Local Governance and the Drivers of Growth



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Foreword

I am proud to introduce this new publication from the OECD's Co-operative Action Programme on Local Economic and Employment Development (LEED). It is designed to deepen understanding of how governance mechanisms can be devised and implemented to enhance prosperity in our localities, cities and regions.

Key growth drivers such as innovation, skills, entrepreneurship and social cohesion are very closely linked to governance, particularly at the local level. Government must recognise these linkages in formulating policy initiatives to promote competitiveness and prosperity. It must co-ordinate actions, adapt them to local conditions and involve business and civil society. Taking full account of the local governance dimension of policy is essential if strategies to build growth and competitiveness are to be effective.

This book offers concrete, practical guidance on how to use the tools and concepts of governance to foster growth. It looks at ways to enhance the governance of employment with a view to increasing opportunities for all members of society and, at the same time, better meeting the needs of business. The reader is offered a clear picture of what can be gained from area-based partnerships, and the various financial instruments those partnerships can use to promote economic development. There is an in-depth discussion of recent critical changes in public services that favour a more effective problem-solving approach while strengthening local democracy. Insight is provided into exactly how governance mechanisms have succeeded in making cities more competitive, and how strategic planning instruments have been used to take cities and regions where they want to go.

This book, part of LEED's policy research agenda on local governance and employment, sums up many of the Programme's latest findings. LEED's Directing Committee launched this work agenda to provide guidance for policy makers on ways to improve social, economic and employment development through the utilisation of governance tools – i.e. in devising integrated approaches to tackle complex local problems. LEED's work in this area commenced in 1998 with the release of a seminal publication on local management, and the Venice high-level conference on decentralisation, both of which explored new frameworks for action. The issues tackled so far in previous publications range from using decentralisation to enhance labour market outcomes, to reformulating the role of area-based partnerships in terms of governance outcomes, to outlining new scope for local strategies to promote

competitiveness and social cohesion. Work currently under way, which will be presented in future volumes, includes such cross-cutting issues as skills upgrading of low-qualified workers; the integration of immigrants into the labour market; and co-ordinating employment, skills and economic development.

Some of the best-known experts in the field have joined the OECD Secretariat to produce the material contained in this book. Some sections were prepared for an international conference on local development and governance held at the OECD LEED Trento Centre for Local Development on 6-8 June 2005. The newly established Centre, whose mission is to build capacity for local development in Central, Eastern and South Eastern Europe, represents the perfect opportunity to translate policy lessons into concrete guidance for both policy makers and practitioners. Other contributions in this volume have been prepared within the framework of the OECD LEED Forum on Partnerships and Local Governance, an initiative of Austria that aims to stimulate the exchange of experience among partnerships and their members from government, business and civil society. The Forum has proved a formidable source of insight and policy thinking on a range of difficult governance issues. The issues discussed in Chapter One provided the basis for a conference in St Petersburg on 21 September 2005, held within the framework of the LEED project on employment, economic development and local governance in the Baltic Sea Region.

I have no doubt that this publication will prove extremely useful to policy makers, practitioners and researchers involved in all spheres of economic, employment and social development throughout OECD countries, and help them make a greater contribution to our global prosperity.



Sergio Arzeni
Director, OECD Centre for Entrepreneurship
Head, OECD LEED Programme

Acknowledgements. *Sylvain Giguère, Deputy Head of the LEED Programme, prepared and edited this book. A number of colleagues provided invaluable help at various stages of the project: Sheelagh Delf, Francesca Froy, Andrea-Rosalinde Hofer, Randy Holden, Kay Olbison and Ekaterina Travkina.*

The contributors to the publication are:

Scott Abrams, Open Society Institute.

Mark Considine, Centre for Public Policy, University of Melbourne.

Randall W. Eberts, W. E. Upjohn Institute for Employment Research.

Sylvain Giguère, OECD.

Xavier Greffe, Université de Paris I Panthéon-Sorbonne.

Fergus Murphy, LED Associates, Washington.

Michael Parkinson, European Institute for Urban Affairs, Liverpool John Moores University.

Charles F. Sabel, Columbia Law School.

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ISBN 92-64-01329-6
Local Governance and the Drivers of Growth
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Chapter 1

The Drivers of Growth: Why Governance Matters

by
Sylvain Giguère

Key growth drivers such as innovation, skills, entrepreneurship and social cohesion are very closely linked to governance, particularly at the local level. Government must recognise that link in formulating any policy initiatives to promote competitiveness and prosperity. It must co-ordinate actions, adapt them to local conditions and involve business and civil society. There are concrete mechanisms that can be used toward those ends. But whatever forms of governance are established, the aim should be to maximise flexibility in the local management of programmes, preserve efficiency in service delivery, and ensure accountability for the use of resources invested.

Today most analysts would agree when it comes to identifying the main drivers of growth and prosperity in advanced economies.[1] These drivers serve varying functions. To begin with, there are those factors that help determine the level of output over time, *i.e.* inputs in the economy's dynamic production function: investment in physical capital; growth in human capital (labour and skills); and technological progress. The last-named factor, long considered exogenous, is now viewed as the result of a process by which research and development (R&D) and investment in human capital translate into higher productivity.

Then there are factors that influence the efficiency with which enterprises function and the effectiveness of resource allocation processes. The rules, policies and legislation that allow firms both to purchase inputs and to produce goods and services in a stable, competitive and transparent framework may appear to be at a remove from the factors mentioned above, but they are no less crucial.

Finally, growth and prosperity hinge on entrepreneurship and social cohesion. Entrepreneurship stimulates risk-taking and contributes to the renewal of the economy. Social cohesion, though itself influenced by the state of the economy, nurtures growth in the long run as it leads to a higher quality of life and helps retain and attract firms and skills. Social capital, often seen as a driver of innovation and entrepreneurship, can also be seen as both an aspect and an extension of social cohesion.

Thus, while the comparative importance of the growth drivers may be open to debate among analysts, few would disagree with the list: a regulatory framework that ensures lively competition and efficient markets; sound and stable macroeconomic conditions; adequate physical infrastructures; a dynamic innovation process; an available pool of skilled labour; a flourishing entrepreneurial spirit; and a high degree of social cohesion.

How these drivers can best be fostered – and by whom – is a different matter. For some the answer is straightforward: regulatory frameworks and macroeconomic conditions are almost exclusively the province of the state, which intervenes through legislation, fiscal and monetary policy, and public spending. Responsibilities are sometimes shared with supranational authorities; the European Union, for example, has a hand in competition and monetary policies.

But other drivers operate in a more complex way. Not only can they be influenced by a wider range of actors; they also seem sensitive to the way stakeholders work together. Central government is only one of the bodies involved, and often more than one government department is responsible. These departments are required to interact with regional and local governments. Autonomous agencies, employer organisations and various types of civil society organisations also play varying roles. The actions of these various partners may be in synergy or in conflict; in any case this influence may extend well beyond the traditional policy focus. This is especially true with regard to four drivers in particular: innovation, skills, entrepreneurship and social cohesion.

Governance as a source of growth

Driver 1: Innovation

Modern growth theory sees innovation as endogenous, with firms forging a continuing market advantage by being the first to create compelling new products. There are technology spillovers among firms in the R&D process as each new innovation contributes to knowledge overall. This provides a rationale for government policy to support research activities and innovation.

Innovation is not only about inventions. It can take various forms, from a new product design to a new production process. Normally innovation is itself the result of a process, consisting of three distinct phases: the generation of knowledge; the sharing and distribution of that knowledge among potential users; and application of the new knowledge to product development, whereby it translates into new business activity and economic development.

These phases are controlled by different factors. Generation depends on the research capacities of educational institutions, the R&D activities of enterprises, and the level of human capital involved. Distribution and (to some extent) application rely on the effectiveness with which the worlds of education, research, business and training co-function.

A key lesson learned from innovation activities over the past decade has been that the most important tools for fostering innovation are to be found at the microeconomic and local levels. Of course, the national climate for innovation plays a role: stable macroeconomic conditions, effective skills development policies and a framework favourable to business development are all essential. However, it is at the local level that firms learn most from other firms, take advantage of external economies, internalise the risks associated with product development and forge supply chain links (Morgan and Sol, 2004). For localities and regions, fostering innovation boils down to: *i)* building a knowledge base, *i.e.* encouraging research activities and attracting enterprises with advanced technology as well as talented researchers and students; and

ii) facilitating co-operation and co-ordination between research production, distribution and exploitation activities. What are the governance aspects of these two strands of activity?

i) Building a knowledge base. A number of factors come into play, for which various policy tools have been designed (OECD, 2004a):

- *Risk capital*. Lack of risk capital for SMEs is a frequent obstacle to generating innovation; this example of market failure could be addressed by financial support for innovation and R&D projects in new and existing firms. Various schemes to provide such support have been introduced at both the national and local levels, and there is a great deal of literature on remedies that draw on the capacity of various actors.
- *Inward investment*. Inward investment allows local firms and organisations to import new knowledge and technologies. Foreign investors often have firm-specific advantages in terms of operational practices and technologies, and these can enter host economies as spin-offs that boost productivity and innovation. Incentive measures do exist, but attracting large firms is a complex issue involving a number of factors (the quality of local infrastructures, an available qualified workforce, etc.) and is best promoted as part of a wider area-based strategy that foresees co-ordinated actions.
- *Talented researchers*. Attracting qualified researchers and students also depends on a variety of factors, such as the quality of the region's higher education institutions and the regional quality of life. Local government can provide grants, scholarships, tax breaks, eased immigration procedures and repatriation schemes as incentives to settle in the region.

ii) Production, distribution and exploitation. Here, the governance aspects of innovation are perhaps more obvious. Various mechanisms are needed to ensure the fullest distribution and application of knowledge, and to link research, production and public services in an effective way. Three different "networking circles" (Giguère, 2004) play a complementary role in promoting innovation. Networks among firms (clusters) can identify and draw on synergies in production, while networks linking production and research bolster learning processes. Networks between research, business and public actors (government, public services, economic development agencies) take a more strategic approach by ensuring that conditions for co-operation are fulfilled and that all incentives required to optimise the innovation process are in place.

Asheim (2004) proposes mechanisms to foster governance within these three circles:

- *Networking between firms.* Technology centres are used in many countries to network firms and support the diffusion of technology and knowledge among enterprises. These centres constitute a tool that goes some way toward overcoming the obstacle of SMEs' limited resource base for innovation.

- *Networking research and production.* This mechanism is crucial because it helps firms to identify their innovation needs and make contact with relevant universities and research institutions. Liaison officers act as intermediaries – sometimes on a sector basis – or as "technology brokers", helping to overcome obstacles such as low technological competence, lack of market research and narrow strategic vision. Such intermediaries often arrange the sharing of equipment between research institutions and enterprises. They can also help strengthen firms' human resource base by promoting the mobility of researchers, academics, consultants and students, and by proposing internships and other schemes.
- *Networking business, research, education and government.* Broader innovation networks bring in government and the relevant public services. Other potential partners include economic development agencies and employer organisations. The mission of these networks is to optimise the generation, distribution and exploitation of innovation. They identify and remove bottlenecks and strengthen the weakest parts of the innovation process. Roles include developing mobility schemes to reinforce co-operation between enterprises and higher education institutions.

Setting up these networking circles in a coherent manner is no easy task. The economic development field is crowded with initiatives led by various organisations, and there is often poor co-ordination between them. Often various tiers of government pursue their own strategies independently, and these may not be fully consistent with one another, let alone with an extra tier of research and higher education activities. If innovation systems are to be effective, a great deal of effort will need to be placed into ensuring cross-cutting co-ordination and co-operation between public and private actors.

Driver 2: Skilled labour

There are a number of channels through which skills lead to growth. First, skills are a core element of economic and employment development – where pools of skilled labour are available, there is greater opportunity for entrepreneurship, business development and inward investment. Secondly, diverse and specialised skills are prerequisites to innovation. Finally, skills development opportunities are essential to social inclusion.

In view of this, labour market policy frequently focuses on developing a strong skills base. Using tools such as job placement, counselling, vocational training and job subsidies, government seeks to develop the employability of the labour force, promote geographical mobility, and provide incentives for the acquisition of further skills. The ultimate aims are to guarantee the efficiency of the labour market and to increase productivity.

Absolutely key to such efforts is taking on board the local level. Research shows that labour market programmes are more likely to be effective when they take account of the local characteristics of their target groups and seek to dovetail them with local labour market needs (Martin and Grubb, 2001). Information provided by local employers and representatives of target groups helps to guide labour market programmes. It also helps reduce the typical ill effects of such programmes: substitution and displacement (respectively, non-subsidised workers and activities displaced by subsidised ones) and deadweight losses (creating jobs that would have been created anyway). Often, additional labour market services are provided by business organisations, trade unions, local authorities and community-based organisations: vocational training, placement and reintegration services are examples. Joint steering is required to maximise complementarity and avoid duplication (OECD, 1998a). In delivering employment services it is important to take account of existing infrastructure (and gaps therein), public transport and municipal services. Finally, labour market efficiency depends on having employment and training programmes that meet business demands for rapidly changing skills that can be adjusted to take account of forthcoming local investments.

If labour market policy makers see co-ordination as a way of increasing policy effectiveness, they also view it as a way of ensuing that local business growth benefits the disadvantaged and socially excluded. Joint efforts with employers can provide particularly disadvantaged groups with work and training opportunities that can both suit their needs and fill business requirements. Evidence suggests that directly helping businesses to access labour market programmes is especially conducive to upgrading the skills of low-qualified workers (Research Institute for Small & Emerging Business, 2004).

Closer integration offers reciprocal advantage. For economic development actors, better co-ordination is key to attracting, retaining and nurturing the pool of skilled labour necessary to fuel local business development. Placement, counselling and training activities are best oriented in partnership with business organisations, economic development agencies and local authorities, who are more aware of current and future skill needs. Some of those needs can be addressed through upgrading the skills of local low-qualified people, others through attracting and integrating highly skilled migrants. The public employment service (PES) cannot address these issues directly, and actors such as non-government organisations and other public authorities often attempt to fill the gap. As Xavier Greffe shows in Chapter 2, the governance of employment is complex; sound orientation of the relevant services benefits economic development directly.

The advantages of closer integration are sometimes clearer in times and areas of economic prosperity. In those contexts, employers voice their

demands for labour more precisely, and the supply side can benefit from the more dynamic market to identify opportunities for the most disadvantaged segments. Less prosperous economies also benefit from greater co-ordination. Where the PES produces information and analysis on the local labour force and skills, this can feed into the strategic planning. In addition, the employment service has a number of tools (programmes and services) that can be used in the implementation of such strategies for endogenous development. For example, it can promote entrepreneurship through training and counselling, and use targeted programmes to foster small business development and stimulate self-employment among the unemployed. Labour market programmes also generate a significant inflow of resources at local level; depressed regions can benefit by linking them to efforts to revitalise the local economy. Eighteen OECD countries devote at least 1% of GDP to (both active and passive) labour market programmes (Giguère, 2005).

Driver 3: Entrepreneurship

A spirit of entrepreneurship is vital for growth. There is a great deal that governments can do to promote it at the national level, such as working to provide a stable macroeconomic framework and a favourable business climate. They can furnish incentives to start up enterprises, and foster an enterprising culture in high school curricula. It is also at this level that government can require PESs to offer training in entrepreneurship for workers and unemployed individuals, and encourage delivery of unified business services throughout local one-stop agencies. All of these elements can provide an important stimulus.

However, the local dimension can prove tremendously important here too. The nature of entrepreneurial activity varies across local areas owing to differences in (*inter alia*) demography, wealth, education and occupation profiles. Within the same country, some areas can have enterprise birth rates up to six times higher than others (OECD, 1998b). Areas in which firms are concentrated are often ripe for further entrepreneurial activity, and give rise to economies of agglomeration that confer important competitive advantages.

Therefore, if they are to be effective, policies must take account of all the various location-specific factors. Business incubators, advisory and information services, training schemes and business networks benefit from being locally designed and tailored to local needs. Local and regional governments are often much closer to the conditions that affect companies most, and they control much of the investment that is needed to upgrade the business environment.

Outside partners such as business organisations and training institutions also play a major role in many decisions that are critical for the business environment and for the success of government policies. To what extent do

companies invest in upgrading the skills of their workforce? And how can these efforts be linked effectively with the training to which companies are entitled through government programmes? Co-operation on these questions can improve overall results (Ketels, 2002).

Local areas often present complex problems for which comprehensive solutions must be found. One such problem is a lack of entrepreneurial activity. Urban distressed areas, rural impoverished communities and isolated areas all have inherent weaknesses that constitute hurdles to starting up or expanding a business. These hurdles can best be addressed locally as part of wider strategies that call on assistance from partners from the private and non-profit spheres, including community leaders who can act as brokers and facilitators (see Randall Eberts, Chapter 6). On closer analysis, local conditions may also provide competitive advantages in a globalised market. Distressed areas often have thriving informal sectors and many micro businesses, especially in urban areas. Inner cities contain many sources of competitive advantage such as large pools of labour, centrally located premises and concentrations of financial services that can serve as catalyst in this endeavour (Porter, 1998; Potter, 2004). Civil society and sector-based and professional organisations are often best placed to identify entrepreneurial development opportunities in disadvantaged areas. Support from an economic development agency or local authority may be needed to breathe life into these ideas. Partnerships and strategic planning processes are important mechanisms for providing the holistic approach necessary to foster small business development at the local level.

Driver 4: Social cohesion

Each of the growth drivers above has social dimensions that can be captured using the terms social cohesion, social inclusion and social capital. The overarching concept of social cohesion is a critical aspect of quality of life, which is in turn conducive to a good business climate that attracts capital and talents. Social cohesion can be viewed as the sum of the degree of social inclusion and social capital present in a region. Social inclusion relates to integrating disadvantaged individuals and minority groups into the labour market and helping them to take part in the development of a prosperous society. Social capital is characterised by networks and shared values, which play an important role in supporting business development.

What are the governance aspects of social inclusion and social capital?

Social inclusion lies at the intersection of several policy areas. It is notably linked to security, health, employment, education, urban and regional planning, the environment, housing and transport. As with the other drivers of growth

analysed in this chapter (and perhaps more so), ensuring social inclusion hinges on the capacity of local government and other local partners to intervene, co-operate and develop comprehensive joint solutions. Issues are particularly complex and interlinked in urban areas, where urban sprawl and unaffordable housing directly contribute to social exclusion. As a result, urban policy and urban and regional planning increasingly follow a social inclusion agenda, as Michael Parkinson explains in Chapter 5.

Meanwhile, the reduction in social protection and complexity of issues that ensue mean that community-based and non-government organisations are now among the main actors tackling problems faced by the disadvantaged in the labour market and in daily life. Diverse measures have been set up locally to address aspects of social exclusion such as drug abuse, alcoholism, early school-leaving and lack of community facilities, and to improve the quality of life in deprived neighbourhoods. Measures have also been taken to provide specialised labour market services to reintegrate the long-term unemployed. Such measures are often developed with varying degrees of expertise and co-operation with the public services – which can lead to a lack of coherence as well as a lack of understanding with regard to the effectiveness of different measures (OECD, 2001).

Social capital is also a locally based concept, defined as the presence of shared norms and values that facilitate co-ordination and co-operation among individuals, local communities, enterprises and sectors to their mutual advantage. Given that innovation is a learning process that relies on co-operation between enterprises, building social capital can be conducive to identifying positive externalities between production processes and improving productivity and competitiveness.

Research analysing mechanisms for building social capital within productive sectors has underlined the importance of stimulating leadership and the broad participation of employers and employees in cluster initiatives. One possible mechanism that has been explored involves encouraging industrial associations to move from their role of lobbyists to a role of "agents of change". This is not an easy task, as associations are often dominated by large firms and not organised at a community level (Andersson *et al.,* 2004). Alternatively, leadership may be assumed by "civic entrepreneurs", a role that is often played in the United States by civil society representatives who nurture close links with local authorities and business and who are able to mobilise resources around projects of common interest, drawing on local assets and synergies (Eberts and Erikcek, 2001).

The role of social capital in supporting economic development is not straightforward, however. One problem that can arise from the development of strong social networks is an excessive reliance on local contacts and tacit

knowledge of methods and procedures in combination with neglect of external linkages and lack of foresight: the dominance of established co-operative practices may lead to "lock-in" effects that prevent improvement (Andersson *et al.*, 2004).

Overarching governance issues

The following governance issues emerge from the analysis above in relation to supporting drivers for growth:

- There are several drivers of growth for which no single public authority is responsible.
- Drivers cannot solely be fuelled at national level. Some have an important local dimension, and so a significant share of action must be carried out at the local level.
- Government cannot adequately support drivers of growth on its own; roles must be played by business and civil society.

It is therefore clear that governance figures strongly in the way drivers work. In addition, it is important to consider the externalities between drivers.

Externalities between drivers

In addition to considering the governance aspects of each individual driver, it is useful to examine governance issues affecting a number of drivers, as they do not operate independently. Tools to activate one driver may have an impact on another. This can clearly be demonstrated by looking at the drivers of entrepreneurship and skills.

It is sometimes argued that the growth potential for new and small firms in distressed areas is not being fully exploited. As seen above, distressed areas often contain sources of competitive advantage that remain to be identified and exploited; meanwhile, surveys show that more residents would like to create their own businesses. A swift conclusion is that one of the best tools to foster urban regeneration is entrepreneurship, and as a result, territories can easily find themselves the target of multiple efforts in that direction. Urban policies and social cohesion programmes in urban settings, delivered by local authorities and economic development agencies, often aim to enhance entrepreneurship, while public service and business-led organisations, usually endowed with greater resources and expertise, pursue the same goal within the same territory. It is true that urban, social cohesion and entrepreneurship programmes can reinforce each other. But just as clearly, duplication and conflict can and likely will arise if approaches are not co-ordinated. At the very least, the organisations involved would benefit from sharing information and expertise.

Skills development is another driver that contributes to attaining a wide set of objectives in given areas, such as the efficiency of labour markets, social inclusion and endogenous development. Activities in these policy areas are carried out variously by the employment services, education and training institutions, regional authorities and community-based organisations. Given that there are frequently very loose links between activities and that different actors are often working in parallel, a co-ordinated approach would (again) be useful.

Such cases of externalities between drivers of growth are numerous. It is important that information, networks and policy instruments are shared across all drivers. Ideally, all actors involved in the social and economic development of an area should participate in the preparation of a comprehensive diagnosis of strengths and weaknesses of their area and the design of an overarching strategy.

While working together on every issue may not always be practical, the ongoing exchange of information between different local and regional stakeholders is especially important. To continue with the example of skills development, the stakeholders involved in this field have links and connections that can produce fruitful information and knowledge of interest to stakeholders in other fields: chambers of commerce, regional development agencies and private human resource management consultants have a well-established role as core partners of business. Trade unions, the PES, career guidance and counselling agencies, and voluntary sector and grassroots organisations are typically in contact with the workforce since their remit is to help jobseekers or incumbent workers. Local educational institutions such as community colleges have a more neutral role which consists of providing a range of educational curricula and training schemes. While these three categories of actors may participate in partnerships and networks of various kinds, they represent different spheres of concern that rarely come together. Each organisation nonetheless has information that is potentially beneficial to the others. For example, while it is often not the role of the PES to design training schemes for incumbent workers, its contact with local SMEs as a job broker may provide it with valuable information about business training needs that could serve local skills strategies, especially with regard to the low-skilled (Nativel, forthcoming).

In summary

Clearly then, co-ordination between policies and actions, adaptation of policies to local needs and conditions, and orientation of policies in partnership with business and civil society will be essential for the local level to have an impact on economic and employment development and growth driver performance. With regard to co-ordination, the justification is twofold.

Firstly, a cross-sector approach is often more effective in fuelling growth and overcoming obstacles to local development. Secondly, the tools used to fuel one growth mechanism will have an impact on others, due to externalities. Co-ordination, adaptation and participation are three facets of the concept of local governance used as gauges in various OECD reports (OECD, 2001, 2003, 2004b).

Mechanisms to improve local governance in support of drivers for growth

What are the mechanisms that government can put in place to improve local governance and further stimulate such drivers of economic and employment development? Two main approaches are currently used in OECD countries: i) setting up partnerships, platforms and alliances; and ii) decentralising, devolving and delegating power.

i) *Partnership, platforms and alliances*

Many governments have consistently valued the role of partnerships in bringing policy closer to citizens and involving them in implementation. From the first programmes launched to stimulate a joint approach to local problems in Canada in the 1980s (Community Future Development Corporations) and Ireland at the beginning of the 1990s (Area-based Partnerships as a Response to Long-term Unemployment), partnership has become a standard tool for addressing difficult issues that cut across different policy fields.

The partnership principle was first applied on a local scale in response to socioeconomic problems associated with urban decay and rural impoverishment. It was later applied by the European Union as a criterion for allocating funds to local projects. The area-based partnerships that were established have often proved helpful in developing new initiatives and ways of working (Box 1.1).

Encouraged by this early promise, OECD member countries have increasingly used partnerships to implement their programmes in co-operation with local communities, and set up local agencies directed by boards composed of relevant local actors. Since the end of the 1990s, the UK government has launched various related initiatives, including the New Deal partnerships (to implement its "welfare-to-work" programme), Urban Regeneration Companies (URCs), Local Skills Councils (LSCs), English Partnerships (for economic regeneration) and Local Strategic Partnerships (LSPs). Part of the LSP's mission is to streamline and co-ordinate other partnerships locally.

However, area-based partnerships have a limited track record in stimulating real co-operation across policy areas within government. Rarely has more than one government department been actively involved in a

Box 1.1. **Area-based partnerships**

Area-based partnerships mainly pursue missions of social cohesion and employment and skills development. In some instances they also work to identify endogenous development opportunities and contribute to the development of entrepreneurship. They maintain close contacts with local authorities, community representatives and civil servants, and typically cover sub-regional or local territories. OECD (2001) showed that their main impact is to stimulate the uptake of public programmes that can help move forward their local agenda, assist in furthering local development projects, and connect local initiatives with government programmes for maximum impact. Their close relationship with the local community helps them identify new productive activities that can bring difficult target groups back into the labour market. Examples include the area-based partnerships in Ireland; various partnerships in Canada, the United Kingdom and the United States; and the territorial pacts in Austria, Greece, Italy and Spain.

strategic planning process; the mission of the partnership is too difficult to harmonise with the policy goals pursued by the other public services. Further, the uncertain legitimacy of civil society representatives has been seen as an obstacle to the genuine participation of the public sector (OECD, 2001). As Mark Considine explains in Chapter 3, if partnerships manage to create a critical layer of "connective tissue" in the social system that benefits local governance, they may not be the best choice as a policy instrument for programme delivery.

Enhanced and revitalised tripartite structures have enjoyed greater success in co-ordinating policies. These councils, grouping business, trade unions and public service representatives, are products of the joint supervision by government and the social partners of the implementation of labour market policies, a tradition in several countries. As it became obvious that there was little need to treat labour market policy in isolation from social and economic issues, these councils were marginalised in some countries. In others, such as Denmark and Belgium (Flanders), their role has grown in recent years, with broader membership and a broader policy focus (Box 1.2). Experience has shown that such bodies can be regenerated by the inclusion of local authority and civil society representatives.

Attempts to co-ordinate social inclusion and employment issues have met with some success in the case of workforce investment boards (United States) and sub-regional employment committees (Flanders). Yet the

Box 1.2. **Enhanced tripartite bodies**

Labour market councils traditionally grouping business, trade unions and public service representatives locally or regionally have been enlarged and strengthened in some countries to play a more significant role in policies and governance. Initially set up to co-ordinate or advise in the implementation of labour market policy, they are now required to promote social inclusion and assist in the development of entrepreneurship and innovation. The original members may now be joined by local and regional authorities and representatives of community-based organisations. Such partnerships often operate at the regional or sub-regional level. The sub-regional employment committees in Belgium (Flanders), workforce investment boards in the United States, and the regional labour market councils in Denmark are examples of these bodies.

economic development actions of these bodies have remained weak despite significant business participation. In the United States notably, partnerships for economic development have in many places been established in parallel to the workforce investment boards. In Flanders, current reform is merging the sub-regional employment committees with the more economic development-focused district platforms (*Streekplatformen*).

Some new forms of governance have recently been set up to address that issue and strengthen the linkages between workforce development organisations and the business community. A greater critical mass helps to engage all the main stakeholders (*i.e.* labour market authorities and the main employers and business representatives) in this field. Perhaps for that reason, where significant public resources are allocated, these partnerships have been set up at the regional rather than local level.

Regional alliances (Box 1.3) are thus becoming increasingly popular to tackle the issue of skills. These partnerships aim to integrate activity on training, business support and labour market activity in support of regional economic development. They provide a focal point for joint planning on skills, business improvement and employment services, aligning provision and services to meet employer demands and regional and local economic needs. This planning includes addressing market failure in skills provision, *e.g.* failure to meet identified regional and local priorities.

The greatest added value provided by such voluntary alliances is to encourage an orientation of employment and training activities more in line

Box 1.3. **Regional skills alliances**

Regional skills alliances are partnerships formed to address workforce issues affecting firms operating in specific geographic areas. Alliances set out to resolve systemic and structural problems related to labour and skill shortages, training mismatches, employee recruitment and retention, and organisational design. They are regional in nature and reflect the local labour market. Alliances engage all appropriate public and private stakeholders in collaborative problem solving. These stakeholders are brought together by an organisation with expertise in the issue area. Regional skills alliances are burgeoning in the United States with numerous state initiatives, and in the United Kingdom, whose national skills strategy, titled *21st Century Skills,* announced the formation of Regional Skills Partnerships (RSPs).

with the demand side of labour. While these services have other opportunities to co-ordinate learning and skills provision from the perspective of the community and individual learner (*e.g.* through tripartite bodies), the organisational structures to promote skills, enhance productivity and meet employer needs are less well developed. Regional skills alliances bring together employers and their representatives to articulate their demands and provide a strong demand-side voice.

Like area-based partnerships and enhanced tripartite bodies, regional skills alliances have a relatively narrow focus; this makes it difficult for them to lead strategic processes for broader endogenous development activities. That explains why significant attention has recently been given to regional strategic platforms. These structures are set up on a geographically large scale to benefit from the legitimacy and political power conferred by administrative borders; they focus primarily on economic development (Box 1.4).

Regional strategic platforms are emerging as the main instrument for coherent planning and organisation of the economic development activities of an area. Depending on their membership, they are sometimes able to extend their strategic approach to solve socioeconomic problems and take a genuinely integrated approach to employment as well as economic development. In many places they nurture regional innovation systems and promote networking between business, research, education, economic development agencies and government. They seek to remove bottlenecks and strengthen the weakest parts of the innovation process.

Box 1.4. **Regional strategic platforms**

Regional strategic platforms have emerged recently as a popular governance tool for the fostering of endogenous development. In particular they promote entrepreneurship, assist business development, and stimulate innovation processes by connecting university, business and government. Covering large regions and trying to group the most powerful actors – including regional government and major enterprises – they seek a better co-ordination of overall economic development activities in the territory, including the attraction of inward investment and the lobbying of central government to enhance regional physical infrastructures. Examples include regional growth agreements in Sweden and regional development agencies in the United Kingdom.

Unfortunately, and despite the greater legitimacy conferred by the participation of regional authorities and state agencies, regional strategic platforms are not immune from the classic illnesses of area-based partnerships. An OECD study (2004b) has shown that some platforms appear to be weak in their capacity to adopt a forward-looking approach. A lack of guidance on co-operation between the platforms and the various government departments and state agencies involved has contributed to an undermining of the accountability of these structures in the use public funds. Further restraining their development are an absence of benchmarking for measuring the performance of platforms and a lack of agreement on how they should be evaluated. As a result, many platforms have chosen to concentrate on more focused and less institutionally complex activities, such as business development assistance.

The OECD report has recommended that the main bodies working on platforms, including central government and its relevant agencies, ensure that their policy objectives are compatible with the platform's overall mission. Partners at central level need to agree on what can best be done at the regional level and what they can expect regional platforms to achieve on their behalf. Similarly, it is important for partners to state the limits of the platforms' mandate. Where relevant, national representatives of government and other stakeholders should agree what the role of their regional representatives should be in steering the platforms. Representation and reporting mechanisms should be established for each sector that are acceptable to all. Finally, they should set up a common set of indicators that fulfil each partner's needs in terms of satisfying accountability requirements.

One response to the difficulty in attaining accountability for regional strategic platforms is the use of empowered regional assemblies (Box 1.5).

The main power devolved to these entities has often been economic development, which is a shared power in any case, and no significant transfer of public resources has been involved in many of these institutional reforms. Accordingly, the main responsibility of the new regional governments is to design and implement regional development strategies, a task somewhat similar to that performed by the regional strategic platforms. Regional assemblies are responsible for proposing new ways of implementing national policies on their territory and proposing new projects to be funded by national or local sources, as well as new co-ordinated approaches for local authorities. To achieve these tasks, the self-governing regions must secure the commitment of public services and government agencies and at the same time build their own legitimacy among local organisations. Thus they must stimulate participatory democracy to win support. Although limited spending power can be interpreted as a sign of weakness for a level of government, the obligation to build consensus can be a source of strength for local governance – especially at the intermediary regional level, where representative democracy is in crisis in several countries (OECD, 2004b).

Another weakness of the regional strategic platforms is the difficulty these bodies have in addressing skills development and employment issues. Co-ordination with labour market authorities, the PES and training

Box 1.5. **Empowered regional assemblies**

Elected regional governments have been created and existing regional authorities have seen their responsibilities enlarged. In both cases, the role of regions now encompasses designing an overarching development strategy and encouraging co-ordination of activities around shared objectives. At the core of their tasks lies the need to stimulate innovation and enhance competitiveness in a globalised economy. If some powers (*e.g.* housing, education infrastructures) have been devolved and some fiscal flexibility granted, these shifts often remain marginal; the regions have to build their influence on local actions and the implementation of national policies through regional leadership, consensus building and participatory planning. Self-governing regions have recently been created in the United Kingdom and the Czech Republic, and Norwegian counties have been given the responsibility of co-ordinating national, regional and local actions within the framework of four-year county plans.

institutions has typically remained poor, as the attention of these organisations is focused mainly on the supply of labour. As highlighted earlier, skills are instrumental to employment and economic development, and they are interrelated with most drivers of growth. Moreover, the absence of co-ordination between labour market policy and economic development at a strategic level is a major impediment to local development (OECD, 2003). Can decentralisation of labour market policy help improve local governance in this perspective?

Decentralisation, devolution and delegation

The analysis of some key growth drivers above has shown that local challenges to growth cannot simply be tackled through shifting powers between levels of government, as this type of action requires the combined inputs of a wide range of organisations and actors. Moving resources from one level to another does not necessarily improve the situation. Seen from this perspective, debates on devolution may have missed the point.

Yet in principle decentralisation can make it easier for national government to align their resources with local conditions and needs. It is largely agreed that decentralised decision making promotes pragmatic solutions to local problems (OECD, 1996). In the 1990s, several countries undertook to decentralise labour market policy to ensure that it would be designed and implemented closer to the level at which strategies for economic development are defined and social demands expressed.

Decentralisation may provide greater administrative flexibility. Policies may be combined with efforts from local and regional governments, the private sector, trade unions and community groups to support development strategies that balance concerns relating to economic development, social inclusion and the quality of life. Through greater flexibility in policy management, decentralisation is also expected to make it easier to respond to the growing concerns associated with low-skilled workers, the working poor and the single parents who face complex issues and barriers that centralised employment services are unable to tackle alone.

In practice, however, decentralisation does not always yield greater flexibility.

Two forms of decentralisation have been the subjects of experiments in labour market policy: devolution to regional government; and administrative decentralisation within the PES.

Although devolution (Box 1.6) seems to provide significant flexibility in the management of labour market policies, in reality that is often not the case. Not only does central government usually remain responsible for a large share of the power (*e.g.* orientations, funding), but the recipients of the delegated

Box 1.6. **Devolution of labour market policy**

A popular form of decentralisation involves the devolution to regional governments of powers to design and implement policies. Regional governments may then transfer the responsibility to their own regional employment services. The central government usually remains responsible for the broad policy framework, the main orientation of policies, and their funding. Some federal countries provide examples of this form of decentralisation – Belgium, Canada, Mexico and Switzerland – as do unitary states, such as Italy and Spain. Canada has pioneered devolution in an asymmetric fashion, giving more powers to some of the regions according to their administrative capacity and willingness to take on responsibility. Devolution has also been negotiated on a case-by-case basis between the central government and the regions in Italy and Spain.

powers are often very large regions, for which the local-level concerns remain equally remote. In addition, the funding transferred to the regions can represent a large sum of money, and there are frequently political and administrative pressures to centralise spending powers in the regions with a view to preserving efficiency and accountability. Indeed, cases have been reported of decision-making power being removed from the local level and transferred to regional headquarters (OECD, 1998a). Accountability and efficiency concerns also tend to limit the scope of joint planning exercises that involve other public organisations, business and civil society.

Devolution may also lead to an increased administrative burden on regional employment services, translating into further limitations on their capacity to take a strategic approach in the field. Regions in Canada, Italy and Spain have had to combine their newly decentralised services with existing regional services and harmonise active labour market policies addressed to different target groups (*e.g.* the socially assisted, the unemployed, jobseekers), a task that has proved time-consuming and administratively demanding for policy makers. In the United States the workforce investment boards implement dozens of programmes funded by the federal, state and local levels, each with different accountability streams; this makes co-ordination of labour market programmes extremely difficult. There is sometimes a mismatch between the responsibilities and resources transferred from central government – the factor cited as the reason the Polish devolution to local authorities failed (Boni, 2003). The quality of professional skills may also be insufficient at local level with regard to the new responsibilities transferred.

Box 1.7. **Decentralisation within the public employment service**

A second form of decentralisation occurs within the framework of an integrated, country-wide PES, where some degree of autonomy in implementing policies and designing programmes is granted to regional or local officers. These officers act in accordance with guidelines or within a policy framework established at national level. This is often the case when the PES is managed in a tripartite fashion, with trade unions and employer organisations protecting the interests of their members at both national and regional level. Austria and Denmark are examples of this form of decentralisation.

Clearly, though it helps in certain circumstances, devolution does not guarantee greater possibilities to co-ordinate policies with other policy areas within a strategic or integrated framework, or to adapt policies to local conditions.

In the second, "integrated PES" model of decentralisation (Box 1.7), all chains of command report to one decision-making body. The main determinant of flexibility in policy management in this case lies within the performance management system, and more particularly with the targeting mechanism. It is a typical management-by-objectives framework: broad policy orientations and funding are provided at the national level, while local officers are free to vary the use of the different measures available provided that they meet the targets set for a series of outputs (*e.g.* job placements, referrals to various programmes, number of people trained). These aspects are broken down into categories of users – the unemployed, the long-term unemployed, social assistance recipients, women, youths, ethnic minorities, etc. Performance monitoring ensures that progress is made with respect to those targets.

The actual degree of flexibility in such a decentralised framework depends largely on how and by whom the targets are fixed. Are targets set unilaterally at national level? Are they negotiated with the regional and local offices? Is there any role for other government departments, social partners or other local stakeholders in establishing them? The methods for targeting measures vary significantly across countries. In decentralised PESs, regions usually have a say regarding the annual targets although the actual bargaining power depends on a number of factors, including budget constraints at national level. In a few cases adjustments are made after further consultations

with the local level to ensure that policies are suited to the local context. As mentioned previously, some tripartite councils have been enhanced to take on board broader social or economic concerns.

Within this type of system, the flexibility provided is often insufficient to have an impact on the degree of co-ordination and adaptation of policies. In many countries the performance of public services is managed in such a way as to maximise output-based efficiency; civil servants are sometimes put in direct competition with private service providers, generating "creaming" effects whereby only the easiest cases are treated. This favours a narrow approach to implementation over a strategic approach. Nonetheless, decentralisation within an integrated PES has potential for increasing flexibility in policy management, if only because the framework for decentralised decision making is in place.

To make employment services more efficient and more responsive to local needs, governments in several countries have pushed the introduction of market mechanisms in service delivery and delegated responsibility to non-public actors for part or all of the services to be delivered (Box 1.8).

In this system, private and non-profit providers pursue well-specified targets and report on the results obtained in a format agreed by both parties, thereby preserving the accountability chain. Financial incentives to meet targets may stimulate problem solving and a more entrepreneurial approach.

Box 1.8. **Delegation to the private and non-profit sectors**

Many governments have introduced non-public sector actors to deliver services to the population, and have delegated responsibility to private and non-profit providers. If the rationale of these reforms first focused on the need to improve efficiency and streamline costs, it has since then encompassed the need to tailor services to local needs and to improve its reach to target groups. The Netherlands has split up the PES into a public provider of basic employment services (placement and processing benefit claims) and a privatised company to compete with private service providers for contracts to promote return to work. Placement and part of vocational training services are being transferred to the private sector in several countries, including Belgium and Denmark. In Australia, active labour market policies are delivered through the Job Network, a network of private/community partnerships under contract with the federal government. Organisations are contracted through a competitive tender process, and many providers are non-profit organisations from the community sector.

Involving non-profit enterprises and community-based organisations makes it possible to draw on their connections with local groups, and their expertise in the local economy may modify the culture of service delivery as innovative ways to approach the public are tried and introduced.

Further, through increasing visibility of actions and mutual accountability, and thanks to better and more disseminated information on performances that facilitates diagnosis by the public when a problem arises, mixes of public, private and community representatives engaged in tackling local problems often yield good results. Nowadays, pragmatist organisations in both the public and private spheres do not hesitate to change ways of working to correct network failures in delivering satisfying outcomes (see Charles Sabel on this topic in Chapter 4).

It remains to be seen how this sort of improvement can transcend the limits of a single policy area. The various groups of actors in a given policy area know each other well and know what to expect from other groups. They can better influence the outcome of the policy area in which they are most involved. Yet, policy co-ordination involves a wider set of actors, with different cultures and more remote relationships. And policy co-ordination goes beyond the service delivery aspect: it concerns strategic dimensions as well.

Managing the trade-off between flexibility and accountability

The lack of flexibility in policies taken forward by individual organisations at the local level is clearly one of the main reasons why strategies developed in partnership or in a decentralised framework fail to be delivered in practice. Designing a strategy is not difficult. Numerous guidebooks on strategic and participatory planning exist, and methods are well known. Common practice consists in: analysing the strengths, weaknesses and opportunities of the area; involving representatives from government, business and civil society; establishing a vision; and identifying objectives, activities and projects. In Chapter 7 Scott Abrams and Fergus Murphy describe the state of the art in strategic planning for local economic development using Central and Eastern Europe as their model.

Accordingly, there is no shortage of local and regional strategies in operation today. Quite the contrary, many local areas count several strategies that are managed independently. The example of Belfast is telling: the City Council has identified no less than 55 development strategies covering its area, pursued by various public and quasi-public bodies. A quick diagnosis of the situation in former transition economies of Central and Eastern Europe suggests that they are hardly lacking in strategies either. Authorities from most policy spheres are now experienced in establishing strategies for their

field of competence and geographical area, and accustomed to inviting relevant actors to participate in the process and contribute towards implementation. In developing countries this trend is actively encouraged by several international organisations and development agencies that fund the establishment of such strategies for the development of regions and localities.

More of a challenge is the *implementation* of these strategies. Agreement on a strategy by no means implies any concrete application, especially when a number of different and possibly conflicting strategies exist in the same area.

A lack of flexibility around organisational targets – which have an important role to play here – means that many bodies, and most notably public or quasi-public ones, are likely to give priority to their own targets over those set collectively. Fulfilling strategic objectives frequently relies on the capacity of each of the organisations involved to match their own objectives with those agreed, which is easier said than done. Partners can of course try to influence joint strategic planning to the extent that the final objectives are consistent with their own aims and targets, but that degree of involvement is not frequent in planning processes. The problem is accentuated because strategies, and the mechanisms set out for their delivery, are seldom legally binding. Most of the time, partners feel free to participate in collective strategic planning but not obliged to translate the result of agreements into concrete action.

Giguère (2004) summarised the barriers that prevent government offices and public services from fully engaging in partnerships and the implementation of local strategic planning processes as:

- *Rigidity in target setting.* Government offices frequently set targets in order to ensure that national policy goals are met. Leeway to adjust targets to local concerns and measures taken in other policy fields is therefore often limited.
- *The pursuit of efficiency.* Performance management methods are introduced to maximise efficiency in the use of public resources, sometimes through open competition with private providers; this narrows the approach to policy implementation.
- *Vertical accountability.* Public service officers are accountable to their internal administrative hierarchy and have no obligation to respond to requests from other policy areas or organisations at local level.
- *Legitimacy.* Public sector officers representing the state and local elected officials are reluctant to co-operate and share information with business and civil society representatives, especially where the representation mechanism for such actors is loose.

- *Monitoring and evaluation*. Public services are often reluctant to participate in joint initiatives if their contribution will not feed into their own performance management framework.

Since many of the actions to co-ordinate, adapt and orient policies in partnership are taken forward by the national government, the full involvement and commitment of the latter is a prerequisite to achieving concrete results. A lack of flexibility, within both centralised and decentralised systems, currently undermines the crucial role government could play in improving the local governance of economic and employment development.

Government must therefore identify ways to make its policy management framework more flexible. To that end it can work on relaxing some of the obstacles listed above. On the other hand, it must reinforce accountability. The analysis of partnerships and new forms of governance above shows that loose accountability relationships undermine the commitment of partners and the effectiveness of co-ordination mechanisms. Increases in administrative flexibility should therefore be matched by greater accountability, or by reassurances that full accountability is maintained on decisions made in a more flexible management framework.[2]

Conclusion

The analysis of governance issues in relation to four different drivers of growth suggests that improving local governance is conducive to economic and employment development and prosperity. Improving governance requires improving co-ordination (between actions targeted towards each different driver and other actions with relevant externalities), adaptation to local conditions and the participation of business and civil society.

Several new forms of governance have emerged over the past years. The main thrust of these developments has been to stimulate co-operation between public, private and civil society actors; to bolster a strategic approach to economic and employment development at local and regional levels; and to take a co-ordinated approach to implementation. Each of these mechanisms has strengths and weaknesses. Some are more particularly suited to one particular driver of growth, and less to another.

Regional strategic platforms and newly empowered regional assemblies have significant potential in terms of breadth of approach and capacity to implement. Both are capable of designing and implementing strategies to foster endogenous development and innovation. Both can involve powerful organisations and obtain significant legitimacy. Regional assemblies may in addition provide the accountability framework that regional strategic platforms lack. Having to build consensus to succeed gives regional assemblies an impetus to stimulate democratic participation in strategic planning exercises.

In terms of linking entrepreneurship and innovation with skills and employment, regional assemblies are probably best placed to influence and broaden the range of objectives guiding the implementation of labour market policy, and to bring policy more in line with economic development concerns and prospects in the region. Some adjustment in the national policy framework by central government may be required to adapt the labour market policy framework fully to the new context. Devolution may help but is not necessary as long as some flexibility is granted in the targeting and performance management system within a decentralised public administration. A regional skills alliance would probably help feed the strategic process with a clearer articulation of employer needs.

With regard to ensuring that social inclusion features within the overall strategy for the region, there is in principle no contradiction in having area-based partnerships feed a broader strategic framework at regional level, whether that framework is operated by regional assembles or regional strategic platforms. Area-based partnerships, with their close connections with community representatives, are well placed to identify solutions to socioeconomic problems, as they tap into the expertise of civil society organisations to propose new endogenous development projects within the strategic framework of the region.

There is a clear role for government in improving governance. Pursuing strategies usually implies a role for central government, and public services face specific barriers – especially relating to participating in joint strategic planning exercises – that undermine attempts to improve governance. The overarching principles that should guide government here are flexibility and accountability.

Institutional reform should not be pushed as an end in itself. It should aim to improve flexibility in the management of relevant policy areas in order to make co-ordination and a strategic approach possible at the local and regional levels. The second important principle to follow is that to make improvements in governance sustainable, accountability should be preserved during the process. No significant impact is to be expected in the long term from governance reforms that spread new issue- and partnership-based organisations, unless there are appropriate changes in the policy and accountability frameworks of the relevant government departments and agencies involved. In the meantime, more significant governance improvements can be expected from the interaction between pragmatist organisations evolving in a context of highly visible performance and mutual accountability, though the type of problem tackled is likely to be sector-focused and not involve complex cross-cutting issues.

Thus, governments should aim to maximise flexibility in the local management of programmes while preserving efficiency in service delivery

and accountability for the use of resources invested, and shape reform accordingly. This would surely be one of the best ways of enhancing governance as a mechanism for fostering economic growth and social cohesion.

* * *

The chapters that follow will go into more details on how these recommendations can be implemented. Chapter 2 will examine the instruments of good governance further and show that it is in the interest of government to facilitate their introduction by encouraging information, evaluation and flexibility in national policy frameworks. Chapter 3 will provide an in-depth analysis of one particular instrument – partnership – and show how monitoring and evaluating outcomes is critical to healthy governance mechanisms. Chapter 4 will explore the latest developments in the governance of local public services, and show how pragmatist organisations improve effectiveness and solve difficult problems in a context of fluid information and visible performances. Chapter 5 will investigate the role of cities in promoting growth and competitiveness. Chapter 6 will turn to ways of financing local development and identify how partnerships and other forms of governance can contribute. Chapter 7 will present the state of the art in strategic planning exercises and examine applications in Central and Eastern Europe.

Notes

1. The author would like to thank Francesca Froy and Ekaterina Travkina for their comments on this chapter.

2. The recommendations contained in the strategy to improve governance through partnerships (OECD, 2001) provide guidance on how to increase both flexibility in the management of policy and accountability in decision-making.

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ISBN 92-64-01329-6
Local Governance and the Drivers of Growth
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Chapter 2

The Instruments of Good Governance

by
Xavier Greffe

Local development brings together stakeholders and projects for improving economic activity and employment in a given territory. It demonstrates that local conditions for development can exist side-by-side with national or even international conditions. It can apply to territories of different sizes that fit together. Whatever these aspects, a common trait of all local development successes is the building of partnerships, and the need to govern them properly. While partnerships would seem to be the wellspring of local development, it is good governance that determines their quality.

Introduction

Local development brings together stakeholders and projects for improving economic activity and employment in a given territory. Local conditions for development can exist side by side with national or even international conditions, just as territories of different sizes can fit together. Whatever the dimension, a common trait of all local development successes is the building of partnerships and their proper governance. Partnerships may seem to be the wellspring of local development, but it is good governance that determines their quality.

Several types of instruments can help here: a proper allocation of responsibilities between the different levels of government involved (the institutional environment for governance); a sound organisation of fora conducive to fruitful interaction between shareholders (institutional design); good management of project execution at its different levels: legal, financial, and cultural (regulation of governance).

It is in the interest of national governments, then, to facilitate the introduction and spread of such instruments by encouraging information, evaluation and flexibility in national arrangements. A wealth of illuminating experiments and lessons is to be found in the experience in OECD countries. It may also be asked how and under what conditions the instruments of good governance can be extended to countries with singular trajectories of experience, such as those of Central and Eastern Europe.

Local development is the sum of economic and social actions taken to improve economic activity and employment in the territory by mobilising its stakeholders. It exhibits three characteristics:

- There is a mobilisation of local stakeholders that may also involve players and programmes at the national level.
- These stakeholders' projects and actions are co-ordinated.
- The territory's frontiers may vary and not always strictly correspond to official administrative borders.

As early as 1993 the OECD had shown the potential and limitations of local initiatives: they could help foster development provided they produced formal or informal agreements between different types of public and private stakeholders at the local or national level (OECD, 1993). At a time when macroeconomic policies were by themselves incapable of combining

economic growth and full employment – a condition for sustainable development – the creativity of territories and their stakeholders made an important contribution. In this respect, local development marshals the conditions necessary for sustainable development within a given territory. It is a strategy, one that can be measured by the yardstick of positive reconciliation between the economy, society and the environment.

It is important, then, to define the notion of "local development":

- It aims to show that there are viable macroeconomic conditions for large territories.
- It can be applied to territories of different sizes – regions, provinces, municipalities, etc. – whether or not they are a good fit for each other. It should be recognised that these local conditions for development will not necessarily be the same from one level to the next.

Local development experiments and policies are many and varied, reflecting the variety of concerns on the part of stakeholders and territories. They all involve the use of levers that constitute the substance, and which can be used to assess the relevance of the instruments.

These levers are conventionally identified in a linear way: creation of businesses and activities; the resulting creation of jobs; furnishing of the required skills; learning and development of innovation capacities; redistribution and the forging of new social bonds, improved living standards, etc. In place of this linear sequence, one could view local development analytically as consisting of three intersecting circles:

- Circle 1 would represent a territory's responsiveness and competitiveness, as measured by its capacity to foster new activities. The creation of new activities accounts for a significant portion of employment creation (perhaps 20%: OECD, 2003a). In disadvantaged areas it can also optimise the use of capital and labour; strengthen the capacity to respond to change; produce better trade-offs between inflation and unemployment; increase tax revenues and the quality of public services. The quest for competitiveness for a territory leads to a reorientation of growth mechanisms. Instead of relying on exogenous growth based on public investments or on attracting industries from outside, the emphasis will be on mobilising local resources through networking: among firms, between firms and research, or between private and public players (OECD, 2004).
- Circle 2 would represent the establishment of labour markets that are efficient or that can respond to the demands of business and incorporate available human resources. In the absence of such markets, the mismatch between the supply of and demand for jobs and skills is likely to worsen, and any prospect for development will depend on importing high-cost

labour. Organising such markets requires co-ordination of economic and social strategies, firms, training institutes, associations, etc.

- Circle 3 would represent the creation of a solidarity-based economy that meets needs and consolidates capacities, without which dualism will grow and the territory's economic activity will suffer. While solidarity is the best yardstick for measuring this aspect, the creation of social capital, *i.e.* the capacity of local players to regroup, exchange ideas, undertake joint projects and learn from their collective mistakes, is an essential dimension (OECD, 2003b).

The three levers of local development contained in these circles highlight a dual need: expanding the field of intervention and the interaction of development stakeholders; and ensuring that the resulting synergies are positive. Contrary to conventional wisdom, the essence of local development lies less in changing the scale of the levels examined than in paying greater attention to the processes of co-ordination.

Local development, partnerships and good governance

When it comes to creating new activities, fostering positive integration into the labour market, or establishing solidarity networks, the stakeholders must be involved. The question arises as to why the conventional mechanisms of the market and the allocation of public funds have not produced such synergies. What should these stakeholders choose as criteria for good governance?

Limitations of the market as the basis for co-ordination in problem territories

The market brings together players and defines them in terms of their role as agents, consumers or providers of goods, labour and capital. In depressed territories, such designations fail to unleash the required synergies. A few examples:

- Creating a skilled workforce may require training the trainers, buying machinery, or establishing budgets with a time horizon that extends far beyond the immediate need and could thus result in incoherence. This is indeed why the "compacts" were introduced in big American cities: accords where employers and training institutes commit themselves to long-term strategies with guarantees and even funding from local government.
- Creating new enterprises based on local human resources may require coaching, counselling, and progressive diversification of financing sources, entailing co-operation among various stakeholders.
- Integrating marginalised youth into the employment market may require assistance with transportation, training, health or housing that goes well beyond the simple labour supply-demand interface.

- Offering new public services implies synergy between associations that possess know-how, local governments with financial means, enterprises, etc. – and here again the scope of these services can be broader than that of the market. It calls simultaneously for economic engineering to satisfy new needs; technical engineering to arrive at new productive combinations; and financial engineering, where prices will gradually replace start-up grants.

Moreover, there is no guarantee in a depressed territory that the market can spontaneously provide the elements of a solution:

- In areas with high unemployment, social networks function poorly and the mechanisms for ensuring a minimal exchange of information are lacking (OECD, 2003a).
- Low property values deprive would-be borrowers of the collateral often required for investment loans.
- The lack of qualified or experienced human resources prevents the emergence of a forward planning culture, and entrepreneurs are unable to mobilise the potential for initiative and creativity.

The limitations of public funding as the basis for co-ordination in problem territories

It may be thought that public funding can create the synergies required among stakeholders, in that it generally imposes upfront co-ordination and involves predetermined sums. But again there are difficulties with public funding in these territories:

- Local governments find themselves short of cash at a time when central governments are placing ever greater demands on them for reasons linked to the macroeconomic situation.
- Governments at the national and the local levels alike will not always have the information and technology available to identify and satisfy new needs. Returning to the instruments of the welfare state in an attempt to correct these failures will only reveal their inadequacy.
- Public services often lack the flexibility to take advantage of new situations, and concerted action is often limited to the traditional social partners of past periods of growth, reflecting the tripartite arrangements in place in many OECD countries.
- The great majority of public subsidies or funding mechanisms are ineffective because they are designed to compensate rather than prevent problems. Schemes to protect the unemployed, for example, represent a passive approach, whereas they could be made proactive, and many successful experiments at local development have indeed been based on such a shift.

The need for new partnership networks or "weak ties"

To escape from these crisis situations, networking through "weak ties" is essential (Granovetter, 2000). People who are linked by a specific category share common objectives and forge among themselves "strong ties", such as through professional organisations or unions. When they engage in bilateral dealings clearly circumscribed by the market, they have a real chance of achieving their objectives. Where such ties do not exist, or where changes to the environment are such that their interests may diverge, another type of networking is needed.

What is needed is a minimum of co-ordination, adaptable case by case, that allows people to advance their interests and to respect the objective bonds of solidarity that link them. In a climate of uncertainty and scarce resources, they must pool their capacities for planning and innovation. This minimum of "weak ties" describes the field of partnerships that are today inherent in local development. Partnership is not a magic wand that can melt down conflicting interests into a consensus. It will not always create the continuity needed to resolve complex problems. But it can give a positive content to interdependence, provided it is "strategic", *i.e.* focused on the future of a territory and the conditions that make different peoples' projects and ambitions compatible.

In contrast, a "cosmetic" partnership, limited to providing meeting places, cannot change the situation. It will suffer from tensions stemming from the dilution of responsibilities, the emergence of opportunistic behaviour, and risks of paralysis or loss of interest.

To understand this notion of strategic partnership, it must be recalled how the market is meant to settle disputes among players with conflicting demands:

- The market resolves disputes through a double device: players are considered as agents in complementary roles, so that the interest of the supplier is to benefit from the presence of a consumer, and *vice versa*.
- The market introduces large numbers, with the result that competition among consumers results in the offer of a remunerative price to suppliers, and competition among suppliers results in the offer of an acceptable price for consumers.

