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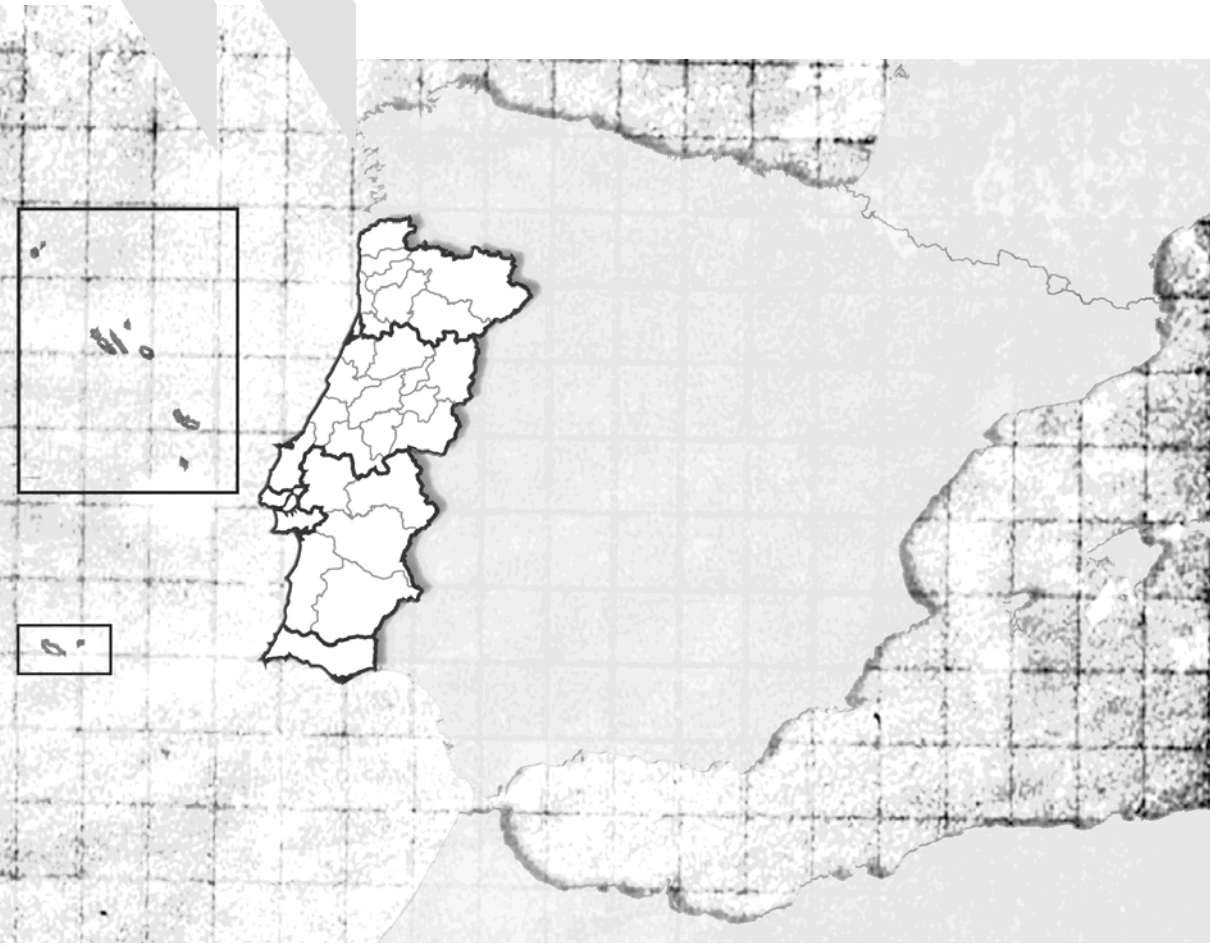

