Territory and economic development: institutional flaws

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Executive summary

Portugal has been experiencing competitive difficulties for a long time, which have clearly harmed income and cohesion levels among its citizens. This paper aims to contribute to the discussion in society over what is desirable and doable to ensure the economy grows sustainably and the Portuguese feel happier wherever they live. It examines the growth and economic development levers and focus on the analysis of public policy effectiveness in promoting these goals. It does so by resorting to economic analysis principles, empirical evidence on growth and development and an international comparison of growth and territorial development policies.

1. **Economic activity is not space-blind**. Each territory is unique in that it is identified by its intrinsic characteristics, such as the number of resident consumers and the size of firms, the labour force's educational and professional qualifications, the degree of social and economic exposure to the outside world, the density of the value chains, the quality of access to public services, institutional thickness, the governance of resident organisations, the networking ability of economic players (both within and outside the territory at stake), not forgetting physical attributes such as the terrain, the distance to major production and consumption centres, and the climate. Such diversity has an impact on both economic activity and the location of jobs and consumers. In the same way, the outcome of economic activity has an impact on the territories themselves, on their individual ability to be competitive and to attract production, consumption, savings and investment. Thus, it becomes crystal clear **that it makes no sense to discuss growth or development drivers and the government's possible influence over them without expressly taking into account the spatial dimension**.

2. Around 54% of the growth in Portuguese GDP is explained by the economic performance of the NUTS II regions whose GDP is below the national average. A more detailed breakdown shows that the major metropolitan areas, that make up 2.4% of total level 3 territories in the OECD geography, only account for 27% of GDP growth in the OECD. This means that **all territories, no matter how small or less prosperous they are, have a contribution to make to national wellbeing** and that it is a mistake to rely solely on the ability of the more dynamic regions to improve overall performance.

The regional development statistics at the NUTS III level convey the following messages. Firstly, **Portugal is more unequal in terms of competitiveness indicators than cohesion indicators**. The standard deviation from the average of the former exceeds that of the latter by 22%. Only five regions, out of a total of 30, are more competitive than the national average, and all of them are on the coast: in descending order they are Greater Lisbon, Greater Oporto, Baixo Vouga, Ave and Entre Douro e Vouga. As regards cohesion, 16 regions outstrip national performance. The most cohesive area is the central band of mainland Portugal. The second message is that **the map of environmental quality is similar to the negative of the competitiveness map**. The respective correlation coefficient is negative (-0.6) and the territories with the best environment are mainly located in the eastern band: Serra da Estrela, Alto Alentejo, Beira Interior Norte, Pinhal Interior Sul and Cova da Beira top the list. Only ten regions record environmental performance below the national average. **The third message comes from the change recorded over the last 40 years**: i) almost all regions showed progress in absolute terms in regard to cohesion and environmental quality; ii) the inter-regional differences in these areas have decreased; iii) competitiveness is the dimension in which absolute progress has been less pronounced and has become increasingly asymmetric.

3. This paper revisits the explanations economics provides for the inter-regional variation in growth and development levels, as well as for each region's trends in these processes. Therefore it recalls the contributions of: i) neoclassical thinking, based on the role of the primary factors of production, labour and capital; ii) the Keynesian currents, based on the role of external demand, productivity of the exportable goods sector and components of self-accumulating regional growth; iii) the agglomeration and network externalities, on the one hand, and transport costs, on the other; iv) the growth poles school of thought, on negative and positive interactions between central and peripheral performances; v) the incorporation of knowledge into labour and capital; vi) the new economic geography; vii) the intangible development factors. From this digression into the economic development theories of relevance to a mature economy, the following conclusions are drawn:

- **the wellbeing** of people living in a particular place is the result of a complex **interaction between factors** intrinsic to the place and **factors** exogenous to it, **factors** that go beyond the traditional labour and capital stocks in supply-side macroeconomic analyses;
- "where are the **resources**" (allocation) and "where are they going to" (spatial mobility, and accumulation over time) are very important **questions**;
- The spontaneous workings of the markets trigger contradictory outcomes. They neither necessarily ensure durable progress in any territory nor, contrary to neoclassical beliefs, long-term real convergence. To put it another way, **the market may fail to provide sustainable development**.

4. These conclusions do not mean that the government would necessarily do better or that, if it were to act upon development factors, its actions would not be flawed. Empirical studies and international comparisons lead to **clear recommendations for devising regional development policies**. In keeping with the multidimensional nature of the causes of both economic growth and economic development, **the policy approach should be across the board rather than sectoral**, favouring:

- **concentration on the causes that, in each region, are most likely to promote growth and the indispensable territorial and social cohesion**, betting that **all regions**, regardless of their development level, have the potential to contribute to national economic growth;
- **the reliance on geographical differentiation**, by means of customised and space-based policy tools;
- **articulated policy sets,** instead of isolated measures, aimed at replacing
    - separate sectoral approaches that are independent of each other by integrated multisectoral solutions, which require good horizontal and vertical governance methods, **open to the participation of regional development partners**, from the strategic planning and identifying of priorities stage;
    - policies designed and carried out top-down and tending towards standardised by **shared vertical governance solutions that are place sensitive**.
- **financial transfers geared towards performance**, transfers that encourage behaviour aimed at improving territorial competitiveness, instead of subsidies unrelated to outcomes and based on inter-regional asymmetries;

5. In Portugal, the approach recommended above to structuring the public sector response to the growth and development challenges faces a host of institutional obstacles that this paper justifiably lists.

- the difficulty the public in general and politicians in particular have in understanding the causes of across the board problems, such as growth and development;
- the inherent unsuitability of the Government and civil service structure to deal with problems that require sectorally integrated responses;
- territorial fragmentation of public policy;
- the ease with which strategies are forgotten when policies begin to be put into practice;
- a general misunderstanding about the use of structural funds and regional development policy;
- society's rent-seeking habits;
- lack of political representation of territories with low population and economic density;
- lack of confidence among economic players that undermines the willingness of people, businesses and public entities to fall in behind cooperative strategies;
- the gap between the elites' aspirations in the NUTS II regions and the statutes of the regional development and coordination commissions;
- the shortcomings of responses to demographic and settlement challenges.

6. The barriers may be many but they are neither inevitable, nor insurmountable. It is possible to reduce their blocking power considerably. To this end a number of suggestions are made as how to enhance the effectiveness of public policy in Portugal in order to promote economic growth and development:

- horizontal governance mechanisms — such as building a national territorial vision with social partners and political parties, identifying a member of Government with sufficient political clout to coordinate sectorally integrated responses, assigning specific powers to a specialist service within the central government (that already exists), increasing the weight of electoral constituencies that are underrepresented in the National Parliament, and conducting regular tests on the consistency of public policy with the national strategy on regional development;
- policy tools designed to the boosting of agglomeration and networking economies— aiming at bringing competitiveness through the voluntary association of economic actors, including local, regional or central government services, in order to meet the challenges in business clustering, interactions between urban areas and rural territories, urban regeneration and cross border cooperation.
- vertical governance mechanisms — they have to do with the national territory's political and administrative organisation and the way the general government is structured to provide services to the public at large and to businesses. They include the strengthening of intermunicipal cooperation, negotiated ways of rationalising the municipalities' network and a smooth regionalisation of the Portuguese mainland, focused solely on regional development and ring fenced by the need for fiscal sustainability.

  The diagnosis and the solution avenues set out here to improve the public sector's ability to promote growth and development across Portugal are the author's contribution to the public discussion which the country needs to hold on the path it should take to ensure a permanently more prosperous and inclusive future.

Territory and economic development: institutional flaws♣

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Abstract

This is a policy paper on the contribution of Portuguese public policies to economic growth and development. Such contribution is mediated by space inasmuch as the effectiveness of public action hinges critically on how policies mobilise regional development drivers. These drivers come out of a digression on economic theory explanations for growth and development which also helps to realise that markets trigger contradictory outcomes and assure neither durable progress everywhere nor long-term real convergence. The international evidence on regional development policies tracked herein unveils two facts: governments may also fail and governments can improve their own performance. Translating lessons from scientific knowledge and international empirical evidence to Portugal allows us to identify a number of flaws in the Portuguese institutional architecture and to recommend solution avenues to make the economic development of Portuguese territories more inclusive and sustainable. These recommendations bet on place-based sectorally integrated approaches which go through a significant improvement in horizontal and vertical governance mechanisms, and the adoption of policy tools headed towards the internalisation of association economies between the three territorial layers of government and the regional development actors in civil society.

Resumo

Este documento incide sobre a contribuição das políticas públicas portuguesas para o crescimento e o desenvolvimento económicos. Trata-se de uma contribuição mediada pelo território, em que a eficácia da ação pública depende crucialmente do modo como as políticas mobilizam as forças motrizes do desenvolvimento regional. Uma digressão sobre as explicações da teoria económica para o crescimento e o desenvolvimento permite identificar as forças motrizes e perceber que o funcionamento do mercado gera resultados contraditórios, não assegurando necessariamente o progresso duradouro de nenhum território nem uma tendência de longo prazo para a convergência real. A evidência internacional sobre políticas de desenvolvimento regional aqui recenseada mostra dois factos: os Estados também podem falhar e os Estados podem melhorar o seu próprio desempenho. Transpondo ilações do conhecimento científico e da evidência empírica internacional para Portugal, são reconhecidas várias fragilidades na arquitetura institucional portuguesa e recomendadas vias de solução capazes de tornar o desenvolvimento económico dos territórios portugueses mais inclusivo e sustentável. São soluções que apostam em abordagens sectorialmente integradas e sensíveis aos contextos territoriais a que se destinam e que passam pela melhoria significativa nos mecanismos de governança horizontal e vertical e pela adoção de instrumentos de política ancorados na dinamização de economias de associação entre os três níveis territoriais da administração pública e os atores do desenvolvimento regional na sociedade civil.

♣ Text written following the author's presentation entitled "Territory, economic development and institutions" at the seminar held on 24 October 2014 as part of the *Fridays of Reform* cycle. A shorter version of this paper can be found in the book of the communications delivered in those seminars, available on the websites of the three organising bodies: Bank of Portugal, Portuguese Public Finance Council and the Calouste Gulbenkian Foundation.

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1 Introduction

The “Fridays of Reform” seminar cycle, organised jointly by Bank of Portugal, the Calouste Gulbenkian Foundation and the Portuguese Public Finance Council, has opened up to the general public the discussion on the challenges faced and solutions available for organising the public sector and public policies in Portugal. This paper focuses on the relationship between territory and economic development. It identifies a series of institutional flaws in the country which block the effectiveness of public policy in promoting development and provides concrete clues as to how to reduce substantially the atrophying effect of the institutional framework.

Three strong ideas run through the entire paper: i) there is no economy without a territory; ii) all territories contribute towards growth; iii) territory is the place where people and policies meet.

It may appear commonplace to state that **there is no economic activity without a space**. However, it is worth highlighting this key notion since it seriously conditions the ability of various territories to contribute to the production of goods and services, employment, investment or any other form of economic activity. When a firm decides where to locate, expand or reduce its business, it takes into account the location of suppliers and consumers. Examples: when choosing a site for a wind farm, account is taken of the intensity and duration of the air flows; the production of a good that requires specific skills or know-how should consider the relative abundance of skilled labour in alternative locations since its availability has a bearing on productivity and training costs; when transportation has a significant weight in the cost structure of a particular output, it is important to choose the production site in accordance with the distance and the bulk of consumers, which are decisive variables to define the firm’s market area. A firm whose business is highly specialised and dependent upon face-to-face contacts, such as investment banking, has to be located in major cities, since the finance departments of its potential clients are concentrated there. Likewise, when choosing where to consume and work, individuals are sensitive to the location of consumption opportunities and to the spatial distribution of earnings matching their skills.

Now territories differ from one another as regards the features referred to above. That diversity impacts on both economic activity and the location of jobs and consumers. Likewise the outcome of economic activity also impacts on the territories, on their ability to be competitive and attract production factors and consumption.

The second important idea is that **all regions contribute towards economic growth.** Of course there are territories that, at any given time, are more competitive than others, territories that contribute more to GDP than the rest. However, it must not be forgotten that all territories, even the least well off in terms of economic attractiveness, can and must contribute to national GDP. Two recent works by the Organisation for Economic Cooperation and Development (OECD) were very clear on this point. Both use panel data covering the period 1995 to 2007, and the difference lies in the degree of territorial breakdown. OECD (2012) highlights that level 2 regions[1] with GDP *per capita* below the national average in 1995 account for 43% of aggregate growth in OECD GDP. In the case of Portugal, around 54% of growth in national GDP came from those regions.[2] Using a

[1] They correspond to large subnational units; in the case of European Union countries the NUTS II units. There are 362 regions at this level in the OECD and seven in Portugal. As for level 3 territories, there are 1794 units in the OECD and 30 in Portugal.

[2] These regions were North, Centre, Alentejo, Algarve, Azores and Madeira.

more detailed breakdown, the OECD level 3, Garcilazo and Martins (2013) concluded that 2.4% of those territories (major metropolitan areas) accounted only for 27% of the growth in OECD GDP. To put it another way, the remaining 97.6% contributed 73% of the growth. The greatest concentration of regional growth rates above the OECD average can be found in intermediate size regions. These figures show that the less developed regions have a non-negligible role to play in the generation of national growth.

Two lessons for general economic policy should be drawn from these figures. First of all, decision-makers would do well to concern themselves with the performance of the major regional hubs: it is there that the more powerful drivers of national performance are and if they fail, the effect on national GDP will be significant. Secondly, if they ignore the non-hub regions, they lose a crucial opportunity to improve national performance. Therefore, the policy approach in the non-hub regions does not have to be one of hand-outs; rather it can and should encourage growth within a structural policy package. There is economic logic in seeking greater income generation outside the leading territories; it is good for those territories and good for the country as a whole.

GDP growth is important but the competitiveness and attractiveness of the Portuguese economy also impact on wellbeing from other angles. There is increasingly more information available about the amenities in the various regions, to which investors and more mobile workers (usually more skilled) are sensitive when deciding where to locate. OECD is once again a fine example. Through its georeferenced information portal OECD Regional Well-Being, any internet surfer can compare one level 2 region with another according to nine wellbeing indicators. Figure 1 shows the position of Portuguese regions in the OECD regional distribution. They record better performance than the OECD average except with regard to the unemployment rate, the rate of participation in the most recent general election, household disposable income and the proportion of the workforce that has completed, at least, secondary education. In the latter case Portugal's regions are especially poorly placed: while the OECD average is 75%, in Portugal it is 41%, with the Portuguese territories ranging from 31% (Azores) to 52% (Lisbon).

Figure 1 — Portuguese NUTS II regions compared to their OECD counterparts, by wellbeing dimensions

Source: OECD (2014b, p. 160).

Making a territory a better place to live and work is clearly the way to make it grow and contribute to national wellbeing. Thus, the policies that take regional differences into account and not just national averages can have a greater impact on growth and national wellbeing improvement.

This leads onto the third strong idea in this paper. **Territory is the place where people and policies meet**. People are the recipients of public policies, they are the *raison d'être* of governments. Now the policies reach the people via the territory and they are enjoyed in line with the specific conditions in the place they are provided. In this way public policies, although they may be set at the regional and national levels, are local public goods. For example, health policy benefits are perceived via the specific way in which citizens receive health care. Waiting times and quality of service are inevitably different across the country and this explains why patients form their own perception of the benefits of this policy in light of the place they live and work.

The text is organised as follows. It begins in Section 2 with an explanation of the terminology used, to make a distinction between growth, economic development and regional development. The next section presents international and national data on development indicators; the figures point to the current need for greater territorial concern for competitiveness over equity or, in other words, concern for what should be done so that competitiveness will be able to support greater equity gains. Section 4 describes the engines of growth and economic development in a market economy using for this purpose a digression on the more important trends in economics in this field. The next section compares these theories with the empirical evidence in the OECD to reach a conclusion as to the growth factors that better explain reality in developed economies. Having identified some market limitations on the provision of growth and development in all territories, the rest of the paper focuses on what the public sector has done to overcome such flaws. A review of international practices in Section 6 shows that a desirable paradigmatic change is underway in the manner in which governments face up and respond to the challenges of regional development. Section 7 identifies a series of institutional misunderstandings and challenges in Portuguese society that still constrain the full adoption of the new paradigm, and Section 8 provides a series of clues as how to remove such institutional barriers and make public policy friendlier to growth and economic development in all Portuguese territories. Lastly, Section 9 draws the paper to a conclusion. Three annexes look at matters which, while not crucial to the understanding of the sections in the main body of the paper, are deemed to be useful to readers interested in empirical measurements of regional development in Portugal (Annex A), economic theories of growth and development prior to the nineteen eighties (Annex B) and recent changes in regionalisation in OECD Member States (Annex C).

2 Concepts

Growth and development are two words often used in common speech and in economic texts but their users are not always sufficiently aware of the difference between them. Given the nature of this paper it is imperative to define the meaning of each.

Economic growth is usually associated with macroeconomics. Economic growth is said to happen when most macroeconomic aggregates evolve, in real terms, in a sense that favours the wellbeing of a substantial majority of the population. The common approach used in political discourse and the press is a positive change in gross domestic product (GDP; at constant prices) and a negative change in the unemployment rate. Often growth is restricted to a short-term perspective; this is always the case when it refers to a change in observed output, in the components of aggregate demand or in the observed unemployment rate. Another notion of output (unemployment) that is crucially linked to a medium and long-term outlook is potential output (natural unemployment); it is the level of income (labour factor unemployment) that the territory would generate if all the production factors were employed at the normal rate under efficient technological conditions. The price mechanism tends to make the observed level converge towards the potential (natural) level in the long-term.

By definition the GDP of a territory is the market value of all final goods and services produced within that territory over a particular period of time. GDP is simultaneously a measure of production undertaken in the territory, of total expenditure on final goods and services produced in the territory and of the total income generated in the territory. Thus, GDP *per capita* indicates the income and expenditure of the *average* citizen in that economy. Accepting the non-satiation principle, which states that a person feels better whenever she has more income or consumes more, it is natural to employ real GDP *per capita* as a measure of the average person's wellbeing. However, we should be aware of the limitations of GDP as a measure of the quality of life or people's wellbeing. Without going into great detail it is enough to say that the first limitation arises because GDP excludes final goods and services that are not sold in the market. Voluntary work certainly benefits lots of people but it is not recorded in GDP. GDP also ignores the consumption of goods and services from which consumers cannot be excluded (like the enjoyment of a park with no gates or the use of a toll-free road). A second limitation stems from the static nature of the measurement. The overfishing of cod over a particular period increases GDP even if the species disappears and fans are unhappy in the future. A third limitation lies with the imperfect correlation between GDP and wellbeing. For example, a person's death is a tragedy for herself and for her family and represents a loss of production to the organisation where that person worked; however, GDP rises when that person dies because the expenditure on funeral services is the only effect accounted for in this variable.

