funded investment projects) in Wielkopolska. The first problem that can be identified is the instability of the legal framework for procurement, which has changed repeatedly in recent years. These frequent changes have forced investors to adjust their ways of doing things and generated additional costs. A second problem concerns the auditors assessing procurement procedures. Officials in the region argue that the auditors, who tend to be meticulous, impose serious sanctions for even minor irregularities in tenders and that these irregularities may be qualified as such, or not, depending on the interpretation of the individual auditor. This perceived inconsistency creates a climate of insecurity and mistrust, which makes the investors undergo increased efforts to assess minor details of projects and hinders the smooth organisation of tenders. Control procedures implemented by the Polish auditors are stricter than those conducted at a later stage by EU auditors. Some respondents to the OECD questionnaire cited further obstacles to effective public procurement procedures, namely red tape, restrictive tender specifications and limited know-how on the organisation of tenders.

Source: Dabrowski, M. and D. Allain-Dupré (2012), "Public Investment across Levels of Government: The Case of Wiekopolska, Poland", report for the 28th OECD Territorial Development Policy Committee, 4-5 December 2012, *www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm*.

Initiatives to improve procurement occur at both the national and sub-national levels. At the national level, several OECD countries have recently changed their

procurement legislation to simplify procedures or improve value for money. Portugal, for instance, introduced a new Code of Public Contracts in 2008 which integrates dispersed regulations regarding public procurement. Slovenia has simplified procurement procedures and increased technical assistance to municipalities. At the regional level, Galicia has developed a web platform for public procurement procedures for all public entities, including municipalities (see Chapter 2). The goal is to integrate all public entities and private companies in a one-stop shop for public procurement. Collaborative procurement across levels of government as well as at the regional level can also help improve procurement capacity (e.g. purchasing alliances, networks, framework agreements as well as central purchasing bodies). In the health sectors in Italy, France, and the United Kingdom, for example, the establishment of specialised procurement units in charge of procurement activities for a number of health agencies has proven very useful (Box 3.5).

While central agencies will continue to have an important function in procurement legislation, or even in actual steps of the procurement cycle – such as for example the evaluation of suppliers, SNGs need to remain involved in the evaluation of needs, analysis of the relevant markets and exploration of possible innovative solutions. International experience points to two key lessons for sub-national procurement capacity:

- It is critical to ensure the right level of capacity: to overcome capacity constraints in the application of new juridical, technical and electronic tools at the sub-national level, local officials should work in larger, co-ordinated teams, instead of individual entities. This can ensure that sub-national procurement is carried out in favour of new economic entrants, innovation and sustainability. Joint procurement can favour both rationalisation and streamlining of the entire supply chain from the definition of requirements to final deliveries. The central purchasing body can support the local level with market analysis, procurement strategy and negotiation of framework contracts with economic operators. This ensures, for example, an often overlooked problem at the sub-national level: the costs of storage and logistics involved in purchasing goods.
- SNGs need to organise procurement so as to minimise capacity gaps: transparency, monitoring, sharing of best practices, and co-ordination should be implemented at the sub-national level.

Goal 4: Promoting results and learning

Monitoring and evaluation (M&E) processes play a crucial role in improving the efficiency and effectiveness of public investment for regional development through results and learning. It is not only an important co-ordination instrument (as seen in Chapter 2); well-designed monitoring activities allow sub-national actors to follow the implementation of investment projects and the achievement of contractual obligations, to encourage performance, to make mid-course adjustments and to identify medium-term outcomes. Evaluation can identify impacts and provide useful information for future investment decisions. Both activities are critical mechanisms for accountability and learning: for transferring knowledge among parties and for improving performance by integrating feedback during and between investment cycles. Some specific capabilities can enhance the value of M&E systems for SNGs: well-designed monitoring

Box 3.5. **Health procurement in a decentralised context: The cases of the Italy, France and the United Kingdom**

In Italy, regions operate through a network of *Aziende Sanitarie* and *Ospedaliere* (hereafter "*health care* agencies"), of which there are 800. The state retains the legislative competence on "competition" and consequently, on the rules for the award of public procurement, while regions have legislative competence only in the composition and functions of the jury participating in the application of award criteria. Regional autonomy affects the organisational model of the *health care* service. Although many models are considered innovative and to some extent efficient (e.g. Tuscany, ESTAV), this diffusion of different models lets the political power orient the choices and the relationship with the private sector and with the suppliers. Another, more structural weakness, of Italian procurement is due to the reluctance to change the "familiar", thus "reassuring", administrative pathways normally followed in the context of public tendering which is affected by abnormally high litigation rates. Finally, collaborative procurement started later in Italy, compared to other European countries, but the awareness of the need to develop aggregation and central purchasing bodies is presently growing. The special legislation on organised crimes (L. 13 August 2010, No. 136, Art. 13) defines pathways to create at the regional level one or more central purchasing bodies. This provision also establishes the awarding of public contracts and the checking of the execution phase at territorial level (regional, provincial, interprovincial, municipal and inter-municipal level) with the other administrative bodies involved. The risk can be that of an overlapping and duplication of the contractual activity with other central purchasing bodies on the same territory and of difficulties in aggregating needs of local authorities. The risk for integrity is high as the sum of different procurement instead of a real joint procurement process raises the value of contracts and concentrates power in a few hands without acquiring the new skills and capacities needed for a collaborative procurement strategy. This can lead to significant cases of "bribery aggregation".

In France, besides the central purchasing bodies with general capacity (such as the *Union des groupes d'achat public* dealing with more than 20% of medical theatres' overall expenditure), there are several central purchasing bodies competent for health products and services at the local level (e.g. RESAH – *Réseau des acheteurs hospitaliers d'Ile de France* and *Assistance publique des Hôpitaux de Paris*) and at the national level (*Consortium achat de la Fédération des Centres de lutte contre le cancer* and UNI.H.A). Central purchasing bodies are sometimes specialised in both *health care* and medical-social sectors and support other regions with training and benchmarking (e.g. RESAH). The savings have proven to be significant, especially considering that such experiences started at the sub-national level around five years ago. They can also play a significant role in Public Procurement for Innovation (PPI) organising networks in order to buy innovative products (e.g. pilot project Happi supported by the EU Commission-DG Entreprise and Industry on health procurement). An estimated 25% of the value of procurement is conducted under joint procurement.

In the United Kingdom in the last decades, there has been a proliferation of initiatives aiming at aggregating and rationalising health expenditure for products and services, which have one characteristic in common: they are not mandatory. Facing the need for controlling and reorganising *health care* products and services expenditure in a highly decentralised system, the UK government first promoted voluntary forms of aggregation at the regional level (collaborative procurement organisations and hubs), fit for achieving scale economies. The results proved to be poor due to the difficulties in harmonising rooted procurement practices, clinical preferences and local interests. The subsequent steps avoided the implementation of mandatory instruments for centralising procuring activities and enhanced the opportunities entailed by the acquisition of know-how and professional skills offered through collaboration and partnership with economic operators, thereby establishing central purchasing bodies (among them ones that offer consultancy, market analysis and supply chain management services), a national system for co-ordinating the purchase of pharmaceuticals, a national database for suitability requirements assessment, and several services for technological information and guidelines for contract documents drafting.

systems, regular *ex post* performance assessment and the use of performance information.

Capacity 10: Sound monitoring systems[8]

A first critical capacity for effective monitoring of sub-national public investment activities is a well-designed monitoring system with a limited number of indicators which link to regional and national goals. The monitoring system should contribute to credible and timely reporting of expenditure and performance. Indicators should be relevant (linked to national and regional objectives), valid (measure the constructs of interest), reliable and useful (provide actionable information for administrators and policy makers). A monitoring system for public investment has the potential to be unwieldy, and as a result time-consuming and costly to manage. It is therefore important to underscore the value of a focused set of indicators that provides actionable information.

Because the investment mix should vary across regions, the indicators monitored should also vary, reflecting policy choices, goals and programming decisions. The need to aggregate and compare data horizontally at different levels of government can be facilitated by encouraging local and regional actors to tailor their monitoring activities to their investment mix, by choosing from a menu of indicators with standardised definitions and requiring a common core set of indicators. To strengthen the understanding of and commitment to monitoring, the menu of indicators should be jointly developed by the sub-national, national and supranational actors that will report, monitor and use the results of the indicator system. The final selection of indicators should include input, output and outcome measures. It is beyond the scope of this report to identify relevant indicators for different categories of investment; recommendations have been made elsewhere.[9]

Designing and managing a results-oriented investment portfolio also requires SNGs to set performance targets.[10] This involves identifying which indicators should be associated with which targets, establishing baseline values, setting targets, establishing the time-frame for measurement and reporting, and determining how accountability for achieving targets will be enforced – with an eye to minimising distortions often created by performance systems. As noted in Chapter 2, monitoring is relatively standard across OECD countries and regions, including the use of performance indicators as well as financial information (i.e. monitoring extends well beyond mere financial audit). However, it is also clear that evaluation is less well-established than monitoring, which implies that the potential for such indicators to inform policy and improve outcomes over time is not being realised in many, perhaps most, places in the OECD.

Capacity 11: Ex post *performance assessment*

Just as crucial as strategic planning is at the outset of the investment cycle, *ex post* evaluation is at the end. *Ex post* evaluation can provide important insights to policy makers regarding the impacts ("results") of investment choices, their contributions to economic development as well as where breakdowns (or synergies) occurred. Done well, such evaluations allow policy makers to verify the achievement of anticipated outcomes while learning how to improve the quality of investment decisions in a subsequent step. SNGs need not conduct *ex post* evaluations in-house, but should have access to independent bodies (e.g. research organisations, universities, consultancies) with the capacity to

conduct high-quality evaluations under contract. While many of the surveyed regions indicate that they conduct performance evaluations, data from the OECD national questionnaire suggest that central governments perceive capacity challenges with respect to *ex post* assessment. Fourteen countries (out of 20) consider the lack of *ex post* impact assessment for public investment projects as a challenge.

The challenges involved in *ex post* evaluation depend to some extent on the sectors involved. It is critical that evaluations be linked as closely as possible to the goals of the investment, which may encompass some combination of growth (of output or employment) or service delivery (scale, effectiveness or efficiency). For example, where physical infrastructure is concerned, the challenge is to identify real economic impacts (in terms of traffic flows, impact on trade and commuting, etc.), rather than, as is sometimes done, to assume that success is achieved if a given expansion of infrastructure provision is completed on time and on budget. Investments in "softer" infrastructures (human capital, innovation systems) may be harder still to assess, since fairly sophisticated analysis may be needed to demonstrate "additionality" (i.e. the level of activity generated that would not have taken place if the investment had not been undertaken).

Capacity 12: Using performance information

Feedback mechanisms are important for M&E to have a positive impact on the quality of public investment. A well-designed M&E system will be for naught if the information it produces goes unused. Learning happens only if information produced in a first step is used in a subsequent one. Critical then is the capacity to use the information generated from these efforts in a productive way. Potential users of M&E information include programme administrators, policy makers at all levels of government, firms and citizens. Importantly, the availability of information does not necessarily lead to productive use. Evidence should exist that performance information is both available to stakeholders and used in decision making. One example of using performance information comes from Galicia, Spain – which introduced elements of performance budgeting into its 2011 budget process (Box 3.6). The primary objective is to use the outputs and outcomes achieved by the government sectors as input for the negotiation process of the 2013 budget.

Due to their comprehensive nature, policy makers and planners at all levels of government should anticipate data needs, plan for their use and seek to minimise the burden of data collection and reporting. Too much information can overwhelm planning, monitoring and evaluation processes, creating a substantial administrative burden and leaving much information unused. Information needs should be assessed early in the investment cycle, collection and use planned for, and reviewed and updated periodically (with a priority placed on introducing as few changes as seems reasonable).

Goal 5: Supporting all stages of the investment cycle

Some capacities are not unique to a single stage of the investment cycle, but are highly relevant at each stage. Such capacities include promoting integrity, transparency and accountability, engaging in "better regulation" and ensuring the availability of professional and technical skills needed throughout the cycle.

Box 3.6. **Performance monitoring in Galicia (Spain) and Victoria (Australia)**

Some principles of performance budgeting were implemented by the Galician regional government (without any demand or guidance from the central government) during the 2011 budget process. The goal is to use the outputs and outcomes achieved by the government sectors as input for the negotiation process of the 2013 budget. Indicators are being developed for all investment policies and aim to improve budgetary management and efficiency and identify inefficient expenditures in a context of crisis and fiscal austerity. To develop the system, the regional government drew on its experience managing EU funds. Galicia is one of the EU pilot regions using outputs and outcomes indicators as a central mechanism for managing public investment funded by EU funds. The introduction of this approach was facilitated by the political environment created by the recent financial crisis and subsequent budgetary pressures. The regional government seeks to reorient the management of public investment from the expenditures side toward "results" (outputs and outcomes).

In Victoria, the bulk of assessment tends to occur prior to the commencement of the project. The focus of the new central quality assurance arrangements is on enhanced *ex ante* control – improving the business cases for major investments. These now require more effort and expertise by the ministry responsible and are subjected to rigorous scrutiny both at a technical level and in terms of their wider assumptions (see Box 3.2). The business case process does, however, include the development of performance indicators and these are the basis for monitoring once the infrastructure is operational. Under the Victorian public service system, *ex post* evaluation of investment rests firstly with the ministry responsible. There are relatively few examples of such evaluation and there has been criticism in some academic literature that PPPs, in particular, receive very little evaluation.

Source: Hulbert, C. (2012), "Public Investment across Levels of Government: The Case of Galicia, Spain", report for the 28th OECD Territorial Development Policy Committee, 4-5 December 2012, *www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm*; Bounds, G. (2012), "Public Investment across Levels of Government: The Case of Victoria, Australia", report for the 28th OECD Territorial Development Policy Committee, 4-5 December 2012, *www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm*.

Capacity 13: Managing integrity and accountability risks

There are risks to integrity throughout the investment cycle that can undermine the very goal of investment, namely to increase sub-national growth performance and/or to enhance public service provision (Table 3.3). Public investment is at significant risk of corruption, as it involves large sums of money for projects that are often very particular in their kind, making it difficult for outsiders to assess costs, technical details, etc. Corruption can originate with both public and private actors and can cause substantial political, economic and social costs (Table 3.4). Not all threats to integrity are unlawful. Private companies, for example, can influence policy decisions, legislation and regulations which shape the environment in which they operate. They may sometimes do so legally through lobbying, large campaign contributions and the so-called "revolving door" (Svensson, 2005; Kaufmann, 2005). In other instances, the behaviours are decidedly unlawful.

