5 A policy roadmap to address regional inequalities now and in the future

The chapter discusses the consequences of leaving persistent regional inequalities unchecked. The first section describes how, when left unaddressed, these disparities can threaten economic growth, the provision of public services, trust, political stability and a just transition. Governments in OECD countries need to act now to ward off persistent divides between regions. The second section of the chapter presents a policy roadmap along five key priorities to guide these efforts.

In Brief

- While economic development is inherently uneven within countries due to differences in factors of production across places, wide and sustained regional inequalities can no longer be considered necessary or a “fact of life”. At a time when megatrends and shocks such as the COVID-19 pandemic and Russia’s war of aggression against Ukraine are impacting regions differently, they serve to highlight and sometimes compound existing weaknesses in national economies. As regional inequalities grow and persist over time in many OECD countries, they are raising costs that are becoming too economically, socially and politically high to ignore.
- Inaction on regional inequalities raises different costs:
    - **Economic costs**, as the aggregate contribution of lagging regions and/or those trapped in a vicious cycle of long-term stagnation or decline (so-called “development traps”) to national growth is substantial, which means that leaving these regions with levels of economic activity below their potential is an important missed opportunity.
    - **Social costs**, as persistent inequalities challenge the capacity of subnational governments to provide adequate access to key public services and infrastructure, both in economically dynamic regions that may struggle to cater to the large numbers of people they attract and in lagging regions and/or those in a development trap where public services become stretched, of low quality or difficult to access.
    - **Political costs**, as regional inequalities, are a factor behind large regional variations in trust in government in OECD countries, with variations between countries’ most and least trusting regions, ranging from below 10% to over 30% difference. These variations have given rise to growing discontent and disengagement, strain social cohesion and undermine democracy over time.
- This geography of discontent is unfolding at a time when countries need to accelerate the green transition and manage demographic changes. As megatrends are not impacting regions in the same way and lagging regions are often most likely to be adversely affected, persistent regional inequalities further hinder these regions’ capacity to respond and adapt to change and, in turn, jeopardise governments’ ability to make the green and digital transitions equitable and just.
- To effectively reduce regional inequalities, policy responses are warranted at the national and subnational levels of government and in a shared responsibly so as to address the concerns of and improve prospects for those regions that have been left behind, while sustaining the prosperity of the most dynamic regions. It requires taking co-ordinated and sequenced actions at different government levels across five policy priorities:
    - Ensuring equitable access to quality public services and infrastructure in all regions.
    - Boosting productivity and competitiveness.
    - Providing the right skills and quality job opportunities in regional labour markets.
    - Improving the quality of multi-level governance systems.
    - Strengthening capacity at the national and subnational levels of government.

Introduction

Chapters 2 and 3 of this report undertake a thorough analysis of regional inequality trends and drivers across OECD regions and within countries over the past two decades and conclude that these trends are heterogenous. The analysis shows a diversity of situations across OECD countries, each of which requires a diverse set of context-specific policy responses to address regional inequalities more effectively. This diversity reflects disparities in productivity resulting from differences in economic structure, the supply of skilled labour, physical capital and natural resources, and public infrastructure and strong path dependency in these spatial distributions. Such diversity may also relate to the local availability of certain amenities and is affected by labour market institutions and redistribution through taxes and benefits.

Not addressing wide and sustained regional inequalities has led to negative by-products and future remedial costs, often outweighing the costs of directly addressing those inequalities, that has become increasingly difficult, whether politically or socially, to ignore. To effectively reduce regional inequalities, policy responses are warranted to address the concerns of and improve prospects for those places that have been left behind, while sustaining the prosperity of the most dynamic regions and helping regions navigate the green and digital transitions. The chapter starts by discussing how inaction on regional inequalities can have adverse consequences on economic performance, service provision, social and political stability and the just transition in OECD countries. To encourage and guide public action, the chapter then proposes a comprehensive policy roadmap to support policy makers at different levels in their efforts to effectively address regional inequalities now and in the future.

Leaving regional inequalities unchecked: The consequences of inaction

Economic development is spatially uneven due to the differences in factors of production across regions. While cities enjoy agglomeration benefits, rural regions tend to depend highly on primary and tradeable activities. As discussed in earlier chapters of this report, pockets of economic activity and clusters tend to concentrate on space and natural resources are localised in specific geographies. Differences in factors of production translate into differences in productivity and growth potential, giving rise to unequal development patterns. Inequality in development patterns is often considered necessary or a “fact of life” of economic development. But there are important downsides to spatial inequality, especially when gaps become too high and persist over time.

This section looks at three negative by-products of regional inequalities: i) missed economic opportunities and a loss of growth potential; ii) cost implications for delivering high-quality services across the entire territory; and iii) risks of discontent and instability when they pass a certain threshold and some territories are left behind. It also examines the importance of anticipating and mitigating the potential increases of regional inequalities to deliver a just green and digital transition.

Across OECD regions, weak and strong signals of these by-products have been emerging in recent years and it has become clear that the consequences of inaction will eventually lead to even higher future remedial costs. Hence, regional policies must mitigate spatial inequality in new and better ways, moving away from quick fixes that have created dependency relationships in the past, towards a mix of muti-level, multi-sectoral policies and sound institutional and fiscal frameworks, tailored to the prospects of different kinds of OECD regions.

Spatial inequality and economic development: What does the theory tell us?

Some level of regional inequalities is inherent to and unavoidable in any country as the cycle of economic development and place-specific endowments of people and skills, firms and industries have led to the concentration of high-technology and knowledge-intensive sectors in some, predominantly urban, regions.

According to the economic literature, several studies provide some theoretical foundations for the rise of spatial inequality:

- Models of the New Economic Geography (NEG), the urban agenda and the new trade theory, have given important insights into explaining why economic activity and settlement patterns tend to concentrate in certain locations, which generates core-periphery spatial patterns. The model is based on a spatial equilibrium between the benefits and costs of agglomeration. Estimates predict that when city size doubles, productivity increases between 2-5% on average (OECD, 2015[1]).
- The cumulative dynamics also apply to superstar firms and industry clusters (Alfaro, Chen and Fadinger, n.d.[2]), showing a clear hub-and-spoke structure in the geographic distribution of agglomeration patterns of industries and plants in Europe related to superstar firms, suggesting that regional policies could have a role in building superstar-centred industry clusters.
- Studies based on endogenous growth theory and institutional economics may also reinforce these spatial outcomes. Acemoglu and Dell (2010[3]) document that about half of the between-country and between-municipality differences can be accounted for by differences in human capital and productive efficiency is determined by national factors and local institutions, such as the availability of local public goods and the security of property rights giving rise to inequality. Frick and Rodríguez-Pose (2018[4]) also find a relation between governance factors and infrastructure factors and divergence in regional growth rates. Their analysis examines the relation between city size and economic growth and finds that growth is highly dependent on adequate infrastructure and governance conditions.
- There are also studies that show the resilience of regions and cities to economic shocks and national economic recovery also differ such as the shocks of the global financial crisis, or more recently the COVID-19 pandemic and Russia's war against Ukraine. Duranton (2007[5]) showed that small, innovation-driven shocks lead to the churning of industries across cities. This may then lead to slower growth or decline in cities, following net gains or losses of industries.

When looking at time dynamics and the evolution of regional inequality over time, there are different scenarios:

- The standard neo-classical growth models using capital accumulation, labour and savings (Solow, 1956[6]), Swan (1956[7]) predicts convergence to a steady state over the long run. This means that poorer regions further away from their steady-state level will tend to grow faster and thus converge, and inequalities would then eventually decline from the bottom of the distribution.
- Williamson's curve predicts a rise in inequality and a decline over time. It suggests that in a catching-up country, a few growth poles concentrate in regions which attract the bulk of capital, knowledge and skilled workers. As productivity rises in these regions, it will lead to faster growth and increasing disparities among regions. At later stages, as higher factor costs or diseconomies of agglomeration emerge in these regions, capital is likely to move to other regions with lower capital per worker. In addition, knowledge spillover effects may enhance the reallocation of productive factors across sectors and regions, which leads to convergence in income levels (OECD, 2012[8]).
- Economic models of the NEG predict a core-periphery equilibrium but do not provide a clear prediction of the links between economic concentration and growth. These models explain why economic activities concentrate in specific geographies and sometimes benefits of agglomeration are offset by costs that arise on the concentration. The forces enhancing agglomeration typically include migration of labour, forward and backward linkages and elasticity of labour supply.

Several studies have investigated how agglomerations can benefit adjacent regions, also called "borrowed" agglomeration effects from neighbouring cities. Estimates of the benefits predict that for a doubling of the population living – at a given distance – in urban areas within a 300 km radius, the productivity of the city in the centre increases by between 1% and 1.5% (OECD, 2015[1]). Thus, evidence has shown that, more often than not, these spillover mechanisms to less-favoured regions have a more limited effect than expected. The increasing importance of knowledge-based services has also reinforced the existing advantages of large metropolitan regions over low-density and less urbanised regions (Oliveira Martins, 2021[9]).

While spatially uneven development is regarded as the price to pay for economy-wide productivity maximisation – the overarching goal being to make the "economic cake" bigger first and then distribute it –, experience over the past decades has shown that this model has in many instances exacerbated inter-personal and regional inequalities and, in fact, failed to deliver and activate development opportunities in lagging regions. Today, inaction on regional inequalities is raising different types of costs, which are discussed in the following sections.

Regional inequalities can lead to missed economic opportunities

Many lagging, lower-income regions and regions in a "middle-income trap" have levels of economic activity that are well below their potential, both in terms of employment and productivity (EC, 2022[10]; Diemer et al., 2022[11]) and are often seen as a drag on national performance, rather than as potential assets to be exploited. Yet, the OECD has evidenced that, while there will always be inter-regional gaps, those lagging regions have opportunities to "catch up" in terms of social and economic development (OECD, 2016[12]). Leaving lagging or stagnating regions behind can not only affect the regions themselves but has important consequences for national aggregates. Indeed, while individually, the impact of these regions on national growth can be relatively small, in aggregate, the contribution to national growth of all regions with catching-up potential is substantial, even at these lower levels (OECD, 2012[8]).