People crave quality of life and not GDP *per se* or personal income; therefore, it makes sense to broaden the effort to measure other aspects of wellbeing — Baleiras (2009a). It is here that the concept of **economic development** comes into play. Economic development is said to exist when the majority of people see their quality of life or wellbeing improve. Therefore economic development is a multidimensional variable. People's wellbeing clearly depends on their disposable income which, by successive aggregations, leads to GDP. But it also depends on their level of education, to the extent that education opens up new opportunities for intellectual and spiritual enrichment and thus for greater personal satisfaction; and it depends on the level of education of the people with whom one interacts since more educated actors make others more productive and enriched, both materially and immaterially. A person's quality of life is affected by the general state of health of the community where she lives; healthier neighbours cause less contamination and pay more taxes to the common good. The quality of the environment also influences the quality of life, since few people would wish to live or work in polluted areas. Most people are still sensitive to the proportion of individuals in their community whose income falls below a certain level of dignity.

It may be argued that many dimensions that economic development adds to GDP are impacted on by GDP itself, and that greater GDP leads to a larger positive contribution of the other dimensions to quality of life. This being the case the territories with the highest GDP are those with the highest salaries, best educated population, best health conditions, less interpersonal income inequality, etc.. However, the latest empirical evidence does not allow us to conclude that there is a stable pattern to the impact of GDP *per capita* on the various components of wellbeing. A very recent study, covering extremely long series, van Zanden *et al.* (2014, Chap. 1), has put a dampener on the overvaluing of GDP as the main target for economic policies. The researchers found various shifts in the statistical link between numerous components of wellbeing and GDP *per capita*; the same level of average income may be associated with different levels of education, life expectancy, pollution levels, crime rates, rates of civic engagement, etc.. Over the 180 years covered by the study, there are components that shifted from positive correlations with GDP *per capita* to negative ones. Certainly there are other variables underlying the behaviour of the components of wellbeing, so GDP does not provide a full understanding of the changes in a population's quality of life. Regardless of the statistical considerations, it is important to pay heed to the teachings of António Simões Lopes: "growth matters to development; but it should not be forgotten that the former only matters as a means or tool at the latter's service and not as a goal in itself." — Lopes (1984, pages 7–8).

In light of the above, it follows that, in theory, there is no closed definition of the factors that determine the level of economic development. Some are qualitative, so the concept becomes subjective. However, being subjective does not mean being irrelevant. Wellbeing or quality of life is a feature of a territory that shapes its competitiveness and its ability to attract resources. Making a territory a better place to live and work certainly better prepares it to grow and contribute to national wellbeing.

There have been attempts to measure development in the literature and by respected organisations. The next section provides empirical evidence for the OECD as a whole and for Portuguese territories. This has been a very dynamic field in recent years. The *Human Development Index*, prepared annually by the United Nations Development Programme since 1990, is, perhaps the first exercise of its type on an international scale, and its preparation benefitted greatly from the intellectual drive of Amartya Sen and Mahbub ul Haq — Malik (2014). In 2007 the European Union, the OECD, the Club of Rome and the World Wide Fund for Nature held a conference entitled *Beyond GDP* in order to encourage research into and regular production of new development indicators — a report on the discussions in 2007 can be found in European Communities (2009). A year later the President of France commissioned a report from a group of experts containing recommendations on the production of statistical indicators that are more relevant to the measuring of social progress than GDP — Stiglitz *et al.* (2009). The website How's Life in Your Region and the van Zenden *et al* (2014) study are consequences of the 2007 initiative. On its 50th anniversary, in 2011, the OECD launched the Better Life Initiative; it is an agenda for a number of years aimed at devising statistics suited to measuring wellbeing and social progress. That year in Portugal, Statistics Portugal (the national statistics authority) and the former Department of Prospects and Planning began work on a project to design a composite indicator of development for the NUTS III regions that culminated in the *Regional Development Composite Index* (ISDR), described in Vala and Pinho (2011), and published annually since 2009. Another consequence of the *Beyond GDP* initiative is the Eurostat project currently underway to create quality of life indicators.

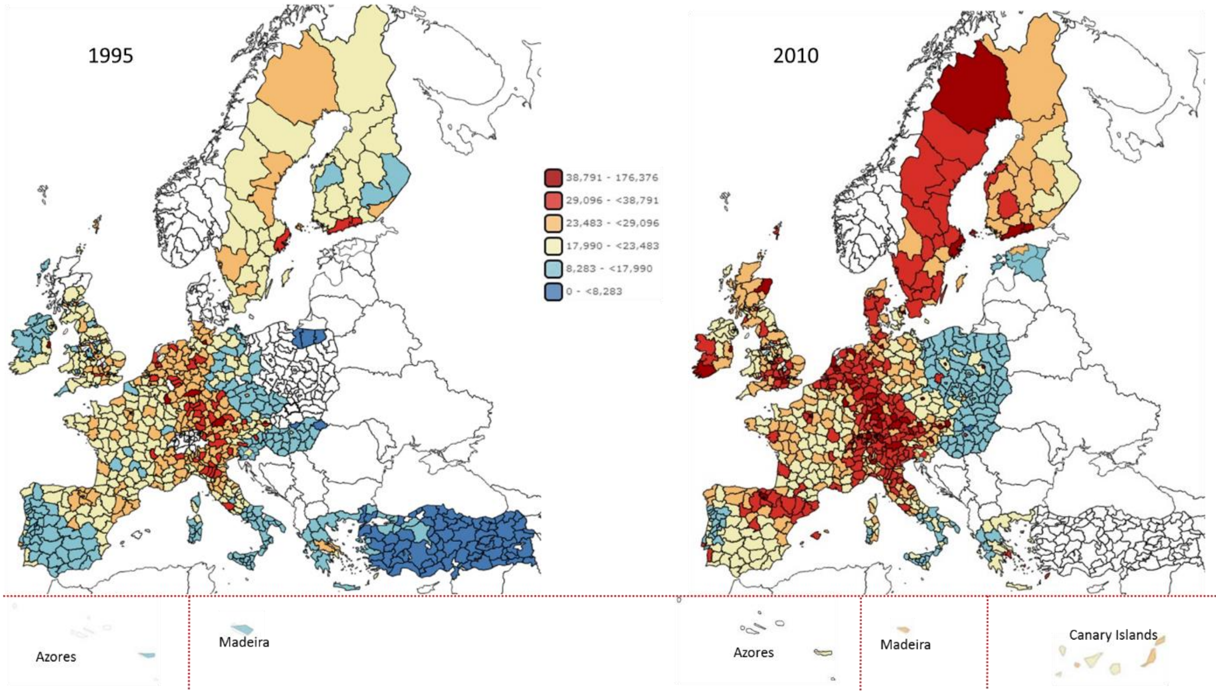
Returning to the examples of the development dimensions described above, note that all at them have a clear association with space. In effect a university professor's salary is, on average, higher in the USA than in Portugal; atmospheric pollution, which is a personal inconvenience, is the pollution recorded in the city where we spend most of our time and we are well aware that emissions are specific to places; someone who lives in Coimbra (famous university city) finds it cheaper to attend a degree in Medicine than someone who lives in Bragança (which is 2.5 hours from a medical school). This means that the quality of life that a person experiences is largely dependent on the place she finds herself in. We can even state that it makes no sense to talk about economic development without referring to space, to places. By definition economic development is a space-based process. Thus we can argue the word "development" is equivalent to the expression "**regional development**". To improve regional development in a territory such as the Barcelona Metropolitan Area amounts to improving the economic development indicators in the Barcelona Metropolitan Area. Having arrived at this point we can draw a lesson that the rest of this paper capitalises on: **the state of regional development, in any territory, is everyone's responsibility, namely**:

- businesses, families and general government, to the extent that the daily decisions they take affect the indicators that contribute to regional development;
- economic actors operating in that territory as well as those residing in other regions of the country and abroad, given the multiple economic interdependencies created by the interregional trade flows of goods and factors of production;
- the current generation of citizens but also previous generations to the extent that decisions taken at one time determine future generations' range of options.

3 Some figures

As a spur the reader is invited to pay attention to the charts in this section. They try to give an idea of the territorial diversity that exists with regard to GDP and regional development. Figure 2 shows the nature of GDP *per capita* in the OECD level 3 regions at two different times.

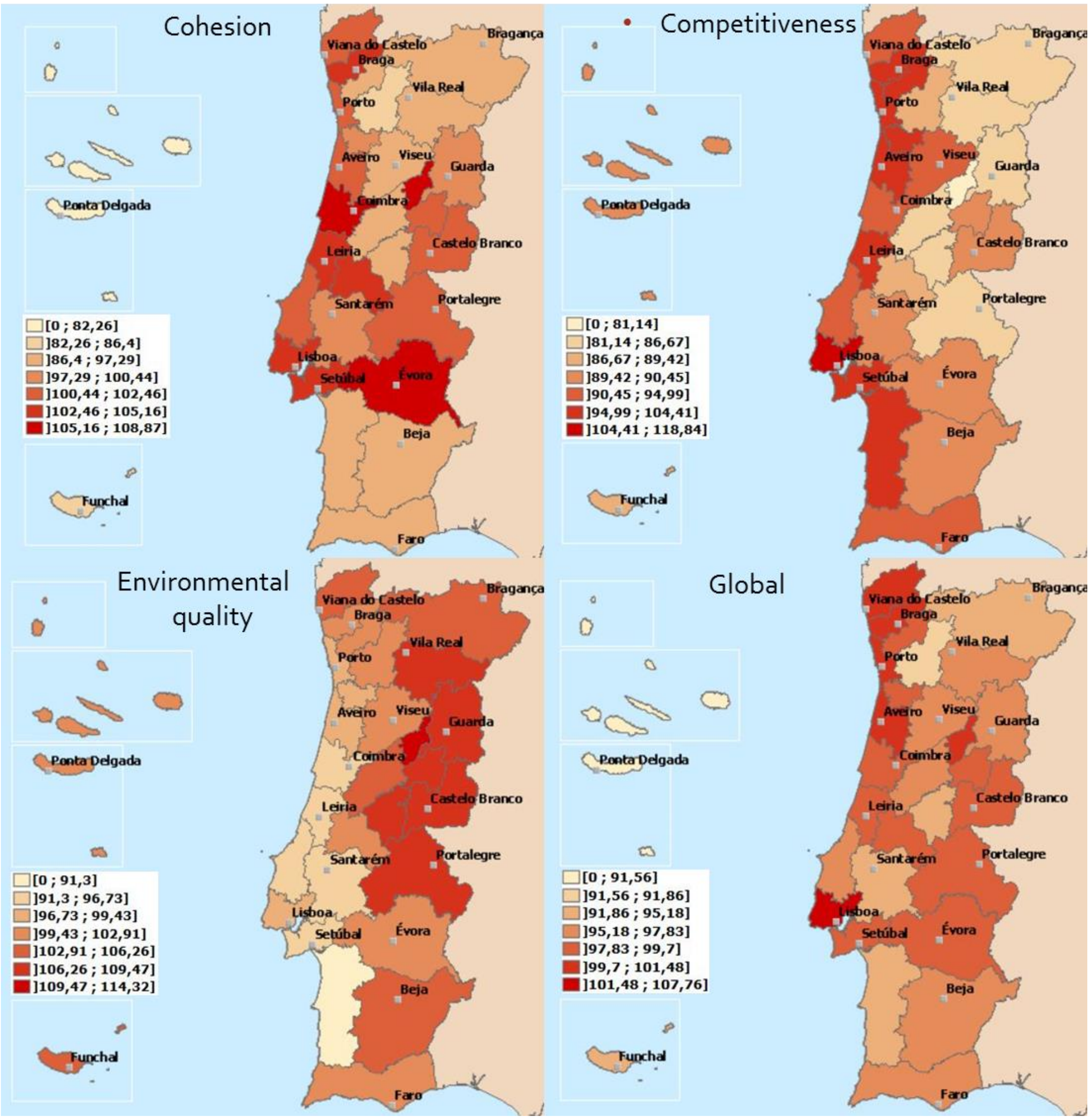
Figure 2 — GDP *per capita* in the level 3 regions of Europe



Notes: 2005 constant prices, US dollars in purchasing power parity; Iberian islands in larger scale.
Source: interactive tool Regional eXplorer and data in OECD (2014c); author's configuration.

From 1995 to 2010 the dispersion increased. This is clearly visible and is confirmed by the coefficient of variation, which went from 2.2 to 2.5 (author's calculations). As regards this indicator, the Portuguese regions seem to have moved away from the more prosperous regions in Europe. It is a development that does not surprise those who monitor the aggregate GDP statistics, at national level.

Figure 3 — Regional Development Composite Index, NUTS III (Portugal = 100), 2011



Notes: 2002 NUTS III classification (Decree-Law No. 244/2002 of 5 November); decimal separator is represented by the comma (",") symbol; sums expressed in relation to national average (100).

Source: maps and data published by INE (2014c); author's configuration.

And what information is available about the state of regional development in Portugal? The Regional Development Composite Index (ISDR), referred to above, provides a quick and suggestive image. It is the average of three composite indices. Each of them attempts to represent a region's performance in terms of an economic development dimension against the national average performance. The dimensions concerned are: cohesion, competitiveness and environmental quality. The average of the three indices expresses the region's overall position compared to the country's. Annex A provides a brief explanation of the nature of and variables underlying this measurement. Figure 3 charts the latest edition of the ISDR, published in April 2014. It is a portrait of the country in 2011.

The following messages may be drawn from the figures. First of all, **Portugal is more unequal in terms of competitiveness indicators than cohesion indicators**. The standard deviation from the average of the former exceeds that of the latter by 22%. Only five regions, out of a total of 30, are more competitive than the national average, and all of them are on the coast: in descending order they are Greater Lisbon, Greater Oporto, Baixo Vouga, Ave and Entre Douro e Vouga. As regards cohesion, 16 regions outstrip national performance. The most cohesive area is the central band of mainland Portugal. Madeira, Tâmega and the Azores sit at the foot of the table, although their performance is less than 20 percentage points down the national average. Secondly, **the territorial snapshot of environmental quality resembles a negative of competitiveness's**. The respective correlation coefficient is negative (-0.6) and the territories with the best environment are located along the eastern strip: Serra da Estrela, Alto Alentejo, Beira Interior Norte, Pinhal Interior Sul and Cova da Beira top the list. Only ten regions' environmental performance falls below the national average.

A third message is important, although it cannot be drawn from the statistical portrait given in Figure 3. It is the **change the country has witnessed in regional development**. According to the additional evidence referred to in Annex A, it can be concluded that: 1) almost all regions showed progress in absolute terms as regards cohesion and environmental quality; 2) the inter-regional differences in these dimensions have decreased; 3) as for competitiveness, absolute progress has been less pronounced than in the former dimensions and it is increasingly more asymmetric.

4 Causes of regional development: the most recent explanations

Having defined the concepts now it is important to understand how the spontaneous workings of the economy impact on regional development. If the market forces allow reasonable development across all territories and in particular, if they do not cause long-lasting asymmetric movements, economic development is not a major political problem. However, if the market fails to provide those conditions, there are reasons for society as a whole to question the government's ability to do better. Any leeway of the government in regard to the causes of economic development is always dependent on market mechanisms. For these reasons we cannot assess the quality of public policies for development in Portugal without first having a good idea of the reasons behind the territories' state of development in a market economy. That is what we set out to do in this section, resorting to economic theory in a simple but meticulous manner. The following is a summary of the exposition in Baleiras (2011a, p. 29–50). To enable a swifter reading we may dispense with the literature's older explanations and relegate them to Annex B (neoclassical thinking, Keynesian based models, explanations based on non-pecuniary interactions between agents, the growth poles school of thought and the role of knowledge). In this section, we will look at the explanations that arose from the end of the nineteen eighties and which are the most relevant to an understanding of current trends in regional development policy.

4.1 New economic geography

The ability to express a theory through a simplified mathematical representation of reality has been a dominant feature of economic science since the middle of the 20th century. In other words, the inability to describe a problem in mathematical terms is a barrier to it being recognised by one's peers. Now the explicit consideration of space in economic analysis models was not easy for a number of reasons. Firstly, unlike any other good or factor of production, location is not a variable of choice in the sense that it is not possible for an economic player to possess more of one location and less of another. Lacking the ability to be everywhere at once, a consumer of housing, for example, may only enjoy a single location. As Fujita states (1989, p. 2 a 4), a consumer's preferences for location are concave, just as the isoquants of a firm choosing where to locate. Now this intrinsic nature of space clashes head on with the convexity assumption on preferences and technology, preventing the use of the usual analytical tools of conventional economic theory. Secondly, any particular location owes its character to a number of attributes. Consideration of a single attribute, such as the distance from an arbitrarily-chosen origin, may still be analytically tractable but analysing a series of attributes simultaneously would requires the use of multiple integrals and would involve mathematically unmanageable models, that is to say, without analytical solutions for the endogenous variables in question. Thirdly, the relatively open definition of the economic (or regional) development concept, moreover as it encompasses qualitative components, is unsuitable for mathematical modelling. Lucas (1988, p. 3) is aware of the limitations of reducing development to growth but advises economists to restrict their analyses to the latter because it can be handled analytically and quantitatively.

For these reasons the models revisited in Annex B do not formally include space. This is taken into account intuitively and not in mathematical terms. It was only towards the end of the eighties, and especially in the following decades, that space was finally included in the mathematical economic models. This was the case in the so called **new economic geography**, where pioneering contributions of note were made by Krugman and Venables (1995), Puga and Venables (1996) and Fujita *et al.* (1999).

Based on general equilibrium modelling, it is possible to bring into the same conceptual framework a number of unrelated explanations that already existed in the literature. Locations are distinguished by their relative distance, as well as by their factors of production endowments, both movable (capital and labour) and immovable (land). A range of goods are produced in and traded across the regions, some of them under conditions of monopolistic competition, since distance acts as a boundary to the market areas that firms can reach. As it adopts an integrated approach, albeit omitting intangible development forces such as social capital, creative capital and institutional capital — Baleiras (2011a, p. 45–50) — the new economic geography provides a consolidated view of development drivers and allows us to write the following synthesis.