Corruption can include, but is not limited to, bribes, kick-backs, embezzlement, theft, nepotism, patronage, state or elite capture, and extortion (Svensson, 2005; Chêne, 2009; UNODCCP, 2002). Some examples of these types of corruption can be found in Table 3.4. Financially, bribery is estimated to cost approximately USD 1 trillion annually worldwide

Table 3.4. **Types of corruption and fraud across the investment cycle**

Stage of the investment cycle	Types of corruption
Planning	• Bribes (gifts) for policy makers to orient public expenditure in a particular way • Bribes/kick-backs for a project design favouring a specific firm • False justification for investment • "Capture" leads to investment choices that confer benefits to specific interests/groups rather than to society more broadly
Financing and budgeting	• Embezzlement, theft
Project selection	• Firms offer bribes (commissions) to secure a government contract • Public officials violate zoning laws to ensure projects move forward • Public officials demand bribes in the issuance of licenses and authorisations • Public officials and/or firms are party to bid-rigging, contract splitting, unjustified by-passing of competitive bidding, leaking information to a favoured bidder • Bidders collude to share the market • Supply firms collude to keep material costs artificially high • Strategic misrepresentation of costs and benefits to secure a contract
Project implementation	• Falsifying documents to misrepresent cost, quality or quantity • Substituting lesser quality materials or services than those specified in the contract • Firms certify or pay bribes to ensure approval of poor quality, defective, incomplete or non-existent work • Illegitimate modifications to the terms or value of awarded contracts • "Capture" leads to implementation choices that confer benefits to specific groups rather than to society broadly • Employment of illegal workers • False or exaggerated claims against a contractor in order to withhold or reduce the payment of a contract
Project operation and maintenance	• Private operator overcharges for end service (e.g. electricity) • Bribes to secure operation and maintenance contracts, possibly from the building contractor • Operators may demand bribes from customers for accessing services

Sources: Based on GIACC (Global Infrastructure Anti-Corruption Centre) (2013), "How Corruption Occurs", GIACC website, *www.giaccentre.org/how_corruption_occurs.php* and Chartered Institute of Building (CIOB) (2006), "Corruption in the UK Construction Industry, Survey 2006", CIOB, Ascot, Berkshire, United Kingdom, *www.ciob.org.uk/sites/ciob.org.uk/files/WEB-INF/files/documents/CIOBCorruption.pdf*.

(World Bank, 2004; Kaufmann, 2005).[11] Within the European Union, corruption costs an estimated EUR 120 billion per year (Malmström, 2013).

The relationship between decentralisation and corruption is complex.[12] On the one hand, decentralisation may narrow the scope for corruption by making politicians more accountable to the citizens they serve and by introducing competition among governments for mobile firms and individuals (Kolstad and Fjeldstad, 2006; Weingast, 2007). Alternatively, there may be greater opportunity and fewer obstacles to corruption at the local level compared to the national one, due to greater discretion of local politicians, weaker separation between sub-national politicians and bureaucrats, weaker governance capacity at the local level, and less developed local monitoring and auditing functions (Prud'homme, 1995; Kolstad and Fjeldstad, 2006). Moreover, "as decentralisation occurs, local elites and politicians gain access to... resources that can be channelled towards the satisfaction of local vested interests rather than ... citizens' needs" (Chêne, 2010). High-risk processes such as procurement can become even more risky due to the proximity between local officials and a potentially small pool of suppliers (Chêne, 2010).

The limited evidence that is available on corruption at the sub-national level shows that some regions have poorer corruption performance than others. Specifically, within Europe lower-income regions, which receive the greatest financial support from the EU, have higher levels of perceived corruption (see Chapter 1 for a discussion of the link). In addition, regions with greater inter-governmental transfers may be more prone to corruption than regions with greater financing through own revenues (Goodspeed, 2011).[13]

Table 3.5. **Potential costs of corruption**

Political	Undermines the rule of law, trust in government and the legitimacy of public institutions
Economic	Wastes public and private funds Diverts public resources from most/better productive use Reduces public revenue Distorts competition Deters private investment Degrades the efficiency of public investment Undermines quality Raises the operating costs of infrastructure
Policy	Distorts and undermines the achievement of the policy's objectives
Social	Leads to an inequitable allocation of goods and services Limits access of the poor Leads to inferior quality and potential hazards to public safety Diverts resources away from socially needed projects (e.g. education) to less needed but more spectacular investments
Environmental	Degrades the environment and leads to resource depletion

Source: Based on Mauro, P. (1997), "Why Worry About Corruption?", Economic Issues, No. 6, IMF, *www.imf.org/external/pubs/ft/issues6/issue6.pdf*; Tanzi, V. and H. Davoodi (1997), "Corruption, Public Investment, and Growth", *IMF Working Paper*, WP/97/139, *www.imf.org/external/pubs/ft/wp/wp97139.pdf*; Svensson, J. (2005), "Eight Questions about Corruption,"*Journal of Economic Perspectives*, Vol. 19, *http://www1.worldbank.org/publicsector/anticorrupt/Svensson%20Eight%20Questions%20About%20Corruption%20(JEP%20Vol%2019,%20No%203%202005).pdf*; Collier, P. and A. Hoeffler (2005), "The Economic Costs of Corruption in Infrastructure" in *Global Corruption Report 2005*, Transparency International, Berlin; Klitgaard, R. (1998), *Controlling Corruption*, University of California Press, Berkeley; Transparency International (2013), "FAQs on Corruption", Transparency International, Berlin, *www.transparency.org/whoweare/organisation/faqs_on_corruption/2*.

SNGs can enhance the integrity of the investment process and accountability in the use of public funds by strengthening their capacity to identify and manage risks throughout the investment cycle. For example:

- At the planning stage, the interests of certain stakeholders that are well-organised and well-resourced could exert disproportionate influence ("capture") on the orientation of investments.
- At the project selection stage, Flyvberg (2006, 2009) warns of "strategic misrepresentation" of costs and benefits in order to ensure a project is selected. He also notes the potential for an "optimism bias" that leads to an overestimation of the benefits and an underestimation of costs.
- During implementation, corrupt procurement processes and poorly selected or poorly designed financing arrangements can present important risks for public investment.
- Effective monitoring of the investment portfolio can be compromised by inaccurate reporting, as well as strategic behaviours designed to achieve performance targets but without necessarily making significant contributions to policy goals.

Electoral cycles can also influence public investments, potentially leading to sub-optimal allocations (Sutherland et al., 2009).

One way SNGs can strengthen the quality of implementation is through regular review of their practices, paying constant attention to specific risks and "red flags". Many of the good practices identified here can reduce the risks to integrity and accountability throughout the investment cycle. SNGs can consider a risk register which first summarises important risks, their triggers and their consequences that may arise at different stages of the investment cycle. The risk register could also list the seriousness of the risks as well as mitigation strategies that SNGs can take. SNGs should also ensure mechanisms exist to manage conflicts of interest.

Capacity 14: Regulatory quality

Regulatory quality and coherence across levels of government play a critical role in sub-national public investment (Rodrigo and Allio, 2012). Because regional development policy involves multiple sectors and multiple levels of government, actors must deal with a myriad of regulations. Different types of obstacles to investment arise, such as overlapping/duplication/contradiction of regulations across levels of government and an increasing stock and flux of regulation which makes compliance difficult and costly. For the private sector, a "lack of needed laws and regulations" or "a procurement process that doesn't fit with existing laws and regulations" can deter investment, lead to delays, or even cause investors to abandon a project (WEF, 2010). In border regions, matters can become even more complicated, as even relatively minor differences in primary and secondary legislation can complicate cross-border investment co-operation (e.g. co-operation in *health care* between Skåne and Denmark's Capital Region).

Box 3.7. **Administrative capacity challenges for EU Cohesion Policy**

For EU Cohesion Policy, the capacity of regions to spend EU funding in a limited timeframe can be a critical obstacle to effective policy implementation. There is substantial variation across EU countries, from Romania which received 20% of available EU funds for the period 2007-13 as of November 2011, to Portugal which received nearly 60%. In 2011, the European Parliament listed reasons for "absorption" difficulties. They include, among others:

- insufficient resources to co-finance projects;
- delays introducing EU and national rules or related guidance, and incomplete or unclear rules;
- overly complicated, overly strict and frequently changing national procedures;
- insufficient involvement of sub-national levels in establishing operational programmes;
- limited staff numbers, inadequately trained staff and difficulties with retaining staff;
- disproportion between the degree of control and the scale of the project; and
- insufficient preparation for the implementation of projects, and missing project pipelines.

Source: Bounds, G. (2012), "Public Investment across Levels of Government: The Case of Victoria, Australia", report for the 28th OECD Territorial Development Policy Committee, 4-5 December 2012, *www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm*.

While sub-national actors are not the sole masters of the regulatory environment, their capacity for "better regulation" makes an important contribution to the effective planning and implementation of public investment. In addition to minimising unnecessary product market regulation at the sub-national level and increasing the transparency of sub-national regulations (de Mello, 2010), SNGs can put a number of good practices in place, including but not limited to, reducing administrative burdens (with a focus on small- and medium-sized enterprises), assessing *ex ante* the costs and benefits of regulation (using tools such as regulatory impact assessment, regulatory checklists, small business impact assessments or deliberative committees) and carrying out formal consultation processes (such as informal inquiries, circulation of regulatory proposals for

public comment, public notice and comment, hearings, and advisory bodies) (García Villarreal, 2010).

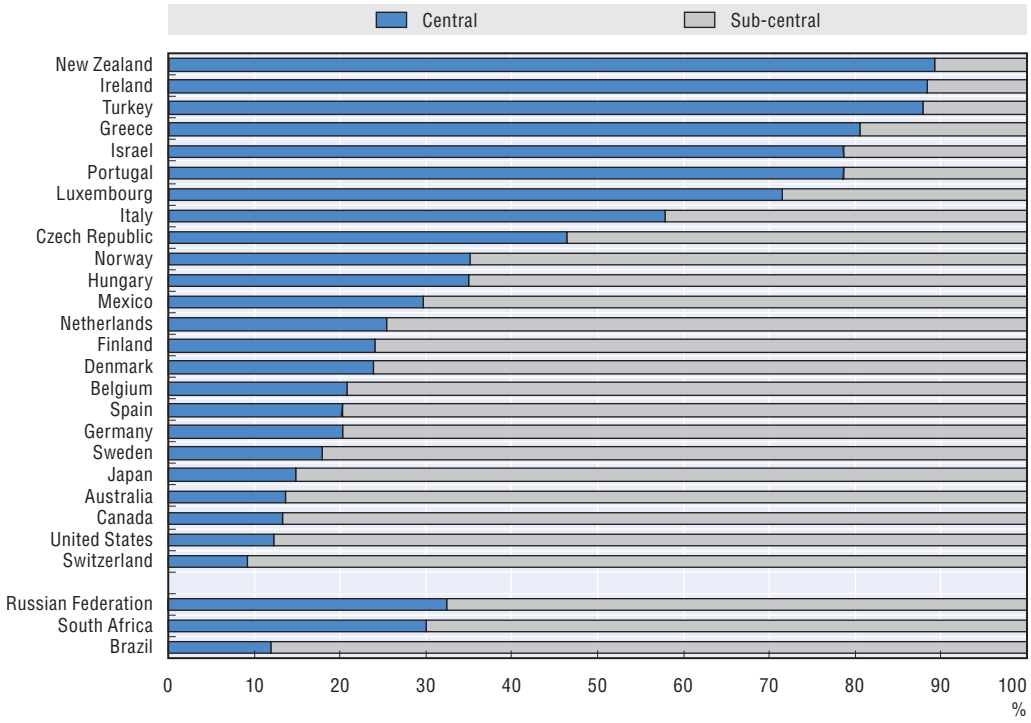
The capacity for "better regulation" differs across countries and SNGs. Few OECD countries have well-developed capacities for regulatory management at all levels of government (Rodrigo and Allio, 2012). Where the pace of decentralisation has outpaced the acquisition of corresponding capacities, SNGs may find themselves ill-equipped for regulatory responsibilities. Likewise, a growing stock of regulations and frequent changes can make compliance a major challenge. Sub-national authorities with small administrations, especially in rural areas, often have adequate capacities to implement an increased number of regulations. For example, in France, a 2011 report indicated that more than 55% of the articles of the *Code Général des Collectivités Territoriales* have been modified in less than ten years. Inflationary regulation is estimated to have cost EUR 1 billion between 2009 and 2010 (French Senate, 2011.).

Capacity 15: Professional and technical skills

Most of the public sector workforce is at the sub-national level (Figure 3.1), and is tasked with increasingly complex demands in terms of managerial and technical expertise. Decentralisation has made SNGs responsible for areas where they may lack expertise. They are also under pressure to reduce the size of their workforce. The types of tasks, such as supporting innovation, addressing social challenges like climate change, or engaging in more complex financial instruments, require new skills. The nature of governance approaches requires more networking-type skills, including the capability of individuals to consult, negotiate and co-ordinate with different levels of government as well as with non-governmental partners. Large regions, particularly established ones with substantial autonomy and significant numbers of staff, can tap a diverse range of professional skills. The same is not necessarily true for small regions, municipalities, newly created regions or SNGs where decentralisation has outpaced corresponding development of administrative capacity. Such challenges can hit rural areas particularly hard.[14]

There are unique human resources management challenges for SNGs to meet technical capacity needs in the public sector (see, for example, OECD, 2008a). Attracting needed skills to the public sector is a challenge for many regions, given that salary scales may be uncompetitive with the private sector. Case study regions report difficulties both attracting and retaining qualified staff. Region Skåne, for example, saw about one-third of its procurement department turnover in 2011, due to private sector competition for its human resources. Regions indicate that offering salaries competitive to those of the private sector is a challenge. Local governments also compete with each other and central governments for qualified staff. However, mobility opportunities between different governments can facilitate the recruitment of staff with the needed expertise. The civil service in general in OECD countries is experiencing a demographic challenge that can both support or impede goals for technical capacity upgrading. With the aging of public sector employees, many are at the peak of the pay scale but not necessarily able to retrain quickly to acquire the necessary new skills. Many employees are retiring, leading to a loss of valuable knowledge and expertise in some cases, but in others offering an opportunity to replace them with staff who have the new skills that are needed. In some countries, sub-national public sector staff turnover may be particularly systemic and problematic, with timeframes as short as every three years (OECD, 2007). Therefore, a greater

Figure 3.1. **Share of sub-national public sector employment**



Source: OECD (2011), *Government at a Glance*, OECD Publishing, doi: 10.1787/gov_glance-2011-en based on data from the International Labour Organization (ILO), *LABORSTA Database*. Data for Turkey are from the Ministry of Finance and Turkish Statistical Institute. Data for Japan are from the Establishment and Enterprise Census.

StatLink http://dx.doi.org/10.1787/888932844676

professionalisation of the public sector and less fragmentation is needed to overcome this and other challenges for meeting skill needs.

Solutions for filling skills gaps range from recruitment, training and workforce planning to using external sources. Strategic workforce planning and management help organisations get the right people in the right job at the right time. It allows for a more effective and efficient use of workers and for organisations to prepare for restructuring, reducing or expanding their workforces.[15] For SNGs, in addition to their own capacity, their access to skills wherever they may be found is critical as well. They may be available through other governmental entities or outside of government through universities, technical consultants, quasi-public agencies, and others that have the expertise in-house or can more easily employ such experts. This is particularly relevant for sophisticated projects, such a "mega-projects" or projects with network characteristics, as technical requirements may extend beyond standard project appraisal skills and require specific types of expertise (e.g. engineering).[16] However, there are examples where constant outsourcing can be detrimental to maintaining a minimum of internal capacity to understand and read the reports with a critical eye, a consideration for competency management.

Box 3.8. **Bolstering public sector skills: Good practices in three regions**

Germany (Brandenburg): The German *Länder* have regional development banks (in Brandenburg it is called the *Investitionsbank des Landes Brandenburg* – "ILB"). In the new *Länder*, they primarily manage government financing programmes, as an agent of the *Länder*. Sometimes the ILB directly takes decisions about the allocation of funds, such as for SME programmes; other times it administers the funding process of an allocation decision taken by the *Land* (such as for the funding of universities or technical institutes). The ILB therefore acts more like a public agent despite being a fully licensed bank, with valuable expertise not found within the regional government.