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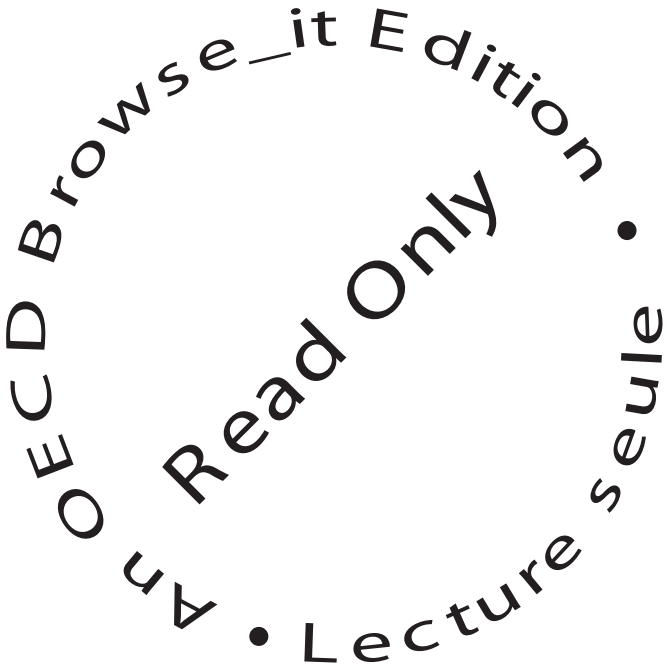

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List of Acronyms

AICEP	Business Development Agency of Portugal
CCDR	Commissions for Regional Co-ordination and Development
ERDF	European Regional Development Fund
ESF	European Social Fund
GCELPT	Cabinet for the Co-ordination of the Lisbon Strategy and the Technological Plan
NSPP	National Spatial Policy Programme
NSRF	National Strategic Reference Framework
OP	Operational Programme
PIN	Projects of National Interest
PRACE	Programme for the Reform of Public Administration
PRIME	Programme of Incentives for the Modernisation of the Economy
PROT	Regional Spatial Plans
PROVERE	Programme for the Economic Valorisation of Endogenous Resources
ROP	Regional Operational Programme

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Assessment and Recommendations

Portugal and the paradigm shift in regional policy: a strong political commitment confronted with a demanding task.

Portugal offers a compelling case study for what is often referred to among OECD countries as the paradigm shift in regional policy (in brief, a shift from subsidies targeting the reduction of regional disparities to investment supporting regional opportunities in order to enhance territorial competitiveness; from different sectoral approaches to multi-sectoral place-based approaches; from a dominant role of certain levels of government to a multi-level governance approach involving co-ordination of national, regional and local governments plus other stakeholders). The example of Portugal draws attention to why and how this new type of regional policy could contribute to national development in a relatively small yet diverse country, with weak growth and limited public spending capacity, and marked by a long tradition of centralised governance and no elected regional level (except in two island regions).

The Portuguese government has stated a clear political will to bolster national growth via long-awaited structural reforms, and regional policy stands as one of the key tools for implementing this agenda. Historically born from the execution of the European Union's Structural Funds, Portuguese regional policy is currently going through a complex transformation process. While being geared back towards the EU's so-called renewed Lisbon Agenda, it faces new policy challenges to achieve competitiveness objectives. The pursuit of competitiveness is intricately linked with supporting innovation (understood in a broader sense than scientific and technological innovation). Innovation depends in turn on knowledge, involving both producers and users (education and research institutions, firms), which together generate a mutually reinforcing dynamics of development through economies of agglomeration and spillovers in specific places. The orientation towards competitiveness objectives therefore calls for place-based policies that facilitate the production and diffusion of knowledge in different specific regions.

In recent years, Portuguese public authorities have increasingly tried to address regional specificities more directly and to ensure greater coherence across the

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central government's sectoral interventions at the regional level. Such efforts are heading towards a promising direction and should be fully implemented, but also open the way for further progress. The true success of reforms will be largely determined by Portugal's capacity to capitalise on the specific knowledge of numerous actors. Building appropriate mechanisms to reveal competitive assets and competencies in each region will provide decisive instruments to reinforce stakeholder engagement around a shared ultimate goal, which lies in the collective improvement of economic, social and environmental well-being. The next few years to come in Portugal deserve close attention as they will deliver valuable lessons for OECD countries working on effectively and efficiently implementing the paradigm shift in regional policy.