Neither of these conditions is satisfied in the field of local development:

- Players there often compete instead of complementing each other, as is the case with established firms versus new enterprises.
- The players are limited in numbers, which reduces their dealings to a zero-sum game.

To arrive at an accord, they will have to situate their plans and ambitions within a perspective that associates them in a positive way. This can be done more readily with a long-term vision where the positive element of interdependence wins out over the negative element.

As the Tavistock Institute (1999) described it, having stakeholders relate to each other through varied mechanisms allows them:

- To target their plans more effectively, since players in a given group know how to put together solutions to the problems they face on a daily basis.
- To carry out projects successfully, since they will have been mobilised from the outset and their respective responsibilities are linked by the need to achieve common objectives.
- To reinforce their capacity for action, now and in the future, since each partner will benefit from the experience and involvement of the others.
- To forestall problems that might arise such as the effects of displacement. The creation of new activities can indirectly work to the detriment of other activities, for example by exerting inflationary pressure on prices for land or scarce human resources.

The strategic dimension of this partnership is especially important because it must also take into account outside players, such as central governments. Such players establish the regulatory framework, which may lead them to influence local development when initiatives taken at this level challenge certain national mechanisms or principles, for example the mobility of capital or labour. They provide what is generally a significant portion of local resources and they have the power to define equalisation arrangements between richer and poorer territories. They produce many public services that help to raise living standards for local people and equip them with specific skills. They possess significant expertise that may be lacking in local governments. Finally, they often control a good deal of local land, and the way they manage it can facilitate or hamper the pursuit of local projects.

The criteria for good governance of partnership networks

If the purpose of networking is to establish a strategic partnership, its viability will depend on the way it is organised.

Establishing strategic partnerships among a great many players requires the co-ordination and pooling of their skills, the establishment of meeting places, and integrated management of complementary or common resources. The result is governance, or the way these players define and settle their problems. Depending on the quality of this governance, the partnership will succeed or fail in promoting local development. Quality of governance thus

determines quality of partnership, and the latter's capacity to foster development.

Since local development requires the mobilisation of local players, it is normal to examine governance on the basis of the relations among them and the tools they put in place for this purpose. Enterprises, workers' organisations, local and territorial governments, public non-profit institutions and specialised agencies are all players whose interactions will define horizontal governance. Two players may fill the role of mediation or leadership: the local authorities, who are meant to represent the general interest and who wield some strategic tools, starting with budgets; and specialised agencies, often created by these local authorities, that are delegated responsibility for preparing, implementing and (in certain cases) making decisions about local development projects. Forms of governance will differ, then, depending on the relative place occupied by these local authorities and agencies, and the stage of the project at hand.

This horizontal governance must also take into account the role of national or other players involved with local development strategies. Governance cannot be solely horizontal, and local players must co-operate with a number of national players or their local representatives. The quality of vertical governance interacts with that of horizontal governance. It is important to strike a balance between the two:

- Good horizontal or local governance without vertical governance may be powerless because it cannot mobilise the necessary resources around the players concerned.
- Good vertical governance without local governance may be deficient because it cannot rally the necessary players around the available resources.

Are there any operational criteria for evaluating the quality of these kinds of governance? There are two possible approaches.

The first has to do with the desired outcome, and the OECD (2001a; 2004) has here pointed to the capacity of governance to produce a situation that combines economic, social, and environmental development and called for the identification of suitable governance indicators.

The second approach makes use of more operational criteria such as:

- The variety of the associated players, and extent to which they are representative.
- The quality and comprehensiveness of the information gathered.
- The clarity of decision making.
- Complementarity and non-competition between these tools and those of the market and of administration.

- The avoidance of duplication and windfall effects.
- Clarification of responsibilities for project execution.
- The capacity to detect opportunistic behaviour or rent capture.
- The capacity to evaluate.
- The consolidation over time of experience and skills acquired.

The organisational instruments of good governance

How can good governance be achieved? Many factors contribute to this goal, directly or indirectly: the nature of actors' preferences, the systems whereby they meet and interact, the usefulness of available information, etc. Moreover, all these elements are linked, so that the way debate and co-operation is conducted influences the formation of people's preferences and choices.

There would seem to be three decisive kinds of instruments:

- Players must have powers commensurate with the nature of the problems encountered. The allocation of responsibilities, then, would seem to be an instrument of good governance.
- Players must have a forum for exchanging information, examining their strategies, and taking decisions. However competent they may be, players who do not have such a forum will not be able to achieve the synergies that lead to good governance. The institutional design of partnerships would thus seem to be another instrument of good governance.
- Players must be in a position to respect their mutual commitments and to manage together legal, financial and physical resources. Adoption of coherent strategies and projects is no guarantee they will be implemented, and co-ordination instruments are needed to maintain the coherence of strategies and projects over time. Instrumental coherence could then be considered a third type of instrument for good governance.

Distribution of responsibilities among different levels of government

A situation where local players do not have the necessary authority to take decisions cannot lead to good governance. This point concerns the different levels of government, central or local, and will be addressed from this angle. But it may also apply to private stakeholders, for example when centralised organisations do not allow their local members to take any decisions at all.

Decentralisation in support of local development

Local development takes place in a setting where responsibilities are distributed among different governments, central and local. The distribution

will be adequate if the different levels of government can take decisions commensurate with the problems they face in their respective territories, subject of course to some limits:

- Problems are never mutually independent. Thus, efforts to create a business-friendly local environment must not degenerate into fiscal competition between local governments.
- Some levels of territory or government may be better endowed than others, offering the potential for economies of scale that will benefit everyone.
- Decisions that may at first glance be favourable to one group of stakeholders may work to their disadvantage when they move to another territory. A local government that establishes very narrow vocational qualification criteria may prevent workers from adapting in the future.

The allocation of powers cannot be reduced, then, to simply dividing up the pie. It must be governed by three principles:

- Local governments must have sufficient capacity to wield information, decision-making and allocation powers that other, more removed levels of government do not have.
- Central governments are concerned with local development to the extent that they must keep markets functioning normally and see to the required redistribution of wealth.
- All governments, central and local alike, must be held accountable for the decisions they take, and they must not get into debates that will confuse responsibilities or cloud the transparency of information: otherwise, efforts to promote local development will fail to inspire the confidence and commitment of local development partners.

Those notes of caution sounded, the discussion can now move on to cite a number of reasons behind the trend to delegate to the local level powers that were formerly held at the central level (Greffe, 2003):

- The impossibility of maintaining centralised mechanisms that are inflexible and hence costly.
- The specific features of certain territories (islands, high mountain valleys, etc.).
- The many dimensions of employment problems or the creation of new activities that require co-operation among different players close to jobseekers or project sponsors. An illustration may be found in the programmes to support self-employment in Italy, Belgium and Spain, or to encourage hiring by very small enterprises in Finland, France and Ireland. These programmes provide both local and national benefits through the learning and growth effects they produce. They are often financed with funds diverted from social protection budgets. The programmes differ in

terms of their eligibility requirements, their duration, their financing structure, and their leverage impact on access to other national or local programmes. They are often criticised for failing to achieve the desired effect, and in some cases they may become nothing more than consumer microcredit programmes. Yet available studies show that the survival rate for such activities is no lower than it is for activities that are launched with no outside help (OECD, 2003a).

- The desire to make employment policies more proactive. Often, as in the United States, financial mechanisms targeted at unemployment were defined by categories of persons or groups, which implied control and decentralisation at the national level (Straits, 2003). This generated great confusion locally, with overlapping responsibilities and inadequate attention to minorities. To resolve the situation it was decided to establish a "one-stop shop" and to enlist the co-operation of the private sector, which implied decentralising these programmes.[1] In Flanders, the move to create new jobs and open new markets was planned at the local level, for it seemed that only there could all the required partnerships be assembled to make such an innovation possible. It must be noted that innovation is generally worked out among the social stakeholders who will have to carry it forward; this dialogue can only take place at the level closest to the problem addressed (OECD, 2001a).
- The increasing volatility of the employment market is driving players to search for the shortest paths to information and training, and this lends great importance to the manner in which employment markets are organised locally.
- The growing gap between employment and economic activity means that programmes to return people to work rely increasingly on community-service (non-profit) activities, and this requires a very detailed analysis of target territories and groups. For more than ten years, the neighbourhood boards (*régies de quartier*) of France, which are managed within a municipal framework, have been seeking to develop such activities to help revive the economy over time.[2]

Examples of such devolution are numerous, and generally take two broad forms:

- In most countries, certain responsibilities are transferred directly to local governments (France, Italy, Spain).
- In other countries, the central government retains its powers but leaves their exercise to its local officials (United Kingdom).

In fact hybrid forms are frequently found, if only because of the long transition time from one system to the other. In the end, there are several

reasons for maintaining responsibilities at the central level, even if they may have a direct impact on local development:

- The desire to avoid the disruptions that can be caused by excessive competition between local governments or by a degree of autonomy that pays no heed to workers' subsequent mobility.
- The desire to achieve a minimum degree of equality in the treatment of individuals regardless of where they live. This is why unemployment assistance is still paid on the basis of national principles.
- The traditions of the welfare state in the area of financing. In countries where the social partners play an important role in collecting funds and distributing benefits, centralised mechanisms are considered a guaranty for the maintenance of these systems.

The redistribution of powers often leaves some overlap or duplication, and it is rare to see systematic redistribution of entire chunks of responsibilities.

In any case, there is a broad agreement that decentralisation can in many cases foster partnerships and promote governance.

While the United States is hardly a typical case, given the specific features of its federal arrangements and the importance of its private sector, its experience deserves recognition. Two recent laws have taken decentralisation further in the production of social services and in occupational training and development (OECD, 2001a). The 1996 Personal Responsibility and Work Opportunity Reconciliation Act promoted vertical co-operation between the federal, state and municipal levels for implementing workforce development programmes. The 1998 Workforce Investment Act encouraged state and municipal governments to contract out services to private agencies and service providers. Non-profit organisations now play a considerable role in co-ordinating public services.

While the first law stresses on-the-job skills upgrading, the second focuses more on investment in job-hunting skills and pre-employment training. Both pieces of legislation have the same objective: to bring training resources and choices closer to the problems they are supposed to address, a trend that has been under way for more than 30 years.[3] These laws in effect complete the decentralisation moves by systematising partnership possibilities at the local level. This "localisation" links training programmes with the obligations that employers and workers subscribe to. Normally, the local workforce investment board (WIB, which generally has a private sector majority) will organise a one-stop agency for accessing training programmes under a director who is recruited by competition. These agencies perform a variety of functions, including preliminary skills evaluation, information on available services, assistance in preparing unemployment insurance applications, training programmes, etc. The local WIB will also sign contracts

with different service providers (private businesses, non-profit organisations, public training institutes) that define in detail their functions, duties and responsibilities. Finally, these local boards may establish education grants, financed from their own budget and awarded to training applicants (OECD, 2001a).

This shift can also be seen today in the countries of Central and Eastern Europe. In 2001 the Czech Republic decided to make the regional level a strategic one for local development planning (OECD, 2004). These new regions can prepare plans, co-ordinate services to households and businesses, administer public facilities and take on major responsibility in environmental management. In carrying out their duties they can rely on the Regional Development Agencies, which are often instituted by chambers of commerce and thus involve a significant partnership dimension.

Reinforcing the decentralisation trend: reorganising public employment services

All the offices and agencies that help deliver placement services and unemployment relief, and that implement measures to promote employment, are traditionally classed together as "public employment services" (PESs). In light of ILO conventions on abandoning the public monopoly in this field, there has been a dual trend towards decentralisation and privatisation of such services.

One solution might have been to reform all administrations simultaneously, but such reforms run into problems with transfer of personnel. An alternative solution could have been to decentralise these administrations and hand them over to local governments. This has been only partially attempted; some local governments were not eager to take over these functions, and the centralised administrations were still perceived as guaranteeing equal treatment for workers. Decentralisation therefore focused primarily on redeployment and the rearrangement of certain powers within the public employment service.

Four measures have been implemented to achieve this:

- *Ensuring co-ordination among the different services*. This is usually done in two ways. The services may be placed under the direction of a local official of the central government (in effect, the head of the local employment agency). The responsibility will clearly not be devolved to a local authority, because this would be tantamount to another form of decentralisation – in this case of the central government's powers. Or, the services are induced to integrate their strategies and actions into a local employment plan. This last solution was the one used in France, which adopted the principle of departmental employment plans prepared by the departmental labour

office. All central administrations are expected to assist with the implementation (employment agencies, adult education agencies, national education services, health services, etc.).

- *Expanding the discretionary powers of public employment services*. Co-ordinating these services locally would make little sense if that merely shifted decision-making downward from a higher level without taking advantage of the information exchange at the local level. Such latitude relates above all to the form their actions take, for example in the furnishing of information and the preparation of training.
- *Setting up one-stop shops*. Nearly all countries are reforming their public employment services on this basis (Germany, Denmark, Flanders, the Walloon region, etc.). While these agencies simplify things considerably for the unemployed or for jobseekers, they also force administrations to work together, to harmonise their terminology, and to strive for economies of scale in their delivery of services. It will come as no surprise that many countries are determined to achieve this objective. Thus, Austria developed a plan to set up a network of one-stop shops by 2003. Germany is in the process of introducing a new local agency model. But other authorities, for example in the Walloon region, have maintained the principle of institutional diversity, for reasons having as much to do with federalism as with avoiding too narrow a concentration of services to the unemployed and to jobseekers (Förschner, 2003; Knutzen, 2003).
- *The possibility of introducing regionalised service delivery*, for example using allowance rates or conditions differentiated by region. This is not a new idea, and with the surge of unemployment in the 1960s some countries had the idea of diversifying eligibility conditions (through what was still a centralised decision-making process) to take account of differing regional economic circumstances. The worse those circumstances were, the more purchasing power would have to be redistributed through unemployment benefits. These policies encountered two problems: how to establish realistic criteria for differentiation, and how to avoid windfall effects. It was thus left essentially to central governments to undertake the redistribution of purchasing power through the tax system and public spending, while recognising that insurance-based compensatory schemes would be difficult to redeploy in that direction. Today the objective seems somewhat different. In addition to benefits distributed through the employment services, there are assistance mechanisms instituted by local governments as a complement or even, over time, a substitute for those benefits. It is natural, then, that public employment services are attempting to work with local governments to streamline the different systems and enhance their social and economic efficiency.

An illustration of such trends can be seen in the informal co-operation that exists in Denmark. The public employment service there has been sharply decentralised to the regional level (OECD, 2001d). This decentralisation has been accompanied by a strong dose of tripartite arrangements: at that level are found the regional labour market councils (RAR), managed by the regional office of the public employment service and bringing together the social partners, the counties and the corresponding central government agencies. Decentralisation of this kind allows Danish labour market policy to operate as closely as possible to the constraints and opportunities facing each player. The idea is to ensure compatibility among three objectives, which could easily come into conflict: greater labour market flexibility; a generous welfare system that constitutes a strong social safety net; and an active policy of creating work opportunities so as to respond as promptly as possible to jobseekers. These objectives form the so-called "golden triangle".

The unemployment insurance reforms of the mid-1990s have placed a growing financial burden on municipalities. When the unemployed exhaust their benefits they have nowhere to turn but the municipal social assistance programmes, which means that any restriction on unemployment benefits increases the financial liabilities of the communes. The PESs have thus associated the municipalities with the RAR, which were dealing precisely with this problem. Moreover, these regional councils now manage the unemployment insurance funds. That kind of dialogue was impossible at the national level where there are 275 municipalities, but was feasible at the regional level where there are an average of 20 municipalities with roughly similar resources and burdens. Everyone gains in such a partnership. The municipalities are able to put across their viewpoint more effectively and to build a strategy in tandem with the RAR in order to respond to the social protection challenge. The public employment service benefits from the municipalities' hands-on experience with social security problems, and in particular from their familiarity with the target groups (OECD, 2001a; Hendeliowitz, 2003).

Whatever form it takes, the decentralisation of public employment services is not in itself a guarantee of a new approach to employment governance. That requires not only new relationships with local government but also – and above all – a new attitude on the part of these public services.

The *Joint Declaration of European Public Employment Services (PES) on Their Role in the Labour Market* (European Commission, 2001a) of September 2001 clearly illustrates the change of attitude required.[4] It asserts that the challenges facing the labour market will include a chronic shortage of certain skills, the emergence of new forms of work, the ageing of the workforce, etc. The PES must serve to highlight the opportunities as well as the bottlenecks;

ensure transparency in the employment market, as expert service providers; provide tailor-made counselling to potential employers and to jobseekers; and fulfil the social tasks of a constitutional state and promote equality of opportunity. It adds that the field of action must be regional, in order to be both effective and flexible (European Commission, 2001c). Such a declaration, coming from agencies that are often criticised for being too rigid and bureaucratic in their approach to employment markets, shows that reforming the PES makes sense only if it involves a radical shift of attitude in the direction of effective decentralisation. That decentralisation implies the development of territorial engineering capacities. In France, where the local public employment service is responsible for preparing an action plan, the shift has taken the form of a call to produce local employment diagnoses and an obligation to draw up an employment plan at the *département* level. This has sparked a great deal of activity. Frequently the proceedings begin with a fairly technical debate to identify the skills that may already be present in a given territory in order to expand the potential local development base, which means bringing in players outside the service (European Commission, 2001b).

Decentralisation by strengthening co-operation

A quite different approach to decentralisation can be seen today in the strengthening of co-operation between the national and local authorities in ways that do not necessarily imply a change to the institutional framework. Such co-operation can involve shared analysis of the territory's needs. It can also involve specific actions, for which a contractual tool becomes essential.

Finland offers an example of the first type of co-operation. As with all countries of the European Union, and in line with the Luxembourg process, Finland has prepared a National Action Plan for Employment. But it decided that the plan would have to be based on specific regional approaches rather than a simple (and irrelevant) summation of the many local plans. It decided therefore to start with three regional employment action plans produced by three regional centres, each of which works in co-operation with the various ministers. Once the regional plans are in place the national plan is drawn up, but most importantly, the public employment service is asked to help carry them out. Ireland and Portugal also offer approaches of this kind, where regional employment plans are supposed to serve as the basis for preparing a national action plan (European Commission, 2001b).

Austria provides another example of this decentralisation through the strengthening of partnerships between different territorial levels. In that country there has been no devolution of powers from the federal to other levels, and the central government is still officially in charge of economic development and labour market organisation. On the other hand, the public employment service (*Arbeitsmarktservice*, AMS) was greatly decentralised in

1994 in such a way that its regional and district agencies could co-operate effectively with the *Länder* authorities, who also have a role to play in economic development. With the introduction of two mechanisms recommended by the European Union (the National Action Plan for Employment and the Territorial Employment Pacts), the Austrian government has been experimenting with a new way of implementing its employment policies, based on partnership at different levels (*Länder* and districts) between the public employment service and the local authorities, and on vertical partnerships between these levels. The national level is responsible for a general analysis of the employment market and for setting objectives in close consultation with the social partners. At the regional level, partnerships have the task of analysing the regional labour market specifically; co-ordinating PES efforts to stimulate or match labour supply and demand; and creating supplementary jobs for the unemployed (OECD, 2001d). The regional partnerships' main contribution has been to broaden the field of traditional partners in employment policies. Whereas these were essentially confined to the social partners in Austria, they are now coming to include the local authorities, starting with the *Länder*; associations representing target groups such as women and disabled persons; NGOs such as Caritas; and even movements of the unemployed. Another positive effect has been to reinforce the capacities of the AMS and local development agencies (OECD, 2001a).

Between decentralisation and good governance: transparency and accountability

However useful it may be in fostering good governance, decentralisation can also result in a non-transparent system where responsibilities are diluted rather than shared, and this may make potential local development partners suspicious and unco-operative. Far from serving as a factor of rapprochement, decentralisation and the new architecture of powers and decision-making authority can evoke resistance among private partners.

Whatever the institutional solution proposed, it will succeed only if behaviour adapts as well. Central government officials who would benefit from sharp devolution must accept joint accountability for local situations. On the other hand, local officials must understand that in exercising their powers they will have an impact that goes beyond the local setting. This dual cultural attitude is a condition for proper functioning of the new arrangements.

Another, all-important condition is transparency. The solutions adopted will never be as clear as desired, for they will always involve a degree of complexity. Issues, decisions and impacts must therefore be very clearly identified. Cronyism or corruption can destroy good governance. Quite apart from its inherent cost, such behaviour will lead people to view these reforms

as a channel for the spread of corruption or rent seeking, and will undermine the dynamics of local development.

The institutional design of good governance

Good governance implies the existence of instances where partners can come together for information, discussion, co-ordination and decision making.

- Such instances must not only associate players at the same level but must also serve to establish contact among players at different levels.
- They must facilitate not only contact but real synergy, opening the way to a strategic rather than purely cosmetic partnership.

The latter distinction is important for defining the quality of institutional design. A strategic partnership implies changing the nature of the decision-making process so that decisions are based on a multiplicity of information systems and objective functions. It accepts that information sources are relative and that all preferences are equal. Here the term "strategic" has to do not with timing (short term versus long term) but rather with this plurality of values and preferences. A cosmetic partnership is designed primarily to adjust decisions to the preferences of the central player. The difference between these two types of partnership has to do, to a large extent, with the manner in which the partners will be regarded and associated.[5]

These instances of parties coming together can take four forms:

- The first occurs when public services seek to mobilise information and organise co-ordination in order to enhance their effectiveness. We may consider these as attempts at a new form of public management.
- The second recognises the desirability of enlisting stakeholders to take care of needs that are not addressed by the market or by public funds. Within a given geographic space, the partners are called upon to assume certain responsibilities collectively.
- The third recognises the importance of these players and their collective organisation at new territorial levels.
- The last brings players together not only to take decisions but also to manage the new services jointly.

New forms of public management

One approach lies in establishing advisory partnerships, in general at the initiative of public policy makers seeking to enhance their information sources and their capacity for action. Thus, local governments establish forums for information and discussion, and sometimes co-ordination, in order to address the complexity of issues and increase the effectiveness of their decisions. These initiatives are often taken in response to the

compartmentalisation of debate inherited from the tripartite arrangements between government, employers and workers that have long existed at different levels of public administration. Local development proponents have shown an interest in broadening this framework to include other agencies, including those of the third sector.

The introduction of proactive employment policies often lies at the origin of these instruments. In Denmark, Belgium and France there is a growing tendency to associate, at least in the information process, players who are not traditionally part of the employment market but who are involved in training, health, housing, or social assistance services.

- In Denmark, a major series of reforms undertaken in 1994 replaced the regional structures of the public employment service with 14 employment market councils, for which the PES served as the executive arm (OECD, 2004). These agencies bring together a variety of players, public and private, thereby significantly expanding the prevailing tripartite arrangements in the public employment service. They are thus able to establish regional employment policies based on maximum information and with at least some input from those who will have do apply them. Together with a policy of making the employment security system more flexible, this association is credited with contributing to the success in keeping unemployment rates low.
- In 1999, the Walloon region considered the possibility of establishing local structures with no formal legal status to serve as the "nerve endings for the public employment service". In partnership with the communes and the federal social assistance centres (CPAS), the Walloon region was seeking to create a place to which jobseekers could turn for information and counselling. The "Contract for the Future of Wallonia" makes clear references to this: "The government will assemble the information and support structures, which are currently too widely dispersed, within a single centre where the public will have access to full information on trades, the conditions for practising them, the opportunities for training, available jobs, and the possibility of pursuing traditional handicraft trades." These employment centres (*Maisons de l'emploi*), which would bring together various partners in the employment system, are designed not only to provide services to enterprises and jobseekers but also to improve the quality of those services, through face-to-face contact between institutional partners who were accustomed to working each in their own sphere. The centres consist essentially of two bodies: a restricted local management committee and a broader local coaching committee. The management committee embraces three partners: the commune(s), the CPAS, and the FOREM (public employment service). The expanded coaching committee is where all interested partners come together to help guide the activities of

the *Maison*, to share experiences, develop their activities, and sign support agreements with the grassroots partners.

This type of instrument poses three problems:

- Even if its scope is limited, there may be some dispute over the kinds of stakeholders invited to participate: some may veto others. Thus, in the territorial pacts some traditional players within the tripartite system have refused to participate in working meetings with other players, on the grounds that they do not have the same degree of accountability.
- If the exercise is to succeed, local governments or representatives must participate fully and share their information. Otherwise, the other partners will have to fall back on strategic behaviour. The atmosphere will not be co-operative, and stakeholders will offer only the kind of information that will serve their own interests.
- Contacts of this kind can undermine accountability and weaken efforts at evaluation. Even if all the players come away from the consultations with their responsibilities undiminished, they may still be tempted to blame any problems on the poor quality of the information transmitted by other partners. These bodies can only be effective if they have a proper computerised information system, especially for statistics, and such systems are seldom found at the local level.

Those three problems have moved some countries to reinforce the role of these bodies by making them more institutional, or by inviting them to offer a common diagnosis of the territory's future:

- In the Czech Republic, reform has involved introducing regional bodies that can undertake the preparation of diagnoses and strategies.
- In France, the regional economic and social councils have steadily raised the quality of information on the economic and social outlook for the region and for its territorial components.
- In Flanders, an effort was made in 1998 to invigorate labour market management organisations by instituting sub-regional employment committees and changing their design in two ways: new stakeholders were added, and they were given greater autonomy *vis-à-vis* the public employment service in terms of defining problems and solutions (OECD, 2001a).

Formalised area-based partnerships

A second instrument, limited in size and purpose, is to recognise the partnership dimension of certain groupings of stakeholders on a specified geographic basis in order to respond to needs that are not adequately addressed by the market or by public funds. In general, these partnerships

deal with problems of labour market entry or re-entry in sensitive rural and urban areas. Formal recognition of these bodies consists not so much in giving them their own statute (although this can happen) as in the possibility these players have to make selective use of certain public mechanisms. This approach, then, implies no new players or institutions, but rather new forms of co-ordination.

All countries today recognise the importance of such partnerships, which range from compacts to the territorial employment pacts of the European Union. In all cases, the originality of the arrangement lies less in the creation of a new player or new institution than in the mutual consolidation of relationships among existing, independent players who used to know or care little about each other.

There are two limits to this flexibility of arrangements:

- The objectives are limited, and often tied to a specific action. Rarely will such partnerships seek to make a territory competitive over the longer term or to manage, even indirectly, the delivery of services to businesses. On the other hand, they are more likely to make joint use of a public mechanism as a catalyst for a given territory. Thus the PLIEs, which in France constitute the main tool for urban local development, present themselves as mutual undertakings among local players for deriving joint benefit from national or EU financing mechanisms. The rationale for the territorial employment pacts introduced in European Union countries was the same: a commitment associating a territory's stakeholders in an effort to define joint objectives and derive common benefits from the public mechanisms that each could activate on their own.[6]
- Because these arrangements are often temporary in nature, the second difficulty has to do with their ability to capitalise on experience and to produce social capital. They are established to address a specific challenge, and there is no sign that the solidarity so achieved will carry over to other challenges. Thus, stakeholders who have succeeded jointly in activating services to businesses may be unable to agree when it comes to identifying the beneficiaries of training programmes, as between locally-rooted enterprises and enterprises relocated from outside the territory.

The most frequently cited example is that of Ireland's arrangements under the National Programme for Economic and Social Progress, 1990-1998. Faced with the problem of reintegrating large numbers of the long-term unemployed, several types of instruments had to be co-ordinated; the manpower services could no longer be relied on alone. For the government, only a localised approach to needs and opportunities seemed appropriate, and so it sponsored the creation of 12 local non-profit corporations to carry out these adjustments with the involvement of the players concerned. These local

partnership corporations were co-ordinated by a national agency, Area Development Management Ltd. (OECD, 2001a). A few years later, under another programme – the Programme for Competitiveness and Work, 1994-1996 – the functions of these partnership corporations were extended to objectives beyond reintegration of the long-term unemployed. They have now multiplied (to 38), as have local interest groups with less permanent functions (33).

One of the partnerships that has advanced the furthest is the Swedish RGA (OECD, 2004), although the initiative came primarily from the central government. In 1998 the government invited the regions to negotiate Regional Growth Agreements (RGA). The idea was to rally the logical development partners – chambers of commerce, universities, local employment offices, employers' associations and labour unions – around the local county government to define growth strategies. This was a way of avoiding duplication of effort between local governments that might be in competition on some issues, and to enhance the prospects of a successful industrial policy by bringing private players into the debate from the outset. The approach was influenced to some extent by experience with the Territorial Employment Pacts, but the immediate emphasis was on fostering thinking about development prospects, as was done at the RGA campus in Uppsala (OECD, 2004).

The establishment of regional platforms for meeting, pooling information, synergising projects and taking decisions is today a favourite approach to the good governance of local development. According to the OECD, "the tasks of these platforms are: *i)* to foster co-operation among the main organisations involved in economic development (*e.g.* agencies, business organisations, regional authorities) and neighbouring policy fields (*e.g.* employment, education, tourism); *ii)* to design and possibly implement a strategy for sustainable economic development; and, often *iii)* to stimulate innovation through building clusters of firms and establishing links between enterprises and the research and education sectors, among others" (OECD, 2004).

These platforms offer great flexibility:

- Geographic flexibility: regional platforms involve a regrouping of all or some of a territory's local government structures. Priority is given here to a geographic area defined in terms of economic development rather than administrative criteria (which are themselves linked to the notion of local public goods). This suggests that local development issues are broader than administrative boundaries, which have perhaps lost the economic significance they had in the past. The platform is highly appropriate because it brings development stakeholders together at a level that allows them to internalise the external effects that smaller territories can have on each other.

- Functional flexibility: the platforms respect the functioning of markets and of existing public funding programmes, while enriching them. Recognised as tools for information and co-operation, they are also employed as implementation tools. Here the platforms are given an oversight role, providing early warning, advice and evaluation. They become endogenous development advisers: drawing upon their understanding of the local situation in relation to the rest of the world, they can highlight the importance of certain assets and innovations. They become exogenous development advisers in that they point the way to integration into the global economy that the territory must strive for, consistent with its resources and responsibilities. Finally, they may be given the role of overseeing regional development agencies.

In the Flemish region of Belgium, it was traditionally left to the Subregional Employment and Training Committees (CSEF) to look at employment issues and define or support initiatives to improve the functioning of programmes. They were well-suited to the task by their composition, representing employers and workers in association with other potential partners including the inter-commune development bodies. The CSEFs, instituted by a decree of 22 December 1989, had three official missions:

- To maintain a standing watch over the employment situation and trends (serving as "micro-observatories").
- To research, propose and recommend any useful employment and training policy measures to help people join the labour market.
- To provide advice on all matters relating to employment and training submitted to them by the regional or federal minister responsible for employment and training. For example they deal with the licensing of occupational training firms and regional employment promotion programmes.

In Norway, it is these local employment committees that fulfil this role of regional platforms. Their composition reflects the tripartite arrangement at the national level, to which they add some further partners in order to take account of the required local complementarities. They do not adopt local development plans, which are the sole responsibility of the counties, but they help to implement them, and this is no less important. These committees become platforms, and experience shows that they are enjoying considerable success (OECD, 2004).

These platforms also have some limitations:

- They would not be needed if the agencies heading the regions, provinces or counties took their decisions on the basis of real consultations with the partners involved. This remark is pertinent, but it is often noted in response that these platforms can be given a more permanent institutional shape,

generally in the form of regional economic councils. This response does not suffice, because there are problems that may transcend regional boundaries and call for the kind of co-ordination that cannot be accommodated within existing institutions. The existence of sub-regional employment platforms in Belgium was interesting because it was recognised that they might not fit exactly with traditional administrative borders.

- Their dimensions can change depending on the kind of problems – specialisation or investment – they are addressing. Yet defining a strategy for training in new technologies is not the same thing as designing a strategy for integration into the global economy, which would call for investments that might be irreversible over perhaps a decade. This brings us into the field of ad hoc organisations, and a great deal of caution is needed with regard to their degree of formalisation or recognition.

New institutions for managing change

Beyond consultation and decision-making arrangements, partners can establish institutional players to manage and run their local development projects. This is the case with local development agencies, which were established from the outset to support local development experiments and policies. In some cases, these agencies are created by local partners; in others they are opened at the initiative of local government, which takes responsibility for them. Some operate under direct public control while others have more autonomy and may even be transformed eventually into private enterprises. Some are established specifically to create new activities resulting from the rearrangement of existing structures, particularly when agencies specialised in employment and training management find their mission broadened to include services to businesses, attracting new activities, etc. Finally, depending on their level, their content and name may change: thus in Belgium, local development agencies give way to *Missions centre-ville* ("town centre missions") as one moves from small communes to large cities and metropolitan areas.

Generally speaking, these agencies offer a number of services, including property, counselling, financial and training services:

- Property services are today seen as essential, and it is rare to find an enterprise that is not looking for public support in this area. This reflects in part the difficulty in finding suitable land within depressed territories. In Germany, for example, 90% of businesses setting up in such territories regard this kind of assistance as indispensable (OECD, 1999a). On the other hand, some local governments take advantage of this demand to negotiate commitments with new entrepreneurs in terms of employment levels or local recruitment (Greffe, 2002).

- Contrary to the generally accepted view, advisory services to businesses are available today. They tend, however, to be organised to meet the needs of fairly large companies. For smaller firms where there is little division of labour and where a skilled workforce is in short supply, it is difficult to fill gaps from the market. This situation may call for offering advisory services to very small enterprises or to would-be entrepreneurs, for example, through publicly funded mechanisms. For larger firms, another bottleneck may appear when they opt for certain technologies.
- Financial services are today the subject of more thorough diagnosis than they were a few years ago. The banks are showing an increasing interest in financing small businesses, especially through national programmes such as the Small Firm Guarantees Scheme in the United Kingdom or the Community Reinvestment Act in the United States. Such arrangements could at last offer solutions to the traditional handicaps that small businesses face – such as their high rate of bankruptcy, their lack of a track record, their inability to provide guarantees, high transaction costs, and lack of liquidity. On the other hand, some observers still point to obstacles when it comes to raising equity capital (OECD, 2003a).

Training services are also a central focus of partnership organisations. Small enterprises may be reluctant to seek training, for this would mean doing without the services of a person who may fulfil several functions at once, and whose absence could expose the business to high risks. Conversely, training organisations are hesitant to mount customised programmes for such firms, and if they do the costs may well be prohibitive (OECD, 2000a).

In some cases, agencies will concentrate on a single type of service for which they can develop the required level of professional expertise – something that is difficult to do if they try to offer several services at once.

The Walloon region has created a particular type of development agency that offers a single strategic service, namely the production of skills. The skills centre exhibits four specific features:

- Its approach is tailored to the nature or the development plans of the local territory. The forest industry centre in Belgian Luxembourg provides a striking example: its challenge is to provide local firms with the opportunity to move beyond the initial processing of wood, where value added is low, and to invest in secondary processing. The latter provides greater value added but has hitherto been performed abroad, with the finished product exported back to Belgium.
- It is designed and run as a partnership. Typically, a public agency (the foremost being FOREM) will make contact with or be contacted by the social partners. Contact could come through the sectoral funds where these partners meet to negotiate collective agreements, or through sectoral

agencies (for example the one for the graphics industry, which has set up its headquarters next to the corresponding skills centre). Other partners are involved as well, such as employers' associations, scientific and technical institutes, and universities. The partnership may be organised in three ways. Some partners take over a given operation, for example monitoring developments in various trades, and then make the information available to the centre and all other members. Or, the partners are bound by an agreement that establishes the role and contributions of each. Finally, a third approach has partners joining together in an ASBL (non-profit association), which then takes over the management of the centre.

- It must be accessible to everyone, which means that it will receive at least four types of users: jobseekers; workers (including at-risk workers), some of whom may come under the umbrella of continuous training programmes; instructors and trainers, as part of their ongoing training; and students.
- It must not limit itself to training in a strict sense, but must also undertake to track and raise awareness of new trades (together with the Walloon Employment Observatory), and to offer services relating to audits of business needs, assistance for jobseekers, support for SMEs, and the production of distance training software that can be used both in the centre and on the web. The Cepegra Centre today produces software for training in computer graphics and web page design.

The tendency today is to make these agencies more flexible, provided they retain the required degree of professionalism. This condition can be difficult to satisfy. The agencies most often take the form of a service counter that must deal with many and varied demands. They can only cope with these demands by working in networks with a whole series of specialised agencies, for which they constitute the access portal. They will be likely to charge for their services, partly because the specialists expect to be paid, and partly to forestall excessive demands or windfall effects on the part of applicants. This tendency is more common in the case of services to businesses than it is for services to individuals. When it comes to social assistance or helping first-time jobseekers, non-profit agencies play the role of "benefit packagers".

The development agencies today face further problems. Their tasks may not be very clearly defined, reflecting the lack of co-ordination among the ministries concerned. Thus they may find themselves pursuing social, cultural and economic issues and providing vocational and handicrafts training all at the same time but without any consistent plan, and this can undermine their credibility.

In the end, while the agencies may be able to respond to certain demands, they are less capable of moving beyond this reactive stage and

adopting a more forward-looking stance – for example by placing *ad hoc* demands or activities within a strategic local plan developed through a partnership platform.

These difficulties can be significant at the start-up of agencies, as was demonstrated in Slovenia (OECD, 2004). In 1999 the central government called for the creation of regional development agencies to bring some coherence to implementation of several European programmes, and it asked them furthermore to work in close co-operation with local employment offices. These agencies are tasked with developing a region, stimulating enterprise creation, developing supply capabilities, and mobilising human resources, while ensuring better environmental protection. Today they are operating in highly diverse ways, reflecting the current state of co-operation among local players.

A number of conditions must be fulfilled, then, if these agencies are to be successful. They must have a solid legal foundation and financial autonomy; they must be transparent; they must be adaptable and ready to take on new partners when the opportunity arises; and they must consider themselves as access portals to services and to service centres.

Instruments for consolidating good governance over time

Successful project implementation requires that stakeholders be permanently involved. In some cases this involvement is direct, for the agents are committed to a common objective that requires them to pool their resources and efforts. In other cases the involvement is less direct: stakeholders are not direct partners, but in the pursuit of their own projects they exert effects – either positive or negative – on others' projects, and this imposes a minimum degree of convergence. In problem territories, the successful completion of one project may help improve chances for other projects. There are many kinds of external effects:

- An investment brought to fruition becomes a source of future activity for other businesses that had no relationship to the first one.
- A successful training mechanism instituted by a relocated firm can be redeployed to meet training needs of other, home-grown businesses.
- Reintegrating the long-term unemployed is a source of new markets for the territory.
- Improving one local public service can enhance productivity in other public and private services.
- Successful co-operation builds social capital in the territory, facilitating the implementation of other projects.

There are two ways of analysing how effectively such co-operation is maintained over time:

- The first asks how the local development partners' "club" can be sustained over time, recognising that the distribution of benefits will not always be equal.
- The second starts from the condition that the resource needs (legal, financial, property and cultural) of local partners are adequately met.

Good governance through the functioning of the local partners' club

Ideally, good governance will result if all these stakeholders – firms, training institutes, public authorities, heritage protection associations – share the same values; that will, one may hope, be enough to ensure proper cohesion. The stakeholders might for example be agreed on the value of perpetuating an inherited production system, because it is consistent with the desired lifestyle or with conservation of the environment. The focus can then turn to games theory or the "core" approach to social interactions, in which there exists a situation or a path of action of uncontested value.

Without falling back on this hypothesis, we can refer to the existence of a "bargaining set". Some stakeholders will want to depart from this development path, believing that they can do better for themselves by pursuing a different one. The other stakeholders will quickly bring them back to their senses by showing them that the ultimate cost of leaving will be much higher than that of staying on the initial path. Such a situation might arise, for example, in an industry that works with highly skilled labour and high-quality materials, where some firms begin to debase their quality standards in order to boost short-term profits. In the long run, this will undermine the product's cachet and make it indistinguishable from mass-produced items that are more cost-competitive. Essentially, the long-term interest demands that they renounce their short-term interest. To achieve this, a bargaining set must be introduced, *i.e.* an observation and discussion mechanism that will provide warning of such behaviour and, if necessary, compile proof of it. A label can be the element for crystallising the bargaining set, for it will induce producers who want to use it to embrace the arguments for maintaining the district's long-term sustainability and preventing opportunistic behaviour.

The milestones to good governance

Partnership offers a situation where social interactions are characterised by entry and exit costs, and there is a direct relationship between its members. The rules or conventions that a partnership adopts will seek to catalyse behaviour, keep action cohesive, and satisfy the desired objectives. They will

also try to prevent situations where the pursuit of private interests would be detrimental to the partnership as a whole. The partners will try to achieve a desirable equilibrium through "positive attitudes" and they will see to it that those attitudes are fostered, disseminated, copied and maintained. If the partnership is to last, four conditions must be satisfied:

- In a repeated "game", the partners have an interest in acting on the basis of positive attitudes and in behaving in such a way as to inspire positive behaviour on the part of the others: this is the "reputation condition". The partnership is viable only between players who regard each other's reputations as good. This implies a dense information system, without which there is the probability that negative attitudes will win out over positive attitudes, inevitably causing the partnership to weaken or collapse. The *appellation d'origine contrôlée* is a means of regulating the organisation (and sanctioning) of this information, but for territories such as industrial districts that cannot organise it, other systems, such as the label, must be used.
- With repetition of the "games", participants must know that if they misbehave today they risk being punished tomorrow by losing their rights to the label: this is the "reprisals condition". The difficulty is that reprisals, even if properly organised, may be impossible to enforce. In some cases, firms may no longer behave as required because their operating conditions do not permit it. Counselling or financial support from the partners may help them do so. The history of industrial districts provides frequent examples of such mechanisms, involving varying degrees of formality. It also demonstrates the importance of cultural, ethnic and religious factors in the way certain districts function. In an atmosphere where individualism reigns supreme, as is often the case in artistic circles, such arrangements are unlikely to be accepted spontaneously.
- Existing players may upset the initial equilibrium over time, as their size or their market fluctuates. Interactions will then become less random, but will take place through alliances and counter-alliances. There is nothing to guarantee that such alliances will not work against the viability of the district. Thus, we have a "proper segmentation" condition. The divisions that may appear must not interrupt the invisible exchanges and the networks of trust that were built up over time. A segmentation that is not necessarily harmful might occur in training mechanisms, where some want (for example) to replace specialised initial training with on-the-job training. There is disagreement, but it does not bear on objectives, merely on the means for achieving them. A harmful segmentation might emerge when some partners want to revise product quality and labelling systems to accommodate larger-scale operations, while others insist on maintaining small-scale "cottage" production methods.

- Finally, new players may appear, which will pose a problem of homogeneity for the underlying partnership, or at least for the segmentation condition. The preferences of these new players will have to be essentially compatible with those of the existing partners if the district is to survive: this is the "proximity condition". Normally the existence of charters or labels should lead to such a situation, because they establish reference points. But opportunistic behaviour cannot be excluded: the new partners may alter their behaviour once they are inside the district. It is not surprising, then, to find here some vestiges of the old trade guilds, where entry conditions are backed up by very strict rules for running the district.

Good governance as a result of managing the local resources

The legal dimension: pacts, contracts and quasi-contracts. The establishment of lasting relations among partners does not always require contracts such as those recognised by the market. Commitments can relate to behaviour rather than outcomes, and this produces exposure to moral risk.

The variety of partners involved makes it difficult to use conventional legal arrangements, for example when a local government has to sign a contract with the central government, or when local representatives of the central government sign contracts with local public or private partners. The result is a multiplication of legal arrangements that depart from ordinary law and are often treated as quasi-contracts, moral commitments, or joint declarations. The problems that arise will differ according to the institutional context: in some countries, the public partner is accountable for its behaviour before the same judge as the private partner, which reduces these difficulties; in other countries there are different types of judges, and they will assess breaches of commitment differently.

A shift in the electoral majority, at the local or national level, can destabilise commitments taken at a given time and create a gulf between the time horizons of different partners.

Finally, the lack of precision in such legal arrangements can lead partners to act in ways that run counter to the declared objectives. In France, the national government has used planning contracts between the central authorities and local ones (regions or municipalities) to force the latter to contribute to national objectives, whereas the stated objective of the agreement was to channel state funding into local development.

What we have here are bilateral relationships rather than contracts, and respect for constraints of participation and incentives will differ from behaviour in a private contract, where reciprocal obligations leave no doubt as to the parties' responsibilities. How can these difficulties be overcome?

- By differentiating the nature of the commitments, for example by defining reciprocal behaviour commitments in a side agreement, and establishing the expected outcomes in a direct contract.
- By bringing a third party into the agreement, as witness and guarantor: in compacts, the local authorities often play this role.
- By supporting these behavioural commitments with financial provisions that will enhance their probability. In a sense, this amounts to using public funds to reinforce the efforts of private partners. The territorial employment pacts introduced in European Union countries used this device: signing such pacts opened the way to specific funding to cover the costs of co-ordination, and facilitated pact members' access to various European Union programmes.

An example of agreements of this type, with their advantages and limitations, can be found in the United Kingdom (OECD, 2004), where the central government has signed Local Public Service Agreements (LPSA) with local governments. Under these contracts, the local authorities undertake to improve the performance of public services and the central government undertakes to reward the results. It may also help achieve those objectives through leverage subsidies or by allowing greater flexibility in the way services are delivered. The evaluation criteria for these new devices must therefore reflect national as well as local interests. This represents a departure from the traditional hierarchical relationships: the "contract" introduces a partnership-type relationship that should produce greater trust, more effective pooling of available resources, and better vertical governance.

Financial instruments for good governance. Good governance of local partnerships depends to a great extent on the quality of the underlying financial mechanisms. There are many variables determining this quality, the first of which is that local governments must have significant resources of their own. Otherwise, they will be dependent on central governments, and the mobilisation and dynamics needed for local development will be missing. This condition relates directly to national constitutions; it is difficult to move beyond these constraints. On the other hand, two other conditions for good financial governance of partnerships may be mentioned:

- Sound trade-offs in the use of available funds among possible projects.
- Proper co-ordination of financing from various sources over time, especially in terms of cash flow.

The use of public funds, whether local or other, implies choices about their distribution among different possible projects. The contractors for these projects may be either public or private, and public funding agencies may tend

to give disbursement priority to the projects they are managing – whereas those projects may in fact be of less interest than the others.

Experience with municipal agreements in Italy points to an original and pertinent solution. Once the public funds have been allocated, there is a question of how to associate them with private funding for projects, recognising that there may be pressure from interest groups. In Italy, most municipalities have adopted the following scheme. The criteria for judging the importance of projects are set by the municipality. The allocation of funds is entrusted to a bank, which will have full independence in assessing the feasibility of projects and the amounts of public and private funding that should be earmarked for them. What is especially remarkable here is that when the municipality defines its own projects, it must go through the same procedure (OECD, 2001a).

The financial management of partnership projects involves many contributions, made more or less regularly over time. Problems will naturally mount with the number of partners or the failure to integrate their respective contributions properly. Moreover, some funding is conditioned on the input of other funding, so that if one partner defaults on its obligations this can lead the other partners to hold back or even default themselves. One response to these problems is to arrange a dedicated "support fund" (*fonds de concours*), into which disbursements are made from the outset to compile the cash needed to carry out the project. A support fund of this kind will be established if one partner agrees to exceed its obligations and advance cash to keep the project moving forward. At the end of the project the contributions are audited and corrections may be made to offset any surplus that some partners may have made to the benefit of others. When this is not the case, the solutions can prove much more painful. In the Walloon region of Belgium, for example, the "town centre missions" complain that appropriations from the central government or even the regional government do not always arrive on time, and so they must meet their cash needs through bank loans.

The human resource dimension. Human resources mobilised to implement local development projects can influence the quality of governance. Three problems arise here:

- Good governance is facilitated by the quality of the human resources contributed by the partners, and by the ways the required information is prepared and submitted, the players are assembled, the instruments are used and the projects are carried out. The resort to training programmes for identifying and formulating local development projects, even at the university level, provides abundant evidence of this. The main difficulty seems to lie in co-ordinating what are often highly disparate initiatives, and controlling their quality.

- Differences in the status under which local and national government personnel work may interfere with the quality of governance. If their status differs too greatly (which generally happens, to the benefit of central government personnel), this may lead to sharp differences of qualification among these partners and undermine the synergies needed for vertical governance. There are frequent cases where the transfer of responsibilities has not been accompanied by the corresponding transfer of personnel, and local governments need to add staff, something that takes time and may be frustrated by the inability to offer attractive remuneration. Thus the imbalance of status becomes an imbalance of professional skills.
- The third source of difficulty lies in the fact that, in their local development strategies, local governments often resort to special employment provisions. This allows them to benefit from national financing mechanisms and to reduce the costs of the project. But it also poses some significant problems. Financial management is complicated by the plethora of regulations and payment delays. Skills formation is haphazard, since the obligation to provide training is far from generalised and may even be impossible to assume. But the greatest difficulty is that the low classification level of some of these jobs is out of line with the nature of their mission. In the Walloon region, for example, several types of jobs were created to make the local partnerships work:
  - Jobs of the "subsidised contractual agent" type, targeted at non-profit associations or the "town centre missions", and stemming from both federal and regional programmes. They are poorly paid in comparison with prevailing wage rates, and there has been high turnover among persons in these jobs.
  - The so-called "Royal Decree 258" jobs, which are better paid.
  - Jobs created under the Vocational Transition Programme of the federal government, targeted at the long-term unemployed who have no secondary school diploma. Their financing is complex because it comes from three sources: a federal subsidy, a grant from the employment ministry of the Walloon region and, depending on the nature of the institution, a grant from the Ministry of Economy of the Walloon region. Since the federal subsidy depends on the local unemployment rate, the employer's contribution is variable and may even disappear in communes where unemployment is high, while it will rise sharply in the reverse case.
  - The final broad category of subsidised employment is the "Rosetta jobs", targeted at young people under the age of 25 who have completed compulsory schooling and hold a secondary school diploma. These

workers retain their unemployed status; they thus continue to draw the corresponding benefits once their "first job" contract ends, and their wages remain modest.

Amending national programmes to improve local development governance

The challenges of local development governance are part of a context that is broadly defined by national mechanisms and policies. Adapting these national mechanisms is thus a condition of good governance. Governments have everything to gain from such moves, since they will then benefit from information, initiatives and partnerships that will contribute to sustainable development. In light of the above discussion, it would seem that action is called for in a number of areas at the national level: information, diagnosis, evaluation, and institutional learning.

Information

Good governance of local development presupposes a sound information system that can provide relevant data and simulate the impact of policy options. Such systems usually exist at the national level, but they are harder to find at the local level.

This difficulty was traditionally explained as follows. Local data are not always relevant, for the decisions creating these data do not necessarily involve local players; an inflow of jobs will depend on decisions taken beyond the territory; an inflow of savings will depend on how the national banking system is organised.

This caveat is valid, but it should be seen as an incentive to strengthen national information mechanisms rather than a sign that things cannot be improved. There are two ways to make progress on this front:

- Produce more data disaggregated to the regional or sub-regional level. National accounting systems too often compile elementary data, generally from the communal level, into national aggregates without exploiting the various possible regional groupings.
- Increase the number of dynamic databases. It is less important for a given territory to know whether its unemployment rate or business creation rate differs from the national average than to know why local indicators change over time in one direction or another, and in this way to deduce the relative importance of national and local determinants. In France, for example, the System of Information on New Enterprises (SINE), would be much more serviceable if it were prepared for use at the local level.

Diagnoses

Information becomes knowledge only when it produces a sound diagnosis of a territory, its problems and its opportunities. Compiling comprehensive and significant diagnoses is a major challenge for local partners, who tend to conduct their diagnoses today in three ways.

One approach examines the kind of local activities needed to sustain the territory. These are basic activities that will meet demand for goods and services beyond the territory and will bring in revenues that will then be spent within it. A basic activity is in fact an export. But while these activities can be identified, there is no guarantee that once production capacity is in place the anticipated markets will still be there. The "basic activities" approach can quickly lead to a paradox: because the solution has to be found abroad, it is vulnerable and may disappear from one day to the next. This is not just a problem of foresight or of adapting planned activities to available local resources: the real issue is the uncertainty of future markets. Fields of basic activity can of course be defined fairly broadly – rather than focusing on a specific activity – in the expectation that market shifts will be marginal rather than radical, but this will not prevent the emergence of new competitors. One may also start with the resources needed to conduct these basic activities, resources that can then be mobilised for highly varied production, as will be shown below. These difficulties explain why many efforts at productive programming quickly turn into a search for firms willing to relocate.

Government intervention is then essential, because government can provide strategic information on the exact nature of basic activities, even if it is merely aggregated for all territories. This would seem to represent a paradox, but it is a superficial one: information provided by central governments is of a kind that can reinforce the understanding of local problems.

Rather than identifying a basic activity in which risks are concentrated and benefits are unevenly distributed, it may do more for unity to construct the diagnosis around the identification of strategic resources, particularly in terms of skills and training since these are a determining factor in a global knowledge economy. This approach faces two difficulties. First, it may very quickly degenerate into excessive enthusiasm about the impact of new technologies; while these are a necessary condition, they are far from a sufficient one. On the other hand, this analysis implies technological planning based on very costly scientific and economic diagnoses. Only central governments are in a position to provide such an outlook, and this underlines the need for the state to ensure that it can provide such information to all territories.

Instead of seeking to define capacity to satisfy basic activities or to produce "competencies", a third type of diagnosis tries to see whether the territory has platforms for bringing together all the potential local development partners and

creating synergy among them. The territory's principal resource becomes in effect its ability to foster communication among its own stakeholders, but also with outside players. That emphasis on communication raises a question: is this merely a new ideology adopted because it is currently in vogue? In a market economy, it is important to stress originality in transforming specific resources into forms not found elsewhere, and this implies an ongoing intelligence operation. Mustering skills around problems, events or objectives, aggregating and communicating them, can release the energy needed to define and implement a strategy. This effort to highlight a territory's specific and original assets is impossible in a setting where members are content to communicate only among themselves. Purely internal communication risks tying up collective choices in the straitjacket of outdated traditions, issuing bafflegab pronouncements, and squelching rather than stimulating the spirit of initiative. Proceeding in this way will only stifle output, squander existing or potential markets, and exhaust energies in attempts at self-justification. On the other hand, in striving openly to reconstruct a territory's identity, better communication can counter the forces that drive activities to leave and those that impede the attraction of new activities. There may be certain regulatory provisions that hinder communication, or others that enable it. There may also be certain possible arrangements that exist elsewhere but are not known within the territory. It is again useful, then, for central governments to promote diagnostic initiatives, if only by disseminating good practices or opening up possibilities for institutional flexibility that will permit them, as in Flanders.

Evaluation

Evaluating partnership practices for local development and the quality of governance is a delicate task. While there is a unanimous clamour for evaluation, the fact is that practice generally runs in the other direction. This can be explained by reasons of two kinds:

- The risks that evaluation brings with it: funding may be stopped, some partners may be reproached, the boldest partners may be criticised for their initiatives.
- Methodological problems: the initial information may not be all that relevant; there may be several factors in the local development environment that make it difficult to identify cause-and-effect links, etc.

Evaluation can contribute to good governance in four ways:

- The first spin-off of evaluation comes from measuring the ratio between the efficiency achieved and the cost. Such analyses are difficult to undertake, for at least two reasons. The first has to do with the many factors that can influence efficiency at any time: the impact of an initiative will obviously vary depending on whether the economic context is favourable. The second

has to do with identifying the criteria for efficiency – an issue that has long been recognised as an obstacle, especially when the partners in the initiative are not in agreement.

- A second spin-off of evaluation lies in monitoring, which means the collecting and processing of information supporting the introduction and development of a programme. Information collection must address the outcomes of local initiatives as well as their economic, social and financial effects. Monitoring represents in effect an initial evaluation. The point is not so much to identify a cause-and-effect relationship as it is to provide early warning of deviation from the initially desired course.
- A third spin-off of evaluation is learning. It was long thought that evaluation methods had to provide direct results to decision makers, who could then apply them mechanically. But policy decisions on local development are taken less on the basis of scientific results than on the basis of commitments or negotiations. The influence of scientific results is therefore not direct, and makes itself felt only to the extent that it changes players' conceptions. The issue here is not so much to produce pure knowledge as to have the capacity to inject that knowledge into the local setting and thereby change behaviour. The evaluation will thus be more useful if it embraces the players in these learning procedures. An evaluation by stakeholders or by persons directly associated is more likely to influence policy makers than one organised without this perspective.
- A final spin-off of evaluation is its mediation role. Evaluation is today treated as a social and political process that creates its own reality; through this process the evaluator becomes a mediator who supports and inspires the processes of learning and negotiation. These mediation processes are superior to the traditional approaches to dispute settlement, because they generally commit their participants to resolve disputes that have existed between them. They avoid the high costs and uncertainties of resorting to legal proceedings. Evaluation is often at the centre of existing mediation processes, and it can only facilitate them. Initially, evaluation will not necessarily be undertaken with this approach; under the more conventional rules, it seems to be conducted by independent experts and to result in one-way communication. This will change if the evaluation attempts to enlist all stakeholders. It will then be conducted so as to produce a consensus, even if this was not the initial objective. Points of view on the criteria selected are developed jointly, and different stakeholders' fields of perception are bound to converge during the process.

Having recognised these roles, we must not neglect the role of the evaluation. The following is an illustration taken from the evaluation of a number of territorial employment pacts in France, concerning Albertville, Montpellier-Hérault, Pays de Valois and Saint Herblain.

Table 2.1. **Net job creation through territorial employment pacts**

	Net number of jobs created	Change in %
Saint Herblain	395	+0.05
Albertville	400	+0.04
Pays de Valois	234	+0.03
Hérault-Montpellier	1 042	+0.01

An analysis of these pacts reveals different underlying approaches. Some – St. Herblain and Albertville – are organised as true partnerships. The others function in the conventional way: partnership is at best cosmetic and implies no change in conventional employment mechanisms, while governance is left essentially to the traditional players. We might conclude a priori that the partnership pacts produce better results than the "administered" ones. But we must not stop there.

We may also identify the relative shares of different instruments, by distinguishing between three types of employment creation vectors:

- Direct creation in connection with new local services.
- Direct creation in connection with the development of entrepreneurship and new services to business.
- Matching of supply and demand on the labour market through greater efficiency.