Decisions to locate firms and households are driven by contradictory forces. Economies of scale and agglomeration are centripetal in the sense that they favour the geographic concentration of jobs and sources of domestic income. Consumers that live in central regions benefit as much in terms of lower prices as from the greater variety of goods produced close to home. The larger the physical concentration of workers and residents, the more likely the emergence of niche services in those locations will be: opera performances, specialist health care and sophisticated consumer goods (the spillovers of urbanisation). The impact on the wellbeing of households in peripheral regions is ambiguous: as workers they lose job opportunities, but as consumers they gain access to goods (due to the fall in prices).

Transport costs operate in the opposite direction, in a centrifugal way. The distance between the production and consumption sites places a burden of competitiveness on firms that limits their market areas. This encourages spatial decentralisation of production facilities, especially when demand grows at distant locations. Transport costs bring jobs closer to households living in peripheral territories, and this also triggers (makes viable) the supply of collective services in the areas of education, health care, culture and mobility. Consumer prices, including transport costs, may rise or fall, depending on the dislocation pattern and the combination of economies of scale and agglomeration, on the one hand, and transport costs, on the other. For households residing in job-losing territories, incomes tend to fall and consumer prices may rise or fall depending on how far the new production facilities are from their homes.

These models are suitable to explain different territorial development patterns. Depending on the starting point and the parameters used, the models may generate multiple equilibria for the location of economic activities, from undefined patterns to extreme central-peripheral cases, including the reversal of territories' relative positions over time. The simulation of scenarios helps to understand some stylised patterns of growth and development of the real world, such as: i) persistent differences in growth rates across countries and regions; ii) long periods of stagnation followed by bouts of expansion; iii) leaps in the natural order of technological progress (leapfrogging) that accelerate development in less prosperous territories and their convergence towards higher performance levels.

4.2 Intangible development factors

More recently the literature on the so-called intangible development factors has aroused interest. Initially developed in other scientific areas, such as sociology and business administration, today it is taken seriously by economists more sensitive to organisational and institutional matters as a means of providing complementary explanations to those offered by the mainstream fields of economic science.

On the road to the 21st century the nature of value added changed around the globe. Today it is the knowledge intensive industries that generate the highest levels of productivity. The need to match short-term progress with environmental sustainability has become tremendously important in recent years. These two features of the contemporary world require ever softer or intangibles skills in territories if they are to react swiftly to external shocks or to promote the reworking of the specialisation models followed hitherto. There have been a growing number of papers and books calling attention to the importance of invisible but hyperactive factors, such as leadership, organisations and the quality of their governance, creativity, innovation and entrepreneurship, for example.[3] These items may be thought of as mixed goods. Part of the benefits generated is appropriated by their owners but another part is public and local, since it is enjoyed by all the economic actors who live in the catchment area. Thus, **the contribution of intangible factors to regional output growth is generated in the economy of the territory itself** — which leads many authors to classify it as an endogenous component of growth.

4.3 Summary

From this digression into the economic development theories of relevance to mature economies, the following conclusions can be drawn.

[3] Stimson *et al.* (2011) collect various examples of this wave.

- **the wellbeing** of people living in a particular place is the result of a complex **interaction between factors** intrinsic to the place and exogenous **factors**, in both cases inputs that go beyond the role of traditional labour and capital stocks in supply-side macroeconomic analyses;
- "where are the **resources**" (endowments) and "where are the resources going" (spatial mobility and over time accumulation) are very important **questions**;
- The spontaneous workings of the markets trigger contradictory outcomes. They neither necessarily ensure a territory durable progress nor, contrary to neoclassical beliefs, long-term real convergence. To put it another way, **the market may fail to provide sustainable development**.

These conclusions do not mean that the government would necessarily do better or that, if it were to act upon development factors, its actions would not be flawed. It may be useful to take a look at what empirical studies and international comparisons have to say on the matter, a subject for the next section.

We have seen in the previous pages how varied the list of factors impacting on growth and development is. Responsibility for the levels of each factor is spread across an enormous host of actors, within and outside the territory in question. In the absence of their coordination the new economic geography and the theory of intangible factors warn us of the risk of contradictory effects. This gives rise to a possible **policy implication**. An intelligent, collective act in favour of territorial development will flow from the deliberate and concentrated mobilisation of wills. This cannot be done top downwards, neither can it be done without cooperation and leadership. Therefore, if a collective intervention of this kind is to be considered, it should be a matrix-based organisational model. In order for the various types of resources to be effectively mobilised, **good methods of cooperation, both horizontal and vertical, are essential**. In the case of the former, we refer to cooperation within each category of economic actors: ministries, municipalities, firms, business associations, TR&D centres, regional development agencies, local development associations. In the latter case we refer to cooperation between economic players from different categories. We will return to this issue with our recommendations on how to overcome the institutional blockages to regional development in public policy (Section 8).

5 OECD empirical evidence on growth factors

The OECD possesses a world renowned skills centre in the field of territorial development—the Directorate for Public Governance and Territorial Development (OECD staff) and the Territorial Development Policy Committee (Member-State experts) — that has a great insight on many nations' experiences. A recent work, OECD (2012), is a fine example of the practical perception that this unique observation post has of how these growth and development processes are forged in the real world. From the econometric analysis conducted on level 2 and 3 territories of its Member-States and 23 case studies, it was possible to draw conclusions about the desirable national scope of economic growth, regional economic growth drivers and the role of institutional factors, including public policy. In the following pages we present the results of that study in light of our own technical and political experience in the subject.

It is important to begin with a few notes about the methodology since the conclusions summarised below are naturally affected by the study's hypotheses and should be read with care. The study's results are conditioned by:

- the level of territorial aggregation — the greater the level the smaller the differences, and the more common become the causes of economic growth or bottlenecks. The statistical analysis employed a sample of 850 level 3 regions (from a universe of 1,794 units);
- the theoretical framework underling the choice of explanatory variables — in the econometric part, this work went beyond the neoclassical thesis of the nineteen fifties and incorporated the role of knowledge and some ideas from the new economic geography literature; OECD (2012, p. 73–4). In the case studies, the written questionnaires and the standardised interviews, as well as the bibliography were used to collect evidence on the intangible development factors, including political and institutional items. They also collected information on how stakeholders perceive the transmission of effects via the determinants studied in the econometric part;
- the operational definition of the variables — such a definition is essential to a statistical work and calls for a delicate balance between data parsimony and its representativeness in the light of the arguments to be tested. Inevitably it conditions the results. For instance, the "infrastructure" factor was represented only by motorway density (p. 73). Infrastructures of potential importance to growth, such as voice and data communication networks and non-road transportation, were omitted.

  Bearing these limitations in mind when reading the results we believe that the conclusions are important and that useful lessons can be drawn when thinking on what should be encouraged for Portugal to grow more and better.

As regards the territorial spectrum that should be the focus of growth, the authors conclude that **inclusive growth of a territorially broad spectrum** brings **benefits to countries in terms of equity, resilience and fiscal health**. That is the case inasmuch as:

- **the existence of growth in all regions means national prosperity is less dependent on a small number of territories**. *Ceteris paribus*, the greater the number of territories that contribute to national growth the more diversified a country's range of activities becomes and the less vulnerable the country is to sectoral asymmetric shocks;
- **the recovery of *per capita* earning lags in the less affluent regions contributes to equal opportunities**, easing the burden that the place of birth or residence puts on an individual's personal accomplishment. It is true that people and firms are mobile and it is not possible to stop them from leaving territories where opportunities are fewer. However, political decision-makers should bear in mind that to ignore substantial inter-regional disparities, sooner or later, leads to problems of equitable access to markets and collective services;
- **the persistence over long periods of real divergence dynamics becomes unfavourable even to the residents of more affluent territories**. This happens at two levels. Firstly it results from the impact the depopulating of the less affluent territories has on the disappearance of amenities generated there and enjoyed by resident of better-off areas. Examples: upkeep of arable land, biodiversity sustainability, preservation of human and animal habitats, survival of crafts, handing down of traditional know-how and practices, protection against forest fires, preservation of historic, religious, civil and cultural heritage, etc. The

second type of harm is of an eminently material nature: i) revenue taxation loss as the less affluent territories' growth potential is not put to use, and ii) political pressure for additional public spending on territorial cohesion, designed to uphold living standards in communities where the ratio of elderly persons to working persons is increasingly greater. Over time that persistence may lead to internal conflicts, if the richer regions get tired of funding the territorial cohesion policy.

As for the **growth drivers**, the following conclusions arise:

- there is no single recipe for growth, the most effective combination of factors depends upon each territory's level of development. This statement has an **important political implication**, which is that **regional development policies should differentiate between territories** and be aimed at strengthening the factors which can make the largest contribution to growth in each case;
- in all regions, **human capital emerges as a critical factor, although its relative importance varies according to the level of development**. Generally speaking, a reduction in the proportion of very low-skilled population in a region dominated by low skill levels appears to impact more on growth than increasing the relative weight of people with very high skills levels. The scarcity of skills and the "brain drain" strangle the less prosperous regions. While in more developed regions, the actions that have the greatest potential are those at the tertiary education level, vocational training and the matching of human capital to employers' needs;
- R&D-intensive **innovation** is a relatively more important determinant in more developed regions, probably because the organisations that produce science and the economic activities that use state of the art knowledge are concentrated there. This type of innovation is easily measured (by the number of patents registered and by public and private spending on R&D). For those territories outside of the leader regions, innovation is still relevant but takes forms that are harder to measure, such as product innovation and changes to organisation processes. In less developed regions, the endogenous capacity to produce innovation needs to be strengthened through technology transfer mechanisms;
- **statistical results on the impact of infrastructure on growth are mixed and do not seem to support development strategies based on the key role of investment in infrastructure**. We believe, however, that that conclusion is constrained by the operational definition of infrastructure. The geographical position, the type of settlement and the make-up and density of economic activities seriously affect the usefulness of motorway stretches in a level 3 region. In any case, a concrete analysis of each region's growth prospects is required to see which type of infrastructure is under discussion and to what extent they complement and enable other strategic actions;
- **the fragmentation of the economic tissue and the unbalanced labour market seem to stifle growth in less developed areas**. The greatest barriers to growth in those regions include insufficient critical mass to produce economies of agglomeration and positive spillovers in the interaction between the more urbanised areas and the respective hinterlands, incomplete value chains, restrictions on internal transport networks, low level of female participation in the labour market and the mismatch between the supply and demand of skills.

Lastly, the role of institutional factors. It was assessed through case studies conducted in 23 regions that also looked at the determinants evaluated with the econometric toolkit. In short, **institutions and policies play as important a role as human capital, infrastructures and innovation**. Among the more dynamic regions, institutional factors, including policies, are in the top 3 more recurrent growth factors. Among the regions with poorer performance, they are one of the 3 main causes of strangulation.

The **performance of more dynamic regions is especially favoured by**:

- **institutional ingredients such as the governance quality of organisations and networks, leadership, the ability to mobilise economic actors, and persistence**. Consultation, conciliation and the devising of cooperation strategies are referred to as very important elements in regional development processes. Social partners are deeply involved in the identifying of development priorities and, in particular, in the drawing up of action programmes focusing on innovation and the matching of demand and supply for vocational training;
- and **by certain features of development policies**, such as measures that favour the endogenous factors of potential growth, promote cooperation and bridges between economic agents (for example, between producers and users of scientific knowledge and in the devising of collective action strategies) and enhance urban regeneration.

While in **regions with poorer performance institutional and public policy elements are among the reasons for strangled growth**, in particular:

- **at the level of institutional blockages**, we would mention the absence of institutional thickness, the difficulty of mobilising economic actors, the lack of continuity and persistence in carrying out policies on the part of organisations (both public and private), unstable governance of organisations, lack of a common strategic vision, weaknesses in the technical capability of subnational governments and difficulties in linking the work of the various levels of government;
- **resistance to the replacement of policies anchored in subsidies and outside investment by policies aimed at unblocking the endogenous capacity to grow and develop**. The persistent pursuit of policies based on the transfer of resources to these territories, on the grounds of redistribution, gives rise to rent-seeking habits and does not strengthen local actors' desire for strategies geared towards growth.

This set of conclusions leads to clear recommendations for formulating regional development policies. In keeping with the multidimensional nature of the causes of both economic growth and economic development, **the policy approach should be across the board rather than sectoral**, favouring:

- **the harnessing of each region's capability** to contribute to national economic growth regardless of its level of development;
- **the emphasis on geographical differentiation** through place-based customised policy tools;
- **policy packages** instead of isolated measures;
- **the engagement of development partners in the regions**, from the strategic planning stage to the defining of priorities;

- **policies based on the causes which, in each region, prove to be the most promising in terms of promoting growth along with the indispensable territorial and social cohesion**.

6 Regional development policy paradigms

To a large extent public intervention towards regional development matched the progress in scientific knowledge. Therefore it is not surprising that European Union regional policy was not born when the Communities were founded in the nineteen fifties;[4] the neoclassical optimism described in Subsection B.1 as to the ability of markets to promote real convergence prevailed in international economic policy circles. In the nineteen sixties a number of advanced economies began to implement policies geared towards territories, greatly influenced by the policy implications of models with Keynesian roots and the growth poles school of thought recalled in Subsections B.2 and B.4, respectively. Those were decades of notable national growth which helped finance development policies based on redistribution mechanisms and exogenous investment in the less prosperous territories.

In the past decade, thinking on the role of the endogenous factors in growth and development began to influence political discourse and the design of policy tools intended to drive them. The relevance of knowledge, the economies of agglomeration, the ambivalent role of the fall in transport costs in consumption and employment, as well as the intangible elements, covered in Subsections B.5, 4.1 and 4.2, begin to make inroads into regional development policies. In Europe, certain national experiments are important landmarks[5] and, in terms of the near future, the Barca Report (2009) on cohesion policy as well as the European Union development strategy up to 2020 "Europa 2020". Baleiras (2011a, p. 51–56) discusses the implications economic theory can have for the government's role in promoting regional development.

Experiments with endogenous factors that have increased since 2000 are so significant compared to the past that many specialists in the field agree with the position the OECD has held for a number of years — OECD (2009, 2010, 2011) — that a **paradigm change** in regional development policies is under way. Table 1 helps us understand the differences and, above all, to identify current trends.

Whilst not wishing to write an exhaustive commentary on the differences between both paradigms, we would like to make the following remarks.

Firstly, the two models will continue to coexist for a number of years. A considerable amount of time, although it vary from country to country, will pass before specialists' awareness of the new

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[4] The DG Regio (Directorate-General for Regional Policy) was created in 1968 but we may argue that the common structural policy geared towards territories only began when the European Regional Development Fund was set up in 1975. This evolution is not unrelated to the changes in European integration itself, to the extent that the successive stages (customs union, enlargements, common market, European monetary system, financial liberalisation and, finally, exchange and monetary union), while globally positive, caused territorial imbalances within and between Member States, making these imbalances a common concern.

[5] In the field of economies of agglomeration, the "Centre of Expertise Programme" in Finland, geared towards the assimilation of innovation processes in small and medium-sized firms, and the "Collective Efficiency Strategies" initiative in Portugal to respond to four types of competitiveness challenge. In the field of sectoral policy coordination towards an integrated approach to rural territories development, we have the Canadian "Rural Partnership" project.

approaches turns into the implementation of innovative policy tools, and in the meantime political decision-makers and those with vested interests in the old approach must become aware of the need for change. Nonetheless, the international assessments we have referred to in this **paper are beginning to recognise the gradual transition from one model to another**.

Table 1 — Regional development policy paradigms

	Old paradigm	New paradigm
The recognised problem	Regional disparities in income, infrastructure and employment	Regional competitiveness deficit and unused growth capability
Objectives	Equity through balanced regional development	Competitiveness and equity
General perspective of public policies	Reactive (to problems) and project-based: temporary compensations for physical handicaps (exs.: low dens regions, outermost regions) or adverse structural shocks (ex.: industrial decline regions)	Proactive (to opportunities), strategic and programmatic: harnessing of idle regional capability *via* regionalised programmes
Thematic scope	Narrow and sectoral, with a small number of sectors	Wide and integrated, with global development programmes encompassing several themes
Spatial orientation	Disadvantaged regions	All regions
Territorial unit for policy intervention	Administrative areas	Functional areas
Time dimension	Short term (basically looks for aggregate demand effects on target territories)	Long term (heading for supply effects in all territories)
Approach	One size fits all	Sensitive to the context (place-based)
Focus	Exogenous investments and public transfers	Endogenous local assets and knowledge
Instruments	Grants and State aids (to isolated individual initiatives)	Facilitating collective actions, both tangible and intangible (institutional capacity building, business environment, labour market, infrastructure)
Methodology	Based on specific projects	Strategic and programme-based
Players	Central government	Multiple partners (all government tiers, private agents, NGOs)

Source: own adaptation of OECD data (2010).

Secondly, the paradigm shift is associated with a change in the diagnosis of development problems and their causes. Under the old model the problem, as recognised in the political debate, is basically about inter-regional disparities in income and access to collective services (health, education, sanitation, transport). The policy collects funds in the most affluent territories to spend in target territories with low levels of development (often related to GDP value as a percentage of national or supranational average), clearly a redistribution approach. Policy resources are used to provide these areas with infrastructure, to subsidise direct exogenous investment (from abroad and other parts of the country) and to subsidise social integration programmes, frequently designed top downwards and outside the target territories. In the old model economic and social cohesion, understood as the goal of reducing regional asymmetries in income and access to collective facilities, dominates policy tools. On the contrary the new paradigm assumes that **there can only be sustainable economic and social cohesion if there is competitiveness**. That principle is to be **applied in all territories**, although adapted to the specific territorial characteristics associated with the determinants of endogenous development. The goal is to unblock and exploit potential growth in all and any region to promote competitiveness and equity. It is no longer a case of a policy aimed at redistribution, although it can and must be a policy that takes into account the distribution of opportunities.

Thirdly, political discourse under the old model is greatly marked by regret over the lags relating to more developed regions. To a certain extent, the response to problems is compensation measures. Under the new model the **discourse tends to be proactive** and more positive and constructive, focused on the exploiting of opportunities to grow and develop; policy measures are less case by case and one-off and are **more integrated and with a large strategic dimension**. Under the new paradigm, policy tools, besides arising out of space-based development strategies, contain **action programmes** and tend to set **targets on the basis of outcomes** (a technically difficult task) that may be incorporated in contracts with the management structures and the beneficiaries of the tools. Since the policy's effectiveness stems mainly from a change in the behaviour of the economic actors, **persistence** in the course and the policy tools is a key value in the new paradigm. Its DNA also includes a requirement to **assess** outcomes.