An exclusive focus on the leading regions is not sufficient to drive average productivity. While the productivity frontier is mostly urban, many regions with large rural populations also do well and have been catching up to the national frontier. At the same time, those regions falling behind national frontiers include many urban regions (OECD, 2016[12]). As discussed in Chapter 3, only by generating stronger growth, fuelling the catching-up machine in all types of regions in a synchronised manner and supporting the performance of the system of regions as a whole, can national economies increase aggregate productivity and reach their total output frontier.

Regional inequalities challenge the capacity of subnational governments to provide quality public services

Differences in quality and access to public services are key determinants of inequalities between regions in OECD countries, as discussed in Chapter 2. In turn, when left unaddressed, high and persistent regional inequalities challenge the capacity of subnational governments to provide people with adequate access to public services and infrastructure.

On the one hand, economically dynamic regions and notably urban areas may have difficulties maintaining infrastructure capacity and/or keeping pace with infrastructure expansion needed to cater for the large numbers of people they attract. The consequence may be shortages in affordable quality housing and congestion problems (OECD, 2015[1]). This creates a challenge, particularly for cities' lower-skilled workers who may work in more precarious jobs and struggle with high urban costs of living, long commutes and air pollution problems.

On the other hand, lagging regions typically get trapped in a vicious cycle of decline that affects the quality of local public service provision, which becomes increasingly expensive. Regions that have suffered from long-term industrial decline have seen their unemployment rise and labour force participation decline and, in many cases, they have lost competitiveness and have not successfully transitioned into other areas of competitive advantage. As a result, public services in these regions have become stretched, are of low quality or are difficult to access, which may then be a catalyst for further outmigration of higher-skilled workers and their families. Furthermore, many of these regions are also often facing accelerated demographic changes, including population decline and ageing, pushing up the demand for health and other social services (OECD, 2022[13]).

The physical infrastructure needed to provide good quality public services can be more complex and expensive in lagging regions and attracting highly skilled people poses an additional challenge. Many rural schools, for instance, are facing or will soon face declining student numbers, generating smaller schools, class sizes and student-teacher ratios (OECD, 2021[14]). While smaller sizes can present some opportunities such as more teaching time per student, many small rural schools operate in isolation and under capacity with a limited educational offer and their principals and teachers struggle with multiple roles. The challenges are even larger in remote rural regions with low population densities. With fewer people spread over a wider area, economies of scale are difficult to achieve.

In principle, differences in relevant aspects such as population density and demographic structure translate into unavoidable higher costs of service provision in certain local units and regions within countries. These higher per-unit costs translate into lower quality services, which in turn could lower the attractiveness of the regions and incentive further drops in population and tax revenue of these places leading to negative downward spiral dynamics. Given that, across many OECD countries, national constitutions recognise health and education provision as core rights, maintaining services in these places represents a high cost and often leads to the transfer of resources across places and dependency dynamics.

Regional disparities in access to quality services, especially essential ones, can lead to increased spending on social support services and more complex healthcare issues for instance and, in turn, lower tax revenues (related to lower employment outcomes from inactivity) (OECD, 2022[15]). In education, a lack of access to quality opportunities can lead not only to lower lifelong employment opportunities, incomes and well-being but also to higher intergenerational inequalities (Hanushek and Woessmann, 2020[16]). In healthcare, a lack of access to quality care can translate into worse health outcomes, higher incidence of chronic disease, increased mortality and ultimately to a lower quality of life (OECD, 2021[14]). Migration induced by inadequate access to services can lead to brain-drain and exacerbate existing gaps in the availability of educated workers such as doctors and teachers in rural areas. Against this backdrop, ensuring the vitality of lagging places by investing in framework conditions for development or making use of technological solutions and network effects to deliver services can act as effective measures to avoid future, and potentially considerable, remedial costs.

Regional inequalities threaten social and political stability, giving rise to the geography of discontent

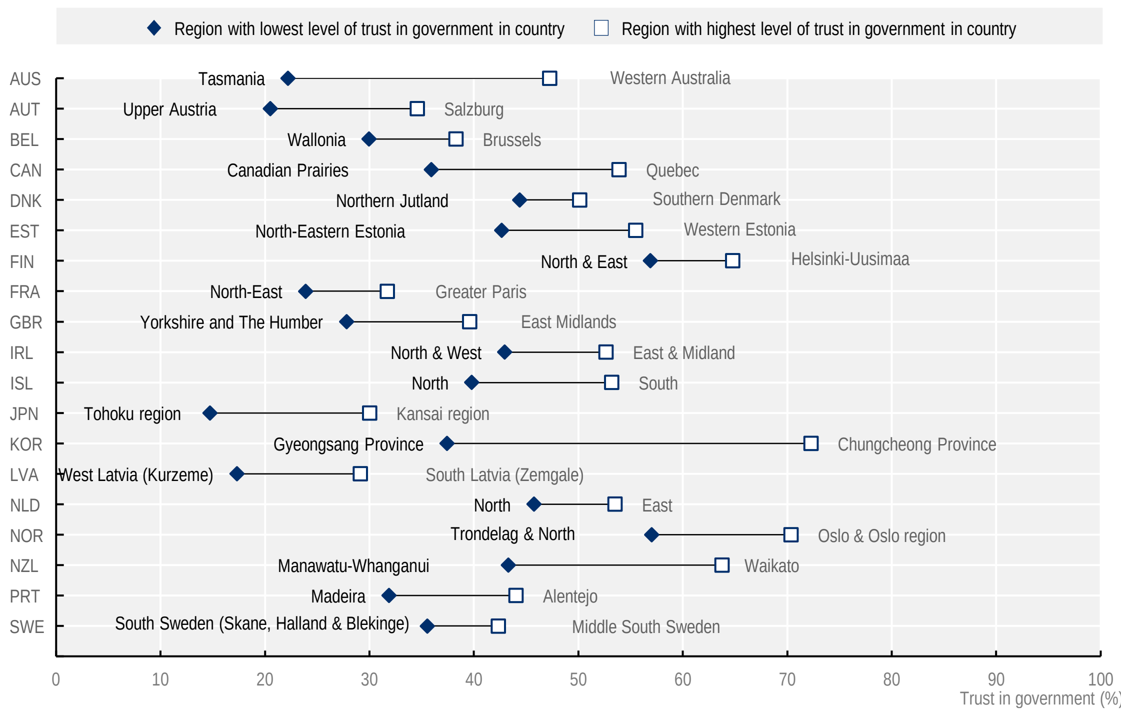
Regional inequalities are a factor behind large regional variations in trust in government in OECD countries. Data from the 21 countries included in the OECD Trust Survey reflect variations between each country's most and least trusting region, ranging from under 10% in Australia to a more than 30% difference in Korea (Figure 5.1). This suggests government trust deficits in many OECD countries have a territorial cleavage (OECD, forthcoming[17]; 2022[18]). Levels of trust in OECD territories have also been in flux in recent years, having declined in certain regions and risen in others.

There are a number of ways in which regional inequalities can contribute to trust deficits in certain places. Empirical evidence from OECD countries suggests that places with higher levels of government distrust are primarily: i) comparatively wealthy areas that have been in long-term economic decline (e.g. certain parts of northern Italy); and ii) middle-income areas that have been unable to sustain economic growth because they are not sufficiently innovative to compete with more productive regions (this primarily includes rural areas and small or medium-sized cities) (Dijkstra, Poelman and Rodríguez-Pose, 2020[19]). These findings reflect the growing divides between places that feel left behind by globalisation and technological change, and those that may benefit from the opportunities offered by megatrends, and even more so since the global financial crisis.

Regional disparities in trust in government reflect the differing levels of success that national and subnational governments have had in dealing with their citizens' challenges and needs. Furthermore, citizens tend to trust subnational governments more than national ones. In 2020, for example, trust in regional and local authorities across European Union (EU) member states was nearly 10% higher than trust in national governments (OECD, forthcoming[17]).

Figure 5.1. Regional disparities in national government trust, 2021

Share of respondents that trust the national government in OECD regions with the highest and lowest level of trust by country



Note: Proportion of respondents that "trust" the national government based on an aggregation of responses from 6-10 on the scale, based on responses to the question: "On a scale of 0 to 10, where 0 is not at all and 10 is complete, how much do you trust each of the following? The national government". "OECD" presents the unweighted average across countries. Finland's scale ranges from 1-10 and the higher trust/ neutral/ lower trust groupings are 1-4/ 5-6/ 7-10. New Zealand shows trust in civil service as respondents were not asked about trust in the national government (note that trust in civil service on average tends to be higher than trust in national government). Colombia, Luxembourg and Mexico are not shown due to data unavailability.
Source: OECD (2022[18]), *Building Trust to Reinforce Democracy: Main Findings from the 2021 - OECD Survey on Drivers of Trust in Public Institutions*, https://doi.org/10.1787/b407f99c-en.

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In addition to long-term economic outcomes, there is also evidence to suggest that trust in government can be undermined by more short-term shocks to regional and local economies, such as increases in unemployment. In the United States, for instance, voters in local communities experiencing significant job losses in the manufacturing sector have shifted strongly towards anti-establishment candidates in recent years (Guriev and Papaioannou, 2020[20]). In the European Union, changes in regional unemployment rates between 2008 and 2014 were found to have a causal effect on decreasing trust in national parliaments and increasing votes for anti-system parties. An unemployment increase of 5 percentage points was associated with a drop of 3.65 percentage points in trust towards a country's national parliament (Algan et al., 2018[21]).

While short- and long-term socio-economic outcomes are important determinants of trust, they often fail to fully explain its territorial variations. An additional factor that is thought to contribute to territorial divides in trust in government is the quality of local public service delivery. In Europe for instance, residents in a rural area or town were found to have a lower average level of trust in government compared to those living in cities, even after controlling for demographic, economic and cultural differences among cities and rural areas (EC, 2022[10]). Researchers found that a key factor behind this was dissatisfaction with local public services (notably education and healthcare) (Mitsch, Lee and Ralph-Morrow, 2021[22]). This finding is also reflected in recent OECD work in countries like Finland and Norway, where responsiveness in delivering public services has been identified as one of the most important determinants of citizen trust in national and local governments (OECD, 2022[23]; 2021[24]).