Poland (Wielkopolska): The implementation of the EU funds has had a catalytic effect for enhancing administrative capacity in the region, particularly in the 2007-13 period. The number of staff dealing with regional policy increased from 12 to 250 in 2007. Staff participated in training courses made available via EU Technical Assistance funds, and efforts have been made to encourage an integrated approach to place-based development. Administrative capacity building is also a priority of the Regional Innovation Strategy, which puts forward special strategic programmes for promoting pro-innovation attitudes and supporting capacity building, co-ordination of actions with an impact on innovative activity within the Marshall's Office ("Innovative Office") and the local authorities ("pro-innovative local self-government").

Sweden (Skåne): Region Skåne promotes mobility within the regional administration. It evaluates its employees' performance and rewards them by making a portion of salary dependent on performance. Challenges for Skåne do not lie in the ability to attract talent, but rather in retaining it after investing in staff to become experts, for example in public procurement for health services. There has been considerable staff turnover in areas such as public procurement, where those skill sets are also valuable in the private sector.

Source: Gamper, C. (2012), "Public Investment across Levels of Government: The Case of Brandenburg, Germany", report for the 28th OECD Territorial Development Policy Committee, 4-5 December 2012, *www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm*; Dabrowski, M. and D. Allain-Dupré (2012), "Public Investment across Levels of Government: The Case of Wiekopolska, Poland", report for the 28th OECD Territorial Development Policy Committee, 4-5 December 2012, *www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm*; Gamper, C. (2012), "Public Investment across Levels of Government: The Case of Skåne, Sweden", report for the 28th OECD Territorial Development Policy Committee, 4-5 December 2012, *www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm*.

The importance of regional characteristics and category of investment

This chapter has discussed sub-national capacities for regional development investment, but capacity needs may differ in different settings. Different types of regional public investment are needed in regions with differing characteristics. This section, therefore, provides some insights regarding the importance of institutional context, type of region and sectoral focus.

The importance of particular capacities and the challenges SNGs face are likely to vary across countries with differing distributions of competences related to investment, legal frameworks and the degree and maturity of decentralisation. Where regions are not self-governing and/or where regional authority over various aspects of the investment cycle is limited, capacities which rely on government authority are likely to exist at higher (or lower) levels of government. At the regional level, some capacity may be vested in an entity like a regional development agency, but with substantial capacity remaining at the central

level. In these cases, planning-related capacities are often critical but others such as *ex ante* appraisal may, in fact, be conducted (or led) by the central level. In some countries, weak (administrative) regions may have to confront a context of significant authority at the central level as well as at the municipal level, such as in Slovenia, where municipal mayors can have a strong impact on what happens in their region (OECD, 2011c), or in Sweden, where regions are pro-actively co-ordinating interests of the centre and the local level in order to influence policy-making processes without regional authority over final decision-making processes. Each of these cases underscores the fact that any assessment of capacity needs to be preceded by a review of the assignment of competences related to public investment for regional development and an assessment of where real authority lies across the investment cycle.

Responses to the national questionnaire suggest that some investment capacity challenges are prevalent in all types of decentralisation contexts,[17] while others vary across them. Co-financing requirements, the integration of sectoral priorities into a balanced investment mix and the involvement of the private sector present greater challenges for sub-national authorities in countries where they have less autonomy and where levels of fiscal decentralisation[18] are low. By contrast, insufficient resources at sub-national level and lack of fiscal discipline are reported to be greater challenges in federal/regionalised countries. This is not to suggest that there is an optimal institutional design. Rather, it underscores the importance of assessing the decentralisation context in which public investment occurs in order to properly understand the capacity challenges faced by SNGs.

Challenges can also vary by type of region and level of development. While all regions need to identify an investment mix that addresses basic needs and capitalises on potential sources of growth, investment needs differ depending on a region's density, economic structure and distance from the productivity frontier. For example, the leading urban regions tend to be well supplied in terms of physical infrastructure and focused on investments in hard and soft infrastructures to support knowledge creation. By contrast, regions further from the frontier often lag the most in terms of human capital, while it is the intermediate regions that are most likely to run up against infrastructure constraints. Rural regions typically face particular challenges with respect to investments in education, *health care* and other public services, where there is a need to ensure adequate access to rural dwellers without over-investing in facilities that are costly to build and maintain in the absence of economies of scale.

Finally, the importance of individual capacities differs across sectors. Large, complex multi-year investments are likely to require a SNG to tap a greater range and greater depth of technical skills over a longer period of time than a relatively short-term project. Large infrastructure projects are likely to be more demanding in terms of *ex ante* appraisal, sophistication of financing arrangements, engagement of the private sector, monitoring and evaluation. Capital-intensive projects are also likely to make greater demands on the integrity and efficiency of procurement processes. By contrast, "softer" skills, like stakeholder engagement, may matter more for investments in things like innovation or entrepreneurship promotion. For some SNGs, existing capacities may be more advanced for designing and delivering traditional infrastructure projects (and sectors that have long been a focus for regional development, such as transport) than for innovation-oriented ones. Victoria, for example, has developed the "High Value High Risk" process (Box 3.2) in part in an effort to address the particular challenges associated with projects in more technically complex fields, like information technology. Brandenburg receives capacity

support through its regional investment bank (ILB), especially to help assess the worth of PPPs, or assist in evaluating business proposals or technical aspects of investment projects. That way, local municipalities can request support when needed, without having to provide the required capacity themselves, rather inefficiently, in each local entity.

It is beyond the scope of this report to identify a weighted capacity mix for each type of region or category of investment, and, overall, the capacities described here are expected to benefit all types of regions. Nevertheless, some capacities stand out as "critical capacities": those that are likely to be valuable for the efficiency and effectiveness of public investment in almost every context. Without these, the other capacities may lack a mature governance foundation on which they can be built. SNGs with weak or underdeveloped capacities for public investment could give priority to these capacities. Indicated by a star in Table 3.1, they are:

- to engage in strategic planning that is tailored, results-oriented, realistic, forward-looking and coherent with national objectives;
- to conduct rigorous *ex ante* appraisal;
- to tap traditional and innovative financing mechanisms for public investment;
- to engage in transparent, competitive, procurement processes with corresponding internal control systems;
- to design and use monitoring indicator systems with realistic, performance promoting targets; and
- to ensure the quality and availability of the technical and managerial expertise necessary for planning and executing public investment.

Where SNGs, and regions in particular, have weak authority over key aspects of the public investment cycle and rely heavily on other levels of government to move a public investment portfolio forward, the capacity to consult, negotiate and co-ordinate with other levels of government will be vital.

Assessing sub-national capacities: A diagnostic tool

The previous section identified 15 sub-national capacities that can enhance the efficiency and effectiveness of sub-national public investment and that can help engage SNGs in the network of co-ordinating actors across levels of government, sectors and other non-governmental stakeholders. An assessment of the major capacity gaps that exist at various stages of the investment cycle is needed to establish priorities for improving investment in a particular region. Not all of the capacities can be strengthened at the same time and some capacities may need to be strengthened before others. It is therefore critical to identify areas of weakness, binding constraints, appropriate remedies and the proper sequence of reforms. "Binding" constraints are those weaknesses in one or more stages of the investment cycle that fundamentally put overall performance at risk. The diagnosis should also identify which challenges are solely the responsibility of SNGs (with various stakeholders in the region), which are shared with other levels of government and which are the responsibility of the national government. Identifying the critical bottlenecks can help to differentiate SNGs from each other, to better calibrate investment strategies to sub-national realities and to establish priorities for capacity development efforts.

Assessing the state of sub-national capacity for public investment can be a complex exercise, requiring substantial information from a variety of stakeholders. Such a diagnosis

is a "big picture" risk analysis to guide the definition of priorities and the sequencing of activities for developing public investment capacity. Using the capacity framework provided here, it should examine the investment process, as well as the broader environment in which investment is undertaken. This type of assessment cannot be conducted effectively on the basis of a handful of indicators; comprehensive information – both quantitative and qualitative – is needed to reveal and confirm where breakdowns occur. "Absorption capacity", for example, is a commonly used indicator of capacity problems in EU countries. It measures the extent to which a member country and its regions are able to spend the financial resources allocated from the Structural and Cohesion Funds in an efficient manner. While useful, it only provides a partial view and signals the need to investigate further the underlying capacity problems.

Capacity assessment must begin with a clear understanding of where authority lies throughout the investment cycle. As underscored earlier, the decentralisation context in which sub-national public investment occurs affects what can be expected of SNGs. The greater the authority of regional governments throughout the investment cycle, the better developed their capacities must be. By contrast, where a higher level of government takes a leading role at different stages of the investment cycle (e.g. for *ex ante* appraisal or procurement), the capacity of sub-national authorities to set the stage for, participate in and use the results of these processes (e.g. through sound planning, effective negotiation, information sharing or monitoring) can enhance governance.

Once the context for sub-national public investment has been established, regions (and other levels of government) should ask themselves a series of (self) assessment questions to initiate a comprehensive review of their public investment capacities (Table 3.6). This tool is designed to reveal which of the 15 capacities might need bolstering and which might be more mature. It is intended to be a broad diagnostic tool, generally applicable for regional development rather than for specific sectors. The goal is to provide a general indication of strengths and weaknesses, and thus be a starting point for further investigation and for capacity development efforts.

Capacity assessment can be undertaken by regions themselves or jointly with a higher level of government. SNGs' engagement in capacity assessment is critical for encouraging a nuanced assessment of the dynamics of investment in a place and for cultivating buy-in for any subsequent reforms or capacity development initiatives. A purely top-down approach to assessment and capacity development involves risks that underscore the value of sub-national involvement. Risks include, but are likely not limited to, inaccurate assessment of sub-national capacities devoid of context, incentives for SNGs to misrepresent capacities, formalistic compliance with "good practice" without real capacity development, the persistence of information gaps between levels of government due to a lack of trust, and a lack of simultaneous improvement of policies and practices at the higher level of government. These risks can be attenuated (even if not eliminated) by active engagement of SNGs in capacity assessment and development activities.

Eight of 22 countries responding to the OECD survey indicate that they have carried out assessments of variations in governance capacities across sub-national authorities in the past – although not necessarily specific to public investment. Estonia, for example, has carried out three studies (two of them are updates of previous studies) examining local governance capacities during the previous five years. These studies have incorporated indices to measure local governments' institutional and financial capacity, as well as

Table 3.6. **Sub-national capacities for public investment: (Self) assessment questions**

Capacity	(Self) assessment questions for sub-national governments
To engage in strategic planning for regional development that is tailored, results-oriented, realistic, forward-looking and coherent with national objectives	• Do mechanisms exist to ensure that sub-national investment plans reflect national and sub-national development goals? • Is the correspondence between territorial assessment, needs and planned projects assessed? • Is there a clear and authoritative statement of public investment priorities at the national level? At the regional level? • What consideration is given to complementarities between investments in both hard and soft infrastructure? • Do authorities assess the potential contribution of investments both to current competitiveness and to sustained growth in the global economy? • Are data available and used to support the territorial assessment and planning process?
To co-ordinate across sectors to achieve an integrated place-based approach	• Is attention given to potential complementarities and conflicts among sectoral investments? • Do formal or informal mechanisms exist to co-ordinate across sectors (and relevant departments/agencies) at the sub-national level?
To co-ordinate with other jurisdictions to promote complementarities and to achieve economies of scale across boundaries	• Have cross-jurisdictional partnerships involving investment been implemented previously? For specific sectors or all sectors? Have they been successful? • Does a higher level of government require, support or provide incentives for cross-jurisdictional co-ordination?
To involve stakeholders in planning to enhance the quality and support for investment choices, while preventing risks of capture by specific interests	• Do mechanisms exist to identify and involve stakeholders throughout the investment cycle? Which categories of stakeholders are the most/least engaged? • Is there a communication strategy for stakeholders in place? • Are stakeholders regularly consulted to see if they are satisfied with the opportunities to engage and the quality of the engagement? • Do citizens have access to timely information throughout the investment cycle? • Is stakeholder feedback incorporated into decision making? How?
To conduct rigorous *ex ante* appraisal	• What % of investment is subject to *ex ante* assessment (by sector)? What is not covered? • Does the SNG have access to and use published guidance that details appraisal methods and standards? • Is there independent review of appraisals to ensure their objectivity and quality? • Is the SNG able to tap appropriate expertise, either in-house or elsewhere, to ensure proper technical appraisal of complex/sophisticated investments? • Are the results of *ex ante* appraisals used to prioritise investments? • What % of SNG staff has project evaluation skills? What % of these staff are in positions that make use of their skills?
To link strategic plans to multi-annual budgets	• Are investments funded with a multi-year budget envelope? • Are operation and maintenance costs assessed on a long-term basis? • Is there a medium-term planning and budgeting framework? Is it integrated with the annual budget? (IMF) • Are multi-year forecasts for public investment reviewed and updated regularly?
To tap traditional and innovative financing mechanisms for public investment	• What is the fiscal situation of SNGs? What are their main fiscal capacity challenges? • How are public investment projects financed? Are innovative mechanisms for public investment used? To what extent have they been successful? • Do SNGs have access to information concerning (supra) national funds for investment? • What challenges are encountered in accessing or using different sources of financing?
To mobilise private sector financing, without compromising the long-term financial sustainability of public investment projects	• Is private sector engagement considered in conjunction with alternative modes of financing and/or delivery? • Has the SNG engaged in PPPs? In which sectors? Have problems been encountered? • Does a dedicated PPP unit exist that can assist SNGs?
To engage in transparent, competitive procurement processes with corresponding internal control systems	• What % of total annual tender procedures is competitive? What % is conducted online (e-procurement)? What % is the subject of complaint? • What % of total annual contracts awarded go to SMEs? • What % of staff involved in procurement activities has related training? • Is formal guidance regarding procurement procedures provided to staff involved in procurement activities? • Is there a procurement unit that can assist SNGs?
To design and use monitoring indicator systems with realistic, performance promoting targets	• Does a system of performance indicators exist? • Do monitoring systems facilitate credible and timely reporting of expenditure and performance? • Does the indicator system incorporate output and outcome (results) indicators? • What % of indicators are associated with targets?
To conduct and use regular *ex post* evaluation	• Is *ex post* evaluation of investment projects required? • What share of public investment spending is subject to *ex post* evaluation (by sector)? • Do clear guidance documents exist that detail *ex post* evaluation standards?
To use monitoring and evaluation information to enhance decision making	• Does a dissemination strategy for monitoring and evaluation information exist – both for public reporting as well as internal use? • Is the timing of budget preparation aligned with the availability of monitoring and evaluation data? • Do policy makers incorporate performance information from previous periods into current decisions? • Are actors sanctioned or rewarded based on the achievement of targets? • Are data made available in a timely way and in a useable format for decision makers?