Fourthly, since competitiveness and equity are multifaceted goals that can be affected by a number of public policies, the new paradigm recognises the inevitability of sectoral policies of a greater structural impact being duly coordinated before and during their application in the territory. In order for the policies combining role to be duly interpreted in the territory, governance mechanisms that favour **integrated approaches, with sector participation, sensitive to the space-base and geared to the long-run** are essential.

Fifthly, under the old model investment tended to be seen as exogenous to the region, *i.e.* an asset coming from outside that is placed in a particular territory; the decision to promote it does not necessarily take into account the inter-industrial drag and drive relationships within that territory. On the contrary, under the new paradigm endogenous ability to take advantage of direct investment, own or external, is essential to the tone of possible public stimuli. The **valorisation of the territories' own assets** is at the heart of the new generation policy tools. Local and regional stakeholders take on a leading and proactive role in the design and governance of space-based development strategies.

Sixthly, the government's role changes under the new paradigm. It becomes relatively less important as a financier and a decision-maker in regard to almost everything and becomes increasingly more of a **facilitator** of the meeting of minds and resources of the residents in the territories and those who wish to invest, work or live there.

In short, the paradigm change consists essentially of putting aside:

- subsidies irrespective of results, based on inter-regional asymmetries, in favour of transfers based on performance, transfers that encourage behaviours conducive to improved territorial competitiveness;
- sectoral separate and independent approaches, in favour of integrated and multisectoral solutions (which require good horizontal and vertical governance, as discussed in Section 8);
- the devising and implementing of standardised top-down policies towards shared, place-sensitive vertical governance.

7 Institutional blockages in Portugal

The previous sections help us understand the trends in international best practice as regards regional development policies. And where does Portugal stand in this matter?

We would say that the country is **in transition from the old to the new paradigm**. Until Portugal joined the European Communities in 1986, one cannot really talk about regional development policy.[6] Since then, public institutions have been created to consider, plan and even implement development measures based on territories (regional coordination agencies, Directorate-General for Regional Development…) and taxpayers' money has appeared, (the structural and cohesion funds of the European regional policy of the time). From 1989 to 2009, around 48 billion euros (B€) of European funds were invested in the Portuguese economy, of which 26.9 B€ will have come from Portuguese taxpayers and 17.8 B€ from resident companies — as calculated by Baleiras (2011a, p. 60). The use of these funds required a genuine cultural change in policy tool management which spread to other fields of government action: multiannual budgetary programming, strategic reasoning, predominance of rules over discretion, and evaluation (prior, during and post implementation) were new values for Portuguese public management, mainly imported by regional policy. Greatly inspired by the policy implications of models with Keynesian roots and the growth poles school of thought, growth incentives through exogenous causes (public provision of infrastructures, aid to private investment projects isolated from their economic environment, i.e., the territory, and policy tools devised with little participation of the economic actors) prevailed, as well as the political view of regional development policy as a Robin Hood type welfare policy, as if development problems only existed in poor areas and redistribution were not an interpersonal matter (instead of being treated, wrongly in our opinion, as an interregional one).

In the meantime the country took giant steps in numerous fields, from the extraordinary decline in infant mortality (to levels below most developed nations) to the shrinking of distances in the country.[7] Various studies[8] show the significant improvement across the country in terms of citizens' access to collective goods and services, such as mobility, waste water treatment, health and education. Defining territorial cohesion as the percentage of the population covered by equipment and infrastructure networks that supply this type of goods, the said studies conclude that the country has become less asymmetric in this field. The same cannot be said in relation to territorial competitiveness, measured by subnational level indicators such as the weight of tradeable sectors in Gross Value Added, percentage of the working population that completed secondary or higher education, number of industrial patents, and the change in the external and internal market shares of resident companies. Territorial competitiveness showed less progress than territorial cohesion, an outcome in line with the macroeconomic indicators that compare the country's competitiveness with other national economies. Unlike the cohesion indicators, the competitiveness asymmetries between NUTS III territories have not ceased to increase since the nineteen seventies (see the quantitative indicators in Annex A).

Since the 3rd Community Support Framework (CSF, 2000/2006), and with greater intensity since the National Strategic Reference Framework (NSRF, 2007/2013), various innovations have arisen in the mainstay of the new paradigm. The NSRF takes on board competitiveness and cohesion, as well as political goals to be pursued with the financial contribution of the European funds

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[6] "There never was regional policy in Portugal although the regional imbalances and the need to correct them have been long discussed" — Lopes (1984, p. 331).

[7] OECD (2008, p. 102) records a decrease of around 50% in journey times between district capitals and Lisbon from 1986 to 2006 as a result of the improvement in the national road network.

[8] Mateus (2005), DPP (2006) and Mateus (2013).

and it also adopts governance solutions aimed at better territorial integration of sectoral policies — details may be found in Baleiras (2011a, p. 61–69). The next programming framework, Portugal 2020, anticipates the strengthening of this approach.

For the purposes of this paper, rather than simply explain the steps taken towards the new paradigm, **it is important to reflect on a series of doubts and challenges** that remain in Portuguese society as institutional blockages to its full adoption. The discussion below paves the way for the presentation of possible solutions in the next section.

7.1 Difficulties in public understanding of across the board issues

One of the reasons why politicians find it difficult to take an interest in across the board policies and issues are the fact that citizens do not feel they exist. What they see is sector policy failures. Two examples. If a maternity hospital is closed, what families see is a health unit has disappeared and they complain about the local hospital or health policy. If a stretch of railway is closed, what the users see is the trains have stopped passing their door and they complain about the rail operator or rail transport policy. What they see are the nearest cause of dissatisfaction but the true causes are different — they are development matters (they are related to the loss of women of a fertile age and the disappearance of subregional jobs and firms and resulting rail traffic opportunities and, therefore, the critical mass for pregnant women, passengers and cargo).

Development matters are too distant from day-to-day life and people cannot clearly identify a member of Government to hold accountable. Therefore, **people feel the effect of the lack of an across the board approach as the consequence of sector policies rather than as the absence of any across the board policy or of sector policy coordination**. They have no idea what this is nor that there should exist an across the board approach and policy coordination. Now that is the first difficulty to be overcome in order to interest central government in horizontal policies aimed at territorial development.

7.2 Across the board problems and vertical governance

A second difficulty lies in the fact that **general government and the make-up of the Government itself are organised vertically, *i.e.*, by sectors**: health, transport, environment, education, commerce, industry… Such a structure does not help find solutions to across the board or horizontal problems. Instead it favours the creation of silos that do not talk to each other and are wary of any attempt at approximation by another sector.

This does not mean we defend the ending of sectoral departments and sector-based Government portfolios. Undoubtedly they are recommended for reasons of specialisation and effectiveness. What is missing in this country is a vertical structure consistent with swift and effective mechanisms of horizontal coordination to deal with the multidisciplinary challenges that demand sectorally aligned responses. This is clearly the case with economic development and even economic growth, for the many reasons presented in Sections 4 and 5.

7.3 Territorial disarray in public policy

Sectoral policies with the largest impact on development rarely have space-based goals and strategies and, when they do show some concern for territorial translations, **they are neither aligned with each other nor with the Government's strategy and goals as a whole**.

Spatial planning instruments actually provide for the participation of the ministries responsible for those policies in the design stage. We are referring to the Regional Land Management Plans (PROTs in the original Portuguese). The ministries contribute their ideas and investment intentions to the planning of collective facilities networks. Knowledge of which facilities will be built or remodelled, what services they will provide, and when and where, clearly aids the integration of externalities between sectoral networks and promotes the rationalisation of networks in line with each PROT's development strategy. The problem is that the PROTs do not bind anyone to their fulfilment. Investment intentions are just intentions; therefore no care is taken to check whether the budget required to their financing is available.

Any review of a sectoral network is normally a "partial balance" exercise. It takes place outside each PROT's agreed strategy and consideration is not given to the rebound effects on economic activity and the social utility of other networks. A good example of this type of action is the attempts to compress facilities networks in the 2005–2009 and 2011–2015 legislatures. The economic rationale of each sector reducing its physical presence in territories where capillarity is less is not in dispute. The development problem is that the ideal solution from the individual standpoint of Health, Education, Justice, Internal Affairs, etc., is to close establishments and lay off or withdraw human resources **from the very same places**. There is an undeniable negative impact on these small local economies due to the disappearance of consumers and direct, indirect and induced jobs. There is also a negative impact on territorial cohesion, in that the ability to provide access to public services is reduced in territories where an ageing population with reduced mobility prevails. Without coordination and in the absence of a wide-ranging development policy in the less populated territories, a series of good partial solutions will not necessarily amount to a good general solution. As stated recently by Professor João Ferrão, "(…) for each individual sector the way they rationalise their networks may make sense, when they apply their strictly sectoral criteria, but if nobody has an overall view, the result is Portugal is turned into a *Gruyère cheese*, full of holes that are the result of decisions taken separately." — Ferrão (2014).

7.4 Strategy

Reference has already been made to the importance of strategy in formulating modern regional development policies. The impact on structural development variables calls for strategy as it provides knowledge of the starting point, enables a medium and long-term vision, inspires action programmes (with targets and resources), mobilises partners, calls for their participation in governance models, legitimises leadership, ensures coherent application of instruments and projects, fuels the resilience needed to persuade others to overcome obstacles along the way and does not do away with critical assessment before, during and after implementation as a validation and adjustment criterion to changes in the framework.

In Portugal beautiful strategic planning exercises are conducted. The country has no problem thinking *ex ante* and planning. **The true difficulties arise when implementation begins**. It is not rare for the strategy to be stuffed in the drawer at that time and what was planned gives way to improvised and circumstantial actions. The *wheel is reinvented* countless times while hardly moving from the spot. Evaluation is not taken seriously enough when conducting public policy and the **constant changes in direction, or even a lack of direction, end up exhausting the decentralised beneficiaries and the facilitators of the policies**, the economic players whose mobilisation and commitment should be the first asset to be built and consolidated. The frailties still revealed in the implementation of strategies are a barrier to the effectiveness of structural policy that must be overcome.

7.5 Regional development policy and use of structural funds

Here are two serious mistakes that the country continues to make. The structural funds available under the European Union cohesion policy, with their goals, eligibility rules and financial envelopes, are undoubtedly designed to lever national regional development policies. One mistake is to confuse regional development policy and the financial implementation of the structural funds.[9] The second mistake is to consider that all uses of these funds in sectoral projects make up regional development policy.

A regional development policy, as defended in this document and in line with the new international practices paradigm, **must not be confused with the financial implementation of the structural funds**. In the first place, because the latter cannot be an end in itself; otherwise the funds' capacity to change the Portuguese economy and society will be jeopardised. The funds are a financial instrument to which Portuguese taxpayers make a marginal contribution through the European appropriation and more significantly through the national public contribution. The private beneficiaries also have to contribute through a private contribution. Even if the funds were *manna from heaven*, account would always have to be taken of the opportunity cost of the chosen allocations. Spending for the sake of spending is not a good criterion. Therefore it is strange that the political debate on the use of structural funds in Portugal almost always slips back to the funds spending rate and almost never to the impacts, the outcomes that these resources should help create in terms of competitiveness and territorial cohesion. Secondly, a good regional development policy involves much more than money. Indeed that is the feature that separates the two paradigms described above. Rather than act as a financier, the government is expected to play the role of motivator and facilitator of the actors' wishes. There is a lot of highly precious immateriality in this role. **It may not offer photo opportunities but it is certainly hard work and is indispensable if Portugal is to progress**.

The second mistake stems mainly from the very large relative weight of the structural funds appropriation in national public expenditure. It is estimated — Baleiras (2011a) — that around the middle of the 3rd CSF (2000/2006) general government investment leveraged by structural funds would account for around half of its total investment. Since national sovereignty fields were not eligible for funds, the effective leverage rate was well above 50%. In state-owned enterprises this rate would not be lower. Central, regional and local governments have become *overdependent* on European funds to the point that almost all ministries have got used to a second budget: in addition to the national sources from the PIDDAC (the central administration investment programme), they had a CSF operational programme under the direct responsibility of the sector's member of Government. After 20 years of European funds sectorisation, **they were used for practically everything that was vertical policy**, from transport to the environment, from education to vocational

[9] For the purposes of this subsection, "structural funds" mean all EU budget financial instruments with a structural aim that are part of cohesion policy, rural development policy and of the structural component of fisheries and sea policy (this is a broad sense definition that lacks legal precision). Over the 2014/2020 programming period they will be known as a whole as the European Structural and Investment Funds (ESIF) and will include the following instruments: European Regional Development Fund, European Social Fund, Cohesion Fund, European Agricultural Fund for Rural Development and European Maritime and Fisheries Fund.

training, from energy to agriculture, even if it had little to do with long-term concerns. It has become extremely difficult to adopt across the board and integrated approaches, guided by the supply side. It is not difficult to understand that this is the ideal policy framework for the proliferation of one-off and space-blinded infrastructure investments.

Given such a large relative weight in public expenditure and such sectoral power over funds, politicians and opinion makers become used to the idea that the pursuit of regional development policy consisted solely of financial management of the structural funds, and it was up to the sectors to decide what to invest, how much, where, with whom and to what end. This standpoint prevents any development dimension or even of competitiveness in the application of structural funds.[10] The review of the economic literature and the evidence of international good practice described above show how ignorant it would be to persist with that view. Regional development policy may, and probably should, coordinate, with the necessary political clout, funds strategy in Portugal; however, regional development policy is much more than this, as the new paradigm shows.

7.6 Rent-seeking habits

While it is clearly not a feature exclusive to Portugal, a relatively rooted practices in its society is the attempt to obtain favoured, privileged or exception treatment in regard to access to common resources, a practice that political science and the theory of public choices call rent-seeking behaviour. The roots may be deep and ancient, dating from the settlement of the territory in the Early Middle Ages, the royal charters and the guild system. Such behaviour is an obstacle to be taken into account in any reform of economic policies in favour of development.

Typically these habits have a short-run vision, are based on the interests of specific groups and **have more ability to attract common resources if the development policies remain fragmented and do not rely decisively on competitiveness and growth**. That is why they tend to be opposed both to the introduction of selectivity mechanisms and competition in the assigning of subsidies and the adopting of space-based strategies founded on partnerships with actors who represent other interests. The setting up and running of projects based on the principle of cooperation and the deliberate search for economies of association are opposed by rent-seeking behaviours.

7.7 Proportionality and representation of minorities

Table 2 shows the electoral constituencies for the Portuguese Parliament in the peripheral territories of the Portuguese economy require more registered voters to have the right to a representative in the national Parliament than more developed territories. Thus, if the national average is 43,941 voters, the districts that require more voters are those where, normally, less people live and the competitiveness indices are lower. Comparing the extremes on the list, 53,222 registered voters in Portalegre are required to have the right to a Member of Parliament (MP) while in Lisbon 39,972 are sufficient for the same purpose.

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[10] The NSRF programming tried to break with this view through a range of measures, such as the replacing of sectoral operational programmes with across the board operational programmes and the introduction of the principle of competition in public access to Community finance. For a general outline of the NSRF and regional development policy over the 2005/2009 period, see Baleiras (2011a, p. 61–69). In the light of current public knowledge the programming of Portugal 2020 seems to consolidate this strategic change.

Table 2 — Distribution of eligible MPs by electoral constituencies: Parliamentary elections of 5 June 2011

	Electors	MPs	Electors by MP
Portalegre	106,443	2	53,222
Bragança	153,902	3	51,301
Évora	145,894	3	48,631
Castelo Branco	190,981	4	47,745
Vila Real	235,536	5	47,107
Beja	135,724	3	45,241
Açores	222,095	5	44,419
Coimbra	395,075	9	43,897
Guarda	172,391	4	43,098
Viana do Castelo	257,039	6	42,840
Madeira	255,867	6	42,645
Leiria	424,758	10	42,476
Viseu	381,601	9	42,400
Setúbal	711,089	17	41,829
Braga	774,995	19	40,789
Aveiro	651,230	16	40,702
Porto	1,570,154	39	40,260
Santarém	402,350	10	40,235
Faro	360,068	9	40,008
Lisboa	1,878,702	47	39,972

Average = 43,941

Notes: constituencies listed in decreasing order by ratio of "voters per MP"; only those constituencies in the Portuguese territory are considered— the Portuguese Parliament also includes two MPS for the Europe constituency and two for the Rest of the World.

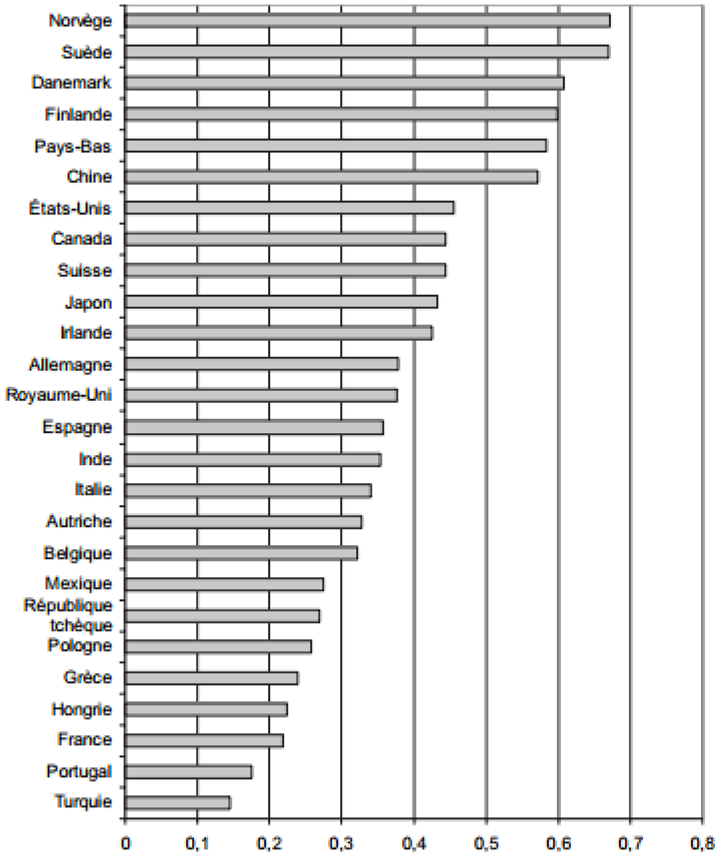
Source: CNE (2011); author's ordering.