Persistent regional inequalities raise the risk that territorial divides in trust experienced by OECD countries will continue to grow and with them the risk of making the economic, social and political costs of inaction even higher:

- Lower levels of trust have been shown to have a negative impact on long-term regional economic performance (Algan and Cahuc, 2014[25]). This is because trust deficits can limit productivity through various channels, including trade, financial intermediation, the organisation of firms and labour markets. For example, a lack of trust may inhibit a country's performance by increasing transaction costs for businesses.
- Lower levels of government trust may affect the willingness of citizens to accept government policies, including in a crisis situation. Evidence collected in the early part of the COVID-19 pandemic provides a stark illustration of this effect. In the European Union and the United States, for example, mobility data show that, on average, people complied with COVID-19 health restrictions on movement less consistently when they did not trust their governments (Bargain and Aminjonov, 2020[26]; OECD, 2021[27]). At the regional level, low trust in institutions was also associated with higher excess mortality in EU and OECD countries during the first year of the pandemic (after controlling for economic and demographic differences), which may reflect, at least in part, lower overall compliance with health measures in these areas (Diaz-Ramirez, Veneri and Lembcke, 2022[28]).

Persistent economic stagnation or decline in many regions of OECD countries has given rise to growing discontent and resentment of the political and economic status quo. This trend has become apparent across the OECD, as indicated by growing political polarisation, growing political fragmentation, as well as the collapse of established political parties, record-low voter turnout and the surge of new or newly reconfigured parties from across the political spectrum.

Persistent regional inequalities can jeopardise a just green and digital transition

As earlier chapters discuss, megatrends such as climate and technological change are not impacting regions the same and lagging regions are often the one standing to be most affected. Persistent regional inequalities further hinder these regions' capacity to respond and adapt to change and, in turn, jeopardise governments' ability to make this transition equitable and just.

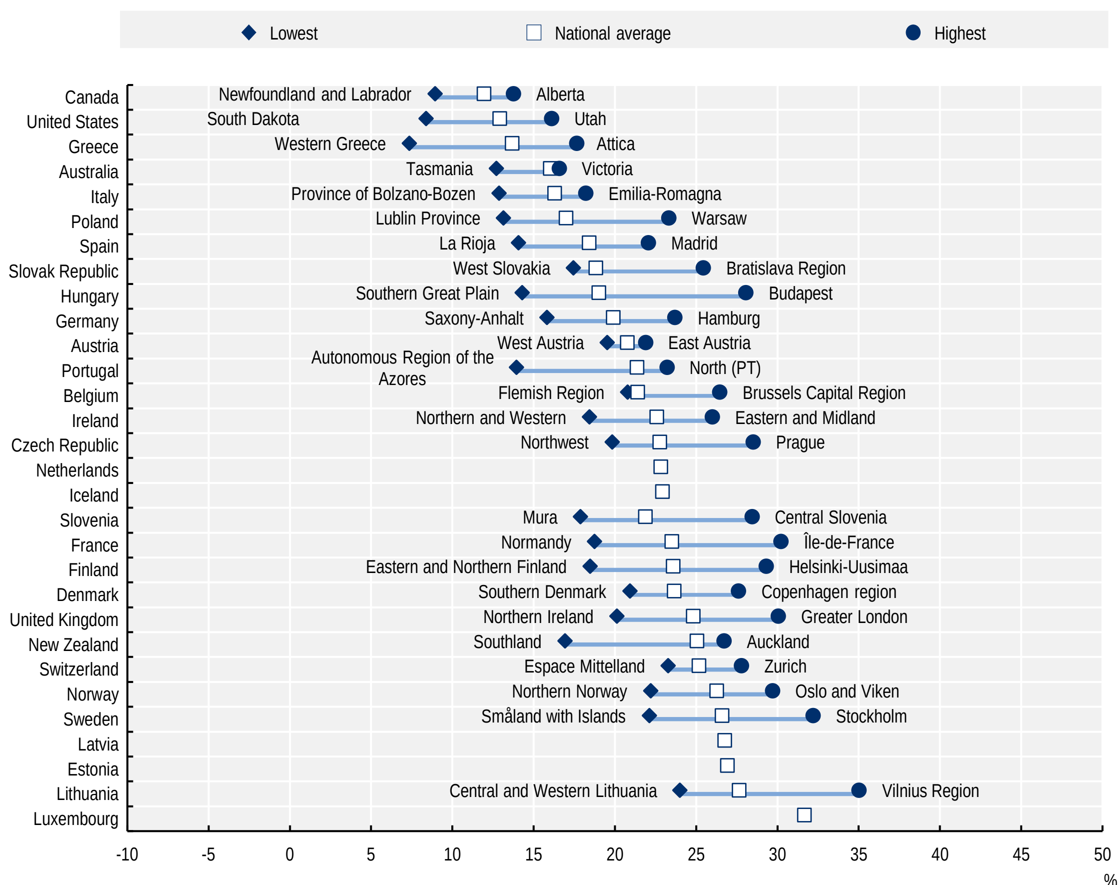
In the green transition, climate adaptation challenges and opportunities differ sharply across regions as some concentrate on employment and carbon emission-intensive activities. Furthermore, average wages in the key manufacturing sectors most likely to be impacted by the green transition are often higher than average wages in the economy as a whole, meaning that job loss or job transformations pose risks for wealth in regions hosting them (OECD, 2022[13]). These regions are often already lagging, implying they may have fewer economic resources to absorb shocks and take advantage of opportunities. In the

European Union, for instance, the largest share of regions most vulnerable to the industrial transition to climate neutrality lag on several socio-economic characteristics, especially gross domestic product (GDP) per capita and average regional wages (OECD, 2023[29]).

The OECD finds that the share of green-tasks jobs differs on average by 9 percentage points between the regions with the lowest and highest share (Figure 5.2). In some of these regions, workers are also exposed to poverty risk or are vulnerable on account of narrow, limited skills (OECD, 2023[30]). Regions also differ in their access to key infrastructure some of these industries will require, notably for hydrogen, carbon capture and storage and zero-emission freight transport, which is key to value chains. Addressing inequalities between regions can therefore strengthen their capacity to weather these changes and take the actions needed to ensure the success of the green transition.

Figure 5.2. Regional disparities in green-task jobs within countries

Share of green-task jobs across and within countries, OECD regions, 2021 or last available year



Note: Last available year. 2019 for the UK. 2020 for Iceland. 2021 for Australia, Canada, EU countries, Norway, New Zealand, Switzerland and the United States. According to the OECD, green-task jobs are defined and analysed at the occupation level based on the greenness of their related task content.
Source: OECD (2023[30]), *Job Creation and Local Economic Development 2023: Bridging the Great Green Divide*, https://doi.org/10.1787/21db61c1-en.

StatLink https://stat.link/it4csf

Similar to the green transition, the challenges and opportunities emerging from the digital transition are uneven across regions. The opportunities being created by digitalisation differ largely due to differences in connectivity, the share of occupations amenable to remote work and the digital skills required to succeed in this new economy (OECD, 2021[31]). The rise of remote working, increasing automation and the digitalisation of services are improving productivity and well-being for many people (see Chapter 3). Remote working, for example, is redefining how and where people choose to work, proving an important opportunity to improve the work-life balance by reducing commuting times and encouraging more flexible working arrangements. At the same time, it is redefining where higher-income higher-skilled workers choose to live, which will impact the future development of regions and transportation systems, and impact carbon emission patterns.

Adapting to the digital transition requires that people and firms in regions have the right digital skills but large gaps remain. The share of people using the Internet in regions with the highest use is 10 percentage points higher than in the region with the lowest use, while, despite an acceleration since COVID-19, small and medium-sized enterprises (SMEs) trail large firms in the adoption of digital tools such as cloud computing and big data for instance (OECD, 2023[32]). This can lead to significant differences in the ability of people and firms to position themselves for the new digital environment.

The challenges posed by the green and digital transition can be turned into opportunities to boost development in lagging regions and reduce regional inequalities. Climate mitigation policies for instance can support prosperity and well-being in rural regions. This can be realised through more sustainable land management, higher valorisation of ecosystem services, making use of innovative production processes around agriculture, mining and renewable energies and new modes of transportation. Similarly, remote working can bring new growth opportunities for rural economies. Remote working holds the potential to create new job opportunities outside large cities because of more affordable and suitable housing and office spaces with better access to environmental amenities (OECD, 2022[33]).

A policy roadmap to address regional inequalities effectively

For a long time, most policies to address regional inequalities aimed at compensating lagging regions and consisted of top-down, often short-term, subsidy interventions (e.g. for infrastructure and setting up public services) to the poorest regions. They mostly resulted in distorted markets and harmed the development chances of these regions in the medium and long terms. Such policies also often focused on keeping declining industrial sectors alive so as to protect local jobs, even when these sectors were condemned in the long term. Overall, these government responses failed to reduce inequality, generate new jobs in lagging regions or trigger a culture of economic dynamism (OECD, 2012[8]). Moreover, these actions had unintended consequences, creating a culture of dependency on the part of recipient regions, many of which are now trapped in a vicious circle of under development.

Effectively addressing and mitigating regional inequalities is no small task. These inequalities are not marginal but touch on fundamental issues in people's lives, from access to healthcare to employment. Regions – especially lagging regions – often struggle, not just on one front but on many. This means that mitigating regional inequalities effectively cannot be done with siloed policy responses but requires taking on multiple systemic and interrelated challenges at the same time.