Table 3.6. **Sub-national capacities for public investment: (Self) assessment questions** *(cont.)*

Capacity	(Self) assessment questions for sub-national governments
To monitor and manage risks to integrity and accountability throughout the investment cycle	• Are processes in place to identify, assess and respond to risks throughout the investment cycle (e.g. captured in a risk register)? • Are measures in place to address potential conflicts of interest? • Are whistleblower protections available? • Does risk assessment have a bearing on the selection or management arrangements of projects?
To engage in "better regulation" at sub-national levels, with coherence across levels of government	• Does the sub-national government have access to and participate in mechanisms for co-ordinating regulatory coherence across levels of government? • Is regulatory impact analysis used? • Are public consultations in connection with the preparation of new regulations of sufficient duration, accessible and appropriately targeted? • Are alternatives to regulation consistently considered? • Have there been efforts to reduce the stock of regulation or simplify administrative procedures in the past few years? • Are e-government tools used to simplify administrative procedures for public investment projects?
To ensure the quality and availability of technical and managerial expertise necessary for planning and executing public investment	• What % of employees work on public investment tasks (% FTE)? What % of these have had formal training in a related area, such as *ex ante* appraisal? • Does a formal process for training staff in technical skills for public investment exist? What are the training utilisation rates? • Are professionals/new hires available from university programmes that provide training related to public investment (e.g. urban planning, regional policy, public policy, economics, etc.)? • Is the performance of agencies/departments/units dealing with sectoral and regional public investment regularly monitored and assessed? Are there specific rewards and sections? • Is the performance of public employees dealing with public investment projects regularly assessed? • Is external technical assistance (e.g. for planning, *ex ante* assessment, *ex post* evaluation) readily available – such as through regional development organisations, universities, think tanks or independent consultants?

Sources: Mizell, L. and D. Allain-Dupré (2013), "Creating Conditions for Effective Public Investment: Sub-national Capacities in a Multi-Level Governance Context", *OECD Regional Development Working Papers*, No. 2013/04, OECD Publishing, doi: *10.1787/5k49j2cjv5mq-en*; Dabla-Norris, E. et al. (2011), "Investing in Public Investment: An Index of Public Investment Efficiency", *IMF Working Paper*, No. 11/37, International Monetary Fund, *www.imf.org/external/pubs/ft/wp/2011/wp1137.pdf*; Milio, S. (2007), "Can Administrative Capacity Explain Differences in Implantation Performances?", *Regional Studies*, Vol. 41, No. 4; Rajaram, A, et al. (2010), "Framework for Reviewing Public Investment Efficiency", *World Bank Policy Working Paper*, No. 5 397, World Bank, Washington, DC, *www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2010/08/09/000158349_20100809092806/Rendered/PDF/WPS5397.pdf* and OECD (2012), "Progress Made in Implementing the OECD Recommendation on Enhancing Integrity in Public Procurement", OECD, Paris, *www.oecd.org/gov/ethics/combined%20files.pdf*.

capacity for providing public services (as along with a composite index). Other countries have undertaken studies which capture dimensions of capacity in a broader context. In Sweden, the state agency "Growth Analysis" studied municipalities' and regions' contribution to regional growth initiatives in an effort to understand their capacities, priorities and constraints (Tillväxtanalys, 2011). In 2007, the United Kingdom conducted its *Review of Sub-national Economic Development and Regeneration*. In Slovenia, municipal management capacity was the subject of academic study in 2008, drawing on a survey of municipal directors.

Assessment should be seen as a learning exercise that reveals where strengths and weaknesses in public investment capacity exist, what might be reasonably expected in terms of contractual obligations in time period *t*, the role of different levels of government in strengthening capacity throughout the investment cycle, and what capacity enhancements might be targeted for period *t*+1. Both a sectoral view and a whole-of-government view, addressing the national enabling environment, including the co-ordination mechanisms discussed in Chapter 2, are critical since cross-sectoral co-ordination and complementarities across investment priorities are fundamental for the place-based impact of public investment.

Towards actions to strengthen sub-national capacity for public investment

The preceding discussion has outlined capacities that can enhance SNGs' efficiency and effectiveness with respect to managing public investment for economic growth and public service delivery. The list is by no means exhaustive but rather highlights capacities that can make a positive impact on the selection, implementation and outcomes of sub-national public investment. It is important to underscore that different types of regions will have different capacity needs and differing arrangements to achieve them. The decentralisation context will play an important role in determining what depth of capacity can reasonably be expected of SNGs. In some cases, it may not be efficient or necessary to require SNGs to maintain certain capacities on their own: what matters is that the key capacities be available when needed, through, for example, shared capacities across a given level of SNGs or the creation of institutions like a central government procurement unit that can assist them. It is crucial that SNGs undertaking public investment pause to review the capacities discussed here, alone or in partnership with higher levels of government, to identify gaps and to seek opportunities to strengthen their capabilities throughout the investment cycle.

Capacity building for sub-national public investment goes beyond a narrow approach restricted to human resources management or workforce improvement activities. Here, capacities have been defined in terms of the institutional arrangements, technical capabilities, resources and policy practices that affect public investment. Thus, a narrow approach to training is unlikely to have the desired, institution-strengthening impact. Capacity development can have the short-term goal of improving specific practices, but should have the long-term objective of improving the quality of key government institutions. For this reason, a systemic perspective is needed that embraces the nature and quality of the institutions involved at all levels of government, as well as relevant parts of the private sector. This will require the SNGs' co-ordination of efforts to "raise their game" with measures by the central government to strengthen the overall implementation environment within which they operate. Across levels of government, then, investing together is thus inextricably linked to the broader challenges of governing together.

Notes

1. The findings presented here are based on seven regional case studies and responses by 22 OECD member countries to the OECD national questionnaire on public investment across levels of government, received as of December 2012. This updates the working paper (Mizell and Allain-Dupré, 2013) from which this chapter is derived, which was based on the first 20 responses to the OECD survey received by July 2012 and 5 regional case studies (Brandenburg, Galicia, Skåne, Victoria and Wielkopolska). OECD regional questionnaire data include one additional region compared to the working paper data (Basilicata). (See Chapter 2 for the methodology.)
2. E.g. comparing and contrasting the administrative capacity of Sicily and Basilicata to spend EU Cohesion Funds, Milio (2007) notes that "[Sicily's] specific characteristics were overlooked. Due to the lack of correspondence between planned interventions and real territorial needs, very few projects were presented requesting Funds… [ultimately] making it almost impossible to spend resources." By contrast, "the programme presented by Basilicata closely adhered to the necessities of the region, and focused on actions that corresponded to subsequent requests and investment of resources by private firms."
3. The World Economic Forum identifies policy and political support as two of eight "key factors in a successful infrastructure project programme" (WEF, 2010).
4. For more on consultation processes, citizen engagement and stakeholder involvement, see OECD (2001; 2004; and 2009a) and International Finance Corporation (2007).

5. See, for example, the 2011 US State of Illinois' "State Rail Plan – Stakeholder Involvement Plan".
6. *http://ec.europa.eu/regional_policy/sources/docgener/guides/cost/guide2008_en.pdf*.
7. Operating and maintenance costs of public investment, which are often underestimated, should be duly considered during the planning and budgeting stages (Rajaram et al., 2010).
8. For an in-depth discussion of indicator systems for regional development policy, see OECD (2009b).
9. See, for example, suggestions in OECD (2009b) as well as Barca and McCann (2011a; 2011b; 2011c;).
10. For a discussion of key considerations for target-setting, see OECD (2009b).
11. This figure is an estimate of bribes paid worldwide. This is only part of the cost of corruption. The figure does not incorporate other direct costs such as embezzlement of public funds, or indirect costs such as the opportunity cost of tainted expenditures, environmental degradation due to lack of regulatory enforcement, etc. (See Kaufmann, 2005, for a discussion of methodology.)
12. The literature on this subject is thoughtfully reviewed in a number of papers. See, for example, Fjeldstad (2004), Kolstad and Fjeldstad (2006) and Shah (2006).
13. Goodspeed's findings (2011) are based on a study of Mexican states.
14. Hall (2008) notes, in reference to the United States, that "insufficient economic development capacity is most prevalent in rural and small communities", with the "more rural the area, the wider the capacity gap in terms of financial resources, expertise, and professionalism".
15. OECD (2012e) based on discussions of a symposium of the same name held on 11-12 June 2012, OECD Headquarters, Paris.
16. The complexity of good *ex ante* appraisal has led some to suggest "dedicated institutional units for project analysis and assessment and network design and management" at the central government level, with similar units at sub-national levels "to assess and judge projects according to nationally set technical guidelines" (UNCTAD, 2009).
17. The institutional context is measured using the Regional Authority Index, a composite indicator measuring the extent to which SNGs with an average population greater than 150 000 exercise formal authority (Hooghe et al., 2009).
18. The degree of fiscal decentralisation is measured using the *OECD's Fiscal Network Database* on sub-national revenue and expenditure indicators.

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ANNEX A

Case study summaries

Basilicata, Italy

Context

The Italian system of public governance comprises the central government, the region, the province and the municipality. The regional administration is responsible for co-ordinating institutional activities, supporting regional development, programming and implementing policies in the health care, social assistance, education and local development sectors, among others. Located in the south of Italy, Basilicata has two predominantly rural provinces, Potenza and Matera, and a large number of small municipalities. The responsibilities of the provinces overlap with those of the region in the area of social services, transport and territorial management. Municipalities have mostly administrative functions.

Historically weak, the economy of Basilicata picked up significantly during the 1990s, with the establishment two multinational industrial plans in the Melfi area and the exploitation of oil and gas. Basilicata's economy begun to slow in 2007 and was hit hard by the crisis in 2008. The recession hit all export-dependent sectors, especially in the automotive sector, which saw a downturn of -13.6% in 2009/10.

Basilicata has a relatively limited financial autonomy, as practically all transfers from the central government are earmarked and even tax revenue is typically assigned to specific purposes. Basilicata's revenues comprise taxes and other own revenues (including royalties from oil and gas), grants for recurrent spending and capital grants from the central government, and to a lesser extent funds from the European Union (EU). Basilicata's expenditure structure reflects its main policy responsibilities, with health accounting for almost half of the total budget. Transfers to local public agencies, including local governments and local health centres/hospitals, account for about 60% of total expenditure, while capital spending represents around 30% (in 2010). As a consequence of the crisis, capital spending decreased sharply between 2008 and 2010 (9.5%) even though the adverse shock was partly cushioned by EU funds. The recurrent budget was also adjusted as personnel expenditures were cut (-6.1% in 2009), reflecting the outcome of a three-year programme to reduce costs in the public administration.

Co-ordination for public investment across levels of government

Basilicata relies on a number of specific national bodies and platforms to ensure co-ordination and dialogue across levels of governments. The Inter-ministerial Committee

for Economic Planning (CIPE), a political decision-making body headed by the Prime Minister, ensures overall co-ordination of the national investment strategy and coherence between regional and national policy priorities. Political dialogue and vertical co-ordination between the regional and national governments is ensured trough the State-Region Conference, a permanent negotiating arena between central and regional authorities. Created in 1997, this conference brings together Italy's regions at least twice a year and plays a key role in influencing the national political debate and decision-making processes on issues of regional importance.

Conditionalities (reporting, timeframes, matching, environmental assessment, earmarking) are commonly required to receive funds from the central government and the EU to finance regional public investment. However, they are perceived by the region as an instrument to reduce freedom without improving the quality/efficiency of public investment. In addition to the use of traditional conditionalities, Italy is piloting an innovative mechanism (*Obiettivi di servizio*) to transfer a part of central government funds to regions. This more flexible performance-based conditionality allocates resources to the most performing regions and incentivizes a more results-oriented attitude towards sub-national authorities. Under this new system, a part of central government transfers (EUR 3 billion for 2007/13) is assigned to regions according to their performance towards quantified targets by 2013. It is expected that Basilicata will meet about 70% of its targets, which will lead to an additional payment of about EUR 146 million.

Italy has a strong tradition of contractual agreements to commit national and regional public administrations to a common framework of interventions. Programme framework agreements, and the more recent institutional contracts (with longer term horizons and encompassing multiple regions), are acts signed by the central and regional authorities that define objectives, sectors and areas for infrastructure development. They provide a clear schedule and well-defined reciprocal commitments to be followed by the region and the central administration to develop specific interventions.

However, important challenges remain in terms of vertical co-ordination. Despite the institutional setting and the development of specific agreements to foster vertical co-ordination, lack of information, weak participation of the region in the priority-setting process and insufficient regional co-financing are still perceived by both regional and central actors as major challenges that hinder regional-central co-operation for public investment.

Basilicata provides successful examples of horizontal co-operation across regions and across municipalities. co-ordinated actions between regions in the south of Italy are needed to implement broad projects in meta-areas. A good example of horizontal co-operation is the Inter-Regional Programme Agreement on Water Management signed in 1999 by Puglia and Basilicata. At the sub-regional level, there is also a long tradition of horizontal co-operation among municipalities, which takes the form of the programming areas (*Unione di comuni*), intermediary institutions grouping adjoining municipalities. Such mechanisms represent an essential tool to reach critical mass, improve public governance, increase the contracting powers of local authorities and involve them in regional decision making.

Capacities at sub-national level

Basilicata benefits from a strong and active regional government and low levels of corruption compared to other regions in the south of Italy. However, administrative capacity challenges exist when it comes to managing public investments. Attracting qualified workers remains a challenge, since salaries and benefits are not competitive with those of the private sector. In addition, the current workforce often lacks the essential skills needed by the public administration. The region has undertaken a set of measures to improve the performance of its public administration, notably the preparation of a more selective and transparent performance-based evaluation system, the mapping of competence gaps and the provision of appropriate trainings to reduce the mismatch between skills and needs.

Regional strategic planning involves the main bodies and stakeholders responsible for decision making in the region, but with limited inclusion of the private sector and financial institutions. The Basilicata Development Plan for 2007-13 and the annual action plan are the result of consultation between the central government and the region and among different actors within the region. However, neither financial institutions nor the private sector are directly involved in setting public investment strategies.

To compensate for the rather small size of its administration, the region looked for innovative public procurement procedures. Basilicata was among the first regions to use a dynamic purchasing system for drugs through e-procurement, provide centralised insurance against clinical risks and set up a central purchasing body for electricity.

Basilicata has invested heavily in monitoring and evaluation to support decision makers. The region has set up a Public Investment Evaluation Unit (NVVIP) responsible for the monitoring and evaluation of all public investments in the region, including impact evaluation of selected projects. Since 2007, Basilicata is also one of the five regions in Italy to rely on the centralised system for monitoring public investment that collects timely data on procedural, physical and financial aspects of the implementation of all public investment projects.

Brandenburg, Germany

Context

The Federal Republic of Germany is marked by a number of government layers, each with distinct autonomy. There are 16 federal states (*Länder*), each headed by a Prime Minister, appointed by the *Land*'s Parliament. Brandenburg became part of the Federal Republic after Germany's reunification in 1990. Its administrative layers include municipalities and districts. Municipalities are responsible for a number of tasks prescribed by the state's communal code, including waste management, spatial planning, day care and local culture. Districts are responsible for cross-municipal tasks which require collaboration across municipalities, such as transport or inter-municipal roads.

Brandenburg's economy has been marked by a difficult economic transition from a communist to an open market economy and still faces challenges in terms of economic development. The transition caused a fall in industrial production and an important loss of jobs (1 million jobs lost by 1995) followed by modest capital investment and an increased reliance on transfers and subsidies from the central government and the EU. The region has, however, a lot of potential and has shown a remarkable dynamism since reunification. It disposes of significant human capital, good public infrastructure and a strong

commitment to strengthen its economic structure, through well-developed innovation strategies.

