Executive summary

Converging fortunes of countries and diverging fortunes of regions

Over the last two decades, levels of gross domestic product (GDP) per capita have converged across OECD economies, driven in large part by higher growth in lower income economies. However, at the same time, over half of 27 OECD countries with available data saw income inequalities between their regions widen and in most other countries, including in those where regional income inequalities declined, they remained significant. Overall, over the last two decades, four trajectories emerge:

- **High income / rising inequality:** Some countries with GDP per capita above the OECD average– including Belgium, Denmark, France, Sweden, the United Kingdom, and the United States – saw regional inequalities increase.
- **Rising income / rising inequality:** Many countries that have been catching up to the OECD GDP per capita average have seen their regional inequalities increase, including many OECD countries in Eastern Europe that grew quickly.
- **High income / lower inequality:** Other countries, including Finland, Norway, Germany, the Netherlands, and New Zealand, demonstrated that it is possible to sustain high GDP per capita while narrowing gaps between places.
- **Low growth / lower inequality:** Southern European countries like Greece, Spain and Portugal saw regional inequalities fall but in a context of weak overall economic performance.

These different paths across countries show that, increasing regional inequalities are not inevitable and that, with the right policy environment, it is possible to tackle the longstanding geography of inequalities.

In many countries, metropolitan regions continue to surge ahead

Most metropolitan regions, both large and mid-sized, continue to benefit from agglomeration economies – advantages in productivity linked to size and proximity, including shared infrastructure, higher quality public services and better matching of workers with jobs and knowledge spillovers – driving new opportunities and growth. On average, metropolitan regions across the OECD had around 32% higher GDP per capita than other regions and the gap between large metropolitan regions and other regions accounts for the largest share of regional income inequality in most countries with large metropolitan regions.

Yet while the largest metropolitan regions have benefited from stronger growth than other regions, they are facing major challenges linked to their success – including in housing affordability, congestion, and, indeed, in inequality inside the regions. This emphasises the need to not only narrow gaps between the most and least successful regions but also for targeted spatial policies inside large metropolitan areas to overcome diseconomies of agglomeration, which can undermine performance.

As successful cities continue to grow and attract skilled workers, other areas are grappling with an ageing and shrinking population. Nearly 40% of remote regions and 22% of functional urban areas in the OECD shrank between 2001 and 2021, undermining local public revenues while pushing up the costs of maintaining public services and infrastructure, and creating additional challenges such as dereliction and blight, which can be costly to fix.

Service gaps are undermining productivity, creating vicious cycles of stagnation and decline

Many areas are falling behind not just in income, but in broader dimensions that impact on well-being. Significant regional differences also exist for example in access to, and quality of public services and infrastructure. Whilst these impact directly on well-being, they also make it harder for lagging regions to attract and retain the people, skills and investment needed to break a vicious cycle of stagnation and decline, weighing down further on well-being and, indeed, productivity and income.

In many rural areas, residents struggle to access good education and training. Students in city schools obtained higher scores in reading than their peers in schools located elsewhere in all but two OECD countries with available data. Investing in quality transport infrastructure, especially public transport, is an important lever to improve access to education in rural communities, but the quality of schools also needs to improve in many such areas to provide a platform for future growth.

Travel times to healthcare facilities are obviously much larger – five times larger – in remote rural areas than in cities. This contributes to the fact that close to a third of rural residents in OECD countries reported health problems that prevented them from doing things people their age normally do compared to only a quarter of city residents.

Data from regulators in 26 OECD countries show a persistent rural-urban divide in digital infrastructure. On average a third of households in rural areas do not have access to high-speed broadband and only 7 out of 26 OECD countries have secured access to a high-speed connection for at least 80% of rural households. In Mexico and Canada, people in rural areas have connection speeds 40 percentage points slower than the national average. These gaps in digital access mean these areas will struggle to benefit from new remote working and telemedicine opportunities that could help them compensate for a lack of physical connectivity to jobs and services.