The best results come from effective use of the more "active vectors" (new local services and entrepreneurship), as opposed to the more "passive vector" (better matching). The "best" pacts give a relative share of 78.6% and 65%, respectively, to active instruments; the less effective pacts accord them only 30% and 32.6%. The correlation between partnership and effectiveness in job creation can then be explained as follows:

- The partnership may spark dynamic complementarities necessary to create new jobs and new positions.

Table 2.2. **The wellsprings of net job creation**

	Total	New local services	Entrepreneurship	Matching
Saint Herblain	395	138 (34.9%)	173 (43.7%)	84 (21.2%)
Albertville	400	140 (35%)	120 (30%)	140 (35%)
Pays de Valois	234	10 (4.2%)	60 (25.8%)	164 (70%)
Hérault-Montpellier	1 042	179 (17.1%)	162 (15.5%)	701 (77.4%)

- The administrative approach may act primarily on reconciling existing supply and demand, without being able to change the number of jobs available.

Exercises of this kind are complicated but they are clearly useful, particularly when conducted both within and outside the territory in question. The role of the central government here is key: by establishing an environment favourable to evaluation, it can encourage sound evaluation practices and will benefit from the results, in terms of added value for development as well as lessons for defining or revising its own mechanisms.

Institutional learning

The demands of good governance in local development imply making some changes at the national level. While such changes may be undertaken in recognition of the need for flexibility, they must be clearly defined: the term flexibility here indicates a principle of action rather than solutions. These changes concern institutions under the control of the central government, the public policies it implements, and the dissemination of good practices. The most pertinent can be defined as follows:

- Introducing new objectives relating to local development in existing institutions rather than creating new institutions at the national level. It is better for local stakeholders to work with a small number of national partners that are flexible in their objectives and their possibilities for action, than to have to deal with a great number of specialised partners.
- Giving the public sector a catalyst role: to boost local development, "traditional" players in the public sector must go beyond their oversight or subsidy-granting roles and assume the role of adviser to businesses.
- Ensuring that public assistance programmes for enterprise and job creation are defined proactively, that they can exert leverage in favour of decentralised initiatives, and that they are sensitive to shifting circumstances.
- Encouraging a "businesslike" rather than a "handout" approach to government instruments, to avoid inciting displacement or windfall effects among certain local partners.
- Ensuring that contracts negotiated by the central government with other public authorities are equivalent to private sector contracts.
- Organising occasions for the demonstration and exchange of good practices in local development, through exhibitions, fairs, awards, labelling, etc.

Mainstreaming: the case of Central and Eastern Europe

Can the initiatives taken in one country to ensure good governance be transposed to other countries?

This debate is far from new, and it has generally produced recommendations to build upon principles validated by experience rather than mechanisms with outcomes predictable only within a particular context.

The debate has been reopened today in recognition of the situation of countries that have substituted a market economy for centralised allocation mechanisms and that are facing major development challenges in connection with actual or future entry into the European Union. Examples include the countries of Central and Eastern Europe, some of which are OECD and/or LEED Programme members. If the initiatives described above are to contribute effectively to their development, it would seem desirable to create a favourable environment, starting with a diagnosis of their past traditions and the difficulties they have encountered.

Given their traditional centralisation, it is important to ensure the capacity and transparency of local governments

In countries with a highly centralised tradition, regional and local levels of government should be given the means to foster local development in full transparency, without denying the need for proper controls by the central administration.

In Romania, a highly centralised country, Law 151 of 1998 created eight programming regions corresponding to the European Union's Nomenclature of Territorial Units for Statistics II (NUTS II).[7] These regions are not new entities, but rather non-profit agencies for establishing links between people who are preparing local development strategies and regional plans with central government representatives in charge of the national development plan. These interfaces are supposed to encourage local initiatives and to mobilise local elected officials in their support, by having the central government provide information and advice on assisting local development, such as by making the productive sector competitive, attracting foreign investment, or enhancing skills levels. The value added represented by this information can help local development given the degree of centralisation, which is explained as much by regulatory thinking as by the lack of local resources. From time to time some of these agencies, for example Timosoara, produce studies to ensure the proper execution of development projects, *e.g.* reconstructing basic infrastructure for transportation or environmental protection.[8] Determining desired regional profiles, conducting SWOT analyses for different types of infrastructure, and having stakeholders work more closely with those preparing these projects are all important. On the other hand, the scarcity of financial resources and the cultural attitude whereby little attention is paid to a project's prospects until its financing is secured tend to weaken the actual impact of this procedure.

The Association of Towns and Municipalities of Serbia-Montenegro has undertaken a project to improve transparency and to democratise local government procedures.[9] The basic principle is simple: to restore public confidence in local government efforts, citizens must be assured that decisions are taken legitimately and that the resources allocated to these entities are not wasted or drained off through corruption. To this end, codes of conduct and of good governance have been prepared and are now being disseminated through all local and regional administrations. These do not duplicate legislation and procedures, but they show how they should be implemented so that the public – households and businesses – will have confidence in the actions of their local elected officials. This may also lead to the amendment of local regulations to bring them into line with national regulations and with the spirit of these codes of conduct. The codes were prepared by a national conference and following their circulation public meetings were held to explain them at the local level. The fact that their launch relied on international funding leaves the initiative vulnerable, and domestic resources will have to be raised if they are to be pursued further, which means that their utility must be generally recognised throughout the country.

Given the traditional concentration of skills in the central government machinery, the resources, responsibilities and capacities available to local governments should be improved

An illustration of local capacity building can be found in Macedonia. An association of local governments (ZELS) has set out to strengthen the capacities of local governments to fulfil their responsibilities and, with more specific reference to economic development, to reinforce local officials' capacities for analysis and mediation vis-à-vis various stakeholders.[10] The organisation has begun to assume more directly this effort of qualifying and reinforcing the skills of elected officials, but it is also looking at those of local government employees. ZELS also recently undertook to create a number of local (essentially municipal) economic development offices: 13 municipalities are now involved in this effort. These offices will focus on five issues: structural priorities, market analysis, current or potential uses of local resources, local job creation, and improvement of living standards. The offices will have to compile information and prepare projects for eventual adoption by local governments. Their operations are currently running into difficulties specific to these countries: they are having trouble pinpointing the distribution of responsibilities and resources, and this is delaying their work. Until future legislation specifies such distribution, the offices at least have the advantage of being able to work with municipal services to create a minimum of synergy on these issues.

The lack of information is illustrated by the case of Bosnia-Herzegovina, which is recovering from a war that destroyed much of its infrastructure and many of the resources normally available to government. The principal problem in reconciling horizontal and vertical governance lies in the absolute need for a minimum statistical base on the population status of towns and rural municipalities, the level of their human resources, and the services available to them. A further challenge is that, before the war, most economic functions were in the hands of state-owned enterprises that have today disappeared. Finally, as a small country of some 5 million people, Bosnia-Herzegovina is over-governed: it has five superimposed layers of territorial administration, each with its own elected officials and civil servants, and the boundaries between them are not always understood in the field. It was decided therefore to launch an antipoverty programme based as much on decisions at the centre as on initiatives by the local authorities.[11] There were many issues to be addressed jointly by the national and local authorities: improving the business environment, restructuring urban and agricultural properties, co-operation between municipalities, improving the delivery of essential services, etc. The republic thus decided to ask the local authorities to provide a minimum amount of statistical information on these elements, for use in creating a real poverty reduction strategy. Implementation problems are considerable: the lack of expertise is compounded by a cultural history of isolation.

Given the top-down tradition, home-grown development levers are needed, in the form of new institutions or local development projects

Local development agencies are coming into increasing use. They allow local economic demands to be addressed in a less centralised and less political manner.

In Bulgaria, six regional development agencies have been established, under the umbrella of the Bulgarian Association of Regional Development Agencies and Business Centres (BARDA).[12] They have proved very useful in creating and fostering small and medium-sized enterprises; to this end they have been prompt to turn to foreign development agencies to undertake joint strategies. They are currently working with two other countries, where they are doing some initial market prospecting. This kind of networking is positive, but there is a major constraint: the shortage of financial means for seizing opportunities as they arise.

In Bosnia-Herzegovina – where the situation is complicated by wartime destruction, by the move from an administered to a market economy and by the uncertain distribution of responsibilities among the five levels of territorial administration – it has been decided to create regional development

agencies.[13] There are now four of them, and their first task is to meet an immediate need: to distribute European Union funds efficiently. These agencies are supposed to respect certain principles: they are meant to bring together a variety of stakeholders, and to associate them in project preparation and implementation. Yet such involvement is more principle than reality, for many stakeholders do not want to accept responsibilities or take any proactive role. Moreover, there are enormous information gaps.

Chambers of commerce should in principle be ideal partners for local development, for they represent the business world without distinction as to the sector or size of enterprises, and this makes them highly representative. Unfortunately, their statutes and resources do not always allow them to play such a role.

Their means are often limited. In Hungary, there are a number of regional chambers of commerce that provide information on local activity, promote their members' business interests, and supervise training programmes. The Chamber of Commerce in the County of Nograd, for example, has been particularly innovative and has defined a tourism development strategy in co-ordination with a neighbouring region in Slovakia.[14] Yet while it seems to be representative and to have the required capacities, this chamber finds itself held back by two factors: the shortage of financial means, and the slowness of its decision-making process. In trying to play a real mediation role in the business world, it can only take decisions once there is a consensus, which means that it can only tackle issues that are sufficiently broad not to provoke real or potential conflicts among its members.

Preparing local development projects is a more systematic way of creating information on a territory's problems and envisaging strategies to rally stakeholders. But that approach is constrained by fears linked to the old central planning culture, and many countries fail to strike a balance between defining local strategies for pursuing projects and a planning vision that can impose *ex ante* coherence among sectors.

In Albania, each of the 12 regions prepares a regional development plan on the basis of co-operation among the various cities (76) and rural municipalities (309). In the region of Lezha, this plan emerged from intensive consultation between the local authorities, the central government, the chambers of commerce, and a number of associations.[15] During the process, training sessions were held and a SWOT-based method was implemented. This preparation of local development plans ran into the following problems:

- Lack of suitable skills and work habits in the local team.
- Ill-defined distribution of responsibilities between the central and regional levels, which made project preparation difficult, dispute-prone, and likely to fail.

- Lack of funds: the operation was financed through international assistance (European Training Foundation), and no specific funding has been earmarked for its completion.

Given the lack of a qualified local labour market, steps should be taken to develop one

The project undertaken by the Kosice region of Slovakia highlights how the problem of matching the supply of and demand for skills requires appropriate partnership approaches.[16] The initial idea is simple enough: increasing numbers of young people are leaving school with high academic qualifications but they are not being recruited by local enterprises, for a variety of reasons: mismatch of skills and needs, problems of remuneration, lack of information. The Bridge Project, a regional initiative, is designed to see how newly graduated students can be useful to businesses and, if necessary, to give them the additional training to make them employable. This initiative is highly pertinent, for enterprises may be unaware of the potential benefits of hiring these youths. Workshops are being held for businesses and students to assess needs and opportunities, and to identify development projects under which local enterprises can take on young workers. This approach has encountered some obstacles: employers lack the necessary time; guidance and coaching activities are of too short duration; and young people may not be sufficiently motivated. Yet the placement rate for these young people is good (nearly 50%), and business needs assessments have become a normal practice.

In the face of local initiatives, central governments should improve their capacity to programme their regional or local investments

The national authorities need an effective tool for programming their regional investments.

In Latvia, the regional development ministry and local governments have created a programme to assess regional and local needs and to allocate their resources in ways that will support their initiatives and, at the same time, make their policies more effective.[17] At the present time, the tax structure is highly centralised and local governments have trouble making use of their own resources, which come essentially from local property taxes, lotteries, or sales taxes. A 1997 law, amended in 2002, created a regional development support programme, and the central government thereupon established a methodology to define in detail the financing needs of the regions and the criteria for distributing funds. Funds are allocated to projects that have a direct economic impact, in several forms: investment in the capital of enterprises, interest-rate subsidies, shared financing for commercial events and trade fairs. The regions were classified according to indicators, which have been regularly revised to track the evolution of Latvian society – thus, the

elementary education criterion, which had been very important in the allocation of funds, was dropped two years ago. More precise criteria, such as the value of real estate or the rate of non-financial investment, were retained. Finally, the weighting of these criteria is different for towns and for rural municipalities, to allow their different needs to be taken into account more accurately. The programme seems to be working well today, with one important reservation: the capacity of the central government to respect its financial commitments from one year to the next.

Notes

1. There may be other risks: employers could manipulate these mechanisms to their own advantage rather than to that of jobseekers, but experience has not shown this to be the case.
2. The current reform of the RMI ("minimum integration income"), to which an RMA ("minimum activity income") will be added, is also moving in this direction: workforce entry can be achieved through neighbourhood service activity, not just through a return to standard employment. This reform implies decentralising operations by giving the departmental General Councils control over both the financial aspect (allocation of income) and the occupational aspect (the possibility of pursuing an activity).
3. In fact, the first law on vocational training, the 1962 Federal Manpower Development Training Act (MDTA), made vocational training a federal service targeted primarily at particularly disadvantaged persons. Managed from the centre, it failed to mobilise many of the NGOs that were especially interested in resolving these problems, and the result was to create gaps or overlapping. The Comprehensive Employment Training Act (CETA) established local co-ordination boards and redistributed federal funding, but the private sector had little involvement in providing training services and this called into question the nature of vocational training provided in standard classes. The 1982 Job Training Partnership Act (JTPA) accordingly targeted vocational training programmes at local employers' needs, and relied as much as possible on their own training systems.
4. An earlier declaration was issued in 1998, in the same European context that changed the role of the PES essentially back to reintegrating the unemployed through a social approach to their situation. Now, three years later, the PESs are taking a very different approach to their activity.
5. It is clear, as has been argued from the outset of this chapter, that the partnerships needed to improve local governance of employment must be strategic partnerships first, and cosmetic partnerships second. Because employment problems are multidimensional, one must first accept the equality of roles and value systems of all stakeholders, although in time other, more technical partnerships may emerge. This plurality associates economic and social considerations, employment and unemployment, activity and sustainability, etc. There is a major difficulty here. If not co-ordinated, these initiatives are likely to result in a series of cosmetic or "convenience" partnerships, and there will be little possibility of strategic partnerships. In its research on the ADL mechanism, the Free University of Brussels noted a flurry of highly divergent activities and projects. The research training conducted by SEGEFA arrived at the same

conclusions, stressing the difficulty for ADLs in implementing their strategic platform and the fact that in the end, the only actions that counted were those initiated by the operational unit. And when it came to economic issues, here again the ADLs most often appeared as go-betweens rather than pioneers or prospectors. Most activities consist of support and counselling, and the strategic platform is, with rare exceptions, a record-keeping body rather than one for co-ordinating development projects within a territory. The operational unit of the ADLs is more incisive, but the proportion of support activities still outweighs proactive engagements. This may explain as well why the ADLs have lagged behind on environmental issues, a topic that arises as soon as territorial thinking begins to take on strategic content. It may be noted, without exaggerating the point, that some inter-communal development associations take more readily to such strategic thinking, which underlines the ambiguity in trying to separate economic from employment concerns.

6. It is no surprise that such partnerships have sprung up with the activation of employment policies, for to be effective those policies must rely on synergy among stakeholders who are, a priori, independent of each other but addressing the same challenges.

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ISBN 92-64-01329-6
Local Governance and the Drivers of Growth
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Chapter 3

Partnerships, Relationships and Networks: Understanding Local Collaboration Strategies in Different Countries

by
Mark Considine

Partnerships are both an instrument of public policy and a potential new form of organisation between the public and private sectors. They have a greater impact in terms of enhancing local governance than in efficient service delivery. Partnerships build local networks and create a critical layer of "connective tissue" in the social system. Evidence shows clearly that this connection spans the social and economic sectors and is strongest among local firms. Performance management frameworks for partnerships must be re-examined in light of this.

Hierarchy, generally, is losing its legitimacy while partnership is in the ascendant as different interest groups flex their muscles and individuals start to take back control of their lives from organisations and governments (Charles Handy, 2004, p. 98)

Everyone, it seems, is in favour of partnerships between governments and other stakeholders (Balloch and Taylor, 2001; McCarthy, 1998; Considine, 2001). As the Charles Handy quote suggests, this affection is often tied to a belief that partnerships represent a new paradigm in public policy. The most pragmatic assessment is that in most countries there "is evidence of a sophisticated level of understanding of the concept and general appreciation of the practical value of partnership" (OECD, 2001a, p. 206).

The key to the partnership idea is twofold. First and most obviously, the hope is to improve the efficiency of transactions between key suppliers, service providers and funders of services. As Bavkis and Juillet (2004, p. 8) point out, "Collaboration can be defined as the active process of not only coordinating activities but also developing, agreeing to and implementing a strategy". The United Nations Development Programme (1998) also argues that such "partnerships represent the second generation of efforts to bring competitive market discipline to bear on government provision of goods and services, the first having been privatization" (Linder and Rosenau, 2000, p. 6).

Second, partnerships may reflect a willingness to share some forms of public authority with citizens and communities. Most public-private partnerships (PPPs) used in the infrastructure field do not have such an ideal in mind. They are simply new forms of contracting between government and its various suppliers. The partnerships of interest here have in common the "local governance question" – that is, how can local stakeholders be engaged to help adapt policies to local conditions? This is a three-pronged strategy that involves "co-ordination of policies, adaptation of policies to local conditions and participation of civil society and business in the orientation of measures" (Giguère, 2003, p. 12). In such partnerships there is a clear sharing of public authority with specific "policy networks found in civil society" (Bradford, 2003, p. 1005). We can distinguish these as local governance partnerships (LGPs). At a purely empirical level these LGPs will have different national and local characteristics, but will tend to have in common the establishment of some form of governance structure and process at the local level to link central policies to specific issues and priorities identified at a territorial level.

These innovations in local governance speak directly to the question of social capital and to the embedded resources (trust, advice, know-how, information, credit, etc.) that communities are able to mobilise in order to work collaboratively. In this way we may also distinguish these policy partnerships from the various infrastructure projects that use public-private financing and that also employ partnership agreements and instruments. In the case of these latter projects there is no pretension that partners will involve themselves in setting public policy objectives (OECD, 2003).

The sharing of authority among public, private and civic actors in policy partnerships can take a number of forms. In the United Kingdom for example, the Local Strategic Partnerships are unincorporated associations made up of local chief executives from key government and non-profit agencies. In Canada, by contrast, there is a strong tradition of forming community development corporations, using a non-profit corporate structure; these are composed of local community leaders and managers from state agencies involved in housing and urban development. And in Austria the partnership idea is encapsulated in a nationally sponsored programme for stimulating the regions to form their own non-statutory alliance of state agencies and non-profit organisations to tackle local employment and regeneration issues.

It is also noticeable that among the most enthusiastic advocates of partnerships are to be found the key international agencies with an interest in economic development. For example the OECD has since at least the early 1990s focused on the desirability of bringing social partners together to address problems of unemployment (OECD, 1993). The World Bank and the United Nations Development Programme too have embraced the virtues of social capital in general and partnership in particular. Mark Malloch Brown (2004, p. 216-18), Chair of the UN Development Group, points out that "public-private partnerships have great potential to fill critical gaps in service delivery" but also recognises that this will involve "making a commitment to be more transparent about investments made and royalties paid".

But it is undoubtedly the European Union (EU) that has done most to further the cause of the partnership movement. For example, Benington and Geddes (2001, p. 2) point out that "partnership has emerged as one of the homogenizing concepts within the European Union" and "represents a distinctive development in the EU's conceptual and operational frameworks." The EU has implemented a variety of collaboration programmes (URBAN, LEADER, etc.) that have pioneered new types of funding and service delivery vehicles for fostering local governance.

These pioneering initiatives were responsible for showing how easily programmes and initiatives can fail if different public and private interests do not achieve sustained forms of co-operation. As a result we are now seeing a

new emphasis placed on ways to make such projects more resilient in the face of changing environmental circumstances, more durable across different local iterations, and more able to achieve results that are sustainable beyond the first generations of centrally subsidised projects. In other words the new frontier has less to do with the desirability of such initiatives than with ways to enhance the local institutions used to develop and support them.

A European strategy?

There are now national policies to promote local governance partnerships in at least fifty countries. In the European cases most of these have been strongly influenced by the policies and funding opportunities of the European Structural Fund. While there is no doubt that the Structural Funds have been a powerful and often effective device for promoting local development, the use made of this set of arrangements has not pleased everyone.

The main critique of these local governance projects in Europe comes from those who regard the Structural Funds as a device to buy support from poorer countries. It is argued that such countries might otherwise have viewed economic and monetary union as a weak reason for giving up their currency devaluation option and for potentially losing their low-wage advantage.

Using local economic projects to stimulate growth is sometimes contrasted with a more comprehensive (and thus difficult to achieve) social policy framework in which the EU might have sought to raise benefits (and labour costs) for individuals in these countries. The contrast is therefore between a social policy initiative oriented towards citizens, and one oriented towards producers. "Eligible beneficiaries within designated assistance areas are not citizens *per se*, but functional economic entities such as firms, local authorities, and labour" (Anderson, 1995, p. 145).

According to this perspective the various projects and partnerships appear as no more than new manifestations of an old structure in which a "diverse territorial coalition" operates at national and European levels; it is a game with an established repertoire. Anderson (1995, p. 149) argues that the local development partnership presents "Union policy makers with pre-existing frameworks for interpretation and action... [M]arginal costs... are quite low". Obviously local firms and new employees have most to gain, but there are other indirect beneficiaries:

> Elected members of local councils and regional, national, and supranational parliaments; trade unions; business interest associations; civic associations; research institutes; and universities (Anderson, 1995, p. 151).

Of course it is difficult to dispute that these projects have such beneficiaries since this is what is written on the box, so to speak. On the other

hand it is also hard to accept that local governance partnerships can satisfy all these diverse interests at once. So for supporters and critics alike, much depends on exactly who participates and how the governance arrangements work.

The specific virtues of this form of local governance from the public administration perspective include the ability to respond flexibly to local conditions (Giguère, 2003, p. 22); achieve lower regulatory costs by stimulating collective action (Ostrom, 1998); reduce transaction costs associated with fragmented service delivery (Sullivan and Skelcher, 2002, p. 20); and increase legitimacy through increased participation in decision making (Rhodes, 1990; Walsh, 2001, p. 111).

While advocates emphasise the role collaboration plays in improving government flexibility and effectiveness, other research traditions in sociology, economics and planning also point to the benefits of inter-sectoral networks for enhancing the economic performance of cities and regions. This social capital literature points to the embedded resources that can be liberated by the enhanced communication and trust that collaboration can foster among participants (Putnam, 1993; Lin, 2001; Stewart, 2003).

From an organisational point of view, in other words, the idea of building local governance relationships has some important things to recommend it. The key seems to be that a multiplicity of strong and weak ties among most individuals creates redundancy and reliability. We can contrast this with traditional hierarchies where there may be only one or two authorised links allowing access to decisions, and where most individuals are inaccessible to most others.

Partnership diversity

Having pointed to LGPs' enormous potential to improve economic performance and social inclusion, it should be added that they take such varied forms and employ such diverse structures that analysis of the whole field is sometimes difficult. This diversity may be described in terms of several dimensions.

Partnerships vary according to whether they are primarily interested in economic development or social inclusion; whether they are sponsored from the international, national or regional level; whether they undertake services or merely co-ordinate the services of their members; and whether they distribute funds or grants, or instead act as a catalyst or consultant for funding agencies.

In functional terms Nunn and Rosentraub (1997) have discerned four domains in which these forms of collaboration develop goals: economic development, municipal services, physical and environmental improvement,

and social inclusion. However, as Furmankiewicz (2002, p. 152) points out in the Polish case, "it is difficult to separate different results. Often they influence one another … increased citizens' participation and involvement in solving social problems can influence the quality of services in a gmina" (municipality).

While these different dimensions are a helpful way to think about the design possibilities for partnerships in general terms, the categories at ground level turn out to be hybrids of these. On one side of this diversity is the regional model of co-ordination, where national governments seek to devolve functions to an authority holder above the level of the municipalities. This approach can be found in places like Norway and Sweden. Here we see a common set of institutions being developed to achieve integration of public services across a whole region and linking national and local agencies.

On the other side of the range is the model found in Austria, Ireland and Italy, where local partnerships receive central support but are shaped by different conditions and actors at the local level. For example, in Austria the regional-level pacts will vary in membership and purpose depending on how the key regional actors such as the employment service (PES) and social partners view the local priorities.

What is common among these diverse cases is the desire to fashion a set of arrangements that links key actors into an effective governance system. This includes both central and local government actors. The end product of these governance arrangements is to generate innovation among the actors so that bottlenecks are removed and local development is achieved.

Horizontal governance

This partnership agenda is closely related to the public sector reform goals of "joined-up" government, "connected government" or "horizontal" governance. As the Canadians recognise, such collaboration "involves the sharing of mandated authority and usually entails ministerial involvement" (Bakvis and Juillet, 2004, p. 9). While the partnership discourse is mostly framed in terms of localism, and of the power of networks to regenerate social and economic conditions, this public administration dimension remains critical.

The imperative for change within government stems from the fact that the institutional frameworks we have inherited in the public sector often do not meet the challenge of contemporary problems. In particular, the forms of specialisation that yielded great efficiency in the early period of state development now create rigidities. Employment bureaus do not take into account environmental issues, health departments are unable to factor in

housing imperatives, and many aspects of social policy are treated separately from most dimensions of economic policy.

Yet the time and effort needed to reform those institutions would be enormous. Without denying that such an effort might be highly desirable, current problems cannot wait for such an overhaul. Partnerships enable new combinations of actors to come together in new arrangements alongside these older structures. However, when this administrative reform agenda becomes a key driver for change at the local level, there is a need to recognise certain dangers. Changes from above depend for their success on the skill of the state partners and their willingness to move from a purely sectoral view of local development to one with a more integrated focus. The health bureaucrats must, for example, be capable of seeing the real value of a linkage with housing and employment, for example.

In a sense this capacity to work collaboratively runs counter to almost everything that bureaucrats are trained to do: staying close to one's defined area of competence, acting only according to established procedure and policy, and handing complex decisions upwards to superiors all ensure that risks are minimised. Partnership work demands that such bureaucrats range outside their sole area of control, consider how policy objectives might be achieved by novel means, and take responsibility for decisions made locally, even when these sometimes conflict with internal stakeholders in their own departments.

Partnership methods

In most partnerships the operating norms and rules require unanimity among partners before a plan is agreed. Because they must reach consensus before a decision is made or a plan approved, the potential for veto by any one interest is high. This has been one of the major challenges for countries with a long tradition of social partnership among government, business and unions. They certainly have an ability to address workplace and wage issues, but can they adapt those traditions to develop the skills to address health, childcare, refugee issues and other matters outside the workplace?

One of the ways partnerships avoid falling back into a regulatory approach in which new procedures and rules fill the gap left by traditional bureaus is to create a strong outcome focus, backed by national policy makers. For example, in Ireland and Austria there is a strong focus on employment and inclusion of the disadvantaged. This helps provide the coherence and rationale that might otherwise have to be created through a complex legal mandate or a set of institutional structures.

The outcome focus in turn depends for its success upon establishing an agreed "condition statement" backed by sound data and analysis. In practice

this means that the partners and their funding agencies must agree on the real conditions in a locality that need attention. Usually this will require one of the local actors to take responsibility for doing a small research report on such things as employment trends, SME profiles, training and human capital stocks and demography.

The very successful Community Futures Development Corporations (CFDCs) in Canada begin their strategy with a detailed analysis of conditions, and then incorporate quantitative measures in their forward plans. As one of the evaluations of this approach points out, this supports a "longer-term perspective with respect to developing issues and trends" (Ference Weicker & Co, 2002, p. vi).

Using this "strong analysis model" with community and government working together, there is a firm foundation for the later discussion of funding of projects. It provides the base not only for very good performance indicators of success, but also for deciding what skills the partnership can bring to the table. Interestingly in this case, the two sides (government and community) operate separately and come together for the analysis and discussion of projects. This increases community engagement and provides strong legitimacy for politicians and bureaucrats who support local priorities.

One of the prime tasks of LGPs is to manage the tension between these different claims of legitimacy. Central rules and finance cannot be allowed to determine everything that happens, or other actors (including volunteers) will not commit resources. But equally, funding agencies at national, international and European level will want to help define outcome targets.

This "expectations environment" is always ready to pressure the partnerships towards the current priorities of ministries and other funding sources. Partnership leaders at local level therefore need to be entrepreneurial in their linking of different department mandates and in seeking new ways to leverage funding sources to obtain further funds. A key to this is the transition from a partnership funded entirely by one government department to one in which there are multiple sources of support.* The more successful partnerships understand this problem; in interview and discussion, they argue that partnerships cannot evolve very far if all they ever do is chase government funds and allow this to shape their own agenda.

This question of multiple engagements by the partnership underpins the idea of leverage which practitioners see as critically important. This has both

* One of the most important evaluation questions to investigate over time is the extent to which partnerships develop multiple backers from within government and beyond, and the challenge this poses for the original bureaucratic champions who will need to surrender some element of control in order for the partnership to grow in this direction.

a demand and a supply dimension. As noted above, partnerships become more sustainable and capable of continuing their work when more than one funding agency demonstrates a demand for their work. On the supply side the leverage issue is seen in the "spill-over" effects that partnerships produce through their outputs.

These different dimensions of the role of partnerships provide a framework in which to consider the nature of their work. Until now we have had few studies of the different approaches taken at local level, and the enormous diversity of partnerships has made it difficult to develop accurate gauges of how they carry out their missions. Since the core of the role is to link different actors to a common set of strategies, this study uses a number of basic measures of interactivity to investigate what is common and what is different about partnership work. What agencies do they mostly interact with? Do these interactions reflect differences in maturity, purpose or funding regimes?

The experience of partnership

This chapter reviews some of the recent experiences of such partnerships in order to reflect upon both this governance question and the ways in which it can be better understood and supported. This is a different question to the one economists usually ask – do partnerships deliver efficient products? That is an important question and is the subject of other ongoing work. But for now the topic will be confined to the performance of improved governance arrangements. The data driving this discussion are drawn from the direct testimony of partnerships in more than thirty countries, collected through survey and direct discussion.

The primary source of material is a survey of partnership leaders who are members of the OECD LEED Forum on Partnerships and Local Governance and who attended the meeting of that group in Vienna in April 2005. Representatives of each partnership group were asked to complete a questionnaire containing background questions concerning the nature of the partnership, its geographical scale, the policy areas it sought to address, the partners, staff size and financial arrangements.

They were then asked to indicate the frequency of their contact with certain key stakeholders and the use they made of certain partnership tools. The network-contact methodology used in this study follows previous comparative work with local employment agencies in different countries that developed and tested this instrument (Considine and Lewis, 2003).

This sample of partnerships may or may not be representative of the total population of LGPs in these countries. Certainly they are a small number compared to the totals. The larger numbers of cases from Ireland and Austria

Table 3.1. **Partnership respondents by region (n = 33, missing data = 1)**

Continental Western Europe	Italy, Austria (4), Norway, Belgium, Spain, Germany
United Kingdom and Ireland	Ireland (5), United Kingdom
Central and Eastern Europe	Hungary (3), Slovak Republic, Romania (2), Lithuania
South Eastern Europe	Macedonia, Bosnia-Herzegovina (2), Kosovo, Slovenia
Non-European	Bangladesh, USA, New Zealand (2), Canada

reflect in part the longer period of partnership development in those two countries.

Of the 33 partnerships, 8 were operating at the national level (that is, under a national policy but with a local "footprint"), 16 at the regional or provincial level, and 8 at the district or municipal level. Further research is needed to distinguish the national partnership type from the other two; it seems likely that this will show that all partnerships are either regional or sub-regional, but that their funding agencies may be either provincial governments or national governments.

It is always difficult to classify partnership work by portfolio, because one of the main reasons for having such collaborative structures is precisely that they work across such distinctions. However, when asked to self-classify, this international sample nominated employment as the most common concern. The "Other" category included health, training and a variety of social priorities.

Table 3.2. **In what policy fields do you mainly work?**

Policy area	Frequency	%
Employment	21	32.31
Economic development	9	13.85
Social inclusion	11	16.92
Other	24	36.92
Total	65	100.00

The number of staff employed directly by the partnership provides a useful indicator of the overall size of the operation. What the survey showed was that core staff are generally few in number, supporting the claim that such structures are efficient in their use of co-ordinating resources.

However, the question of size and scale is more complex. Respondents reported that their small number of core staff was supplemented by many volunteers and in-kind resources contributed by other agencies. Of the

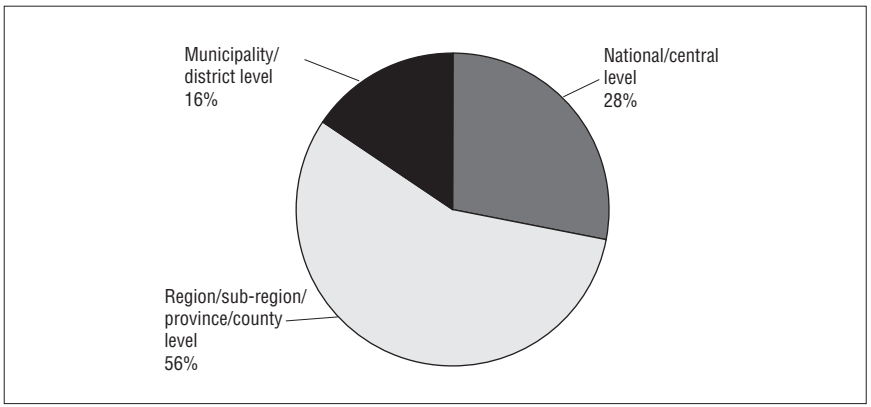
33 respondents almost one-third either employed no staff or did not answer the question. In the written comments a number indicated difficulty in deciding whether people employed on projects organised by the partnership were their own employees or not. This is further complicated when such staff are paid by other sponsoring agencies to help with partnership work.

Several respondents reported very high numbers of employees (ranging from 30 to 600); they seem to be including all the employees across the national level as well as employees on various projects being managed by the partnership. That brings up a further issue for researchers and policy makers wishing to understand the impact of these new arrangements. The relationship between the operating core of the partnership and its functional staff seems to be quite different to that found in other forms of organisation. While there is direct control and monitoring by the central staff, the actual projects may be highly autonomous, flexible and short term compared to the roles of central staff.

Approximately half of the respondents reported their staff numbers as ranging from 1 to 6, with the average at 3.3. This shows the small size and concentrated nature of partnership work. Partnerships remain a relatively inexpensive tool for generating local collaboration and optimising local resources given this small staffing base. Conversely, partnership work is plainly concentrated in few hands, and the skills of this group must therefore be extensive.

In addition to size and policy field, the other demographic key in partnership work is the level or scale at which collaborations are developed. This is sometimes a difficult issue to research because of different national traditions and multiple potential constituencies. For example, municipalities in Austria may be very small villages with a few hundred citizens, while in the United Kingdom they will almost always be made up of many thousands,

Figure 3.1. **Partnership operational level**



perhaps hundreds of thousands of inhabitants. Similarly, some countries have county-level governments and others have strong provinces or states. Questions of scale, in other words, very soon shade into questions of structure.

In this sample the most popular level of operations was above the municipality and below the national. This suggests that collaboration has a place focus and is also attentive to the leverage to be found among regions or provinces. Perhaps it also points to the fact that employment, economic development and social inclusion need to be approached from this middle level, where attachments to locality are strong but where institutions can obtain a reasonable economy of scale.

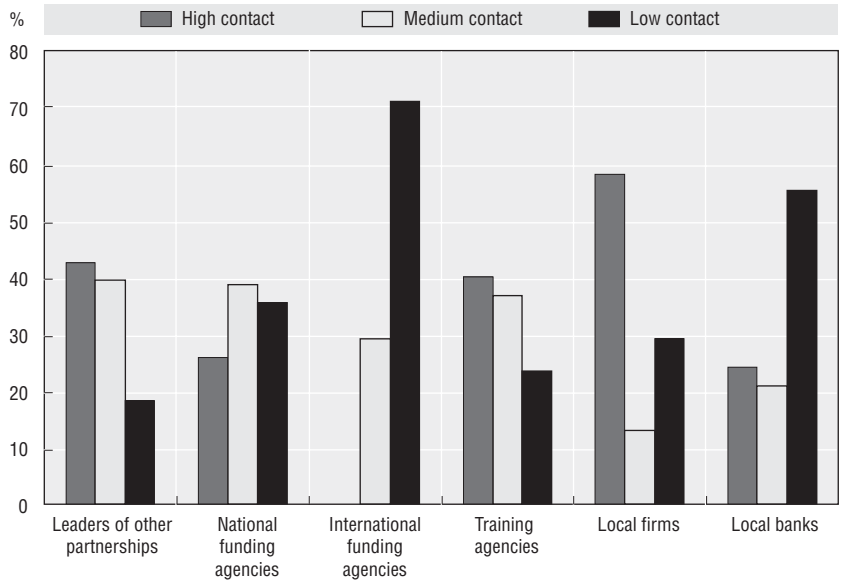
Partnership work: interactions and instruments

The next questions to ask concerned the kinds of interactions or networks that partnerships develop in the course of their ordinary work. Which agencies most interest them? What kinds of connections seem most important? The measure here was the frequency of contact between agencies. This obviously yields a crude estimate of the importance of relationships. There are no doubt some circumstances in which an agency might have a great deal of interaction with another organisation but not actually share goals or projects – for example, if they are involved in some protracted conflict. Agencies might also have only a few exchanges with an organisation that delivers substantial funding and support, making high frequencies seem somewhat more significant than they might really be. Overall, frequency of contact was recognised as a useful approximation for the level of collaboration.

What the data show is that there are two different kinds of partnering network. The first is the *supply network,* made up of funding agencies and central departments. The pattern here is a large number of connections, but low levels of intensity. For example, more than half of these supply networks have links with international agencies but interact only periodically, perhaps around grant application and evaluation deadlines. The most impressive spike in the data for this question is the annual contact figure for international funders, which sits above every other statistic at more than 50% for this sample. National funders, on the other hand, appear to be somewhat more evenly engaged in the ordinary work of the projects, with more of the partnerships reporting frequent contacts with these agencies.

It is also worth noting that the partnerships have relatively high levels of interaction among themselves, spending more time exchanging information and advice with one another than with local firms, banks or funding agencies. Perhaps the most interesting relationship to emerge from these responses is the high level of frequent interactions with local firms. There is both a high rate of daily contact (almost 30 per cent) and high rate of weekly contact (also

Figure 3.2*a*. **Which other actors do you have regular interactions with as part of your partnership work?**



almost 30%). Taken together these figures show just how involved partnerships are with the local economy in most cases. It is also important to contrast this with the contact patterns with employer organisations, which tend to be lower. This suggests that employer groups play a role in steering or interest mediation, but it is the local firms that mostly interest partnerships.

The other sector to occupy a large part of the partnership agenda is local NGOs. The NGOs rate as high or even higher than local firms, reflecting their part in local service delivery in many countries. And the third element of this local engagement is the role of municipalities, local politicians in particular. They have a lower daily contact level but a high weekly engagement, suggesting strong strategic steering of these activities. The other notable feature of this networking style is the relatively high level of contact with media organisations. Approximately half of the partnerships have monthly contact with the media and a fifth of them have weekly contact. This points to a well organised approach to publicising and advocating partnership work to the local community.

Outside this core group of organisations with whom partnerships interact is another set of agencies or interests. Not surprisingly, the most important of these are officials from other national and provincial bureaucracies. Next are

Figure 3.2*b*. **Which other actors do you have regular interactions with as part of your partnership work?**

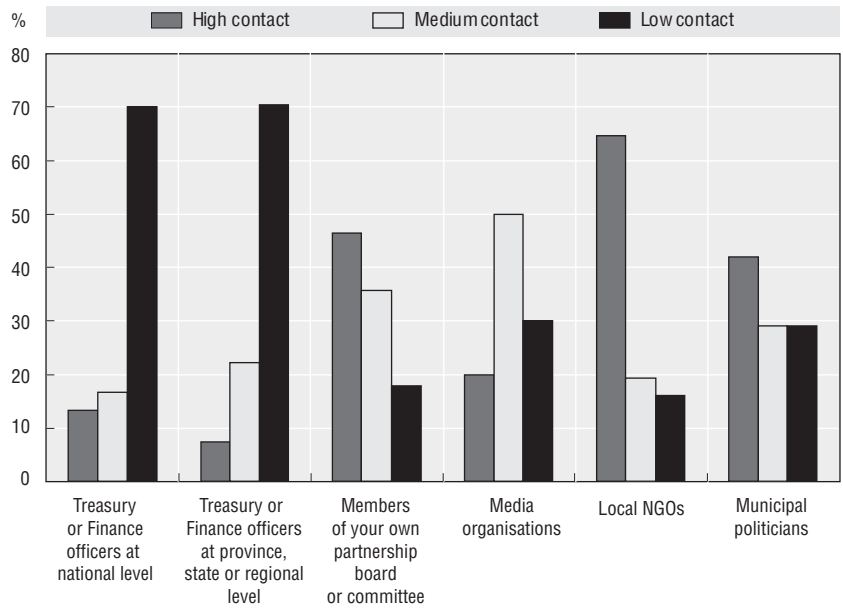
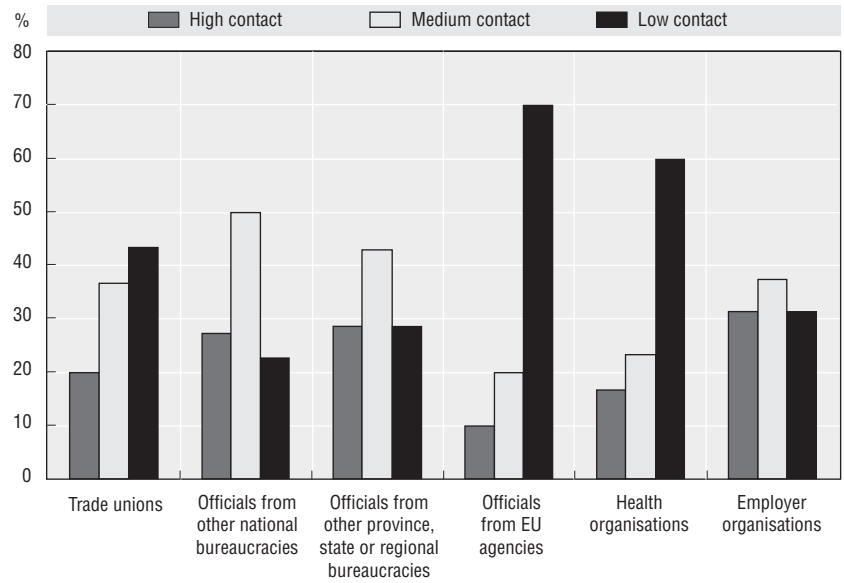
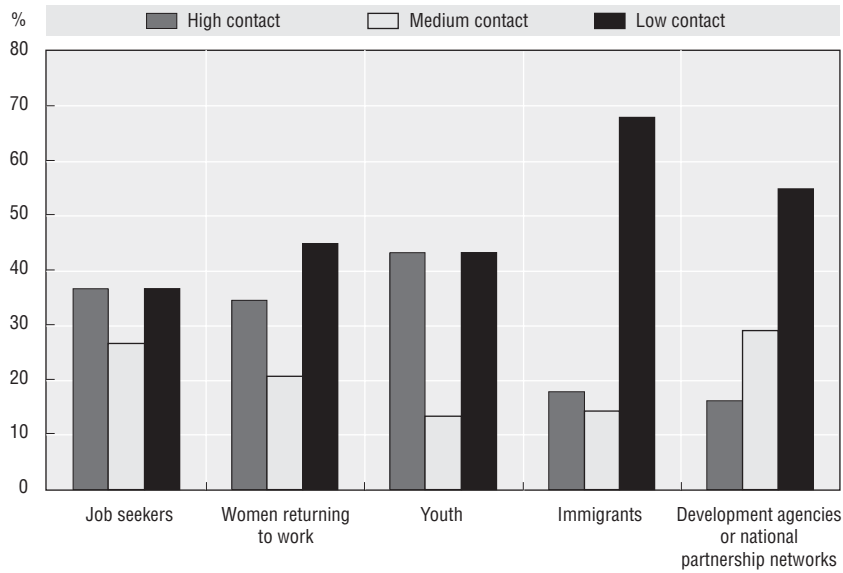


Figure 3.2*c*. **Which other actors do you have regular interactions with as part of your partnership work?**



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Figure 3.3. **Which local group do you have regular interactions with as part of your partnership work?**



employer organisations; these rate a little higher than trade unions but, as noted above, not so high as actual firms at the local level.

The figures for contact with different groups of local citizens show the distribution across categories known to be important to these projects. Jobseekers of all types, women returning to work, and youths are the top three. Youths are the most popular category, although not by a great degree. The figures for immigrants are lower but it should be noted that this issue is quite country-specific and not easy to generalise across all the different partnerships researched here.

These comparative data concerning networks give a summary picture of the typical partnership relationships. What they lack when viewed in isolation is a detailed sense of what is being done within these relationships. What is the work done by a partnership when it utilises such contacts? The respondents were asked to nominate and rank the tools and methods they used from "all the time" through to "not very often" or "never". The list of tools was derived from interviews and includes the typical methods employed by these agencies. As the bar-charts show, the most common methods are:

- Providing advice or training for jobseekers.
- Providing advice or training for entrepreneurs.
- Co-ordinating local services.

Figure 3.4*a*. **Which of the following tools or methods best describes your partnership's normal method of work?**

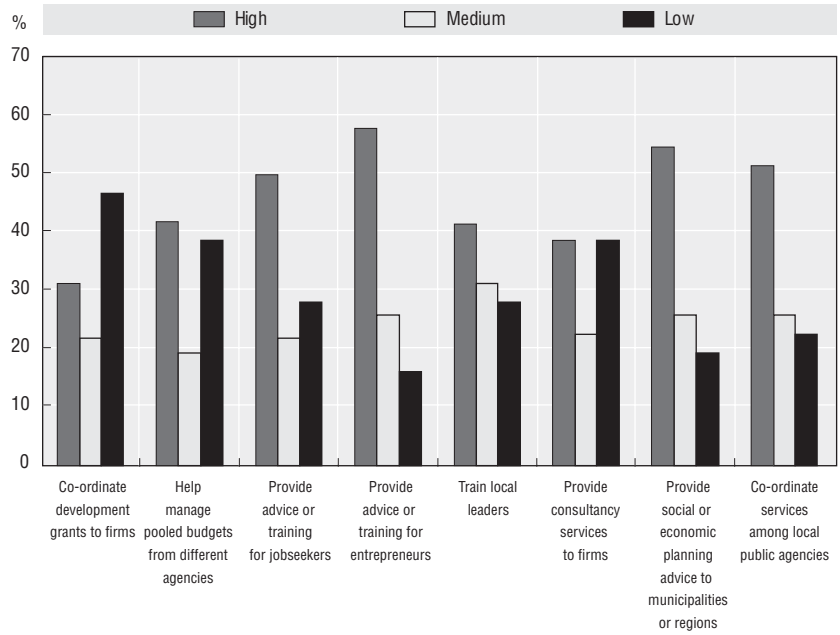
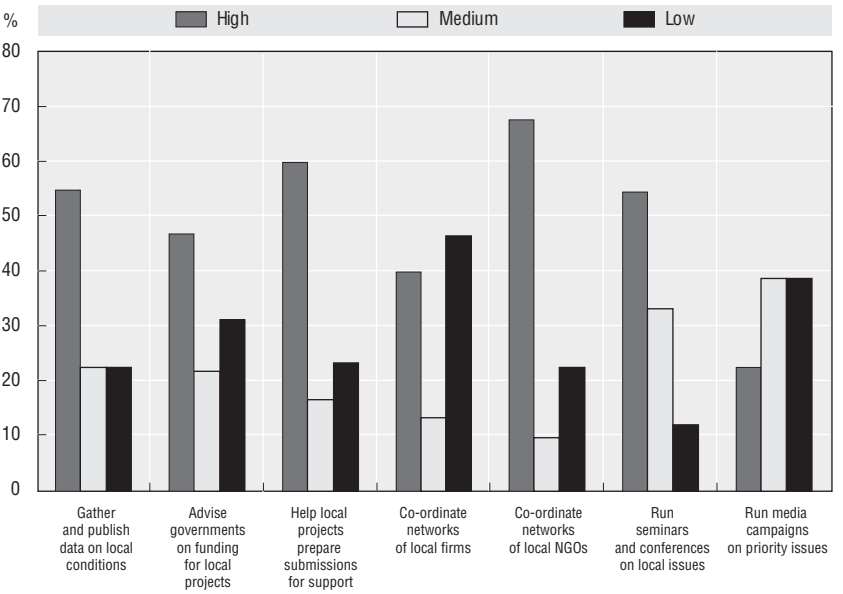


Figure 3.4*b*. **Which of the following tools or methods best describes your partnership's normal method of work?**



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It is clear from these two graphs that partnerships almost always provide advice or training for entrepreneurs and jobseekers. And of these two, it is work with entrepreneurs that is the most prevalent across this sample of cases and countries. The next most typical activity is co-ordination of social and economic planning and services, where more than half the sample report very high involvement and another quarter report medium-level commitments.

The flipside of this picture is the tools or activities seldom or never used. Almost half the sample are not involved in co-ordinating networks of local firms (but are involved in doing the same for NGOs). The figures for managing pooled budgets show a large group with low usage of this tool. Naturally caution is needed in interpreting these data. Any selection of tools or activities will produce a distribution, and that distribution will contain "apples" and "oranges", or items that are not commensurate. A little time spent on media work might be much more significant in terms of outcomes than an extra hour or two spent on providing services. The point is not to make assumptions about the correct mix but to better understand how work is being done, how limited resources are distributed, and how these decisions shape the likely impact of partnership work.

Conclusion

Partnerships are both an instrument of public policy and a potential new form of organisation between the public and private sectors. If we understand them simply as instruments we will note the role that is played by the partnership agreement, the nature of the stakeholders and the funding sources. These are important dimensions, and they point to the partnership as an increasingly popular tool for governments seeking better local delivery of programmes and projects.

As a policy tool the partnership sits alongside the grant-in-aid and the service delivery contract as the methods preferred by governments that cannot achieve results by bureaucratic action alone. Compared with these other two tools, what the partnership adds in complexity it may subtract in short-sightedness. Rather than reinvent a tender or contract process for each new programme, policy makers can hope to reach the best delivery agencies every time. Of course the durability feature may have a darker side if it means that potential new players are locked out of local programmes and that a pattern develops of preferred local suppliers regardless of their efficiency.

Here again, using only the logic of instrument selection, governments may choose to add to the partnership tool a number of other stipulations

concerning outcomes and ethical behaviour so as to minimise these adverse selection problems.

But if considered only as policy instruments for programme delivery, partnerships might not be the best choice in many situations. They take time to establish, they cede authority to semi-independent actors and they have the kind of local profile that could prove embarrassing to governments should problems occur.

The other dimension of partnership work, in addition to their function as instruments of programme delivery, is that of enhancing local governance. This is an institution-building function that must be evaluated separately from programme efficiency. By building local networks of the type described above, these partnerships create a critical layer of "connective tissue" in the social system. What the data from the survey show very clearly is that this connection spans the social and economic sectors and is strongest among local firms.

This points to the critical role that such structures have in forming new kinds of institutional development at local level and between localities and central actors. Tensions could arise with regard to the precise role played by service delivery. For example, if short-term efficiency of delivery is emphasised within central programmes, many NGOs and some municipalities would not be favoured because they lack capacity. But if medium-term development and sustainability are emphasised, such actors may be considered vital to local effectiveness.

This capacity-building role for partnerships will require careful management. Not all localities have the same assets or the same deficits. A process for auditing and assessing capacity will be vital for both local and central actors. Leadership training and skill development clearly have a central part to play in this process. Partnerships already have strong attachments to municipal governments and to firms and NGOs. This offers them unique opportunities to create new leadership paths at the local level and beyond. Given the multidimensional design of partnership, it could be expected that those who gain experience at this level will be well equipped to fill gaps elsewhere. From this perspective the relatively small numbers of staff currently employed in the core of partnerships is a matter of concern. No doubt this promotes efficiency, but it may also limit opportunities for partnerships to foster new leaders.

Finally, the patterns of interaction and networking suggest further lines of research and evaluation to better understanding how these new structures are evolving. More precision is needed in measures and descriptions of partnership organisation so that the partnerships might learn from one another, but also to enable governments to appreciate the new styles of work

being generated. This will be especially valuable as these groups move to a second or third generation of partnership evolution.

Such development will undoubtedly see the partnerships create new relationships with one another and with their supply networks. Funders will need to appreciate the growth pressures this will put upon local leaders and partnership stakeholders. Appropriate methods of benchmarking and performance management will be required to maintain the high levels of trust necessary for this work to continue to evolve in a creative and responsive manner. That evolution will obviously need to reflect both the desire to improve the partnership instrument to gain greater productivity, and also to enhance the contribution partnerships make to governance so as to build stronger local capacity.

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ISBN 92-64-01329-6
Local Governance and the Drivers of Growth
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Chapter 4

Globalisation, New Public Services, Local Democracy: What's the Connection?

by
Charles F. Sabel

A feature of current trends is the breakdown of hierarchy as the instrument of collective problem solving and its replacement by institutions based on search networks: institutions that solve apparently intractable problems – designing and producing goods at long distance, defining and delivering bundles of services that work for particular individuals, families and groups – by finding others who are already solving aspects of it. The explosion of this new organisational form has deep implications for local democracy because it obligates different technical elites in the centre and the periphery to justify themselves to each other and to the public, not least by providing rich information on performance that allows citizen/clients to participate in new ways.

Two convergent developments

The future of local democracy is being crucially shaped by two, convergent tendencies so broad – nearly universal – as to count among the grand themes that dominate our epoch.[1] The first is globalisation of production: the increasing importance of long-distance collaboration in both the design and production of many of the goods and services on which we rely. So deep is the transformation wrought by this process that it uproots, as we will see, even economic forms, such as industrial clusters, that were already thought to be globalised in the sense that full participation in international competition was taken to be part of their very constitution. The second, perhaps less remarked, tendency is the slow shift from the social welfare state to service-based solidarity: a politically fraught move away from compensating market "losers" through redistribution towards providing all potential market participants the complex, often individualised bundles of services they need in order to mitigate the risks they face of "losing" out in economic competition in the first place.

A common feature of both tendencies is the breakdown of hierarchy as the instrument of collective problem solving and its replacement, as we will see, by institutions based on search networks: institutions that solve apparently intractable problems – designing and producing goods at long distance, defining and delivering bundles of services that work for particular individuals, families and groups – by finding others who are already solving aspects of it. The explosion of this new organisational form has deep implications for local democracy because it diminishes the directive authority of the "centre" – be it a national or even local bureaucracy or a corporate headquarters – in favour of more decentralised, "on-the-ground" decision making. More generally, it obligates different technical elites in the centre and the periphery to justify themselves to each other and to the public, not least by providing rich information on performance that allows citizen/clients to participate in new ways – but with uncertain implications for traditional, representative democracy.

But tendencies do not, of course, translate themselves directly into social, political and institutional realities. Take as one example likely to be familiar to readers of this volume the movement towards the formation of public-private local partnerships in distressed (parts of) municipalities or rural counties. In these partnerships representatives of local civil society and the operational

levels of government agencies collaborate to find solutions to problems of economic development, labour market participation, and social inclusion appropriate to the particular circumstances in which they arise. A decade ago such partnerships looked to be a natural bridge or transition between old and new forms of governance: a way of allowing local actors to consolidate their capacities while reducing the overtaxing burden on central authorities and suggesting new forms of public participation in decision making and even service delivery that might make government more accountable as it became more effective. In the event local partnerships and other local problem solving institutions, such as "regional platforms" that co-ordinate economic development efforts in at-risk areas, have come to supplement and perhaps enable the slow reform of traditional decision-making processes. But even though the new entities often continue to evolve in useful ways, and their example sparks still other interventions with the same general aims, this generation of innovations is manifestly not on the verge of replacing traditional methods of delivering public services anytime soon.

Why change has gone so far and no further is unclear. Certainly there has been no resurgence or regeneration of the traditional centre. Confidence in the directive capacities of central or apex institutions continues to ebb. The Dutch government, with the concordance of leading figures in the civil service, has made it a matter of policy to govern "from the second line": by means of framework objectives rather than detailed rules. In responding to questionnaires about their activities, Danish municipal officials and politicians take it for granted that they operate in a system of "networked governance" that cuts across departmental boundaries and hierarchical levels as well as the boundary between government and civil society. But it is equally clear that, for complex and still poorly understood reasons, the partnerships and other such institutions have failed to win through incontrovertible accomplishments the combination of local and supra-local allies that could make them the beachhead of a broader transformation "from below".

But the – temporary? – difficulties of local partnerships and other deliberate strategies for a smooth transition from, roughly, centralised to decentralised governance mask profound changes in particular institutions such as public schools, police departments or child protective services (foster homes, protection against child abuse) that do reveal a deep break with hierarchical governance and the successes of alternatives to it. These specialised institutions are the service deliverers whose efforts partnerships and other local governance reforms aim to reform: effective social inclusion reforms the links among a reformed police department, a reformed social service agency, a reformed family protective system, a reformed public school system and a reformed training and placement service. Indeed, on reflection, it is perhaps not surprising that the new tendencies – which even in the most favourable circumstances face strong

opposition from traditional incumbents – are more conspicuous and easily observed in distinct pieces of what could become a new, well co-ordinated structure than in the shaky efforts to co-ordinate the separate and still fragile reforms of what are, from the perspective of the locale or region as a whole, specialist service providers. This situation is, moreover, not particular to the public sector. The break from hierarchy in private firms is more pronounced in operating units and even particular design and production teams than in overall corporate structures. As recent writing on the multinational corporation shows, in the private sector no less than in government, headquarters permits, even requires subordinate units to break with old practices while continuing in many ways to cling to them itself.