Brandenburg has fairly limited financial autonomy and is dependent on central government transfers and EU Structural Funds to finance public investment. The German economy was badly hit by the financial crisis (-5.9% of GDP growth in 2009), and both regional and local governments' budgets were negatively affected. With about 60% of current revenues derived from taxes, Brandenburg's financial capacity was severely weakened by the economic downturn. Capital transfers from the central government, by contrast, increased strongly during the crisis, reflecting the stimulus programme initiated by the central government to cushion the shock of the crisis. Borrowing, in particular short-term borrowing, also acted as a budget stabilizer for regional and local governments. On the spending side, the main regional expenditures are mandatory, as they represent legal or contractual entitlements, such as wages or social transfers. This leaves Brandenburg with fairly limited autonomy over its spending decisions. Public investment represented the only potential adjustment variable during the crisis. However, the federal anti-cyclical programme focused on sustaining capital spending, in particular for municipal infrastructures, prevented a drop in public investment at least during the first phase of the crisis (until 2009). Finding new mechanisms to finance public investment will be crucial for Brandenburg in the future as funds from the central government (through its joint tasks) and the EU (Structural Funds) are expected to decrease considerably in the coming years.

Co-ordination for public investment across levels of government

The central government plays a decisive role in determining public investment priorities at the *Land* level. Vertical co-ordination is well established in Brandenburg, with joint tasks and requirements on central government funds the most common tools for vertical co-ordination between the *Land* and the central government. Joint tasks (*Gemeinschaftsaufgabe*) are key contracts for setting priorities and implementing specific policies in close collaboration between the centre and the *Land*. Regional development, including the development of business and infrastructure, are important elements of the joint tasks, which together with EU funds, represent the most important funding for regional development in Brandenburg (EUR 160 million for Brandenburg with a 50% regional co-financing requirement).

Horizontal collaboration across German *Länder* has not been actively encouraged by higher levels of government. Funding mechanisms for public investment defined by the central government tend more to encourage a competitive rather than a collaborative approach between the *Länder*. In addition, EU funding agreements are set up in a way that inhibits joint projects with Berlin. Against these odds, Brandenburg has nevertheless successfully established collaboration with Berlin, notably on spatial planning, innovation and transport programmes. For example, Brandenburg and Berlin have created a joint transport network with a common tariff system, to provide public transport for the metropolitan region of Berlin-Brandenburg.

Horizontal collaboration across local governments has been strongly fostered by Brandenburg. The demographic change in Brandenburg is creating smaller and smaller municipalities that have great difficulties in fulfilling their assigned tasks. In order to increase the efficiency of service provision and induce scale effects, Brandenburg encourages formal and informal collaboration agreements among communes, and provides financial incentives for merging municipalities. In addition, core growth centres

and clusters, grouping a number of municipalities, have been created to focus resources on selected areas and avoid fragmentation.

Capacities at sub-national level

Brandenburg is confronted with administrative capacity challenges at the local level and to some extent at the regional level. In an effort to downsize its public administration, recruitment of new staff has slowed down considerably, which limits the capacity of the region to bring in new expertise in emerging issues such as climate change or sustainable development. The local level lacks skills on various stages of project management (*ex ante* evaluation, procurement or monitoring). The region has well-established capacity support institutions (such the Communal Academy that provides training for communal administrators) and advisory bodies (the regional development bank ILB), which could help to increase the capacity of the public administration and address administrative bottlenecks.

Strategic planning is carried out in consultation with some, but not all, key regional stakeholders. Regional investment priorities are defined in Brandenburg's regional strategy, which was prepared in consultation with all lower levels of government, private actors, NGOs and researchers. Neither regional investment banks nor other financial institutions or citizens were involved in this priority setting process.

The private sector represents an untapped potential to finance regional development and investment priorities, in particular in light of future public funding constraints. Its involvement in investment financing has so far been limited and public-private partnerships (PPPs) have rarely been used, partly because they are believed to be uneconomical and an administrative burden for the communes. The region needs to find innovative ways to finance public investment and partnering with the private sector bears a lot of potential benefits in terms of know-how and increasing the efficiency of public investment processes.

Public procurement is mainly regulated by the centre and some procedures are perceived as excessively administrative. New procedures are being introduced to improve public procurement, such as online bidding, but the process is still perceived as overregulated and producing significant transaction costs. In addition, sub-national capacities for public procurement remain weak.

Even though monitoring and evaluation systems have been well established, evaluations could be carried out more systematically. Brandenburg shows a key commitment to monitoring and evaluating its public investments. The counter-factual evaluation of one of its enterprise's investment programmes is just one example of this. However, there is potential to carry out rigorous evaluations and to streamline monitoring systems more systematically for future public investments.

British Columbia, Canada

Context

Canada is one of the most decentralised countries in the OECD. It is comprised of ten provinces[2] and three territories. Provinces are federal entities with sovereign powers created by the Constitutional Law of 1867. Their competencies are defined by the Constitution and residual powers are the mandate of the federal government. Provinces and territories are gathered in six regions that have no formal administrative or political

powers, that are overseen by six regional development agencies (RDAs). RDAs promote regional economic development. British Columbia belongs to the RDA Western Economic Diversification Canada (WD).

Strategically located on the Pacific coast of Canada, with a fast growing population and sustained economic growth, British Columbia plays a key role in the Canadian economy. The province experienced a period of high and steady growth from 2000-07. After two years of recession (2008-09), it recovered rapidly recording 3% of real GDP growth in 2010. Thanks to its strategic location it has the potential to become an important commercial gateway between North America and the Asia-Pacific region.

Sub-national governments in Canada enjoy great financial autonomy. They are responsible for collecting almost 50% of the country's total tax revenues and for financing more than 90% of public investments. Public investment in British Columbia increased by more than 40% between 2006 and 2010 (supported in part by the central government's stimulus package in 2009), but remains insufficient to meet the municipal infrastructure investment needs. Local infrastructure is mainly the responsibility of the municipalities. Growing urbanisation, the increasing needs of the population and a constrained fiscal environment pose significant challenges. The funding gap for municipal infrastructure is estimated at CAD 10 billion. The second priority for public investment in the province is the development of large strategic investment programmes to increase the commercial position of British Columbia (such as the Asia-Pacific Gateway). They are deemed of national importance because of their impact on competitiveness, job creation and business opportunities, and are the joint responsibility of the province and the central government. They attract important additional financing from the private sector as well.

Co-ordination for public investment across levels of government

Canada has developed a complex system to achieve efficient co-ordination across levels of governments. RDAs play an important mediating role between the provincial and federal governments and across provinces. WD is a department of the government of Canada, with regional offices in each of the Western Canada provinces. It acts as a co-ordination hub across levels of governments and across sectoral policies. It contributes to interpreting and implementing federal policies according to the region's priorities and represents the provinces' interest at the central government level. Two federal institutions, the regional federal councils and the minister regional offices, have been created to further facilitate the co-ordination of federal sectoral policies at the provincial level, share information across levels of governments and represent regional interests and perspectives in the national decision-making process. In addition, various sector-specific councils, such as the Council of the Federation, have been created to co-ordinate sectoral policies among provinces and territories. Most of the institutions created for co-ordination have the double mandate of both vertical co-ordination across levels of government and horizontal co-ordination across sectors.

British Columbia has created a number of institutions to foster horizontal co-ordination between municipalities and reach efficient scale for service provision and public investment. Twenty-eight districts deliver services and joint investment projects for their member municipalities. Membership in a regional district is compulsory for all of the municipalities within its borders. The services covered by a district depend on the specific needs and preferences of its member municipalities. For example, water, waste management, planning and housing are the services provided by the district

Metro Vancouver to its 22 municipalities. British Columbia has also created a number of independent authorities who provide specific public services for the municipalities, such as Trans Link in charge of the public transport system in the district of Vancouver. By providing services to a pool of municipalities, those agencies allow for economies of scale and hence lower prices.

Flexibility is a key characteristic of the Canadian public governance system. Bodies in charge of co-ordination across levels of government have mandates and guidelines that are sufficiently general to allow flexible interpretation and adaptation to local needs. The mandate of the WD, for example, is broadly defined, which allows the organisation to adapt to changing regional needs and economic conditions.

Capacities at sub-national level

Capacity standards, both for public servants and employees of specialised agencies, are very high in British Columbia. Attracting qualified personnel is generally not considered to be a challenge. In addition, the province created a number of institutions (such as Trans Link and Metro Vancouver) with highly specialised and qualified staff. Those institutions support the municipalities in the management of public investment.

Strategic planning for local development could be reinforced. It is often difficult for municipalities to come to agreement on issues related to strategic planning and local development policies due to contrasting interests among local actors. For example, reaching agreement on transport infrastructure priorities in Metro Vancouver has been difficult, since all of the concerned municipalities plead for more public transport in their own areas. To increase the efficiency of strategic planning and base it upon objective criteria, the province decided to assign the task to an independent body (Trans Link). The solution is, however, not optimal as mayors are no longer involved in the elaboration of transport plans.

The private sector is a key partner for public investment in British Columbia. PPPs are frequently used in infrastructure projects, involving the private sector mainly in the design and construction phase such as for the Asia-Pacific Gateway Initiative or the development of the Vancouver Airport. According to regional authorities, there is room to increase the use of PPPs as they represent the most efficient way to finance some infrastructure projects.

Implementation of public investment projects is mostly delegated to an independent agency which contributes to the overall efficiency of public investment management. British Columbia created a non-for-profit private company, Partnership British Columbia (PBC), which is in charge of the planning and design of most investment projects in the province. PBC serves municipalities through the planning, delivery and oversight of major infrastructure projects, also handling PPPs and playing a large role in procurement. It is an autonomous entity relying upon service fees.

Galicia, Spain

Context

Autonomous communities (AC) in Spain have relatively large executive, legislative and regulatory powers. Galicia was among the first regions, in the early 1980s, to achieve the status of AC. It is divided into 4 provinces and 315 municipalities. Until recently, provinces had few political or budgetary powers, but are gaining importance within the regional

framework. Municipalities are key players in the decentralisation process, as they have multiple responsibilities dependant on the size of their population.

Galicia is a sparsely populated, relatively inaccessible region, situated in the west of Spain. Its economy relies mainly on services (45.8% of GDP), industry (12.7%) and construction (10.1%). Galicia experienced important economic growth before the crisis, with a GDP per capita that doubled between 1995 and 2009. It will become an EU "transition region"[3] in 2014.

Galicia's financial capacity has significantly deteriorated since the beginning of the crisis, making it challenging for the region to keep up with its public investment needs. Its revenues – comprised of taxes, transfers from the central government and the EU – and borrowing, were highly affected by the economic downturn. The share of tax revenues in total budget financing dropped from 40% in 2007 to 31% in 2010. Central government transfers, accounting for almost half of Galicia's total revenues, rose over the 2007-09 period due to the Spanish stimulus package, but declined from 2010 onward (-14% in 2010 and -50% in 2011). To compensate, Galicia's debt has risen sharply. External funds, in particular EU funds, have remained relatively stable, but they are expected to decline from 2014 onward, when Galicia will no longer be an EU convergence region (but will become a transition region). On the expenditure side, the main adjustment variable during the crisis has been public investment, cut by 54% between 2008 and 2011. Given its weakened financial capacity, one of the main short-term challenges for Galicia will be to secure investment financing and to improve the overall efficiency of limited resources for public investment.

Co-ordination for public investment across levels of government

Formal agreements are the main tool used by the central government to co-ordinate with the regional government for public investment. Responsibilities for service provision and public investment are delegated to regional and municipal governments in basically all sectors. The central government only keeps responsibility for financing and implementing infrastructures of national importance (airports, inter-regional roads, etc.). However, since transfers from the central government mostly take the form of earmarked grants, the central government plays an important role in regional development and in influencing the long-term strategic planning of regions. Transfers for capital expenditures from the central government to the autonomous communities are managed through bilateral co-operative agreements, called *convenios de colaboracion*, which specify the obligations of both signing parties for developing a concrete project. Galicia signed 65 *convenios* in 2010, mostly in the environment, education and health sectors. *Convenios* are generally negotiated between the region and a central sectoral unit, as cross-sectoral co-ordination remains a major challenge in Spain.

Galicia moved from earmarked to non-earmarked grants to transfer funds from the region to municipalities for local investment projects. Under the previous system, municipalities had to apply to obtain specific purpose grants from the region. The process was somewhat cumbersome, discouraging municipalities to apply for funding. In early 2000, Galicia introduced a new and simplified system of automatically distributing grants (non-earmarked) across municipalities based upon objective criteria such as the number of inhabitants or the surface of the municipality.

The regional government is promoting the use of innovative inter-municipal agreements to improve service provision in a sparsely populated environment and increase the efficiency of public investments. Galicia has developed a new type of contracting ("soft" agreements), allowing municipalities to achieve economies of scale. Financial incentives are used to promote this inter-municipal co-operation, as funding from the region is given in priority to projects involving several municipalities. Galicia is also experimenting "hard" inter-municipal co-operation, enforcing collaboration through law, to improve efficiency in the provision of services (transport, water, social services) among the 14 municipalities in the Vigo area.

Capacities at sub-national level

Capacity challenges for public investment have arisen due to an absence of qualified personnel in the regional administration. Galicia reports difficulties in attracting skilled staff as the regional government cannot compete with the salaries and carrier evolution offered by the private sector. To overcome this problem, Galicia created several public agencies (for example the Galicia Infrastructure Agency created in 2011) that can hire professionals from private companies and experts. Those agencies are less bureaucratic than traditional administrations, and rely on qualified staff whose contracts are performance-based. They are expected to promote a more efficient system of management for regional public investment focused on objectives and monitoring results.

A key strength in Galicia's strategic planning is the capacity to engage different stakeholders, in particular citizens, civil society actors and to a lesser extent the private sector, in defining regional priorities. Citizens are involved in the development of both the regional strategy and sectoral plans. The private sector is less involved in planning public investments. Its involvement is also weak in financing public investments. PPPs have not been used much in Galicia and their use is not expected to increase in the near future since access to funding by private companies has become more difficult and more expensive to obtain since the crisis.

To render the implementation of public investment and the provision of public services more efficient and transparent, Galicia has recently introduced several new measures, particularly on procurement. The creation of a web-based platform for the development of online procurement systems is expected to have a positive impact on the efficiency and transparency of public investment. The platform improves access to information and reduces contracting costs for municipalities, especially small ones.

Galicia is making important progress in the use of performance monitoring and evaluation tools, which are, in general, not extensively used for investment projects in Spain. The regional government aims to modernise the management of public investment from a mere expenditure control to actual output and outcome achievements, by establishing budget performance indicators. This process aims to improve budgetary management and efficiency and identify inefficient expenditures in a context of crisis and fiscal austerity.

Region Skåne, Sweden

Context

The regionalisation process in Sweden started relatively recently, in the late 1990s, driven by the objective of maximising Sweden's growth potential. In a context of significant

territorial heterogeneity, the formation of the regions addresses the need to put local actors in charge of elaborating regional development strategies tailored to local needs and mobilising resources for regional growth. The current Swedish system of public governance comprises the central government, the county/region and the municipality. A distinct feature of the Swedish system is its "hourglass" configuration: the central government and the municipalities hold the majority of powers and functions, while the powers of the county/region, and especially their financial capacity, remain relatively limited. Skåne is one of the 21 Swedish counties, officially referred as a region since 2010 due to its additional responsibilities.[4]

Skåne is home to 13% of Sweden's total population and its economy contributes 12% to Sweden's aggregate economic output.[5] The region was hit particularly hard by the onset of the financial crisis in 2008 but it recovered quite quickly and its economic performance in 2009 appeared relatively healthy compared to the Swedish average.