This means that the electoral law and demographics combine to support the own immediate interest of the more populous and affluent constituencies. It is an example of *tyranny of the majority*, a concept that has been well developed by the political and economic scientists who are interested in the theory of the vote — see references to Alexis de Tocqueville, Gordon Tullock and Richard Musgrave in Cullis and Jones (2009, p. 117–118). The national elections geography **over-represents the more developed constituencies** which, on top of that, are those which already have a greater voice in dealings with the political power through other channels. We think that this fact does not help promote the territorial rebalancing of policies in the sense prescribed by the new paradigm.

7.8 Lack of confidence among economic agents

The Portuguese are a somewhat suspicious people. They do not trust each other or institutions. There are a number of popular sayings that reflect this, such as "trust no one and speak the truth to no one ", "security lies in the distrusting" or "with an eye in the donkey and the other in the Gypsy". But there are also polls that provide some empirical evidence on the phenomenon. For example, according to the studies quoted by Algan and Cahuc (2007), the Portuguese are the 25th out of 26 nations whose citizens least trust others: less than 15% of Portuguese people answered that it is possible to trust others — Figure 4. That book also contains interesting figures and data on people's trust in institutions. Portugal almost always ranks below average.

Figure 4 — Interpersonal trust levels in 26 countries



Note: each bar represents the fraction of the national sample that answered "It is possible to trust other people" to the question "Generally speaking, do you think that it is possible to trust other people or are you always suspicious?"; the comma (",") symbol is used as the decimal separator.

Source: 1990 and 2000 polls of the World Values Survey network, chart taken from Algan and Cahuc (2007).

Now lack of trust in other people undermines networking and indicates unwillingness, and maybe even the inability, to enter into cooperative strategies. **It is not an economy friendly behaviour nor is it an endogenous resource that benefits new generation regional development policies.**

Greater consistency and continuity of policies with structural goals, those which by their nature depend on enthusiastic and committed acceptance by the economic actors, are demanded of policy decision-makers and the government. Excessive reforms and the *regular re-inventing of the wheel* must be avoided since they tire the actors and lead them not to believe in public institutions and to opt for individualist strategies.

7.9 Regional aspirations and the status of the CCDRs

The Regional Development and Coordination Commissions (CCDR) are peripheral services of the central government that have specific responsibilities in the fields of regional development, environment and spatial planning, and are also charged with providing technical support to local authorities and their associations. In addition to these responsibilities, successive legislation has charged the CCDRs with two unique tasks within central government: 1) coordination and articulation of the various sectoral policies of a regional basis; 2) management of the regional operational programmes under European Union cohesion policy. Careful reading of the legislation shows how across the board their mandate is and the important role they have in matching those national policies to the regional, public and private, economic actors.

These characteristics make the CCDRs an important player in regional development processes. The social prestige of those who led the commissions in the past also contributed to this notoriety. To such an extent that among the regional elites, especially in the North of Portugal, there are high expectations as to the ability of the CCDRs to intervene in the political decision-making process. On a number of occasions the CCDRs have been seen as the embryos for future regional governments on the Portuguese mainland; on others, consideration has been given to assigning political status to the heads of the commissions, although not by direct and universal suffrage. Now that causes a *cognitive dissonance* because, under the law, the CCDRs are a technical institution. The members of their boards are appointed by the respective ministers and by the Prime Minister and they report to them on the matters under discussion.

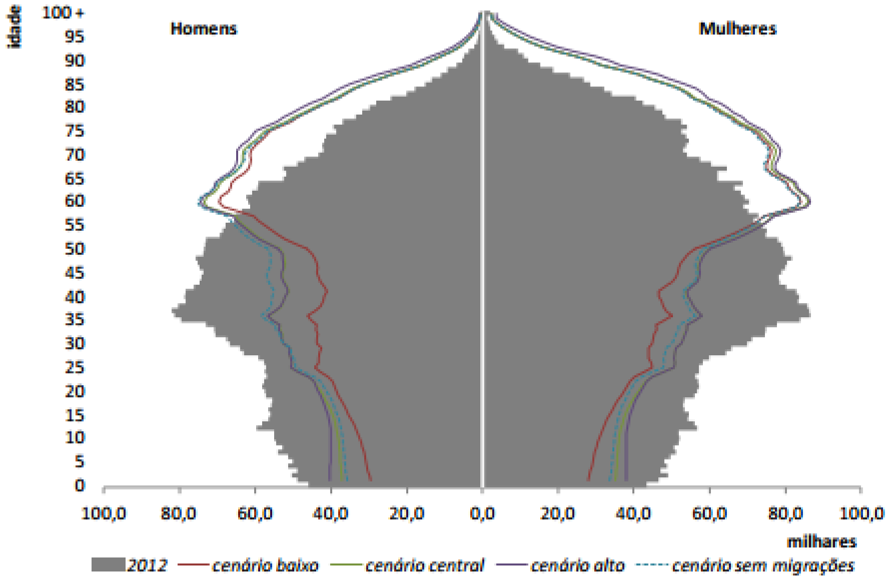
We refer to this issue because the new paradigm of regional development policies calls for vertical governance solutions within the public sector and horizontal governance solutions at the regions level. Bearing in mind the experience and capabilities built up in the CCDRs, they are natural candidates to a privileged place in these solutions. Their status must be discussed and the dissonance referred to above must be undone.

7.10 Demography, desertification and development

Portugal already faces a tough demographic reality, characterised by a low birth rate, progressive ageing and a negative migratory balance. It is a particularly painful reality in the eastern territories and some NUTS III regions in the central interior. However, the future risks being much worse. According to the INE (2014d), "the resident population (…) will tend to decline until 2060, under all projection scenarios. In the central scenario the population shrinks from 10.5 million in 2012 to 8.6 million in 2060 (…). The ageing index increases from 131 to 307 elderly persons for every 100 youngsters, in the central scenario. Over the same period and in the same scenario the potential sustainability index goes from 340 to 149 persons of working age for every 100 elderly persons". Figure 5 shows the reversal in the country's age structure.

If there is no substantial change to the population growth and population rejuvenation factors, the loss of population and the intense ageing will spread west and cover the whole country, and the progress will be "more intense in the regions that currently record higher potential sustainability indices." — INE (2014d, p. 6).

Figure 5 — Age pyramid in Portugal: estimates in 2012 and forecasts for 2035



Note: the lines represent the outlines of the pyramid in 2035 associated with the scenarios studied by the source; the vertical and horizontal axes show age and thousands of individuals, respectively.

Source: INE (2014d).

The economic impacts stemming from the demographic prospects are very serious and relatively clear, so we do not need to expand on them. **An integrated and durable response is required to the challenge of economic, social and environmental desertification and we believe that it should seek to foster a new attitude to regional development in the country**. Promoting growth factors in all territories, and not just the hubs, as we have warned in this document, is the direction that must be followed to combat the spread of the desertification winds and reverse, where possible, this destructive force. The implementation of the features of the new regional development policy paradigm will certainly help contradict the enormous challenge that the demographics and desertification represent to the Portuguese.

8 Clues to the solution

What to do? That is the question that naturally emerges from the above arguments. We have seen that the market is flawed when it comes to providing growth and development across all territories. We realise that there is room for improving government intervention. However, public policies can also fail.

In this section, we take into account the diagnosis made above and we offer a series of feasible solution types, capable of i) making public policies more regional development friendly and ii) promoting a regional development policy that is up to the competitiveness and cohesion challenges that the country faces. We are talking about types of solutions and not closed solutions because the proposals are deliberately open so as to provoke discussion on the possible variants of each type of response set out below.

For clarity sake, we can divide the proposals into three categories: horizontal governance mechanisms, policy tools geared towards economies of agglomeration and networking, and vertical governance mechanisms.

8.1 Horizontal governance mechanisms

Under this title we wish to look at **ways to improve national coordination of sectoral policies**.

8.1.1 National territorial vision

We should always begin by assuming a consensual **territorial vision of the country,** accepted by a broad spectrum of political parties and social partners. The idea is to have a space-based development strategy that shapes public policy and economic actors' options over **a time horizon to be discussed**, of between at least one and at most two parliamentary terms of office. A period greater than one parliamentary term of office has some advantages. The first is that its implementation mechanisms need stability and persistence for the strategy to bear fruit. The second is that adopting a vision of more than four years encourages commitments with opposition parties, social partners and representatives of subnational governments. Such commitments are desirable so that we can have a national vision and not a circumstantial political majority vision. A period of seven years would bring those benefits and also facilitate the alignment of the territorial vision with the EU development model and the seven year programming cycle of Community policies and budget. This option would provide for the incorporation of the structural funds strategy in the national strategy for regional development, instead of obliging the country to prepare two separate strategies for related topics. It is worth mentioning that this was the solution adopted by Ireland in 2000.[11] It would also give Portugal additional legitimacy in the eyes of its European partners when negotiating the multiannual financial framework every seven years, as it would show them that Portugal's negotiating position is based on a territorial vision that is agreed internally and links the national sectoral political options.

The territorial vision should **contain the following elements**:

a) statement of the national goals of regional development;
b) indication of the policies that should contribute to its achievement, in general terms;
c) identification of allotted resources, in particular fiscal resources, in order to match the territorial vision with the medium-term fiscal strategy which the country so needs;
d) qualitative and quantitative targets and monitoring indicators;
e) duty of sectoral ministries responsible for the polices with the largest impact on regional development (education, employment, science, transport, environment, agriculture, economy, spatial planning) to devise their own strategies on a region-by-region basis that will help achieving the national regional development targets. This condition is justified by the need to match ministers' incentives to the Government's will as a whole. Sectoral ministers would be evaluated on the basis of their space-based strategies and so they would have a shared interest in the national territorial vision, instead of seeing

[11] The European Commission (2014) states that the National Development Plan 2000/2006 prepared by the Irish Government in 1999 differs from the two previous ones in that it is wider reaching than the strategy of using cohesion policy funds. As the Commission put it: "Unlike the two previous Plans, which were drafted exclusively for the purpose of securing EU Structural Funds, the NDP 2000-2006 is broader in its scope and size and is designed to address a wider range of infrastructural, economic and social needs, with Structural Funds accounting for only 10% of planned investment and the bulk of the funding coming from domestic sources. The National Development Plan and the Community Support Framework are, therefore, being implemented as an integrated investment plan and strategy for economic and social development for the period 2000-2006."

it as someone else's responsibility. It is one way, among others described below, of bringing about the so called "whole of Government" approach proposed for dealing with across the board policies;[12]

What is proposed here is not radically different from what exists in other countries, such as Japan, Norway and Finland. The latter case is of particular interest when thinking about how to introduce a national territorial vision in Portugal. A parliamentary decision approves the *Regional Development Act*: it is a law that lays down the country's regional development system and a set of institutional organisation principles, which include items a) and e) above. The previous version ran for eight years. It gives the Government a mandate to define items b) to d) and to adopt operational solutions that it deems more suited to abide by those principles. More information can be found on the webpage entitled National regional development (a name which reveals the high across the board priority given to the topic).

We believe that this territorial vision of at least four years can and should generate synergies for adopting medium-term strategies in other fields of national public governance. In addition to the sectoral polices with the largest territorial impact referred to in item e), we are also thinking of the public finance areas, attracting of direct investment, and licensing of economic activities.

8.1.2 Political chief with enhanced powers

There has to be a Government member at the helm of the territorial vision, someone who can ensure the strategy is fulfilled, obtain the contribution from the sectoral ministries and oversee execution of the specific policy tools, such as those proposed in Subsection 8.2. There are two meanings for regional development policy. Under the narrow meaning the policy is made up of its own policy tools that can be devised and executed with minimum cooperation with other ministries. There is a broad sense which includes the above and the intersectoral coordination of which we have spoken.

It is precisely to enable this horizontal dimension of regional development policy that the political chief must be given his or her **specific status**. In order to be able to coordinate the contribution from the sectoral ministries, the chief must be expressly and clearly empowered by the Prime-Minister to "boss" the others in this task. There has to be an empowering clause in the law, as in the Finnish case, which will assist each Government in the choice of to whom to assign the task. There are different and interesting solutions in other countries with pros and cons that need to be weighed before adapting them to the Portuguese case. In Japan, there are currently some ministers who, on top of their sectoral portfolios, have more powers than their colleagues as regards the coordination of across the board policy. This comes from the status of *Minister of State* which is granted solely for this purpose. Their titles are self-explanatory, as can be seen on the webpage that sets out the makeup of the Government. In Finland the aforesaid *Regional Development Act* (a parliamentary act) confers these powers to the Minister of Employment and the Economy, which exempts the organic law of the Government of having to make the choice of the first among equals. In Austria it is the Chancellor who takes this role by directly heading a special department that has

[12] We adhere to the following definition of the *whole of Government approach* for these matters: "Public service agencies working across portfolio boundaries to achieve a shared goal and an integrated response to particular issues." — quote found on the portal of an Australian department that more or less corresponds to Portugal's Directorate-General of State Administration and Employment.

duties similar to those we propose in Point 8.1.3. In France it is the Prime Minister who ensures the coordination of these matters, assisted by a department recognised for its technical expertise in spatial planning and regional development policies at home and abroad (DATAR — *Délégation interministérielle à l'aménagement du territoire et à l'attractivité régionale*).

8.1.3 Specialist agency

Intersectoral coordination of space-based policies, together with the promoting of regional development instruments based on economies of agglomeration; require a **dedicated department** within central government. We should use the accumulated experience and take advantage of what already exists. **It is not necessary to create a new department**. The Agency for Development and Cohesion (ADC, which resulted from the merge of three departments in 2013) may perform this role admirably. At the moment it is focused on the Structural Funds and is responsible for planning, management coordination and assessment. It has human resources capable of designing and driving territorial development policy tools. What is actually proposed here is to extend its mission and assign it a federating role in discussions with the departments of other ministries responsible for policies that have the largest impact on regional development. Under a minister with enhanced powers, this agency would strive on a technical level for the horizontal governance and perform the following duties: i) planning and assessment of space-based policies and tools; ii) consultant to general government (in order to encourage consistency between sectors' territorial actions, as explained below); iii) implementation of regional development policy tools under the narrow sense as those proposed in Subsection 8.2, in cooperation with the CCDRs.

8.1.4 Increasing the weight of the electoral constituencies underrepresented in Parliament

In Subsection 7.7 it was stressed that the constituencies with smaller populations are underrepresented in the Portuguese Parliament. We already know that there is a direct association between that demographic feature and GDP *per capita*. We believe that giving these territories a *bigger voice* in the home of democracy is a factor that will help the entire Government to adopt a territorially more balanced position on economic development. There will be more pressure on sectoral ministries to be sensitive to the contribution that they can make to this across the board policy. In this context we propose a slight amendment to the distribution of the number of MPs per electoral constituency that **strengthens the relative representation of the constituencies with smaller populations or less GDP *per capita***.

8.1.5 Strategic compliance devices

This heading addresses institutional methods of monitoring the territorial impact of national policies with structural goals and, more importantly, of preventing the occurrence of harmful effects to the development of the most vulnerable territories. The idea is to influence the design of sectoral policy tools from the initial phase so as to minimise those effects. In more general terms, those devices may be seen as **regular tests of public policy compliance with national regional development strategy**. They seek to ensure that the plans are put into effect and in line with the approved territorial vision. Such devices exist in, at least, the United Kingdom, Finland, Canada and South Korea.

The sectors identified in the territorial vision draw up regional strategies for their policies that demonstrate their contribution to the national regional development strategy targets. The agency proposed above regularly assesses the territorial impacts of the sectoral actions. That assessment goes beyond that which the ADC currently performs on the NSRF programmes and will conduct in relation to Portugal 2020.

8.2 Policy tools aimed at economies of agglomeration and networking

The arguments presented above on the causes of growth and development and the change in the regional development policies paradigm recommend that countries favour partnerships with economic and social actors, including subnational governments, capable of channelling creative energy into space-based programmes that **breed competitiveness**. These partnerships are just as promising as it is certain they can help decisively in the normally difficult task of applying integrated approaches to public policies: coordination and consistency between government levels and the various stakeholders operating in a particular territory. The idea is to align strategies and collective and individual action plans with the economic enhancement of endogenous resources. That is achieved through the **stimulating of positive externalities in the interaction among agents**, in accordance with the opportunities provided by economies of agglomeration and networking. The Collective Efficiency Strategies, launched in Portugal in 2008, are a good starting point. For a theoretical and operational basis of policy tools of this type see Schmitz (1999) and Baleiras (2012).

In essence the role of government is that of instrument driver and facilitator. It may be responsible for defining the principles by which partnerships are to be governed, take part in some of them through the departments that, according to the subject matter, should become partners, and discriminate positively in favour of the involvement of partners in collective projects as opposed to individual, piecemeal actions, be it through increased financial incentives or the simplifying of licensing and administrative procedures. However, the other partners should take the leading role both in the drawing up of the strategy for their territory and in the governance of the partnership and mobilisation of own resources to the action programme implementation. As a rule, any involvement of the government as investor should complement the private investment.

These instruments seek structured and territorially different responses to **challenge types** such as:

- Sectoral clustering — the goals are to facilitate exports, promote the applied knowledge market (acting as a bridge between those who produce knowledge and those who apply it to goods and services) and optimise the benefits of specialisation throughout the value chain;
- Urban-rural synergies — the idea is to strengthen the polycentric urban model and contain the demographic and economic losses felt in the less populated territories;
- Urban regeneration — it consists of actions coordinated over time and space, between the local authorities and the owners and users of private property, geared towards the economic attractiveness of the urban areas;
- *Second generation* of cross-border cooperation — following a long cycle dominated by the creation of infrastructure, it is time for territorial cooperation to take on a new direction in the regions on the border with Spain. In Baleiras (2009b) three new avenues are described: i) sharing of demand and co-management of collective services (in fields such as health care, education, culture, sport, solid urban waste, urban water cycle, spatial planning); ii)

joint programmes for the economic enhancement of territorial resources (similar to the PROVERE initiative)[13]; iii) removal of public costs relating to cross-border trade that damage companies' business and citizens' quality of life.

Any granting of public incentives to these consortia should derive from a demanding and **selective** process, based on strategies and action programmes **proposed by the consortia**. The political leadership of these instruments should be clearly **assigned**.

These policy tools are of extreme interest to the promotion of economic development in the terms set out in this paper. They should be devised and monitored so that they achieve some of the following **results** — OECD (2013):

- facilitate the development of across the board outlooks and integrated approaches to collective and multidisciplinary problems, such as growth and economic development;
- bring public programmes closer to the locally identified priorities, which will help
  - on the one hand, to identify and exploit opportunities that combine and improve the impact of public programmes and local initiatives;
  - on the other, to identify potential conflicts and synergies between public policy and to inform the respective political decision-makers.
- incorporate the concerns and views of civil society and the private sector in strategic planning;
- hand governance of the partnerships over to the consortia themselves, thus contributing to local self-accountability and the development of public-private governance capabilities in the territories;
- strengthen local leadership capability, build confidence and reach a consensus as to priorities;
- improve local and regional information systems by better use of local data and indicators, as well as work on the basis of recognised local skills and knowledge;
- develop the strategic ability to look beyond the execution of projects and programmes, stimulating the participating organisations capability to adapt to the new challenges;
- develop the ability to predict, taking into account the challenges and opportunities to attract new partners and build strategic foundations for long-term development.