At any event, rather than rehash the now-familiar situation of local governance initiatives in relation to their democratic potential, it would be best to look beyond the current debate by looking in effect beneath it: to the current transformation in the problems institutions face and the new responses of the latter. These responses, it can be argued, are both the building blocks – the structural elements – of the new, co-ordinative governance and the setting in which the general principles informing the new kind of co-ordination are being elaborated. The next section of the chapter reviews the emergence of what can be called the search network or pragmatist alternative to hierarchy in the private sector, and indicates how this new form of problem solving disrupts even the form of contemporary economic organisation that seemed most securely rooted in the global economy: the industrial cluster. The following section shows how pragmatist organisations are becoming a key to the provision of social solidarity as the notion of security in a market economy shifts away from redistribution and towards the provision of risk-mitigating services. The final section explores the implications of these changes for our concept of democracy, and suggests some ways they can be democracy enhancing on any of the conceptions.

From vertical integration to iterated co-design

The vertically integrated firm was centralised and closed. Headquarters and its specialised staff designed products from garments to cars to computers. The hierarchically ordered subunits of the organisation executed the design, or inspected the efforts at execution to make sure subordinates were following instructions and that output conformed to plan. This was efficient, but only in a world stable enough to allow the high design and development costs to be recouped over long production runs, and stable enough as well so that the inevitable ambiguities in even the most detailed rules could be accommodated by nearly invisible, "informal" action by subordinate actors. But stability, of course, is exactly what the world, and world markets, has not had for the last quarter-century.

A first reaction – *circa* 1990 – to this instability was often a geographic separation of design from execution. In this early version of vertical disintegration the design centre was in a rich country, the production facility and especially the assembly plant in a much poorer one. The goal was in effect to achieve even greater economies of scale – there was much talk of a world car – and thus to save the traditional system by making it more efficient. But the world market turned out to be composed of many, locally differentiated segments. Long-distance collaboration, with superiors far away from the subordinates who encountered problems but lacked the authority to resolve them, multiplied the problems of hierarchy. Physical disruption of supply chains was enormously costly; designs were arduously and expensively adjusted for manufacturability only when it came time to actually manufacture them; even the most responsive firms were tardy in responding to shifting markets.

As the shortcomings of this response were becoming manifest, it was also becoming clear that Japanese manufacturers, originally intent on improving the American manufacturing model of hierarchy and economies of scale, had in fact pioneered a profound alternative. This Toyota production model reintegrates conception and execution rather than separating them. Instead of starting in effect with a finished design and translating this into a production set-up, these methods establish a first idea of what to produce (and how) through benchmarking: an exacting survey of current products and processes, supplemented by assessments of new and unproved techniques that might become available for use. Once benchmarking provides a provisional starting point, design follows a disciplined, decentralised process known as simultaneous engineering. Each subunit responsible for a constituent component proposes modifications of the initial plan, while also considering the implication of like proposals from the other subunits for its own activities. Provisional designs are thus evaluated and refined, and the cost of each attribute is compared to its contribution to functionality using the techniques of value analysis/value engineering.

Once production begins, systems of error detection and correction use breakdowns in the new routines to trigger searches for weaknesses of the design or production process that escaped earlier examination.[2] Just-in-time production, for example, requires at the limit the elimination of all in-plant inventories, so that parts are supplied to machines only as they are about to be processed. In case of a breakdown anywhere in the system, therefore, there are no reserves from which to supply downstream operations. All production halts until the cause of the breakdown is identified. Errors have to be corrected when they occur. This restriction goes hand and hand with the creation of a whole series of problem identification disciplines generally called root-cause analysis. In root-cause analysis, disruption is traced back to its original source,

which is frequently not linked palpably to the proximate cause of the breakdown. Thus, in a form of root-cause analysis called the five why's, actors ask "why" a problem is occurring until they locate the cause that "causes" all the preceding ones. Why is a machine jamming? Because it is not being maintained. Why is the maintenance faulty? Because the repair crew is overtaxed by failures at another machine. Why is that other machine failing? Because of a defect in the part it cuts, which points, finally, to a design flaw. We can think of these disciplines as pragmatist, in the sense that they oblige firms routinely to question whether their own routines – habits gone hard, into dogma – are still good guides to current problem solving, and if not, to readjust their ends and means to one another in light of the results of such questioning.[3]

Taken together, these new pragmatist disciplines play an important part in mitigating the cognitive limits – the limits of our ability to grasp and respond to the information flooding upon us – that become especially burdensome in volatile times, and thereby in shaping the links that connect firms in the new economy to each other. Most directly the new disciplines increase the mutual transparency of the actors to each other by revealing to each how widely and rigorously the others scan for solutions in addressing joint problems of design or quality. In the form of benchmarking or root-cause analysis, for example, they require the actors to undertake searches that are unbounded *ex ante* (consider all the products "like" the one you want to build; assume that the root cause of a problem will have no direct connection to the proximate cause), yet sufficiently informative to produce a serviceable map of the available solution space. As each party monitors the others' search process, tacit knowledge is rendered at least partly explicit, easing long-range collaboration (by reducing the chances that the parties take incompatible things for granted) and reducing the chance that all the parties cling to the same dangerously limited assumption (by routinely disrupting the disposition to take the same things for granted). Put another way, these disciplines point towards a form of flexible or continuously corrigible formalisation that blurs the distinction between fully explicit knowledge at the heart of traditional hierarchy, with its supposedly exhaustive specification of tasks, and the tacit informal knowledge that comes with the craftsman's mastery of particular materials and tools, the clinician's experience of patients, or the assembly line worker's easy familiarity with the quirks of various machines and co-workers.

On another, still deeper level, the new pragmatist disciplines associated with the Toyota production model transform the way we respond to the inherent bounds on our cognitive ability. Hierarchies solve superhumanly complex problems by decomposing them into simple tasks, each well within human reach. Instead of decomposing tasks, pragmatist organisations respond to the problem of superhuman complexity by creating search

networks: networks that allow you to rapidly identify people or institutions that are *already* solving (part of) a problem closely related to the one you are trying to solve. Search networks arise, for example, from the first round of benchmarking – finding solutions that inform your provisional design – and enable subsequent rounds to improve on the first. And, as we will see in more detail with regard to public sector institutions, search networks are also key to disentrenching faulty strategies, in that they make it possible to demonstrate that others in your situation are doing better than your own efforts suggest is possible. Though we will not pursue these themes here, this capacity routinely pieces together new solutions; new solutions make the new organisation robust in the face of disruptions that would cripple hierarchies, which must, after all, solve problems whole before they can reduce them to pieces. Moreover, such robustness also seems to increase the capacity of the pragmatist institutions to discover efficiency-enhancing improvements inaccessible to hierarchies – so that the advantages of the new organisations in volatile settings have spill-over effects in more stable contexts as well.

Innovative, robust and efficient firms based on search networks increasingly dominate the second, current phase of today's globalisation, with profound consequences for the relations between large firms and their suppliers – and thus for whole national economies. In the first phase of globalisation, noted above, vertical disintegration lead to long-distance collaboration. That collaboration functioned erratically, at best; but functioning poorly or well, the collaboration was dominated by the large, final customer, who retained full control of design and thus of innovation in products and production processes. With the diffusion of the Toyota production system to essentially all (competitive) industrial areas of the world, suppliers at all locations in the supply chain have to be capable of iterated co-design and just-in-time production. This means, for instance, that the medium sized (500-person) firm in El Salvador producing short runs of fashion-sensitive goods for several different international brands must be able not only to correct "headquarters" design errors and suggest improvements and shift rapidly from one model and type of garment to another, but also source fabric and trim locally, so as to avoid long production delays without paying high inventory costs. The upshot is that globalisation today is linking groups or clusters of local suppliers over long distances to complementary groups or clusters. This regrouping of supply relations and radical decentralisation of design and organisational capacity creates enormous opportunities for firms and economies previously condemned to the "periphery" of the world market; but these opportunities come at the price of commensurate dislocations in the "core" economies, long used to their monopoly of innovation.

For purposes of grasping the tendencies shaping local governance and democracy, these disruptions are most salient and pertinent in regard to the

industrial districts or clusters that form the core of many OECD economies. As traditionally defined, clusters are "naturally" occurring, geographically compact agglomerations of firms, generally small and medium sized, co-operating directly or otherwise drawing on common resources in one or several closely related areas of economic activity. By spontaneously recombining and augmenting fragmented, specialised and mostly tacit knowledge – know-how embedded in a way of life – a co-operative multiplicity of clustered firms adapts rapidly to changes in the economic environment. Since the turbulent, continuing transformation of products and markets of the first phase of the current globalisation began to put a premium on such robustness in the mid-1980s, clusters have been widely regarded as a model, microcosm, or key component of the "new" economy, able to prosper in much more volatile conditions than the traditional large corporation. They are, in other words, the model for the kind of economy that "regional platforms" and partnerships aim to create or re-enforce.

The formalisation of tacit knowledge and, above all, the formalisation of the search for new, "piecemeal" solutions through search networks is, however, fundamentally undermining the organisation of these traditional industrial districts. Equipment makers are developing new generations of specialised machines for emergent clusters in China or Latin America, leaving their long-standing, domestic customers to fear that they lag, not lead, in the introduction of new technologies. Successful firms within clusters are using the new disciplines of co-design to source key components by means of competition among suppliers in several different, often distant districts, rather than relying on the tacit expertise of a local provider. The most successful cluster firms are combing ideas about new materials and production processes from several different and usually widely separated districts into new product categories. But on the evidence so far only about 10 to 20% of the firms in the well-established clusters are turning the new disciplines to innovative advantage. The others may be overwhelmed by the changes before they can adjust. To compound the problem the numerous producers' associations (themselves often rooted in party-political milieus in crisis because of the waning of the 19th century ideologies from which they grew) are disoriented by developments and as likely to quarrel with each other as to address the situation jointly. Thus clusters that could manifestly benefit from agreements to co-develop, *via* a mutually beneficial division of labour, with nascent production centres in developing economies, lack the interlocutors necessary to orchestrate such agreements, and individual firms daunted by the task of adapting to the new pragmatist disciplines are left alone with their trepidations.

The plight of the clusters of the advanced countries is in many ways a microcosm of the challenges facing the advanced economies as a whole, and at the same time a key example of the issues posed to local governance. The

advanced economies, like the clusters, are both discovering that deep reserves of tacit, "rooted" knowledge is no longer an effective shield against innovative competition from all corners of the globe. And just as they are coming to grips with this reality the advanced economies are, like the clusters, beginning to acknowledge that the governance mechanisms, traditional and less so, charged with easing adjustment to new circumstance, are frequently overtaxed by the novelties they currently face. Indeed, if the argument so far is well founded, part of the reason that partnerships and "regional" platforms, among many other forms of innovative local governance, are struggling to find their way is precisely because they are discovering that they have to solve a new problem by way of a new means of problem solving. The new problem is helping the local actors – firms, professionals, "at risk" labour market groups, training institutions, consultancies – acquire the bundles of skills they need to participate in an economy ever more dependent on pragmatist disciplines. The new means of problem solving are the pragmatist disciplines themselves. For by the logic of the argument so far it seems that the institutions needed to define and then deliver the necessary assistance will have to be pieced together by means of search networks: by recourse, that is, to just the pragmatist principles that the new governance structures, and the entities they help shape, will eventually impart. To judge by the limited success of local initiatives to ease firm adjustment to the new competition or increase access of early school leavers to secure occupations, if not jobs, the sobering news is that mastery of the new method of problem solving, let alone of the new problems, has not progressed as far as the urgency of the situation requires. The encouraging news is that other parts of the traditional welfare state, faced with equivalent crises, have begun to avail themselves of the new disciplines, demonstrating along the way that new forms of non-hierarchical problem solving can contribute as much to public solidarity as to private prosperity. It is to that experience of crises and piecemeal renewal by means of the pragmatist disciplines that we turn next.

From the welfare state to service solidarity

In the traditional welfare state the risks to citizens of participating in the market economy were mitigated by (nearly) fixed regulatory rules, transfer payments and standard services to educate, heal, incarcerate and rehabilitate "typical" client populations. The regulations protected the citizen against harms ranging from food poisoning to financial fraud to polluted air. Transfer payments, via social insurance systems, redistributed gains from market winners to market losers, assuring the latter something close to a decent existence no matter how they fared in competition. Standard services equipment allowed young persons, in theory regardless of their family background, to join the labour force at a level commensurate with their

capabilities, and older ones to rejoin it after some misfortune forced temporary exit.

The current globalisation has helped undermine each of these mitigating institutions. In a world where markets change too rapidly for firms to design and build products by traditional, centralised means, it is also impossible for centralised authorities to write rules protecting the public against risks associated with the new products and services. As for the system of transfer payments, the new conditions of competition wreak havoc with the actuarial assumptions matching payers to payees: unemployment insurance, for instance, typically anticipated seasonal or cyclical downturns, not structural crises that dislocated entire industries. Put another way, much economic risk became non-actuarial: so unpredictable that it is impossible to insure against it. In theory public services might have assumed some of the burden, preparing citizens in various stages of life to mitigate on their own, or with their families, risks against which they could no longer be insured. But just as the demands on them were growing, standard public services failed as "clients"' needs became more and more differentiated: public schools designed to teach native speakers from traditional families how to perform semi-skilled work failed miserably to equip immigrant children ill at ease linguistically and culturally in their home/host country for demanding jobs in the new economy.

An initial response to the breakdown of social security based on hierarchy/command and control assumptions, and particularly to the turmoil in the public sector, was "privatisation" in two senses. The first was to allow private providers to bid on formerly public services; the second was to contractualise public services, setting elaborate and precise goals and carefully incentivising public or private actors to meet them. The model for this New Public Management (NPM) was the old, vertically integrated firm and rule-following or principal-agent accountability that went with it.

The good side of NPM was to shake up encrusted bureaucracies and establish the ideas that performance – output – and performance monitoring are crucial and possible. In this regard the controversies surrounding NPM were an important indication that the public – through the legislature and the administration – recognised that working public services were a precondition to solidarity, and therefore very much worth fighting for. The bad side of NPM was to separate conception (goal setting) from execution (actually delivering services) in a way that produced many of the same dysfunctions noted in the first phase of globalisation, in which vertical disintegration was antithetic to any redistribution of design authority and capacity. For example, in order to define goals clearly enough to enter them into a contract, it was necessary to narrow them. But once many different entities were pursuing many, tightly specified but distinct goals, a new problem arose: integrating all the partial

outputs into an overall solution actually addressing the particular problem at hand. This required new forms of local co-ordination; the difficulties encountered in assembling the fragments of a solution into a workable whole eventually lead to a re-evaluation of the idea of separating conception and execution at the top in the first place. The goal of joined-up government that has become a mantra, a New Labour reform under Tony Blair, is an expression of the need to address this problem, and especially telling as it arises in the home country of the NPM.

Much of this is, of course, taken for granted in current discussion of "local" reform and new governance, even if the twists and turns of ideology and academic conceptualisation (which are themselves of course intertwined) are not readily at hand. Thus much of the current OECD LEED research is in fact devoted to examining and evaluating the operation of various forms of local networking that grow up as ad hoc solutions to the breakdown of the old model, and the partial successes and failure of NPM (see Giguère, 2004; OECD, 2001).

Here the author wishes to focus on the emergent actors behind these changes, and especially the new public services, that provide customised (combinations) of services to help individuals and families mitigate life risks. What makes these public services new in contrast to familiar public services is that defining and redefining what they should be is anything but straightforward. In economic theory the purpose and value of public services is self-evident enough to give rise to a characteristic free rider problem: each citizen assumes all the others will want it, and that she can free-ride on their willingness to pay for the service. The result is that no one pays for traditional public goods unless all are obliged by joint decision to pay together. New public services, in contrast, are so idiosyncratic and mutable that they have to be "co-designed" by client users if they are to be useful at all. Financing for new public services is not, of course, automatic. The defining difference is simply that the free rider problem in new public goods is no more important than the problem of specifying the service in the first place. A recent report by the peak tripartite body in Ireland, the National Economic and Social Council, on the country's "developmental welfare state" underscores the importance of what new public services are to social solidarity:

> The development of services is the key to improving social protection for Ireland. The development of services is the key to improving social protection for Ireland's population in the coming years ... The principal requirements for widening participation today are of a nature which increases in social welfare alone are inadequate to address – *e.g.*, access to childcare by lone parents, education and training for people with low skills ... the return to education of early school leavers ... public services and public places that are accessible to persons with disabilities.

School reform in the United States provides a well-studied example of how the principles of pragmatist co-design are now commonly invoked to address the new public service problem of determining what service to provide, and how to provide it. The example is particularly well suited to establishing the continuity in the use of the pragmatist disciplines across the public and private sectors because the old model school in the United States (and of course not only there) was consciously patterned on the mass production factory. Men in teacher's colleges designed curricula, which were then translated into textbooks. Women teachers in classrooms read the texts to students who moved from classroom seat to classroom seat, like pieces on an assembly line that advanced one position in a year.

To respond to the needs of heterogeneous classes, with many students arriving without the whole panoply of middle class family support, required a thorough reorganisation of the school: a reorganisation aimed at building a school that can teach pupils complex skills regardless of their starting point, rather than communicating information to them on the assumption that they started with the knowledge of how to use what was communicated. After more than two decades of desperate experimentation reforms settled in the mid-1990s on a variant of root-cause analysis that, fully in the spirit of the pragmatist disciplines, allows effective reorganisation to proceed by using partial solutions, and without presupposing any definitive model of the ultimate goal: use standard tests to reveal shortcomings in the learning strategies of pupils, the teaching strategies of the staff and defects in the organisation of schools and school districts that are the root cause of these shortcoming.

To see a bit more concretely how these disciplines might operate in school reform, consider the problem of teaching literacy. Learning to read, like mastering any complex task, requires each learner to assemble her own idiosyncratic combination of bundles of general skills. So in learning to read, each kid must decode phoneme streams (phonics) with/while inferring the meaning of words in context (holistic semantics) – in her own way, which is to say with her own strengths and weaknesses in both skill areas. Thus some kids will use the meaning to guess sounds, while others will sound their way to the meaning. Many will have troubles doing either, but could benefit greatly if strengths in one area could be used to bootstrap them past difficulties in another (by, say, learning to decode a proper name that reveals a context, that then prompts more sounding out). Standard tests can be used to diagnose individual learning problems, but also the systematic difficulties of some teachers, relative to others, in helping students overcome their particular blockages. The aim of the institutional reform is to rebuild classes, schools and school systems so that these individual "defects" can be identified and remedied systematically.

Thus the job of the teacher in this new public service is to organise the classroom to identify and remediate each pupil's difficulties. The job of the principal or schoolmaster is to organise the school so that teams of teachers within and across grade levels help each other achieve this goal (new search networks). And the job of the district head is to organise the system so that principals have the authority and autonomy to do this (more search networks).

Reform by means of the pragmatist disciplines gives rise almost naturally to a new local politics of schools. Teachers and school officials are accountable to each other through the performance measures that make diagnosis of problems possible in the first place. They are also accountable to the public. Thus in many of the United States, parents can compare the extent to which demographically comparable schools close the achievement gap between rich whites and other groups. This allows them to put pressure on school authorities, on politicians. It also allows them to take action as families: school rankings have demonstrable effects on real estate prices. (The discussion among EU countries, and especially internally in Germany among Länder, regarding the striking differences in performance on the PISA test academic achievement and problem solving is certainly a harbinger of things to come.) There is in addition often more involvement of parents with the ongoing operation of schools and the schooling of their own children, although these effects are harder to capture.

But this politics of school improvement does not, yet, connect to "politics" in any traditional sense. Parties do not know how to respond to these changes, even though they have typically approved many of the enabling laws at the state and national level. Parties are still based on traditional ideological divisions – more market or more state. Or, sensing the tenuous grip of these distinctions on actual problem-solving strategies and popular moods, if not imagination, they may appeal to culturally divisive themes – yes or no to headscarves in schools – in hopes of forcing their opponents to endorse the currently unpopular choice. But the new, pragmatist reforms are typically illegible through the optic of either traditional ideologies or contemporary culture wars, and for that reason invisible or at least undiscussable in traditional political terms. Thus for Republicans in the United States the reforms just noted are unpalatable because they require too much government intrusion into what has been, since colonial times, a quintessentially local matter. For Democrats the reforms are unpalatable because they are not sufficiently attentive to redistribution and the prerogatives of the teachers' unions, one of their key client groups. But local activists in both parties are well aware that parents are acutely concerned about the quality of their children's education; that the reforms are widely regarded as promising, if not yet successful; and that traditional, "political" nostrums – bigger school budgets without accountability reforms, vouchers to move from public to

private schools – have been tarnished by unsuccessful use. As a result school reform seldom becomes a political issue, or is treated as a matter for experts (even when, as we just saw, the experts are learning how to reform schools as they go). (Can it be that some of the echoes of local governance reform die away in a silencing baffle analogous to this? Or perhaps more to the point, can it be that many of the local partnerships and other local governance innovations wander into such political dead zones, where their own capacity for reflection is limited by the discomfort some participants experience in traversing between the categories of their habitual working languages and the categories of the innovative institutional design?)

Even civil society organisations are unsure of how to react. The typical non-governmental organisation (NGO) is used to demanding inclusion – a seat at the table – from politicians and top administrators. It has much less experience actually engaging at problem solving at the truly local level – in the institutions where problems are being fixed, or not. This is perhaps one of the reasons that local partnerships, often heavily reliant on NGO participation, have often proved better at shaping the decisions of public authorities rather than providing services themselves or becoming active partners with public authorities in their provision. But this is not a stable situation. If clients are indeed drawn into the co-design of services on which they rely, but NGOs claiming to represent those clients are themselves unable to participate in this kind of collaboration, there will be doubts about the legitimacy of their representations. (Another possibility, of course, is that professionals in the new public services can adequately design the programmes needed by consulting clients without giving them a substantial influence on controversial decisions. Under these conditions it might be expedient for *both* the professionals and the NGO to act if the latter were the true representative of the clients. The author returns to these themes in the conclusion.)

To this confusion, add the complexity that comes from undertaking similar incrementally revolutionary reforms in areas as diverse as the police (community policing), child protective services, and eventually vocational and continuing training, job placement, and so on. And remember that all this confusion and complexity will only be compounded as separate reforms all begin to connect, as they are already doing in many locales. Thus restoring order in the schools can require help from community policing, just as community policing can require help from the schools. Family protective services involve both schools and police, and the same goes for treatment of substance abuse, and so on and so on. It is these changes, informed more and more by use of the pragmatist disciplines, that together with the reorganisation of private firms in the second phase of globalisation form the building blocks from which a new local governance is being constructed

And then there are the courts. In the United States, and soon in the EU and perhaps Latin America (Argentina has already had an important case) many of these reforms have been compelled and monitored by courts. The courts today in all three areas are prone to recognise that badly broken institutions violate constitutional or human rights. They are especially prone to do this when, as is increasingly the case, the state promises to but in fact does not provide a minimum of security though services that build individual or family capacity rather than redistribution. The are most especially prone to do this when, as is again becoming generally the case, the political organs have repeatedly promised to make the state meet its obligations, and then failed themselves to keep the promise of reform. A familiar and well-founded objection to judicial intervention in such matters is the manifest inability of courts to devise and supervise complex institutional reforms, leaving aside the questions of how such remedies are to be deduced from legal doctrine typically innocent of all the relevant concerns. By requiring that the relevant actors use pragmatist disciplines to establish a step-by-step reform, whose progress can be monitored by the same indicators used to guide change, the courts can, however, determine that there have been violations of right without prescribing remedies – but also without abandoning responsibility for public supervision of obligatory change in the public's name.

In this way court intervention also increases pressures for participation – civil society actors are highly motivated to take part in the elaboration and monitoring of the reform programme. But it does so in a way that does not lead to any direct connection with the institutions of representative democracy.

The prospect – near certainty is more like it – of court pressure to accelerate reform of public administration on pragmatist lines does nothing to resolve the open questions regarding the shape of local governance in the medium turn that we have encountered again and again along the way. But the prospect of increasing court involvement in what will perforce be largely local reforms raises again, and acutely, one of the key questions with which we began. What is the fate of local democracy in what could well be a coming age pragmatist problem solving?

But are experimentalist organisations democratisable?

The foregoing suggests pragmatist institutions enable the social learning needed effectively to provide new public goods, with their imprecisely specified ends. But even if new public goods are a necessary component of solidarity in today's democracy, provision of such goods alone is surely not sufficient to secure the legitimacy of government in any modern democracy. New service providers – and all government that relies on the pragmatist disciplines for public problem solving – must be democratically accountable at

least in the sense of being responsive to the (political) will of immediate stakeholders and, beyond that, to the public of the polity as a whole. If the pragmatist institutions cannot be democratically domesticated, and still assuming they are especially, perhaps uniquely, suited to collective problem solving under current conditions, our democratic societies would face a fateful choice between effectiveness and fidelity to the principle of self-rule. Without pretending to address fully, let alone resolve, all the questions that arise in connection with the democratic vocation of pragmatist organisations, the author wishes to address some relevant general, theoretical issues on the one hand and some practical, institutional ones on the other, and thereby provide at least elements of an overall approach to the many concerns put aside for now.

The first, general worry is that the new, pragmatist institutions are really at best (slightly more effective) cousins of the technocratic NPM reforms. They share with the latter an emphasis on performance metrics, "flat" hierarchies, treating the client as at least a customer (if not a co-producer), and so on. Perhaps, this worry goes, the new institutions blur the distinction between principal and agent just enough to overcome the crippling defects of NPM, but not nearly enough to truly empower citizen/clients in the sense of giving them a potent voice in the choices that determine which services to deliver and how. This fear shades into the much more alarming prospect that, at worst, the new institutions are *intended* to disenfranchise the public, precisely by creating sham forms of participation and consultation. The beneficiaries of this deception would be the technocratic rule makers and the organised interest groups – labour, capital, the entrenched civil society organisations – with which they all too comfortably consort.

A first response is that this self-serving and manipulative outcome, while clearly possible, is hardly inevitable. Decentralisation of authority of the kind associated with the new organisations has demonstrably uprooted vested interests in ways long thought to be impossible by students of complex organisations. The well-documented disentrenchment of traditional school authorities that went hand in hand with the introduction of experimentalist school reform in the United States is a case in point. Through the 1990s public schools were widely referred to in the US debate as an example of the un-reformability, by democratic means, of a key institution of democracy: Because successive cohorts of elected school authorities (the principals) entrenched conflicting rules favouring their separate values and interests, the interests groups (agents) running the school system were free to do whatever selfish impulse suggested (Chubb and Moe, 1990). Coalitions of disaffected insiders and outsiders imposed the governance and organisational innovations described above, and the combination of decentralisation of authority and transparency thus afforded has, so far, prevented a clandestine

reassertion of power by new or old interests. That there are no conspicuous limits to this reform movement in those places where it has been undertaken does not mean of course that it will be automatically extended to include fully clients and citizens in decision making – a problem to which the discussion will return (but not resolve) momentarily.

Reference to the transparency of the school reporting regime points to a second, deeper response to the worry about manipulative, sham reform. Because they are polycentric or polyarchic, with a notional "centre" benchmarking the performance of local units facing related problems, pragmatist institutions are always out of reflective equilibrium. Inevitable variations in the performance of the various units provoke ongoing review and criticism of each in the light of the others' experience.[4] This means that professionals – technocrats of all stripes – and the more or less formally organised interests with which they are affiliated must frequently explain why their actions differ from those of peers in like situations. Experts and interests, in other words, must justify themselves, again and again, in public, and to respond to deeply informed challenges to, respectively, their expertise and their claims of the legitimacy (or at least inevitability) of their interpretation of what their needs compel. Contrast this idea of continuing contestability of professional expertise in particular with the conventional presumption that fully certified professionals are qualified to make complex decisions on the basis of their own informed judgement alone, and are answerable to colleagues only if there is suspicion of negligence. The pragmatist disciplines thus seem more like a machine for disrupting potential conspiracies, especially technocratic cabals, than a scaffolding for erecting them.

Note further that from this perspective it is possible to distinguish advantageously democracy built on pragmatist institutions from two near cousins, associative and deliberative democracy: two other, and more familiar alternatives to the form of representative government we know.[5] Associative democracy assumes that the co-operation of certain groups – classically, labour and capital – is indispensable to the public interest. Such groups are accordingly given quasi-constitutional authority to bargain with each other, under the auspices of and in consultation with the government, in view of promoting public-regarding outcomes. But however effective and legitimate such arrangements may have been, it is clear today that associative democracy rests on the same flawed assumption of the panoramic powers of the sovereign principal that brings NPM, among other reform efforts, to fall. It has proven in practice no more possible to identify which groups are the necessary and sufficient parties to public co-operation than to identify public principals who "know" what is to be done in regard to particular reform projects. A democracy that relies on pragmatist institutions, in contrast, is no more

inclined to presume that the circle of participation in decision making is fixed than to treat any body of expertise as self-validating. It is thus not hostage to the once-and-for-all guesses about the identity of the "natural" social partners that have in time paralysed all associative democracies.

Deliberative democracy, as its name suggests, is not hostage to interests. Quite the contrary: its aim is to so abstract decision making from the trammels of everyday necessity that the decision makers are free to engage such deep reflection that their prior ideological or material preferences (if they had them at all) are likely to get sacrificed to the demands of public reason. In its purer, Madisonian forms, deliberative democracy is inclined to entrust power to a magisterial or senatorial elite, protected by wealth or tenure of office from the tugs of personal advancement or factional scheming. The classic stumbling block for deliberative democracy is thus not to disentrench interest groups, but rather to connect, yet not simply subordinate the deliberative elite to the everyday cares and concerns – the interests – of the everyday citizens of democracy.

Here too democracy that relies on pragmatist institutions is promising. Like deliberative democracy, it induces citizens to change their preferences. But it aims to do this not by having the participants remove themselves from the world, but rather by having them open themselves to it in a new, practically deliberative way. The mutual learning that grows out of and fosters problem solving in pragmatist institutions brings the actors to change their view of possibilities even as they put their identities at risk by reorienting their goals, their ideas of potential collaborations, and their understanding of fruitful problem-solving strategies. If this is too good to be true – because it assumes inhuman plasticity of the all-too-habit-bound human self – consider that individuals and groups only turn to pragmatist problem solving when pervasive uncertainty has thoroughly undermined their confidence in their inveterate problem-solving strategies (the market, more government) and the ideologies that articulate them. The determination to govern "from the second line" in the Netherlands, for example, surely did not emerge from an insouciant delight in novelty, any more than did the Irish engagement with that improbable creature, the developmental welfare state. We do not go to the trouble of creating the elaborate learning institutions described above unless we think we have something to learn. Acknowledging our need to learn, we are less disposed to manipulate strategically the information we give and get, and the resulting surprises loosen the bonds of habit.

Thus where associative and deliberative democracy can be said to be inherently exclusive (of interest groups or practical interests), pragmatist democracy is at least *potentially* inclusive. Instead of addressing the plainly pertinent questions of whether and under what conditions such a democracy might actually realise this potential, allow the author to switch from general

to practical themes and consider finally the possibility of an immediate, institutional response to the problems of accountability posed by the spread of public problem solving on pragmatist lines. An institutional response to the question of accountability is not of course a substitute for a compelling theoretical justification. But in the history of democracy it has often been the case that institutional reform outran, and became a spur to, theoretical reflection (think of the incorporation of organised interest groups into parliamentary regimes in roughly the first half of the last century). There are signs that this could be about to happen again, and, all current reverses aside, perhaps sooner at the local level – in local governance – than elsewhere.

Notes

1. This chapter synthesises and brings to bear on the discussion of local governance and democracy a series of the author's recent papers. For that reason, counterarguments are not given their due. Those interested in further pursuing the controversies elided here should consult the references in the bibliography, which in turn contain exhaustive references to the relevant debates.
2. Any textbook on Japanese production methods will demonstrate that root-cause analysis and related problem-solving techniques are especially useful to reduce set-up times and otherwise facilitate small-batch production in volatile environments.
3. For a fuller discussion, on which this presentation draws, see Helper, MacDuffie and Sabel, 2000.
4. Recall in this connection the emphasis pragmatist institutions put on diagnostic monitoring as opposed to global measures of output typical of NPM.
5. For further discussion see Cohen and Sabel, 1997; Cohen and Sabel, 2003; and Gerstenberg and Sabel, 2002.

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ISBN 92-64-01329-6
Local Governance and the Drivers of Growth
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Chapter 5

Local Strategies in a Global Economy: Lessons from Competitive cities

by
Michael Parkinson

Cities matter to national economic and social prosperity, yet many policy makers have not sufficiently recognised this – or acted upon it. If policy makers and politicians could rise to the enormous challenge cities represent, the reward would be great. This chapter explores the contribution cities can make to the development of regional and national economies. It identifies the reasons for their continuing political and economic importance, assesses the challenges and achievements, identifies ways in which national governments attempt to support cities, and explores some of the tensions involved in city-regional co-operation. It identifies the drivers of economic competitiveness and assesses the performance of a range of successful European cities.

Do cities matter in a global era, and why?

In the last decade there has been a transformation in the perceptions of the role cities play within Europe. They are now high on the European agenda for a variety of reasons:

- Traditionally cities have been seen in their respective national economic hierarchies. Increasingly they are seen in (at least) a wider European economic context.
- There has been a rapid growth in the development of networks between cities at a European level. These are designed to promote trading links, exchange good practice and promote the interests of cities at a European level.
- There has been growing awareness of cities' contribution to and potential for Europe's economic competitiveness. Cities are increasingly seen as economic assets, not liabilities, that need to be exploited not only at a national but also at a European level.
- There has also been growing recognition of the double-edged character of much economic change in cities during this period. The search for economic growth has not always led to social equity; indeed, it has often contributed to increased social exclusion.

So we face a paradox. Despite their growing contribution to the economic competitiveness of Europe, not all places or people contribute or benefit equally. As a result, social problems are growing in many cities. This juxtaposition of success and failure, growth and decline, innovation and stagnation, wealth and poverty, great architecture and environmental deterioration poses a major challenge to the social cohesion of Europe. Linking increasing economic competitiveness to increasing social inclusion is a crucial challenge for policy makers at all levels of government, and all social partners in all European countries.

Why are cities still important politically?

There are different views about how important cities are in contemporary Europe. Historically they have critically shaped Europe's economic, social and institutional arrangements. But it has been argued that cities have been overtaken by events and are no longer the critical forces they once were in

national economic competitiveness. This argument is based on a number of assertions:

- Cities are now wholly fragmented economically, socially and institutionally, and can no longer be seen as united actors.
- The process of metropolitanisation has made central cities obsolete.
- City networks have made traditional urban territorial boundaries obsolete.
- Global capitalism has made European cities insignificant.
- The increased mobility of labour, capital and ideas and the space of flows have made place and community less important in a globalised world.

There is something in these arguments. But there is more evidence to suggest cities still do matter – and probably more rather than less. For example, the death of cities has been predicted many times before – without it actually happening. Also, the challenge of metropolitanisation has been managed without the loss of identity or role for central cities. Even in large conurbations, medium-sized cities are not lost. More specifically the impact of globalisation means that the nation state can no longer do everything, which gives opportunities to cities. Cities still provide hugely important facilities and services. Cities still make decisions that are critical to business, consumers, environmentalists and poverty groups. And it can be argued that place, space and community have become more – not less – important for identity and action in an increasingly globalised and insecure world. So cities are still critical sites not only for identity and action but also for decision making – and also crucial to national economies. They matter economically, politically and culturally, to nations and to Europe. National and European policies should recognise and act upon this fact.

Why are cities still important economically?

Many volumes have been written about why people and economic opportunities congregate in cities and whether the economic attractions of cities are increasing or declining. The theories and arguments are endless. Essentially the argument in favour of cities is that large urban areas have agglomeration economies that make them more efficient than other areas. Essentially they have two advantages. First, production costs are lower by being shared with common social and physical infrastructure. Second, transportation and transaction costs may be reduced as a consequence of enhanced interaction between suppliers and customers located side by side.

The rise of globalisation has led some to argue that these traditional urban advantages have been reduced. Others argue that the death of geography, distance and cities has been much overstated and that places matter more, not less. It is tremendously complicated but a reading of the literature in this

field leads the author to share the second interpretation. Large urban areas exhibit agglomeration economies, which means they will remain important economically despite the consequences of globalisation.

Agglomeration economies – urbanisation or localisation

But crucially there are different kinds of agglomeration economies, which generate much analytical and policy debate and dispute. The two referred to above are the classic, traditional urbanisation economies. But more recently, great emphasis in the analytical literature and in policy terms has been placed on other urban economies, which may be termed localisation rather than urbanisation economies. Again the literature is large and complex. However, the essential argument is that firms' attraction to urban areas has less to do with infrastructure and transportation and more to do with being close to other customers, suppliers and competitors in cases where close physical location leads to shared understanding and transactions – untraded interdependencies. The weight one attaches to these two explanatory factors has important implications for analysis and policy. Despite many complexities, essentially this principle underpins the cluster analysis of Michael Porter, which has become very fashionable as a policy concept and in turn underpins much of current understanding of regional competitiveness. However, the whole idea is contested analytically, empirically and in policy terms.

This is not the place for a learned discourse on the matter. But it is worth unpacking the idea and identifying some of the policy implications. They are not mutually exclusive but the relative weight attached to them in explaining – and improving – economic performance produces rather different policy orientations. The distinction between urbanisation and localisation economies is important because they lead to different ways of seeing the world. One emphasises structural factors, external forces and relationships, and public actions and goods. The other tends to emphasise cultural factors, internal factors and private factors. "Urbanisation economies" relates to the general economies of regional and urban concentrations that apply to all firms and industries in a single location. They represent those external economies passed on to firms as a result of savings from the large-scale operations of the agglomeration as a whole. These are the forces that lead to the formation of industrial core regions and metropolitan regions. And they are often essentially publicly provided resources and assets – for example transport infrastructure, advanced education, research and development. Such advantages are often linked to external linkages and economic activities as well as exports, and have implications for the provision of external connectivity.

By contrast, localisation economies are the specific economies that relate to firms engaged in similar or interlinked activities, leading to the emergence of spatial agglomeration of related firms – industrial districts, localised

industry clusters, etc. Such advantages tend to be cultural, local, and private – for insiders – as they emphasise innovation, learning and flexibility within and between firms. This view of economic life also tends to emphasise internal intra-regional relationships rather than external linkages and exports. It tends to explain differences in economic performance in terms of cultures and private and internal factors. There are many nuances to this debate, and the discussion here is oversimplifying enormously for the sake of debate. But some policy implications are clear. In particular the significance of and need for public and government intervention in connectivity, labour markets and innovation systems are particularly emphasised in the urbanisation orientation – to which the author subscribes.

Why can cities flourish in the knowledge-based global economy?

The economic importance of European cities in an increasingly knowledge-based global economy has recently been assessed by the STRIKE report prepared for the Dutch Ministry of the Interior. The report dramatically underlined that growing importance and the need for European and national government policies to recognise it much more than they currently do and to build upon cities' potential. The global economy has several key features. Knowledge and information are its main, more rapidly diffused inputs and outputs. The knowledge economy is a network economy. There is a high premium on entrepreneurship and innovation. The knowledge economy is volatile. There are no single trajectories towards the knowledge economy. Knowledge and creativity are growing in significance as factors of production. The development of the knowledge economy is evident not only in the growing service sector, but also in such traditional sectors as agriculture and manufacturing industry. The core activity in all sectors is no longer the physical manufacture of a product, but the development of new products and production processes, the generation of new knowledge, and the devising of marketing concepts.

And cities are uniquely placed to contribute to and benefit from this development. European and national policy needs to recognise and exploit those opportunities. Highly educated workers are in demand, required for knowledge-intensive activities. Countries and regions that can attract and keep such workers have the edge. The quality of the local knowledge and educational infrastructure is gaining ground as a location factor. The growing internationalisation of education offers new opportunities for cities to attract knowledge. And networks are becoming more important in the knowledge economy. Companies need to co-operate to develop new products, techniques and concepts. But networks of companies are not all that is needed. Strategic alliances between companies and institutions of education and research are

also crucial. And new networks between regions, cities and national governments are required as well.

Cities will benefit from and contribute to these trends in a variety of ways. The creation of knowledge mainly takes place in cities. The quality, quantity and diversity of the universities, other education institutes and R&D activities determine to a large extent the starting position of a city in the knowledge economy. Cities often have diverse economies. Urban regions with an economy dominated by service activities often have a better starting position in the knowledge economy than those specialised in manufacturing and port industries. Cities with a diversified economy are less vulnerable in rapidly changing economic circumstances. And cities with a diversified economy can become incubation places for new developments and economic innovation.

Cities are accessible. Good international, regional and multimodal accessibility is crucial for successful knowledge cities. They need good and fast access to international airports and high-speed-train stations, good regional linkages to other urban centres and an efficient local infrastructure network to accommodate face-to-face contacts. Naturally, knowledge cities have to have high-quality electronic infrastructure for vast and swift global communication. Urban diversity promotes creativity. Diversity fosters growth in cities, especially in their most innovative sectors. Diversity fosters innovation in cities, while narrow specialisation hinders it. Cities have advantages of scale. Knowledge-intensive activities take place especially in medium-large and large cities. Here there are greater economies of scale for knowledge activities, a larger market for specialised services and a larger common pool of knowledge workers. Larger cities normally have better international transport infrastructure and offer scope for international subcultures and international amenities. In addition, creative workers prefer cities with a thriving cultural life, international orientation and high levels of diversity. Larger metropolitan areas are much more likely to attract these types of workers than remoter, smaller places.

What's going on? Urban trends in Europe

Cities are the best of places and the worst of places. The concentration of economic, physical and intellectual resources makes many of them centres of prosperity, creativity, culture, communication and innovation – the dynamos of the European economy. Some of Europe's larger cities play important roles as the command and control centres of a rapidly developing global economy. But at the same time many cities are experiencing poverty, declining economic competitiveness, growing social exclusion and physical and environmental deterioration – making them a drain on Europe's potential economic performance and its social stability.

Diversity and commonality

Of course, urban Europe remains enormously diverse. There is not a single model of a European city and the challenges are not the same in any two cities. Important differences in their economic structure and functions, social composition, size and geographical location shape the challenges cities face. Equally, national differences in traditions and cultures, economic performance, institutional arrangements and government policy have an important impact. The problems of global cities like London or Paris are not those of medium-sized cities. Declining large industrial cities with exhausted manufacturing economies, less skilled workforces and substantial immigrant communities face different dilemmas from fast-growing cities based on high-tech industries. Cities in the periphery face different economic, social and environmental challenges than those at the centre of Europe.

The causes of change

However, although the challenges are faced by and within cities, they are caused by a number of structural changes that are taking place outside cities and that are primarily beyond their control. They are:

- Economic globalisation – with power going upwards from the nation state and the loss of local control.
- Economic restructuring – which is creating divided labour markets (and the so-called segmented "Porsche-hamburger" economy).
- Competition between cities, regions and nations as well as firms, with winners and losers within as well as between cities.
- The restructuring of welfare states with the loss of support for already vulnerable individuals, communities and areas.

Rapid changes in the economic environment caused by internationalisation and industrial and corporate restructuring have transformed the character of local economies. They have brought a more fragmented labour market, a decline in manufacturing and rise in the service sector, high levels of structural unemployment, an increase in part-time, insecure and low-paid employment, a shift in the balance of male and female employment, and a growing gap between the highest and lowest household incomes. These changes are not only found in cities where the economy is in decline or during periods of recession. They are also a feature of booming economies. Growth does not guarantee an increase in the number of jobs. Instead, capital-intensive production methods reduce them. And many potential workers in the most successful cities lack the skills needed in modern industries. Growing polarisation in incomes, employment quality and job security has occurred in cities with very different economic trajectories across the European Union.

These structural changes are being exacerbated by cyclical factors like global recession as well as by the enlargement of the Union through membership of the accession states in the east.

These forces have encouraged uneven social development that is increasingly played out on a spatial level in our cities and regions. This involves not only labour markets but also housing markets and social welfare systems. It has to be tackled through many policy areas. It needs an integrated rather than a sectoral approach. Achieving the latter – an integrated approach – remains a key challenge for all governments at city, regional, national and European level. Many have not yet addressed the challenge. Some have attempted to do so, and a few are succeeding. But much more needs to be done.

The precise forms these developments take vary by country, region and city. But they pose similar challenges to decision makers at urban, national and European level. As a result, the major challenge for European cities into the next millennium will be to increase their economic competitiveness without at the same time increasing social exclusion. Cities, national governments and the European Commission will need to determine which urban strategies they wish to pursue and how to reconcile the two goals of competitiveness and cohesion. In the recent past governments have alternated between policies either seeking to promote social welfare or strengthening individuals' or areas' economies. In many countries the realisation is now growing that the two goals of cohesion and competitiveness and are not mutually exclusive and that urban strategies need to focus both upon social need and economic opportunity.

What does this mean for cities?

Some indications about the condition of European cities with respect to social exclusion can be seen from the findings of the European Commission's Urban Audit 1, which looks at 58 cities in EU15 member states:

- City population levels are stabilising and populations at wider conurbation levels are growing.
- The cities are becoming more international and more cosmopolitan. Ten per cent of the population of the cities were non-nationals, around one-third from the EU, and two-thirds from outside.
- Cities have relatively small households and they are getting smaller.
- Cities bear the brunt of unemployment and long-term unemployment.
- Income disparities and poverty are growing. About 25% of households had income, which was less than 50% of national household income.
- Home ownership is increasing. Ninety-five per cent of cities had experienced an increase in levels of ownership.
- Cities are improving on some health indicators.

- Crime rates are higher in cities, especially northern and capital cities.
- Service sector employment is increasing. Over three-quarters of employment is now in services and less than a quarter in industrial employment.
- Voter participation in city elections is relatively low and declining. Average voting in local elections varied enormously, from 20% to 60%. But the percentage had fallen in two-thirds of all cities between most recent elections.
- Educational levels are rising. Cities lag behind at lower educational levels but most have more graduates than the national average.
- Travel is increasing, car ownership is increasing and public transport is declining.

What urban challenges do the new EU countries face?

In 2004, ten new countries joined the European Union. This expansion has been the biggest the EU has ever undertaken. What opportunities and challenges will they present for an EU urban policy and for the member states themselves? Some answers are again provided by a study commissioned by the Dutch government within the framework of its presidency of the EU during the second half of 2004. It is crucial to recognise that the expansion of the Union will bring increased markets and opportunities and new sources of labour and creativity. It is also important to recognise that there is a great diversity of circumstances within the 10, just as there is great diversity within the 15 member states. Patterns of industrialisation and urbanisation vary significantly so that there are differences within the 10 countries and their cities that are almost as great as differences between them and the 15. In particular some of the challenges facing cities in the new member states are closer to those faced in de-industrialising countries than in less urbanised countries. Many of the urban problems that can be found in west European cities can also be found in the cities of the new EU countries. However, some social problems that are typical of a West European city are less apparent in the cities of the new EU countries. But other problems are very visible. The limitations of basic physical infrastructure in terms of transportation systems, housing and road networks are critical. Traffic and environmental problems are cases in point. Large housing estates, mostly built in the period 1960-90, often belong to the most problematic urban areas. Issues related to traffic (congestion, parking) are particularly problematic in a large number of countries, a consequence of the enormous increase in the last decade in car ownership and use. Urban sprawl is a major problem of urban conurbations. A rundown housing stock seems to have become a major difficulty in a

significant number of countries. In most cases, the postwar stock seems more problematic than the older stock.

There are many economic troubles. Unemployment ranks high in all countries, with the exception of Cyprus. In all the countries the average income is very low in comparison with other new EU countries. In comparison with physical and economic problems, social issues seem to be less prominent on the policy agenda. Problems related to spatial segregation are not very prominent in most of the countries concerned. The same holds for social polarisation issues. But many cities have experienced a population decline in the last decade.

How well have European cities responded to the challenge?

Despite the challenges presented by globalisation, economic restructuring and institutional change, European cities have substantial economic, social and cultural assets – and potential. Much remains to be done, but much has already been achieved which can be built upon. Many of the factors which attract investment and people to particular places – the quality of labour, education and training, the cultural, residential and physical environment, the planning and fiscal regimes, the communication and transportation infrastructure – remain under the influence, if not sole control, of cities. They can be affected by city policies, although increasingly these involve other actors. And there are many examples of successful responses to the new challenges. Despite the fact that levels of social exclusion in European cities may be less than in their American counterparts, a tradition of social democracy and welfare state provision, greater national governmental intervention, less fragmented urban governance and a greater role for political parties at urban level has meant that the impulse to address social exclusion is greater in European than in American cities.

Many cities have achieved substantial physical regeneration, especially through the renovation of city centres that offer impressive commercial, residential, cultural and retail facilities. Many cities have concentrations of intellectual resources in universities and research institutions that encourage high levels of innovation. Many play important roles as centres of communication, decision making and exchange. Many have substantial cultural resources which are increasingly the source of economic growth and job creation. Cities also have enormous integrative potential with the capacity to encourage community participation and civic identity. And despite the growth of exclusion, many cities remain ethically and social diverse and offer vibrant cultural opportunities that attract visitors and residents. Within many there are flourishing neighbourhoods and communities with extensive levels of social capital which are the source of community empowerment.

Across Europe there have been many successful efforts to make cities more sustainable through innovative environmental and transportation schemes. Also, there is a range of innovative initiatives to develop partnerships and achieve integrated responses to social exclusion in many cities. And despite the growth of economic competition between cities, there has been an important growth in networking between them as they seek to trade, exchange ideas and information and share good practice.

A key aim of European urban policy should be to increase awareness of what has been – and can be – done, and to encourage the institutional processes that will enable cities to build upon their assets and potential to achieve long-term sustainability. The challenge is to develop strategies, policies and instruments that will:

- Improve the economic competitiveness of cities and Europe itself by maximising their economic, physical and intellectual assets and encouraging innovative institutional and individual behaviour.
- Distribute the benefits of increased economic competitiveness and reduce the growing social exclusion that is a threat to both the economic competitiveness and social stability at a European level.
- Make cities more sustainable and not impose the costs of development upon their surrounding regions, the planet itself or future generations.
- Encourage innovative and flexible decision-making processes that will integrate the actions of partners in the public, private and community sectors, from European to local level, and increase synergy between existing institutional processes and resources.
- Encourage a more balanced European urban system by discouraging unnecessary competition between cities, support the needs and opportunities of medium-sized as well as larger cities across the Union, encourage better urban-regional and urban-rural linkages and encourage more effective networking between cities across the Union and between cities within regions.

What have national governments been doing about cities, and with what results?

National policies are an important part of the context in which cities have to respond to change. The institutional, financial, planning and legislative frameworks still vary enormously between European countries. Nevertheless, three trends that transcend national boundaries are worth noting. The first is that since the 1990s the balance between national, regional and local responsibilities and powers has been changing in many European countries. In particular, there has been a growing pattern of decentralisation of powers and

responsibilities to lower levels of government. Traditionally decentralised countries like Germany have taken that process further still. But even countries more traditionally centralised like Belgium, France, Spain and Italy have been creating or increasing the authority of regional and urban institutions during the recent past.

National motives varied. Sometimes the changes were in response to regional demands for greater territorial autonomy. Sometimes governments were anxious to dismantle centralised decision-making systems created in the postwar period. Sometimes national leaders were anxious to shift responsibility for difficult problems of urban economic restructuring down to local level. The degree of national fiscal support given to regional and urban institutions to face their new responsibilities also varied and induced differing degrees of financial difficulties. Nevertheless, the important point is that decentralisation created greater autonomy and political space at the lower levels of decision making, which many of Europe's most dynamic urban and regional leaders exploited to develop new political roles for themselves and new economic strategies for their areas.

A second general trend has been the emergence of more explicit national urban strategies in many European countries. The countries that urbanised first and hence experienced urban decline first – Britain, France and Germany – were the first systematically to develop urban policies. The process that began during the late 1960s increased in the 1980s. But the trend emerged in many other countries since. The scale and sophistication of national strategies still vary and remain relatively underdeveloped in some countries, but national recognition of the importance of cities and problems strengthened throughout the 1990s and continues through this decade. Responses differ in detail but all are attempting to develop explicit urban strategies to improve both competitiveness and social cohesion through integrated, area-based and partnership based national strategies.

A third trend has been growing recognition of the economic opportunities for cities. This was encouraged by increased awareness of the importance of economic competition between nations and cities during the 1980s and the potential for an increased pace of that process after the creation of the Single European Market. Urban leaders became more aware of the need to avoid falling behind the already successful European cities and sought to identify new economic niches in the European economy. But national leaders also became conscious of the potential contribution of cities to national economic competitiveness and performance. In particular, in many countries the contribution of capital and larger cities was acknowledged and the governmental restrictions that had been placed upon their growth by redistributive regional and planning policies in the 1970s were frequently relaxed during the 1980s. This encouraged the economic and population

resurgence of many cities but also encouraged the growth of economic competition between European cities. In these three ways, national strategies guarantee that cities will remain high on both domestic and European agendas.

What impact have national urban policies had?

A recent report for the Netherlands government tried to assess the consequences of these policies. What did it show? The first conclusion is that explicit national policy attention for the larger cities has grown during the past decade. Increased awareness of the (inter-) national importance of urban and regional competitiveness, especially within the EU, and of the pattern of social exclusion in cities has contributed to this modest increase in attention. However, the general picture for national urban policies in the EU15 is still diverse, despite continuing European integration and internationalisation. Administrative, political, economic, social, cultural, geographical and historical differences account for the great variety of national urban policies.

At the same time, a number of common trends and developments for groups of member states are apparent. Four member states have formulated extensive explicit national urban policies – United Kingdom, France, the Netherlands and Belgium. Six countries – Germany, Finland, Sweden, Denmark, Italy, Portugal – have put urban issues on their national agendas, although the policy responses do not have the same critical mass as in the four above.

There is some evidence that empowerment of cities has become more important. There is more scope for manoeuvre for the cities and sometimes regions in the national urban policy frameworks, at least for the four countries with explicit national urban policies. The empowerment of cities is associated with more national attention for bottom-up initiatives. Traditional top-down approaches have become less popular. There are several examples of cities that have (independently or through associations) come up with initiatives and in some cases have exerted more influence on the national urban policy agenda.

The growing attention for local *partnerships* and the importance of civic *involvement* are repeated themes in the urban policies of the member states. Most national governments see partnerships – among cities as well as between public and private parties – almost as a precondition for the effective delivery of national urban policies. Another major trend is the attempt to achieve more integrated approach in the delivery of national urban policies. Equally, the large number of area-based initiatives indicates that the national governments have faith in the effectiveness of these policies. However, the selection criteria, spatial scope and (mis)match with mainstream policies remain barriers to successful area-based policies. Several member states have developed policies to prevent intra-regional competition.

Social exclusion is the most difficult problem to solve in most large cities across Europe. The policy responses to combat this problem differ considerably: residential and urban renewal (applied almost everywhere); more affordable housing; prevention of urban sprawl and promotion of compact cities; support of social mix in neighbourhoods; provision of cheap public transport; integration policies targeting ethnic minorities; reduced dependency on state allowances. In most of the member states housing policies and (mostly) physical interventions (urban renewal and urban regeneration) are used to combat social exclusion. In some countries demolition programmes of outdated housing estates have been planned or carried out in the fight against social exclusion. In most countries the integration of ethnic minorities and immigrants is increasingly considered a major issue that is most of all a challenge to cities. Integration problems are increasingly linked to social exclusion and feelings of insecurity. In a number of the relatively prosperous western European countries explicit integration policies are now starting to form a considerable part of national urban policy making. In particular, the search for social inclusion is encouraging some cities and national governments to attempt to reduce suburban sprawl and encourage more compact cities with a variety of mixed uses.

National governments in several countries have shifted their policy emphasis from social, problem-led policies to economic, opportunity-led policies. In several large-scale flagship projects are important catalysts for urban revitalisation and economic competitiveness. Some member states still see spatial planning policies as a means to maintain equilibrium in the national urban system. Others, however, pay more attention to the international competitive position of key urban areas.

What urban policy is there in the new EU states?

We have seen that states from the former eastern countries that have joined the EU have particular kinds of urban challenges. What policies have they adopted towards cities? Urban policies do exist in the new EU countries. However, they show enormous diversity. In some cases the central state has or has had a prominent role. But in most cases local government authorities are now more important for the development of urban areas and dealing with urban problems. In a few of these countries the private sector is an important player, too. The political transformations of the early 1990s meant the central state took a back seat. Now, however, in several new countries the call for more central state intervention in urban issues is gradually becoming louder.

In most of the new EU countries local initiatives seem important while regional and national attention for urban areas is generally more limited. For the ex-socialist countries, the absence of a national urban policy is the direct result of the political and economic transformation occurring around 1990.

Since then, responsibility for urban issues has been continually devolved to more local levels, to public-private partnerships, to private companies, and even to individual households. This has caused a number of challenges, including the lack of co-ordination, the lack of attention to urban problems and urban issues, and the lack of money to assist the cities. Local government authorities are often forced into short-term thinking in order to resolve acute problems because there is no time, capacity, or money to think about more long-term and structural policies and solutions. Local governments increasingly recognise that they cannot handle the problems of their cities and urban areas alone, or even in collaboration with the private sector. Urban problems are generally not addressed by central governments; local government authorities have to do the work, and that is no easy task. Problems of fragmentation, co-ordination, and a lack of financial resources clearly undermine the power of the local authorities in many countries. In particular, local governments in the major cities of the new EU countries have been requesting a nationally organised urban policy.

The challenge of achieving good urban governance does not take the same form or have the same intensity in every European city. The precise patterns vary from country to country and city to city, partly depending on national economic trajectory, labour market policies, welfare state policies and citizenship rights. Despite such differences however, there are a number of common financial and institutional trends that affect the capacity of cities to achieve good governance. These include:

- Growing political and public concern about rising levels of public expenditure and taxation, which has made national governments anxious to reduce the former. The pressure for financial orthodoxy has been increased by the needs of EU member states to meet the convergence criteria for EMU. There will be fewer public resources available in the future – and cities will have to shoulder their share of the burden.
- As national governments attempt to roll back the public sector, there has been the increasing substitution of private for public provision in many policy sectors: housing, welfare, education and training, transportation, infrastructure and communications.
- A decline in service provision by single public agencies and the growth in mixed models of service delivery and public provision.
- Increasing decentralisation of responsibilities – if not always resources – away from central government to regional and city governments.
- Paradoxically, despite the first four trends, the pressure for increased public services and expenditure is growing. Social and demographic changes mean there will be more old people, more single-parent families, more women in the labour force, and growing social exclusion. In the countries of

Eastern Europe, in addition to problems on revenue budgets, there are huge pressures to modernise and upgrade physical stock, which will affect budgets at national government and European level.