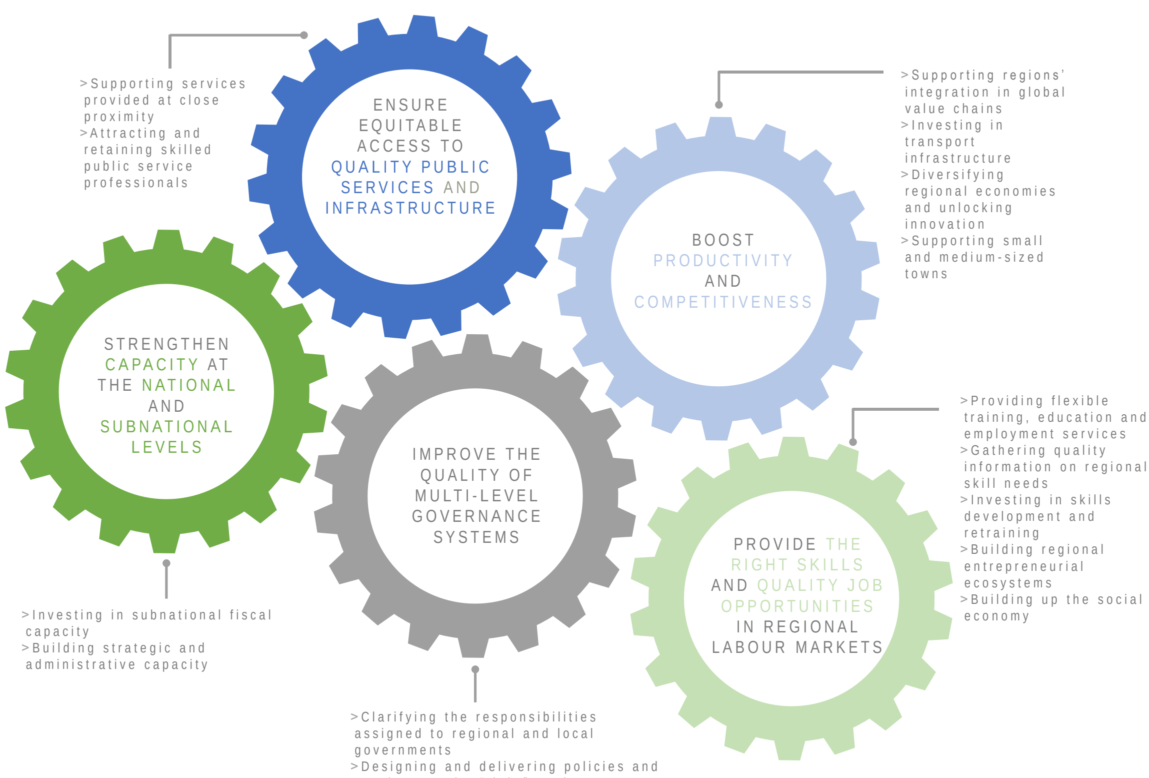
To guide policy efforts to address regional disparities in a way that both stimulates catching up in lagging/stagnant regions and sustains prosperity in the most dynamic regions, this section presents a policy roadmap structured around five priorities. These priorities, presented in Figure 5.3, should not be considered in isolation. Rather, policy makers should take co-ordinated and sequenced steps across all five to create equal opportunities across regions.

- Ensuring equitable access to quality public services and infrastructure in all regions.

- Boosting productivity and competitiveness.
- Providing the right skills and quality job opportunities in regional labour markets.
- Improving the quality of multi-level governance systems.
- Strengthening capacity at the national and subnational levels.

How to address regional inequalities depends largely on local economic, socio-demographic and geographic circumstances and differs from place to place. It means that delivering on the policy roadmap requires galvanising action across a wide range of governmental and non-governmental actors at different levels. This is best done through a place-based approach, one that recognises the heterogeneity characterising OECD regional economies, in terms of place (i.e. there is a continuum of places with different characteristics and different economic specialisations), activities (i.e. manufacturing, tradeable and non-tradeable services) and firms (i.e. in terms of productivity levels and growth) (OECD, 2019[34]; 2016[12]; Barba Navaretti, 2021[35]; Iammarino, Rodríguez-Pose and Storper, 2018[36]). The following sections discuss each of the five policy priorities in detail and present concrete policy measures and experiences across OECD countries.

Figure 5.3. A policy roadmap to address regional inequalities



Ensuring equitable access to quality public services and infrastructure in all regions

Why it matters

Improving access to quality public services can offer high social returns to investment including not only through better education and healthcare outcomes but also improved lifelong and intergenerational income and well-being outcomes. Indeed, bridging access gaps can generate higher tax revenues and decreased spending on social support services and more complex and costly health services. As the COVID-19 pandemic demonstrated, investing in reducing inequalities in service provision can also improve the resilience of systems to respond to unexpected shocks (OECD, 2022[15]).

Policy measures

Supporting services provided at close proximity and through flexible and/or digital models

The provision of basic services such as primary care remains essential in keeping the need for more specialised services at bay. OECD countries have striven to bridge access gaps in places lacking other options, including through innovative and digital solutions, such as expanding telemedicine and developing digitally based sharing mobility services. These strategies however often need to be accompanied by substantial transversal investments to tackle rural-urban gaps in (digital) skills and connectivity (OECD, 2022[15]).

The costs of service delivery not only depend on density or absolute or relative distances but also a wide range of other factors including economies of scale and scope. Policy efforts have focused on pursuing integrated and flexible approaches to the provision of services, notably by offering different types of related services in a single location, in order to broaden access, reduce costs and improve outcomes, especially for underserved communities in rural or remote regions.

Country examples

- In **Finland**, municipalities have streamlined service delivery to immigrants in communities with a high share of foreign-born population in multi-service centres. In these centres, public employment services collaborate with municipal services to help foreign-born jobseekers find employment or help them enrol in education (OECD, 2020[37]).
- In **France**, a network of over 1 000 Public Service Houses (*Maisons de service au public*) delivers public services in low-density or isolated territories through one-stop-shops, thus lowering fixed costs and staff needs for the different services. They offer a range of services, from postal services, public transport ticketing and energy utilities, to unemployment insurance and welfare services. Furthermore, the Ministry of Social Affairs and Health launched the Health Territory Pact (*Pacte territoire santé*) to promote the recruitment and retention of doctors in underserved areas. This pact includes a mix of measures including financial incentives, the creation of new multidisciplinary medical homes allowing physicians and other health professionals to work in the same location and the promotion of telemedicine (OECD, 2021[14]).
- In **Japan**, the Small Stations initiative creates basic service hubs to help sustain rural communities around small, multi-functional cores. Their offer includes administrative services, healthcare and shopping opportunities; transport networks are arranged to facilitate access to the population of the surrounding rural areas (OECD, 2016[38]).

Attracting and retaining skilled public service professionals

This is especially important at a time of high labour demand and staff shortages, especially in the care sector. Policy measures to address this challenge typically focus first on improving the attractiveness and working conditions in these professions, including working hours, pay, job security and access to training. Specific support for workers interested in moving into the care sector can also be part of the solution, for example in the form of career guidance and training. Additional incentives – financial or otherwise – can then help encourage professionals to take up work in underserved locations (OECD, 2016[39]). This can take the form of special scholarships to obtain certain qualifications and could be combined with return-of-service obligations, one-off payments for those moving to underserved areas and to support their installation, or recurrent bonuses (OECD, forthcoming[40]).

Country examples

- In **Australia**, the Workforce Incentive Program, implemented in early 2020, provides targeted financial incentives to doctors and general practitioners to encourage service delivery in rural and remote areas. Financial incentives are linked to both the level of remoteness and the years of service provided. In the most remote areas, doctors are eligible for an annual payment of up to AUD 60 000, about EUR 40 000. But relocation packages can go beyond direct financial incentives and include rewards through better career prospects and skill development (OECD, 2021[14]).
- To encourage and support workers interested in moving into the care sector and make up for staff shortages in these professions in some regions, regional agencies in the **Netherlands** run campaigns to improve the public image of long-term care, providing students with short lectures and training sessions on regional labour market needs (Georgieva, Downes and Bachtler, 2021[41]).

Boosting productivity and competitiveness

Why it matters

Stagnating productivity growth and its consequences for well-being contribute to social and political polarisation (see discussion earlier in the chapter). Inversely, more productive regions tend to offer better jobs that translate into better wages and incomes for households, and more balanced development within countries. These places are also more likely to generate the tax revenues necessary to finance public services and infrastructure, such as health, education, transport and social support (OECD, 2020[42]; Tsvetkova et al., 2020[43]).

Policy measures

Supporting regions' integration in global value chains (GVCs)

As discussed in Chapter 3, operating in global markets exposes regions to practices of the global productivity frontier and makes them less constrained by country-specific limitations (e.g. technological, financial and related to market size) or equilibria (e.g. when frontier regions already dominate the local markets) (OECD, forthcoming[40]). An advantage of healthy tradeable sectors – especially tradeable services and manufacturing – is that they can enhance productivity in all types of regions – i.e. predominantly urban or rural – although tradeable subsectors and mechanisms in place might vary depending on the type of area (OECD, 2016[12]).

The impact of the war in Ukraine on GVCs has created a renewed focus on reshoring and nearshoring critical industries in regions. This is part and parcel of a broader trend of the macro-regionalisation of supply chains since the global financial crisis, which has been further accelerated by the COVID-19 crisis, albeit recognising that diversified supply chains can also be a source of resilience (see discussion on sectoral specialisation and diversification in Chapter 3). Regions must navigate and make the most of this new global environment and the OECD Programme on Regions in Globalisation provides an analytical framework to help examine and understand subnational drivers of attractiveness to key international target groups (Box 5.1).

Box 5.1. Rethinking regional attractiveness in the new global environment

Recent crises have prompted regions in OECD countries to rethink their participation in globalisation, as well as their relative attractiveness to investors, talent and visitors. As a result, regions need to better understand the structural challenges emerging or reinforced by these crises (i.e. COVID-19 pandemic, Russia's war of aggression against Ukraine) and existing megatrends (e.g. digitalisation and demographic change) and how their international profiles may have changed, while maintaining a focus on providing benefits to local residents and businesses and preserving environmental resources.

To help regions better understand their position in the new global environment and rethink their attractiveness strategies, the OECD has designed an innovative and multidimensional methodological framework that first considers and maps a region's international connections across four families of connections: business (e.g. foreign direct investment [FDI] projects, trade, employment in foreign-controlled businesses, etc.), human (employment, migration and visitors), knowledge (international students, research and development [R&D], patents) and infrastructure (broadband, ports, airports, stations). However, simply understanding a region's position in the world is not sufficient – other tools need to be identified to help strengthen that position.

Identifying available policy levers to enhance international connections and more effectively attract specific target groups (e.g. investors, talent and visitors), for example, requires a closer examination and understanding of subnational drivers of regional attractiveness. To do this, the OECD regional attractiveness framework considers global engagement beyond international connections and economic factors alone. In total, the methodology considers a dashboard of over 50 indicators to develop regional attractiveness profiles, covering 14 dimensions of attractiveness, across 6 domains, at the level of large regions:

- Economic attractiveness (e.g. innovation, entrepreneurship and labour market).
- Connectedness (e.g. transportation, logistics and digitalisation).
- Resident well-being (e.g. health, education and social cohesion).
- Natural environment (e.g. environment and natural capital).
- Visitor appeal (e.g. tourism and cultural capital).
- Land use and housing (e.g. usage and affordability).