In a country marked by persistent structural challenges…

The recent return of economic growth in Portugal contrasts with the persistence of deep-rooted structural challenges. Real GDP growth of 1.3% in 2006 confirmed a recovery from the 2003 recession, but remained below the euro area average and far below the average 4% per year that had prevailed during the 1990s. Portugal still exhibits one of the lowest levels of GDP per capita in the OECD (only above Turkey, Mexico, Poland, Slovak Republic and Hungary). In order to curb escalating unemployment and to upgrade the economy locked in low value-added activities, the competitive edge lost in low-cost labour must be earned back in education and innovation. In terms of the educational attainments of the working-age population, Portugal scores among the lowest in the OECD (next to Turkey and Mexico) with a slow pace of improvement between generations (in contrast with Ireland, Finland, Spain or Korea). Spending in R&D is one of the lowest in the OECD, especially private spending (only 0.5% of GDP in 2003). Such low performances explain a major part of Portugal's modest economic growth and suggest large room for progress.

… and a clear need to focus public investment on efficient levers of growth, …

Given that structural reforms to upgrade human capital and nurture knowledge-based activities have earned wide consensus at the top of the national policy agenda, attention must then shift to what and where the needs for public intervention are. The current Portuguese context of fiscal constraints added to anticipated cuts in future external funding (following EU enlargement) urge for a particularly vigilant choice of public investment projects, and therefore for a sharp understanding of the levers that will most efficiently reinforce the

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knowledge base and build up innovation capacity (ranging from breakthrough innovation to the upgrading of traditional industries).

… a new type of regional policy better connected with innovation policy could help trigger an endogenous development dynamics.

Experience in OECD countries increasingly suggests that knowledge and innovation capacity stem from the synergies and economies of agglomeration that form between the various competencies of specific actors, such as inventive firms and entrepreneurs, dynamic universities, or proactive NGOs. By nature, these actors are anchored in fixed places (a city, a rural area) and draw their strength from their connection to this specific environment. Portugal's ambitions to modernise the national economy by stimulating innovation will thus require policies that identify the specific assets entrenched in different regions and facilitate their valorisation.

This requires a critical shift compared with past policy orientations in Portugal. Until recent national flagship programmes such as the *Plano Tecnológico*, innovation policy has long been missing and disconnected from regional policy, which yielded mixed outcomes for national development. After absorbing more than 50 billion EUR of Structural Funds between 1989 and 2006, Portugal has remained eligible for another 21.5 billion EUR for the 2007-2013 period (close to 15% of its GDP). In contrast to the buoyant economic take-off in other countries (such as Spain and Ireland) which also used to qualify for European special aid (Cohesion Fund), Portugal's standstill indicates that past investment focusing on physical infrastructure and basic services – albeit credited for causing necessary improvement – was not enough to trigger an endogenous development dynamics based on competitive assets.

While the variety of competitive assets across regions was primarily addressed via cohesion-oriented policies, …

By population or GDP size standards, Portugal might equal a single region in some large OECD countries; its internal diversity nevertheless confirms that its different regions host different assets. Its 10.6 million inhabitants are unevenly distributed across five administrative regions in the mainland (Norte, Centro, Lisboa e Vale do Tejo, Alentejo, and Algarve) and two autonomous regions in Atlantic islands (Azores and Madeira). In Portugal, the urban/rural divide commonly found in OECD countries has translated into a gap between dynamic and densely populated urban areas (mainly along the coast) and

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declining low-density rural areas (concentrated in the interior). Disparities are less visible in terms of income (in 2003, the Gini index of GDP per capita across TL3 regions in Portugal was 0.14, just below the OECD average at 0.15) than it is in terms of GDP size (Portugal displayed the fourth highest Gini index of GDP across TL3 regions in the OECD, with 0.57 versus an OECD average of 0.48 in 2004), unemployment rates (third highest level of disparities in the OECD in 2003), educational attainments (the highest level of disparities in the share of labour force with tertiary education across TL2 regions in the OECD in 2003), and R&D investment (Lisbon alone accounted for almost half of national R&D expenditure in 2002).