Boosting productivity will be key to reviving the fortunes of lagging regions

Efforts to raise productivity in lagging regions will be critical to tackle the longstanding geography of inequalities. Whilst different sector specialisms explain some of the productivity differences between regions, three quarters of the gap reflects differences in the productivity of firms within the same sector. Regional differences in the quality of infrastructure, access to skills, innovation spillovers, finance and markets and investment all play a role here. This implies that place-based policies that address these inequalities can also play a significant role in driving productivity growth in existing industries and sector specialisms.

Yet higher productivity does not automatically translate into better employment outcomes. While in urban areas productivity and job growth have typically gone hand-in-hand, in non-metropolitan regions a combination of automation and competitive pressures from lower-income economies, have resulted in a lower share of regions generating jobs growth as productivity has grown. At the same time, these areas have struggled to attract and retain the higher-skilled workers needed to develop new opportunities for growth, including in new industrial activities.

Place-based policies must be broad based to ensure that they support both productivity and jobs growth. Investment in skills, digital, infrastructure and communication gaps, as well as in access to finance, knowledge and innovation networks, and the quality of public services and local government can improve the attractiveness of all regions, and encourage inward FDI, and support businesses to invest, export, innovate or adopt innovations and scale-up. In addition, the net zero transition can offer new opportunities for regions to boost productivity, while remote working also provides potential to entice high skilled workers away from metropolitan regions to mid-sized cities.

Persistent regional inequalities raise costs that are becoming too high to ignore

Some level of regional inequalities is inherent and unavoidable. However, the longstanding geography of inequalities is becoming deeply entrenched, with a scale and costs that are becoming increasingly difficult to ignore, including:

- *Economic costs*. Lagging regions and/or those trapped in vicious cycles of long-term stagnation account for a considerable proportion of economic activity in all countries and reflect untapped potential to drive growth. Their underperformance also comes with a fiscal cost – in terms of high levels of welfare support.
- *Social costs.* Persistent inequalities, also challenge the fiscal and administrative capacities of subnational governments to provide adequate access to key public services and infrastructure. These social costs are apparent both in economically dynamic regions that struggle with high house prices and congestion as well as in lagging regions where public services become stretched, reduced in quality or increasingly more difficult to access.
- *Political costs.* Regional inequalities can undermine trust in government across OECD countries, where the difference between a country's most and least trusting region can be as high as 30 percentage points. Low levels of trust are a signal of growing discontent and disengagement, and low social cohesion and can undermine democracy over time.

Building the resilience of all regions to face shocks and adapt to megatrends

Recent global crises and the urgency of adapting to megatrends have heightened the need for more agile and flexible policy frameworks. The three forward-looking scenarios for 2045 presented in Chapter 4 explore different futures for regions and their policy. The chapter also sets out ways to future-proof regional development policy, by adapting fiscal systems and governance structures and developing foresight capacity at the national and subnational levels to better prepare regions for the future.

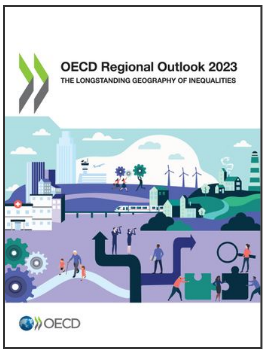
A policy roadmap to address regional inequalities now and in the future

This report proposes a policy roadmap to support catching up in lagging and stagnant regions while sustaining prosperity in the most dynamic regions. To do so will require coordinated action across five complementary priorities:

- *Ensuring access to key public services and infrastructure*, e.g. by improving access to services close to where people live, including through digitalised services, and attracting and retaining skilled public service professionals.
- *Boosting productivity and competitiveness*, e.g. by supporting regions' integration in global value chains, investing in transport and digital infrastructure and supporting small and medium-sized towns.
- *Providing the right skills and job opportunities in regional labour markets*, e.g. by providing flexible training, education and employment services, building regional entrepreneurial ecosystems and building up the social economy.

- *Improving the quality of multi-level governance systems*, e.g. by clarifying the responsibilities assigned to subnational governments and delivering policies and services at the “right” scales.
- *Strengthening capacity at the national and subnational levels*, e.g. by investing in subnational fiscal capacity and building strategic and administrative capacity.

These actions build on and complement the 2023 OECD Recommendation on Regional Development Policy, which will serve as a compass to help governments implement effective place-based regional development policy.



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