The OECD approach provides regions with a graphical representation in the form of an "attractiveness compass" that highlights the strengths and weaknesses of regions across the six domains. It enables regions to compare their attractiveness relative to regional performance in their country, the European Union and the OECD. As a diagnostic tool, regional profiles can highlight to policy makers those areas where attractiveness can be strengthened. Furthermore, they can provide useful evidence to inform decisions concerning the various levers at their disposal to enhance regional attractiveness to key target groups, within the context of a region's development priorities, trends and ambitions.

Source: OECD (2023[44]), "Rethinking regional attractiveness in the new global environment", OECD, Paris.

Investing in transport infrastructure

Transport infrastructure can contribute to leveraging agglomeration economies of metropolitan regions and expand the benefits of well-functioning cities to other lower-density regions, including in terms of knowledge and innovation diffusion and links to financial institutions, which are crucial to entrepreneurship, firm growth and public infrastructure investment. To help create new economic activity in lagging regions, transport infrastructure investments call for complementary policies supporting the (re)activation of unutilised resources, such as coupling FDI attraction policies with investment in major international transport hubs (OECD, 2020[45]).

Developing transport infrastructure that maximises the accessibility of opportunities for people and firms requires accounting for functional relationships across space that often go beyond administrative boundaries. A functional approach to transport infrastructure accounts for the diversity of scales and can thus help fit transport infrastructure to the needs of people and workers living in a place (Dijkstra, Poelman and Veneri, 2019[46]). This approach has important governance implications and requires incentives to work (see the following section on multi-level governance).

A functional approach is especially important to leverage rural-urban interlinkages through inter-regional transport infrastructure, inter-municipal co-operation, urban-rural partnerships, etc. Accessibility to metropolitan areas (through distances or driving times) is a powerful determinant of the "agglomeration economies" that rural areas can borrow from urban areas (Fadic et al., 2019[47]) and thus of the productivity growth potential that governments can leverage through better transport infrastructure. The functional approach is also behind the OECD definition of functional urban areas (FUAs) for instance, which delineate metropolitan areas' boundaries through labour market interactions between cities and their surroundings (OECD, forthcoming[40]).

Country example

- In **Germany**, the Branderburg *Land* implemented the Connecting Strengths strategy based on the promotion of core regional growth areas and clusters. The strategy capitalises on regional "strengths" including new forms of work and technologies, renewable energy, mobility, organic farming and tourism while leveraging on vertical and horizontal co-ordination between actors across themes, sectors and ministries. In the future, the strategy will evolve with an approach based on growth corridors to strategically connect people, businesses, governments and R&D along existing railway lines to better connect metropolitan and rural areas (Land Branderburg State Chancellery, 2021[48]).

Diversifying regional economies beyond their traditional strengths and unlocking innovation

Economic diversification is important to boost productivity and competitiveness, especially in lagging regions where innovation creation and uptake often lag behind metropolitan regions, weighing down on aggregate productivity, income levels and overall well-being (OECD, 2022[49]). Focusing on labour-augmenting innovation that improves job opportunities and wages can contribute to dynamically stimulating lagging regions and bend the trend of high-paying jobs concentrating in certain, often metropolitan, regions (Storper, 2023[50]).

A broad approach to innovation consists in promoting technology and non-technology-driven innovation, building innovation competencies of SMEs, better connecting regional innovation actors and stronger engagement with regional innovation cluster organisations, creating a stronger regional innovation ecosystem and linking innovation with broader regional development goals. It also means supporting innovative entrepreneurship to generate economic and industrial diversification and, through this, diversify innovation potential (OECD, 2021[51]). The OECD has developed a self-assessment toolkit for regions that allows national and regional policy makers to implement up-to-date assessments of bottlenecks for innovation diffusion in different regions. The toolkit provides a regional innovation profile (relative to other

OECD and EU-27 regions), quantifies the strength of different innovation diffusion channels in the region and allows policy makers to engage local stakeholders to gather their views on actions for improvement.

Country example

- In **Italy**, Piedmont's regional innovation policy aims to strengthen regional innovation capacities in order to boost regional competitiveness and foster innovative and dynamic enterprises. Since its inception, the policy has supported collaborative R&D, including through innovation clusters and the promotion of partnerships in important areas such as the smart factory, Industry 4.0, life sciences and the bioeconomy. Yet, Piedmont's strong concentration in manufacturing and sophisticated and specific innovation activities in local core industries are at risk of decline due to ongoing industrial transitions. Moreover, where innovation does occur, it tends to be created by larger firms, with only limited innovation by SMEs that dominate Piedmont's industrial system. In recognition of these challenges, the Piedmont Regional Government is taking a fresh look at its innovation policy design, implementation, monitoring and evaluation to prepare its smart specialisation strategy and revisit the current innovation cluster model that supports innovation in the region (OECD, 2021[51]).

Supporting small and medium-sized towns

Smaller urban areas are increasingly being seen as potential motors of regional development and catching up, although they are extremely heterogeneous in terms of development trajectories and underlying driving factors. They hold great potential to enable more polycentric development and greater territorial cohesion through a more balanced diffusion of activities and opportunities across space while helping boost broader territorial development by providing services and amenities to surrounding territories.

In this respect, intermediary cities can offer an attractive alternative to large metropolitan areas, especially to people looking for more affordable housing and better environmental quality and, in turn, boost well-being and reduce many of the negative externalities often presented by larger metropolitan areas, including urban sprawl and pollution, whilst also helping to preserve natural resources and landscapes.

In some OECD countries, urban strategies and programmes are no longer limited to addressing urban challenges characteristic of large metropolitan areas but also encompass specific visions and measures for smaller and medium-sized towns with the aim of increasing their innovation capacity and transition potential and preventing them from losing their socio-economic function.

Country examples

- In **Belgium** (Flanders), a document outlining a new urban vision outlines a common agenda for 34 regional cities. Within this approach, the government earmarks 10% of the 2021-27 Flemish European Regional Development Fund (ERDF) budget to 11 smaller, regional cities (*Centrumsteden*). Thematic interests are aligned with Flanders' long-term policy framework, Vision for 2050, whereas multi-level governance and horizontal co-operation are the strategic objectives in order to bridge the gap between these cities and surrounding territory (Georgieva, Downes and Bachtler, 2021[41]).

- In **France**, the Small Towns of Tomorrow programme (*Petites villes de demain*) was launched in 2020 and will mobilise EUR 6 million over 2020-26 with the objective to revitalise over 1 600 small towns and municipalities, especially in declining regions. The programme aims to strengthen the capacity of elected officials and intercommunal bodies in these places to implement projects that leverage opportunities arising from the green transition and make these places more resilient (Agence de la Cohésion des Territoires, 2023[52]).
- In **Norway**, the recent white paper *Vibrant Communities for the Future* focuses on districts and the challenges they face (e.g. skills and labour shortages, high age dependency ratios, quality of public services, challenges to business development). The white paper provided for two commissions to report on aspects of district policy – one on the role of businesses and the other on demographic challenges. In addition, a "youth panel" was set up to provide insights into what makes, or would make, district life attractive to younger people. Under the white paper, a study was commissioned by the Ministry of Local Government and Regional Development (KDD) to explore the role of small towns in regional development. The study highlights the diversity of Norwegian small towns and settlements outside major agglomerations and notes that, unlike major urban centres, they have not been a focus of policy in spite of their potential for stimulating regional development. A new strategy has focused on tapping the potential of small towns and reinforcing their role as "specialised" centres for service provision and makes concrete proposals to develop partnerships, digital technologies, greater collaboration and potential co-location of government (Ministry of Local Government and Regional Development, 2020[53]).

Providing the right skills and quality job opportunities in regional labour markets

Why it matters

Geographic inequalities in the number and quality of jobs available are large. Many policy responses to regional inequalities have given priority to distributing job opportunities more equally across regions, addressing regional skill imbalances, improving regional labour market outcomes and forecasting skill needs at the regional level to alleviate risks associated with structural change, such as industrial transitions.

Policy measures

Providing flexible training, education and employment services

In the context of the knowledge economy and as skills become more important to innovation and growth, the availability of a skilled workforce is increasingly important to firms' decisions to locate, remain and/or expand in a locality or region. In regions where quality job opportunities are rare, workers and young people have lower incentives to invest in their human capital and to increase labour market participation (OECD, 2020[54]). Meanwhile, businesses that lack qualified staff are unlikely to innovate and create good-quality employment. Wages and productivity are low and higher-skilled workers and innovative employers have the incentive to move to economically more dynamic areas leaving behind a low-skilled workforce and high unemployment (OECD, forthcoming[40]).

Flexible training, education and employment services are required to proactively respond to skills gaps that may act as barriers and obstacles to business growth and expansion. Providing workers with training in place-sensitive skills, which are relevant in the local context, can be one solution. For example, while the demand for basic digital skills will likely grow in all places, demand for more specialised skills may be more regionally concentrated. However, in addition to training workers, employers need to create the corresponding job opportunities to make sure that qualified workers can be retained and that their skills are put to good use. It is also essential to increase the visibility of learning and training offers and raising awareness among firms and potential learners to facilitate their participation.

In some cases, longer-term skills strategies are devised, such as for growing industrial sectors, which can increase the relevance of the training offered. However, regions and localities need to be careful to avoid overspecialisation and “lock in” to a limited rage of sectors. To ensure lifelong learning becomes a reality, local education and training systems also need to better adjust to the needs of workers, for example by offering flexible learning modules and after-hour classes (OECD, 2014[55]).

Country examples

- In **Latvia**, Public Employment Services offers support with taking up job offers, including subsidised employment or attending training at distant locations. Jobseekers who receive a job or training offer more than 15 kilometres away are eligible for temporary support of up to EUR 150 per month to cover transport or accommodation costs. Between 2013 and 2017, more than 9 000 workers benefitted from this support, a third of them under the youth guarantee. Evaluations show good results: receiving mobility support had positive employment and earnings effects including training participation. In practice, workers’ ability to take up a distant job offer will of course also depend on factors such as their family situation or on whether they own a private vehicle or depend on public transport (OECD, 2019[56]).
- In **Sweden**, employers can report their skill needs and work with education providers and public authorities to adapt vocational education programmes on regional skills platforms. Regional governments usually chair the platforms but all actors contribute to coming up with tools and activities needed to improve local dialogue, co-ordination and knowledge accumulation. Furthermore, the Swedish Job Security Councils provide workers at risk of collective dismissals a dedicated coach and a range of personalised services, including guidance and advice, training, financial support and business start-up support. Councils are financed through an employer levy of 0.3% and are run by social partners based on sectoral or cross-sectoral collective agreements (OECD, 2019[57]).
- The Rural Innovation Initiative in the **United States** seeks to assist rural regions interested in building local workspaces for remote workers, as well as creating digital skills training programmes to give residents the skills to take on remote jobs or start their own companies.