The fact that income inequalities are less salient than more "structural" types of inequalities suggests that income redistribution policies driven by cohesion objectives have been effective in Portugal. In addition to the past orientations of Portuguese regional policy driven by cohesion objectives, the Portuguese fiscal system (reinforced by the recent reform of the Local Finance Act) placed strong focus on ensuring equitable standards of living and compensating for specific regional handicaps (*e.g.*, mountainous rural areas). The geographic design of TL2 (NUTS 2) regions, which stretch horizontally from west to east, and the limited availability of data at TL3 (NUTS 3) level have also led to a statistical harmonisation that makes regional economic disparities between the coast and the interior less visible.

... the capacity to fuel national growth is still more visible in a few leading regions than in many lagging regions, ...

Obviously, this does not mean that all regions in Portugal have the same capacity for growth.

- A small group of regions has pulled national growth from the top: mainly the capital Lisbon (which grew slower than OECD average with 2% per year between 1999 and 2004, but accounts for about 31% of national GDP in 2004), an excellence pole concentrating the bulk of the country's knowledge-intensive activities and FDI inflows; the polycentric urban region around Porto (about 12% of national GDP in 2004), where small and medium-sized firms historically excelling in traditional sectors had boosted Portuguese exports but are increasingly confronted with low productivity and unemployment, causing the deterioration of growth performances; and the dynamic tourism platform in the Algarve region (only 4% of national GDP in 2004 but one of the fastest growing regions since 2000), where the rapid proliferation of tourism facilities targeting domestic and international markets must be counterbalanced with sustainable development imperatives.

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- By contrast, a large group of regions (mostly rural) have less potential for development or have been less successful in exploiting their assets, thus lagging behind (77% of Portuguese TL3 regions grew below OECD average during the 1999-2004 period). Such regions are often endowed with distinctive natural amenities (sometimes protected under the EU Natura 2000 network) but they are also struggling against rural exodus, population ageing, lack of human capital and economic activities that could offer a viable alternative to the decline of agriculture, and lack of critical mass that hampers public service delivery and reinforces marginalisation.
- The two autonomous regions of Azores and Madeira present particular assets and challenges (with nuances between the two). Their abundant tourism amenities present substantial potential *vis-à-vis* domestic and international markets (underdeveloped in the case of Azores); at the same time, their ultra-peripheral location requires specific attention.

… which tends to inspire uncertainties about the relevant mix of regional policy to be adopted.

In Portugal as in many OECD countries, the fact that competitive assets vary inevitably across regions and the urgency of helping lagging regions to diversify their economies have triggered concerns that regional policy – although envisaged as a tool to support national development by exploiting the specific assets of regions – might, as a side-effect, exacerbate disparities and undermine national cohesion. Such uncertainties over the relevant mix of objectives and instruments have led to the recent experimentation of a new generation of regional policy in Portugal. Faced with the improvements brought about by the focus of past regional policy on physical infrastructure (better accessibility in terms of public services), but also recognising the limits of such choices (agglomeration effects have tended to reinforce the already developed urban poles on the coast), Portugal is now striving to support soft investment for competitiveness.

Portugal has started to address regional specificities more directly…

The Portuguese government has multiplied recent efforts to take into closer account the specific characteristics of different regions. It seized the opportunity of the National Strategic Reference Framework (NSRF) – a comprehensive document asked by the European Commission to assess how each country will use Structural Funds over the 2007-2013 period – to undertake a broad process of regional diagnosis and design policies so that the regional assets identified may

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serve the competitiveness objective underlined in the renewed Lisbon Agenda. At the same time, after decades of limited use of spatial planning, Portugal just adopted a wide-ranging instrument called the National Spatial Policy Programme (NSPP, or PNPOT in Portuguese), which identified a series of territorial challenges and proposed strategic objectives (*e.g.*, preserving landscapes and biodiversity, promoting the polycentric development of the country, etc). The NSPP was conceived as an umbrella plan that could help to emphasise the territorial dimension in various sectoral plans (*e.g.*, infrastructure, environment) and to ensure coherence between them.