8.3 Vertical governance mechanisms

We have seen in the theoretical-empirical digression on growth and development factors that regional development policies have to be based on territories and take account of each territory's attributes. This conclusion suggests that local and regional governments should be called to intervene and take responsibility in this matter. However, that suggestion needs a qualification if it is to become a recommendation. Proximity is a necessary but not sufficient condition for decentralisation. It is also necessary that subnational governments have an information advantage over

[13] PROVERE: the Portuguese acronym for the Economic Enhancement of Endogenous Resources Programmes. A regional development policy tool launched in 2008 and still under way, aimed at competitiveness in less populated territories and based on cooperation networks of economic actors designed to create added value and jobs from a territory's distinctive resources. It is one of the four types of Collective Efficiency Strategies launched at the same time. In Baleiras (2011b) we can find the economic and political rationale, as well as useful information on the operational design of instruments of this type. The Rota do Românico (Romanic Route) and Aldeias do Xisto (Schist Villages) are two PROVERE initiative success stories that have been recognised nationally and internationally.

central government, as regards territorial diversity, and make use of that advantage.[14] Therefore it is very important that the respective institutional frameworks give local actors (firms, citizens, non-governmental organisations) a voice when formulating their political decisions.

8.3.1 Intermunicipal cooperation and administrative reorganisation

We believe that the current political and administrative framework on the Portuguese mainland has room for additional intermunicipal cooperation. It is very important to think and act on a scale larger than that of municipalities for, at least, two structural purposes: **strategic planning of development** and **the provision of collective goods and services**.

In the former case we believe that **territorial planning at the NUTS III level** cannot fail to be done with and by the Intermunicipal Communities (IMC) and the Metropolitan Areas (MA); yet, it must always incorporate the preferences of other local development agents. And it must be consistent with the national territorial vision held by the Portuguese Parliament and the Government, under the terms proposed in Point 8.1.1.

As for the supply of goods and services with geographically bounded benefits, we believe that efficiency gains could be obtained through vertical adjustments in the public sector. The intermunicipal scale may help Portugal improve the quality and ensure the financial sustainability of the supply of certain goods and services, namely those rendered via facility networks. Scale economies, internalising of spillovers, and greater value for money are advantages that intermunicipal cooperation can bring about. To this end consideration should be given to **handing over some municipal responsibilities to the IMCs or MAs**. In the municipalities with smaller populations and greater land areas, services such as waste collection, treatment and valorisation and the downstream section of the urban water cycle are natural candidates to be studied because of their relatively high fixed provision costs. There have been some experiments in this area and their evaluation could be usefully extended to other territories. An analysis of the sharing of technological and human resources to invoice and collect fees and charges may be also of interest to other geographical areas. The management of municipal facilities by intermunicipal entities is another aspect that can improve resource allocation. With time and the success of these experiments, **it may become politically easier to consider the merging of municipalities**.

But the **shifting of responsibilities from Central Government to the IMCs and MAs** could also bring efficiency gains. The management and regulation of public transport are pretty clearly areas of interest for the vertical rearrangement of public provision. Decentralisation is also likely to be considered in the primary healthcare network and the 2nd and 3rd basic education cycles, and later even in the secondary education network.

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[14] A conclusion to be drawn from the so-called budgetary decentralisation theory under which budget decision-making autonomy at the local level (in terms of the allotting of public finance) is only efficient (as defined by Pareto) when: i) there is territorial heterogeneity in the demand for and supply of goods of collective interest; ii) it is cheaper for local authorities rather than central government to collate information on local demand and supply; local authorities act in accordance with that information to maximise local wellbeing. The argument that the decision-maker is closer to the problems and the citizens in itself is not a justification for budgetary decentralisation — as shown in Baleiras (2002).

Lastly, **some recommendations as to method**. We think that rigid decentralisation or centralisation solutions are not advisable. They should arise within a framework of **negotiations between those who provide and those who receive the tasks and the resources**. We believe that this process should be undertaken as a *principal–agent* contractual relationship, with clearly identified incentives to encourage the agent to behave as the principal expects. To these end financial transfers based on inputs should be avoided and be replaced with agent remuneration based mainly on the achievement of results and compliance with contractual targets.

There are some **useful lessons to be learnt from countries with which we sometimes like to compare ourselves**. In Denmark it was felt that local and regional government were too fragmented to receive new powers. During a process of reform in 2007, the municipalities were given the choice of cooperating with each other or merging so as to ensure a certain minimum number of beneficiaries were covered. The number of municipalities fell from 271 to 98. Since it had been decided to place health service provision in the hands of regional government, the 16 counties were replaced by five regions. Finland is another interesting case. The legislation restructuring local government in 2006 encouraged cooperation on a voluntary basis. Under the law, in order for a municipality to be in a position to provide basic health care or vocational training, it had to have at least 20,000 residents (50,000 in the case of vocational training). Nonetheless, the smaller municipalities could provide these services if they achieved that threshold in one of three ways: i) voluntary merging with one or more neighbouring municipalities; ii) building of a structure shared with neighbouring municipalities to provide those services and respect the threshold; or iii) purchase the services in question from neighbouring municipalities that exceeded the threshold. The final example is Norway. In 2006 the country expanded the range of responsibilities municipalities could delegate to intermunicipal structures or even to another municipality (the host municipality). It is important to underline that in the latter two Nordic cases central government offered financial incentives to encourage municipalities to opt for a merger**. In the three examples a merger was never imposed, only proposed** (albeit it under favourable conditions) **along with other institutional options** to achieve the critical mass for public provision of services; the municipalities had the final word.

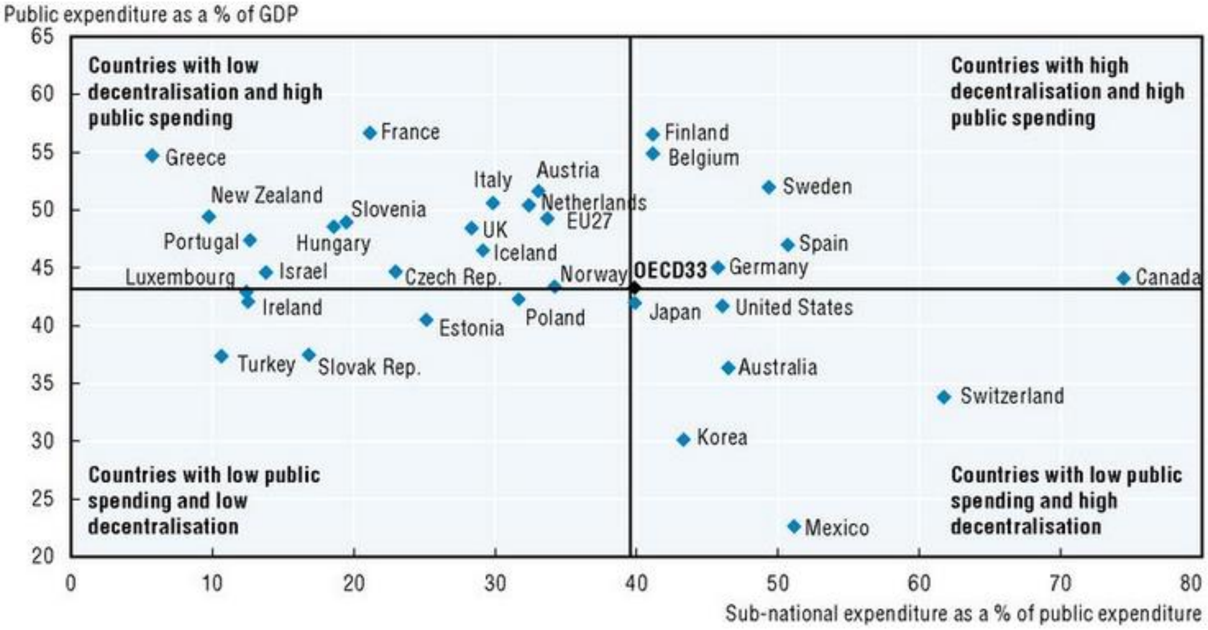
8.3.2 Regionalisation

Cooperation with and among municipalities does not solve all problems of scale nor the negative urban-rural spillovers. In Portugal, even the two Metropolitan Areas are too small to think about development. In OECD (2014a, p. 79–89) reference is made to the political and institutional difficulties that municipality associations created to operate in metropolitan basins considerably larger than the Portuguese ones face when attempting to act as efficient drivers of development. The indirect political legitimacy and the estrangement of non-governmental actors in their governance are identified by OECD technical staff as weaknesses to be examined.

We are well aware that the creation of political and administrative regions on the mainland is a controversial subject in Portuguese society. However, in an essay on institutional solutions for vertical governance it would not be intellectually honest to ignore the possibility. Over the last 20 years a number of countries have resorted to the establishing or strengthening of regional authorities with their own political legitimacy. The interest the public management theory has paid to decentralisation over the same period also contributed to this movement. Quite clearly each country is a separate case and what is a good solution in a particular historical, institutional, economic and political context may prove to be a poor decision in another. In Annex C readers are invited to examine the two tables that summarise some characteristics of this process, in particular the method of choosing leaders, functions and budgetary autonomy within the OECD. It is curious to find that there are countries whose regional governments only have powers in the economic development area. Before going into the Portuguese case, it should be noted that no clear statistical association seems to exist between regional and local governments, on the one hand, and the relative weight of aggregate public spending in GDP, on the other. Chart 1 shows that average spending on general government as a whole in 33 OECD member countries accounts for around 43% of GDP and that approximately 40% of that spending is undertaken by subnational governments. The scatter pattern in the chart does not reveal a significant relationship between the degree of fiscal decentralisation (so measured) and the size of general government.

The following paragraphs are a necessarily schematic approach, to the nature and role that politically legitimate authorities at the regional level could play on mainland Portugal. Even then we believe that it is worth putting this option up for public discussion in the context of State reform of economic development. The archetype we propose here is a soft model of governments at the regional scale with their own political legitimacy.

Chart 1 — Degree of fiscal decentralisation and size of general government, OECD Member States, 2012

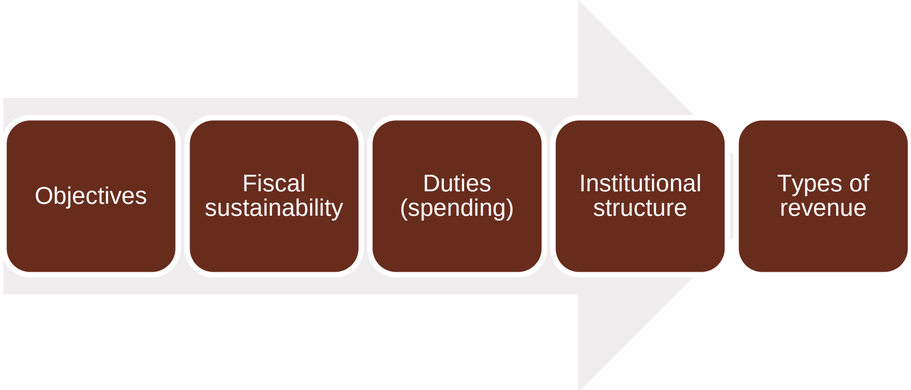


Note: public finance data on 33 Member States, referring to 2010 in the case of one country, 2011 in the case of nine and 2012 in the case of the other twenty-three.

Source: OECD (2014a, p. 32).

We suggest that the discussion be conducted on the basis of the algorithm shown in Figure 6. In the first place, we should think seriously on the purposes to be achieved by mainland regionalisation. The assumption of fiscal sustainability must be accepted at once. Later, the minimum powers required to achieve that goal must be identified. Fourthly, the institutional architecture and governance model most suited to performing the duties must be defined on the basis of a cost-benefit logic. Last, but not least, consideration must be given to the nature and makeup of the regional authorities' financial resources.

Figure 6 — Algorithm for thinking on the creation of regional governments in mainland Portugal



As for the goals, **we propose a single one: promotion of economic development at the regional level**. It will have to be a goal based on a medium and long-run strategic vision and linked to the development model in use in the larger politico-administrative areas with which the region interacts the most: the country (the territorial vision set out in Point 8.1.1) and the European Union (at this time the Europe 2020 strategy).

Fulfilment of the mission can never undermine the **general government fiscal sustainability**. The use of a regional scale when fostering economic development will inescapably require the transfer of national and local level responsibilities. According to the arguments put forward in the introduction to Subsection 8.3, the starting point for political and administrative decentralisation has to be an efficiency advantage and in the end it has to lead to a gain for national taxpayers. Given the need to redress public finance which will continue in coming years, we feel that the guarantee of fiscal sustainability is a minimum requirement if soft regionalisation policy is to be politically viable in Portugal.

In this framework **policy tools that are better suited to achieving the goal must be considered**. Strategic thinking must exist before and during implementation of the tools. Below we stress the crucial importance of guaranteeing the political, economic and social partners play a leading role in the defining and monitoring of strategy and its main application tools. In order to encourage discussion we would like to suggest some areas where development policy tools could intervene under regional governments' responsibility:

- enhancing the alignment of the labour force's skills and the needs of the productive fabric (design models and policy tools that help bring demand for and supply of labour closer together in line with the regional development strategy);
- enhancing competitiveness of the entrepreneurial fabric while taking the mobility of capital into account. Business investment incentive schemes would be on a regional basis but closely coordinated with central government; perhaps the incentives subject to negotiation with the beneficiaries (the current contractual scheme) would only be possible for investment projects above certain PIN[15] thresholds and they would be managed only by central government, although subject to the regional government's opinion before final commitment;

[15] PIN: the Portuguese acronym for Potential National Interest. Private investment projects that fit into this category are subject to specific central government monitoring mechanisms. For further information see Portal da Empresa.

- developing of facilities for collective use (in the fields of mobility, environment, health, education, sport, etc.). In theory ownership should remain as it is (central government or local government) and regional government would come to have means under its political management (for example, structural funds) in order to co-finance the expansion, modernisation or reconversion of facilities, once again in line with regional economic development strategy. Basically, the regional governments would define the appropriate co-financing tools to which the owners of the amenities might compete for or negotiate;
- drawing up of territory plans at the NUTS II level and possibly the sub-regional level in cooperation with central government, intermunicipal communities or metropolitan areas, as well as with the autonomous Spanish communities in the case of cross-border spaces.

We believe that a **light and generally horizontal institutional structure** is sufficient to perform those duties. The existing capability in the CCDRs and the regional departments of other ministries should be the administrative foundation on which political governance rests. Attention is drawn to the need to avoid, as much as possible, the temptation to replicate in the regions the vertical and sectoral structure that is a feature of national Government and central administration. As has been widely justified in this paper, the promoting of growth and development factors, in particular the endogenous factors, clearly does away with the silos that institutional architecture encourages.

The **nature of financial resources** that the regional government will be able to mobilise must be well thought out. Political legitimacy implies that the political burden of acquiring resources should be placed on the regional governments. The best method of self-control over the budget constraint is precisely to make regional governments accountable for the mobilisation of their income. To this end, in addition to imposing the aforementioned fiscal sustainability condition, we recommend the centrality of the beneficiary-payer principle (tax burden) and a possible ban on indebtedness. In effect, if regional governments do not own the amenities and other collective infrastructures, the efficiency argument (the intertemporal matching of costs and benefits in public provision of goods and services) disappears in favour of the issuing of debt to finance capital expenditure. According to the transfer to regional governments of central government and local authority powers, it may make sense to make intergovernmental budget transfers to the regions. The management of regional operational programmes, including responsibility for allocation the appropriate structural funds, should fall to the regional governments. In such a framework in which regional governments have powers that are essentially immaterial, we do not believe there will be vertical budget imbalances or interjurisdictional externalities when acquiring resources, which are the main reasons mentioned in the economic literature for the existence of central government transfers.

Lastly, some additional words on geography and governance of regional Governments and administrations. As for **geography**, we wish to stress that the territorial jurisdiction of these institutions must correspond to the NUTS II regions. When regionalisation was discussed in previous decades, all processes collapsed mainly because the competing political proposals were divided as to the geographical boundaries. It is clear that central government operated with multiple maps of physical presence in the territory at that time, leading to the spatial mismatch of ministries. Furthermore, intermunicipal cooperation was much less mature and territorially more diversified than it is today. However, over the last ten years this panorama has changed substantially. The spatial organisation of ministries have converged to the NUTS II map and, when their powers require a thinner spatial presence, to the NUTS III geography. Today the general purpose intermunicipal associations are built upon the NUTS II pattern. Thus, it does not seem sensible to consider a soft regionalisation in any other geography than the NUTS II territories. Note that both the nature of the responsibilities and the nature of revenue depend crucially on the size of the regions and the mobility of the tax bases. The consensus on the geography of the jurisdictions simplifies the discussion of the essential issues, which in our opinion are those set out in Figure 6.

Having said so, it is very important to realise that **political and administrative borders are one thing and functional borders another**. The former must be stable because they are the basis for the exercise of political power and the administrative duties. The latter are fluid and naturally changeable since they are determined by the unrolling of economic processes. Awareness of this difference is essential to an effective implementation of regional development policies. The activities of firms and individuals certainly cannot and should not be blocked by political and administrative borders. Thus regional policy tools must be coordinated in cross border areas between neighbouring jurisdictions be they Portuguese or Spanish. In the past, the territorial eligibility rules for structural funds were a problem in this context.

As for governance, we wish to underline the advantages of the regions always maintaining a **healthy vertical cooperation** and a **constructive horizontal dialogue**. In the case of the former we have the relationship between the central and local levels of government. The goal proposed here for future regional governments will not be achieved effectively by means of their own actions alone. Undoubtedly it will be necessary to negotiate and contract out some shared responsibilities. In the case of the latter, it is important to bear in mind the irreplaceable value that multiparty partnerships with political bodies (local authorities and their associations) as well as economic and social stakeholders should bring to governance of regional government policy tools. Those horizontal partnerships must be linked to medium-term strategies and targets and must take part in monitoring and evaluating of policy tools. Development processes tend to be more sustainable the more the actors feel they are involved in their governance.