Gathering good-quality information on regional skill needs

Access to quality information on regional skill needs is the first step to steer investment towards in-demand skills. Skill forecasting and intelligence at the regional level can be effective particularly if it brings together local stakeholders such as industry organisations, and education and training providers, with national and regional authorities. Skill anticipation, however, should also fit into a national framework to prevent fragmentation.

Investment in the supply of skills alone will not be sufficient to improve job quality and the resilience of regional economies. The degree to which employers are demanding and using skills also has to be taken into account. There are considerable variations in the supply and demand for skills at the regional and local levels (OECD, 2014[55]) and these may very well increase as megatrends accelerate. Some regions can fall into a vicious circle known as “low skill equilibrium”, i.e. it does not pay for people to invest in skills when skills are not valued by employers. At the same time, those who do not attain skills move away to better-quality jobs elsewhere. In such regions, skills policies need to be embedded in a broader drive to support economic development. This can include helping existing firms to move towards more skills-intensive, higher-value product market strategies.

Policy makers also need to pay attention to regions and places which are experiencing persistent problems of unemployment, in particular youth unemployment and labour market exclusion. Immediate barriers to work can include a lack of affordable childcare, poor transport links and complex welfare arrangements that make reconciling work and benefits difficult (OECD, 2014[55]). In the longer term, living in areas which are isolated from the labour market and ill health can become more persistent barriers to employment. As the employment barriers experienced by individuals become more complex, a joint approach is often needed to tackle them, involving employment service providers, vocational education and training institutions, economic development agencies and social welfare organisations.

Investing in skills development and retraining

Skills development and retraining are vital to ensuring that workers have the right skills to prosper in a changing world of work and are a prerequisite for making the green transition a “just transition”. New skills will be needed throughout the economy, whether it is retraining construction workers on environmentally friendly materials and techniques, or reskilling workers in automotive for electric vehicle production. The jobs and skills needed will differ geographically: some regional and local labour markets will have people with skills that can be easily redeployed and others not (OECD, 2023[30]).

In the context of rapidly transforming labour markets, workers with skills that are becoming outdated or obsolete require early support. Demographic trends, coupled with industrial transitions, including through digitalisation and automation, will likely bring about major changes in the skills supply and demand in local labour markets. In the past, some regions that underwent such heavy structural change experienced high numbers of layoffs with long-lasting negative consequences (OECD, 2018[58]). Helping workers affected by structural transformation avoid unemployment is better for their employment prospects, earnings trajectories and human capital development, and it is less costly for the public budget than providing support after dismissal (OECD, 2013[59]). Still, across the OECD, at-risk workers are less likely to participate in training or use guidance services than other workers (OECD, 2021[60]). One effective solution for identifying workers with potentially outdated skills can be to target specific groups of workers, for example at firms or in sectors facing declining demand or high risk of automation.

The extent to which employees and regional economies are capable of diversifying depends, to a large extent, on the success of reskilling and re-education programmes. In the context of the green transition, local, bottom-up organised training to leave high carbon emitting (“brown”) industries is necessary to help the most affected workers transit into new career opportunities, make the human capital needed for the green transition available and include more disadvantaged groups in new emerging sectors. Furthermore, the transition to a low-carbon and resource-efficient economy as well as the effects brought by other megatrends require a workforce capable of acquiring skills throughout their lives. Effective and inclusive adult learning systems can help workers remain employable and productive throughout their life cycle, despite changing skills needs. If such systems are in place, the green transition can be delivered effectively and benefit most workers. Otherwise, skills shortages may hinder its implementation and inequality will likely increase. In turn, effective adult learning systems can become a comparative advantage that regions can leverage to attract investment from green businesses (OECD, 2023[30]).

Country example

- Labour foundations (*Arbeitsstiftung*) in **Austria** are a mechanism used mainly to address mass layoffs (outplacement foundation) and skills shortages (inplacement foundation) in a region. The mechanism involves a wide variety of counselling and skills development opportunities. An important component of labour foundations is collaboration between the company, regional labour market actors and territorial authorities. In response to the impact of the green transition on the labour market, an environmental inplacement foundation was started by the Austrian Trade Union Federation, the Austrian Federal Economic Chamber and the Public Employment Service. The foundation has a budget of EUR 10 000 000 and aims to support 1 000 unemployed individuals with no vocational training to acquire the qualifications required in the environmental sector (Aufleb Environmental Foundation, 2023[61]).

Making the most of the social economy

Jobs are not just created in the private sector. The social economy and social entrepreneurship can also play an important role in generating employment. In some regions, percentage growth in employment in the social economy has usually outpaced that of the private sectors in recent years (OECD, 2013[62]). The social economy also brings the added benefit of being embedded in communities and offering jobs to the most excluded in the labour market, either by providing training and work experience opportunities or by offering direct employment.

Country examples

- In **Belgium**, social economy organisations have been pioneers in developing the textile recycling sector since the 1960s, combining the development of the green credentials of this sector by selling the best pieces and utilising the worst pieces for other purposes such as insulation, while also running a work integration programme that creates and maintains employment for vulnerable groups. These organisations work together as a federation to streamline textile collection and exchange best practices. The success of these actors in developing this sector is demonstrated by new economic actors entering this field, including private for-profit actors, strengthening the sector and intensifying competition (OECD, 2020[63]).
- SINGA is a social enterprise established in 2012 that facilitates refugee integration by identifying job opportunities and social activities. Today, SINGA counts over 50 000 members and 90 full-time employees across **Belgium**, **Canada**, **France**, **Germany**, **Luxembourg**, **Spain** and **Switzerland**. At the core of SINGA's mission is providing business incubation services to refugees and migrants as well as individuals seeking to launch migration-related initiatives. SINGA operates nine incubators and one accelerator in France, Germany, Italy and Switzerland, each of which can support up to ten companies each year. Building on the success of its incubator programme, SINGA expanded its services to support entrepreneurs from the pre-incubation to the acceleration phase. To date, SINGA has helped to launch 337 companies, 62% of which created new jobs within 6 months of their creation. Businesses launched through SINGA's incubator programme currently operate in various sectors including the hospitality, education, healthcare and technology sectors (OECD, 2022[64]).
- In **Italy**, the social enterprise Quid employs 140 staff members from diverse backgrounds, most of whom with a history of social exclusion and marginalisation. Founded in 2013 in Verona, Italy,

Quid recovers and transforms high-quality fabrics into fashion items for ethical fashion brands. Over 80% of staff are women and close to 80% of managers are women. Their training activities include tailoring workshops in nearby Montorio prison. During the COVID-19 crisis, Quid quickly shifted production to contribute essential services by making face masks certified by the Italian health service (OECD, 2022[64]).

Building regional entrepreneurial ecosystems

Net job creation is typically led by a small number of young firms. While much industry now operates globally, new firms are strongly dependent on the local economic contexts in which they emerge, with most high-growth firms developing in regions with high population density and high levels of tertiary education. Despite their positive contribution to the local economy, high-growth firms are faced with barriers to development, including a lack of access to investment. Governments can help by putting in place strategies to build regional entrepreneurial ecosystems, where new firms can learn through knowledge-sharing networks and through inputs from more experienced managers.

In some OECD countries, business accelerators have been developed to provide a variety of support. OECD countries have also supported entrepreneurs build the skills required for their success. Common approaches are to embed entrepreneurship training into the curriculum in schools, vocational training and university-level courses and to develop stand-alone training for entrepreneurs and “would-be” entrepreneurs (OECD, 2023[65]). Other approaches are to support coaching and mentoring relationships and to develop peer learning programmes (OECD, 2014[55]).

Country example

- In **Sweden**, the Academy for Smart Specialisation is hosted by Karlstad University (KAU) and co-managed by the latter and the region of Värmland. It has contributed to innovating such a strategy, by identifying comparative advantages in new sectors and emerging skills needs and by connecting these with teaching and research activities carried out at the KAU. The academy has been playing a transformative role in the region of Värmland’s smart specialisation strategy since its creation in 2015. It is the result of a longstanding partnership between the regional government of Värmland and the University of Karlstad, with a dual objective: to generate academic research and skills in areas relevant to regional competitiveness and to generate advanced services that enhance the region’s capacity to identify emerging industries and key local assets. Smart specialisation has been transformational in Värmland. It has contributed to promoting new specialisations and skills in a variety of sectors and has helped the region capitalise on its existing strengths and generate new knowledge networks. The academy has supported this agenda by promoting and funding a range of innovative and entrepreneurial activities with a strong connection to local businesses, notably in value-creating services, forest-based bioeconomy, digitalisation of welfare services, advanced manufacturing and complex systems, nature, culture and place-based digitalised experiences, and systems solutions with photovoltaics (OECD, 2020[66]).

Improving the quality of multi-level governance systems

Why it matters

Designing and implementing policies to address regional inequalities is a responsibility shared by national and subnational levels of government and involves diverse policy sectors. A key issue for policy makers to consider is how to manage this mutual dependence through effective multi-level governance arrangements. It requires clarifying how responsibilities are assigned across levels of government, ensuring efficient co-ordination across levels of government, sectors and jurisdictions as well as strengthening administrative and fiscal capacities, especially at the subnational level (see following section) (OECD, 2014[67]; 2019[68]).

Policy measures

Clarifying the responsibilities assigned to subnational governments

How effective policies are at reducing regional inequalities depends, in part, on how national and subnational governments manage the functions they share. In practice, the question is not of a clear-cut allocation of responsibilities but rather of how to manage these shared responsibilities. The challenge comes from the fact that functional responsibilities – i.e. financing, regulating, monitoring – within each policy area are often not clearly defined or inconsistent (OECD, 2019[68]). The lack of clarity in the assignment of responsibilities is an important obstacle in ensuring overall institutional efficiency and local political accountability, which in turn is also linked to lower levels of trust in government (OECD, forthcoming[17]).