In the Swedish system, regions enjoy limited discretion over spending; financing and implementation of public investment remains essentially a central mandate. The region's revenues are comprised of own revenues (tax and operating revenues) accounting for almost 80% of the resources available for regional public spending, transfers from the central government in the form of grants and equalisation transfers accounting for about 20% of resources, and limited borrowing (bank loans mainly with the European Investment Bank). Regional public expenditure in Skåne is confined to the health sector, which represents 93% of overall public expenditure. Health spending is a mandatory item and leaves the region with little room for manoeuvre for other spending options. Public investment only makes up 7% of Skåne's expenditure (2011). Core "hard" (e.g. transport) and "soft" (e.g. higher education) infrastructure investments remain the responsibility of the central government.

Co-ordination for public investment across levels of government

In a context of weak regional autonomy in public investment financing, strong vertical engagement with the central government has been crucial for the region to ensure that regional investment priorities are taken into account by the central government. Given its limited formal powers, Skåne has used its regional human resources to create informal links and networks across levels of government and to lobby for its own agenda at the central level. In addition, to incentivise the central government to invest in the region, Skåne closely aligned its regional sectoral strategies to the central sectoral plans. For example, 80% of regional infrastructure investment decisions are taken by the central transport authority according to the national infrastructure plan, which in turn is developed by incorporating priorities specified in the regional plans. Negotiation and co-ordination with the central transport administration has become a key success factor in making projects happen. The Malmö-Simrishamn rail connection, for example, was not initially a priority for the national authority but thanks to the efforts of the region and its co-financing of *ex ante* assessments, the project was implemented. Even if the amount of co-financing provided by the region is marginal, its co-ordination role proved to be crucial.

Crucial vertical co-ordination for public investment has also taken place between the region and the municipalities, as well as between the region and inter- and supranational levels. Vertical co-ordination between the region and the municipalities was key in elaborating the regional transport plan. Although municipalities are very often not the final decision makers for specific projects, their inclusion in the process has proved crucial.

For example, some of Skåne's municipalities blocked the expansion of the railway link between Malmö and Stockholm because of the negative environmental externalities they would have incurred. The region was able to mobilise its own regional resources to co-finance measures to address these problems, which avoided stalling the project at higher levels. Vertical co-ordination with supranational platforms has been equally important, in particular in the transport sector. Platforms have been used to foster collaboration among countries and co-ordinate international transport priorities. The European Transport Network and the EU's INTERREG initiative are examples of a supranational platform for the development of certain transport projects across countries (Denmark, Germany and Sweden), in which Skåne has been a key player.

Horizontal collaboration at regional and sub-regional level has a long tradition in Sweden. Local federations consisting of several municipalities or counties have been used as an instrument to achieve cost efficiency for service delivery, in particular in the sectors of education, rescue services and environment/construction. Inter-regional collaboration has been of crucial importance in the transport sector, particularly for projects that increase the connectivity between the south of Sweden and its capital. Skåne has an incentive to co-ordinate horizontally with other counties across the South Sweden Region, as the joint weight they are able to give shapes the negotiations at the national level.

Horizontal co-ordination across the Öresund region (Sweden and Denmark) is equally important. The Öresund Committee was created as an official platform to foster regional co-operation and to lobby for the wider Öresund region's interests in both countries. However, despite the common economic interests, the co-ordination across the Öresund faces some difficulties due to the difference in policy-making processes, planning horizons and cultures between the Swedish and Danish regions.

Capacities at sub-national level

To support the entire investment cycle, Skåne benefits from an engaged and qualified workforce, comprised of about 32 000 staff employed by the region. Qualified staff have been attracted by a reward-based payment mechanism and incentives such as training or additional pensions/health care support. However, public employees that have reached a certain level of expertise have often become attractive for the private sector causing significant turnover of staff in the regional administration.

Skåne has strong competencies in strategic planning and has developed its regional programme in an exemplary manner. The aim of the regional programme, developed in collaboration with all affected stakeholders, has been to bring together investment priorities in a harmonised approach so to maximise the outcome for the region. The main challenge of the regional programme relies on the little power the region has over actual implementation and financing. In addition, the involvement of the private sector, which represents an alternative source of finance as well as a means for improving the entire project process, has so far been quite limited.

Public procurement is administered at the regional level. Region Skåne has an important procurement service with highly specialised staff including an innovation team that seeks to foster innovation in the public procurement process in order to improve efficiency and maximise economies of scale.

Evaluation (*ex ante* and *ex post*) remains a fairly centralised task. *Ex ante* project appraisal, such as cost-benefit analyses and environmental assessments, is generally a

centrally organised process carried out in a time-consuming way at the national level. Efforts at evaluating the regional development strategy are also conducted at the regional level in the form of citizen surveys or user feedback mechanisms.

Victoria, Australia

Context

The Australian system of public governance comprises three tiers of government: the central government (the Commonwealth), the states (six states and two territories) and the municipalities. Each state, led by an elected Parliament, is sovereign according to its Constitution and principally responsible for delivering its own infrastructure and public services. The powers of municipalities are mainly confined to town planning and local services.

Victoria is the second largest economy in Australia, contributing around a quarter of the nation's GDP, and the second most populous state, with about 5.5 million inhabitants living mostly in the capital city, Melbourne. Despite the lack of mineral resources, compared to other states, Victoria remains well-positioned to provide services to other parts of the Australian economy and to foreign markets. With high-quality infrastructure, a skilled service sector and a competitive business environment, Victoria continues to attract qualified migrants and new businesses.

Australian states are responsible for setting their investment priorities, but given their limited tax powers, they depend to a large extent on funding from the Commonwealth to finance them. About 46% of Victoria's total revenue is obtained from Commonwealth grants, half of which takes the form of generic purpose grants with the remaining specific purpose payments (SPPs) that cover five broadly specified areas: health, housing, school, vocational education and training, and disability services. SPPs give the state enough flexibility to manage its own budget and finance its investment priorities, while leaving the central government general oversight over regional investment. Compared to other Australian states, Victoria receives a smaller share of Commonwealth grants, relying more on its own limited tax base. Given the increasingly constrained fiscal environment following the impact of the financial crisis, one of the main challenges for Victoria in the near future will be to maintain and increase its investment in infrastructure (particularly transport and water supply) to meet the needs of a continuously growing population.

Co-ordination for public investment across levels of government

Victoria is responsible for setting its own strategic infrastructure priorities in consultation with concerned stakeholders. Public consultative processes allow for priorities to be selected and assessed; engagement with citizens and business is generally an important component for project development and delivery. An example is given by the water resource planning, developed with extensive community involvement and public consultation.

Through the introduction of the Intergovernmental Agreement on Federal Financial Arrangements (IGA) in 2008, the central government is promoting a more "hands-off" approach to regional public investment. The IGA defines the terms of collaboration between the central government and states for the use of (specific purpose) Commonwealth funds. The agreement was introduced in 2008 to substitute a previous framework under which payments were very specific and directive, and funding was

divided across more than 90 separate agreements. Its main objective is to reduce the degree of fiscal control at the national level and devolve increased responsibilities to the states. The IGA makes limited use of conditionalities attached to central government funding and gives the state government the discretion to develop its own public management practices for the implementation of investment projects.

In parallel to the IGA, national partnership agreements (NPAs) have been developed for vertical, joint investment in projects of national significance. Their use was supposed to be limited in order to avoid excessive oversight and control by the Commonwealth. However, the Victorian government reports a proliferation of these separate small agreements, increasing considerably the transaction costs, the bureaucratic burden and the control of the central government.

The central government created an advisory body, Infrastructure Australia (IA), to co-ordinate with the states for investments of national importance. The body was established in 2008 to advise the central government on investment priorities in the transport, communication, water and energy sectors and to help states identify infrastructure projects that are a national priority. IA assesses the states' applications for funding under the Building Australia Fund (BAF), the Commonwealth's main mechanism to finance critical infrastructure projects. Victoria was able to prepare sound business cases and received AUD 3.2 billion from the BAF to finance its regional rail link project.

The large distances separating population centres across Australia mean that horizontal co-ordination across states is not always necessary. Few examples exist where collaboration between states for investment projects is required, such as the management of the Murray Darling River Basin, which covers three states and where the activities of one state impact on another. The central government plays a key role in supporting the development of collaborative investment models and providing funding for those types of inter-regional projects.

Capacities at sub-national level

The Victorian public sector capacity for developing and managing public investments has improved in recent years. The Victorian Department of Treasury has been instrumental in developing overall institutional capacity for infrastructure investment, providing central quality assurance and control (including for procurement processes and PPPs), as well as process guidance and research. It also facilitated access to experienced technical staff for departments dealing with unusually big projects.

Victoria has been a pioneer in PPPs and in the use of other forms of innovative collaboration agreements with the private sector for regional investments. Since PPPs were first used in the state in 2000, they have comprised 10% of infrastructure investment. The state has established Partnership Victoria as a source of standard guidance and policy development for PPPs. One feature of the PPP business case development process is the requirement that each project establish a "Public Sector Comparator" (PSC) – an independently verified cost estimation of the project assuming conventional contracting. The PSC serves as a benchmark for assessing the value for money of the PPP proposal. Alliance contracting is a method of procuring and managing complex investment projects in collaboration with the private sector. It is characterised by less-specific obligation and enforcement mechanisms and for this reason it is used particularly when uncertainty makes it difficult to specify "hard" transactional contracts. Alliances are extensively used

in Australia but a recent study shows that they are often applied in circumstances where more conventional contracting approaches (less costly) could be more suitable.

In Victoria, strong *ex ante* monitoring mechanisms are in place, especially through an innovative High Value/High Risk (HVHR) process used for certain investments. Under the new HVHR introduced 2010, investment projects with a value above a defined threshold or which are deemed to be high risk undergo rigorous scrutiny and approval processes, with increased oversight over various stages of investment development, procurement and delivery. The focus of this new process is to enhance *ex ante* control, improving the business case for major investments. The business case process also includes the development of performance indicators, creating the basis for monitoring infrastructure performance after implementation. *Ex post* evaluation has not been extensively used, in particular to evaluate the overall performance of PPPs.

Wielkopolska, Poland

Context

The recent regionalisation process in Poland brought wide-ranging responsibilities to the regional authorities but relatively limited financial capacity. Like many countries in Central and Eastern Europe, Poland's administrative system was very centralised until the early 1990s. Over the past two decades, Poland has embarked on significant decentralisation and regionalisation reforms, which resulted in the establishment of the most decentralised territorial system among the "new" EU member countries. The Wielkopolska region was established in 1999, comprising 35 districts and 226 communes. The regional authorities are responsible for elaborating public investment policies and implementing public investment at the regional level. Fiscal decentralisation has not been implemented at the same pace as decision-making autonomy, which means the regions are still fairly dependent on the central government to finance investment activities.

Wielkopolska is one of the fastest growing regions in the OECD, whose fiscal situation proved quite resilient to external shocks. GDP per capita increased by about 40% from 2000-09. The regional economy is diversified and export oriented. It benefits from easy access to Western markets, in particular Germany and, thanks to the low cost of its labour force, it attracts substantial volume of foreign direct investment (FDI). The region's revenue consists of shares of the personal and corporate income taxes, central government transfers and grants, as well as transfers from EU Structural Funds. Stable corporate tax revenues, as well as special central government transfers during the crisis cushioned the impact of other tax losses.

The spending structure of the region reflects its main policy responsibilities. Transport spending makes up around 38%. Almost all spending categories were affected by the crisis in 2009 but recovered quickly in 2010/11. Public investment has increased considerably over the past years, supported by an important volume of EU Structural Funds. The regional investment strategy (Regional Operational Programme 2007/13 – ROP) is, in fact, funded chiefly (at 75%) from the European Regional Development Fund (ERDF).

Co-ordination for public investment across levels of government

The Polish system of vertical co-ordination for regional public investment relies on a number of central level institutions that, given its relatively recent institutionalisation, still poses challenges. In 2007, regional authorities became responsible for the development

and implementation of their ROPs and the management of EU Structural Funds. The co-ordination needs that come along with the increased distribution of powers across levels of government are handled by the Department for co-ordination and Implementation of Regional Programmes within the Ministry of Regional Development, with the support of special central level institutions (such as the Committee for co-ordination of the National Development Strategy, the Committee of the National Strategic Reference Framework or the Monitoring Committee). Their role is to ensure complementarity with the national sectoral programmes and to avoid duplication among projects implemented by different levels of government. As the Polish regionalisation process is relatively recent, the institutionalisation of this multi-level system of co-ordination for public investment is still in progress and challenges in terms of complementarities of programmes and issues of competencies are still arising.

Contractual agreements for the use of central government funds are the primary tool for vertical co-ordination in public investment. Regional contracts, in use since 2000, determine the modalities for the use of the central government transfers offered to regions for the implementation of their ROPs. Despite occasional cuts in the funds because of changes in the state's budget, the experience with the regional contracts to date has been positive. They have provided a stable and multi-annual framework for vertical co-ordination, making it possible for the regions to complete long-term investment plans.

Horizontal co-ordination between municipalities appears to be increasingly popular but still faces some obstacles. A growing number of municipalities are engaged in associations in order to pool resources and reduce the cost of investments to respond to common needs. An example is the National Programme for the Extension of Local Roads 2008/11 that promotes collaboration between neighbouring districts and municipalities for road investment projects. Limited inter-institutional trust, lack of institutionalised mechanisms and lack of guidance in setting up partnerships are among the main obstacles for effective inter-municipal/regional collaboration.

Information asymmetries are reported as being one of the main challenges for co-ordination among levels of government, and are particularly prevalent in some sectors. Spatial planning requires that decisions taken at the regional level be in line with the planning priorities determined by the central government. However, flows of information between the two levels of government remain deficient, obliging the region to interact one by one with each individual level and unit whose activities have an impact on regional land-use plans. This situation should be addressed as significant risks and planning conflicts could arise, potentially impeding the region's future development.

Capacities at sub-national level

The capacity of the regional public administration in designing and implementing public investment has increased significantly since 2007, when the region became the managing authority for ROP. The team of officials dealing with regional development policy increased from 12 to 250 people in 2007. Over time, this team has accumulated extensive experience thanks in part to the substantial EU funding for training courses. At the local level, on the contrary, capacities remain limited as municipalities struggle to attract skilled employees due to the low salaries they offer.

The region developed a sound investment strategy in consultation with relevant stakeholders, including the private sector. The regional development strategy and the ROP

(2007-13) were elaborated by the regional authorities in consultation with lower levels of government and other stakeholders, including higher level education and research institutions, as well as enterprises operating in the region. The region proved to be particularly pro-active in promoting the involvement of the private sector in the design and financing of investment projects. Albeit limited in number, there have been interesting and innovative PPP initiatives for urban development, for example for the revitalisation of post-industrial areas. These are in an early stage of implementation as part of the EU JESSICA initiative. The use of PPPs is, however, limited by an inadequate legal framework and low levels of trust.