If the country chooses to implement a regionalisation project of the type described herein, it will have consequences for the central government's responsibility for regional development. The regions should play an important role in defining the national vision of development and the horizontal coordination of public policy should be re-examined in the light of the powers that come to be assigned to the regions.

9 Conclusions

Growth in GDP and employment is a major collective aspiration due to its significant positive impact on citizens' wellbeing. There are other aspects of economic development that contribute to this wellbeing and which are aspirations shared by many, such as access to education, health care and mobility, the level of social cohesion and the quality of the environment. It is at the territorial level that all these variables come together, interact and combine to carry people's quality of life in a favourable or unfavourable direction. This paper examined the causes of growth, in particular, and of development, in general, and focused on identifying the blockages that the institutional architecture of Portuguese public policy brings to the fulfilment of those aspirations.

We believe we have made it clear that all territories have a contribution to make to growth, competitiveness and development in the broadest sense. More developed territories become more attractive for those who live, work and invest in them. Therefore, regional development is not a charity or assistance concept, although it incorporates aspects of territorial cohesion. It is unquestionable that making a territory a better place to live, work or invest facilitates its growth and improves its contribution to national wellbeing.

Markets combine labour and capital to produce goods and services that generate development. However, there are other factors that play a part in the development process that we can call endogenous, either because they are incorporated in labour and capital or because they are intangible and intrinsic to each territory: i) knowledge, ii) means of transporting people and goods, iii) positive externalities of the interaction between economic actors due to their geographic concentration (economies of agglomeration) or deliberate attitudes towards cooperation (networking economies), iv) institutional thickness, v) governance and ability to innovate of organisations, vi) as well as the individual characteristics of the people — entrepreneurship, sociability, leadership, creativity and reliability.

Markets fail to take full advantage of the territories' endogenous capabilities to grow and develop, especially those that depict lower urbanisation indices. However, we have seen with reference to the Portuguese case that the government, in the broadest sense, also fails in this respect. That being the case, what can we do?

Based on the quoted scientific knowledge and international practices, the paper offers up for public discussion some recommendations on how to make Portugal's public sector institutional architecture friendlier of growth and development in all regions. Horizontal governance mechanisms within central government are proposed that are supported by a national vision of regional development, and directed towards the devising and implementing of sectorally integrated approaches. Policy tools are suggested that aim at encouraging and exploiting economies of association among private and public economic agents. In addition, vertical governance mechanisms are put forward for consideration, with emphasis on strengthening intermunicipal cooperation and a possible soft regionalisation on the mainland, meshing the various jurisdictional levels of general government and mobilising development actors existing in the territories. The three types of solution proposed in this paper are not independent of each other and should be duly coordinated in the light of any political decision as to the acceptance of each of them.

It is hoped that this paper may contribute to a national debate on what does Portugal want to be in the medium and long term and how it should get organised in order to succeed. As a community, to be concerned with improving development prospects in all territories is a rational concern from the economic standpoint, since their capacity to contribute to the progress of the nation as a whole is underused. However, as a citizen, the author cannot forget another, equally or more important, rationale: the social one. Encouraging the lagging regions to come closer to the standards of the most prosperous not only boosts the national economy, but "also contributes to a more inclusive and sustainable growth model. It helps to build a fairer society, in which no territories, and people living in there, are left behind."[16]

[16] OECD (2012, p. 16).

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Annex A: Regional development statistics in Portugal

Section 3 presented the country's geography according to the *Regional Development Composite Index* (ISDR). This annex aims to provide a brief explanation of this measure and to refer to other statistics that were compiled in the past in order to provide readers with an historical perspective of territorial performance in terms of economic development.

Composite indicators, as in the case of the ISDR, are particularly suitable for incorporating large volumes of data and synthesising them in "easy to read formats and, therefore, (suitable for transforming) information into knowledge for analytical political decision-making purposes" — Vala and Pinho (2011, p. 85).

A thorough explanation of the ISDR can be found in that source. It describes the changes under way in the world, at the level of political authorities and international agencies, aimed at combining the social and environmental aspects with the macroeconomic indicators when measuring countries' and regions' performance and formulating policies. The European Union development strategy which frames all its policies up to the end of the decade, *Europe 2020*, precisely emphasizes this triple dimension, which was already present in the preceding *Lisbon Strategy*. It justifies the use of composite indicators to measure multidimensional variables, such as economic development. It describes the ISDR methodology, presents the results of the global index and the partial indices relating to 2008 and examines the changes in them from 2004 to2008.

For the purposes of this paper it is enough to mention the following methodological features. The ISDR is an average of three partial indices, each reflecting one aspect of development: competitiveness, cohesion and environmental quality. Three types of factors shape the contribution to each aspect of economic development: resources, behaviour and outcomes. Each aspect must be understood as the combined effect of the resources (human, natural, infrastructure, technological, institutional) available to regional performance, of the behaviour (shown by economic, social and political actors) to enhance resources and of the outcomes, that is to say, the effectiveness of the improvement in quality of life in the region. According to the INE (2014a, p. 2), the competitiveness index aims to express "each sub-region's potential (both regarding human resources and physical infrastructure) for the performance in competitiveness as well as the efficiency in the path followed (measured by the educational, vocational, entrepreneurial and productive profiles) and also the effectiveness in creating wealth and the ability to compete in international markets". The cohesion index seeks to capture "the extent of the population accessibility to quality basic collective equipment and services, the profiles that lead to greater social inclusion and the effectiveness of public policies given by an increase in the quality of life and a decrease in territorial disparities" — *idem*, p. 3. Lastly, the environmental quality index seeks to reflect the pressure put on the environment by economic activity and social behaviour (including spatial planning), the "corresponding effects on the environment and (the) economic and social responses (both regarding individual behaviour and public policies)" —*idem*, p. 4.

The competitiveness index combines 25 individual indicators that record three types of factors. In the first place, the driving forces behind competitiveness (resources), which include human resources (measured by indicators such as number of employed persons of working age, renewal of working population ratio, and rate of participation in secondary education vocational courses), hotel capacity (ratio of the number of beds in three or more stars accommodation to the average resident population), Internet infrastructure (broadband penetration rate) and economies of agglomeration (population density, share of population that lives in cities with over 10,000 inhabitants). In second place, this index records some of the factors that ease regional economy restructuring (behaviour) through indicators such as the degree of specialisation in advanced competitive factors, proportion of Gross Value Added (GVA) in tradeable activity branches, proportion of employed population that switched job from firms that did not close (in relation to total employment), weight of companies' R&D spending in GVA, and the birth rate of enterprises. Lastly, it measures the ability to generate outcomes in two targets: income (GDP *per capita*) and external market penetration (relationship between exports and GDP).

The cohesion index relies on 25 individual indicators grouped in the following way. As resources, they record access to collective use services that provide quality of life and personal and professional improvement opportunities (networks supplying education, health, culture and basic sanitation services). In the realm of behaviour, the index brings together indicators that record the degree of social adaptation and inclusion, such as gender equality, ethnic integration, unemployment and criminality. In the sphere of results, it contemplates the observed levels in the territory of variables such as income, social equity and longevity.

Lastly, the environmental quality index which uses 15 individual indicators. As resources, it identifies the pressures on the environment and spatial planning and measures them through indicators such as soil and air pollutant emissions and urban growth quality. In terms of behaviour, it looks at the effect of these pressures on water and air quality, resorting to indicators such as the density of emissions that cause acidification and eutrophication and the density of emissions that impact on public health. Action effectiveness is portrayed via the measures to reduce those pressures, such as the share of the population served by waste water treatment plants, the eco efficiency rate and the percentage of classified zones in total surface area.

The indicators are duly standardised to enable their arithmetical combination. The national value is estimated by the population-weighted average of the indices of the respective NUTS III regions and then standardised to 100. The regional outcomes for the four indices are presented by reference to that figure (Portugal = 100). All the indicators have the same weight and the global index is obtained as a non-weighted average of the three partial indices. The complete list of indicators is given in INE (2014b, Annex to point VI).

The figures for 2011 were shown graphically in Section 3 of this paper. Vala and Pinho (2011, p. 102–103) examines the change in the global index in the 30 NUTS III regions *versus* the national average from 2004 to 2008. Around half converged to the average and the remainder diverged. More details can be found in this source.

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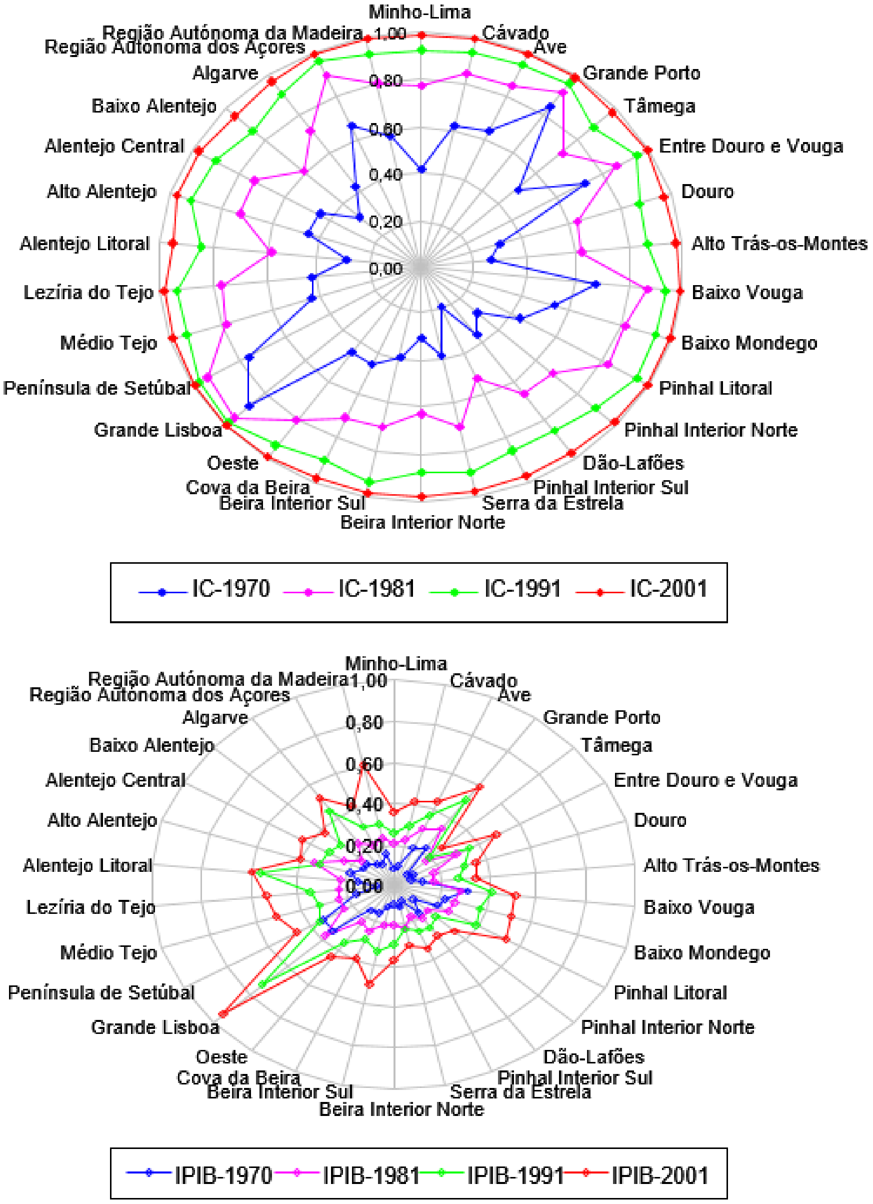
Efforts at quantified analysis of the state of economic development in Portugal began before the ISDR was invented. On the basis of Census data, authors at the former *Department of Prospects and Planning* calculated a comfort index that, to some extent, resembled a composite measure of cohesion as it records household access to collective services provided by a network, such as electricity, basic sanitation and health care. Web charts like Figure 7 allow us to see how a variable is distributed over time (each line represents a year) and space (each region is measured along a radius; each vertex on a line corresponds to the observation of the variable in a particular region in that year). The more irregular the line, the more unequal is the spatial distribution of the variable in that year.

The change in the comfort index from the 1970 to the 2001 Census (upper panel) shows two essential features: firstly, all regions saw progress over those decades; secondly, there was substantial real convergence and inter-regional inequality decreased in each decade, the vertices on the 2001 line being almost unnoticeable. The same cannot be said for GDP *per capita*. It is clear that all territories have seen their absolute positions improve since 1970, as is shown by the outward shift in the line in the lower panel. However, the irregular shape did not disappear and there were still significant differences in 2001. That year Greater Lisbon (the region with the largest GDP *per capita*) was 3.6 times bigger than Tâmega (which recorded the lowest figure).

Figure 7 — Comfort and real GDP *per capita* indices, Portugal, 1970 and 2001

Comfort index (CI)

Real GDP *per capita* index (IPIB)

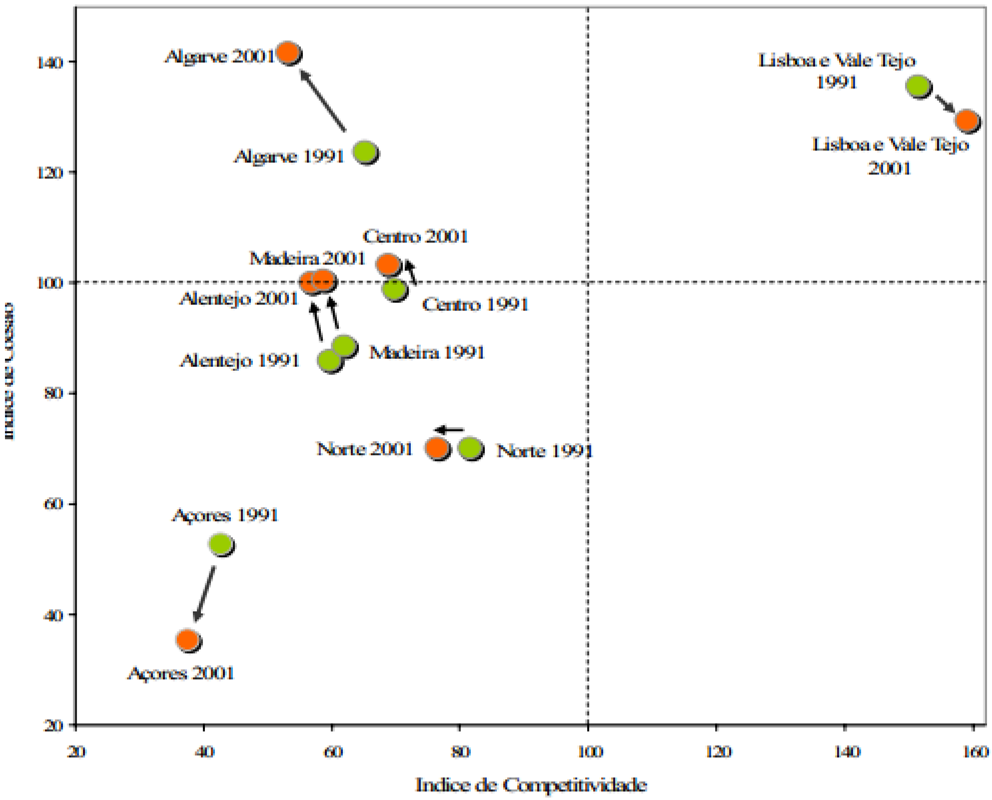


Notes: each line consists of territorial observations in a given year, beginning in 1970 on the line closest to the centre and ending in 2001 on the line furthest from the centre; territorial unit: NUTS III.

Source: adapted by the author from Cónim (1999) and Carvalho and Matias (2004).

The study by Mateus (2005), commissioned to aid preparation of the National Strategic Reference Framework (NSRF), is a national benchmark of excellence for the building and analysis of composite development indicators. Later it influenced the building of the ISDR, as Vala and Pinho (2011) recognised. It proposes a Global Index which is the average of two partial indices, themselves composite: the cohesion index and the competitiveness index. The methodology is explained in chapter 4 of their work and the results are given in Chapter 8. The data base contains indicators observed from 1990 to 2002, which made it possible to appreciate the changes in the country and each region over that period. Based on the NUTS II regions (1999 classification),[17] Figure 8 shows the starting and final positions of each territory in relation to the aforesaid partial indices. It is worrying to find that only the Lisbon and the Tagus Valley region has progressed in terms of competitiveness and that no region has a double winner path (which would appear as a north easterly shift from 1991 to 2001.

Figure 8 — Change in competitiveness in the NUTS II regions, 1991-2001



Notes: The cohesion and competitiveness indices are measured along the vertical and horizontal axes, respectively; for each index regional figures are expressed with reference to the standardised national mean (Portugal = 100).

Source: Mateus (2005, p. 365).

The quoted source contains representations of and comments on the NUTS III paths (pp. 367 *et seq*), which are not reproduced here due to lack of space.

[17] The NUTS II and III classification in force following the amendment laid down by Decree-Law no. 317/99 of 11 August.

Annex B: Early explanations for regional development

This annex completes the contents of Section 4. It presents the oldest explanations to be found in the literature for economic growth and development in the regions, beginning with the neoclassical thesis. What is written here is not essential to an understanding of the text after that section but it may be useful to readers interested in knowing how economic thought has developed in this field. The natural reading order is to begin with this annex and then go to Section 4.

B.1 Neoclassical thinking

So as not to go too far back in the history of economic thought, we begin with the neoclassical school. From the nineteen forties, the explanations for economic phenomena increasingly resort to stylised representations of reality that may be treated mathematically. Economic development crucially depends upon the structure of the economy and any changes in its state are medium and long-term changes. So, it is not surprising that the neoclassical authors of that time favoured potential output as the variable that represented development and explained that it depended upon the available technology and the allocation of labour and capital.[18] Given certain technical hypotheses, the most famous formulation is due to Solow (1956) which states that potential output *per* worker, y, increases with the quantity of capital *per* unit of work, k, according to the relationship

$$y = A(t) f(k) \ , \tag{1}$$

where $f(\cdot)$ is the production function (it expresses technology) and A is a scale factor that varies over time (t). This mode of change is not explained by Robert Solow, rather he states that it reflects the stage of technological development available at any given time. A change in technology will bring an increase in output *per* worker for a given ratio of capital *per* worker but no explanation is given as to what determines these increases in productivity; thus, $A(\cdot)$ may be seen as a *black box*. Therefore, under the Solow style neoclassical formulation, growth (in productivity) is explained by growth in the supply of the primary factors labour and capital. "Factor A" is, thus, a multiplicative residual that incorporates exogenously (to the firm) possible explanations for growth that go beyond the increased supply of primary factors.[19] Firms maximise profit in a world of perfect competition, seeking the quantities of labour and capital that equal the value of their respective marginal

[18] Curiously the first neoclassical contributions to an understanding of the causes of development come from Keynesian macroeconomics. Harrod (1939) and Domar (1946) sought to compensate the concentration of the former on the short-run effects of demand management policies, and reflected upon the determinants of output formation and job creation in the long-run. They focused their attention on GDP because they held it was the variable with the greatest influence on the quality of life or economic development. This vision pointed the way for economic thought and is one of the reasons why, still today, development is often confused with its growth component. The other will be presented in Subsection 4.1.