Over the past decades, an overall trend in the OECD has been in favour of decentralisation as a way to manage mutual dependence between national and subnational levels of government to achieve common objectives. Today, 40.4% of public expenditure in OECD countries is undertaken at a subnational level (OECD, 2019[68]). The forms and extent of decentralisation vary greatly from one country to another – and even within the same country. There are also varying degrees of upward and downward accountability and central government control. The trend has also been towards more differentiated (or asymmetric) governance systems at the subnational level in certain countries, with different responsibilities assigned to regional and local governments – at the same level of government, depending on their capacity, population (urban or metropolitan areas), and certain characteristics like geographic characteristics (e.g. islands) (OECD, 2019[68]).

Country examples

- A new Act of Decentralisation was introduced in **France** in Spring 2021 (*Le projet de loi 4D*). The act has four objectives: i) decentralisation, with a review of competencies between the national and subnational levels; ii) differentiation, to allow flexibility in the way subnational authorities organise themselves and implement public policies; iii) de-concentration, to enhance decision-making and policy competencies of local state services (prefects); and iv) de-complexification or simplifying local public action. Furthermore, the various forms of contractual arrangements are being revised, with different contracts being combined to streamline and achieve better coherence between the various actions of the government. In this context, the new generation of State-Region Planning Contracts (2021-27) (*contrats de plan État-région*, CPER) began preparation in 2020 and the new CPER arrangement reflects a renewed framework for dialogue between the state and regions.

- Within the wider objective of increasing local democracy, an ongoing process of decentralisation in **Portugal** underpins the transfer of new additional state administration competencies to local authorities and inter-municipal entities in a wide range of domains. This reform is expected to enhance the efficiency and effectiveness of public service delivery and increase local government participation in public revenue. Resources under the Decentralisation Financing Fund, created by the revised Local Finance Law, have been included in state budgets to help finance, on a transitional basis, the new competencies. By July 2021, 18 sectoral decrees stipulating the transfer of competencies in different areas have been adopted. It is foreseen that all local authorities and inter-municipal entities will eventually assume the new competencies (the process not being optional), although at a varying speed, depending on the complexity of the competencies to be transferred and the existing municipal capacity, among others.

Designing and delivering policies and services at the "right" scale

Scale matters and it is functional areas rather than administrative boundaries that are important to the implementation of many policies for addressing regional inequalities. The OECD has empirically documented the productivity penalty that results from administrative fragmentation in metropolitan areas and has shown that strengthening urban-rural linkages can generate economic, social and environmental dividends for both urban and rural residents alike and contribute to bridging urban-rural divides (OECD, 2015[69]).

Across the OECD, inter-municipal, inter-regional and cross-border co-operation, metropolitan governance arrangements and "regionalisation", i.e. the strengthening of regions (OECD, 2022[70]; 2019[68]) have been leveraged for physical infrastructure provision where the efficient scale often exceeds the boundaries of individual regions or localities, and for investments in human capital development and innovation where administrative and functional boundaries may not coincide. Co-operation among subnational governments is important also for subnational public service delivery, especially in the case of small or lagging regions with limited resources. However, co-operation rarely occurs spontaneously, hence the need for national governments to provide the right incentives for this co-operation to happen.

Country examples

- In **Austria**, a project implemented by the Department for Coordination, Regional Policy and Spatial Planning in 2019-20 aimed to identify ways in which regions, understood as the territorial level between municipality and *Land*, can be empowered to contribute to sustainable spatial development. The project recognised that the challenges facing society are complex and interrelated and that defined areas of administrative competency no longer always match the spatial and functional areas in which these interactions take place and need to be managed. It recognised that the "region" has become an important spatial level in Austria's multi-level system. The main reason for this is the effectiveness with which topics such as mobility, services of general interest and digitisation, but also integration, employment and equal opportunities can be dealt with at that spatial level. This is because the "region" has the appropriate framework conditions in terms of functionality, context, resources, spatial proximity and living environment. The results were published in October 2020 and fed into the programming process of the 2021-27 programme period of EU Cohesion Policy and Rural Development Policy.
- To address the fragmentation of inter-municipal and supra-local forms of collaboration, in March 2021, the Flemish government (**Belgium**) approved the development of an intermediate sub-regional level. Seventeen sub-regions, officially referred to as "reference regions", have

been created, with each Flemish province divided into 2-5 sub-regions. These will co-ordinate different sectoral policies and new and existing collaborations will have to adhere to their boundaries by 2024. The aim of the reference regions is to present an innovative consensus model rather than create a new administrative layer. Within their boundaries, the formation of new inter-municipal links is stimulated through a small subsidy provided by the Flemish regional government.

- A new tier of organisation was introduced in **Denmark** in March 2021, when the government announced the creation of seven Regional Growth Teams (*Regionale Vækstteams*), covering part of or the entirety of the five Danish regions. The teams combine private sector partners, local authorities, trade unions and higher education institutions, and are tasked with developing strategies to address specific challenges, individually set by the government after consultation with the local business development centres.
- A 2020 amended law in **Lithuania** reinforces the territorial concept of the functional area for the implementation of regional policy. This was preceded by a 2017 white paper that includes the concept of the functional area, or functional region, as a system of economic development, worker migration and urban-rural partnerships using common infrastructure, transport and service networks that go beyond administrative boundaries. Regional policy makers are now required to consider functional areas, as opposed simply to municipal administrative boundaries, when formulating regional development or multi-regional development plans.

Strengthening capacity at the national and subnational government levels

Why it matters

Poor government effectiveness at the subnational level severely limits the prospects of regions (OECD, 2019[68]). The capacity of subnational governments to design and implement policies and public investments effectively and to fund and deliver the public goods and services for which they are responsible, is crucial for them to be meaningful partners. Unfortunately, there is wide heterogeneity in the level of capabilities of subnational governments in OECD countries and, often, subnational capacities suffer from significant limitations, be they in investment financing, policy design and implementation, or governance more broadly (OECD, 2019[71]).

Although measuring government quality is notoriously difficult, it has become increasingly clear that many regions that are either lagging or declining have much weaker institutional systems than more developed ones (Charron and Lapuente, 2013[72]). Some research has demonstrated that weak institutions, in general, and poor-quality government in particular constitute a crucial obstacle to development (Rodríguez-Pose, 2013[73]). Poor institutions affect essential growth-promoting factors, such as the returns on European Cohesion Policy (Rodríguez-Pose and Garcilazo, 2015[74]) and competitiveness (Annoni, 2017[75]). Poor-quality institutions can also curtail the prospects of economic development progress because regions cannot seize economic opportunities as they arise.

Policy measures

Investing in subnational fiscal capacity

Sustained investment in fiscal capacity at the subnational level is essential to strengthen incentives for local policy makers to support a proactive approach to development while being accountable for the results achieved. Fiscal autonomy and reliance on own source revenues appear to help the catching-up regions more than those above the national average (Blöchliger, Bartolini and Stossberg, 2016[76]). This requires limiting unfunded and/or under-funded mandates to ensure subnational governments have the requisite resources to invest, provide services or manage policies, and ensure they are properly staffed (Rodríguez-Pose and Vidal-Bover, 2022[77]).

Most OECD countries have developed fiscal equalisation systems to mitigate regional differences in fiscal capacity and expenditure needs, each of them with different specificities. With the overarching goal of achieving fiscal equity among jurisdictions, fiscal equalisation aims to offset differences in revenue-raising capacity and/or public service costs with the purpose of allowing subnational governments to provide similar public services with a similar overall tax burden. However, evidence indicates that, while fiscal equalisation can effectively create a level-playing field in the fiscal arena across subnational jurisdictions, it is not typically designed to reduce regional income inequality, whether GDP per capita or adjusted household income per capita. However, there is considerable scope to leverage complementarities between fiscal equalisation policies and regional development policies to achieve better fiscal and economic outcomes (OECD, 2022[78]).

Country examples

- Established in 2021, **Colombia**'s Decentralisation Mission works to evaluate the current decentralisation model and propose constitutional and legislative initiatives to improve how responsibilities are shared across levels of government. Over 2022, the Decentralisation Mission met with stakeholders in 15 municipalities, from public administration, academia and Indigenous communities to trade unions and the private sector, to gather contributions and proposals across several priority topics, including: i) strengthening competencies across government levels; ii) improving sources and uses of revenues for local development; and iii) modernising the public administration (DNP, 2023[79]).
- In **Costa Rica**, the recently approved Regional Development Law No. 10.096 puts forward a new development management approach emphasising the role of subnational units and planning regions. The law reinforces the Regional Planning Subsystem and provides new tools to strengthen the capacity of regions to play an active role in regional development, including the creation of a Regional Development Fund, regional budgets and Regional Development Agencies. The law also includes provisions to improve development planning and budgeting at the regional level (Costa Rican System for Legal Information, 2023[80]).

Building strategic and administrative capacity

Building more qualitative strategic and administrative capacity is a fundamental dimension to improving subnational government quality. This refers to skills and competencies in strategic planning, policy and programme management, budgeting and finance, project appraisal, regulation, infrastructure investment, procurement, data management, stakeholder engagement, partnership building and monitoring and evaluation. Well-developed competencies in these areas allow regional and local authorities to design and deliver public services and carry out administrative procedures effectively. Several OECD countries have invested in dedicated strategic capacity-building initiatives to boost subnational capabilities.

Strengthening subnational capacities in the broad sense requires commitment from all levels of government as well as from public sector staff to continually develop skills. It also requires fostering a learning culture, including providing knowledge exchange opportunities and encouraging continuous training, experience-sharing, learning-by-doing and innovation. Such efforts should be targeted and incremental, including with pilots and experiments, so as to avoid burdening subnational authorities, especially those with limited human and financial resources (JRC, 2022[81]).