A series of plans launched recently have attempted to better take regional specificities into account. For example, a new type of urban policy called POLIS XXI aims at supporting different types of urban dynamics at different scales (urban neighbourhoods, networks of cities, city-regions). Rural policy makes a distinction between rural zones, defavourised zones, and zones protected by the EU Natura 2000 network. Particular attention was paid to the needs of low-density regions via recent programmes such as the Programme for the Economic Valorisation of Endogenous Resources (PROVERE) and the Multi-Purpose and Proximity Services Network. This reflects the government's concern to preserve landscapes and biodiversity, which are distinctive assets in Portugal, and to promote sustainable development.

… and to encourage regional innovation dynamics, …

While there was little evidence of an explicit regional dimension in policies for education and human capital for example, recent regional policy projects such as the "Competitiveness and Technology Hubs" initiative (inspired from the French model of *pôles de compétitivité* and partly from the Finnish Centres of Expertise) and the "urban networks of competitiveness and innovation" (under the POLIS XXI urban policy) have shown a promising approach to foster innovation. Although detailed information is limited at this preliminary stage of elaboration, the overall idea to launch calls for projects based on specific regional assets is expected to stimulate creative bottom-up ideas and partnerships between local governments, firms, universities and research institutions. This movement to bolster regional innovation is also in line with the Portuguese government's strong commitment to the Lisbon Agenda (the Portuguese NSRF earmarked 83% of the funding available for the "Convergence" objective and 78% of the funding for the "Competitiveness and Employment" objective to Lisbon-related investment, surpassing the minimum thresholds determined by EU rules which are 60% and 75% respectively).

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… with a strong push to ensure coherence across the central government's various interventions at the regional level, …

Attempts to better adjust policies to regional specificities while supporting the overall goals of innovation and sustainable development have been accompanied by efforts to enhance intersectoral co-ordination at the central government level. There has been growing awareness that regions should not host an accidental collision of sectoral policies that confuse economic agents via contradictory signals, but a carefully planned set of integrated and mutually reinforcing policies according to a place-based approach.

- *At the central government level*, the creation of the NSRF Co-ordination Team contributed to improving horizontal co-ordination. A high level of interministerial and intersectoral collaboration was also necessary to streamline the NSRF into three broad thematic Operational Programmes ("Territorial Enhancement" for transport, environment and urban development projects; "Human Capital" to promote skills and qualifications; and "Factors of Competitiveness" to promote innovation and the modernisation of the economy).
- *At the subcentral level*, the search for a more coherent implementation of policies was translated into a strong impetus from the central government to harmonise most of its own interventions via the Commissions for Regional Co-ordination and Development (CCDR). The CCDR are the deconcentrated arms of the Ministry of Environment, Spatial Planning and Regional Development, which were created in 1979 for planning purposes and currently administer each of the five mainland regions (TL2/NUTS 2). In this sense, the CCDR serve as a managerial regional level as there is no elected regional government in mainland Portugal (the two autonomous regions of Azores and Madeira elect their own regional government and regional assembly). The responsibilities of the CCDR are complex and demanding, including regional spatial planning, environmental issues, regional development, and support to local governments.

… namely through harmonised deconcentration.

Within the framework of the ongoing Programme of Public Administration Reform (PRACE), other ministries are reorganising their deconcentrated units according to the same geographic scale as the CCDR. The recent creation of an "intersectoral co-ordination council" within each CCDR is a promising move to initiate collaboration among the regional directorates of different ministries.

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Similarly, the Portuguese government has launched a powerful movement to group municipalities at the existing TL3 (NUTS 3) statistical level. Existing laws (voted in 2003) allow municipalities to set up intermunicipal associations on a voluntary basis and at flexible geographic scales, but experiments remained limited due to the lack of financial and institutional incentives. The central government is currently proposing to revise the laws in order to harmonise local public investment at the NUTS 3 level by offering different kinds of incentives (*e.g.*, possibility to collect the local property tax themselves and to receive the EU "global grants" as managing authorities of certain programmes). In practice, all municipalities are now engaged into joining intermunicipal associations at the NUTS 3 level.