The combination of these trends means that cities will face growing social exclusion but increasing financial pressures in a more complex, fragmented institutional environment. Cities will need to be more creative, more institutionally innovative in finding financial packages that will allow them to fund programmes and projects that will contribute to their economic competitiveness but reduce social exclusion. Increasingly, partnership models will be required. The challenge of devising effective models of governance will become increasingly urgent.

How do cities work with regions?

This raises the question of what is the right spatial scale at which to intervene – the region, the city or the neighbourhood? The answer may vary across policy sectors. For example, in terms of economic policy – labour market, transport, infrastructure, planning issues – the wider regional framework might be the most appropriate spatial level. By contrast, for addressing social exclusion, the answer may well be the neighbourhood. Just as policy cannot be confined to neighbourhood initiatives but must connect to the wider city, the fate of urban areas cannot be considered outside their regional context. This is particularly the case in terms of the labour market. It may never be possible to find enough jobs for excluded people within the excluded community. There needs to be a strategy for the wider labour market. If area-based approaches towards excluded communities are adopted, there is still a need to develop mechanisms that link them strategically to the economic and social mainstream of the wider urban and regional areas.

The relationship between cities and regions is crucial – they cannot and must not be separated. There is growing recognition that economic, social and institutional links between cities and regions are becoming more complex. Just as urban regeneration cannot be confined to neighbourhood initiatives but must connect to the wider city, the fate of urban areas cannot be considered outside their sub-regional or regional context.

The threats and opportunities faced by cities are similar to those faced by regions, and equally the challenges for regional policies are similar to those for urban policy. A recent OECD review of developments in regional policy, for example, identified the following trends:

- A shift in the goal of policy away from the simple goal of achieving regional equality to one of economic competitiveness.

- New territorial bases for regional policy, with a greater recognition not only of sub-national territories but also of the role of regions in their national and international contexts.
- The state is ceasing to be the lead actor in policy; the move is towards the state enabling broad partnerships between it, industry and the community involving the transfer of skills, new forms of joint financing and new structures based on equality rather than hierarchy.

These trends in regions are identical to those faced by cities and urban policy. But in the past governments have not recognised the scope for institutional and policy collaboration. Cities and regions often do not function well together even though problems and opportunities typically cross boundaries. Not recognising these facts gives rise to such problems as:

- Fiscal exploitation, with the region using but not paying for services provided by the city.
- The physical segregation of excluded communities, with an unwillingness across the region to collaborate and share services and financial responsibility for those communities.
- Local tax regimes that encourage municipalities to compete against each other.
- Administrative boundaries that are often too narrowly drawn to make economic or social sense.

The relationship between cities and regions will be a key future issue for the European urban policy agenda. Their respective fates cannot be regarded as separate affairs; they are closely intertwined. And increasingly, policy makers and researchers recognise that there is no economic or institutional conflict between cities and regions, that their interests are complementary. Many have focused on the need to understand and improve the working economic and institutional linkages between them. Much research in Europe and internationally has underlined the significance of these links. Many national governments are attempting to align urban and regional policy. This is likely to be the trend of the future.

There are a number of threads to this argument. The first is that large cities have undergone a renaissance in both Europe and North America in the past decade. They are the drivers of competitiveness, in part because of their traditional agglomeration advantages of infrastructure, connections, skilled workforces and large markets. Improved communication has not made space or cities redundant but underlined some of the latter's critical strategic functions. Extensive research in the United States has shown that cities have improved their economic performance in the past decade; that cities and their wider metropolitan areas are more connected; and, most importantly, that

urbanised regions have been more successful than less urbanised regions. Research on Europe has also demonstrated that urban regions have performed more successfully in the past decade than non-urbanised regions. The relationship between urban and regional performance is open to interpretation. Some economists have argued that there is simply a correlation between the performances of the two. But others have shown that urban areas do indeed drive regional economies.

So it is clear that large cities remain critical to regional economic performance. Cities are becoming more significant in a number of countries. Urban and regional economies are becoming more closely integrated. It can be demonstrated that there are no successful urban regions in Europe that do not have successful cities at their core. In many ways cities are actually a huge proportion of regional economies anyway. Analytically it is becoming increasingly less sensible in an integrating and globalising economy to separate urban from regional economies. The interactions and linkages between them make it more sensible to see them as part of a wider system.

Policy makers in many countries are increasingly realising the need to understand and develop both the linkages and the strategies. In many member states there is a growing focus upon the wider urban and regional areas beyond the local authority. In many countries this is encouraging efforts to develop polycentric urban systems in which larger, medium-and smaller-sized cities collaborate within a region. In some countries government departments are attempting to align more closely their policies for urban and regional areas. The administrative details may vary from country to country, but the big picture is clear: urban and regional areas need to co-operate more closely for their mutual benefit. Policy needs to encourage that process of collaboration and integration – formally or informally.

Defining cities and urban areas is complicated. There is no single agreed definition across different states. However, the fact that in many European states the administrative boundaries of cities are often much smaller than their economic boundaries can cause problems. It creates fragmentation, which in turn can lead to economic and fiscal competition between local governments, suburbanisation and decentralisation, the exclusion of specific communities and groups from wider labour markets, unsustainable traffic patterns and land use. To address these difficulties requires greater collaboration across administrative boundaries in wider functional urban regions. Many countries are exploring the city-region concept, which emphasises the principle of partnership and joint work among a range of public and private partners across the wider economic territory. The approach could help overcome narrow administrative and local government boundaries, allowing the integration of (for example) housing markets, labour markets, economic development, transportation systems and environmental

strategies. The city-region concept is also valuable because of its flexibility, the fact that it does not impose uniformity upon member states. The latter vary enormously in their administrative and boundary arrangements. So it leaves the precise definition of the city-region boundaries in the hands of national and local partners. A number of countries accept that if increased strategic decision-making capacity at city-region level can be achieved, that will mean sustainable economic, social and environmental urban development.

What and where are the competitive cities in Europe?

Cities are back at the top of the European policy agenda. After a decade of talk of crisis, cities are now seen as the drivers of economic competitiveness. Everyone – the European Commission, national policy makers and city leaders – is talking about the contribution that cities can make to the wellbeing of Europe and its nation states. But a lot more is said about the competitiveness of cities than is actually proved. This section tries to throw some real light on the economic performance of European cities based on the author's recent research work for the UK government in over 20 European cities. They are: Helsinki, Stockholm, Copenhagen, Rotterdam, Amsterdam, Lyon, Lille, Toulouse, Dortmund, Munich, Frankfurt, Stuttgart, Turin, Milan, and Barcelona on the continent of Europe; and in the United Kingdom: Newcastle, Manchester, Liverpool, Birmingham, Leeds, Bristol and Nottingham. This section does three things:

- It identifies the key factors that explain urban economic competitiveness.
- It shows how different European cities compare in terms of economic competitiveness.
- It raises some key policy questions for cities and national governments.

What are the characteristics of urban competitiveness?

Urban competitiveness is the capability of an economy to attract and maintain firms with stable or rising market shares in an activity, while maintaining stable or increasing standards of living for those who participate in it. The competitiveness of cities is not just about the income of firms but also how that income goes to residents. And competitiveness is different from competition. Competition can be a zero-sum game, where if one city wins another loses. By contrast, cities can all increase their competitiveness at the same time, so that all cities and the national economy can simultaneously grow and benefit.

The following factors are critical to competitiveness: innovation in firms and organisations; economic diversity; connectivity, both internal and external; strategic decision-making capacity; and quality of life.

Economic diversity

The cities that are most successful in responding to economic change are the ones that are least dependent on a single sector. Those that do depend on a single sector – whether old-fashioned (coal, steel, shipping) or new-fashioned (financial services, mobile telephones, culture computers) are most vulnerable to the vagaries of global economic forces. This applies as much to Helsinki, Frankfurt and London as it does to Liverpool, Sheffield and Newcastle. Munich is the clearest example of a city with a successful mix. It has strength in global and local firms, large and small, manufacturing as well as services, the old as well as the new economy. Constantly seeking to diversify its economic base, Munich pushes into different sectors, but not indiscriminately. There is a continuing debate about the relative merits of old versus new economies; the lesson from continental practice is that both matter. The German cities are the most successful and have still have the highest proportion of manufacturing. Stuttgart in particular remains heavily dependent upon the automobile and related industries. Rotterdam for example is not rejecting its port but trying to change it from "mainport" to "brainport". The message from all our cities – best expressed by the leadership in Rotterdam – was the need to diversify but to deepen existing strengths. Nobody believes a city can build strength on a greenfield site where none currently exists locally. The trick is to work with what you have and to modernise.

Innovation in firms and organisations

This factor is perhaps the most crucial characteristic of a competitive city. Innovation is defined as the introduction of a new or changed process, service or form of organisation into the marketplace. The OECD estimates that between 1970 and 1995 more than half the total growth in output of the developed world resulted from innovation. And since most economic activities are concentrated in city regions, knowledge and innovation are two of the most significant contributors to the economic growth and competitiveness of cities. The European Commission has estimated that over 40% of the variation in per capita regional income can be explained by differences in innovative performance. Four features lead to regional and urban competitiveness: investment in modern, knowledge-based physical equipment; investment in research and education; investment in innovation; and labour productivity. In all these, knowledge and innovation are closely linked – the main drivers of place competitiveness. Knowledge-based industries are the key to innovation and the development of world-class standards of living.

Connectivity – internal and external

Another feature of competitiveness is the significance of internal and external communications, whether physical, electronic or cultural. The most successful cities have the physical and electronic infrastructure to move goods, services and people quickly and efficiently. External connections are important since exporting remains critical to success. Airports are thus critical. They facilitate face-to-face communication, which has been supplemented, not replaced, by technological communication. And a significant feature of our successful continental cities is the importance they attach to internationalisation and having city foreign policies. Munich, Rotterdam, Lyon, Helsinki, Barcelona and Stuttgart in their different ways have invested significant time and effort in international networking to raise their profile, gain new allies, expand market share, influence decision makers and learn new strategies and practices.

Strategic decision-making capacity

Systems, institutions and organisations do shape competitiveness. But processes and politics matter equally. The narrative from our individual cities constantly generated the same themes: the significance of networks and relationships between key players in the public and private sectors; the importance of politicians in shaping strategies or influencing key programmes; the significance of having allies to influence the decisions of regional and national governments. Economic competitiveness strategies have to be fashioned and implemented – they do not just emerge. And they take a long time to develop and to implement. Although they have now become virtual clichés, it is still true that all of our competitive cities emphasise the notions of vision, leadership, partnership and politics in shaping long-term development.

Quality of life

It is increasingly clear that soft location factors are becoming an increasingly important part of economic decision making. One of the constant threads of interviews with public and private decision makers was the critical significance of attracting skilled workers to their cities and retaining them. And in their calculation the quality of life for themselves and their families is an increasingly important factor. Cities with the assets of good environment, distinctive architecture, cultural facilities, diverse housing stock and access to natural amenities are attempting to preserve an improve them. Those not so well blessed are attempting to create them. Munich, Lyon and Barcelona have different mixes of those characteristics and their policy makers are trying to enhance them. Dortmund and Rotterdam, which are not so privileged, are

Table 5.1. **GDP per capita, 2001**

Rank	City	GDP per capita (€)	Rank	City	GDP per capita (€)
1	Frankfurt am Main	74.465	32	The Hague	30.110
2	Karlsruhe (Germany)	70.097	33	Essen (Germany)	29.760
3	Paris	67.200	34	Bristol	29.437
4	Munich	61.360	35	Lyon (France)	28.960
5	Düsseldorf	54.053	36	Bologna (Italy)	28.282
6	Stuttgart	53.570	37	Bochum (Germany)	27.900
7	Brussels	51.106	38	Parma (Italy)	27.491
8	Copenhagen	50.775	39	Dortmund (Germany)	26.548
9	Hanover	47.223	40	Rotterdam	26.227
10	Hamburg	43.098	41	Strasbourg (France)	26.015
11	Mannheim	41.674	42	Florence (Italy)	25.693
12	Nuremburg	41.456	43	Leeds	25.619
14	Augsburg (Germany)	39.360	44	Duisburg (Germany)	25.259
14	Cologne	39.108	45	Eindhoven (Netherlands)	25.226
15	Amsterdam	38.203	46	Turin	25.042
16	Münster (Germany)	38.149	47	Toulouse	24.852
17	Wiesbaden (Germany)	37.454	48	Rome	24.766
18	Dublin	36.591	49	Bordeaux	24.252
19	Vienna	36.572	50	Malmo (Sweden)	24.233
20	Stockholm	35.733	51	Gothenberg (Sweden)	24.065
21	Gelsenkirchen (Germany)	35.688	52	Grenoble (France)	24.026
22	Helsinki	35.322	53	Verona	23.954
23	London	35.072	54	Berlin	23.428
24	Bremen (Germany)	35.022	55	Marseilles	22.809
25	Edinburgh	35.018	56	Birmingham	22.069
26	Bonn	34.112	57	Manchester	22.099
27	Antwerp (Belgium)	33.090	58	Newcastle-upon-Tyne	20.499
28	Milan	32.122	59	Lille	20.191
29	Glasgow	31.893	60	Barcelona	18.449
30	Utrecht	31.712	61	Liverpool	16.466
31	Saarbrücken (Germany)	30,368			

Source: Barclays Bank, 2002.

actively seeking ways of improving their offer to influence private investment and retain skilled workforces.

Economic competitiveness – how do European cities compare?

This section analyses the comparative performance of our cities in three critical areas of competitiveness – innovation, connectivity and skilled workforce. This is a complex area; experts disagree about the relative merits of indicators. There are never perfect data with which to illustrate such indicators. Boundaries always present difficulties. But this chapter uses the

best available evidence from the most robust sources. As a measure of competitiveness, it uses GPD per capita. As indicators of innovativeness it uses the EU innovation score for regions, which is a composite of public and private investment in R&D, the percentage of the workforce in high tech activities and patents registered. For a measure of skilled workforce, it uses percentage of workforce with qualifications to ISCED level 3. Traffic through airports and Internet connections serve to measure external connectivity. Finally, this section presents data from a variety of private sector surveys of the factors that shape the attractiveness of cities for investment.

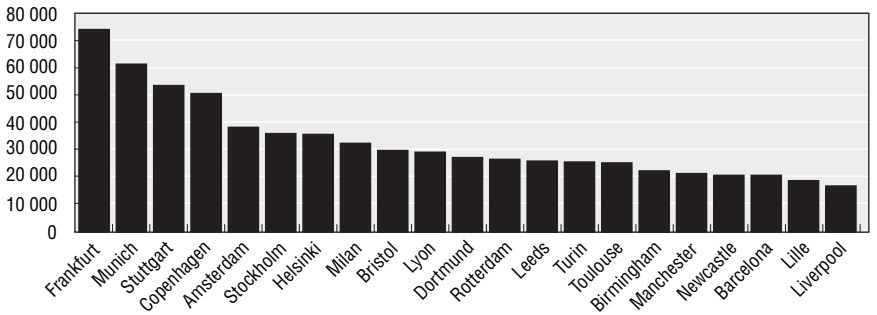
Table 5.1 shows the GDP per capita of the top 61 cities in Europe, in order to locate our smaller sample of cities in the wider picture.

Figure 5.1 shows the relative performance of our selected sample of 23 cities. A number of features from the two tables are obvious. Capital cities tend to be at the top of the league table. Large cities tend to do well. German cities, despite the country's economic difficulties, perform very well, accounting for 15 out of the top 20. The so-called group of "UK Core Cities" do not perform well. Bristol and Leeds, at 34 and 43 respectively, perform best. But several are at the bottom of the list, and Sheffield and Nottingham do not appear. The majority of UK Core Cities have GDPs less than one-third of the richest cities in Europe.

How innovative are European cities?

Table 5.2 shows the performance of the top 50 European regions – rather than cities – on innovation. The European Innovation Scoreboard has seven indicators: tertiary education; participation in lifelong learning; employment in medium-/high-tech manufacturing; employment in high-tech services;

Figure 5.1. **GDP of sample of European non-capital cities, 2001**
(in euros)



Source: Barclays Bank, 2002.

Table 5.2. **European Innovation Index – The top 50 scoring regions**

Region	City	Country	Rank	Score
Stockholm	Stockholm	Sweden	1	225
Uusimaa	Helsinki	Finland	2	208
Noord-Brabant		Netherlands	3	191
Pohjois-Suomi		Finland	4	161
Eastern		United Kingdom	4	161
Île de France		France	6	160
Bayern	Munich	Germany	7	151
South East		United Kingdom	8	150
Comunidad de Madrid		Spain	9	149
Baden-Württemberg	Stuttgart	Germany	10	146
Sydsverige		Sweden	11	143
Berlin		Germany	12	140
Östra Mellansverige		Sweden	12	140
South West	Bristol	United Kingdom	14	147
Västsverige		Sweden	15	146
Midi-Pyrénées	Toulouse	France	16	141
Wien		Austria	17	126
Etelä-Suomi		Finland	18	124
Utrecht		Netherlands	19	123
Flevoland		Netherlands	20	114
Vlaams Gewest		Belgium	22	112
Lombardia	Milan	Italy	22	112
Kärnten		Austria	23	111
Région Bruxelles		Belgium	23	111
Rhône-Alpes	Lyon	France	23	111
Lazio		Italy	26	110
Piemonte	Turin	Italy	27	109
Zuid-Holland	Rotterdam	Netherlands	27	109
Hessen		Germany	29	108
Southern and Eastern		Ireland	29	108
West Midlands	Birmingham	United Kingdom	29	108
Groningen		Netherlands	32	107
Comunidad Foral de Navarra		Spain	33	105
Noord-Holland		Netherlands	33	105
Limburg (NL)		Netherlands	33	105
North West	Manchester Liverpool	United Kingdom	36	104
Hamburg		Germany	37	103
Scotland		United Kingdom	38	102
Cataluña	Barcelona	Spain	39	101
Gelderland		Netherlands	39	101
Väli-Suomi		Finland	41	100
London		United Kingdom	41	100
Mellersta Norrland		Sweden	43	99
East Midlands	Nottingham	United Kingdom	44	98
Övre Norrland		Sweden	45	97

Table 5.2. **European Innovation Index – The top 50 scoring regions** *(cont.)*

Region	City	Country	Rank	Score
Ceuta y Melilla		Spain	46	95
Franche-Comté		France	46	95
Sachsen		Germany	48	94
Lisboa e Vale do Tejo		Portugal	48	94
Attiki		Greece	50	93

Source: European Trend Chart on Innovation, Technical Paper No. 3, EU Regions, 2002.

public R&D expenditure; business R&D expenditure; high-tech patents. These have been combined to generate a Revealed Regional Summary Innovation Index (RRSII), which compares each region against the EU mean.

Figure 5.2 shows the performance of the smaller selection of cities. Even though the precise ranking varies, a familiar pattern emerges. Northern European cities and countries perform well – Sweden, Finland, the Netherlands and Germany. Few southern European cities perform well, except for Madrid. German cities as a group perform well. From the United Kingdom only London and the southeast make the top ten. Of the United Kingdom cities, Bristol leads. But the remainder fall in the bottom 25, with innovation scores about half that of the high-performing regions.

How well educated is our workforce?

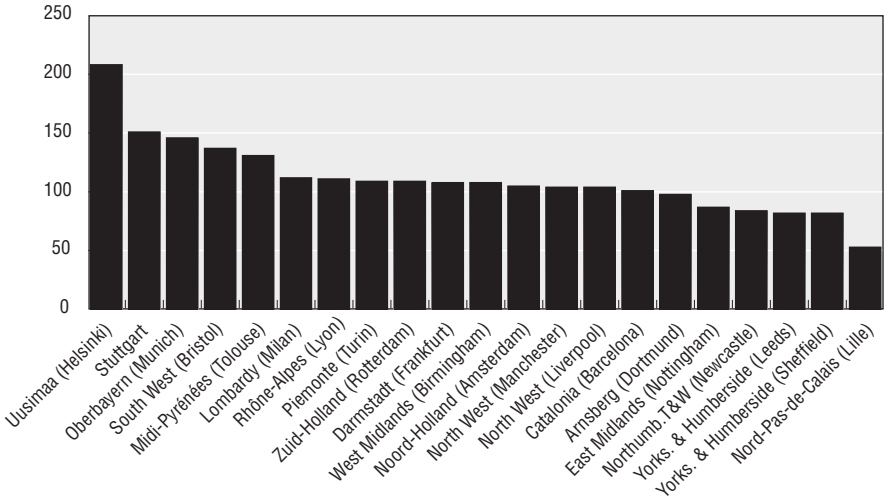
Figure 5.3 shows the qualifications of the workforce of the 23 sample cities in their regional context. Again there is a familiar pattern: northern European cities, especially German ones, perform well. Bristol and Leeds perform best of the Core Cities. But again, the majority congregate at the bottom part of the league table.

Further evidence about innovation and the quality of the labour force can be found in Figures 5.4 to 5.6. These again demonstrate the higher percentages of the workforce in high-tech manufacturing, services and knowledge-intensive services in continental cities than in UK cities.

How well connected are European cities?

External connectivity was measured in two ways: passengers though airports and Internet connections. Figure 5.7 shows passenger transport. The familiar pattern emerges. Frankfurt Amsterdam and Milan perform well. The leading UK provincial city is Manchester. But the remaining UK cities lie near the bottom of the table.

Figure 5.2. **European Innovation Scoreboard, EU regions, 2002**



Source: European Innovation Scoreboard, Technical Paper No. 3, EU regions, 2002

Figure 5.3. **Percentage of population (25-64 years old) with 3rd level education, 2000**

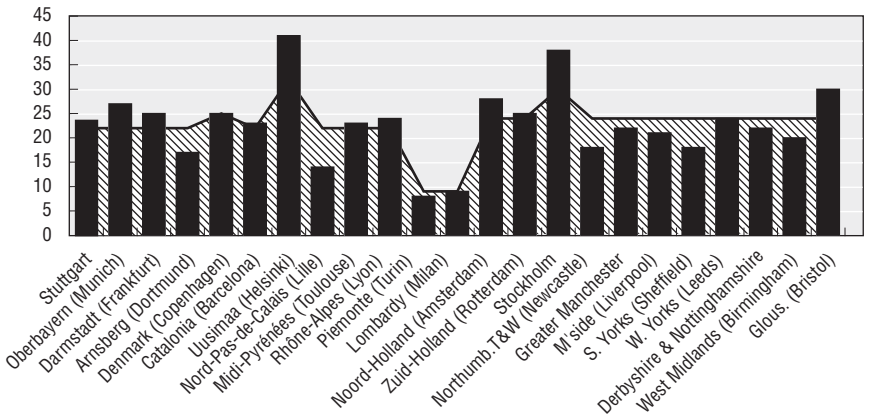


Table 5.3 shows patterns of Internet connection. The familiar suspects emerge. The global cities of London, Paris and New York are best connected. Five of our sample continental cities appear in the top ten. But none of the UK cities appears.

Figure 5.4. **Percentage of employees working in high-tech manufacturing sectors, 2000**

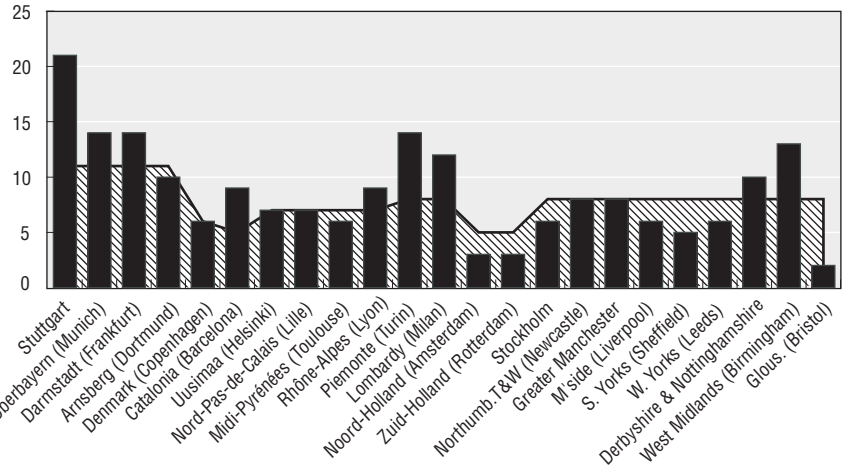
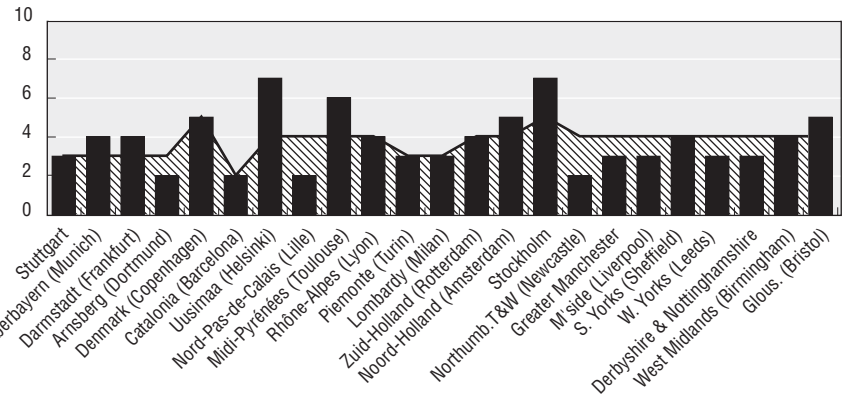


Figure 5.5. **Percentage of employees working in high-tech service sectors, 2000**



How does the private sector see European cities?

One critical feature of competitive cities is their attractiveness to private sector investors. The next section is based on the most reliable study of these issues: the Healey and Baker city surveys, which are commonly accepted as a robust, objective measure of cities' attractiveness. Table 5.4 lists the cities, regarded as the best 30 in Europe in which to locate a business.

Several features stand out. First, the global cities of London and Paris (and possibly Frankfurt) are rated the best. Second capital cities in general are the most attractive. Third, only one core city, Manchester, made it into the top thirty. The cities identified as having the highest GDP, highest innovation levels,

Figure 5.6. **Percentage of employees working in knowledge-intensive services, 2000**

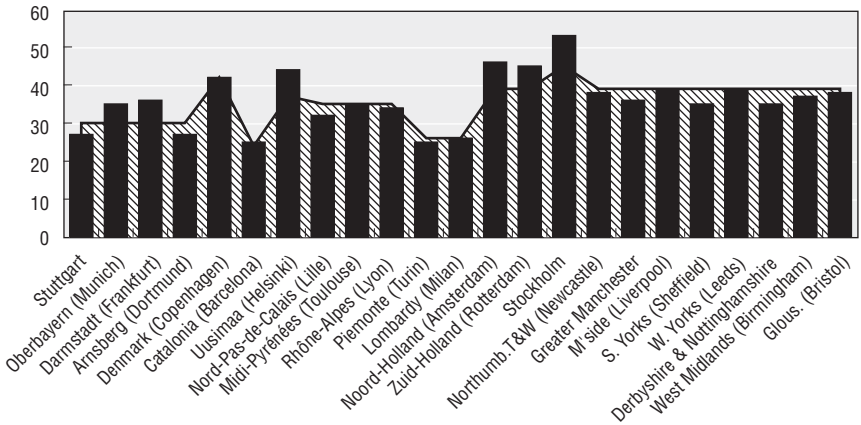
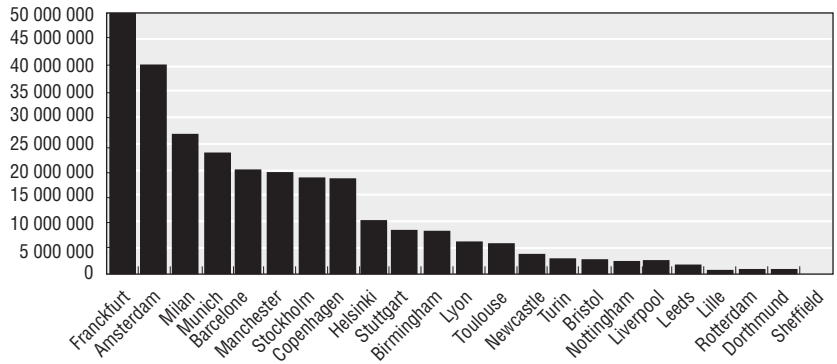


Figure 5.7. **Total air passengers, 2001**



higher skilled workforces and better external connections are frequently perceived by the private sector as the best places in which to locate.

A further feature of this table is worth noting. There was no change in the relative attractiveness of the top five cities during 12 years that were economically unstable. The hierarchy looks stable. However, it is not completely so. It is possible for cities to improve their performance. For example, Barcelona and Madrid in Spain both improved their image with the private sector, reflecting the growth and modernisation of the Spanish economy during the 1990s. But equally, Copenhagen and Helsinki, which were outside the charmed circle a decade ago, have entered the private sector's

Table 5.3. **Top 10 international Internet hub cities for Europe, 2002**

City	Internet Bandwidth 2002 (Mbps)	Rank 2002	Rank 2001	Rank 2000
London	319 475	1	1	1
Paris	227 803	2	2	3
Frankfurt	194 902	3	5	5
New York	174 180	4	3	4
Amsterdam	163 942	5	4	2
Copenhagen	109 204	6	8	20
Stockholm	94 741	7	7	7
Brussels	81 536	8	6	6
Milan	66 424	9	9	17
Zurich	51 488	10	n/a	n/a

Note: Figures represent Internet bandwidth connected to European locations across international borders from Consolidated Metropolitan Statistical Areas or equivalents, including cities outside Europe.

perceptions as attractive for investment. In fact it was for this reason Barcelona and Helsinki were added to the original proposed list. Their experience is discussed further later.

Table 5.5 provides a more detailed understanding of the ways in which the private sector judges cities' attractiveness. It indicates that the three most important features of a city for the private sector are: the quality of the workforce, access to markets and external transport links. These correspond fairly closely to those things identified earlier in this chapter as the drivers of competitiveness identified by researchers and policy makers. The table provides comparative rankings on the three characteristics.

Is the problem national or urban?

One question that immediately arises from this data is whether the UK cities perform relatively poorly because the UK national performance is poor, or whether the cities themselves are under-performing. Figure 5.8 provides evidence on this. The picture is very clear. The competitive cities in our sample considerably outperform their national GDPs. Recent improved performers like Helsinki or Barcelona match or beat their national performance. The cities included in the study as comparable to the Core Cities – Dortmund, Rotterdam, and Lille – perform less well, as would be expected. But with the exception of Bristol, the UK Core Cities lag significantly behind the UK average. Just as the continental cities in the study are arguably leading their nation's performance, the Core Cities are arguably constraining UK performance. The implication must be that if the Core Cities could improve their performance to match that of their continental counterparts, the gains to the UK national economy would be enormous.

Table 5.4. **The best cities in which to locate a business today**

City	1990	2001	2002
London	1	1	**1**
Paris	2	2	**2**
Frankfurt	3	3	**3**
Brussels	4	4	**4**
Amsterdam	5	5	**5**
Barcelona	11	6	**6**
Madrid	17	8	**7**
Milan	9	11	**8**
Berlin	15	9	**9**
Zurich	7	7	**10**
Munich	12	10	**11**
Dublin	–	14	**12**
Düsseldorf	6	17	**14**
Stockholm	19	15	**14**
Geneva	8	12	**15**
Prague	23	22	**16**
Lisbon	16	16	**17**
Hamburg	14	18	**18**
Manchester	14	14	**19**
Lyon	18	20	**20**
Glasgow	10	19	**22**
Rome	–	25	**22**
Vienna	20	23	**23**
Copenhagen	–	24	**24**
Budapest	22	22	**25**
Warsaw	25	27	**26**
Helsinki	–	26	**27**
Athens	22	29	**28**
Oslo	–	28	**29**
Moscow	24	30	**30**

Source: Cushman & Wakefield, Healey and Baker, European Cities Monitor, 2002.

What are the key policy messages and principles for government and cities?

What policy messages?

The urban hierarchy is stable – but cities can improve quickly

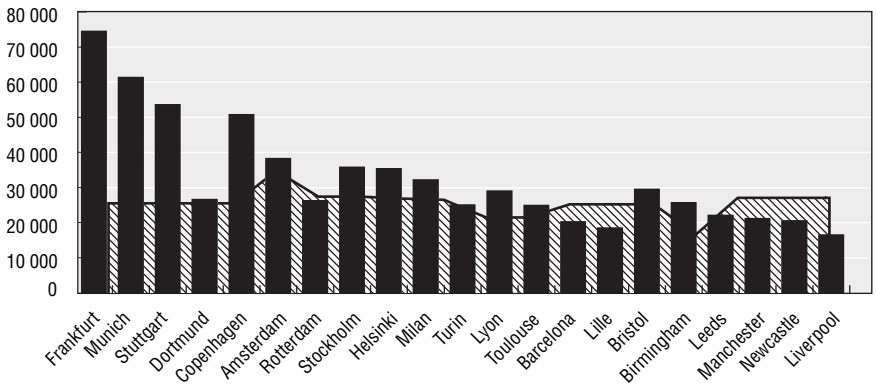
A key question for cities is the extent to which they can improve their relative performance in relation to their European competitors. The evidence underlines that there are structural characteristics of competitiveness, which are acquired over a long period of time and not lost quickly. The cities that performed well and were well regarded by the private sector as places to do

Table 5.5. **Best cities in terms of ...**

	Qualified staff	Easy access to markets	External transport links
London	1	1	1
Paris	2	2	2
Frankfurt	3	3	3
Munich	4	9	6
Brussels	5	4	5
Milan	6	6	8
Berlin	7	10	9
Amsterdam	8	5	4
Dusseldorf	9	7	11
Madrid	10	8	9
Manchester	11	11	14
Stockholm	11	23	20
Barcelona	14	14	11
Lyon	17	16	18
Helsinki	19	28	29
Copenhagen	22	20	14

Source: Healey & Baker, European Cities Monitor, 2002.

Figure 5.8. **National and urban economic competitiveness: a comparison GDP per capita, 2001**
(in euros)



business a decade ago still head the league table. Nevertheless, there is evidence that cities can change their performance. The quantitative evidence showed how in Spain Barcelona and Madrid had improved their position, as had Helsinki.

What was the lesson from Barcelona and Helsinki? In fact it is an interesting illustration of the difference and links between urban renaissance

and urban competitiveness. Barcelona has become widely seen as a model of economic recovery, but it should be understood that its achievements have been in the field of urban renaissance. Since entry into the European Union, Barcelona leaders have pursued a long-term strategy to reconstruct the city to capitalise upon its strategic location and cultural and natural environmental advantages. Efforts began with the Olympics, which were used creatively to reconstruct much of the physical environment of the city and transform its international image. Clear political leadership and a sophisticated planning strategy have achieved a great deal.

A recent internal review of the city listed its strengths as experience of transforming physical infrastructure, managing prestige projects, the quality of its architecture, its city centre, the wealth of design specialists, its cultural achievements, its international connections and its sophisticated urban planning system. These are indisputable. But it is was also recognised in the strategic review that in terms of hard-edged competitiveness, the city remains some way behind the heavy hitters of northern Europe. GDP is lower. Productivity levels are lower. Innovation levels are lower. Educational levels are lower. ICT facilities are not that well developed. Banks are conservative and venture capital is not readily available. Despite the high student numbers, universities do not well serve the needs of the local economy. The city has maximised its assets and achieved what it could in the areas of urban renaissance. But it has much more to do to improve its economic competitiveness.

Nevertheless, Barcelona's achievement should not be underestimated. Physical and strategic renewal has changed its internal and external image, and improving the renaissance features of the city has made it more – not less – likely that it will be able to achieve greater long-term economic competitiveness by attracting investment and by improving its skill base.

Helsinki is another example of a city that has dramatically changed its fortunes during the past decade. Ten years ago, because of the collapse of the Soviet Union, its main trading ally, Helsinki was in deep economic recession. But leaders in the city used that period to devise a new economic strategy built upon the communications industry and on close links between the city Nokia and the universities, which has made it a global player. Helsinki has risen quickly in the perceptions of the private sector and scores highly in the innovation stakes.

In a longer-term perspective it is also instructive to recall the experience of the three most successful non-capital cities in Europe – Frankfurt, Stuttgart and Munich. Fifty years ago all had been virtually destroyed. Indeed, there is a strong view in those cities that this destruction of older industrial structures and attitudes encouraged the view in the cities that change, innovation and reinvention was both desirable and possible.

Cities lead nations

There is extensive evidence from continental Europe that urban renaissance is taking place. The demographic data clearly demonstrated the revival of cities as places to live. Cities are increasingly seen as areas of potential opportunities, not liabilities. There is a growing recognition among national and local policy makers in the countries examined that cities are the dynamos of their national economies. Of course, this belief manifests itself in very different ways in different countries. For example, the French national government's long-term investment in hard and soft urban infrastructure has made a major contribution to the country's economic performance. The Netherlands, with a population of 16 million, recognises that its four large cities are critical to its economy and the national government has a separate policy for dealing with them – the large city policy. Cities have a major part to play in national policy and frequently are the test-beds for policies, which subsequently become adopted as national policy. This is clearly the case with Rotterdam, whose experiments with neighbourhood-based initiatives and (more recently) its efforts to increase security in the city have much influenced national government policy. This again clearly supports the Core Cities' position about the need to support and invest in cities as economic dynamos.

Successful cities – successful regions

The question of the relationship between successful cities and successful regions is a challenging one that raises a number of policy and analytical issues. However, some things are clear. Views in our cities confirm the results of the quantitative analysis presented earlier: the most competitive regions also had the most competitive cities. Conversely no examples were found of successful regions that had unsuccessful cities at their core. Many policy makers believe that cities actually lead their region's economic performance. There is no conflict of interest between cities and regions, nor should there be one between urban and regional policy.

There is also a consensus across many of our cities that although regions matter, they are often too large an area at which to tackle economic competitiveness. Sub-regional approaches are increasingly being adopted – even in federal Germany, where Länder with 16-18 million people are seen as too distant from economic realities on the ground to be the sole player. In all our cities and countries there is growing concern to create the right relationships between regions and cities. The question of the appropriate spatial level at which to tackle economic competitiveness issues is an increasingly growing concern. Just as there is an agreement that the city is too small a space to tackle these issues, there is a growing view that in some cases the region is too large.

Cities and sub-regions

The appropriate relationship between cities and their economic hinterlands is an important issue. This chapter explored the variety of relationships in our continental cities. Despite the assumption that things work better on the continent, this did not prove to be the case. In fact there are a series of regional-urban difficulties that are found in the United Kingdom. These include, for example, local government fragmentation, economic competition between adjacent local authorities, worries about the environmental impact of residential and job decentralisation, fiscal exploitation of the central city by suburban service users, the segregation of excluded communities as municipalities contest to attract richer and repel poorer people and housing, failures to market the sub-region effectively, and concerns that the central city is too small to hold its own in European and global markets.

This has led to growing efforts to create sub-regional working relationships between municipalities. These have different forms and varying success. In France the intense municipal fragmentation into 36 000 small communes has meant that much effort has been invested in creating *communautés urbaines* to encourage collaboration. But the partnership has typically been between the public sector agencies. And increasingly, as is the case in Lyon, the *communautés urbaines* are actually too small to function as effective economic units; efforts are being made to move towards a *région urbaine*. There is considerable political willingness to operate at the sub-regional level, but the achievements as yet are modest. Barcelona has only in the very recent past managed to move its spatial and economic planning from beyond the City of Barcelona to the wider metropolitan area, producing a new strategic plan for that area. Munich has created a tri-area sub-regional organisation in an attempt to do area marketing.

But the overall picture is that few urban areas have yet devised a satisfactory set of arrangements that capture the wider economic territory with an agreed plan. There are a series of territorial tensions with smaller municipalities reluctant to be overwhelmed by the larger city or national governments reluctant to strengthen the power of already powerful central cities. There is thus a very mixed picture, with some areas unable to devise metropolitan-wide arrangements. Some have ad hoc separate agencies to undertake limited metro or sub-regional functions, most typically transport, waste and environment. But in all the cities examined, there is a view that the core city is not large enough to serve as the basis for economic development; all are attempting to create informal strategic alliances, often led by powerful mayors as in Lyon, Barcelona and Helsinki.

Equally important, there have been few recent examples of regional structures being formally created to undertake the full range of economic

development functions. Indeed in the Netherlands the proposal to create metropolitan-wide arrangements was voted down a decade ago and the experience has probably worsened intra-metropolitan tensions. The important exception is Stuttgart. At the height of an economic crisis a decade ago, at the behest of the Länder government, it created a formal economic development organisation in which 179 local authorities voted to transfer powers and resources to the Stuttgart Regional Agency to promote the economic development of the region. There were particular circumstances in Stuttgart; for example, the depth of the economic crisis in the car industry and the loss of almost 200 000 jobs led the Länder government to propose the solution and made local players receptive to it. The same combination of circumstances has not been found elsewhere. Nevertheless, the RSA's supporters argue that the new association with its powerful economic development agency has significantly improved the region's ability to cope with economic change, and has been responsible for a more flexible and comprehensive regional economic development strategy.

One message for UK cities is that their counterparts in Europe are convinced that to be competitive in the global marketplace in the future they have to organise and act at a wider metropolitan or sub-regional level. Another message is that, despite Stuttgart's achievements, most of them have decided it is not worth attempting to create formal institutions to that end, since these are unlikely to be established. The most common view is that informal strategic alliances between willing partners, which can be mobilised around agreed territories, powers and resources, are better than the alternatives of acting only on a local basis or of spending a great deal of time and energy fighting unwinnable battles for formal change.

There is great awareness of the importance of the economic relationships between cities and regions. Everyone recognises that city administrative boundaries do not correspond with current economic realities and that the wider region or sub-region needs to be taken into account for long-term policy making. Second, there are increased efforts to devise sub-regional institutional relationships so that cities and their surrounding regions can work together more efficiently, partly to manage internal issues – economic development, physical infrastructure, human capital, environment, transport issues – and partly to market their regions externally. The nature of the relationships ranges from formal to informal. Both approaches have costs and benefits. Third, these urban-regional relationships are never simple; economic and political tensions make it difficult to find easy solutions. Fourth, drawing boundaries and deciding who is in and who is out – formally or informally – is not simple. Different cities have worked with different boundaries. Political realities and relationships are a key consideration. But in many urban areas there are efforts to build relationships between neighbouring local authorities,

or occasionally between more distant towns and cities, all of which emphasise the economic advantages derived from critical mass and increased collaboration. Working on the widest possible scale on which you can get political agreement is probably the best advice.

National and regional government matters

Cities have to maximise their opportunities if they are to succeed economically. But the framework set by national government matters a great deal. The experience of France is instructive. The decision to decentralise and create alternative urban centres to Paris over 20 years ago has had a major impact upon the French urban hierarchy. Paris still dominates but many of the second cities now perform well. For example the author's work on Toulouse underlined the importance of investment by the central state in technology and research and development facilities over a 20-year period, which means that it is now one of the leading centres of innovation. The author's work on Lyon underlined the critical importance of state investment in transport infrastructure and the TGV, which allowed the city to become more clearly connected to European markets. Equally clearly, the current national reluctance to allow expansion of the Lyon airport at the expense of Paris or the reluctance to extend the Lyon-Milan TGV system underlines how critical continuing national investment in transportation is to the future performance of cities.

The significance of national government is also underlined by the impact of national decisions to relocate key technical, educational and international organisation to both Lyon and Toulouse during the past decade, which has allowed them to raise their educational and international profile. The Netherlands government has similarly recognised the significance of the four large cities to the Dutch national economy in their GSB Large Cities Policy. A second point can be underlined about the relationship between national and local governments. Both France and the Netherlands have been moving towards more long-term contractual relationships between a national and local government to deliver economic performance. Germany is clearly a different case with its federal arrangements; national government plays a less critical role. But Länder state policies are also critically important. The success of Munich was reinforced by a variety of state policies to invest in the city, including its strategy of using the profits from the sale of state utilities in the 1990s to invest in high-tech facilities in the city.

National policies matter – money and powers

Although there are differences, the trend in continental Europe is to decentralise and regionalise decision making, placing powers at the lowest level. Continental cities have responsibility for a wider range of functions affecting their economic competitiveness than do their UK counterparts. Although it is not

a straightforward relationship, the evidence does suggest that where cities are given more freedom and autonomy they have responded by being more proactive, entrepreneurial and successful. Decentralisation in France has invigorated provincial cities during the past 20 years. The most successful cities in Europe have been German, and Germany is the most decentralised country in Europe. The renaissance of Barcelona in part stems from the move towards regionalisation and the lessening of the grip of the capital city, Madrid.

Continental cities typically have more diverse forms of local revenue and more buoyant tax bases, which make them less fiscally dependent upon the national state and more proactive in their development strategies. Many European cities have powerful elected mayors who give clear leadership to economic development. Many successful cities have been deeply involved in European systems and networks, which has encouraged them to be internationalist, expansionist and entrepreneurial. UK cities arguably have fewer powers, resources and responsibilities than their competitors and have been less engaged in the European project. They have also been less successful economically. The more centralised governmental, institutional and financial system must be one factor behind the underperformance of UK cities.

Cities must help themselves

Cities operate within a set of powerful structural economic, social, physical and institutional constraints. The impact of global economic change, of national policy-making powers and decision-making systems, of history and geography can all place real constraints upon an individual city's capacity to perform well economically. One view about encouraging the economic competitiveness of the UK Core Cities is that it actually might be best to start from somewhere else. For example, cities that are in strategic locations and have benign climates, attractive natural environments and no legacy of traditional industrial structures, attitudes or values operate in decentralised systems, have access to powerful regional governments, or simply benefited from luck of the consequences of post-war relocation of private firms, are more likely to be successful than cities which do not have those advantages. The experience of successful southern German or French cities underlines this point. There is no point denying those powerful realities. But that is rather a counsel of despair. Cities are not powerless to shape their economic trajectories.

The evidence from our successful – and currently less successful – continental cities indicates that cities need to do everything they can within their limits to maximise the critical success factors identified earlier – innovation, diversity, connectivity, skilled human capital, quality of life and strategic decision-making capacity. Cities need to:

- Develop their long-term strategic view of their economic role and trajectory.

- Build upon and deepen existing strengths in clusters and sectors to modernise and upgrade the functions they undertake in those economic sectors.
- Build strategic alliances with private partners.
- Develop sub-regional territorial alliances and initiatives.
- Maximise their internal and external connections.
- Develop a local innovation strategy.
- Encourage the skilled labour force to come, stay and contribute.
- Encourage university and city links in which universities see the importance of their economic contribution to the local economy.
- Develop their cultural infrastructure and improve their quality of life.

But cities very often need support and encouragement from national government if these assets are to be maximised and their strategies to be achieved. Cities can help themselves. But they do better with national support.

What principles for future policies?

This chapter has shown how cities are making a renewed contribution to the economic performance of Europe. A wide range of organisations – national, European and international – have developed increasingly sophisticated understandings of the challenges and opportunities facing cities and a range of policies to address them. What has been learned from the experiences of those policies so far that we can build upon for a more coherent approach to cities and urban policy in Europe in the future?

It is clear that the experiences of different European countries vary enormously. They have different policy traditions, practices, programmes and instruments. The balance of power and decision making between national, regional and local governments is very different. And the circumstances of European cities themselves vary enormously. The challenges faced by global cities or those at the centre of the European economy are different from those of cities nearer the periphery. The challenges faced by fast-growing cities based upon modern high-tech and information-based economies are different from those in cities based upon declining traditional industries with less skilled workforces that often include many immigrant and ethnic minority communities. The dilemmas faced in large cities are different from those faced in medium and smaller cities in Europe.

So the position is complex. Nevertheless, the experience of the past decade has generated a set of common principles about the ways that policies should be prioritised, designed, resourced and implemented. There is a core of good practice based upon local, national and European policies and experiences to draw upon in identifying common policy principles. Such principles are the basis of a more coherent approach to cities and urban policy

that can be encouraged throughout Europe. Some of the principles are strategic. Others are more operational.

The recent experience of a range of places, policies and projects across Europe suggests the key principles for successful urban policies would include the following:

Priorities for urban policy

- Policy should focus upon economic competitiveness, social cohesion and environmental sustainability to achieve balanced development. Policies have frequently focused upon one or the other goal. The experience is that this does not work. Policy needs to focus on opportunity and need at the same time for successful cities.
- Policies should recognise that liveability as well as economic success is crucial to peoples' choice of where they want to live. This leads to a concern with the public as well as the private realm, and the quality of services offered as opposed to simply the economic opportunities that are offered.
- Cities and neighbourhoods must become places of choice and connection rather than compulsion and exclusion. Many cities have declined in attractiveness to people in a position to make economic and social choices. Often they have become places where people without real choices are required to live. Successful cities remain or become attractive to a richer economic and social mix of people and communities.
- Cities are important as sources of identity, culture and connection between communities and cultures. Cities are more than economic marketplaces. They can encourage social integration, community engagement, and cultural recognition. This points to a wider set of policy goals than simply economics.

Mechanisms for successful urban policy

- Policies for economic, social and environmental development in urban areas should be integrated, not treated separately.
- Urban policy must support both places and people. Policies that support people and places are not mutually exclusive. It is possible and desirable to have strategies that focus on individual needs but also on the social and physical infrastructure that make cities attractive in the long term.
- Urban policy should adopt an integrated approach and recognise the linkages between housing, education, transportation, security, health and welfare policies rather than treating them separately. Urban problems are not separated into functional specialisms; policies must not be, either.

There remains a great challenge at national, regional and local government levels to make organisations flexible and integrated.

- Mainstream government departments, programmes and resources – in addition to special urban initiatives – are crucial to cities. Many governments have developed special urban programmes for particular areas or policy sectors. These are important, but increasingly it is recognised that it the resources and policies of mainstream government programmes for all the services affecting cities – housing, education, transport, social security, security – make the difference to urban success or failure. Those policies and the departments that deliver them need to be committed to urban areas if they are to succeed.
- Cities and urban policy must have long-term support rather than short-term interventions. Urban policy experiments are often limited in their time span. However, urban problems are long term. The evidence is that policies need to be sustained over a period of years if they are to make a difference to urban areas. Meeting urban challenges is a marathon, not a sprint. There are no quick fixes.
- Policy should balance leadership from the top by national government with leadership and engagement from below by community and local partners. Government must give strategic leadership, vision and long-term commitment to sustainable development. But the full engagement of citizens and communities is also crucial to the successful ownership and implementation of sustainable urban development.
- Government should build long-term contracts between different partners and levels of government that focus on the outcomes of policies rather than on short-term policy inputs. Governments increasingly recognise that they have to work in long-term collaboration with partners. They recognise the importance of focusing on the results of actions rather than controlling the contributions of local and regional partners. Increasingly, contractual arrangements specify clear and agreed responsibilities for results, sanctions and incentives. However, it is better to give local partners the freedom to determine the best way of delivering them, than to have national governments attempting to micro-control local partners.

Engaging all stakeholders

- Partnership, which engages on an equal footing the public, private, and community sectors, should be encouraged. Partnership is desirable but difficult. Different partners have different resources and often, different interests. However, successful policy does require contribution from governments, the community and the private sector if it is to succeed. That often requires government to actively encourage and facilitate the

engagement of the community and private sectors. In particular, the engagement of "community" in urban policy can give both legitimacy and effectiveness to government actions. But community groups frequently lack the resources of more powerful partners and hence must be empowered and supported by those partners.

- Partnership mechanisms that engage different stakeholders must be balanced with democratic political accountability. Partnerships can deliver many projects but typically the partners are appointed, not elected. However, elected governments – local and regional – have democratic accountability. Policy making needs to ensure that the inclusiveness of partnerships does not relegate the democratic element of decision making.

Achieving the right spatial balance

- Area-based approaches where particular areas of opportunity or need in cities receive concentrated attention should be encouraged. There is evidence that the sustained concentration of resources and attention upon carefully defined areas can make a difference to their economic and social prospects. Concentrating resources, rather than spreading them thinly, does work.
- Policy should adopt a wide territorial focus linking the social challenges faced at neighbourhood level to the larger metropolitan or sub-regional economy where the problems are often created. The problems of deprived areas cannot be solved in terms of the opportunities within those areas. Many residents need to access the jobs in the wider areas. Neighbourhood-based policies thus need to be linked to wider regional economic processes.
- Economic and institutional collaboration between urban and regional areas should be encouraged. The interests of cities and regions are interconnected. However, policy making systems and institutions often do not recognise this. Encouragement should go to relationships and/or institutions that at least promote collaboration, rather than conflict, between cities and regions.
- Networks and functional collaboration between cities and polycentric patterns of development should be encouraged. Just as the interest of cities and regions are interdependent, so are the interests of larger and medium-sized and smaller cities in regions. Cities and regions benefit when the interests of larger and smaller cities are reconciled rather than when the larger cities dominate decision making and policies. Balanced polycentric development rather than functional dominance of the largest should be sought. This requires collaboration and networking rather than hierarchical or centralised decision making.

Encouraging good practice, policy learning and capacity

- It is important to learn from experience and good practice, nationally and internationally. There is much good practice. It is foolish to reinvent the wheel.
- There is a need to evaluate policy with robust audits, reliable socioeconomic baselines, systematic collection of intelligence and independent reviews of impact. Increasingly, good urban policy builds assessment and evaluation of policy initiatives into the process from the beginning so it is possible to know what has worked and what has not and what should and should not be done in the future.
- There is a need to improve the skills and capacity of professionals, politicians, community partners and the private sector involved running cities. In the final analysis the quality of policy depends heavily upon the qualities of policy makers. The challenges involved in successful policy making require particular skills and aptitudes. Increasingly, policy makers realise that such skills need to be systematically promoted with new and existing policy professionals. This will require new relationships between players in the urban sconce, and possibly new institutional arrangements.

Policy making for cities is no longer the responsibility of a single agency or territorial level of government. The public, private and community sectors must be engaged for successful policy making and delivery. Equally, no single government level is responsible for the fortunes of cities. National governments, regional governments and local governments are all involved. Inevitably the particular division of responsibilities varies between member states. Nevertheless, the responsibility is shared. This emphasises the fact that the policy principles outlined above do not apply to a single partner or to a single level of government. They are applicable to cities, regions and national governments. Different cities and countries have had different levels of success in implementing them. The challenge is for more partners and governments to succeed in achieving them.

ISBN 92-64-01329-6
Local Governance and the Drivers of Growth
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Chapter 6

Financing Local Economic Development: Experiences in Europe and the United States

by
Randall W. Eberts

Government entities at all levels use their resources and powers to promote the creation of jobs and to further the general economic development of their jurisdictions. Facing tight fiscal circumstances due to slow economic growth in Europe and the lingering effects of the recession in the US, government and its partners innovate and look for alternative funding and administrative arrangements. The chapter discusses not only the broad range of financial tools used in economic development initiatives, but also the planning, implementation and administration of programmes. It provides a set of principles for selecting the appropriate level of government for delivering certain economic development programmes and incentives.

Introduction

Most government entities carry out programmes to promote the creation of jobs and to further the general economic development of their jurisdictions.[1] In the United States more than 5 000 separate economic development policies are pursued, as each state and local jurisdiction applies various policies to attract and retain existing businesses or to nurture new ones. Economic development efforts are carried out by different levels of government within the European Union (EU), providing funds and programmes to reduce the economic disparities between member states and regions within these states. Government entities at all levels use their resources and powers to reduce the risks and costs that could impede private investment within their jurisdiction. By altering the risk and cost factors of one location *vis-à-vis* another, local economic development entities can make their location more attractive to businesses, which stimulates the local economy. It should be emphasised at the outset that economic development is ultimately the result of private investment. Government intervention may be needed to help nurture or "jump-start" a local economy, but government intervention alone cannot sustain local economic growth. Economic growth must be driven by market forces, and incentives must enhance these forces.

The purpose of this chapter is to provide an overview of the broad range of financial tools used in economic development initiatives. Particular emphasis is placed on efforts to stimulate economically distressed urban and rural areas, but many of the financial tools, particularly tax incentives, are employed in growing regions as well. The chapter discusses not only the funding of economic development initiatives, but also the planning, implementation, and administration of programmes. An increasing number of local public-private partnerships are emerging to offer an alternative to having government entities perform these activities. These partnerships include non-government agencies such as chambers of commerce, businesses, local workforce/employment agencies, and non-governmental agencies.

Slow economic growth in Europe and the lingering effects of the recession in the United States have placed budgetary pressures on governments as they attempt to remediate economic disparities. This chapter considers the implications of tight fiscal circumstances in addressing the needs of distressed areas, and the implications of using alternative funding and administrative arrangements, such as private-public partnerships, for

leveraging limited government resources. Recognising these constraints in carrying out economic development efforts, the chapter addresses the following questions:

- What are the financial obstacles to projects for urban regeneration, rural development, social inclusion and human resource development?
- How can municipalities contribute to finance local development projects?
- What are the pros and cons of delegating responsibility for local development to regional development agencies (RDAs), operating as private-public partnerships seeking to maximise the commercial value of projects?

In addressing these questions, the chapter will offer criteria to justify government intervention in a market economy to stimulate growth, and will provide a set of principles for selecting the appropriate level of government for carrying out certain economic development programmes and incentives.

The chapter begins with a brief discussion of the economic disparities in the United States and the European Union that are addressed by development efforts. It then discusses the role of government in development initiatives, partnership arrangements, and the financial tools available. A short section is then offered that provides a schematic framework for governmental units to use in addressing these issues. Next is a section that highlights some of the programmes that provide funding and assistance to distressed areas. This is followed by a section that describes the place-based initiatives that have been conducted in both Europe and the United States. The chapter concludes by addressing the three questions listed above, based on the evidence presented herein.

Regional economic disparities

Most government efforts to stimulate economic development, particularly via federal programmes in the United States and via the European Union social and structural funds, have been directed toward distressed urban and rural areas. In the United States, the economic boom of the 1990s was particularly favourable toward metropolitan areas, but many inner city neighbourhoods were left behind, leaving stark contrasts to affluent suburbs. Today, many of the nation's inner city neighbourhoods offer few well-paid jobs, a declining population base as more affluent residents flee to the suburbs, leaving poor retail options, and a diminished quality of life. Suburban residents, on the other hand, enjoy the nation's highest salaries, lowest unemployment rates, excellent job and educational opportunities, and a high standard of living. Rural areas also lagged behind metropolitan areas in terms of employment and income growth. Federal programmes provide incentives and assistance to promote job creation in these lagging areas.