Public procurement remains a major challenge in the implementation of public investment. The legal framework for procurement has changed repeatedly in recent years, forcing investors to adjust their procedures and thus generating additional costs. The audit process of public tenders, extremely rigid and cumbersome, is also perceived as a major obstacle to the smooth implementation of public tenders.

Monitoring and evaluation tools for the regional development strategy and regional investment projects have been developing rapidly since 2007. Progress in the implementation of the regional development strategy is monitored on a biennial basis according to a set of indicators defined for each of the strategy's priorities, and the ROP for 2007-13 is monitored on an ongoing basis by the regional Monitoring Committee. There is also a growing emphasis on impact evaluation, and Polish evaluation studies are often presented as an example of "good practices".

Notes

1. For the full case study, please see *www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm*.
2. The term "province" in Canada refers to the level of government immediately below the central/federal level. "Region" refers to geographical areas comprised of several provinces (with neither political power nor administrative responsibilities). "Territories" are administrative divisions created by law by the federal government, which enjoy a number of legislative rights.
3. Average level of per capita GDP between 75% and 90% of EU average.
4. Skåne emerged as a "pilot region" in 1997 bringing together the former counties of Malmohus and Kristianstand and was institutionalised in 2010.
5. 2007 figures.

ANNEX B

National and regional questionnaires

OECD national questionnaire: Multi-level governance of public investment

1 Multi-level governance of public investment: Sectoral context

Before completing the first part of this questionnaire, please indicate the sector (and if applicable define the sub-sector, such as renewable energy in the environment sector) to which your answers will correspond:

☐ Transport – if you choose to respond to a narrower sub-sector category (or investment strategy), *please specify*: _____
☐ Innovation – if you choose to respond to a narrower sub-sector category (or investment strategy), *please specify*: _____
☐ Environment – if you choose to respond to a narrower sub-sector category (or investment strategy), *please specify*:
☐ Regional development

Please keep in mind that your answers to all of the remaining questions will be understood with respect to the sector you have chosen above

1. If possible, please indicate how much (in approximate % or approximate absolute values) this sector's share of public investment represents in comparison to the total budget for public investment in your country?

2. How has the use of certain types of financial sources used for your sector's public investment on the sub-national level changed over the last five years?

Sources of funding for public investment on sub-national levels	*Have increased*	*Have stayed more or less the same*	*Have decreased*	*Don't know*
Borrowing by sub-national governments	☐	☐	☐	☐
Issuing bonds				
Earmarked transfers from the central government to sub-national governments for public investment	☐	☐	☐	☐
User fees	☐	☐	☐	☐
Public Private Partnerships	☐	☐	☐	☐
Local taxes	☐	☐	☐	☐
Funding from supra-national organizations, such as EU Cohesion/Structural Policy Funds	☐	☐	☐	☐
Use of new types of funds to finance public investment	☐	☐	☐	☐
Other, *please specify*: 1. _____	☐	☐	☐	☐
2. _____	☐	☐	☐	☐

1.1 Requirements and incentives attached to public investment funding

3. Do the central or supra-national levels in your chosen sector attach explicit requirements to public investment funds allocated to sub-national level governments in order to have access to funds? – *Check all that apply.*

☐ Yes, the central level attaches such requirements
☐ Yes, the supra-national level attaches such requirements
☐ No **(go to Q.8)**
☐ Don't know **(go to Q.8)**

4. Which of the following types of requirements are attached to central sectoral funds provided to regional/state governments (or municipalities in countries which do not have regional tiers)? – *Check all that apply.*

Type of requirement	*Check all that apply*
Reporting requirements	☐
Timeframe of spending	☐
Matching requirements	☐
Additionality requirements (i.e. funds should not substitute for planned investments made by sub-national governments)	☐
Use of *ex ante* economic evaluation tools (cost-benefit, cost effectiveness, or multi-criteria analyses)	☐
Use of environmental impact assessment	☐
Earmarking all or parts of grants to specific thematic priorities	☐
Implementation of certain reforms, legislation, or regulations	☐
Involvement of private sector/firms in design of public investment strategies	☐
Involvement of private sector/firms in financing public investment strategies	☐
Project needs to involve several municipalities (minimum municipal or inter-municipal size for authorising the project)	☐
Other - *please specify*: 1. _____	☐
2. _____	☐

5. How (if at all) has the use of mechanisms such as those listed in question **Q4** above changed since the onset of the financial crisis in 2007-08? – *Please describe.*

6. What have been the main challenges encountered in the use of such requirements/mechanisms?

Challenges	*Is a major challenge*	*Is somewhat a challenge*	*Is not a challenge*	*Not applicable*
The requirements are too demanding	☐	☐	☐	☐
The requirements are not effective in improving the quality/efficiency of public investment	☐	☐	☐	☐
The stated requirements are not applied or effectively enforced in practice	☐	☐	☐	☐
The stated requirements involve significant additional administrative burden	☐	☐	☐	☐
The mechanisms applied unduly constrain the freedom of sub-national levels to undertake investment projects or programmes	☐	☐	☐	☐
Other, *please specify*: 1. _____	☐	☐	☐	☐
2. _____	☐	☐	☐	☐

7. What, if any, have been the main benefits of using such requirements? *Please illustrate with examples of good practices, if possible.*

1.2 Performance monitoring

8. Do central levels or supra-national authorities monitor the use of public investment funding in your sector that goes to sub-national governments over the course of implementation? – *Check all that apply.*

☐ Yes, central sectoral level conducts monitoring
☐ Yes, supra-national levels conduct monitoring
☐ Yes, sub-national governments conduct monitoring
☐ No, monitoring is not conducted at any level **(go to Q.11)**
☐ Don't know **(go to Q.11)**

9. Are performance indicators used in the context of such monitoring?

☐ Yes
☐ No
☐ Don't know

10. Are target values for the performance indicators defined for certain or all public investment projects/programs?

☐ Yes
☐ No
☐ Don't know

11. Are impact evaluations of the use of public investment resources conducted in the sector studied?

☐ Yes, always
☐ Yes, sometimes
☐ Yes, rarely
☐ No
☐ Don't know

1.3 Co-ordination across levels of government

12. What are the main mechanisms in your sector for co-ordinating the prioritisation and implementation of public investment between central and sub-national levels? – *Check all that apply.*

☐ Specific sectoral body in charge of national - sub-national co-ordination – please provide name
☐ Specific national body in charge of national – sub-national co-ordination
☐ Specific forum gathering sub-national governments
☐ Contractual arrangements across levels of government
☐ Central sectoral level representatives appointed to sub-national levels
☐ Don't know
☐ Other – please specify:

13. To what extent do the following challenges confront your sector with respect to co-ordination of public investment between central and sub-national levels?

Challenges	*Is a major challenge*	*Is somewhat a challenge*	*Is not a challenge*	*Not applicable*
Lack of information at the central level regarding existing sub-national projects/needs	☐	☐	☐	☐
Lack of engagement by the sub-national levels in the priority setting process for public investment	☐	☐	☐	☐
Insufficient financial resources at sub-national level to co-finance investments	☐	☐	☐	☐
Lack of involvement of private sector actors/firms	☐	☐	☐	☐
Regulatory and administrative obstacles to co-ordinate between central and sub-national levels	☐	☐	☐	☐
Lack of capacities at the sub-national level to implement investment projects	☐	☐	☐	☐
Lack of information of sub-national actors on central government investment priorities	☐	☐	☐	☐
Other – *please specify:* 1. _____ 2. _____	☐ ☐	☐ ☐	☐ ☐	☐ ☐

1.4 Horizontal co-ordination across sub-national levels

14. Are mechanisms or incentives in place in your sector to encourage co-operation for public investment projects or programmes (horizontally) across sub-national authorities? *Check all that apply.*

    ☐ Yes, there are mechanisms to encourage co-operation among regions/states
    ☐ Yes, there are mechanisms to encourage co-operation among municipalities
    ☐ No **(go to Q.19)**
    ☐ Don't know **(go to Q.19)**
    ☐ Other, please specify:

15. What types of mechanisms or incentives are they? – *Please describe type and applicability in terms of level of government. Please indicate, in particular, if horizontal co-ordination is linked to financial incentives (for example, higher central government financing may be available for multi-region or multi-city projects).*

16. What are the main challenges in promoting collaboration horizontally across sub-national levels for public investment programs/projects? – *Please describe.*

17. If possible, please select one example of good practice to enhance horizontal co-ordination across sub-national governments (regions or municipalities) and provide details about why it is successful:

18. (*For EU countries only*) What are the main governance differences between the management of public investment received from EU funds, and national sources of investment? *Please describe.*

2 Multi-level governance of public investment: National context

The second part of this survey aims at understanding the multi-level governance dimensions of public investment as a whole in your country. This section seeks to investigate specifically the measures in place to co-ordinate cross-sectorally for public investment projects or programmes ***across levels of government****.*

Please keep in mind that your answers to all of the remaining questions will be understood with respect to multi-level governance of public investment in general, and not simply with respect to any specific sector.

2.1 Policy background

19. Is there a national-level, strategic guidance document in place that sets out priorities for public investment **across levels of government**? *Check all that apply.*

    ☐ Yes, cross-sectoral national plan, strategy or similar
    ☐ Yes, different sector-level plans, strategies or similar
    ☐ No **(go to Q.22)**
    ☐ Don't know **(go to Q.22)**

20. Is the guidance multi-annual in its nature?

    ☐ Yes, *please specify how many years it usually covers:*
    ☐ Don't know
    ☐ No

21. To what extent is the national guidance relevant to regional/state governments (or municipalities in countries which do not have regional tiers)?

    ☐ It provides concrete mandatory requirements for sub-national governments.
    ☐ It is used as general policy guidance based on which more detailed sub-national guidance documents are elaborated.
    ☐ It does not affect sub-national policy making processes regarding public investment.
    ☐ Don't know
    ☐ Other, *please specify:*

2.2 Co-ordinating public investment at the national level

22. Are mechanisms or incentives in place to encourage co-operation for public investment projects or programmes (horizontally) across sub-national authorities? – *Check all that apply.*

    ☐ Yes, there are mechanisms to encourage co-operation among regions/states
    ☐ Yes, there are mechanisms to encourage co-operation among municipalities
    ☐ No **(go to Q.24)**
    ☐ Don't know **(go to Q.24)**
    ☐ Other, *please specify:*

23. What types of mechanisms or incentives are they? – *Please describe type and applicability in terms of level of government. Please indicate, in particular, if horizontal co-ordination is linked to financial incentives (for example, higher central government financing may be available for multi-region or multi-city projects).*

24. What governance instruments are there to foster vertical ***(between national and sub-national levels of government)*** co-ordination of public investment? – *Check all that apply*.

☐ There is one specific institution rather than authority? in charge of national/sub-national co-ordination – *Please provide name of authority:*
☐ There are several sectoral authorities – *Please provide examples of authorities:*
☐ Contractual arrangements/partnership agreements across levels of government
☐ Don't know
☐ No
☐ Other, please specify:

25. For which sectors/policy areas does ***vertical*** (across national/sub-national) co-ordination appear to work well and why? – *Please describe.*

2.3 Sub-national capacity

26. To what extent are the following challenges for sub-national governments in the governance and administration of public investment?

Challenges	*Is a major challenge*	*Is somewhat of a challenge*	*Is not a challenge*	*Not applicable*
Weak long term strategic planning for public investment; a focus on short term priorities	☐	☐	☐	☐
Views of municipalities prevail over regional priorities	☐	☐	☐	☐
Sectoral priorities dominate over integrated approach	☐	☐	☐	☐
Insufficient evidence-based investment policy (lack of economic research on regional needs)	☐	☐	☐	☐
Administrative obstacles and red tape	☐	☐	☐	☐
Difficulty of involving private firms	☐	☐	☐	☐
Fraud/corruption in public procurement at the sub-national level	☐	☐	☐	☐
Weak capabilities for administering public-private partnerships	☐	☐	☐	☐
Lack of fiscal discipline				
Insufficient resources (e.g. staff) to design and monitor strategies	☐	☐	☐	☐
Lack of performance monitoring of investment strategies	☐	☐	☐	☐
Lack of *ex post* impact assessment	☐	☐	☐	☐
Other – *please specify*: 1 .	☐	☐	☐	☐
2.	☐	☐	☐	☐

27. What types of policies have been implemented in the past 5-10 years (or are currently being planned) by the national level to enhance sub-national capacities? – *Please describe one or several recent policy examples in the table below.*

Policies implemented by the national level to enhance sub-national capacities	*Implemented in past years*	*Currently planned*	*Not applicable*	*Please explain*
Policies linked to sub-national **public employment systems** (staffing, recruitment, performance management, mobility)	☐	☐	☐	_____
Policies linked to **sub-national finances** (reform in local finances, tax system, grants, equalisation, etc.)	☐	☐	☐	_____
Policies linked to **sub-national budget procedures** (requests to publish accounts more regularly, stricter accounting procedures, and performance budgeting, multi-year budgeting, etc.)	☐	☐	☐	_____
Policies linked to **sub-national fiscal rules** (tightening fiscal rules, borrowing conditions, expenditure limits, etc.)	☐	☐	☐	_____
Policies linked to **regulation for sub-national governments** (reduction of the stock of regulation, harmonisation of regulation, use of regulatory impact assessment, etc.)	☐	☐	☐	_____
Policies linked to **public procurement** (simplification of procurement procedures, technical assistance for contract management capacity, etc.)	☐	☐	☐	_____
Policies linked to **strategic planning** (guidance to establish regional development strategies, contracts/partnerships across levels of government, etc.)	☐	☐	☐	_____
Policies linked to **involvement of private actors** (new rules for PPPs, removal of bureaucratic constraints in key areas for SNGs such as land use, etc.)	☐	☐	☐	_____
Other, *please specify*: 1. _____	☐	☐	☐	_____
2. _____	☐	☐	☐	_____

28. If you would like to explain any of the above interventions in more detail, please describe here.

29. In the past, has the national government carried out any kind of systematic assessment of the variations in governance capacities (e.g. human capital/finances) across sub-national (regional or municipal/local) authorities?

☐ Yes **(please complete question 30)**
☐ No
☐ Don't know

30. Please provide a very brief description or name the document/website link in which such an assessment was reported.

If there is anything you want to add to the questionnaire that you deem important to the subject but not sufficiently covered, please feel free to add it here and/or send us any additional information through email.

OECD regional questionnaire: Multi-level governance of public investment

1. Key facts: Public finances and public investment in your region

1. What was the latest approximate share of public investment spending by the region in % of regional GDP?
   % and (fill in year)

2. Has this share changed over last five years?

   ☐ Share has increased
   ☐ Share has decreased
   ☐ Share has remained the same
   ☐ Don't know

3. From the total regional public investment spending, how much (in %, approximately) is co-financed by the national level?
   % and (fill in year)

2 Co-ordination for public investment across different levels of government

2.1 Vertical co-ordination (between the region and the national government)

4. Do the policies defined for public investment on the central/national level affect the regional priority setting process?

   ☐ Yes, to a significant extent
   ☐ Yes, to some extent
   ☐ No
   ☐ Don't know

5. Is your region involved/consulted in the central/national policy making process for public investment priorities for regional development?

   ☐ Yes
   ☐ No
   ☐ Don't know

6. Are requirements attached to public investment funds received from the central level in order to secure or retain access to funds? (Examples might include the implementation of specific policy or institutional actions, or the achievement of performance targets.)