To be more effective, Portuguese regional policy will require more open mechanisms to integrate the specific knowledge of various actors in the policy-making process.

The Portuguese model of harmonised deconcentration may present undeniable advantages in terms of coherence; it is less clear, however, to what extent it serves the effectiveness of regional policy in differentiating development strategies according to the specific assets of regions. The CCDR resemble the organisational choice of "prefectures" in France (prefects represent the central government at the subnational level and co-ordinate the action of eight ministries), which tends to leave little room for integrating the specific knowledge of local and regional actors (*e.g.*, municipalities, firms, chambers of commerce, business associations, universities, citizen associations) in the policy-making process. Contrary to France, Portugal has no elected regional level of government that could reflect bottom-up views. The CCDR are endowed with formal procedures for consultation (*e.g.*, committees, commissions), but evidence of constructive dialogue conducted through them in practice has remained uncertain. The redesign of a consultative body called the Regional Council (*conselho regional*) within each CCDR and the recent creation of Strategic Advisory Committees within the NSRF framework have been promising signs, but it has not yet matured into a concrete interface where all knowledge holders can contribute to the elaboration of place-based policies. The existence of a few successful examples of regional development driven by inter-firm collaboration under the impulse of a business association (footwear cluster in the Norte region) or a proactive local community (Guimarães, Mértola) suggests that appropriate mechanisms to better exploit regional knowledge could help stimulate similar dynamics in other regions and thus contribute to fuelling national growth.

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Summary of recommendations.

Portuguese regional policy has experienced significant advancement in recent years. Further progress could be achieved by reinforcing the following lines of action:

- Build better linkages between innovation policy and regional policy. The Portuguese economy needs continuous efforts to upgrade human capital and foster knowledge-based activities; innovation policy could be made more effective through a combination of national leadership (providing political momentum, strategic guidelines, and basic investment) and regional interfaces (competencies and tools to seize specific regional opportunities for development), as shown in the experience of Finland for example.
- Stimulate bottom-up projects based on regional competitive assets through appropriate mechanisms to reveal the development potential of all regions. Calls for projects need to provide clear information, transparent criteria of selection, and credible incentives. The objective is not to distribute subsidies that will substitute local resources, rather to leverage private investment and promote partnerships between key regional actors (municipalities, firms, chambers of commerce, business associations, universities, research institutions, financial institutions, NGOs); it is not to pick winners and dismiss losers, rather to trigger mutual emulation and liberate creative dynamics.
- Help lagging regions to identify niches for development. Such niches might achieve national or even global reach over time, but they should most often target local and regional markets first in order to ensure the sustainable development of lagging regions. This will also require closer co-ordination between the recent programmes specifically designed for low-density areas and parallel yet often disconnected programmes related with agriculture, rural development, education, environment, tourism, and infrastructure among others.
- Accompany lagging regions with appropriate mechanisms to improve public service delivery and to ease their way back to self-support without creating "poverty traps".
- Clarify the role of the CCDR as promoters of policy coherence and facilitators of collaboration (for example, by animating the Regional Councils and the Strategic Advisory Committees with effective mechanisms for dialogue). Policy coherence and participatory policy-making are prerequisites for the implementation of differentiated regional development strategies and should not be regarded as mutually substitutive.

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- Encourage functional collaboration based on potential synergies and common development projects, notably by fostering more flexible intermunicipal collaboration (not necessarily constrained at the NUTS 2 or 3 level).
- Promote stakeholder engagement by adopting appropriate communication tools. More effort to create positive expectations among actors could help encourage collaborative behaviour and information sharing. This is particularly required to support ongoing reforms because the benefits of "soft" infrastructure are less immediately visible than physical infrastructure investment.
- Exploit evaluation mechanisms to identify and diffuse good practices in regional development projects. Providing adequate information will help actors to accept risks related with reforms more easily and consolidate their commitment.
- Enhance accountability, monitoring and continuous assessment of policies through dissemination of performance indicators and benchmarking information. Significant progress was already achieved in terms of planning and programme management capacity; complementary training programmes could further support local capacity building.
- Strengthen the "enabling role" of the central government as provider of strategic guidelines and facilitator of creative initiatives.