Country examples

- The Ministry of Regional Development of the **Czech Republic** created a web-based application to support municipalities in designing their municipal development strategies and/or programmes. The application users through the content and structure of an example strategy and offers practical tools (e.g. statistical data, templates and samples of supporting documents and studies, e-learning courses, handbooks for municipalities, etc.). The complete municipal development strategies are published on the webpage, so municipalities can learn from one of their peers. Using the digital platform and promoting peer learning can contribute to building strategic planning capacity among municipalities (OECD, 2023[82]).
- In **Germany**, the initiative Small Towns in Germany is a package of programmes and activities for small-town development, aiming to strengthen their functionality. It targets over 2 100 towns across Germany, mostly in peripheral areas. As part of this initiative, in 2019, the Federal Ministry for Housing, Urban Development and Building launched a pilot called Small Town Academy, which offers a purpose-built platform for networking, exchange of experiences and advanced training on urban development. The pilot phase between 2019 and 2022 was used to define suitable content and formats, which led to the final launch of the platform in 2023. The planned activities include advice from experts who come to the municipality and forge creative strategies (mobile coaching teams) or tandems among mayors who exchange views on a common topic in urban development over the long term. Both activities will generate model projects that test different urban planning and project management methods and will lead to a collection of learning and exchange modules (JRC, 2022[81]).
- To support the implementation of the National Strategy of Regional Development 2030 (NSRD 2030), the Ministry of Development Funds and Regional Policy of **Poland** launched a pilot project to create the Centre for Advisory Support (*Centrum Wsparcia Doradczego*, CWD). The centre focuses on strengthening the institutional capacity of local authorities to participate in strategic development activities, including designing, planning and managing infrastructure projects in 894 areas of strategic intervention (ASIs). By doing so, the CWD also helps build capacity and strengthen the territorial approach to investment, i.e. by helping build cross-jurisdiction partnerships with other ASI communes and with non-public socio-economic partners such as civil society organisations in order to tackle local development challenges and advance the competitive advantage of working in partnerships (Malik-Kapler, 2021[83]; JRC, 2022[81]).

Making the most of complementarities across the policy roadmap

Economic development policies, labour market policies, policies to support entrepreneurship and social entrepreneurship, and education and training policies all have a role to play to reduce regional inequalities. Integrated approaches can be built across these policy areas to help foster inclusive growth. Yet often this does not happen and policies are delivered "in silos".

In some cases, this is because of institutional inertia and the organisational challenges of working together. However, there can also be trade-offs between meeting national policy objectives and fostering regional development and resilience. The search for efficiency in the delivery of national policies and programmes can sometimes lead to a lack of attention to the negative effects that a "one-size-fits-all" approach can have in certain regions.

Furthermore, interaction effects across regions need to be accounted for. An intervention that addresses a given challenge in one region – say expanding the affordable housing stock and improving transport infrastructure in a rapidly growing metropolitan area – may have unintended consequences elsewhere, e.g. a further loss of skilled workers in less dynamic non-metropolitan regions nearby. And in some cases, the investments required to stabilise relative incomes in economically lagging regions may be so large that they may not represent a good use of the available resources (OECD, forthcoming[40]).

While there is no simple policy prescription to mitigate regional inequalities, the policy roadmap presented in this chapter proposes five priorities for public action to help boost both balanced development and inclusion. Importantly, advancing on all five priorities requires implementing complementary measures in parallel that can reinforce each other and for which sequencing matters. For example, regions will only manage to develop high-value-added industries if they can offer employers a skilled workforce. But good job opportunities alone will not be enough to attract and retain skilled workers and their families: access to good-quality and affordable public services, notably housing, childcare, schooling and healthcare, equally matter.

Capitalising on the positive linkages presented in Table 5.1 that exist across the five priorities of the policy roadmap can offer a double dividend in terms of socio-economic progress and individual well-being. Furthermore, if smartly combined, actions across the five priorities can counteract a race to the bottom among regions within a country. Rather than having regions trying to undercut each other, for example, at the expense of tax revenues or environmental and labour standards, a combination of these priorities offers regions a productive way to compete with each other and better function in a "system" of regions, while lifting the economic performance of the entire country (OECD, 2019[34]).

Going forward, the *OECD Recommendation on Regional Development Policy* adopted by the OECD Council at the Ministerial level on 8 June 2023 will serve as a compass to guide governments' efforts at different levels to promote and implement effective place-based regional development policy that improves the contribution of all regions to national performance and reduces inequalities between places and between people (OECD, 2023[84]).

The Recommendation is articulated around ten pillars that are well-aligned with and can serve to reinforce the five priorities of the policy roadmap presented in this chapter, as illustrated in Figure 5.4. As such, the Recommendation can further support efforts by OECD governments to ward off persistent divides between regions.

Figure 5.4. Linkages between the policy roadmap and the Recommendation on Regional Development Policy

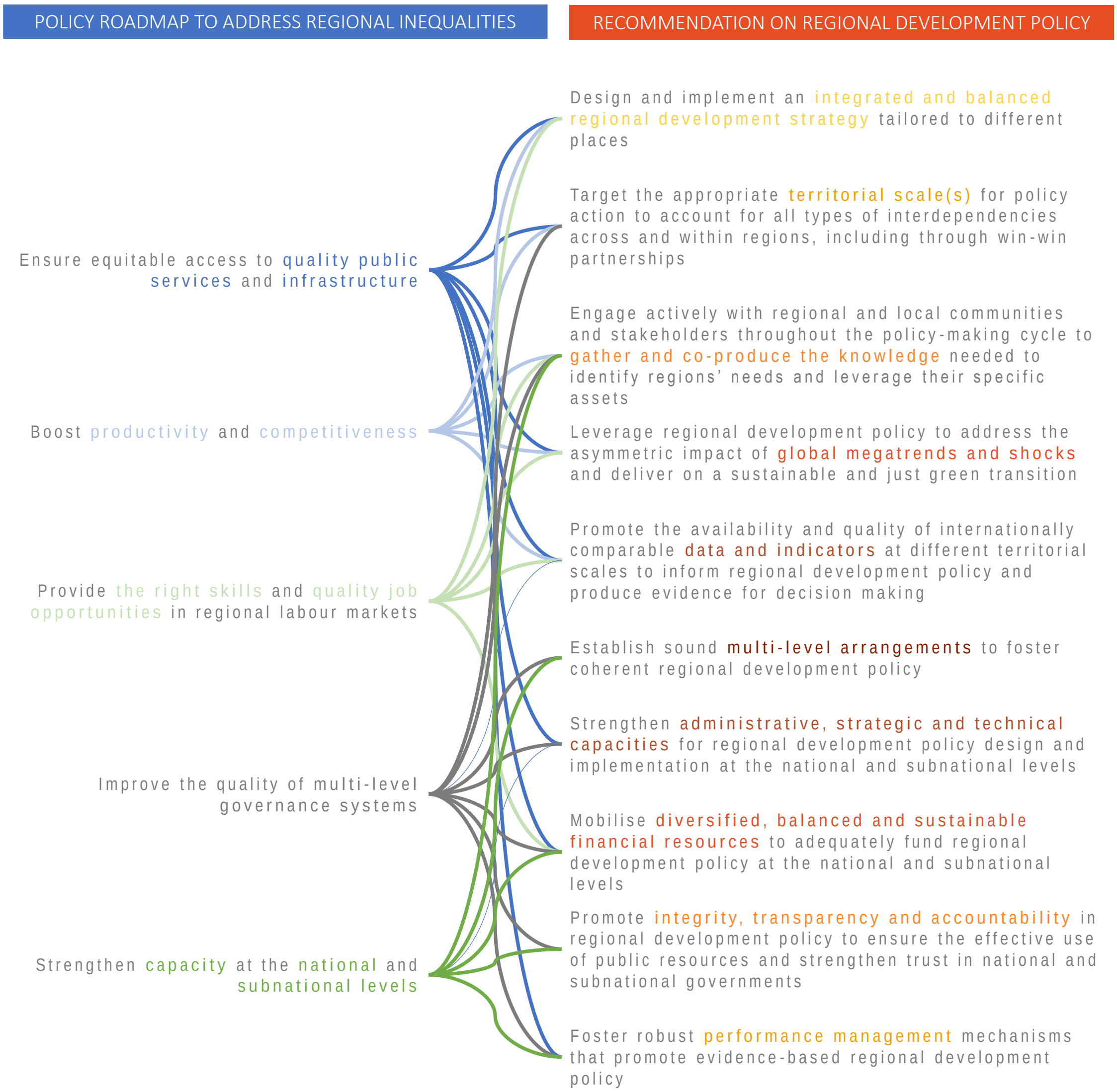


Table 5.1. Examples of complementarities across the policy roadmap

	Ensure equitable access to quality public services and infrastructure	Boost productivity and competitiveness	Provide the right skills and quality job opportunities in regional labour markets	Improve the quality of multi-level governance systems	Strengthen capacity at the national and subnational levels
Ensure equitable access to quality public services and infrastructure		• Increasing tax autonomy • Increasing the potential for economies of scale	• Providing skilled workers	• Reducing inefficiencies and co-ordination failures • Improving resource allocation across different programmes and investment	• Improving public service and infrastructure policy design and implementation • Improving administrative efficiency • Strengthening social services
Boost productivity and competitiveness	• Investing in human capital (education, training, skill development) • Facilitating the assimilation of knowledge and innovation • Connecting leading and lagging regions • Supporting economic integration • Stimulating private sector activity in less-connected places		• Providing a skilled labour force • Improving/creating a good business environment • Supporting firm development with training	• Reducing inefficiencies and co-ordination failures • Improving resource allocation across different programmes and investment	• Creating conducive policy and institutional environments to attract private investment and support firm development
Provide the right skills and quality job opportunities in regional labour markets	• Investing in human capital (education, training, skill development) • Facilitating the assimilation of knowledge and innovation	• Developing clusters and agglomeration economies		• Reducing inefficiencies and co-ordination failures • Improving resource allocation across different programmes and investment	• Protecting workers' rights
Improve the quality of multi-level governance systems	• Facilitating the assimilation of knowledge and innovation across levels of government				• Improving public service and infrastructure policy design and implementation • Improving administrative efficiency
Strengthen capacity at the national and subnational levels	• Facilitating the assimilation of knowledge and innovation across levels of government			• Reducing inefficiencies and co-ordination failures • Helping identify and build local knowledge	

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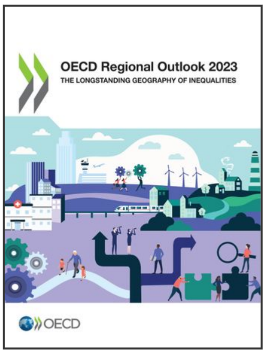

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