Similar economic disparities exist among regions within the European Union. Metropolitan areas are growing faster than rural areas, and many city neighbourhoods and small rural communities are disenfranchised from the mainstream of economic and social life. Furthermore, the integration of ten new members into the EU, while seen as beneficial to the Union as a whole, raises further concern about economic disparities among the member states. Although the European Union has succeeded in recent years in narrowing the disparities between cohesion countries and the EU average, both income and unemployment rates have widened as the 10 new members States joined. The average GDP per head in the ten is under half the average of the EU15 and only 56% of those of working age are in jobs, compared with 64% in the EU15 (Third Report on Economic and Social Cohesion, 2004). Continued success in reducing regional disparities requires that the economies of these new members grow at a much faster rate than they have in the past. This requires a focused and concerted effort to bring resources and technical advice to these regions to help foster local entrepreneurship and link them more effectively to the major growth centres of Europe.

The Third Report on Economic and Social Cohesion states that these disparities in the EU stem from structural deficiencies in key factors of competitiveness – inadequate endowment of physical and human capital (of infrastructure and work force skills), a lack of innovative capacity, and of effective business support (Third Report on Economic and Social Cohesion, 2004). The report continues by identifying the challenges ahead in integrating the ten new member states into the EU. These challenges include identifying structural deficiencies in each region that may have a damaging effect on competitiveness and growth potential, formulating a long-term development strategy for each region in line with its strengths and weaknesses, promoting balanced development and not just in the present growth centres, and helping to strengthen the administrative capacity for designing, implementing, and managing development programmes at the regional level.

The role of economic development policies: Why should government intervene?

The overarching goal of economic development policy is arguably to enhance the capacity to create wealth for local residents. For many local economic developers and elected officials, this translates first and foremost into creating jobs, preferably well-paid jobs for local residents. The primary policy role then is to identify the factors that have impeded economic growth and devise ways to stimulate the process. The justification for government intervention in a market economy, in addition to its role of protecting property rights and providing a workable regulatory environment, is to counter market failures – the failure of private markets to achieve an optimal allocation of

resources. Bartik (2003) notes several possibilities of market failures that prevent regional economies in general from realising their full potential:

- Inadequate supply of information on how to improve business productivity.
- Underinvestment in research and development for business.
- Undersupply of business capital.
- Underinvestment in education and worker training.
- Underinvestment in public infrastructure.
- Inflexible business regulation and tax structure.

While this list of possible market failures can apply to both growing and declining regions, there are more specific issues facing distressed urban and rural areas. These include, among others, the lack of social inclusion and the limited employment and educational opportunities for residents. Policies and tools targeted at distressed areas must recognise not only the market failures facing businesses but also the deficiencies and barriers facing the residents of these areas.

Urban regeneration

Urban scholars and public officials see distressed urban areas as underutilised and/or unexploited submarkets. Some scholars, such as Michael Porter, find little need for government intervention to revitalise these areas. He views them as having strategic competitive advantage because of their supply of developable land, large labour pools (albeit low-skilled to a large extent), built-up transportation and communication infrastructure (although neglected and deteriorating in many neighbourhoods), and proximity to commercial and information hubs of major cities. Porter posits that the private sector is fully capable of exploiting these advantages and revitalising these neighbourhoods without government assistance. In fact, he insists that government assistance focuses efforts on the wrong goals – redistribution of existing wealth and not the creation of additional wealth (Porter, 1995).

Critics of Porter's laissez-faire posture toward revitalising decaying inner city neighbourhoods point out that getting government out of the way is not enough to do the job. It takes reconnecting people with the rest of the metropolitan area through re-establishing social networks, developing local business, civic, and political leadership, and promoting home and business ownership. For example, Harrison and Glasmeier (1997) contend that successful neighbourhood redevelopment lies in collaboration among all stakeholders – residents, businesses, and government. Nunn (2001) concludes that distressed inner city neighbourhoods need to overcome the higher costs that result from high crime rates, labour problems associated with workers with deficiencies in essential work skills, general disorder, and different

culture practices in inner city neighbourhoods. He concludes that "inner city neighborhoods need more than financial tools; they need tools that will address the economic, political, and social conditions within their neighborhoods" (p. 196).

Essential to local economic growth in distressed neighbourhoods is the nurturing of entrepreneurship. A recent OECD study (2003, p. 12) affirms this conclusion and addresses several barriers facing entrepreneurs in trying to establish businesses in distressed areas. Some of these barriers mirror the list of market failures offered by Bartik, but the list includes other factors specific to the circumstances of urban areas. They include:

- Limited social and business networks.
- Low levels of effective demand in the local economy.
- The system of tenure and low value of housing.
- Constraints in access to finance.
- A lack of work experience and skills among residents.
- A lack of role models.
- Cultural obstacles.
- Lack of personal motivation.
- Sectoral clustering.
- High crime rates.
- Problems of transition from reliance on benefits.
- Inappropriate government regulation.

Because of these barriers and deficiencies in resources, neighbourhood business development requires more, not less, local government involvement, at least in the initial stages. Governments, particularly federal and state governments, have resources to provide financial and technical assistance to these distressed areas. Early on, the local government can play a supportive role to facilitate the development of clusters and the establishment of networks. In addition, local governments can help maintain general order through an effective and fair police force and ensure that basic services such as education, the fire department, sanitation and maintenance are provided efficiently. Also, distressed areas need civic leaders who can bring together the necessary stakeholders into effective partnerships and provide vision for a better future for these areas (Harrison and Glasmeier, 1997). The Silicon Valley, Austin, Texas, the Silicon Forest of Portland, Oregon, and the North Carolina research triangle owe their success in part to local officials and citizens who acted as brokers, financiers and facilitators during the early stages of their regional growth (McLean and Bates, 2003).

Distressed areas also need an infusion of resources to improve the skill sets of their most important asset – local residents and workers. Government or public-private partnerships must provide training, healthcare, and other services, at least until local residents can provide these services themselves.

Rural development

Many rural areas share the same plight as distressed urban areas. According to Drabenstott and Shaeff (2001), "by all measures rural areas lag behind in many economic statistical categories, and their citizens do not participate fully in the economic development seen in metropolitan areas." In the United States, per capita income levels and economic growth lag behind the nation and metropolitan areas within individual states. In 2003, for example, per capita income in non-metropolitan areas was about 70% of that in metropolitan areas.

In rural areas, organisations devoted to economic development often need assistance because of their limited economic tools – human capital, financial assets, and natural resources. Rural areas are often populated by less-educated individuals, and they lack the worker skill sets required to produce the quality, value added goods demanded by consumers and firms prospering in a knowledge-/innovation-driven economic system. Magill (2003) lists the following hurdles to rural development:

- Distance to markets.
- Independent spirit of rural populations (different cultures than in metropolitan areas).
- Capital availability (high price of capital because of lack of competition among lenders).
- Lack of economies of scale.
- Absence of entrepreneurial networks.
- Lack of information and business services.
- Lack of connection with rest of the economy.
- Lack of a skilled workforce.

In order for economic development efforts to be successful in revitalising rural areas, they must attempt to remedy the deficiencies included in this list.

Taxonomy of regional economic development policy

Regional economic development programmes are many and varied and reach into nearly every aspect of the needs of businesses to become profitable and of local communities and rural areas to provide a nurturing economic environment. Programmes are typically targeted at attracting

and retaining businesses through various incentives and promoting start-ups through technical assistance and loan funds. Because of the multifaceted nature of these programmes, classifications are difficult and subject to debate. However, it is useful to put some structure around their fluid nature.

One dimension to consider is whether programmes are discretionary or non-discretionary. Discretionary policies are targeted at specific businesses whereas non-discretionary programmes must include any business that meets certain pre-specified categories. Another dimension delineates tax incentives from non-tax incentives. Tax incentives come in various forms, including tax exemptions, tax credits, tax abatements and tax increment financing. Non-tax incentives are divided into direct and non-direct programmes. The former include grants, loans, revolving loan funds, community development financial institutions, venture capital; the latter include programmes to stimulate entrepreneurship, provide assistance to small business start-ups, subsidise research and development, train workers, promote technology transfer from university research to marketable products, and foster networks between businesses and among other community stakeholders. Non-tax incentives have increasingly relied on partnering with private entities to help leverage public funds, and try to use incentives to fill the gaps in the market economy caused by market failure. These incentives include various types of loans and community development financial institutions.

Another useful framework with which to view the multidimensional and dynamic aspects of regional economic development initiatives is based on the evolution of economic development practice. Herbers (1990) and Ross and Friedman (1990) describe three waves of economic development in the United States during the past 60 years. They view the first two as focusing on the supply side by offering incentives directly to firms. The goal of the first-wave policies is to attract firms, primarily manufacturing plants, from outside the area by reducing the cost of production. These policies began in the 1940s with Mississippi's "Balance Agriculture with Industry" programme.

All economic development programmes in place today offer a sophisticated set of incentives to reduce the cost of firms doing business in their area. As shown in Table 6.1, the difference between the first wave and the second wave is that in the latter the incentives are extended to local firms for retention and expansion purposes as well as to outside firms that are looking to locate locally. The third wave of economic development policies, which is still unfolding, corresponds to policies that enhance regional resources to nurture a competitive business environment and to promote industry clusters.

Table 6.1. **Classification of economic development strategies**

Component	First wave	Second wave	Third wave
Goal	Attract outside firms	Retention and expansion of existing firms	Enhance regional resources to promote industrial clusters
Location assets	Discount them to attract outside businesses	Reduce taxes and provide incentives to all businesses	Build regional collaboration
Business focus	Outside firms	Assist all local firms	Create context for better relations among firms
Human resources	Create jobs for local unemployed people	Develop training programmes	Utilise workforce training to build businesses
Community base	Physical resources	Social and physical resources	Leadership and development of quality environment

Source: Adapted from Blakely and Bradshaw, 2002.

While the waves denote an evolution of economic development strategies, all three types of policies are pursued concurrently. In the United States, governments at both the state and local levels have an arsenal of incentives and tax-reduction measures aimed at reducing the cost of doing business in their jurisdictions while at the same time pursuing programmes that provide the infrastructure to support business growth. The EU and its member states appear to have placed less emphasis on tax incentives, skipping to some extent the first two waves and focusing more on the third wave of enhancing the local economic environment. Examples of the various programmes that incorporate these strategies will be presented and discussed in the following sections.

Criteria for choosing the appropriate level of government: Who should do what?

As previously mentioned, the justification for government's role in promoting economic development is based on market failure. The question of the level of government that is best suited to address the various types of market failure is linked to another concept – externalities. Externalities, or external benefits and costs, occur when the actions of one economic agent affect the environment of another agent other than through prices (Varian, 1984). Markets typically ignore externalities because there is no market mechanism to pay the entity generating the positive externality by those who benefit from it. For instance, cost savings can accrue to businesses when economic activity in a region reaches a critical level. Achieving a critical number of businesses within a similar industry can attract more suppliers to the area, enlarge the pool of workers with skills required by the industry, bring in more specialised business service firms and expand retail opportunities – all of which benefit the businesses and workers in the area. If these benefits

are realised, the justification for government intervention is that a business's location decision fails to recognise the collective effect on a broader circle of businesses and households. Those benefiting have no way to compensate the one generating the externalities. Government, through its broad taxing authority, offers an option of creating a payment mechanism. For example, it can offer a tax break to reduce the cost of a business's location decision in line with the benefit that that decision offers others within the jurisdiction.

Fiscal federalism

A basic tenet of public economics is that a government jurisdiction should encompass the region within which the benefits (or costs) fall. Therefore, municipalities, counties, states and national governments should take responsibility for addressing different market failures according to the externalities generated by their efforts to address them. For example, the federal involvement in financing the US interstate highway system is justified on the grounds that the benefits of the system extend beyond local and state boundaries. Traditional government jurisdictions rarely match with any precision the areas in which externalities are contained. As a result, special districts have been formed, such as transportation districts, water districts, air quality districts, and economic development districts.

Tax efficiency

However, matching the geographical reach of externalities is not the sole criterion for determining which level of government should take responsibility for different types of economic development efforts. An equally if not more important criterion is taxing authority. In most countries, an arrangement for sharing taxing power across levels of government has evolved. Typically in the United States, for example, property taxes are reserved for municipalities and counties, sales and income taxes for states, and income taxes for the federal level. The sharing of taxing authority results in part from historical and political circumstances, but ends up making sense in terms of tax avoidance. The mobility of businesses and households allows them an opportunity to change location if they deem a tax to be higher than the benefits they receive from government services financed by the taxes. Thus capital, one of the most mobile business assets, should be taxed at the national level, and property, which is the least mobile, should be taxed at the local level.

There is, however, a reverse logic to taxation and the mobility of assets when considering economic development initiatives. Many of these efforts focus on specific and small geographical areas and use tax incentives to entice mobile assets, such as businesses, to locate there. The more mobile assets are more likely to respond to these incentives. Therefore, instead of being

concerned about losing businesses because of a region's high tax rates, local economic development authorities are interested in attracting highly mobile companies by offering tax credits and abatements. Of course, those businesses that are easily enticed by tax credits in one area can probably be easily persuaded by other areas to move to their location if the incentives are richer. Also, local areas are likely to select taxes on the basis of whether they can be "exported" to outsiders. A tax on hotel rooms and restaurants in areas that attract a high number of tourists is one way to tax outsiders; levying taxes on natural resource operations, such as coalmines or oil fields, is another.

Responding to local preferences

Another consideration in determining the appropriate level of government is meeting the needs and preferences of local citizens. Centralised governments tend to provide the same level and types of services throughout the country, regardless of differences in these needs. Clearly, it is more efficient to tailor services to meet local preferences. Unfortunately, local areas may not have the resources to fill these needs, and so intergovernmental partnerships are called for in which the local governments can determine the type and level of services appropriate for their needs but the higher levels of government can offer the resources to pay for these programmes.

In the United States the workforce system is organised in this fashion so that local workforce boards have a say in the way national programmes can be administered to meet local needs. Block grants, which typically have the most flexibility in using federal funds, are ideal for this arrangement, particularly when local administrators have the expertise to use the funds in the most effective way. The Community Development Block Grants (CDBGs) are examples of providing federal dollars – with limited restriction on their use for community development activities – to local decision makers. The Netherlands has had 15 years of experience with a block grant system, with the establishment of an Urban Renewal Fund in 1985. This fund provided an important financial relationship between central and local governments, and has facilitated the decentralisation and bundling of resources for urban renewal.

Staff expertise

A third consideration in determining which levels of government are most appropriate to fund and administer economic development services is the expertise of staff. While in theory local government may be the closest to understanding and responding to local needs, in practice the local staff may not have the expertise to conduct the proper assessment, design the appropriate strategy, know about possible funding sources or administer the

programmes effectively. In countries with a long tradition of decentralised government and local autonomy, this may not be as much of a problem as in countries that have only recently moved to such a government structure. The central government may offer technical assistance to local staff and provide programmes to develop the professional expertise they need to develop and administer effective programmes. Also, professional associations, universities, and special institutes provide training to local staff.

Competition among government entities

Another issue regarding local discretion and control of initiatives is the potential competition among local communities. It has been argued that competition among local governments leads to an overinvestment in various infrastructure facilities and excessive and needless subsidies to business, which in turn takes resources away from important public services and increases tax rates. US policy makers have debated this point periodically, and the US Congress has attempted to address the issue at times.[2] Yet, the practice of local entities – a government and non-government organisations – taking the initiative to meet the economic development needs of their local areas prevails in the United States, with few restrictions. While the US government shies away from overtly targeting assistance to one region of the country instead of another (except for distressed areas), it does provide a host of programmes, which when applied for and used by local entities, favours one region over another. Although there generally are restrictions and priorities placed on how it is to be used, financial assistance flows to those areas where local administrators are most aggressive and entrepreneurial in soliciting funds.

Two aspects of state and local government financial decision making may lead to overly generous subsidies. First, the political horizon of elected officials is short relative to the life of most economic development initiatives. Governors and local officials have an incentive to negotiate subsidies that spread the costs to the local taxpayers far beyond their current terms of office, shifting the political consequences of this financial burden on to their successors. Second, there are typically few fiscal constraints on the amount of subsidies that may be offered. Tax abatement in particular is not included on the expenditure side of the government's budget, and consequently there is little fiscal constraint on these decisions.

Several proposals have been offered to address the issue of competition among state and local governments (Farrell, 1996):

- Disclose incentive offers made during the bidding process, including disclosure by the company.

- Initiate a multi-state compact that would share information, create an analysis model, identify "best" and "worst" practices and note legal risks and costs.
- Encourage legislators to adopt uniform standards and accountability measures.
- Develop standards for awarding incentives that derive from best practices, which include performance and enforcement mechanisms and take into account the quality of jobs and their availability to local populations.
- Establish a multi-organisation task force to promulgate uniform reporting standards that would measure and evaluate the costs and benefits of incentives.

Legal rulings

Legislatures in the United States have yet to adopt these principles, although some states have at least talked about forming a multi-state pact honouring some of them. The courts, however, have handed down decisions that prevent economic development incentives from restricting interstate commerce. A recent court decision reiterates the test imposed in 1977 by the US Supreme Court on what constitutes unfair interstate commerce practice. States have nearly complete authority to tax activities, and thus offer tax incentives, within their own borders. The US Constitution imposes limitations on these broad taxing powers, however. The most important structural limit on state tax power is the Commerce Clause, which gives Congress the sole power to regulate commerce among the states. The Supreme Court has used the Clause to strike down state tax schemes that place an undue burden on interstate commerce.

The most recent case involved the City of Toledo, Ohio and the tax incentives it and the state offered DaimlerChrysler to expand its Jeep assembly plant in that area. In exchange for expanding the plant, a project worth approximately USD 1.2 billion, the company would have been entitled to an investment tax credit against its Ohio franchise tax liability in the amount of 13.5% of the cost of newly installed manufacturing machinery and equipment. DaimlerChrysler also stood to receive a ten-year, 100% property tax abatement based on its commitment to create and preserve existing jobs.

The question of the tax break's validity was brought before the courts. Validity was first upheld but upon appeal, the Sixth Circuit Court of Appeals held that Ohio's investment tax credit violated the Commerce Clause and reversed the portion of the district court's opinion that upheld it. However, the appeals court affirmed the lower court's decision that the property tax abatement was proper. In a previous decision handed down in 1977, the Supreme Court announced the four-pronged test against which all

subsequent Commerce Clause cases have been analysed. A state statute satisfies the clause if 1) the activity taxed has substantial nexus with the taxing state; 2) the tax is fairly apportioned to reflect the degree of activity within the state; 3) the tax does not discriminate against interstate commerce; and 4) the tax is fairly related to benefits provided by the state. There was no dispute that the Ohio investment tax credit and property tax abatement satisfied the first, second and fourth prongs. However, the plaintiffs claimed the incentives discriminated against interstate commerce, and the court agreed.

It is interesting to note that conditions 1), 2), and 4) are similar to the principles based on externalities and that there was no dispute over these principles, only the one regarding interstate commerce. Furthermore, the circuit court of appeals upheld the use of the local property tax abatement, suggesting that if the court applied the same set of principles, the externalities at the local level did not spill across state boundaries. The EU has explicit language in its treaties regarding competition, and there does not appear to be the reluctance on the part of policy makers to address the issue directly that there is in the United States.

Government practice

The responsibility of funding various economic development programmes is distributed across government entities; there is some correspondence with the extent of externalities and/or taxing efficiency. For example, in the United States local jurisdictions offer property tax abatements, which correspond with an immobile asset – land. In addition, local governments and public-private partnerships apply for and administer these programmes, since they are best able to meet the needs of their local areas. State governments offer tax credits on capital and business property, which are more mobile. The state also funds infrastructure investments such as state roads and a system of higher education, which yield benefits beyond local jurisdictions. The federal government provides guaranteed loans to small businesses, financial assistance for small business development centres, industrial technical centres, funds for targeted distressed areas, and infrastructure investments. These programmes and activities help targeted individual businesses and promote economic activity in depressed areas. Assistance to small businesses purportedly helps a sector of the economy that creates a disproportionate share of jobs, and assistance to depressed areas raises the level of economic activity not only for that location but also for the country as a whole. As with state governments, the federal government funds the national highway system, which includes the interstate highway system.[3] These road systems are used by motorists and freight traffic originating outside the state, and thus generate externalities beyond the state boundaries.

There are many programmes that do not fit into this framework, but it is a useful set of principles for thinking about how to fund and administer economic development programmes. As the court case demonstrates, these are principles that have been adopted to determine the proper administration of economic development incentives at the state level. What has emerged in Europe and the United States is a decentralised system in which the different levels of government partner in providing assistance to businesses and people in specific distressed areas. Higher levels of government, which typically have more efficient taxing power, a wider geographic range to capture externalities, and more staff capacity, provide funding and technical assistance through programmes targeted at various economic and social deficiencies. Local governments then partner with the higher-level governments to assess the local needs and administer the programmes. A horizontal dimension to partnerships has also evolved at the local level, in which government entities have teamed with non-government entities to leverage public resources with private resources and to unleash the innovative powers of local civic entrepreneurship. More detail will be provided about these programmes and partnerships in the following sections.

The role of partnerships in designing and administering economic development policies

As discussed in a previous section, the implementation of local economic development activities takes place primarily at the local level, while many of the resources to finance these efforts originate at the national or state levels. In most instances, higher levels of government have more taxing authority and are better able to spread the financial burden across a broader population base than lower levels of government. Yet, local government and non-government organisations are closer to local businesses and residents in their areas and are better able to assess their needs and direct resources to meet them. They are equipped to determine the combinations of programmes that are best suited to target the needs of businesses and residents within their geographical area of concern.

The responsibility of designing and implementing local responses to economic development needs is shared by government and non-government entities. In some instances, municipalities and other local government entities, such as counties and states in the United States and territorial governments in Europe, assume sole responsibility for administering certain programmes. Local elected officials in the United States consider promotion of economic development in their areas one of their primary responsibilities. According to a recent survey, 86% of local elected officials placed economic development among their top priorities.

In both Europe and the United States, partnerships between private and public entities are being formed to pursue economic development efforts. In Europe, partnerships have been endorsed and encouraged by the EU and the number of local economic development agencies has reached more than 500. The Committee of the Region and the Economic and Social Committee both emphasise the importance of adopting a bottom-up perspective that places the needs of citizens and deprived communities at the centre of any new initiative. In the United States, which has a tradition of a local decentralised approach to providing government services, local partnerships are the norm. Many federal programmes encourage, if not require, the involvement of local partnerships. For example, more than 600 local workforce investment areas administer the federal and state workforce programmes in the United States.

One reason for the increased move toward decentralised, area-based approaches to economic development policies is the fact that mounting budgetary pressures have forced central governments to share the financial burden of providing services and promoting growth with local authorities. Another factor is the anticipation that forming partnerships between the public sector and the private sector will help the public sector leverage its limited resources. A third reason is the reaction to the poor results attained by policies and programmes that did not have strong linkages to local actors (Eberts and Erickcek, 2001).

There is no single model or organisational structure that typifies local economic development partnerships. Local agencies reflect local conditions, history, culture, and social and political characteristics of the jurisdictions they serve. Thus, they each have their own distinctive features and approach while coalescing around some common themes. They emphasise networking, integration of services, attention to the needs of business, active involvement of the business community, worker training that fits the labour needs of existing businesses, and identification of their region's strengths and building on them. They also address the barriers facing their region's key and emerging industries, and they work collectively – not individually – with customers to solve the problems they face (National Governors Association, 2002). Partnerships turn to the same tools that government economic and workforce development agencies have at their disposal, but they often combine them in ways that government entities are not able to do because of regulations and other constraints they face as government entities. Therefore, partnerships provide the flexibility to deliver services in innovative and effective ways that in many instances can better meet the needs of businesses and jobseekers.

Several examples of partnerships devoted to economic development in Europe and the United States offer insight into the wide range of issues they deal with and approaches they take in promoting local economic

development. The OECD LEED Programme carried out a study to learn more about the role of local partnerships in economic development and workforce development activities (OECD, 2001). The study included case studies of partnerships in seven countries. In order to gain a sense of the nature of these organisations, some of the partnerships included in the study are summarised here along with some that were not included.

The Right Place Program is a private, non-profit organisation focused on promoting economic growth in the urban core of Grand Rapids, Michigan. It provides the standard set of economic development services (*e.g.* information on industrial sites, tax abatements, statewide business incentives) and works closely with businesses to help them connect with the proper government agencies to receive the appropriate incentives and assistance. In addition, it has partnered with other organisations to offer several unique programmes. One such initiative partners with the City of Grand Rapids to redevelop abandoned industrial land in the inner city. Such a venture is risky, since companies looking to locate in an area are more attracted to undeveloped "greenspace" than to urban locations with uncertain payoffs. However, the Right Place Program is willing to pursue this riskier venture as a way to provide job opportunities to individuals in the depressed neighbourhoods of the city.

Croatia has created Local Economic Development Agencies (LEDAs) to carry out a "bottom-up" approach to promoting job creation and income generation in lagging areas of the country. As of 2002, Croatia has established four LEDAs. One is in the city of Drnis, and the other three cover their own counties. These LEDAs are located in war-torn areas of Croatia that suffer from slow growth and high unemployment. These areas have experienced unemployment rates as high as 35%, compared with 20% in the rest of Croatia. The war destroyed physical infrastructure and industrial facilities and has driven the young and skilled workers out of the area; there is thus a need for investment in physical and human capital. These areas are also characterised by a small number of economic support institutions and weak organisations for civil society and private institutions (Van Empel, 2000). The LEDAs brought together the county, all municipalities and towns within the county, the chambers of commerce and crafts, NGOs, financial institutions based in the area, and co-operatives to help design them and set them up. The LEDAs provided direct assistance to businesses through Guarantee Funds and counselled and provided technical assistance to SMEs.

Puljiz (2003) attributes the creation of LEDAs to the lack of progress by the central government in solving socioeconomic problems of lagging regions. Their formation faced several challenges. Substantial time and effort was needed to bring the local parties closer to the ideas of the local economic development approach and the role of institutions like LEDAs. It was difficult to find qualified staff to operate the LEDAs, as the most capable people had

already left the area. The lack of small and medium-size enterprises in the distressed areas and the non-existence of entrepreneurial culture have been barriers as well.

The workforce development system in the United States is a good example of two dimensions of partnerships. The first is a vertical dimension linking the different levels of government, from federal to local workforce investment boards (WIBs). The second is a horizontal dimension at the local level, in which local WIBs partner with local social service agencies and non-profit organisations within their local jurisdiction. The Workforce Investment Act of 1998 established more than 600 WIBs across the country. They are responsible for providing labour exchange and workforce training services to workers and businesses within their local areas. Increasingly, the local WIBs are becoming more closely integrated with the economic development efforts within their jurisdictions, as businesses find it more difficult to find qualified workers to fill their vacancies. To do so, they subcontract with local providers, which include government entities, non-profit organisations, and for-profit businesses. Each WIB is governed by a local board, a majority of whose members are representatives of local businesses. In many areas, the WIBs act as facilitators to bring together the various entities – businesses, social agencies, educational institutions, labour groups – to help address workforce issues in their areas. The extent to which the local WIBs are proactive in assuming this role varies. Nevertheless, WIBs have emerged as significant catalysts for integrating workforce and economic development activities in various areas.

An example of regional partnerships in the EU is in the Sicilian province of Alto Belice-Corleonese. Local mayors in this province, located in northwest Sicily with a population of 122 000, decided to work together on a common development plan that was to become a European Territorial Pact (TP) in April 1997. In addition to mayors of 20 local municipalities, the partners included four trade unions, 12 professional associations, and four other institutions (Melo, 2001, p. 233). The plan included the development of farm-based food production, the promotion of tourism, environmental infrastructure investment, assistance to SMEs and non-profit organisations, and promotion of human resources. The plan also stimulated co-operation between the north and south of Italy by establishing links between local provincial businesses and firms in northern Italy. The TP also revitalised the vocational training sector, by aligning the training with the needs of local businesses.

The United Kingdom created ten regional development agencies in 1997, to give greater emphasis to regional development and to transform England's regions through sustained economic development. Government sponsored, each is responsible for providing strategic leadership in economic development and in co-ordinating national programmes at the regional and local levels.

These strategies are shaped by the views of local residents, private, public and voluntary organisations including research organisations, and educational institutions. The South West of England Regional Development Agency, for example, pursues three strategic objectives: it raises business productivity, increases economic inclusion and improves regional communications and partnership.

Partnerships are constantly evolving as they try to position themselves to meet the needs of businesses in order to generate or retain jobs for their constituents. It is difficult to measure their success (Eberts, forthcoming). Even though some evaluations have been conducted showing positive results, none as yet has used an appropriate comparison group to see if they actually add value to their participants and stakeholders. Nonetheless, bringing together key stakeholders and leveraging resources can be a powerful catalyst. Several lessons for successful partnerships were gleaned from the OECD/LEED studies. The more pertinent ones for promoting economic development are: 1) business, as customer, should be the common focus; 2) outcomes must be agreed upon, quantified, and tracked; 3) local organisations must become entrepreneurial and problem solvers and form strong networks among the stakeholders; and 4) strong leadership is required to help define and advocate for the common purpose and to mobilise community resources (Eberts, 2003).

Schematic framework

At this point, two questions regarding economic development initiatives have been addressed. First, what is the role of government? And second, which levels of government should do what? The ability of any governmental unit to answer these questions depends upon several factors that vary among governments, particularly for those that have had different experiences with the role of markets and the decentralisation of responsibilities within their countries. To further complicate a thoughtful response to these questions, one recognises that the issues are intertwined. Therefore, to help place them in proper perspective, this brief section offers a schematic framework that delineates the key features that figure into decisions regarding the design and implementation of economic development initiatives.

Factors related to these two questions are contained in the matrix displayed in Table 6.2. The columns are divided into four groups: 1) national, 2) state (provincial or territorial), 3) local (*e.g.* within municipalities), and 4) non-governmental (typically not-for-profit) organisations. These groupings serve two purposes, depending upon which row (or factor) is being considered. For those rows that relate to governments, the first three columns refer to national, state, and local levels, respectively. For those that relate to organisational capacity, the columns then relate to the capabilities by government and other

Table 6.2. **Schematic framework for design and implementation of ED initiatives**

Factor/Level		National	State	Local	NGOs
Government structure	Direct Provision		X	X	
	Tax Authority	X	X	X	
Partnerships	Vertical	X	X	X	
	Horizontal			X	X
Local capacity	Civic leadership			X	X
	Staff expertise and competency	X	X	X	X
	Self governance		X	X	
Resources	Capacity		X	X	
	Effort	X	X	X	

entities, particularly non-government, not-for-profit organisations. That is where the fourth column, labelled NGOs, comes into play. One could also include a fifth column for private for-profit businesses but this group is omitted only because it is assumed that they are central to successful economic development and must therefore be involved in the process. Furthermore, the fact that businesses may face barriers or experience weaknesses in certain local areas is the reason for economic development efforts.

Each row of the matrix designates a factor that dictates how these questions will be addressed. The first row focuses on government structure in the sense of whether the government unit has the authority to provide services directly to customers and has taxing authority. The second factor relates to partnerships, both vertically and horizontally. "Vertical" here refers to intergovernmental relationships among the various levels of government, and "horizontal" refers to partnerships at the local level among government entities and non-government organisations. The third factor deals with local capacity to carry out economic development efforts. This includes the expertise and competency of staff of government entities and non-government organisations, civic leadership by local organisations and the ability to self-govern, both legislatively and practically. The final row has to do with resources to carry out economic development efforts. Capacity refers to resources from which governments can draw, which basically means the tax base of the area (national, state, or local), which in turn depends upon the size and health of the economy. Effort refers to the tax rate, or effort by which public revenue is raised from private activities.

The boxes that are checked in the matrix in Table 6.2 relate to the situation in the United States and serve as an example for others to fill in the matrix depending upon their own circumstances. Going down the rows, we

find for the United States that state and local governments are the predominant provider of direct services whereas the national government is not. All three levels of government have taxing authority, but each level focuses on a subset of taxes for their own purposes. For example, although there are significant overlaps, the predominant source of revenue for the federal government is the income tax, for states the sales tax, and for municipalities the property tax. With respect to local partnerships, local governments and non-profit organisations have formed partnerships in many local areas. Under local capacity, the appropriate boxes for civic leadership are the last two, and these can be filled in for most local areas. Staff expertise is prevalent at all levels and for all types of organisations for the most part, although there is always a need for training and technical assistance at all levels, particularly for small communities. The issue of self-governance is pertinent for state and local governments, since in some countries the national government assumes all or most authority, or self-governance has been granted only recently and local governments have little experience or expertise in tending to their own affairs. Finally, resources relate to taxing authority and sufficient economic activity to sustain government efforts. In the United States, all three levels of government have this authority, but in many countries it may only rest at the national level.

Financial tools

Economic developers draw upon an arsenal of financial tools to encourage economic growth and job creation in their jurisdictions. The tools range from direct government expenditures for basic services and infrastructure to equity positions in private companies. The federal programmes in the United States and the EU programmes listed in the previous section include combinations of the various tools listed in this section. In addition, state and local programmes bring their own unique tools and capabilities to economic development efforts. This section describes each of the tools and provides examples of how they are implemented in both the United States and the European Union. This is not an exhaustive list, but it attempts to show the range of options and to give examples of programmes.

Tax incentives

This section discusses tax incentives that directly affect the tax liability of businesses, and thus their cost of operation associated with locating within a specific location. Tax incentives are also offered to investors and to financial institutions that in turn can affect businesses and individuals indirectly by providing greater access to loan funds and at lower interest rates. These tools will be discussed in the section on financial assistance.

The use of tax incentives as economic development tools should be viewed with respect to a state's basic tax system. Of course, various tax incentives are applicable only if sub-national units, such as states and municipalities, have autonomous taxing authority. This is critical not only as a vehicle for the local government to reduce the cost of a company conducting business in their jurisdiction, but also as a means for it to recoup the costs of financing these incentives through higher tax revenues in the future. If a local government entity cannot benefit from higher tax revenues as a result of increased economic activity, then there is little means or incentive by which local governments can provide these incentives. In the United States, states, counties, and municipalities have taxing authority with respect to specific taxes. This may not be the case in other countries, and such incentives may not be applicable.

As US states have been more aggressive in competing for jobs, they have become more concerned about their overall business tax climate and have taken steps to avoid any tax that may be viewed negatively by potential investors. They also are careful that their overall tax structure does not look very different from their competitor states. Shannon (1991) points to six characteristics that may raise concern among investors: 1) a high overall tax burden, 2) business taxes that are out of line with other states, 3) heavy property taxes on business realty, 4) any property tax on business personal property, and 5) a sales tax on a substantial share of business purchases. Therefore, many states that levy taxes on such aspects of doing business in their jurisdiction may turn to tax incentives to try to reduce their effect on business costs. Fisher and Peters (1998), using a hypothetical firm analysis computed for the 24 largest industrial states, found that tax incentives level the playing field between distressed and non-distressed areas. Without tax incentives, distressed areas, which are typically high-tax areas, would be at a disadvantage relative to growing areas. Unfortunately, by only levelling the playing, tax incentives were, they concluded, not encouraging investment in high unemployment areas.

Tax incentives are commonly offered in the form of tax credits, abatements and reductions, exemptions, refunds, and a mix of benefits. A national survey of US state economic developers compiled a total of 1 105 business incentive programmes across the 50 states (International City/County Management Association, 2000). Of those, 40% are tax-based and about 2% are categorised as mixed. Tax credits are the most prevalent of the tax incentives (258 out of a total of 445 tax incentives) with tax exemptions a distant second (101). All but four states – Alaska, Nevada, South Dakota and Wyoming – have at least one tax credit programme. Three of the four states without tax credits do not have a corporate income tax. Alaska is the only state in the country with a corporate income tax that does not provide any tax

incentives. The use of tax incentives seems to be distributed fairly evenly across regions of the country, at least with respect to their population share. For instance, states in the south, which in the 1950s and 60s aggressively lured manufacturing plants from the north, offer 40% of the tax incentives, while claiming 36% of the population. The states in the west offer the fewest incentives – 17%, but this is still in line with their share of the population, 17%. The value of the incentive is not necessarily associated with the number of programmes, since some states can be more generous than others in the extent to which tax incentives reduce a business's tax burden, as discussed above. The most recent estimate of the value of tax incentives approaches USD 4.6 billion in foregone state tax revenues.

Each tax incentive is associated with a particular state or local tax. Tax credits are used to reduce the tax rate of corporate income taxes and include credits on different aspects of business. States offer tax credits against investment, new jobs, inventory property tax, sales tax on fuel and electricity, and other state income taxes. Tax exemptions are typically related to a state's sales tax on business purchases. States exempt manufacturing machinery and equipment, and electricity and natural gas. Instead of complete exemption, some states reduce the tax rate on specific expenditures if used directly in the manufacturing process. Tax abatement is associated with property taxes, which are levied primarily by local governments. Therefore, tax abatements are one of the key economic development tools used by local governments. The latter may offer them to businesses that are locating or expanding their facility, or may designate only certain locations – such as within enterprise zones – within which businesses are eligible for the tax breaks.

The advantage of these tax incentives in reducing the tax burden of businesses depends to a large extent on the type of business, use of the various inputs that are targeted by the tax incentives, and the respective tax rates. Fisher and Peters (1998) show that a typical tax abatement results in the largest percentage reduction in tax burden for the various types of businesses included in their analysis, followed by the sales tax exemption for manufacturing machinery and equipment, and the new jobs tax credit. These incentive programmes reduce the tax burden for a group of representative firms by a range of 9% to 36%.

As mentioned previously, local communities are concerned that some tax incentives may create a "revolving door," in that businesses that are lured to an area with favourable tax incentives could be just as easily persuaded to move to another community that offers a slightly richer package. To encourage businesses to stay put for a reasonable period, many communities have included provisions called "clawbacks" in their tax incentive packages. Clawback provisions stipulate that a business that receives an incentive upfront must give a portion of it back to the community if it closes, moves, or

does not meet performance goals, such as a certain number of new jobs created, before a specified period of time. In 2002, 19 states had clawback laws and a survey found that nearly 60% of the local communities responding always required a performance agreement as part of the incentive package (International City/County Management Association, 1999). Other, similar options include recisions (cancelling a subsidy agreement), penalties (special charges for non-performance or relocation), and recalibrations (subsidy adjustments to reflect changing business conditions) (Ledebur and Woodward, 2003).

Tax abatements

Tax abatements are legal agreements between a government entity and a property owner or real estate developer to forego taxing some share of assessed real estate value for a certain period. As an economic development tool, local governments promise to eliminate the tax for specific companies that agree to move into their jurisdiction. The tax abatement gives a company a financial boost during its initial phase of operation in the new location, with the expectation that by the time the abatement expires the company will become established and profitable. When rates are reapplied, they will bring in increased tax revenue to the local government, linked to an appreciation in property values.

The justification set forth by proponents of tax abatements is that without these subsidies, a jurisdiction would receive no new tax revenue, jobs, or other benefits if a firm chose an alternative site. Opponents question whether one can argue with certainty that the plant would not have chosen the site if the tax abatement were not offered, and that it deprives local governments of funds to provide the necessary services during the time the abatement is in effect. It can also affect the revenue-generating capabilities of other governments, such as local school districts, that also depend on taxes generated from the same property base.

Tax abatements are the most popular type of tax incentive and the least costly to administer. Since they are targeted primarily at property taxes, and property taxes are the primary source of revenue for municipalities and other sub-state local governments in the United States, they are the primary tax incentives available to local governments. Taxes are typically frozen for 10-15 years. The agreement can also list promised improvements, specify types of activities permitted on the property, and allow for inspection by city government personnel. Some abatement agreements contain clawback provisions, recisions, or penalties if the company does not meet predetermined performance thresholds or close down within a specified period of time.

For example, the City of Toledo, Ohio granted DaimlerChrysler a 10-year property tax abatement to expand its Jeep production facility in the city. The tax abatement saved the company USD 8 million during the first year. The total project was worth approximately USD 1.2 billion with property tax abatements and other incentives totalling USD 280 million. To compensate other local government entities for lost tax revenue associated with this deal, the agreement called for DaimlerChrysler to pay the Toledo School District USD 1.4 million, which roughly equalled the amount of taxes that would have been generated by the houses and businesses torn down to accommodate the construction of the new plant.

Some state governments place provisions on the use of tax abatements and expectations about the outcomes. California, for example, permits local governing bodies, including municipalities, to rebate some or all of the property tax revenue that local agencies would receive from "economic revitalisation manufacturing property" for a period of five fiscal years from the date the property was placed in service. The tax abatements are made with expectations toward generating additional, decent-paying jobs. Tangible personal property must be directly involved in the manufacturing process, the project must lead to the creation of 10 new full-time manufacturing jobs, the company must pay wages of at least USD 10 per hour, and those jobs must be in continuous existence for the duration of the rebate (California Department of Commerce website).

Tax exemptions

For economic development purposes, tax exemptions are granted to encourage desired activities of new plants, which means exempting land, capital improvements, and capital from taxation. Also, taxes on personal property and inventories are exempted. One difference between exemptions and abatements is that exemptions are usually a permanent elimination of a tax for a specific purpose or organisation, whereas an abatement is temporary and the tax is reinstated after a specified period.

For example, the City of Pearland, Texas and the Pearland Independent School District have adopted the Freeport Tax Exemption of certain property. This exempts taxes on eligible inventory that is transported out of the state of Texas within 175 days of acquisition. The goods must first be in Texas only for a limited purpose, such as for storage or factory processing. This exemption was proposed to enhance the ability of certain areas to attract warehouse and distribution centre facilities by offering a special property tax exemption for the goods they typically handle. Some types of companies currently receiving Freeport tax exemptions include automakers, computer manufacturers, beverage producers, ironworks, warehousing and distribution facilities, and

medical supply companies. For the most part, these are export-based activities, bringing "new" dollars into the community.

Tax increment financing

Under a tax increment financing arrangement, the local jurisdiction borrows money, uses it to make improvements to property or infrastructure, and repays the borrowed funds with increased tax revenue generated by the improvements and the resulting increases in property values. The borrowed money, in the form of tax-increment bonds, provides financing for street improvements, lighting, water and sewer lines, curbs, gutters, and landscaping – improvements that make the land more desirable to developers.

Under TIF arrangements, municipalities reserve or set aside the increases in property taxes to pay for improvements. Increments are designated for a period necessary to fully pay off the debt incurred to make the improvements. When bonds are fully paid, the TIF district can be dissolved and the full share of the tax increment can be designated for the city's general revenue.

Municipalities find the TIF approach attractive since the jurisdiction does not incur out-of-pocket costs and does not obligate itself to raise taxes. Rather, the enhanced tax base can be used to pay for any additional services, such as police and fire, required by the new development, and no voter approval is required since the bonds are revenue bonds and not included in a city's general obligation debt. Critics say TIFs are not accountable to voters, do not pay for the increased need for services of those outside the development zone, and subsidise big developers who may have carried out the project without government assistance. Nonetheless, a recent survey of local officials reported that tax increment financing was the second most important revenue source for economic development, next only to the general fund of the municipality (International City/County Management Association, 2004-2005).

For example, the City of Chicago enticed the Ford Motor Company to establish North America's first automotive supplier manufacturing campus by using tax increment financing to acquire land and prepare the site. The campus is built on a 155-acre brownfield site near Ford's Chicago assembly plant on the southwest side of the city. Investment from Ford, its suppliers and its development partner, Center Point properties, totalled more than USD 400 million. The project was meant to create at least 1 000 permanent, full-time jobs with Ford suppliers in the manufacturing campus, along with several hundred construction jobs with the first few years of construction and operation. Moreover, it was estimated that the campus would generate USD 163 million in city, state and county tax revenues over ten years, according to a study by the accounting firm of PriceWaterhouseCoopers.

Drawing largely on tax increment financing and Illinois FIRST funds (state-assisted financing for infrastructure projects), the City of Chicago and State of Illinois provided nearly USD 16 million for land acquisition and site preparation, USD 13.6 million for job training and recruitment programmes and USD 2.5 million for the installation of energy-efficient equipment at the new and existing Ford facilities. Finally, the city and state invested approximately USD 64 million for road improvements throughout the area, including the relocation of a major artery.

Tax credits

Companies can receive credits against various taxes from local and state jurisdictions if these establishments locate in their jurisdiction. Tax credits are more desirable than tax deductions or tax abatements because they directly reduce tax obligations instead of reducing taxable values, and typically have no time limit on the period they are in effect. A tax credit reduces tax liability dollar for dollar for the entire period the business is in operation.

Tax credits are typically targeted at industries that the state wants to attract or nurture. The State of Michigan, for example, initiated a high-tech job creation tax credit for employers in electronics, communications, medical science and other high-technology fields whose companies devote at least 25% of operating expenses to research and development. Each credit is awarded for up to 20 years and for up to 100% of the tax related to the project. The tax credit is against the state's single business tax, which is a value added-type tax on Michigan businesses (Michigan Economic Development Corporation).

California offers manufacturers operating in the state a 6% manufacturers' investment credit. This credit is generally unlimited. The manufacturers' investment credit can be used to offset income or franchise tax based on the purchase or lease of manufacturing and related equipment which is "depreciable" under certain federal regulations and which has California sales or use tax paid on its purchase. In addition, special purpose buildings and foundations – such as clean rooms – for certain electronic manufacturers, semiconductor equipment manufacturers, and commercial space satellite manufacturers, as well as property related to specified pharmaceutical activity, are eligible for the credit (California Department of Commerce).

Direct non-tax incentives

Non-tax incentives are even more prevalent in the United States than tax incentives. The survey of state economic developers reveals 643 programmes (International City/County Management Association, 2000). Non-tax incentives

are offered through direct or indirect financial assistance to businesses. The survey defines direct financial incentives as financial assistance through grants, loans, equity investments, and loan insurance/guarantees to businesses through the state government or a state-funded organisation. Indirect financial incentives include investment in workforce training, market development, manufacturing modernisation, and technology commercialisation (National Association of State Development Agencies, 2002). States also provide grants and loans to local governments and community organisations, such as universities, community colleges and private training providers, to support business investment and community economic development.

The latest tally of expenditures on non-tax incentives in the United States amounts to USD 5.3 billion, with 35% of the funds devoted to community assistance (indirect non-tax incentives) and 23% to workforce preparation and development. Upwards of 21% was spent on direct financial assistance to businesses. Not included in the USD 5.3 billion estimate for non-tax incentive spending are infrastructure subsidies.[4] States provide funds for road improvements and water and electricity hook-ups to new, relocating, or expanding facilities.

Grants

Businesses find grants a highly desirable type of financial assistance, since they are under no obligation to repay the money. The use of government grants in the United States to finance basic services harks back to the nation's infancy when land was set aside during the establishment of the Northwest Territory (which included Ohio, Michigan and Illinois) to support the creation of land-grant universities under the Morrill Act of 1862. Direct grants to businesses gained a foothold during the great expansion of the West, with land grants to private railroad companies to help finance the building of the intercontinental railroad system.

Most direct grants are for infrastructure projects and training programmes. Public infrastructure financing provides financial assistance to cities and counties for public infrastructure projects. Although not directly available to individual businesses, cities and counties can secure public infrastructure financing and provide it to qualified businesses locating in their area. Local governments then use these funds to accommodate the needs of targeted businesses, with such projects as providing highway access, or water and sewer hook-ups.

As previously mentioned, the Economic Development Administration (EDA), an agency of the US Department of Commerce, promotes development in distressed areas, both urban and rural, by providing federal resources for public works construction, economic development planning at the local level,

and capital subsidies for industry. The US Department of Housing and Urban Development (HUD) provides block grants to states, which in turn states funnel to local jurisdictions. In California, as with many other states, these grants can be applied toward the creation or retention of jobs for targeted income groups. Local governments apply to the California Department of Housing and Community Development on behalf of a business or developer. Eligible activities include land, building or working capital loans, loan guarantees, and grants for publicly owned infrastructure.

In South Dakota, a state that relies heavily on agriculture and has experienced a steady loss of farm jobs with little alternative job opportunities, the EDA awarded USD 1.4 million to a consortium in the City of Aberdeen to build the Smart Connections Center and to strengthen the region's telecommunications infrastructure. The centre is a nearly 12 000-square-foot technologically equipped business incubator for telecommunications-based businesses. The centre is part of a local public/private partnership called Dakota Interconnect that utilises fibre optic and microwave technologies to connect independent networks, offer high-speed Internet access, and provide facilities with video conferencing. The project partners contributed another USD 1.6 million. The goal of the consortium and the centre is to diversify the local economy through upgrading telecommunications infrastructure and developing companies that can use that infrastructure.

The US Department of Agriculture focuses its economic development programmes on rural areas, with the mission of enhancing the quality of life for rural residents and promoting a competitive business environment. The Department's programmes include grants to rural small businesses, and grants for the construction and improvement of basic infrastructure such as water and sewer but also for the installation of broadband Internet connections.

Loans

Economic developers use loans as a financial incentive to promote commercial and industrial expansion in their area. Loans are available for a variety of purposes, including real estate acquisition, working capital, new product development, equipment purchases and environmental investment by businesses (Robinson, 2003). Publicly provided loans allow economic developers to offer affordable capital to business borrowers who are unable to secure a loan from private banks. Lending is typically targeted at non-traditional borrowers including women, minorities, and residents of distressed communities or neighbourhoods that may have been neglected because of discrimination in the lending markets. Borrowers may also include those who do not have the tangible assets to offer as collateral or whose income is uncertain. By loaning funds to businesses that banks and other financial

intermediaries deem as credit risks, public loan funds also push the risk of default and financial loss onto taxpayers.

Yet, by targeting small businesses, particularly those in distressed areas or minority owned, public loan programmes address a specific market failure associated with these enterprises. A Federal Reserve Board survey found that less than half of those businesses with fewer than 20 employees had any form of bank loan, credit line, or capital lease (1998). In contrast, medium-size firms (100-499 employees) were found to have much greater involvement in financial markets, with 92% using at least one form of financing.

Robinson (2003) cites four reasons for the lack of access to credit/loan markets. First, these small businesses are risky, with typically little collateral and uncertain income streams. Second, it is difficult for banks to assess the credit risk of these small companies. Start-ups have no or little credit history and their accounting systems are typically not sufficiently sophisticated and not audited regularly. Third, loans are typically small and the fixed costs of administering the loans are relatively high. Fourth, small business owners focus on the core mission of their business and do not have the specialised staff to apply for and manage loans.

Public loan programmes take several forms. The EDA's Title II Business Development Loan programme provides loans and loan guarantees to both for-profit and non-profit organisations. These loans are provided to organisations that may have trouble getting a conventional loan through private financial intermediaries. The loans made to businesses in distressed areas and to minority owners typically have lower interest rates than those charged by private banks.

States also have direct loans funds. Ohio, for example, offers direct loans to businesses, preferably involved in industrial projects, for land and building acquisition, expansion or renovation, and equipment purchase. Businesses are eligible for these loans if they demonstrate good management practice and the ability to repay the loan. Businesses also must create one job at Ohio's prevailing wage rate for every USD 25 000 worth of loans received. Loans are granted up to 30% of total eligible fixed cost with a minimum of USD 350 000 and a maximum of USD 1 million. The rates on the loan are subsidised at two-thirds of the prime fixed rate for 10-15 years. Ohio also has a direct loan programme for minorities, which offers businesses with 51% minority ownership a subsidised fixed rate of 4.5% for up to 15 years and for up to 40% of the project cost. For both loan programmes, management must show the capability of repaying the loan and promise to create a specified number of jobs per dollar loaned.

The US EDA offers a programme that guarantees business loans made through private financial institutions in order to induce investments and

create jobs. The maximum guarantee may not exceed 80% of the total project cost and the maximum loan amount is USD 10 million. As with the direct loans, business applicants must demonstrate they will create or retain a minimum of one job per USD 20 000 in EDA loan guarantee assistance. The business must also show that they are capable of repaying the loan.

A similar loan programme is available for rural areas through the US Department of Agriculture's Rural Enterprise Grants and Rural Economic Grants. In addition, the Rural Business Opportunity Grants are available to rural communities with exceptional need. Funds from these grants can be used to pay costs of providing economic planning for rural communities, technical assistance for rural businesses, or training for rural entrepreneurs or economic development officials. As with most of these programmes, applicants must be a public body, non-profit corporation, Indian tribe, or co-operative with members that are primarily rural residents.

Revolving loan funds

Public loans are also offered through revolving loan funds (RLFs). These funds are set up so that the repayments of outstanding loans replenish the pool of loanable funds and in theory provide a self-renewing pool of funds. In contrast to direct loans, the RLFs have the potential to be self-sustaining after the first round of capitalisation. The primary role of most economic development RLFs is to provide the difference between the amount borrowers need and what they can obtain through private financial intermediaries. RLF loans in many instances provide a secondary loan to supplement what the borrowers can receive from a conventional bank. It is typically structured to ensure timely repayment with the risk transferred to the RLF and thus the taxpayers. In this situation, the RLF takes a subordinate position to the private bank and defers payment until the first loan is paid. RLFs also provide loans to businesses of a size too small to be profitable to conventional banks. In addition, RLFs offer bridge loans to allow a project to move forward quickly by providing short-term capital until a private bank loan can be arranged (Robinson, 2003).

RLFs are initially capitalised through government programmes or through foundations. The Department of Housing and Urban Development, through the Community Development Block Grants, is a large source of funds for RLFs. Businesses that receive funds from these projects typically need to create jobs for low- to moderate-income households. Some of these funds are directed to distressed areas within cities. The US Department of Agriculture Intermediary Relending Program provides funds for projects in distressed rural areas. Foundations also provide funds for RLFs.

Proponents of RLFs see them as partners more than competitors with private banks. They cite several reasons. First, RLFs help small businesses that have little experience with borrowing prepare the proper paperwork required to apply for loans from private banks. Second, by providing gap financing, small businesses may be able to present to a conventional bank a project that would not have been viable without RLF funding. Third, by offering "micro loans", which conventional banks find unattractive, small businesses have the potential to grow large and profitable enough to be an attractive customer to private banks. Thus, RLFs leverage government and not-for-profit funds by enticing the private sector to commit resources to development activities to which they might not otherwise have committed.

Since RLFs are lending to risky borrowers, they are expected to have higher default rates than experienced by conventional banks. Robinson (2003) summarises the results of several studies on this subject. RLF default rates average less than 10%, and loss rates, which include recoveries of collateral, range from between 4% and 8%. However, further analysis shows that the reserve ratios of these funds are low relative to the default rates. One study found that the size of these reserves averaged between 8% of total assets for large funds and 12% for small ones, which may not be sufficient to cover losses. Consequently, RLFs face the challenge of sustainability if they continue to deplete their pool of funds through defaults.

Yet, studies have shown that the RLFs have made an impact on creating and saving jobs. A study by the Corporation for Enterprise Development estimated that the 290 RLFs it studied made more than USD 560 million in loans and created or saved 200 000 jobs, at a cost of USD 5 338 per job (Robinson, p. 178). Another study found the cost per job of loans from the EDA to be around USD 3 312 per job. This same study found that every dollar loaned to businesses through the RLFs leveraged an additional USD 2.50 of private sector funding.

Another innovative loan programme is the Capital Access Program (CAP), first started by the State of Michigan in 1986. CAP is designed to encourage conventional banks to make loans that are too risky under current bank lending rules. CAP reduces the higher credit risk associated with these loans by establishing a loan-loss reserve fund, which can be used only to recover the losses from CAP loans. The loan-loss reserve fund is capitalised by both the government and the banks making the CAP loans. The banks charge 3-7% of the loan value as points, which the customer pays. The government matches that amount. Unlike government loan guarantees, the banks are liable for losses that exceed their loan-loss reserve. Public contributions to CAPs are only 4.5% of cumulative loan volume, suggesting that each government dollar is leveraging 23 dollars of additional business loans (Bartik, 2005).

Community development financial institutions

Another form of financing available to businesses and even households for economic development purposes is a variety of community development financial institutions (CDFIs) in the United States. CDFIs are mission-driven financial institutions that provide financial products and services to people and communities underserved by traditional financial institutions. The CDFI industry began to emerge during the "War on Poverty" launched by the federal government during the late 1960s and early 1970s. They were funded initially through the federal programme of community development corporations, which targeted urban and rural poor communities. Soon after, they expanded their funding sources to include private organisations. In addition, the Department of Housing and Urban Development, the Economic Development Administration, and the Department of Agriculture provided funds for business-development loans. These efforts resulted in the establishment of the South Shore Bank in 1973 and the Santa Cruz Community Credit Union in 1977. Today more than 1 000 CDFIs operate in low-wealth communities in all 50 states and the District of Columbia. CDFIs can be banks, credit unions, loan funds, venture capital funds, community development corporations or micro-enterprises. The common thread is that their primary purpose is community development (Coalition of Community Development Financial Institution website).

Community Development Financial Institutions differ from revolving loan funds primarily in their ongoing capitalisation. They often receive initial seed money from government sources or private organisations, as do RLFs, but they sustain themselves through deposits as well as the repayment of loans.

CDFIs are market-driven, locally controlled, private sector organisations that work in partnership with conventional financial institutions to channel private investment into distressed communities either through direct investment in CDFI or through co-ordination of lending, investment and other services. There are six types of CDFIs.

- Community development banks.
- Community development loans funds.
- Community development credit unions.
- Micro-enterprise funds.
- Community development corporation-based lenders and investors.
- Community development venture funds.

These organisations attract capital from private and public sources. Private sources include corporations, religious institutions and private foundations. Depository CDFIs, like community development banks and community development credit unions, receive capital from customers and

non-member depositors. One crucial source of support for CDFIs in the United States is the CDFI Fund, administered by the Department of the Treasury. The CDFI Fund makes capital grants, equity investments, and awards to fund technical assistance and organisational capacity building. CDFIs can apply for limited funds through a competitive process that requires the CDFI in most cases to provide at least a one-to-one match of non-federal funds to receive financial assistance. The Fund also rewards traditional banks and thrifts for making investments in CDFIs and in distressed communities through its Bank Enterprise Award Program. In addition, the New Markets Tax Credits Program, started in 2002, encourages the private sector to invest in CDFIs by offering tax credits for qualified community development investments. The Community Reinvestment Act (CRA) also encourages and rewards mainstream financial institutions to invest their own capital directly in CDFIs. The CRA, passed by Congress in 1977 and revised in 1996, requires regulated financial institutions to help meet the credit needs of all communities in the service area in which the bank is chartered to operate. Investing in CDFIs is one way for banks to earn credits toward their CRA requirements of making credit available in low-income areas.