This component must be understood as the increase in a territory's ability to support an economy that produces goods and services. Demand determines the degree of use of the existing productive capacity but it is supply that limits that capacity. This distinction is important because, outside the scientific world, any positive change in observed output is seen as growth.

[19] Robert Solow was perhaps the growth economist who bequeathed the greatest influence throughout the 60's to the 80's. It is only fair to recognise that later he was concerned with understanding how technological progress affects growth. In Solow (1962) he argued that it is incorporated in the productive process when a generation of capital is replaced by a more recent one (it is assumed that a new generation of machinery will be more productive than the previous one — the vintage capital theory).

productivity to their earnings. Factor owners maximise their utility by moving their respective supplies in search of the best real earnings. One possible extension of equation (1) to *n* products and *m* regions, assuming mobility of factors between economic sectors and regions, leads to the conclusion that growth in a region will be positively influenced by growth in the indigenous supply of labour and capital and by inter-regional and intersectoral factor mobility. The theory contains the following **policy implications**: a region is more developed (in the sense that it generates more potential earnings *per* worker) the more capital intensive its economy is; geographical and sectoral mobility of factors corrects any initial interregional differences in productivity and promotes real convergence (*i.e.*, in the long-term regions converge towards the same degree of capital intensity and the same level of productivity). In this context if populations are sufficiently patient for time not to be a political problem, the government does not have to concern itself with fostering regional development; the market provides it everywhere and uniformly.

The neoclassical vision of economic development is, however, blind as to location because nothing distinguishes territories from each other except the relative endowment of labour and capital; even that difference is transitory and disappears as a result of geographical mobility. Neoclassical development is gauged purely by growth in output and that is internal to the firm, in the sense that it does not depend upon non-pecuniary interactions (commonly known as external factors) with other economic actors.

The opening of the neoclassical black box was too tempting a challenge to remain unanswered for long. Many other rationales were proposed, discussed and tested in the following decades. Some lines of research sought answers in the technology itself, while others dived into the role of the interactions (knowledge, for instance) between economic actors. More recent theories broaden the study goal to other aspects of regional development to the extent that they realise that potential output growth is limited by factors such as institutional thickness, entrepreneurship and social capital. All those directions have in common the assimilation of "factor *A*", through various channels, in some cases complementary and others alternative. Due to this common thread the theoretical developments will we discuss briefly are classified as *endogenous* development models as they share the notion that the change in the variables *per* unit of work or *per capita* is fully explained by the economy's own mechanisms and not by external forces.

B.2 Keynesian based models

The significant contribution to the growth of industrialisation and trade processes between Western economies in post Second World War led to a line of research of Keynesian influence. On the one hand, it underlined the importance of external demand and the export sector as driving forces for the rest of the economy (export-base models). On the other hand, it highlighted the role of technologies with increasing returns to scale that featured most exportable production (industrial goods, which carried great weight at the time). Kaldor (1970) questioned the neoclassical thesis that any initial differences in regions' states of development dissolve over time through the mobility of factors and the free trade of goods. On the contrary he argues that, once a particular region has gained a comparative advantage, growth in its export base gives it a new competitive edge, from the fall in the price of the exportable goods made possible by economies of scale; that fall increases sales to the outside world and reinforces, in a **cumulative or self-fuelling manner**, the territory's initial comparative advantage. The repeated export stimulus encourages the lengthening of the production chain of basic activities *(i.e.*, exporting activities) and gives rise to multiple specialist suppliers, including the development of complementary sectors (logistics, transport, marketing, etc.). The process was formalised years later by Dixon and Thirwall (1975). The cumulative nature of growth is captured by a recursive element according to which the growth in labour productivity increases in line with the growth in output recorded in the previous period — the Verdoorn effect (1949) or dynamic economies of scale. Growth is cumulative and circular: a rise in export demand leads to increased production of exportable goods, which increases GDP; labour productivity improves in the following period, making it possible to lower the price of exportable goods for a given rate or return, *i.e.*, improving territorial competitiveness; export demand expands once again and new rounds of positive effects follow in future periods. Thus, the better the region is endowed with exportable goods and dynamic scale economies at a given point in time, the more it will grow in the future.

This theoretical framework brought attention to the usefulness of government intervention capable of promoting or accelerating changes in the production specialisation profile of territories. This was the origin of the first generations of **regional development policies**. On the one hand, it upheld the idea that regions specialised in sectors with low labour productivity are condemned to lose competitiveness, firms and employment in a globalised world. On the other, it influenced the devising of policy tools designed to encourage capital accumulation in industries geared towards exports facing high income elasticity demands, as well as the spread of lower-skilled worker-saving technologies.

Nonetheless, it is clear that this development model has limitations. They arise out of three risks that affect the sustainability of cumulative causation: the drying up of growth in importing economies, scarcity of factors (that leads to increased costs of exportable output and loss of the comparative advantage) and competitiveness progress in other regions.

B.3 Explanations based on non-pecuniary interactions between actors

More or less independent contributions began to appear in the literature that highlighted the role that certain forms of interaction between economic actors could have in output growth and other variables that contribute to regional development. We are referring to the so-called non-pecuniary interactions, as opposed to the relationship between the buyer and seller in a market where both interact through the price system. The more important ones take the form of agglomeration economies, networking economies and transport costs.

Geographic concentration is a source of comparative advantage to the location of firms and consumers. The essence of **economies of agglomeration** as a driving force of development may be appreciated by means of a simple reasoning. To be specific and in the case of decisions to be taken by firms, the accumulation in a given space of either skilled workers, suppliers of intermediate outputs with production scale economies or information dissemination structures, is a comparative advantage for that location because it reinforces the cumulative causation of its growth process. A firm in search of a place, either to start up or expand, will value locations with a relatively high accumulation of one of those resources depending on whether its technology demands specialist skills, intermediate goods or knowledge, respectively. Physical proximity to those resources reduces that firm's average cost of production. The mass of pre-existing actors generates a positive spillover for new actors that set up in the territory and this spillover is not traded in the market (therefore the economies of agglomeration are a type of non-pecuniary externality).[20] As with economies of scale, economies of agglomeration are a **centripetal force**, *i.e.*, they tend to concentrate production and employment in a location. If they are concentrated in a location it is because they left another, and this type of development is naturally asymmetric between regions. Once again it is an outcome that defies neoclassical territorial uniformisation.

Network interactions are an effective replacement for face-to-face contacts in numerous industries. One clear example is the relationship between newspaper editors and printers. Up-to-date news was and is a valuable asset for the press, so the texts are produced at the last minute before being printed. Historically, newspapers and printers were located in the same neighbourhood (in Lisbon it was the *Bairro Alto* area) because given the communication technology of the time, face-to-face contact was the fastest means of transmitting the texts to the presses. With the advent of computers and the Internet, everything changed and today physical proximity between those economic actors is no longer a decisive factor in locating decisions. It was replaced by the capacity to discover and maintain commercial relationships through a network (virtual interactions). That replacement is a comparative advantage for the firms which, through networking, save on location costs or gain access to suppliers or clients who, otherwise, would not be on their radar. The physical location of suppliers and clients loses importance when deciding the location of firms and certain types of self-employed professionals. Unlike economies of scale and agglomeration, **networking economies** are not a centripetal force.

Lastly we turn to the role of **transport costs**. Moving people and goods between locations has specific costs. The interaction between a producer and a consumer is not direct and goes through a number of intermediary services. The most obvious are the transport costs themselves: the sum paid to the agent that physically moves the resources from one place to another. But in a broader view of transport costs, we can include the other expenses that the physical removal involves, such as packaging, storing, surveillance, insurance, custom duties, exchange rate changes, banking fees and advertising in the consumption destinations. They are expenses that add to the ex-producer price of the goods and which, given competition from suppliers in other places, limit the producer's market area, *i.e.*, the territorial area within which a particular producer is competitive. For this reason transport costs are a centrifugal development force, that is to say an item that favours territorial dispersion of production and employment. However, it is important to bear in mind that the world trend, in recent decades and in ever more businesses, is to reduce transport costs through various channels (improvements in transport infrastructure, trade liberalisation, progress in information and communications technology, exchange unions, etc.). This means that, in practice, transport costs have operated in reverse: their decline has proved to be a force that concentrates GDP peaks in territories.

[20] The concept came into economic thinking a long time ago, at least with Marshall (1920), under the name of external economies (external to the firm). The much acclaimed book on the theory of trade, Ohlin (1933), already distinguished between two types of economies of agglomeration, which are popular today in textbooks on urban and regional economics: localisation economies and urbanisation economies. It took almost 60 years for that notion to be (re)discovered and applied to the field of regional development. That came about with the persuasive contributions of Porter (1990) and Krugman (1995).

In short, these arguments help us to understand that the economy is not spatially uniform, and why (central) locations favoured by the concentration of activities intensive in scale and agglomeration economies and low transport costs arise, as do (peripheral) locations disadvantaged by the scarcity of those activities.

B.4 Growth poles school

The idea of centripetal and centrifugal forces acting at the same time is not new. We can go back to the 1950's and 60's, at least, to find musings on contradictory driving forces and multiple equilibria. We are talking about the **growth poles theory** that was fairly popular at the time. Perroux (1964) explicitly embraced the argument of territories' economic interdependence. He assumed that a territory is relatively developed (the *pole*) and is surrounded by less prosperous "hinterland". A web of inter-industry relationships links the two regions through the markets for products and factors. The dynamics of trade and migration explains why the pole's growth triggers contradictory impacts on output growth in the hinterland: the *spread effects* are driving forces favouring real convergence and develop through drag and propulsive linkages among sectors. If the sectors in the pole grow, their orders for raw materials and intermediate goods from the hinterland also grow (drag) and, by means of a Verdoorn type mechanism, they provide sectors in the hinterland with better conditions in terms of price, quality and quantity (propulsion). In addition, economies of scale and agglomeration, as well as the decrease in transport costs in the centre will not last forever and eventually become a negative pressure on its competitiveness. Phenomena such as traffic congestion, pollution and others that stem from excessive concentration in the centre are an incentive to relocate to the surrounding region.

However, the *backwash effects* work in the opposite direction and are an anti-convergence driver. The poles are usually dominated by capital-intensive industries, based on technology and rapid growth. In these circumstances the migration process is highly selective. Economies of scale and agglomeration in the centre extract factors from the hinterland in search of higher rates of return. Savings and better killed workers tend to be sucked out of the hinterland and into the centre, reducing the average quantity and quality (productivity) of the workers that remain in the hinterland while improving the pole's.

In short, the growth poles school extended the arguments of the cumulative causation theory to a world of locations with unequal resource endowments to discover that **two opposing equilibria are possible**. 1) The more region i grows, the more region j will grow; 2) the more region i grows, the less region j will grow. To find out which effect will win out is an empirical question and there will certainly be actual situations in which proposition 1) is not contradicted by the data and others in which proposition 2) shows up more plausible. However, the propositions are hardly testable. Despite this fact, these ideas were taken up again and refined by the so called *new economic geography* (see Subsection 4.1).

B.5 Knowledge

As stated at the beginning of this section, in the 1950's knowledge was in the black box A. In the 80's intense research was conducted on the phenomenon of technological change and knowledge was presented as an **endogenous process,** closely linked to the traditional factors of production, labour and capital, rather than be seen as a gift from heaven, as in equation (1). In

Romer (1986), knowledge is appropriated by production through capital and in Lucas (1988) it is incorporated in labour and it is through this factor that it impacts on the production process.

B.5.1 Capital-embodied knowledge

Workers and managers learn with past investments in such a way that the firm's knowledge about its technology at any one time, *i.e.*, knowledge as to efficient ways of combining labour, capital and other factors, is the greater the more capital has accumulated in previous periods. Therefore knowledge is a sub product of previous investment decisions and, as such, becomes an endogenous process (in that it is internal to the firm).

However, it is difficult to retain knowledge acquired in this manner solely within the firm that generated it, even when it is patented. The geographical proximity to skilled workers and managers of other firms in the industry leads to the spread of knowledge, both through formal channels (seminars, conferences, magazines) and informal ones (socialisation). This is a type of economy of agglomeration. As mentioned earlier the Internet has come to replace, in part, these networking spillovers and broadened the knowledge spread spectrum.

Paul Romer's contribution is important as it teaches us the importance of investment, especially in Technological Research and Development (TR&D), in sustaining competitiveness gains for firms and their supporting territories.

B.5.2 Labour-embodied knowledge

Workers accumulate knowledge mainly through two ways: education and work experience. In his paper Robert Lucas describes how this happens, how workers transfer that knowledge to their firms and why the surrounding space makes a difference to the endogenous appropriation of knowledge incorporated in labour.

He recalls that **education** is a mixed good. This means that it is both a private good and a public good. It is a private good for the person receiving the education in that learning through formal education or vocational training systems brings salary and immaterial benefits which are appropriated by the individual. But these skills transmitted by education to an individual are a public good in that they bring useful benefits to people who interact with the educated person. In addition, the more educated people there are in a community, the greater the knowledge and benefits that spread from one to another in that territory. Naturally, more educated individuals make the organisations for which they work more efficient and, therefore, more able to grow, according to any of the mechanisms examined in the previous subsections. The Lucas model produces an endogenous growth driver through economies of agglomeration. Cities, especially large cities, are the places where the external benefits of education spread furthest. There are professions that depend on human interaction to this end more than others. It is the case with science, arts and culture in general, which are often called *creative industries*.

Some **policy implications** may be drawn now. A friendly environment to knowledge dissemination is an infrastructure to be taken into consideration when promoting regional development. Betting on driving forces that stimulate agglomeration economies and on creative activities in places where this infrastructure exists may make sense. Obviously the initial conditions matter.

For example, it would not make sense to subsidise a biotechnology business park where there are no suppliers of applied science.

Another type of knowledge accumulation in people happens in the workplace. It results from work experience itself, **learning by doing**. Lucas (1988) argues that this process of acquiring knowledge is subject to decreasing marginal returns. So it is sensible for managers to introduce new challenges to their employees now and again, to renew their product portfolios, for example. The search of innovation is a very effective way of enhancing the role of professional experience, and of fighting the fleetingness of this type of knowledge accumulation.

Now, a successful innovation process is greatly dependent upon the firm's interaction with surrounding environment. Richard Florida underlined this years later. The ability to introduce new product lines with potential human capital growth **is greater the more innovative the supporting territory ("milieu")**. An innovating territory is a place that attracts and holds creative economic actors, be they firms, TR&D centres, regional development agencies, local leaders or artists, and has suitable networks for collaborative interaction between them — Florida (2002). The effective performance of these networks depends mainly on intangible factors of production, such as proactivity, leadership, entrepreneurship, cooperation and robust governance[21] of private and public institutions. Once again, these attributes are to be found in people. The competitive advantage of innovative territories rests, to a large extent, on the appropriate combination of these attributes. The authorities may stimulate these interactions and even the flow into "their" territories of creative activities from other places but they cannot replace the regions' endogenous energy.

The digression on regional development and growth theories follows in Section 4.

Annex C: Signs of regionalisation in the OECD

The following tables were taken from the OECD (2010) publication and summarise some features of the moves towards regionalisation in this organisation's Member States in the nineties and the noughties. They help to frame the topic covered in Point 8.3.2 of the main body of this paper.

[21] In this work we have chosen the term "governance" whenever we refer to "rules, processes and behaviour by which interests are articulated, resources are managed and power is exercised in society" or concrete organizations of this nature. The quote is from the European Commission (2013, p. 3) and corresponds to the meaning the word "governance" is usually given in the English language.

Table 3 — Recent regionalisation processes in OECD Member States

Country	Name	Year	Elected membership	Fiscal power	Notes
Czech Republic	Regions (*kraje*)	Established in 2001	Yes	Yes, but limited	
Czech Republic	Cohesion regions	Established in 2007	No		Membership is elected by *Kraje* assemblies
Chile	Regions	Established in 1993	Yes (after 2010)		The intendant (head of the regional council) is appointed by the President
Denmark	Regions	Established in 2007	Yes	No	Grants come from the state and municipalities
Finland	Regions		No	No	Membership of the Regional Council is comprised of member municipalities. It is also financed by member municipalities
France	Regions	Strengthened in 2003-04	Yes	Yes	
Italy	Regions	Strengthened since the late 1990s	Yes	Yes	
Norway	Counties	Strengthened in 2004, 2010	Yes	Yes, but limited	
Poland	Regions	Established in 1999	Yes	Yes, but limited	
Slovak Republic	Regions	Established in 2002	Yes		
Spain	Regions	Strengthened in the 1980s-2000s	Yes	Yes	
Sweden	Regions/counties	Strengthened since 1997	Yes (partly)	Yes (partly)	Structure differs across regions
United Kingdom	–	Established in 1999	Yes	Yes	Except for England

Source: OECD (2010, p. 32).

Table 4 — Regional government functions

Country	Name	Planning	Main functions other than economic development and planning
Czech Republic	Regions (*kraje*)		Social services, health care, regional transport
Czech Republic	Cohesion region		
Chile	Regions	Regional Development Strategy	
Denmark	Regions	Regional Development Plan, Business Development Strategy (Growth Forum)	Health care
Finland	Regions	Regional Plan, Regional Strategic Programme	EU fund management
France	Regions	Regional Territorial Planning Master Plan, Regional Economic Development Master Plan	
Italy	Regions		
Norway	Counties	Regional plans, regional strategies	Upper secondary schools, regional development including main roads, regional business development, broadband and regional R&D
Poland	Regions	Regional Spatial Development Plan (after 2010)	Health care, higher education, labour market policy
Slovak Republic	Regions	Economic and Social Development Plan, Spatial Plan	
Spain	Regions		Health care, education, public works, agriculture, tourism
Sweden	Regions/counties	Regional Development Programmes, Regional Growth Programmes	Health care
Switzerland	Cantons	Ten-year Spatial Development Plan, Four-year Implementation Programme for NRP	Education, health care

Source: OECD (2010, p. 35).