   ☐ Yes, to all of the funds received
   ☐ Yes, to some of the funds
   ☐ No (**go to Q.10**)
   ☐ Don't know (**go to Q.10**)

7. Which of the following specific requirements are attached to funds received from the central level? – *Check all that apply.*

Requirement (select all that apply)	*All transfers*	*Sectoral transfers*			
		Transport	*Environment (e.g. water)*	*R&D, innovation*	*Regional development*
No requirements ever attached	☐	☐	☐	☐	☐
Timeframe for spending (i.e. deadline in the allocation of funds)	☐	☐	☐	☐	☐
Matching requirements	☐	☐	☐	☐	☐
Additionality requirements (i.e. funds should not substitute for planned investments by regional administrations)	☐	☐	☐	☐	☐
Use of *ex ante* economic evaluation tools (feasibility study, cost-benefit, cost effectiveness, or multi-criteria analyses)	☐	☐	☐	☐	☐
Use of environmental impact assessment	☐	☐	☐	☐	☐
Earmarking all or parts of grants to specific thematic priorities	☐	☐	☐	☐	☐
Implementation of certain reforms, legislation, or regulations; capacity building	☐	☐	☐	☐	☐
Involvement of private sector/firms in design of public investment strategies	☐	☐	☐	☐	☐
Involvement of private sector/firms in financing public investment strategies	☐	☐	☐	☐	☐
Other - *please specify*: 1.	☐	☐	☐	☐	☐
2.	☐	☐	☐	☐	☐

8. Has the use of requirements and conditions such as those listed in Q.7) increased since 2007?

☐ Yes
☐ No
☐ Don't know

9. How would you judge the performance of those requirements along the following statements?

The central government requirements attached to public investment funds…	*Agree strongly*	*Agree somewhat*	*Don't agree*	*Don't know*
…can be fulfilled by the regions	☐	☐	☐	☐
… have improved the quality of public investment projects	☐	☐	☐	☐
… are effectively enforced	☐	☐	☐	☐
… do not impose additional administrative efforts	☐	☐	☐	☐
… do not constrain the freedom of region to undertake investment projects or programmes	☐	☐	☐	☐
… facilitate rapid design of investment projects	☐	☐	☐	☐
…facilitate co-ordination between the central and the regional administrations	☐	☐	☐	☐
…facilitate co-ordination within the regional administration	☐	☐	☐	☐
…accelerate execution by firms	☐	☐	☐	☐
…are very demanding in terms of time	☐	☐	☐	☐
…limit the freedom of region to allocate investments	☐	☐	☐	☐

10. What are the main challenges with respect to co-ordination of public investment between the centre and the regions?

Challenges	*Is a major challenge*	*Is somewhat of a challenge*	*Is not a challenge*	*Not applicable*
Lack of incentive to co-ordinate between central and regional levels	☐	☐	☐	☐
Lack of understanding by central level on existing regional projects/needs	☐	☐	☐	☐
Unreasonable co-finance requirements stretching the means of regional administrations	☐	☐	☐	☐
Lack of co-ordination across regional governments on the design of investment projects	☐	☐	☐	☐
Lack of involvement of private sector actors/firms	☐	☐	☐	☐
Regulatory and administrative obstacles to co-ordinate between central and regional levels	☐	☐	☐	☐
Lack of information of regional actors on central government investment priorities	☐	☐	☐	☐
Other – please specify:				

2.2 Use of contractual arrangements for regional development

11. Are contractual arrangements used for the design and/or implementation of public investment (for regional development) between your region and the national government?

☐ Yes
☐ No **(go to Q.13)**
☐ Don't know **(go to Q.13)**

12. Are the following characteristics part of contractual arrangements?

Characteristic	*Check all that apply*	*Always*	*Sometimes*	*Never*	*Don't know*
Defined on a multi-year basis If yes, how many years? _____	☐	☐	☐	☐	
Defined on a multi-sectoral basis (across ministries)	☐	☐	☐	☐	
Defined in collaboration with private sector actors/firms	☐	☐	☐	☐	
Attached to a specific budget	☐	☐	☐	☐	
Incorporate reward or sanctions mechanisms	☐	☐	☐	☐	
Defined under high level political leadership	☐	☐	☐	☐	
Defined with clear arbitration mechanisms in case of conflicts	☐	☐	☐	☐	
Flexible (i.e. aspects can be adjusted/ renegotiated following evolving priorities)	☐	☐	☐	☐	
Inflexible (i.e. generally unable to be renegotiate except in highly specific circumstances)	☐	☐	☐	☐	
Limited in number (to avoid proliferation of contracts)	☐	☐	☐	☐	
Other - *please specify*: _____	☐	☐	☐	☐	

2.3 Co-ordination between your region and other regions or across levels of sub-national government

13. Are mechanisms in place to encourage (or require) co-ordination of public investment projects or programmes horizontally across regions or other sub-national levels? – *Check all that apply.*

☐ Yes, across regions/states
☐ Yes, across municipalities
☐ No(**go to Q.15**)
☐ Don't know (**go to Q.15**)
☐ Other, *please specify*:

14. What types of mechanisms are they?

☐ Mandatory requirements (such as regions have to co-ordinate with other regions for certain type of investment)
☐ Voluntary requirements (such as regions are incentivised through financial advantages)
☐ Don't know
☐ Other, *please specify*:

3 Critical Regional Governance Capacities for effective public investment

3.1 Designing and selecting investment

15. Is there a regional-level, strategic guidance document or plan in place that sets out priorities for public investment decisions for your region?

☐ Yes
☐ No (**go to Q.17**)
☐ Don't know (**go to Q.17**)

16. Which of the following actors are involved in elaborating the regional strategy? – *Check all that apply.*

Actor	***Check if involved***
Actors from the regional administration	☐
Municipalities	☐
Banks, including development banks	☐
Private actors	☐
Non-governmental organizations (NGO's, CSO's etc)	☐
Academics	☐
Citizens	☐
Other – *please specify:* 1. 2.	

17. Is cost-benefit or cost-effectiveness analysis, or a similar methodology used to inform or help prioritise public investment decisions? – *Check all that apply.*

☐ Yes, because it is centrally mandated
☐ Yes, because it is mandated by supra-national organisations, such as the European Union
☐ Yes, because the region has adopted it (e.g. in its own regional legislation)
☐ No
☐ Don't know

3.2 Financing public investment in your region

18. What is the share (in approximate %) of the different funding sources for regional public investment in proportion of the total funding available for regional public investment, and how have they changed since 2007?

Sources of funding for public investment on sub-national levels	***% share(if possible) and year of reference***	***Have increased***	***Have stayed more or less the same***	***Have decreased***	***Don't know***
Own revenues:					
Local taxes		☐	☐	☐	☐
User fees/market –type mechanisms		☐	☐	☐	☐
Grants					
Central government grants/transfers		☐	☐	☐	☐
Grant-type of funding from international organisations (such as EU cohesion/structural policy funds)		☐	☐	☐	☐
Borrowing					
Commercial bank loans		☐	☐	☐	☐
Loans from banks related to the sub-national governments					
Intergovernmental loans		☐	☐	☐	☐
Financial markets (bonds)					
Other, *please specify*: 1.		☐	☐	☐	☐
2.		☐	☐	☐	☐

19. How are grants/transfers for public investment grants distributed by the central level to the regions? – *Check all that apply.*

☐ Periodically by applying a fixed formula unilaterally decided by the centre
☐ Periodically by applying a fixed formula decided by the centre in consultation with sub-national actors
☐ On a project-by-project basis
☐ Through bilateral negotiation (between centre and each region)
☐ Other, *please specify*:

20. What are the main challenges to the financing of public investment in your region?

Main challenges	*Is a key challenge*	*Is not a challenge*	*Don't know*	*If it is a challenge, please briefly describe why*
Difficult access to credit	☐	☐	☐	
Reduction of grants from central government	☐	☐	☐	
Reduction of revenues from taxes	☐	☐	☐	
Lack of Public Private Partnerships	☐	☐	☐	
Other, *please specify*: 1. Other, *please specify*: 2.				

21. Does the annual budget documentation for the region contain multi-year expenditure estimates?

☐ Yes
☐ No
☐ Don't know

3.3 The role of the private sector in designing and implementing public investment projects

22. Are private actors involved in the design of public investment projects in your region?

☐ Yes
☐ No (**go to Q.25**)
☐ Don't know (**go to Q.25**)

23. In which sectors are private actors involved in the design of public investment projects? – *Check all that apply.*

☐ Transport
☐ Environment
☐ Innovation/ research & development
☐ Regional development
☐ Other sector, *please specify:*

24. How often are the following types of partnerships with the private sector to finance/implement investment used in your region?

Type of partnerships	*Frequently used*	*Sometimes used"*	*Not used at all*	*Don't know*
Public Private Partnerships	☐	☐	☐	☐
Local public enterprises	☐	☐	☐	☐
Other, *please specify*: 1.	☐	☐	☐	☐

3.4 Public procurement, transparency and integrity

25. Does your region have mechanisms to make public procurement procedures publicly available? – *Check all that apply.*

☐ Yes, announcement of tenders are published
☐ Yes, the outcome of tenders are published
☐ No
☐ Don't know
☐ Other – *please specify:*

26. Is your region being externally audited?

☐ Yes
☐ No
☐ Don't know

27. What are the main challenges to manage public procurement in your region?

Main challenges	*Is a key challenge*	*Is not a challenge*	*Don't know*	*If it is a challenge, please briefly describe why*
Excess of administrative procedures and red tape	☐	☐	☐	
Lack of capabilities from the region to administer public procurement (in terms of staff, know how, competencies, …)	☐	☐	☐	
Lack of time to administer public procurement	☐	☐	☐	
Overly restrictive bid specifications at the regional/local level, creating red tape	☐	☐	☐	
Other, *please specify*: 1. Other, *please specify*: 2.				

28. What practices have helped to improve public procurement by regions? – *Check all that apply.*

☐ Guidance to regions on procurement legislation
☐ Simplification of certain procurement rules
☐ Improving control systems for sub-national procurement
☐ Training regional and local officials on public procurement
☐ Procurement information made public through website, etc.
☐ Codes of practice for regional and local governments on the use of procurement
☐ Harmonisation of public procurement rules across states/regions
☐ Exchange of good practices across regions
☐ Other – *please specify*:

3.5 Public sector employment

29. What, if any, have been the main challenges to achieve excellence in public employees' capacity for public investment?

Main challenges	*Is a key challenge*	*Is somewhat a challenge*	*Is not a challenge*	*Not applicable*
It is difficult for regional administrations to attract qualified talents	☐	☐	☐	☐
Public servants' salaries and benefits are not competitive with the private sector	☐	☐	☐	☐
Public servants cannot be provided a reasonable perspective, therefore cannot be retained for long at the job	☐	☐	☐	☐
Other, *please specify:* 1.				

30. What mechanisms does your region use to increase public employees' capacity (skills, competencies) for strategic planning and monitoring (notably for public investment)? – *Check all that apply.*

☐ Promotion of mobility within the regional administration
☐ Promotion of mobility across other regions or sub-national levels
☐ Performance management (use of performance evaluation for staff)
☐ Performance-related pay
☐ Regular training (on contract management, etc.)
☐ Don't know
☐ No specific measures are taken
☐ Other – *please specify*:

3.6 External capacity support

31. Does your region benefit from external support in designing and managing public investment projects (e.g. from an economic development agency, consulting firms, independent experts, etc.) – *Please describe.*

☐ Economic development agency
☐ Consulting firms
☐ Independent experts
☐ Private-public partnership agency (on regional or national level)
☐ Other – *please specify*:

3.7 Monitoring and evaluation

32. Does your region conduct performance monitoring for public investment projects? – *Check all that apply.*

☐ Yes
☐ No **(go to Q.35)**
☐ Don't know **(go to Q.35)**

33. Are performance indicators used in the context of such monitoring?

- ☐ Yes
- ☐ No **(go to Q.35**)
- ☐ Don't know **(go to Q.35)**

34. Does the funding source (such as the central level or a supra-national authority) attach sanctions or rewards to the achievement of target values? – *Check all that apply.*

- ☐ Specific rewards are associated with the achievement of target values of indicators
- ☐ Specific sanctions are associated with non-achievement
- ☐ No such sanctions are attached
- ☐ Don't know

35. Does the region conduct (*ex post*) impact evaluations of public investments?

- ☐ Yes, throughout all sectors
- ☐ Yes, but only in some sectors

In which of the following sectors? (check all that apply)

- ☐ Transport,
- ☐ Renewable energy
- ☐ Water management
- ☐ Innovation
- ☐ Environment
- ☐ Other, *please specify:*
- ☐ No
- ☐ Don't know

4 Sectoral section on: Transport

36. What is the approximate share of regional public investment in transport in % of the total regional public investment budget?
    % in (specify year of reference)

37. Of the total regional transport public investment amount how much is transferred to municipalities?
    % in (specify year of reference)

38. How much of the regional public investment for transport is financed by the centre, in approximate %, (that includes any form of financing, i.e. grants/transfers, loans, etc.)?
    % in (specify year of reference)

39. How is regional transport policy formed? How are priorities selected? Is there a regional strategy/policy document for transport? Who is involved in the policy making process?

40. Do you monitor the implementation of transport policy, if so how? Does your region conduct impact evaluation of transport investment? – *Please describe.*

41. How do you co-ordinate with the national government on public investment for transport? What has worked well and where do challenges arise? – *Please describe*.

42. How do you co-ordinate with the other regions or municipalities on public investment for transport? What has worked well and where do you see challenges? – *Please describe*.

43. How are private actors involved in the design, financing and implementation of transport public investment projects in your region? What has worked well and where do you see challenges? – *Please describe*.

44. Overall, how is your region's performance in the public investment management of transport? What could be improved? – *Please describe.*

5 Sectoral section on: Innovation/R&D

45. What is the approximate share of regional public investment in innovation/R&D in % of the total regional public investment budget?
    % in (specify year of reference)

46. Of the total regional innovation/R&D public investment amount how much is transferred to municipalities?
    % in (specify year of reference)

47. How much of the regional public investment for innovation/R&D is financed by the centre, in approximate %, (that includes any form of financing, i.e. grants/transfers, loans etc.)?
    % in (specify year of reference)

48. How is regional innovation/R&D policy formed? How are priorities selected? Is there a regional strategy/policy document for innovation? Who is involved in the policy making process? – *Please describe.*

49. Do you monitor the implementation of innovation/R&D policy, if so how? Does your region conduct impact evaluation of transport investment? – *Please describe*.

50. How do you co-ordinate with the national government on public investment for innovation/R&D? What has worked well and where do challenges arise? – *Please describe*.

51. How do you co-ordinate with other regions, or the sub-national level on public investment for innovation/R&D? What has worked well and where do you see challenges? – *Please describe*.

52. How are private actors involved in the design, financing and implementation of innovation/R&D public investment projects in your region? What has worked well and where do you see challenges? – *Please describe*.

53. Overall, how is your region's performance in the public investment management of innovation/R&D? What could be improved? – *Please describe.*

6 Final questions

54. Overall, which recent reforms have contributed to improving governance of public investment in your region, and across levels of government and how? *Please describe*.

If there is anything you want to add to the questionnaire that you deem important to the subject but not sufficiently covered, please feel free to add it here and/or send us any additional information through email.

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Investing Together

WORKING EFFECTIVELY ACROSS LEVELS OF GOVERNMENT

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