CDFIs differ from traditional financial institutions in several key aspects:

- CDFIs cultivate specialised knowledge about the communities in which they do businesses.
- They offer loans below market rates by subsidising the loans.
- They offer loans without the collateral or credit history that mainstream banks require.

As with revolving loan funds, a policy issue is whether CDFIs compete with traditional banks. In a strict sense, if they provide loans and financial services to individuals who are not able to secure conventional loans, then CDFIs are not competing. Some proponents of CDFIs extend the argument even further and contend that CDFIs complement traditional financial institutions. They share a market-based approach to serving communities and often work in partnership with banks to develop innovative ways to deliver loans, investments and financial services to distressed communities. Furthermore, proponents argue that CDFIs create a future market for mainstream financial institutions by incubating businesses and people, helping them grow and prosper and achieve sufficient success through establishing good credit history and gaining sufficient size to qualify for traditional loans and credit.

Critics, on the other hand, rebut that CDFIs have crossed the line to provide loans to individuals and businesses that do qualify for traditional loans. They insist that CDFIs, in order to sustain their own existence, have

moved into more profitable, less risky financial activity to subsidise the loans they make to more risky customers.

CDFIs measure success by focusing on the "double bottom line" – economic success and contributions to the community. In Wisconsin for the year 2002, for example, CDFIs are credited with loaning more than USD 19.2 million to 600 customers. These loans included closed financing to 360 customers, financing 96 businesses and micro enterprises which created or supported 836 jobs, and providing training and technical assistance to 14 organisations and more than 2 000 individuals. A third of the loans went to customers in rural areas and the remainder to urban areas. Minorities, low-income individuals and women were the primary recipients of the loans.

Community Development Venture Capital

One of the fastest-growing sectors of community development finance is its venture capital arm. Community Development Venture Capital (CDVC) funds make equity investments in businesses for the purposes of creating jobs for low-income people and strengthening the local economies of distressed regions. These funds mirror in many respects their private sector counterparts but fill the niche voided by the private sector by providing risk capital and entrepreneurial assistance to small businesses that are overlooked by traditional venture capital (VC) investors because of their size, geographical location, or industry focus. CDVC funds surged in the 1990s, riding the wave of VC investment in general and spurred by supporting federal legislation. The number of active funds grew from around 6 in the early 1990s to nearly 80 in 2002, with USD 485 million under management (Community Development Venture Capital Alliance, 2002).

CDVCs are organised in a variety of ways and can be either for-profit or not-for-profit entities. Two models offer a flavour of the approach taken by many CDVCs. Like their traditional VC counterparts, CDVC funds can be either "limited lifespan" funds or "evergreen" funds. Limited lifetime funds are incorporated for a limited time, typically ten years, whereas evergreen funds are on-going enterprises. The evergreen funds combine the management and investment components, while the limited lifespan separates the two. In both cases, the investment portion is a for-profit entity, while the management component can be either for-profit or not-for-profit. Slightly more than half of all CDVC funds are for-profit, and 75% of limited lifespan funds are for-profit entities. The remainder are not-for-profit, with a small portion, around 8%, quasi-governmental agencies.

Investment decisions are typically made by committees of roughly a half-dozen members. Committee members come from various backgrounds, including venture capitalists, bankers, entrepreneurs, lawyers, non-profit

organisations, community representatives, corporate executives and government staff.

Similar to their traditional VC counterparts, businesses that receive CDVC investments are high-growth businesses that promise strong financial returns. However, CDVCs invest in different sectors and different locations than private VC firms. While both VC firms and CDVCs will invest in the computer sectors, for example, CDVCs will more likely invest in Internet services for inner city neighbourhoods and rural areas or software companies in small towns. Furthermore, a majority of CDVC funds invest in companies at all stages of development, from seed to expansion stage – a strategy that enables CDVC funds to consider the largest possible number of high-quality investments within their geographic regions. These investments help to diversify the local economic base and bring economic opportunities to these distressed regions.

The Kentucky Highlands Investment Corporation was one of the first CDVCs to be established. KHIC was formed in 1968 to stimulate growth and create employment opportunities in a nine-county region of south-eastern Kentucky, which has experienced high unemployment and low job opportunities as the coal industry in that area has gradually closed down. It also strives to build the entrepreneurial capacity of the region. To pursue this mission, KHIC makes debt, equity, and near-equity investments in Kentucky businesses and provides technical assistance. Kentucky Highlands has helped 140 businesses finance USD 178 million and create more than 7 900 jobs. As of December 2003, its total committed capital was USD 45.6 million. According to an independent analysis, the venture capital fund of KHIC has generated a 16.5% annual return (based on an internal rate of return calculation). Subtracting out management and other fees, the net return would be closer to 9% (Schmitt, 2004).

The United Kingdom has similar venture capital funds. One such fund is the Bridges Community Ventures Ltd. (BCV). It was established in 2002 with GBP 40 million to make equity investments in businesses located in wards around England that are in the most deprived 25th percentile on the Index of Multiple Deprivation. BCV is dedicated to management funds that are both for-profit and mission-driven, aiming to stimulate economic growth and create jobs, wealth, and role models of business success in underinvested communities. In addition to offering equity financing, they support businesses with management advice and a network of contacts. The Fund invests in all industries and typically makes investments of between GBP 100 000 and GBP 2 million.

In the United States, the funds invested in CDVCs come from four major sources: banks (32%), federal and state governments (21%),

foundations (16%), and corporations (15%). The remainder come from individuals and parent funds (CDVCA, 2002). Banks are highly involved with CDVCs because it is a way for them to meet their Community Reinvestment Act (CRA) obligation.

An incentive for individuals and corporations to invest in CDVCs is the tax credit they can receive for qualified investments. In 2000 Congress passed the New Markets Tax Credit (NMTC) to stimulate investments in commercial real estate and business ventures located in low-income urban and rural areas. The NMTC programme provides investors, both individuals and corporations, with tax credits against federal income taxes that total 39% of their investment, distributed over a seven-year period. The NMTC is administered by the Community Development Financial Institutions Fund, an office within the US Department of Treasury.

NMTC can be applied only to equity investments in certified Community Development Entities (CDEs). The CDEs must be for-profit and have a primary mission of community development through capital investment. They can be community development banks or venture funds, community development corporations, small business investment companies focused on low- and moderate-income community, New Market Venture Capital companies and other investment funds.[5] To ensure accountability to residents of low-income communities, community representation on a governing or advisory board is required. Certified Community Development Financial Institutions and Specialized Small Business Investment companies are automatically qualified (Miara, 2004). The NMTC programme has specific definitions for low-income communities, but most urban census tracts qualify for NTC investments.

One of the first deals using NMTC was a USD 12 million renovation of an historic property consisting of commercial and residential space in Tacoma, Washington. The NMTC authority of approximately USD 11 million was provided through the local office of the Local Initiative Support Corporation (LISC), the qualified CDE. The project was a key component of a larger revitalisation plan for Tacoma's deteriorating warehouse and shipping area along its waterfront, including rehabilitating a Superfund hazardous waste site.

Angel investors – source of early stage capital

Estimates show that most of the early stage investments in businesses come not from venture capital funds but from "angel" investors. Angel investors are wealthy individuals – they may have recently cashed out from successful technology-based companies – who are prepared to invest USD 100 000 to USD 1 million in the early development of a promising

company. They fill an important financing gap when the money from friends and families has been exhausted and before the company has grown enough to be of interest to the venture capitalist. Equally important, angel investors offer their technical advice to budding entrepreneurs. It is estimated that USD 18 billion was invested by angel investors in 2003, almost all of it in early-stage companies. Venture capital accounted for roughly the same amount, but only 2% was in early-stage companies.

Several states are increasing the availability of early-stage capital for new companies by helping create statewide networks of private angel funds. For example, the Oklahoma Technology Commercialization Center, equipped with incentive legislation for the formation of angel funds, helped create a dozen community-based USD 1 million to USD 2 million funds (Loague, 2004).

Wisconsin has recently launched the Wisconsin Angel Network (WAN), designed to help link angel investors by providing among other things needed resources for angel networks – including organisational and administrative services, research and networking programmes – and to enhance deal flow by facilitating co-operation among angel networks and early stage venture capital firms. As a first step, the state is creating an online portal called "The Angel Capital Resource" on its website which directs angels to the networks and other resources in the state including lawyers, accountants, and technology transfer organisations. The Wisconsin legislature has also enacted a 25% tax credit to early stage investors who invest in Wisconsin businesses. The goal is to create at least a USD 10 million statewide angel network fund.

Angel investor networks have been established by several other states and in Europe. In Europe there are an estimated 150 business angel networks. Some are partnerships with municipalities, such as the one in Rotterdam. Some are private networks that operate on a commercial basis, such as Proxicap in the Nantes area of France, and others are local association networks such as Club Essor 92 in the Paris area (Aernoudt, 2001). In Scotland, LINC (Local Investment Networking Company), an independent not-for-profit organisation, offers a nationwide business introduction network for companies and early-stage investors. LINC is funded in part by the EU and by private banks (*www.lincscot.co.uk*).

The United Kingdom has recently introduced a Community Investment Tax Credit. It provides tax credits to individuals or to institutions that invest in loans or equity funds earmarked for community development activities. These funds may finance small businesses, social enterprises or other community-based ventures, including some property-related development projects (OECD, 2001).

Indirect non-tax incentives

Workforce training

The US government supports a wide range of educational institutions, including K-12 school districts, community colleges and public state universities. In addition, the government also provides workforce training and job search assistance through the federal Workforce Investment Act (WIA). While these institutions and programmes are essential for preparing people to fill the needs of businesses, they do not provide training for incumbent workers for the specific needs of a business. State governments and some local government do tailor training to meet the specific needs of individual firms, with the goal of underwriting staff development costs to attract new businesses into their area.

WIA allows state and local entities to use federal funds for training employed workers, but only a small proportion of the funds is available for that purpose. Temporary Assistance for Needy Families (TANF) block grants to states also allowed states more flexibility in serving low-wage workers. Even though funds are available for employed workers, the emphasis under WIA has moved from training toward "work first." In the early years of WIA, it placed less emphasis on training than did its predecessor, The Job Training Partnership Act (JTPA). Recently, WIA has moved away from sequential service referral to more targeted referrals and the percentage of WIA participants referred to training has increased (Eberts, forthcoming).

States also use their own funds to provide training to employed workers, but these programmes are typically reserved for purposes of attracting and retaining businesses, or to target specific sectors and occupations. States can also fund such activities in conjunction with other federal funding grants, such as the Department of Housing and Urban Development's Community Development Block Grant. These grants can be used for economic development purposes that expand job and business opportunities for lower-income persons and neighbourhoods. These state-sponsored training programmes are intended primarily to help businesses address a variety of issues including skill development, competitiveness, economic development and technological changes. In 1999, 54% of the funds for state customised training programmes (roughly USD 317 million) were targeted at incumbent workers (Ducha and Graves, 1999).

Bartik (2005) points out that in-kind customised subsidies or incentives, such as customised training programmes or infrastructure investment, have an automatic clawback provision, in that most of the trained workers and the entire infrastructure will remain if the company decides to leave. Therefore, the subsidy or incentive continues to be a value asset in the community, as

long as the infrastructure is used by other parties in the community and the customised job training is transferable to other local jobs.

Technical assistance to businesses

Businesses, particularly small businesses, can receive assistance on a broad range of topics, from establishing a business plan, engineering issues and protecting intellectual property rights, to understanding how to grow a business from a small start-up company. The training and assistance is provided by small business incubators, university extension programmes such as the National Institute of Standards and Technology (NIST), and business centres. NIST deserves special attention, because of the measured impact its manufacturing extension programme (MEP) has had on small and medium-size manufacturers. Through a national network of affiliated centres and offices in all 50 states, MEP provides small and medium-size manufacturers access to tools, techniques and other resources. Each centre works directly with area manufacturers to provide expertise and services tailored to meet their most critical needs, which range from process improvements and worker training to business practices and information technology applications. These centres leverage resources from universities, community colleges, trade associations and workforce training agencies to help manufacturers. Researchers at the Center for Economic Studies, US Census Bureau, found that manufacturers who received assistance from MEP centres experienced between 3.4% and 16% higher growth in labour productivity over a five-year period than similar clients who did not receive services (Jarmin, 1999).

Schematic summary of the various tools

The matrix in Table 6.3 is offered as a means of summarising the various tools available to government entities. The checks in the boxes refer to the typical practice in the United States. There may be instances in which levels of government provide such tools to businesses, but the aim here is to show the general pattern by which these tools are used.

Economic development programmes to assist distressed urban and rural areas

This section offers a sample of the wide variety of programmes that the United States and Europe have established to address issues regarding distressed urban and rural areas. It is not intended to be an inventory of all programmes. At last count, there were 35 federal economic and community development programmes in the United States, totalling USD 16.2 billion (FY 2005). While some programmes apply to businesses anywhere, such as

Table 6.3. **Economic development financial tools by predominant use in the United States**

Type/level		National	State	Local	NGOs
Grants	Not targeted at specific firms	X	X		
Loans	Guarantees	X	X		
	Self-sustaining	X	X		X
Tax incentives	Credits	X	X		
	Exemptions	X	X		
	Abatements			X	
	Tax-increment financing			X	
Direct expenditures (Targeted to specific firms)	Infrastructure		X	X	
	Worker training	X	X		X
	Technical assistance	X	X		X
Regulations	Licensing		X	X	
	Zoning			X	
Equity investment			X		X

small business guaranteed loans by the US Small Business Administration, as mentioned previously the federal and EU programmes directed at economic development initiatives are intended to help reduce the disparities between regions. After highlighting some of these programmes, the attention will turn to place-specific programmes and then to local partnerships that help direct programmatic funds to their local areas and administer the programmes.

US federal programmes for distressed urban areas

In the United States, the federal government is interested in providing assistance to chronically distressed areas and previously excluded subgroups of the population and economy. Federal programmes support local economic development efforts that target economically distressed areas, small businesses, minorities, and workforce training. These programmes are typically area-based and emphasise the integration of their own services with those of other programmes in order to meet the comprehensive needs of people and businesses in those areas. The federal government has been reluctant to support one region over another because of possible "zero-sum" or even negative outcomes for the country as a whole if government incentives were to promote poor site selection in less than optimal locations. State and local governments, on the other hand, view the goals of economic development primarily in the context of their own jurisdictions and pursue what they deem best for their region, with little regard for its broader effects.

The Economic Development Administration (EDA) is one of the primary federal agencies that targets economic development of distressed areas. Its mission statement reflects the stance of the current administration to use federal resources to help distressed areas by partnering with local organisations and leveraging public dollars. Its mission is to "help partners across the nation (states, regions and communities) create wealth and minimise poverty by promoting a favourable business environment to attract private capital investment and higher-skill, higher-wage jobs through world-class capacity building, planning, infrastructure, research grants and strategic initiatives. It sees its role as creating an environment where the role of the public sector is to leverage resources in which the private sector will risk capital investment (Economic Development Administration, 2005)."

The EDA supports the following strategic investments:

- Upgrade core business infrastructure, including transportation, communications, and specialised training.
- Implement regional strategies, involve all stakeholders and support regional benchmarking initiatives, encourage institutional collaboration, reflect strong leadership commitment, and encourage a formalised structure to maintain consensus.
- Initiate cluster development establishing research and industrial parks that encourage innovation-based competition and recruitment efforts.
- Help communities plan and implement economic adjustment strategies in response to sudden and severe economic dislocations.
- Support technology-led economic development, and reflect the important role of linking universities and industry and technology transfers.
- Enhance community and faith-based social entrepreneurship in redevelopment strategies for areas of chronic economic distress.

EDA requires that the activities it undertakes demonstrate a return on investment of public dollars through measurable, quantifiable performance measures.

EU programmes for distressed urban areas

EU economic development policies share the US emphasis on partnerships and community participation in improving the economic conditions of distressed areas. In 1989, the Council of Europe endorsed a resolution advocating a greater role for the community at local and regional levels. Numerous EU programmes (*e.g.* URBAN, INTEGRA and Poverty 3) have emphasised the importance of partnership, community participation, and community development. The basic strategies behind most of the EU programmes is to provide technical assistance and guaranteed loans to small

and medium-size businesses, provide training to the local workforce, invest in local infrastructure, and improve social cohesion.

The URBAN initiative of the European Social Fund, for example, focuses on small urban neighbourhoods and on concentrating funds on a number of integrated programmes involving the active participation of local communities. Between 2001 and 2006, the EU plans to invest more than EUR 728 million of European Regional Development Fund (ERDF) money in these areas. Adding local and national co-financing, including the private sector, makes a total investment of EUR 1.6 billion. Funding concentrates on physical and environmental regeneration, social inclusion, training, entrepreneurship and employment.

A particular feature of the URBAN initiative is the high degree of involvement of the local level. In most cases the local authority is responsible for day-to-day implementation, advised by local community groups and in partnership with the national/regional authorities and the European Commission. Another interesting feature is that there will be a network of the URBAN II programmes ("URBACT") to exchange information and experience on sustainable urban development across the European Union.

Evaluation studies have shown that the projects have led to some improvement in quality of life in the 118 neighbourhoods participating between 1994 and 1999. These improvements resulted from investment in public transport, education and cultural facilities and increasing access to public services. URBAN focuses on creating and improving local social capital by including active learning activities as an integral part of the programmes in order to build local leadership and civic entrepreneurship. URBAN has also acted as a catalyst for regeneration of neighbourhoods by offering programmes that leverage public funds with private ones. A study showed that for one project in Rostock, Germany, EUR 3.9 were generated from private funds for every euro invested in renovation from public funds.

Another EU programme, ADAPT, is also aimed at nurturing partnerships and integrating programmes at the local level. ADAPT is a European support programme with the goal of safeguarding employment and creating jobs by helping small and medium-size enterprises adapt to the changing requirements of modern industry. They act as a catalyst for change by feeding new ideas into policy and practice in both the public and private sectors through the dissemination of project results and by demonstrating their relevance for meeting labour market needs.

In the EU, the mission of the European Regional Development Fund (ERDF) is similar to that of the US EDA. The ERDF was established in 1975 to assist the development of lagging and declining regions of the European Community and compensate for the adverse redistribution effects of the

process of European economic integration. ERDF has three objectives: achieving convergence in regional economic development; enhancing regional competitiveness and employment; and promoting territorial co-operation. Among the many action steps prescribed in the treaty that formed the ERDF, those related to providing technical and financial assistance to small and medium-size enterprises (including venture capital, loans and guarantee funds), improving infrastructure, and focusing on distressed areas are most aligned with the programme priorities of EDA.

US and EU programmes for rural areas

The US Department of Agriculture offers several programmes that provide either grants or loans to small businesses located in small cities and rural areas. The department also provides funds to help improve the physical infrastructure in rural areas, including expanding broadband Internet service to areas where the number of users is too small to make installation commercially viable. Rural areas also benefit from Community Development Block Grant funds, which can be used for infrastructure investment, and the Small Business Administration loans and technical assistance for small businesses.

For almost forty years, the Common Agricultural Policy (CAP) has influenced the spatial development of rural areas in the EU. In expenditure terms the CAP is the most significant policy of the EU, and consequently one of the most intensely discussed. A series of reforms in the past decade have shifted the focus of CAP from the previous dominance of sectoral market initiatives to a concern for a more integrated and sustainable agricultural and rural development policy for all those who live in rural areas. As the problems of rural society go beyond agriculture, it is hoped that a multi-sectoral, integrated and bottom-up approach will help secure employment and development in rural areas.

The LEADER programme, in particular, aims at stimulating the non-farming side of the rural economy (decentralised businesses, green tourism) and improving local infrastructure, services, and education and training programmes. Since its inception, it has provided nearly 1, 000 organisations with assistance in rural development efforts. Most of the organisations were local partnerships in the form of local action groups (LAGs). These organisations helped to form a bottom-up approach to formulate and implement innovative, multi-sectoral, and co-ordinated strategy for local development. By establishing and strengthening these groups, LEADER helped to decentralise the management of available funding from both the structural funds and national sources. The next generation, LEADER+, is one of four initiatives financed by EU structural funds and is designed to help rural actors consider the long-term potential of their local region. It too places a strong

emphasis on partnerships and networks to exchange experience and encourages the implementation of integrated, high-quality and original strategies for sustainable development.

Place-based incentives

Place-based initiatives are specifically targeted at chronically distressed areas, typically of relatively small geographical size, such as a neighbourhood or an industrial area. The strategy is to direct a concentrated and focused array of economic development tools and programmes at the area. Proposed by academics in the United States and the United Kingdom, the British were the first to put the strategy into practice. Other countries soon followed.

Since the 1980s, federal, state and local governments in the United States have established economic development policies that focus on stimulating private investment in specific chronically depressed areas. These policies have taken the form of enterprise zones, empowerment zones, industry processing zones, and community development zones. These programmes target resources to companies that are willing to locate within a designated area, which by several measures has a high unemployment rate and concentration of poverty. These programmes make low-interest loans in older and existing neighbourhoods of metropolitan areas, grant tax breaks on hiring, developing, or sustaining economic activity, and market poor neighbourhoods to potential investors. Michigan, for example, has established 20 regions of the state as Renaissance Zones, which are located in areas of high unemployment, poverty, and on abandoned industrial sites. Companies willing to locate in these areas are exempt from paying nearly all state and local taxes. The size of the zones ranges from 5 to 3 000 acres.

The French government has established 45 Zones Franches Urbaines (ZFU) to help revitalise specific distressed areas. Within these zones, companies of less than 50 employees can benefit from exemptions from local business tax (taxe professionnelle), from land taxes, corporate taxes, social employer charges and personal social contributions for illness and parenthood. Some of the conditions are bound to a certain time limit. After the five-year exemption period, there is some extension of the fiscal advantages by way of favourable tax rates. At least one-third of the employees of the companies that want to receive exemptions have to live in the ZFU or in other designated zones within an urban area.

To become designated as a ZFU, a distressed area must have more than 10 000 inhabitants, an unemployment rate that is 25 percentage points higher than the national average, a youth percentage that is 36 percentage points above the national average, and more than 30% of youth above the age of 15 without a school qualification. Within these zones, services are offered

such as professional education, accessibility, development of shops and services and support for setting up companies (NRTEE, 2003, pp. 245-246).

The United Kingdom has recently embarked on a new set of initiatives to further address geographical disparities, particularly the high concentrations of the socially excluded (Rhodes, Tyler and Brennan, 2003). These area-based initiatives (ABIs) include a rich array of measures including Enterprise Zones, Urban Development Corporations, Inner City Task Forces, City Challenge, the Single Regeneration Budget Challenge Fund, New Deal for Communities and more recently the Neighbourhood Renewal Fund.

These ABIs mark a new wave of place-based initiatives in which partnerships and local autonomy are increasingly important. Among some of the attributes of ABIs are a significant level of involvement by other parties, including government departments, the private sector and the community/voluntary sector; a significant degree of competition for funds; a breadth of functions included in the activities designated to regenerate the area; local autonomy identifying needs and prioritising resource allocation; local capacity to undertake regeneration activities; and funding from the central government.

Brownfield redevelopment

A specific type of place-based initiative is targeted at brownfields, which are defined as abandoned industrial sites that are typically unusable in their current state because of contamination by industrial wastes. All industrialised countries have former industrial sites that are contaminated as a result of their industrial legacy, and require remediation. For example, the US Environmental Protection Agency (USEPA) estimates that there are between 500 000 and 1 million brownfield sites in the United States. More than USD 2 trillion worth of property within that country is devalued due to the presence of environmental hazards (USEPA Web site). The total cost of restoring these sites to productive use may be in excess of USD 650 billion. For France, it is estimated that there are about 200 000 former industrial and service sites that can be considered brownfields, as well as about 200 former mines. The stock of industrial brownfields alone covers nearly 50 000 acres. In Germany, the number of suspected contaminated sites is about 362 000 covering 316 000 acres.[6]

Despite the nearly universal problem among industrialised countries of contaminated sites, the approach to remediating and redeveloping them and the zeal in implementing programmes is far from uniform. The United States, for example, has addressed the challenges of contaminated sites since 1993 with EPA's Brownfields Economic Redevelopment Initiative. In 1997, the Clinton Administration combined the resources of more than 15 federal

agencies to expand the brownfields initiative and created the Brownfields National Partnership Action Agenda. This provided a framework for co-operation among governments, businesses and non-governmental organisations. In 2002, the Brownfields Revitalization Act was signed into law, authorising programme funding of USD 200 million annually and clarifying liability on the part of property owners. The US federal programme currently operates in conjunction with the brownfield programmes of 48 states and more than 300 local governments.

Today, about two dozen federal agencies are involved to help finance some aspect of brownfield reuse, such as basic site preparation, planning, site assessment, cleanup, and construction. Only three of these programmes explicitly focus on brownfields – assessment and cleanup programmes under the USEPA and the brownfield economic development initiative under the US Department of Housing and Urban Development. The EPA provides three types of financial assistance:

- Demonstration Pilot Grants of up to USD 200 000 each to states, cities, towns, counties and tribes across the US to conduct environmental assessment-related activities and develop remediation and redevelopment plans.
- Cleanup Revolving Loan Funds of up to USD 500 000 (USD 1 million under the new Small Business Liability Relief and Brownfields Revitalization Act) awarded to states, cities, towns, counties and tribes to provide low-interest loans to carry out cleanup activities at brownfield sites.
- Job Training Pilot Grants of up to USD 200 000 each to provide job training for residents of communities affected by brownfields.

In general, US federal brownfield financial assistance is targeted to state and local governments, and little is applicable directly to the private sector. There are, however, tax incentives for private firms operating on designated brownfield sites, in which environmental cleanup costs are fully deductible in the year they are incurred, rather than having to be capitalised. In essence, the states and local governments have become "partners" in the delivery of federal programmes to local areas. Local governments also seek to work with private firms in order to leverage private funds in redeveloping brownfield sites.

Italy, on the other hand, is an example of a country that has no specific legislative or regulatory framework at the national level for addressing brownfield redevelopment, other than the legislation and funds generally relevant to contaminated site rehabilitation.[7] However, municipalities have led the effort to redevelop contaminated sites. In 1998, national legislation was established to provide public funds for a number of selected sites defined as "sites of national interest". These are defined as contaminated sites with special features (*e.g.* location, heavy environmental contamination, economic

and social stresses, urgency of redevelopment) that locally might justify a "brownfield" label. The original list has been expanded by a recent (2001) decree, and there are currently about 40 sites of national interest. The initial public budget for rehabilitation of these sites is over EUR 500 million for the next three years.

Municipal governments, particularly those in the industrialised northern regions of the country, have initiated many redevelopment projects. These activities typically involve the private sector, community groups and public authorities. Some projects are co-financed by the European Commission, including:

- "Urban pilot projects" (municipalities of Genoa and Venice), financing specific programmes for renewal of historical or traditional urban areas.
- "Municipia" (municipalities of Terni and Trento), a network of towns managing the urban environment.

The municipality of Milan has been particularly active in brownfield redevelopment, constructing 4 300 housing units, four urban parks and commercial services on former brownfield sites. About EUR 700 000 have been invested, mainly by private companies.

Conclusion

This chapter presented an overview of the financial tools used by governments and private-public partnerships in Europe and the United States. It also offered economic principles for justifying the use of these programmes to intervene in a market economy to stimulate regional growth, particularly in distressed urban and rural areas. In addition, it offered a framework for determining the proper institutional arrangements for funding and administering programmes. While not an exhaustive inventory, the examples presented in this chapter suggest that many of the same tools are employed in Europe and the United States, and that the institutional arrangements in terms of the level of governments responsible for funding and administrating these programmes are also similar.

These entities engaged in economic development efforts also face similar issues with regard to finding sufficient resources and devising the proper strategies to address urban regeneration and related economic development issues. The chapter concludes by responding to the three questions posed in the introduction.

- What are the financial obstacles to projects for urban regeneration, rural development, social inclusion, and human resource development?

It is a simple truth that those areas that need economic development assistance the most have the least financial means to fund economic

development efforts. Even in better economic times in which the public sector has more revenues, local governments would unwisely stretch their limited resources if they tried on their own to fund programmes to rejuvenate their distressed areas, jeopardising even further their ability to provide basic services. Raising taxes or borrowing (if statutorily possible) in order to generate additional revenues would only make the area less competitive in retaining and attracting businesses. Arguably, investment in infrastructure and other assets may yield a return that could pay off the debt or reduce taxes in the future, but it is difficult for residents of distressed areas to sacrifice personal consumption in return for a vague promise of future improvement in their local economy.

According to the concept of fiscal federalism and of capturing externalities, the costs of economic development initiatives that generate broad geographical benefits should be borne by higher levels of governments. Governmental units at the level of US states and member states in the EU are better able to spread the costs of assisting rural and urban distressed areas than are the city governments and rural authorities in which the lagging areas are located. Furthermore, they have more efficient taxing power, which can capture more completely the broader externalities of revitalising these areas.

As discussed in a previous section, national governments (and some state or provincial governments) offer and fund programmes that target distressed areas. Local governments, regional development agencies, and local partnerships apply for these programmes and help to administer them on behalf of their local areas. They have the advantage of understanding the local needs and key actors more than staff from a national programme, and local partnerships can contribute innovative strategies to the delivery of services. Furthermore, by partnering with local organisations, government can leverage public funds with private resources. In fact, the public sector has become more interested in enabling development rather than in providing development directly and in stimulating development rather than in regulating development.

- How can municipalities contribute to finance local development projects?

Within the most recent wave of economic development efforts, local governments are taking the role of a moderator, managing the intersecting areas of interest and exerting more leadership and control as they provide their resources on a conditional basis. Thus, they are not necessarily expected to fund the initiatives solely on their own. Rather, they must have sufficient capacity to follow through with the policies devolved and decentralised by the national government. A concern is that local governments may not have the expertise to carry out these responsibilities effectively, particularly those that have little experience in these matters. That is why training of and technical

assistance to staff is critical in ensuring the success of local economic development efforts.

Their contribution to that success lies with their ability to assess the needs of their local area, devise a strategy that effectively meets those needs, and demonstrate the management skills and professional expertise to administer the programmes effectively. While it can be argued that local governments should have a financial stake in the development programmes that are targeted within their jurisdiction, sufficient commitment can also be achieved by holding the local governments accountable for the outcomes of the projects. This requires that the outcomes of the efforts be agreed upon by all partners, both at the local level and with higher levels of government, and quantified and tracked.

- What are the pros and cons with delegating responsibility for local development to regional development agencies (RDAs) operating as private-public partnerships seeking to maximise the commercial value of projects?

In principle, there is nothing inconsistent with regional development agencies seeking to maximise profits on commercial ventures and promoting economic development efforts, as long as the profit motive is also mission-driven. In other words, an RDA must set out a mission statement that seeks to increase the wellbeing of all residents in their region. An example is the mission statement of Southwest of England RDA: to "increase sustainable prosperity and productivity for the region and for all our people". As previously stated, it seeks to achieve this mission by raising business productivity, increasing economic inclusion and improving regional communications and partnership.

Another way of expressing mission-driven profitability is the "double bottom line" criteria articulated by CDFIs. Community development banks, for example, are created to serve those residents and businesses that are not adequately served by conventional financial institutions. But in order to achieve this mission, the community development bank must be profitable. Without achieving profitability, the organisation could not be self-sustaining or continue to make loans to its targeted customer group.

However, if profitability and thus viability of the organisation becomes harder to achieve, the CDFI, or any commercially based organisation, may be tempted to compromise their mission and step across the line to act as a conventional for-profit bank. In this case, the CDFI ceases to carry out its social role of filling a niche abandoned by conventional banks. It no longer addresses a market failure and is competing directly with commercial banks, while it is being subsidised by government or the charitable non-profit sector.

To summarise the responses to the questions, local governments and partnerships in distressed areas face financial obstacles in trying to

rejuvenate their local economies and create better opportunities for their residents. However, the principle of fiscal federalism assigns responsibility for funding to higher levels of government and the assessment of needs, development and strategies and administration of programmes to those at the local level. The best way local governments can contribute to economic development is through their ability to respond to local needs and form viable networks of partners, both horizontally with local for-profit and not-for-profit entities and vertically and higher levels of government. Using market incentives to address market failures, such as mission-driven, profit-maximising community development financial institutions attempt to do, is consistent with sound policy of financing economic development.

Sound administration of these financial tools requires governments and partnerships to open up the incentives policy process to broader public participation and debate (Bartik, 2005). This is best done at the local level rather than at the federal or national level. At the local level, the effects of economic development policy could be improved with more information on incentive offers, a budget constraint on the volume of incentives, stronger standards for job quality, accessibility, social inclusion, and performance in incentives, and better cost-benefit analyses of incentives. Even indirect non-tax incentives, such as infrastructure investment and workforce investment, need to be scrutinised through cost-benefit analysis so that scarce public resources are allocated optimally. Reforming incentives in this way is better than incentive regulation or abolition. Government intervention through incentives is necessary when market failures arise, but the intervention must be seen as a way to correct for market failures, not exacerbate them. Sustainable economic development requires a well-functioning market economy, and economic development policy must be designed to enhance this process and nurture economic growth, and not to create additional impediments to its progress.

Notes

1. The author wishes to thank Linda Richer for research assistance, Tim Bartik for helpful comments, and Claire Black and Phyllis Molhoek for clerical assistance.

2. Two of the more vocal proponents of this view are Arthur Rolnick and Melvin Burstein of the Federal Reserve Bank of Minneapolis. Their views, and those of others on both sides of the argument, are found in a special issue of *The Region* entitled *The Economic War among the States,* published by the Federal Reserve Bank of Minneapolis in June 1996.

3. It is interesting to note that the funding formula for the interstate highway system is 70% federally funded versus 30% state and locally funded. Following the tenets set forth regarding externalities, this suggests that 70% of the benefits of the interstate highway system accrue outside the state. Considering that the

interstate highway system is a network that benefits everyone linked to it and that estimates show that on average roughly 50% of the traffic within a state originates in another state (depending on geographic size of the state), this funding formula approaches the distribution of externalities from the interstate highway system.

4. The federal government provides states and local governments with more than USD 20 billion annually to expand and improve their highway systems. States and local governments have a good deal of discretion in how these funds are to be used, and thus the funds should be considered as part of the economic development efforts of these jurisdictions.

5. A New Markets Venture Capital Company (NMVCC) is a privately managed, newly formed, for-profit investment company created for the purpose of providing equity-type capital and hands-on operational assistance to smaller businesses located in specific rural and urban areas. The benefit to a NMVCC is that the Small Business Administration will supplement the company's own capital through guarantees of debentures to be issued by the company in a face amount of up to 1.5 times its capital. The debentures will have a term of up to 10 years from the date of drawdown and be issued at a discount. Interest for 1-5 years is paid upfront in the form of the discount, interest only is payable for 6-10 years, and principal is due at the end of 10 years.

6. Estimates for the European countries derived from the Montreal Centre for Excellence in Brownfield Rehabilitation as reported in NRTEE (2003).

7. Other examples of brownfield redevelopments can be found in Tomerius and Ferber (2003).

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ISBN 92-64-01329-6
Local Governance and the Drivers of Growth
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Chapter 7

The Design and Implementation of Local Development Strategies: the Case of Central and Eastern Europe

by
Scott Abrams and Fergus Murphy

Local economic development is essentially about maximising the potential of a range of factors including location, physical infrastructure, human resources, capital and finance, knowledge and technology, industrial structure, quality of life, investment climate, institutional capacity and community. Designing and implementing a local economic development strategy can help cities and communities to enhance their prospects for economic growth and development in the global economy. This chapter examines the practices of strategic planning for local economic development and identifies obstacles that exist and ways to overcome them. Case studies from Central and Eastern Europe provide concrete insights into the organisation, management and execution of local economic development programmes.

Introduction

The most recent United Nations Economic Survey of Europe (United Nations, 2005) notes that the average rate of economic growth in South Eastern Europe is likely to slow down in 2005.[1] The protection of property rights, including law and contract enforcement, is generally weak, and public administration is widely perceived as being inefficient and lacking in transparency. That public institutions in most of these countries[2] are underdeveloped has a negative effect on the business-enabling environment. In the new Central European[3] member states of the European Union, labour markets continue to be weak with low employment and high unemployment rates. The region suffers from low labour productivity and employment generation, and the key challenge facing these new member states is to create conditions that encourage growth in employment.

Local practice in OECD countries shows that improvements in national and local investment climates have enabled private sector development to occur and job creation to take place. At the sub-national level, OECD regions and cities are increasingly responding to the need to enhance their competitiveness by developing local economic development strategies, or undertaking strategic planning efforts with a strong economic component.

As a policy response that seeks to bring about the right conditions for jobs to be created and for businesses to grow, local economic development (LED) is essentially about maximising the potential of a range of factors including location, physical infrastructure, human resources, capital and finance, knowledge and technology, industrial structure, quality of life, investment climate, institutional capacity and community (Wong, 2002). Designing and implementing an LED strategy can help cities and communities enhance their prospects for economic growth and development in the global economy. LED strategies administered and implemented at the local level can increase the potential of employers to generate jobs (World Bank, 2000a).

In examining the design and implementation of strategies for LED in Central, East and South Eastern Europe, this chapter explore the concept of LED and will examine how LED strategic planning is being applied to encourage private sector development and employment in transition economies. Drawing on World Bank and Open Society Institute experience of capacity building to develop and implement LED strategies based on good practice from OECD countries, the chapter will identify how designing and

implementing an LED strategy can lead to increases in local economic competitiveness, improve the co-ordination of local-level efforts to raise output and productivity, strengthen municipal capacity, improve livelihoods, enable the creation of employment opportunities and alleviate poverty.

Local economic development: a perspective

Numerous definitions exist as to the scope and meaning of economic development in the local context. Economists generally define economic development as the process of creating wealth in a nation, state or local economy. In the strategic overarching sense, LED is widely viewed as a "catch-all" term (Moore and Pierre, 1988). Local economic policy should, however, seek to address economic problems within areas ranging from the municipality to the sub-region (Eisenschitz and Gough, 1993), and LED should focus on activities and strategies to increase productivity through investments in physical infrastructure and human capital.[4]

One of the key points raised consistently by mayors and municipal officials in Central, East and South Eastern Europe in response to industrial restructuring and informal economy activities is the issue of employment generation and private sector development. Since the fall of the Berlin Wall, entrepreneurship, business development and the generation of employment have become major concerns of municipalities wishing to foster local economic growth.

While the precise meaning of LED is varied and open to interpretation, a widely shared framework has emerged as to the general tenets of local economic policy and practice. Based upon OECD good practice and the report "LED Good Practice from the European Union and Beyond" (World Bank, 2000b), the primary objective of LED is to build up the economic capacity of a local area to improve its economic future and the quality of life for all. It is a process by which public, business and non-governmental sector partners work collectively to create better conditions for economic growth and employment generation (World Bank, 2004).

Open Society Institute and World Bank LED programmes in Central, East and South Eastern Europe seek to build the capacity of local governments to improve local economies and create employment opportunities. Reflecting the unique circumstances and historical legacy that has shaped the development of the region, these programmes advocate that local governments use a sequential five-stage strategic planning process. The overarching aim of both organisational approaches to LED is to strengthen the capacity of municipalities to conduct LED strategic planning and develop appropriate action plans, to enable the exchange of LED best practice among municipalities to provide access to international expertise and knowledge, and to facilitate the dissemination of results.

Why local economic development? A regional perspective

There is an increasing acceptance by communities throughout Central, East and South Eastern Europe the need to improve economic growth and performance through locally co-ordinated, integrated and multi-sectoral strategic economic development planning. This recognition comes as a reflection of the fundamental political shift that has occurred in the region since the break-up of the Soviet Union, the gradual transition to a market-based economy and the realisation by central and local governments alike of the need to create conditions conducive to private sector development.

In creating the right conditions to foster a positive local business-enabling environment, municipalities and communities are increasingly pursuing a strategy-based approach to LED, one that is guided by a number of principles. The role and importance of public-private partnerships with vertical linkages to other tiers of government is increasing; the *local* business-enabling environment matters to private sector development and national competitiveness; and the capacity and action of local actors is important if municipalities are to improve the local investment climate. Governance, at both national and local levels, is a growing factor in determining and improving the local investment climate. Local institutions need to be effective, responsive, accountable and resourced if they are to *act* in the best interests of local development.

The political and economic transition that communities in the region have experienced since 1989 has resulted in a broad range of challenges that have hindered and impacted on the region's capacity for development. With a lack of experience in city strategic planning, undefined regulations on property rights and ownership,[5] nonexistent or poor-quality cadastral mapping, and a lack of practical experience in devising strategies for economic development, municipalities have had little historical experience in undertaking local development activities. Many therefore have limited capacity for identifying their local competitive and comparative advantages and working in partnership with businesses and communities. Similarly, systems of municipal management, municipal finance, strategy planning and business development are relatively new to many parts of the region.

A significant problem affecting cities and labour markets, and one that governments and municipalities are struggling to overcome, is the mismatch between geography and labour market skills. While job markets in eastern European capitals are generally buoyant, unemployment rates of up to 30% and higher are common in secondary cities, declining industrial regions and rural areas. The reasons for these differences in employment and unemployment are many. They have often been linked to hard-to-change or long-term development factors, such as proximity to Western borders or large

cities, the educational level of the population, diversification, urbanisation, quality of infrastructure, entrepreneurial tradition, and historical and cultural background (Keune, 1998).

With labour mobility limited through an historical lack of geographic movement, in part as a result of poor transport links but also as a result of poorly functioning housing markets, unemployment and underemployment remain entrenched in many regions through a lack of appropriate skills and opportunities. Cities and municipalities are increasingly cognisant therefore of the need to create a positive local business-enabling environment and a skilled workforce to facilitate private sector development.

The prolonged conflict in the countries of the former Yugoslavia throughout the 1990s and the transformation of the command economy into a market-oriented economy have caused these countries to suffer from high rates of unemployment, low rates of business start-up, a large and thriving informal economy, and aged and antiquated manufacturing operations. Despite various efforts by reform-minded governments, donors and international institutions, unemployment remains high. With levels reaching 50% in Bosnia and Kosovo and 30% in Macedonia and Serbia, and with few opportunities to work in the formal private sector, many of the unemployed are forced to resort to informal economic activities (Daskalovski, 2004).

High levels of informal sector activity considerably undermine the ability of national and local governments to enforce the rule of law in matters such as tax collection or utilities payments. This in turn limits their capacity to encourage private sector growth and employment. The growth of the informal economy leads to a reduction in revenues to local and national governments that in turn reduces the provision of public goods and services. This can lead to an increase in the tax rates for businesses and individuals in the formal sector, and is often combined with deterioration in the quality of public infrastructure and administration. The result can be a stronger incentive to participate in the informal economy (Belev, 2003). The need to create employment opportunities in the formal sector is therefore a key priority for governments wishing to encourage economic growth and foster private sector development.

As Table 7.1 shows, total employment growth between 1992 and 2001 in the Baltic States and Eastern Europe was almost nonexistent. Joblessness and youth unemployment remain significant problems.

Even though the trend in the region has been towards the decentralisation of governmental activities, which increases the responsibility of municipal governments to retain and attract private industry, it is important to point out that most municipalities still have limited autonomy to raise local finance. Combined with a general lack of experience of municipal

Table 7.1. **Total employment growth (%): Baltic States and Eastern Europe**

Region	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Baltic States	–4.64	–5.85	–6.75	–3.23	–2.87	1.52	–0.85	–1.66	–2.98	–2.98
Eastern Europe	–1.23	–5.74	–3.37	–0.59	–0.65	3.74	1.16	–1.79	–1.5	–0.61

Source: United Nations Economic Commission for Europe Statistical Division.

and private sector interaction, with municipal government and businesses having limited understanding of each other's activities and functions, this lack of finance and experience often impedes a municipality's capacity to implement and pursue LED initiatives.

The role of integrated local development strategic planning

As Helmsing (2001) suggests, LED is essentially about defining and embedding new roles for government in the local economic context. Both national and local governments need to ensure that the right mix of local public goods exist, and they need to put in place systems to facilitate communities, the private sector, workers and others to make a productive contribution to economic growth.

By actively reviewing its economic base, a municipality or community can develop an understanding of the opportunities for, and obstacles to, growth and investment. Communities wanting to expand their economic and employment base can devise and implement strategic programmes and projects to remove obstacles to development and facilitate investment.

A local economic development strategy should therefore be directed to correcting sources of *market failure* in the local economy such as factors that impede the efficient workings of land and property markets, as well as sources of *government failure,* such as inappropriate regulations or official behaviours that create excessive transaction costs and risks for local investors.

At the international level, globalisation increases both opportunities and competition for local investment. It offers opportunities for local enterprises to develop new markets but also presents challenges from non-local competitors entering local markets. Today, industries and businesses increasingly require a skilled and educated workforce and a supporting business infrastructure conducive to private sector development. As local conditions determine the relative advantage of an area and its ability to attract and retain investment, communities, including small towns and their surrounding rural regions, can develop local economic opportunities at a national or international level by building on their local economic strengths.

Macroeconomic, fiscal and monetary reforms at the national level directly impact the functioning of the economy at the local level. National regulatory and legal frameworks such as tax reform, deregulation, governance, decentralisation and environmental standards influence the local business climate, either enhancing or reducing the potential for LED.

At the municipal level, businesses both large and small often choose to locate or develop in an area because of agglomeration economies – that is, the benefits derived from sharing markets, infrastructure, labour pools and information with other firms. The economic advantage of an area therefore depends on the quality of governance and management, and on the policies affecting the availability, or lack, of business infrastructure such as electricity, transport, telecommunications, sanitation and developable land. Factors affecting worker productivity in the local economy can include the availability and quality of housing, health and education services, skills, security, training opportunities and public transport.[6] These *hard* and *soft* infrastructure factors are major determinants of a community's relative advantage, and the quality and provision of hard and soft infrastructure forms the cornerstone of a successful local economy. The vast majority of businesses in a municipality are, after all, small and local, and reliant on the effective functioning of the municipality.

While unco-ordinated and disparate institutional frameworks for LED will often serve to undermine area-wide economic growth, municipal LED departments, agencies and networks can be developed to address such constraints. These institutional frameworks, which can serve to represent the interests of different municipalities and partner agencies in the same geographic area, can bring significant economic benefits. Such approaches can also serve to strengthen municipal and community representation in higher levels of decision making.

The most important and effective LED activity that a municipality can undertake is to improve the regulatory processes and procedures to which businesses are subjected. A survey of most municipalities in Central, East and South Eastern Europe would reveal examples of complex, poorly managed, burdensome and unnecessary business registration systems. By reducing these, a municipality can quickly improve its local investment climate.

In many countries in the region, economic growth is determined not only by the formal economy but also by the informal economy; in some cases, the size of the latter is greater than that of the former. Recognising that the informal economy interacts with the formal economy by supplying certain goods and services is imperative to LED strategy development, and the linkages between the formal and informal sectors of the economy need to be understood and considered in the devising of a local economic development strategy.

In many communities, large numbers of low-income families work within the informal economy. However, these informal activities are often low-growth activities as a result of a lack of access to proper infrastructure and services, regular means of financing, information and skills. The development of an integrated and informed LED strategy should serve to recognise and accommodate the constraints and opportunities of the informal economy so as to broaden the strategy's appeal.

Good practice indicates that local economic development should always be guided by a strategy. Ideally, an LED strategy will form a component of a broader strategic development plan that includes social and environmental components. The LED strategy provides a focus for strengthening the local economy and building local capacity. The timeframe for an LED strategy is typically three to eight years and should include annual implementation plans. The logical sequence of these stages is described below.

The strategic planning process

A local development strategic planning process typically has five stages. While these are highlighted below as separate stages, LED strategic planning is in reality a flexible process, with one stage often continuing in parallel with another according to local needs. If problems are encountered during a particular stage, it may not be as a result of work in that stage but the appropriateness of a previous stage. Previous and subsequent stages may need to be refined or reworked to resolve problems. The strategy is a living document that should be changed as circumstances dictate.

Organising the effort

To successfully organise an LED strategy, institutional arrangements and stakeholder involvement need to be agreed at an early stage of the planning process. An LED team should be established within the municipality, and this

Box 7.1. **The five-stage sequence of the LED strategic planning process**

Stage 1: Organising the effort
Stage 2: Local economy assessment
Stage 3: Strategy making
Stage 4: Strategy implementation
Stage 5: Strategy review

Source: World Bank, 2004.

team should initially manage the process. Undoubtedly, successful LED requires the collaborative effort of public, private and non-governmental sectors. The strategic planning process should begin by identifying the people, institutions, businesses and other groups that comprise and impact the local economy. The skills, experiences and resources that stakeholder groups bring to the effort will each contribute to the overall strategic planning process.

Establishing solid working relationships and organisational structures to support the process will lead to beneficial long-term, public, private and non-governmental partnerships. These working relationships often range from relatively informal working groups to semi-formal, loosely aligned networks, to the establishment of a regional development agency or a constituted public-private partnership. Maintaining and sustaining such partnerships is often a critical and challenging factor determining the effectiveness of LED efforts.

Local economy assessment

LED strategic planning is based on an assessment of the economic characteristics of a local area and its position in the national, regional and even global economy. The assessment helps to identify past – and forecast future – driving forces in the national, regional and local economy and their potential for, and impact on, local economic development. It can provide an understanding of the external trends and events that impact the local economy, the economic relationships of neighbouring communities, future trends and issues for LED strategy development, and the appropriate policy responses that will build LED opportunities. Above all, the local economy assessment enables a community to determine critical issues affecting the local economy and identify appropriate LED objectives and projects as well as key partners, agencies and stakeholders.

Strategy making

As in comprehensive strategic planning, the intent is to achieve an *integrated* approach to LED strategic planning. In devising a strategy, practitioners in municipal governments and principal stakeholder groups are encouraged to balance economic with environmental and social needs. A typical LED strategy has a number of components, shown in Box 7.3

Vision

A vision should be a description of the stakeholders' preferred economic future for the community, *i.e.* where the city, town or community wishes to be in the future. A vision will usually cover a period of three, five, or eight years, and while a vision may not be fully achievable, it should provide the community with a clear sense of direction. A vision should both draw on and

Box 7.2. **Organising the effort case study: City of Rezekne strategy for local economic development, 2004-2010, Latvia** *

The city of Rezekne is centrally situated in the rural Latvian region of Latgalia close to the region's ports and main cities, and lies within the main Warsaw-Riga-Moscow motorway corridor. During the 1980s and 1990s, the majority of Rezekne's factories operated in traditional industries and these experienced increasing competition from international competitors. Throughout the 1990s a number of Rezekne's major companies were forced to close, resulting in soaring unemployment and growing social problems. During this time, Rezekne faced a number of serious challenges:

- The collapse of traditional industries and markets, particularly those industries that produced for the large Soviet Union market.
- Social integration of a multinational community.
- Redevelopment of a poor technical infrastructure.
- The strengthening of local government institutions responsible for the local community.

During this period, city representatives sought to establish international contacts to share experience with other cities that had faced similar problems. In 1999, Rezekne joined the Cities of Change programme initiated by the World Bank and the Bertelsmann Foundation. Rezekne, together with a number of other cities, participated in the Economic Development Cluster. A primary aim of the cluster was to develop an LED strategy to strengthen LED institutional capacity within the city. The programme methodology was based on a five-stage approach to LED strategic planning.

Towards the end of 2000, the Rezekne City Council adopted appropriate institutional structures to develop its LED strategy. A cross-departmental working group was established to support the strategy output process, comprised of municipal members and local experts. The Latgale Entrepreneurship Supporting Centre became a partner. Work on Rezekne's local economy assessment commenced in February 2001, and in July 2001 a draft LED strategy was confirmed and conveyed for public discussion and comment to the residents of Rezekne, state bodies and to municipal institutions. The council approved the final strategy document in December 2001. With a strategy document covering the period 2004-2010, the city aims to implement a new approach to LED strategic planning and initiate new collaborative activities between the municipality, entrepreneurs and residents. A system of annual reporting has been implemented and a new Department for Economic Strategic Planning was approved. The tasks of the new department include:

- Co-ordination of other departments in dealing with LED strategy implementation.

Box 7.2. **Organising the effort case study: City of Rezekne strategy for local economic development, 2004-2010, Latvia** *
(cont.)

- Collection of all applications concerning strategy implementation projects.
- Balancing of financial and implementation requirements.
- Administering the database concerning the city itself and the strategy-related projects.
- Cooperation with entrepreneurs, organizations and residents in implementing the strategy

The Economic Development Department transitioned into an independent economic development agency: the Rezekne Business Centre. The Centre has already started providing services to the business community and is preparing applications for development projects. Three LED teams were established in developing the strategy, and in 2001 the Mayor established an internal LED Working Group with representatives from various municipal departments including the urban planning department, the economic department, the city marketing unit, the finance department, the social services department and city utilities. An LED Steering Committee was also established to discuss, oversee and approve the draft LED strategy document. The Steering Committee consisted of politicians and technical professionals, including the Mayor of Rezekne; two members of Rezekne City Council; the director of the Economic Department; the head of the Economic Department at Rezekne University; the head of the cross-departmental working group; and a representative of the Rezekne Special Economic Zone. A Stakeholders Group was identified and invited to participate in the strategy development process. The Stakeholders Group consisted of:

- City council leaders and members.
- County administration representatives.
- Representatives of local utility companies and Rezekne University.
- Key private sector companies.
- Non-governmental organisations.
- Local media representatives.

* Full strategy available to download at the World Bank's LED Web site Case Studies section: *www.worldbank.org/urban/led/casestudies.html*.

reflect key issues highlighted in the local economy assessment. It is on the basis of the vision that LED goals, objectives, programmes and project action plans will be developed. Clearly, competing interests come to the fore in

Box 7.3. **"Vision to Projects" – The 5 steps of LED strategy making**

Vision	Describes the stakeholders' consensus on the preferred economic future of the community.
Goals	Specify desired outcomes of the economic planning process, based on the overall vision.
Objectives	Establish the performance standards and target activities for the development of each goal. They are time-bound and measurable.
Programmes	Set out approaches to achieving realistic economic development goals. They are time-bound and measurable.
Projects and action plans	Implement specific programme components. They must be prioritised, and costs must be established. They are time-bound and measurable.

defining the vision; municipalities are encouraged to find visions that are realistic and achievable.

Goals

Goals point to the specific outcomes that a community seeks to achieve, and are much more descriptive and concrete than a vision. They should be directly related to the findings of the local economy assessment. Experience of advising municipalities in the region indicates that in selecting goals, a manageable number is usually no more than six.[7]

Objectives

Objectives are more specific than goals and should be time-bound and measurable. Their aim is to take advantage of strengths, overcome weaknesses, exploit opportunities and deal with threats identified in the local economy assessment. A widely accepted way to formulate objectives is to check whether they are specific, measurable, attainable, realistic and time-bound.

A community will need to decide upon the key programmes that will become the core of its strategy. Many options are in use by communities today, and the programme options listed below are typical core choices. The programmes discussed here cover practically all possible LED interventions, and as communities become more sophisticated, so will the programmes and projects they develop.

Programmes

Having completed a local economy assessment and identified an LED vision, goals and objectives, a community must decide on the key

programmes that will become the core of its LED strategy. Municipal programme and project selection must be realistic in scope and framed by needs and resources. While many municipalities in the region still understandably focus their efforts on the provision of roads, buildings and industrial units, a core component of the technical assistance offered by the World Bank and the Open Society Institute is to highlight the role of hard *and* soft infrastructure provision, and their contribution to a balanced set of LED outputs.

Where basic infrastructure is limited, programmes that assist the municipal government to put in place infrastructure cost-recovery schemes and private infrastructure provision are a good starting point.

Programmes that focus on attracting foreign direct investment should be considered at length and pursued with caution. Good practice shows that much of the effort and investment expended on attracting foreign direct investment is wasted unless it is thoroughly researched and focused. Numerous examples exist of inward investment projects that have collapsed locally as a result of changes in national and international economic and financial markets.

In selecting LED programmes, communities have a range of both problems and opportunities to tackle. Selectivity and focus, though hard to achieve, are a priority. One of the most effective ways of facilitating job creation is to develop LED programmes that improve the local business-enabling environment and support the development of micro, small and medium-sized businesses. Thereafter, programme selection will be dependent upon the results of the local economy assessment. Communities that have suffered from the closure of a major traditional industry will need to consider the appropriateness of developing a regeneration programme based on the affected industry or a particularly affected district of the town or city.

Another good practice is that programmes should be undertaken where clear champions are committed to ensuring that programme delivery occurs. Project champions may come from local government, the private sector, the community or other sectors including research or educational institutions.

In advising municipalities in Central, East and South Eastern Europe to consider a balanced set of LED programme options, the World Bank has identified ten programme options that it recommends to the communities it works with. These are listed in Box 7.4.

Given the lack of adequate roads, water and sanitation, schools, housing and other physical facilities that is a feature of many communities in the region, the local economy assessment often highlights physical infrastructure as being a major local economy weakness. Municipalities therefore have a tendency to select hard physical infrastructure programmes above softer

Box 7.4. **Local development programme options**

- Improving the local business investment climate.
- Investing in hard strategic infrastructure.
- Investing in sites and premises for business.
- Investing in soft infrastructure.
- Encouraging local business growth.
- Encouraging new enterprise.
- Promoting inward investment.
- Sector (and business cluster) development.
- Area targeting/regeneration strategies.
- Integrating low income or hard-to-employ workers.

Source: World Bank (2004), "Local Economic Development: A Primer – Developing and Implementing Local Economic Development Strategies and Action Plans", October, Washington, DC.

programmes that can contribute to educational and entrepreneurial programmes and achieve multiple development objectives. For example, to promote linkages and co-operation between different ethnic, national and community groups, the "Society Integration Programme" – devised as part of the city of Rezekne, Latvia, LED strategy – includes projects that seek to establish a cultural centre for national minorities. The programme holds an annual festival of national minorities in the city.

Projects

Determining which projects to undertake will depend on the critical issues, goals and objectives that the LED strategy making process has identified. Some projects will be complex and be implemented over a longer period of time; others will not. Box 7.5 lists some common LED projects.

Strategy implementation

For the purpose of implementation, action plans should be developed for each project so as to provide specific details on project components including a hierarchy of tasks, responsible parties, a realistic delivery timetable, human resource and financial needs, funding sources, expected impacts, results, performance measures and systems for evaluating progress for each project.[8] This can ensure that projects have ownership by named individuals that are responsible for ensuring that timetables are maintained and agreed outputs delivered.

Box 7.5. **Common local development projects**

Business advisory and assistance centre.

Business incubator.

Development of a cluster business group.

Regeneration of old factory buildings or abandoned sites.

Urban upgrading or renovation scheme.

Public-private partnership for the development of city-owned property.

Extension of a road or the provision of utilities to new industrial sites.

Improvement of a vital service (wastewater treatment, or public transit).

Training programmes for new job skills acquisition.

Job-to-work apprenticeships.

Development of directories and databases on land, services and business geared towards investors.

New business network or forum.

New tender process for city.

Development of incentive guidelines for attracting business, and for expanding or starting up businesses.

Revision or review of business permits, fees, taxes and regulations.

The development of "one-stop shop" for businesses in city hall.

Development of academic curricula geared to employment opportunities and business needs.

Source: World Bank (2004), "Local Economic Development: A Primer – Developing and Implementing Local Economic Development Strategies and Action Plans", October, Washington, DC.

Projects that can be implemented in the short term and that result in "early wins" play an important role in building momentum and stakeholder confidence. In each case, projects should be "championed" by individuals or a group of stakeholders according to interests, resources, commitment and expertise.

Strategy review

Developing a good monitoring and evaluation system for an integrated local development strategy is important and allows for analysis and review. It should enable the local development team to correctly assess outcomes, justify expenditures, determine necessary enhancements and adjustments,

and develop good practices. Indicators[9] can be identified to measure both process and impact.

Results of strategic planning exercises

As might be expected with any locally driven process, strategy documents vary significantly in scope, content and direction. Most, however, focus on improving the quality of the physical infrastructure, facilitating economic development by growing local businesses and learning new planning and delivery skills. The focus around the broader municipal framework should be balanced by a strong local dimension in most of the strategy documents, reflecting sectoral strengths and weaknesses and local economy opportunities and issues. Examples include:

- Transport infrastructure within and between the local area.
- Upgrading the skills of the unemployed and the working population.
- Transport infrastructure and access.
- Promoting programmes for excluded and underserved communities.
- Priority of tackling derelict and contaminated land.
- Proximity and distance to key markets.
- Sectoral growth and development.

Some lessons can be learned from strategic planning exercises. Box 7.7 and Box 7.8 outline some of the main ones.

Developing local development strategies in Central, East and South Eastern Europe

Planning for local economic development is a relatively new responsibility and competency of municipalities in the Central, East and South Eastern Europe transition region. Although in recent years strategic planning for LED has become a more common practice in the region, it remains an underutilised mechanism for economic advancement for a variety of reasons.

Strategic planning in transition economies

Strategic planning for local economic development in the transition region took place solely at the central level for much of the 20th century. After the collapse of the old regime and the initiation of the decentralisation process – which remains ongoing in many countries – the concept of enacting a planning process for local economic development was introduced, primarily by international donor organisations.

More than a decade on, and despite some encouraging success stories, the impact of those efforts is still arguably marginal. This can be attributed

Box 7.6. **Entrepreneurship and SME development strategy in Zenica municipality, Bosnia and Herzegovina (BiH), 2003-2008**[1]

During the preparation of the Zenica LED strategy, the Municipality of Zenica in co-operation with South-East Europe Enterprise Development (SEED)[2] and the World Bank, adopted and modified the principles, experiences and best practices of the World Bank LED strategic planning programme. An organisational framework was established so as to engage key stakeholders in the economy and municipal administration to help significantly change the way that the economy of Zenica was managed and planned. During these discussions, four key strategic goals were identified as being of importance to Zenica's future development. These include:

- Developing the local economy through entrepreneurship and SME development.
- Developing the physical and business infrastructure as a base for development of economic activities.
- Human resource development in accordance with the needs of a new economic structure.
- Restructuring of agricultural and entrepreneurial development in rural areas.
- Based on the local economy assessment and analysis of statistical data, business surveys, interviews with entrepreneurs, working groups and stakeholder forums, and a review of national and international experiences of other municipalities in LED, an assessment of the four goals was undertaken. A range of projects was selected that includes:
- Simplifying registration procedures for new companies.
- Introducing support schemes for dynamic SMEs (consulting, preparations of business plans for banks, consulting for internationalisation of activities).
- Supporting projects for quality development and standards in SMEs.
- Facilitating and encouraging industry networks and clusters.
- Organising meetings and the exchange of experiences and co-operation with SMEs from neighbouring countries.
- Supporting the "internationalisation" of SMEs to participate at exhibitions and conferences.

1. The full Municipality of Zenica SME Strategy is available to view at the World Bank LED website: *www.worldbank.org/urban/led/*.
2. Southeast Europe Enterprise Development (SEED) is a five-year, USD 25 million initiative managed by the International Finance Corporation to strengthen small and medium enterprises in Albania, Bosnia and Herzegovina, FYR Macedonia and Serbia and Montenegro: *www2.ifc.org/seed/*.

Source: World Bank (2004), "Local Economic Development: A Primer – Developing and Implementing Local Economic Development Strategies and Action Plans", October, Washington, DC.

Box 7.7. **Good practice for strategy success**

- An **integrated** approach that includes social, environmental and physical issues as well as economic ones.
- A carefully developed strategy built by all relevant **partners** and based on a **shared vision**.
- Reference to the **informal economy**: the **informal economy** needs to be carefully taken into account. In some localities, it can represent a significant part of the local economy, be strongly interlinked with formal activities and provide the economic basis for the majority of the local population.
- A **range of projects**: short, medium and long term, to catalyse partnerships and build stakeholder confidence.
- **Influential** and **effective local leaders** that bring commitment, credibility and an ability to unite stakeholders. **Capacity building** of management and "on the ground" teams is essential to project implementation.
- The LED strategy should be owned by the municipal government, and there should be a demonstrated **political will** to implement it.
- Political, financial and technical support from **other levels of government** that add value.
- Projects and action plans should be undertaken only where a responsible manager or champion has been identified who is **committed** to successful implementation.

Source: World Bank (2004), "Local Economic Development: A Primer – Developing and Implementing Local Economic Development Strategies and Action Plans", October, Washington, DC.

to many factors, including inadequate degrees of political and fiscal decentralisation in most of the countries, weak political leadership behind the efforts, inappropriate donor interventions and sub-optimal planning methodologies. What is conclusive, however, is that through trial and error a raft of lessons have been learned and best practices identified that should ensure that future undertakings will have an increased likelihood of success. Many of these are highlighted in the Conclusions section.

Locally produced strategies

Since successful planning encompasses a thorough assessment of the current situation of a municipality, a discussion of alternative policies and practices, and an evaluation of projected outcomes and implications, it is vital

that a broad spectrum of local stakeholders be intimately involved in the planning stages. Not only does this ensure local realities are understood and considered, but it guarantees a maximum degree of local ownership for the plan that is ultimately developed.

In the early years of the transition process it was not uncommon for donor organisations to support international consultants who would spend a number of months in a municipality conducting interviews and then drafting a strategic plan. It was correctly recognised that local capacity to organise a strategic planning process was limited and thus external intervention was required. Today we know that consultant-drafted plans are highly efficient dust collectors. It is, after all, hard to imagine a strategy of any kind being properly implemented if those directly affected did not play a major role in its formulation.

Stakeholder groups

The more common practice today is to build the capacity of local stakeholders to construct their own strategic plans, and then to support the process with expert assistance. Once a municipality has organised its planning commissions and an implementing agency has been hired and fully trained, the process usually takes between nine and 18 months. Organising and maintaining the involvement of the key stakeholder groups is as essential as it can be challenging. Most commonly, stakeholder groups consist of: 1) the municipal government; 2) the private sector;[10] 3) community groups,[11] and 4) non-governmental organisations (NGOs) and other public sector institutions.

Each of the above groups undertakes an indispensable and mutually supportive role in the elaboration of the LED strategy. The local government should be the driving force behind the initiative since it establishes the legal and regulatory environment for economic growth and is best positioned to mobilise human and financial resources.

The private sector has first-hand knowledge about the obstacles that impede economic growth. Business representatives also bring capital and entrepreneurial resources to the table, which can be harnessed for a variety of partnership initiatives to spur development. Community groups can be instrumental in, among other things, assuring social concerns are adequately addressed and that transparency and accountability are increased. Finally, the community must have a say in the process as well, since the plan's ultimate beneficiaries are the citizens of the given municipality. The public's opinion can be incorporated via open hearings, feedback from the publication of the draft plans and/or direct participation at any of the numerous planning sessions that take place as the strategy is elaborated.

Aside from the partnerships established for the planning phase of economic development, and equally important, are the partnerships

constructed for the implementation phase of the process. In the transition region the private sector has often maintained a great deal of distrust for municipal governments. And municipal governments are frequently perceived by the private sector to be uninterested in their affairs. This wall of distrust and disconnect can be mitigated as the two groups work together over the course of a year or so to define a strategic plan. And if mutual trust is built throughout the process, the partnership opportunities are plentiful once it comes to acting on the plans. Creative funding mechanisms between the municipality and local banks or local businesses, such as the development of a business improvement district or capital investment projects with a "build-own-operate" or "build-own-transfer" arrangement are but a few examples.

The roles and responsibilities of the various stakeholders should be clearly elaborated and agreed upon at the outset of the planning process. The municipal council, for instance, should formally adopt terms of reference that delineate how the mayor will lead the effort, how the council will support the process, how often the planning commissions will meet and which departments will be responsible for what areas. The private and community sector groups can also establish a formal work and participation structure that complements the efforts of the local government.

Capacity building and technical assistance

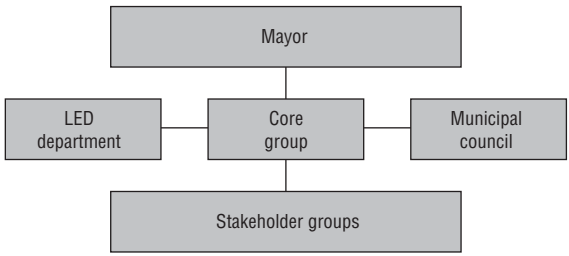
It is usually necessary to create a core group of stakeholders, usually four to six individuals, to lead the strategic planning effort in each municipality (with support from the broader stakeholder groups). This core group, which should include representatives of the local government and private and community sectors, should be incrementally trained to: develop LED institutions; undertake a municipal local economy assessment (SWOT analysis); develop a vision and a set of goals, objectives, programmes and projects for their municipality; and prioritise, implement, monitor and evaluate projects that are likely to improve the local economy.

Receiving training in the above-listed concepts is one thing; going back to ones' municipality and leading the LED effort is another. Many of the concepts related to strategic planning, and LED in particular, are new for leaders in the transition region. It is thus vital that experts facilitate the entire LED strategic planning process. An operational case study will be presented later in this chapter to highlight how the training and technical support have been organised in Kosovo and Albania.

Local economy assessment (SWOT analysis)

In order for a municipality to design appropriate policies and projects to improve the local economy, the stakeholder groups must be fully informed

Figure 7.1. **Sample organisational chart of the LED operational structure as described above**



about their own city, and how it relates to the regional and national economies. A SWOT analysis (Strengths, Weaknesses, Opportunities and Threats) is a common tool for analysing municipal characteristics and data.[12] The items listed in the SWOT analysis should be fact-based, specific and prioritised. It has often proved useful for a city to develop multiple analysis for different sectors (such as the business community, local infrastructure, education and health, and so on) and then to eventually integrate them into one meta SWOT analysis chart that all stakeholders can use as a platform to further elaborate the municipal strategy. The final strategy should build on the identified strengths and opportunities while mitigating the weaknesses and threats.

Local business-enabling environment survey[13]

Extensive surveying of the business community should be carried out by the implementing agency, which as a neutral actor is well positioned to do so. The results should identify the barriers that exist to business growth, retention and attraction in the municipality and should be presented to the entire LED planning commission, including the mayor and city council. The findings can be integrated into the SWOT analysis and eventually specific projects can be designed to address the identified barriers to business development.

Study tours

It is a worthwhile investment for the core planning group to undertake a study tour of an economically more advanced transitional country. Participants have the opportunity to see successful and unsuccessful LED practices and instruments that have been applied by cities abroad. A range of different-sized cities can be visited, and those that developed and implemented LED strategic plans are particularly useful to consult. Experience has shown that many of the project ideas that are eventually included in the LED strategies are generated from the on-site visits during the study tours.

"Vision to Projects" matrix

Annex 7.A3 provides an example of an almost-finalised matrix developed by the city of Shkodra, Albania with technical assistance from the World Bank and the Open Society Institute. Stakeholder participation was extraordinarily high in working out the matrix, which features a clear vision, a limited set of goals (five), quantifiable objectives (some of the x and y indicators still need to be finalised), and an appreciable mix of soft and hard infrastructure projects. Currently, the stakeholder planning commissions are working on completing the matrix and prioritising the projects based on a methodology designed by a Peace Corps Volunteer working in Shkodra.[14]

Benefits of strategic planning

Strategic planning can be a lengthy, arduous exercise irrespective of the specific type of planning being undertaken. Stakeholder groups must be assembled and convened on a regular basis. Data must be collected, processed and analysed. A feasible vision must be elaborated and realistic goals, objectives, programmes and projects must be identified that will facilitate the attainment of that vision. Priorities must be agreed upon, action plans must be constructed, partnerships need to be enacted and resources must be harnessed. Accomplishing all of the above is a challenge for any community. For economically marginalised cities in Central, East and South Eastern Europe that often have little tradition of public participation and public-private co-operation, the challenge is greater still.

The above considered, it is becoming increasingly apparent to local leaders in the region that the benefits of strategic planning far outweigh the hardships involved. LED strategic planning offers a city considerable direct and indirect rewards. To begin with, once the planning commissions finalise their strategy they have at their disposal a prioritised plan of action for economic progress. The days of ad hoc decision making ("strategic planning on a five-minute basis") are over. In principle, once a strategy has been approved by the municipal council, everyone knows what needs to be done, who needs to do what, how to do it, and in what order. Having all this in mind greatly reduces the time needed for debating projects that may or may not have been well thought out and well connected to the overall improvement of living conditions. Rather, if done properly, each project action plan should serve as a mini-blueprint that articulates how each project will be implemented and how it ties into the broader goals of the community's economic development.

Another crucial benefit is the partnerships that are created and formalised during the planning process, and particularly the bridge between the public and private sectors. As discussed, once the barriers of mistrust are lowered or removed, the two groups, by harnessing their complementary

strengths, can work together to develop and finance creative projects included in the municipal strategy, such as a business improvement district, a business incubator, training facilities and courses, and infrastructure needs.

A well-formulated strategic plan that is developed in close co-operation with large stakeholder groups should increase municipal access to national and international funds and credit. This is true for many reasons. Those capable and interested in providing funds and credit naturally feel more comfortable investing in projects that have been thoroughly analysed, that have been prioritised by a broad segment of the municipality, and that demonstrably feed into a broader but well-defined plan to increase the economic conditions in the municipality. Credit is viewed as more secure when it is requested on behalf of the community rather than a small group of governmental officials. One reason is that governmental successors would have a harder time arguing that the municipal debt is a result of a former mayor's favoured projects that did not benefit the citizens.

Strategic planning is also good politics. Local business owners and the general population undoubtedly appreciate a concerted effort to forge community partnerships to improve the business-enabling environment, spur increased economic activity and better ensure the retention of existing enterprises. Local governments can advertise their efforts to the community, which in turn should raise hopes and accountability for the project. Groups with special needs (*e.g.* minorities, the disabled, the elderly) can and should be invited into the process. Best practice has all interested citizens providing extensive feedback to the planning commissions during the strategy's development. A good opportunity exists to bring down numerous walls of opacity that are still far too common in Central, East and South Eastern Europe.

Lastly, the increased awareness of the strategic planning process among municipal officials, private sector leaders and representatives from civil society organisations is a highly useful and fungible skill. Strategic planning is a generic term that can be applied to anything from managing an enterprise to managing a major urban centre. Feedback from regional LED planning work has unsurprisingly confirmed that the skills obtained during the training and technical assistance programme have been applied to scores of other tasks as well.

A Case Study: Developing Economies Locally Through Action and Alliance (DELTA)

The World Bank Group and the Open Society Institute (Local Government and Public Service Reform Initiative) designed and piloted the DELTA programme in Kosovo and Albania between 2002 and 2005. In constructing the programme, the two institutions drew on the experiences of a number of LED

programmes piloted and undertaken by the World Bank Group between 2000 and 2002. In partnership with local governments and other local stakeholders, the DELTA programme focuses on the development of strategies and action plans for policy reform and private sector development at the municipal level of government.

Overview of the DELTA programme

The DELTA programme relies on a methodology that promotes and combines best practices in helping to foster an improved business-enabling environment. DELTA operates by promoting capacity-building training and technical assistance to local institutions, municipal officials, private sector representatives and community groups. Municipal stakeholder groups, which in Kosovo and Albania have numbered between 40 and 175 people per city, work with technical support from a local implementing agency to develop their own locally written three- to eight-year strategies for improving the local economy. Under the programme, public-private partnerships are institutionalised and the development of goals, objectives, programmes and projects are jointly identified, prioritised and implemented.

The DELTA programme is grounded in two premises: that the institutional and policy environment for private sector growth matters more than what was previously thought, and that institutional or policy changes should include regional- or local-level reforms, since it is often at the sub-national level that some of the most pervasive obstacles to the private sector exist.

Geographical selection

The DELTA programme was first piloted in seven Kosovar municipalities in 2002. Kosovo was selected for the following reasons:

1. To contribute to international efforts to rebuild the province after the war.
2. Its small size was conducive to piloting the project and there was a good opportunity to roll out the project to neighbouring municipalities.
3. A sufficient degree of economic activity existed.
4. The decentralisation process was under way.
5. A high unemployment rate needed to be addressed.

The initial group of Kosovar municipalities finalised their strategies in 2003. Another five Kosovar municipalities are now participating in the programme and discussions are ongoing to include a final group of five cities beginning in mid-2005. Meanwhile, DELTA Albania was launched in five municipalities in 2004. Albania was selected for the following reasons:

1. Promising steps had been taken towards implementing the private sector development component of the country's Poverty Reduction Strategy Paper.

2. The existence of a highly entrepreneurial and burgeoning informal sector.
3. A treacherous business-enabling environment needed attention.
4. Adequate decentralisation of tax, customs and economic development competencies.
5. A common language with Kosovo facilitated the transfer of the programme.

Maximising local knowledge and sustainability

Experience has demonstrated that the most important decision taken during the DELTA programme was which institution to partner with in each country. The local institution is the primary implementing agency responsible for the organisation and execution of the capacity-building workshops, the provision of technical assistance and the finalisation and promotion of the strategies. Its role is critical at every stage of the strategic planning process, and weak performance could spell sub-optimal results for all of the municipalities engaged. To ensure the most qualified institutions were chosen for the project, extensive interviews were administered with each potential organisation. The short-listed candidates were then asked to submit a project proposal which addressed all of the framework components of the project (as designed by the DELTA team), as well as creative suggestions each institution may have had in terms of best adapting the project to local conditions.

Often donors that operate LED strategic planning programmes choose to partner with international companies to carry out the project. These companies usually bring to the table a wealth of experience in LED planning and normally staff talented locals as well as internationals. The DELTA programme's philosophy has been to work with a local institution that not only demonstrates a considerable understanding of the relevant legal and practical frameworks, but also is more likely to remain operational in that country for the long term.

The local implementing partners selected for Kosovo and Albania differed in many ways. In Kosovo the DELTA programme partnered with the Riinvest Institute for Development Research, arguably the province's most established and strongest NGO working on economic issues. While it was necessary to provide Riinvest with training on operating an LED programme, the Institute offered a large and experienced staff, organisational resources and strong links with municipal leaders. In Albania, DELTA selected the Foundation for Local Autonomy and Governance (FLAG) as its implementing partner. FLAG had been established as an NGO only two months prior to its selection and maintained a staff of only three persons. The director and vice-director, however, had been instrumental in the implementation of previous LED efforts in Albania sponsored by other organisations. Although staff capacity was limited (and would require that external consultants were brought on board), and an

institutional reputation had yet to be established, selecting FLAG was perceived as an opportunity for the DELTA team to build the capacity and sustainability of a talented group of local individuals and to help institutionalise LED undertakings in the country. Partly as a result of the programme, FLAG has been able to expand institutionally, and that organisation's achievements with the cities greatly exceed its own diminutive size.

Municipal selection

After teaming up with a local partner, municipalities must be selected for the programme. A shortlist of potential cities can usually be drawn up at an early stage that highlights municipalities meeting the basic quantitative criteria, *i.e.* sufficient economic space (population over 40 000), ample business activity, lack of recent experience with LED strategic planning, and the existence of an LED office, to name a few.

As was the case in Kosovo and Albania, once the short-listed cities have been identified, each municipality should be provided with detailed information about the programme along with a formal application package should they wish to apply. The application process requires the submission of a signed expression of interest from the mayor and the municipal council, and the completion of a municipal questionnaire.[15]

Once the applications are received, each municipality should be visited for a personal interview with the mayor and staff. This is probably the most important element of the selection process as it provides the interviewers with an insight as to the commitment that may or may not exist for the project. It is important to note that without the true commitment and leadership of the mayor, any LED programme is likely to fail. Finally, each municipality should be asked what they are prepared to contribute to the project, financially and/or in kind. At a minimum, municipalities in Kosovo and Albania were required to allocate staff time for the training and planning sessions, and they had to cover the travel costs related to the domestic workshops and events. Even if municipal contributions are nominal, at least they demonstrate some level of commitment and dedication to the initiative. After the first round of seven municipalities completed their strategic plans in Kosovo, the second group of five cities offered to contribute 10% of the project related costs. Having witnessed the results of their neighbours, they wanted to make sure they would be able to participate in the DELTA II programme.

Capacity building and technical assistance

The DELTA programme is structured around three principal training workshops that take place every three to four months. The workshops introduce participants from municipal core teams[16] to theories and practices

of strategic planning for local economic development. The training is carried out by local and international experts and includes the following modules:

- *Workshop I:* Developing stakeholder partnerships, collecting data, undertaking a competitive assessment (SWOT analysis) and creating LED institutions.
- *Workshop II:* Developing a vision, goals and objectives for each municipality. Evaluating LED policies, programmes and projects that create more conducive local business-enabling environments. A discussion on financial instruments that may accompany this process. Team simulations are the anchor of this workshop, where municipal teams must make decisions about priorities, costs/benefits, outcomes, and satisfaction of their constituencies.
- *Workshop III:* Selection of LED programmes and projects. Prioritisation, implementation, monitoring and evaluation of projects and the strategy as a whole.

In between training workshops, expert facilitators from the local implementing agency visit the core teams and stakeholder groups two to three times per month. The facilitators assist the municipalities to fulfil the "homework" assignments that are distributed at the end of each workshop (*i.e.* collecting data, developing a SWOT analysis, the "vision to projects" matrix, etc.). It has proven useful to engage the services of full-time facilitators that are dedicated and accountable to the project. In Kosovo and Albania two full-time facilitators have been hired to work with two municipalities each. The full-time DELTA manager facilitates the fifth municipality in each location. The benefit of having the programme manager facilitate one municipality is that they develop an intimate understanding of the facilitation process and the difficulties that other facilitators may be experiencing in their municipalities. Bringing together the different sectors in each municipality (still a novel concept in most South Eastern European municipalities) and getting them to co-operate constructively, is challenging work.

Results to date

At the time of writing this chapter, only the initial pilot project in Kosovo has been completed. The seven municipal strategies[17] were adopted by their respective local assemblies in 2003 and city budgets were matched to the prioritised needs of the communities. An official follow-up assessment of the short-term results is currently being organised but the preliminary feedback is decidedly positive.

Before the DELTA programme was launched, public-private dialogue and co-operation was minimal in most of the participating municipalities. Today, however, the two sectors have maintained intense collaboration on areas related to local economic development. Business associations have been

established in the municipalities of Vushtrri, Klina and Istog, where none existed before. After one year, 62 projects had been implemented collectively. Representatives from the municipality of Viti have reported that more than half of their prioritised projects had either been completed or were currently in the process of being implemented.

In Albania, where the strategic planning effort is coming to a close and project implementation is commencing, a number of best practices have already been realised. In many ways, LED is as much about the *process* as it is about the *product*. While it is often easier to conceive of an ambitious plan than it is to implement it, the way that a plan is developed often has a direct impact on how (or if) the strategy is subsequently realised. As a direct result of the strong leadership of the mayors, council members and business communities in the participating Albanian cities, a broad range of stakeholders were engaged. Municipal (*i.e.* community) ownership and support is high. As in Kosovo, the public and private sectors have been co-operatively engaged for the first time, with a spill-over effect into other areas aside from LED. The practical nature of the programme was noted among the Albanian participants to be extremely appreciated. Unlike many other training programmes donors operate, the DELTA programme was viewed as being "decidedly tangible, because not only were people taught something, they also accomplished something vital to the development of their cities".[18]

Conclusions

In drawing conclusions on how best to design and implement LED strategies in Central, East and South Eastern Europe, a number of points emerge as to ensuring the sustainability and continuity of programmes to embed strategic planning as a viable and practical approach to encouraging local economic growth.

Cross-country networking, while an invaluable mechanism to share good practice and identify programmes and approaches, is costly in terms of travel and translation. With finite resources, experience demonstrates that in multi-country programmes, the costs of administering the programme outweigh the benefits. While implementing a programme to develop LED strategies in a country, there is however a need to have operational scale to ensure that competitive and peer pressure exists between municipalities to truly benefit from a group working.

In devising regional programmes to foster LED strategic planning capacity, municipal partners should be selected using a competitive process to encourage commitment and political buy-in. Such a system should be transparent and open so as to ensure a fair and balanced selection of municipalities that are at different stages of development.

Municipal finance and capital investment planning should be addressed from the outset of the LED strategic planning process so as to instil a sense of realism and commitment on the part of stakeholders.

An in-country consultancy or research group should be engaged as a focus for facilitation support, and a "train the trainers" programme should be undertaken ahead of main city capacity building so as to build local capacity and an understanding of the realities and difficulties of the LED strategic planning effort. Greater awareness also needs to be given to the valuable and meaningful role and contribution of the private sector and civil society. Without the input and participation of these groups, an LED strategic planning effort is effectively pointless. Mentorship facilities such as a sister cities programme are also useful.

The following boxes provide a concise overview of some of the critical lessons learned in the Central, East and South Eastern Europe region over the past decade of LED efforts.[19]

Box 7.8. **Planning insights**

Strategy objectives and projects are often not prioritised. By default this means that everything is a priority, which unequivocally translates to nothing is a priority. Without a clear indication of what the most pressing needs are, and in what order to address them, the municipality will find itself back where it started.

Strategic goals are often vague and generic. If LED goals are not well defined from the outset, or do not adequately reflect identified municipal assets, the LED strategy is inherently weakened. Every municipality has unique, positive characteristics that can be exploited and maximised.

The lack of political agreement and support from all sections of the community can seriously hinder LED efforts. In many of the post-communist states, a failure to communicate and negotiate between stakeholders, including political parties, and the lack of a unified front, remains a key barrier to fulfilling LED goals and strategies. Any LED strategy that seeks to improve the local economy will require broad and continuing support across the political spectrum throughout the timeframe of the strategy. Where opposition parties have not been included in the strategic planning effort from an early stage, a change of political party or mayor will increase the likelihood of the strategic plan being open to political manipulation and patronage. It is all too evident that unless political "buy-in" and agreement has occurred, a change in the political composition of a municipality will result in the LED strategy being ignored or usurped in favour of more politically expedient programmes.

Box 7.8. **Planning insights** *(cont.)*

In many cases, LED strategies are too comprehensive. Ideally, a LED strategy will be one component of an overall municipal development plan. Where a municipality already has an integrated development plan, the LED plan should seek to build upon, and leverage, existing municipal programmes thereby creating a business-friendly environment that encourages investment and employment generation.

Strategies must be owned by the municipality and locally written. Where a municipal LED strategy is devised and compiled by an individual or team of consultants not from that municipality, the strategy itself is unlikely to be implemented with the enthusiasm, commitment or conviction that a locally written strategy would be. In building local capacity to take responsibility for implementing the LED strategy, it is better to have an imperfect locally produced strategy that is owned by the community than a strategy that has been produced externally.

Private sector engagement is essential. Economic development is led by private sector growth. It is the business community that best understands the obstacles impeding local economic development, and their input is critical in addressing those impediments. Business representatives bring capital and entrepreneurial resources to the process, resources that can be harnessed in a variety of partnership initiatives to spur development. Businesses after all operate with the guidelines, rules and regulations of the local economy, and are best positioned to comment upon changes to, and the requirements of, the local business-enabling environment.

Mayors should be encouraged to sign a commitment agreement to the process and obtain the full support of the municipal council, with identified performance targets.

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Box 7.9. **Implementation insights**

Unclear action plans and/or weak monitoring systems reduce strategy impact. Not only do strategy goals and projects need to be prioritised, but the priorities need to have detailed and feasible action plans. Project descriptions should serve as blueprints for activity. They should include a list of contributors (specifically naming what each group can and will assist with), a timetable, a realistic budget, risks to be mitigated, and clear ways to monitor and evaluate the progression and impact of the project. The blueprint will allow anyone in the municipality to pick up and manage the project at any time (staffs change). The monitoring and evaluation mechanism (that is, a clear set of [measurable] indicators) is intended to ensure that the project is adapted if needed to increase its impact, or cancelled if it turns out to be a net loss initiative.

Too great a focus on external (*i.e.* state and donor) funds is commonplace. The principal rationale for the strategy should be to manage self-generated and existing resources more efficiently, as well as to create a more favourable investment environment via internal reforms. While external funds are of natural importance, municipalities have less control over this domain and therefore may end up with strategy components that cannot be implemented. Often a strategic plan has been a precondition for donors to "invest" in a municipality. While this approach clearly makes sense, one must also avoid a situation where the municipality sees the strategy foremost as a way to leverage external funds rather than as a tool for better allocating own-source revenues.

Weak link between strategy and municipal budgeting process. This point relates to the one above. The strategy should serve as a guide to the annual budgeting process. Priorities have been identified and should be matched to existing resources, with co-funding and private sector contributions (and partnerships) sought whenever possible.

Local strategies should be integrated into their respective regional or national economic strategies. The adoption of new programmes or the introduction of new policies at higher levels may be of great use to the municipalities.

For sustained success, strategies must be reviewed annually to adjust to changing environments. New opportunities arise; new threats emerge. One cannot expect the same successful policy to be successful year after year without modification.

The mayor's role is crucial in directing the effort. While this is undoubtedly true, sustainability of the implementation phase must also be based on institutionalized processes (*i.e.* budgeting in relation to the strategy, public-private partnerships) and a social environment favourable to the strategy's implementation. Otherwise the initiative is likely to be abandoned if the mayor leaves office.

Box 7.9. **Implementation insights** *(cont.)*

Quality of life factors enhance economic development. Green spaces, cultural attractions, sports facilities, cleanliness and other quality of life attributes can advance economic development. A city that is pleasant to live in is one that is more likely to retain local businesses and attract new ones.

The quality of labour is often more important than the cost of labour. The Swianiewicz study notes that this has proved true in "several modern Western location theories, but research suggests it is also valid for Central and Eastern Europe (or at least for the parts of the region)". Educational and training programmes can thus play a major role in local economic development programmes, a key point to remember as increasing numbers of businesses relocate to Asia in search of lower-cost, but not necessarily skilled, labour.

Municipalities can strengthen their positions through horizontal collaboration. Often detriments to economic growth are external factors, ranging from macroeconomic state policies to national tax rates to centralised processing of business-related matters. Horizontal networking among municipalities – via the respective associations of municipalities or through informal ad hoc structures – faced with the same barriers can result in a strengthened position vis-à-vis the central government to address some of these.

Notes

1. Guidance, contributions and support received from Gwen Swinburn, Senior Urban Specialist, Urban Development Unit, World Bank, are gratefully acknowledged and appreciated.
2. Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Romania, Serbia and Montenegro, the former Yugoslav Republic of Macedonia, Turkey.
3. Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, Slovenia.
4. For an overview of how LED has evolved since its inception in the 1960s, see Annex 7.A1, Three Waves of Local Economic Development.
5. See for example the Land and Real Estate Procedures in Russian Regions Case Study, a presentation delivered at the World Bank LED Seminar, "Enabling the Economic Role of Cities: Analytical Approaches and Operational Implications", 10 January 2005, Washington, DC: *www.worldbank.org/urban/led/seminar.html*.
6. LED infrastructure comprises two main components: hard physical infrastructure incorporating roads, rail, water, sewerage and drainage systems, and energy and

telecommunications networks; and soft infrastructure of social, cultural and community facilities and capacity that enhance the quality of life and encourage industry and business development.

7. See for example, the goals contained in the LED Strategy of Kaçanik Municipality, Kosovo: *www.komuna-kacanik.org/en/strategy*.

8. An example of an LED Project Action Plan can be seen in Annex 7.A2.

9. For further information on indicators for economic development and regeneration, see Economic Regeneration Performance Indicators, March 2003 – Feedback Paper: *www.local-pi-library.gov.uk/pdfs/ER_report_Low_res.pdf*.

10. Chambers of commerce, business associations and support organisations, multinational corporations, sole traders, etc.

11. Non-governmental organisations, professional associations, educational bodies, religious entities, etc.

12. More general information regarding the types of data that municipalities should collect and general data collection tips is available at: *www.worldbank.org/urban/led/led_primer.pdf*.

13. To view a sample Local Business-Enabling Environment Survey, visit: *http://lgi.osi.hu/documents.php?m_id=58*.

14. See Annex 7.A4 for a prioritisation table.

15. The questionnaire allows the DELTA team to obtain a better understanding of the city's economic potential and problems. Information is sought on such areas as unemployment, local industrial composition, access to credit, infrastructure, experience with LED and activities of international organisations.

16. Core teams are generally comprised of four to five representatives from the municipal government and the private sector.

17. These seven completed municipal LED strategies developed as part of the DELTA I Programme in Kosovo are available to view at: *http://lgi.osi.hu/documents.php?m_id=58*.

18. Feedback obtained from DELTA participants after a closing workshop in Durres, Albania.

19. This list derives from an unpublished LGI study led by Pawel Swianiewicz entitled "Local Governments and Development – What Works and What Does Not?" and the operational LED programmes that LGI and the World Bank have supported in Albania and Kosovo. The Swianiewicz reports can be viewed at: *http://lgi.osi.hu/documents.php?m_id=98*.

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ANNEX 7.A1

Three Waves of Local Economic Development

Wave	Focus	Tools
First: 1960s to early 1980s	Mobile manufacturing investment. Attracting outside investment, especially the attraction of foreign direct investment. Hard infrastructure investments.	Large grants. Subsidised loans usually aimed at inward investing manufacturers. Tax breaks. Subsidised hard infrastructure investment. Expensive "low road" industrial recruitment techniques.
Second: 1980s to mid-1990s	The retention and growing of existing local businesses. Still with an emphasis on inward investment attraction, but usually this was becoming more targeted to specific sectors or from certain geographic areas.	Direct payments to individual businesses. Business incubators/workspace. Advice and training for small and medium-sized firms. Technical support. Business start-up support. Some hard and soft infrastructure investment.
Third: Late 1990s onwards	Soft infrastructure investments. Public/private partnerships. Networking and the leveraging of private sector investments for the public good. Highly targeted inward investment attraction to add to the competitive advantages of local areas.	Developing a holistic strategy aimed at growing local firms. Providing a competitive local investment climate. Supporting and encouraging networking and collaboration. Encouraging business clusters. Encouraging workforce development and education. Closely targeting inward investment to support cluster growth. Supporting quality of life improvements.

Source: World Bank (2004) Local Economic Development: A Primer – Developing and Implementing Local Economic Development Strategies and Action Plans, A Knowledge Product of Cities of Change, October, Washington, DC.

ANNEX 7.A2

Example of Project Action Plan: Business Advice Centre

Project: # 1 BUSINESS ADVICE CENTRE	Programme type(s): Encouraging local business growth Encouraging new enterprise
Short description of the project:	
Establish an office with one or more professionals to offer advice to existing or potential entrepreneurs in management, finance, marketing and personnel. Related services include: assisting owners in business planning, preparing loan applications, offering business expansion information, organising short business courses, supporting the business community through information and communication (roundtables, conferences, etc.). The Advice Centre should provide feedback to the local administration on potential problems in the business climate and highlight areas for improvement. Potentially, the centre could be financially self-sustainable with clients paying the full costs of services received; alternatively, a subsidised fee may be charged for direct services with other services such as seminars being fee of charge.	
Expected results:	**Target group(s):**
Decrease in unemployment. Reduction of business failures. Increase in new businesses. Increased contribution of the private sector to the municipal budget and local economy. Improved business-enabling environment (favourable to new investments).	Existing entrepreneurs that wish to expand their businesses. People with business ideas that lack knowledge or the means for starting up a business. New small investors.
Possible stakeholders:	**Possible contributions to the project:**
Local business association and/or private sector: professional assistance.	Potential champion of the project. Material contribution: equipment and/or expertise.
Local government: stronger SMEs lead to lower unemployment, improved economy and local income.	Offer of direct support: premises, political support, expertise.
Local educational and other institutions: future jobs for students.	Contribution of technical advice through experts. May provide job matching service.
City Diaspora: assistance in finding investment. opportunities and support for local relatives.	Financial support. May offer information and opportunities: business opportunities, apprenticeships for managers, innovative ideas.
International organisations: practical assistance for SME development.	Financial support. Technical assistance.

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Project: # 1 BUSINESS ADVICE CENTRE	Programme type(s): Encouraging local business growth Encouraging new enterprise
Prerequisites:	**Risk factors:**
An organisation exists to take on project leadership. Specialists are available to provide services. Available premises and equipment. Available financial resources.	Potential for Center to be owned or unduly influenced by special interest groups. Low business potential of the region. Limited financial or other resources for businesses.
Estimated Costs:	
EUR 22 000 in the first year; EUR 16 000 in years 2 and 3. Premises: EUR 3 600/year (EUR 300/month). Equipment: EUR 6 000. Salaries: EUR 8 400 for 3 people. Running costs: EUR 4 000 annually.	Stakeholders may contribute in cash or in kind: premises, equipment, volunteer work. For special events (training, conferences) additional funds should be raised.
Time for implementation:	**Time to impact:**
Minimum duration at least 3 years. Start-up in less than 6 months.	First evaluation after 1 year of operations. Each subsequent year results monitored against an initial set of data (number of businesses, contribution to the total revenue of the community, number of unemployed, increased export).
Outputs:	
50% of loan applications granted 40% of all assisted businesses increase revenues	20% of assisted businesses expand markets. 50 new jobs created in 3 years. 5 new business start-ups annually.

ANNEX 7.A3

Example of "Vision to Projects" Matrix: The Case of Shkodra

Shkodra, Albania (Population: 88, 245)				
Vision	Goals	Objectives	Programmes	Projects
Shkodra will be an important economic, educational and regional exchange centre, where the beauty of nature will be harmonised with the history, culture and people; an attractive place to live, work and host friends.	G1: To have an active economy which will incite the development of manufacturing businesses, merchants and services and return Shkodra to a regional economic centre.	G1:O1: Increase the total number of businesses operating within the Shkodra industrial zone by 20% by 2007.	G1:O1:PG1: Invest in critical infrastructure within the industrial zone.	G1:O1:PG1:p1: Construction of new telephone lines and redevelopment of the existing network within the industrial zone. G1:O1:PG1:p2: Improve energy network within the industrial zone. G1:O1:PG1:p3: Connect buildings and streets within the industrial zone to an effective storm water drainage and sewage system. G1:O1:PG1:p4: Increase coverage of street lighting in the industrial zone. G1:O1:PG1:p5: Improve the system of roads within the industrial zone. G1:O1:PG1:p6: Improve and expand green spaces within the industrial zone.
			G1:O1:PG2: Promotion of the industrial zone.	G1:O1:PG2:p1: Develop a map of the industrial zone to show areas of existing activity and show spaces for new businesses. G1:O1:PG2:p2: Create promotional materials for businesses operating within the industrial zone.
		G1:O2: Increase the number of markets within the city from 7 to 12 by 2006.	G1:O2:PG1: Development of a system of retail and wholesale markets.	G1:O2:PG1:p1: Construction of fruit and vegetable wholesale markets in Shkodra. G1:O2:PG1:p2: Construction of new fruit, vegetable, fish and meat retail markets in the city.

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Shkodra, Albania (Population: 88, 245)				
Vision	Goals	Objectives	Programmes	Projects
		G1:O3: Increase the number of systems that provide service and support for SMEs within the city from x to y by 2006.	G1:O3:PG1: Create systems, activities and promotional materials to support existing, and to facilitate the development of new, SMEs within the city.	G1:O3:PG1:p1: Establish a "one-stop-shop" within the municipality. G1:O3:PG1:p2: Create small business incubators within the city. G1:O3:PG1:p3: Prepare business profiles for the most successful businesses in the city. G1:O3:PG1:p4: Establish a business service centre. G1:O3:PG1:p5: Develop an annual survey to analyse local SMEs with respect to their wants and needs. G1:O3:PG1:p6: Development of training modules for businesses and curriculum for technical high schools.
		G1:O4: Increase the number of cross-border co-operations by x% in y years.	G1:O4:PG1: Cross-border activities.	G1:O4:PG1:p1: Establish a board to increase investments and improve collaboration, experience among border cities. G1:O4:PG1:p2: Preparation of an information package for foreign investors to increase trade and investment in the region. G1:O4:PG1:p3: Construction of a regional trade, fair and training centre.
		G1:O5: Increase the yearly number of visitors to the city from 10 000 to 25 000 by the year 2006.	G1:O5:PG1: Supporting and developing tourism infrastructure.	G1:O5:PG1:p1: Establish a Tourism Development Office within the municipality. G1:O5:PG1:p2: Provide information on transportation services within the region. G1:O5:PG1:p3: Create tourism marketing for the city. G1:O5:PG1:p4: Develop a network of hotels and restaurants to improve their standards and diversify their services. G1:O5:PG1:p5: Construction of handicraft development and marketing centre. G1:O5:PG1:p6: Development of a ferry line between Shkodra and Montenegro. G1:O5:PG1:p7: Publication of a tourism periodical "Tourism in Shkodra". G1:O5:PG1:p8: Organise regular capacity building training for tourism agencies and businesses. G1:O5:PG1:p9: Creation of a pilot tourism development zone in the towns of Shiroke and Zogaj. G1:O5:PG1:p10: Draw up a tourism development plan.
	G2: Preserving and developing the cultural, historical and artistic traditions of Shkodra.	G2:O1: Increase the number of cultural and artistic activities in Shkodra from x to y by the year 20xx.	G2:O1:PG1: Preservation, enrichment, restoration and exposure of the historical values of the Shkodra region.	G2:O1:PG1:p1: Restoration and development of new and existing museum facilities in the city. G2:O1:PG1:p2: Preservation, restoration and identification of historical and artistic objects in city museums. G2:O1:PG1:p3: Improvement of the infrastructure of the "Migjeni" theater. G2:O1:PG1:p4: Restoration of the city's Cultural Centre. G2:O1:PG1:p5: Promotion and exhibition of the "Marubi" photo collection. G2:O1:PG1:p6: Restoration and preservation of traditional houses in the city.

Shkodra, Albania (Population: 88, 245)				
Vision	Goals	Objectives	Programmes	Projects
			G2:O1:PG2: Reviving traditional historical and cultural events in the city.	G2:O1:PG2:p1: Creation of an Art Commission for the development of Art and Culture. G2:O1:PG2:p2: Development and publishing of promotional materials related to the cultural heritage of the city. G2:O1:PG2:p3: Revival of traditional annual activities. G2:O1:PG2:p4: Development of the "Summer Day" feast in Shkodra. G2:O1:PG2:p5: Redevelopment of the Carnival celebration in Shkodra. G2:O1:PG2:p6: Redevelopment of the traditional New Year's celebrations in Shkodra.
	G3: University centre for North Albania, an important factor for increasing and improving the education and professional level in all areas.	G3:O1: Increase the number of active students at the University from 4 500 to 7 500 by 2012.	G3:O1:PG1: Improving infrastructure for boarding, teaching and student services.	G3:O1:PG1:p1: Rehabilitation of existing classroom infrastructure and the development of new facilities. G3:O1:PG1:p2: Creation of a university campus. G3:O1:PG1:p3: Construction of a new library at the "Luigj Gurakuqi" University.
			G3:O1:PG2: Increase the quality of teaching and number of faculty programmes offered.	G3:O1:PG2:p1: Analysis of all the competitive fields at the university. G3:O1:PG2:p2: Improvement of the economic, tourism and law faculty and training of the public administration. G3:O1:PG2:p3: Creation of distance learning, professional assistance and postgraduate education modules.
			G3:O1:PG3: Creation of partnerships and links in the context of regional development.	G3:O1:PG3:p1: Exchanging scientific and technical information and experience between regional and global universities. G3:O1:PG3:p2: Creation of a fund to support and increase the development of research and knowledge transfers in the context of regional economic development. G3:O1:PG3:p3: Recruiting and developing a qualified staff to improve the quality of teaching.
	G4: A city with a sustainable, developed, environmentally friendly infrastructure.	G4:O1: Rehabilitate and develop x% of urban roads by 2010.	G4:O1:PG1: Rehabilitation of the urban road network.	G4:O1:PG1:p1: Resurfacing of the road for the south entrance of the city, the road from "Ali Kelmendi" to "Lek Dukagjini", the ring road from "Tophane" to "Rus", the road from "Ura e Thive" to railway overpass and the road from "Ura Thive" to the train station. G4:O1:PG1:p2: Resurfacing of "Skenderbeg", "Guerrile", "Justini Gudar", "Bajram Curri", "Halit Bajraktari", "Artistike", "8 Marsi", "Karvenej", "Isuf Sokoli", "Musa Luli", "Ruzhdi Tyli", "Tahsim Berdica", "7 Shkurti", "Vaso Kadija", "Qazim Llazani". G4:O1:PG1:p3: Construction of sidewalks and lighting for the streets "Zogu i Pare", "Vasil Shanto", "Clirimi", "13 Dhjetori", "Marin Barleti", "Osa Kuka", "Daniel Matlia" and the road to the ambulance service.

Shkodra, Albania (Population: 88,245)				
Vision	Goals	Objectives	Programmes	Projects
				G4:O1:PG1:p4: Construction of sidewalks for the streets, "Bujar Bishanaku", "Daut Borici" and "Muhamet Gjollesha".
				G4:O1:PG1:p5: Construction of street lighting on Road 1 in front of main university campus.
			G4:O1:PG2: Rehabilitation of wastewater collection systems in the city.	G4:O1:PG2:p1: Rehabilitation of 7 main wastewater exit points.
		G4:O2: Increase the number of families and businesses that have access to the sewage network from 15 000 to 24 800 by the year 2010.	G4:O2:PG1: Rehabilitation of sewer system.	G4:O2:PG1:p1: Rehabilitation of sewage pumping station.
				G4:O2:PG1:p2: Construction and rehabilitation of sewage discharge pipes.
				G4:O2:PG1:p3: Improvement of the technology for the sewage emergency service.
				G4:O2:PG1:p4: Construction of new pipelines for sewer system.
		G4:O3: Increase the number of families and businesses that have direct access to drinking water from 22700 to 24800 by the year 2010.	G4:O3:PG1: Rehabilitation of the drinking water delivery system.	G4:O3:PG1:p1: Complete construction of the drinking water reservoirs in the "Tepes" hills.
				G4:O3:PG1:p2: Rehabilitation of the drinking water distribution network.
				G4:O3:PG1:p3: Improvement of customer service management.
				G4:O3:PG1:p4: Installation of auxiliary equipment for drinking water management.
				G4:O3:PG1:p5: Reduction of water loss in the network.
				G4:O3:PG1:p6: Replacement of the old valves in the distribution network.
		G4:O4: Increase the green areas in the city by 45% by the year 2010.	G4:O4:PG1: Greening of city streets.	G4:O4:PG1:p1: Greening of 8 city streets.
			G4:O4:PG2: Rehabilitation of existing and the creation of new public parks.	G4:O4:PG2:p1: Rehabilitation of 5 city parks.

Shkodra, Albania (Population: 88, 245)				
Vision	Goals	Objectives	Programmes	Projects
			G4:O4:PG3: Rehabilitation and construction of new green areas in courtyards for residential buildings.	G4:O4:PG3:p1: Construction of a new park in the "Xhabije" residential area. G4:O4:PG3:p2: Construction of a new park in "Ish Parku" residential area. G4:O4:PG3:p3: Construction of a new park in the "Isuf Sokoli" road G4:O4:PG3:p4: Construction of a park in "Zdrale".
		G4:O5: Increase the coverage of the garbage collection services to 100% of the city by 2009.	G4:O5:PG1: Improvement of the management, collection and disposal of municipal solid waste.	G4:O5:PG1:p1: Construction of a landfill for municipal waste. G4:O5:PG1:p2: Improvement of the technology for the collection, transportation and management of municipal solid waste. G4:O5:PG1:p3: Develop an awareness campaign to educate citizens about their roles in keeping the city clean.
		G4:O6: Improve and increase planning tools for the development and urban management of the city from 2 to 5 by the year 2006.	G4:O6:PG1: Planning tool development.	G4:O6:PG1:p1: Redevelop the regulatory plan for the city. G4:O6:PG1:p2: Develop an action plan for the implementation of the regulatory plan. G4:O6:PG1:p3: Creation of a regulatory plan for the "Shiroke – Zogaj" quarter.
	G5: Improve the quality of life by preserving and developing a secure, friendly and attractive city environment.	G5:O1: Increase the number of the recreational areas and places where people spend their free time in the city from x to y by 2010.	G5:O1:PG1: Development of facilities for recreational and leisure-time activities.	G5:O1:PG1:p1: Establishing an activity and service centre for the elderly. G5:O1:PG1:p2: Establishing an activity and service centre for youth. G5:O1:PG1:p3: Rehabilitation of sporting facilities for city schools. G5:O1:PG1:p4: Construction of public sports facilities.
		G5:O2: Increase the number of public activities and events in the city from x to y by the year 2010.	G5:O2:PG1: Stimulation of amateur sports activities in the city.	G5:O2:PG1:p1: Organisation of spring and autumn sports leagues among elementary and middle schools and for other age groups in the city. G5:O2:PG1:p2: Organisation of historical games' championships.

Shkodra, Albania (Population: 88, 245)				
Vision	Goals	Objectives	Programmes	Projects
		G5:O3: Increase the number of tools available to the municipality for improving social services from x to y by 2010.	G5:O3:PG1: Improvement of social services for the community.	G5:O3:PG1:p1: Increase the capacity of the local administration and NGOs with regard to social services. G5:O3:PG1:p2: Develop and evaluate of the social situation of the city. G5:O3:PG1:p3: Improve the distribution of social services around the city.
			G5:O3:PG2: Modernisation of state civil services.	G5:O3:PG2:p1: Computerisation of the Civil Office and statistical data. G5:O3:PG2:p2: Creation of a system of addresses for the city.
		G5:O4: Construction of new or rehabilitation of 4 health centres in the city by 2010.	G5:O4:PG1: Improvement of primary health care service in the city.	G5:O4:PG1:p1: Reconstruction of a community health center in the “Tre Heronjt” district. G5:O4:PG1:p2: Reconstruction of a community health center in the “Partizani” district. G5:O4:PG1:p3: Reconstruction of health clinic in the Zogaj and Shiroke villages. G5:O4:PG1:p4: Construction of a new health clinic “Marlulaj”.

ANNEX 7.A4

*Project Prioritisation Methodology**

Necessity/desirability quotient (stakeholder group)

Step 1: Group projects according to their goal (split the projects up by goal).

Step 2: Categorise projects, within each goal group as hard and soft (add examples).

Step 3: List all projects on the "Stakeholder Form" according to the group number and hard and soft categories (list Goal 1 projects first, followed by 2, and so on).

Step 4: Provide each stakeholder with a separate Stakeholder Form.

Step 5: Ask each stakeholder to identify the 3 most and the 3 least desirable/necessary projects within each goal and hard and soft groups.

Ask stakeholders to rank project within the groups with a 1, 2 or 3, with 3 being the most desirable/necessary projects, 2 being desirable/necessary and 1 being the least desirable/necessary. Stakeholders can only rank three projects within each grouping as most desirable/necessary (for the hard and soft projects).

Step 6: Add up points for each project from each stakeholder form to get the Necessary/Desirability Quotient and input onto the Project Prioritisation Sheet.

Feasibility quotient (municipal expert group)

Step 1: List projects by group on the Feasibility Form.

Step 2: The group will discuss and rate each project based upon the criteria set out in the form.

* This prioritisation formula has been developed by Nathan Borgford-Parnell, a United States Peace Corps Volunteer working in Shkodra, Albania. This prioritisation formula is currently being tested in Shkodra.

Methodology: Each criterion will be rated from 0 to 2 with 0 being highest/most feasibility and 2 being lowest/least (note that this is the opposite of the ranking format used for the Stakeholder Group Form).

Criteria 1: Internal funding available (secured funding).

Criteria 2: External funding available.

Sub-Criteria 1: Secured funding.

Sub-Criteria 2: Identified potential funding sources (≥ 2 rates a 0, one funder rates a 1, and zero rates a 2).

Criteria 3: Number of Goals/Objectives addressed by the project (≥ 3 rates a 0, < 3 rates a 1).

Criteria 4: Groups represented. (If the project affects the general population, rate it with a 0. If the project affects an underserved population/s specifically being targeted for support by the municipality, score it with a 1. Projects targeting one particular population that is not a specific priority of the municipality rate a 2.)

Criterion 5: Does the municipality have the expertise to implement the project or are the experts readily available? (Yes rates 0, Maybe rates 1, No rates 2.)

Criterion 6: Groups targeted by the project. (If the project affects the general population, rate it with a 0. If the project affects an underserved population/s specifically being targeted for support by the municipality, score it with a 1. Projects targeting one particular population that is not a specific priority of the municipality rate a 2.)

Criterion 7: Number of risks for project implementation (no risks rates a 0, one-two risks rates a 1, and more than two risks rates a 2).

Criterion 8: Has the municipality consulted outside experts or other institutions that have implemented similar projects? (Yes rates 0, No rates 2.)

Step 3: Add the scores in each row to arrive at the Feasibility Quotient each project. (If the Feasibility Quotient comes out 0, change to a 1.)

Step 4: Input Feasibility Quotient into the Project Prioritisation Sheet.

Project prioritisation

Step 1: Designate each project as (S)oft or (H)ard.

Step 2: Designate each project as (L)ong-, (M)edium- or (Sh)ort-term based upon implementation time.

Short: < 1 year; *Medium*: 1-3 years; *Long*: ≥ 3 years

Step 3: For each project, divide the Necessity/Desirability Quotient by the Feasibility Quotient to get the Priority Score.

Step 4: Reorder projects from highest to lowest according to their Priority Score.

Step 5: List projects in now prioritised order including letter designations for hard and soft and implementation time.

ANNEX A

Authors' Biographical Notes

Scott Abrams is Project Manager with the Local Government and Public Service Reform Initiative of the Open Society Institute. Projects under his responsibility include the joint World Bank-OSI programme "Developing Economies Locally Through Action and Alliance" in Kosovo and Albania. He also manages the LGI Fellowship programme and other good governance and decentralisation projects in South Eastern Europe and the Newly Independent States. Before joining LGI, Scott worked in the Department of Peacekeeping Operations at the United Nations.

Mark Considine is Professor of Political Science and Director of the Centre for Public Policy, University of Melbourne, Australia. He has published extensively on local governance, contracting, partnership and institutional change in OECD countries. Mark also works as a special adviser to the Department for Victorian Communities on governance reforms at state and local level. His current research involves a comparative study of local governance reforms in OECD countries focusing on the role of networks and other mechanisms of collaboration.

Randall W. Eberts is Executive Director of the W.E. Upjohn Institute for Employment Research, a leading independent, non-profit research organisation in the field of labour market policy and regional development in the United States. Prior affiliations include Professor of Economics at the University of Oregon and Senior Economist on the President's Council of Economic Advisers.

Sylvain Giguère is the Deputy Head of the LEED Programme. A Canadian economist, he joined the OECD in 1995 and initiated a work agenda on local governance and employment, addressing the issues of decentralisation, partnerships and policy co-ordination. He also directs research on labour markets, skills and economic development, co-ordinates the programme of work of the OECD Division for Local Economic and Employment Development

and is the manager of the OECD LEED Forum on Partnerships and Local Governance.

Xavier Greffe is Professor and Director of Doctoral Studies in Economics at the Université de Paris I (Panthéon-Sorbonne). He is an expert for the European Commission and the OECD on issues related to decentralisation, local development, the social economy and the economic impact of culture. He held various high-level positions in the French administration, chaired a European association for local development (LEDA Partenariat) and is currently the co-ordinator of the OECD LEED Scientific Advisory Group on Local Governance, based in Trento, Italy.

Fergus Murphy is Principal Consultant at LED Associates, an independent research consultancy based in Washington, DC. Fergus also worked as consultant in the Urban Development Department of the World Bank where he advised on the Cities of Change initiative, a World Bank-Bertelsmann Foundation programme that supported policy and administration reform in Central and Eastern Europe. His main fields of research include strategic planning, urban governance, social and financial inclusion and policy transfer.

Michael Parkinson is Director of the European Institute for Urban Affairs at Liverpool John Moores University. He publishes extensively and is a regular contributor to the media about urban regeneration. He acts as adviser to the Office of the Deputy Prime Minister, the European Commission and the OECD. He recently completed a project on competitive European cities funded by the British government and the "UK Core Cities". He now leads the multinational consortium appointed by the ODPM to undertake the State of the Cities Report 2005.

Charles F. Sabel is Maurice T. Moore Professor of Law and Social Science at Columbia Law School. His current writing focuses on questions of organisation theory and the implications of new organisational forms for law and democracy. Earlier work focused on questions of industrial organisation, especially the transformation of the vertically integrated firm and the rise of more flexible forms of production.

OECD PUBLICATIONS, 2, rue André-Pascal, 75775 PARIS CEDEX 16
PRINTED IN FRANCE
(84 2005 04 1 P) ISBN 92-64-01329-6 – No. 54401 2005

Local Governance and the Drivers of Growth

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ISBN 92-64-01329-6
84 2005 04 1 P

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