Summing up: a unique opportunity for a qualitative leap.

The next few years are likely to determine the future of Portugal in the globalised economy. Portugal has launched an ambitious competitiveness agenda and faces a narrow window of opportunity to implement it. The government's pledge to endorse structural reforms and the opening of the 2007-2013 EU Structural Funds programming period are offering Portugal a unique momentum to take a qualitative leap. Investment in long-term assets for competitiveness must be pursued via differentiated strategies building on the specific potential of each region (ranging from high-end skills to landscapes and biodiversity). The success of ongoing reforms will depend on their capacity to motivate full commitment from all actors of the Portuguese society via appropriate communication tools in view of collective improvement.

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Box 0.1. **Basics facts Portugal**

Country profile of Portugal

Population: 10.6 million people (December 2006)

Form of state: unitary state

Structure of government: parliamentary republic

- executive branch: President of the Republic (directly elected for a 5-year term and re-eligible once); Prime Minister (appointed by the President of the Republic) and Council of Ministers (appointed by the President of the Republic upon recommendation of the Prime Minister);
- legislative branch: unicameral parliament composed of 230 deputies (elected for a 4-year term by proportional representation according to the d'Hondt method);
- judicial branch: Supreme Court; Constitutional Court; administrative, fiscal and military courts.

Member of OECD (1961), EU (1986) and euro area (1999)

Territorial and institutional framework of Portugal

Portugal has long been characterised by a tradition of centralised government, no formal regional level of governance in the mainland, and strong municipalities.

Central level

Under the Ministry for Environment, Spatial Planning and Regional Development, the Secretary of State for Regional Development (SEDR) is in charge of regional policy. He has authority over the Financial Institute for Regional Development (IFDR), which was previously named the Directorate General for Regional Development (DGDR). DGDR was created in 1983, when the negotiations to join the then European Communities were underway.

Regional level

Portugal has no formal regional level, except for two autonomous regions in the islands of Azores and Madeira. The territory is divided into:

- **5 mainland regions** (TL2): they have no elected body and they do not have the status of local governments (Norte, Centro, Lisboa, Alentejo, Algarve). Each region is administered by a Commission for Regional Co-ordination and Development (CCDR), which is the deconcentrated representation of the Ministry for Environment, Spatial Planning and Regional Development. The government attempted once to launch a formal regionalisation process, proposing a map of 8 regions with elected executives and regional legislative competencies; but the population rejected the project during a referendum in November 1998. According to the guidelines of the recent Programme of Central Administration Restructuring (PRACE), the deconcentration of national policies and government bodies is planned to be based on the existing 5 mainland regions.

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Box 0.1. **Basics facts Portugal** *(cont.)*

- **2 autonomous regions** (*regiões autónomas*) (TL2): due to their specific geographic, economic, social and cultural characteristics, Azores and Madeira have since 1976 had their own regional legislative assembly (directly elected, which can present proposals to the National Assembly), their own regional government presidents (*Presidente do Governo Regional*) and their own regional secretaries (*Secretários Regionais*).
- **18 mainland districts:** each is headed by a Civil Governor appointed by the Minister of Internal Administration. Districts are administrative structures of coordination for the deconcentration of national policies, and they are endowed with operational competences in security and civil protection. They were created in 1835 but they are planned to disappear (Aveiro, Beja, Braga, Bragança, Castelo Branco, Coimbra, Évora, Faro, Guarda, Leiria, Lisboa, Portalegre, Porto, Santarém, Setúbal, Viana do Castelo, Vila Real, Viseu).

Local level

- **308 municipalities** (*município*): they are the main level of local government. Portuguese municipalities rank among the largest in Europe (both in terms of surface area and population, with an average of 34 000 inhabitants). They have a municipal assembly (*assembleia municipal*), a mayor (*presidente da Câmara municipal*) and an executive council (*Câmara municipal*) elected for a 4-year term. They are in charge of collective equipment and basic infrastructure.
- **4 260 parishes** (*freguesias* – lowest level of local government): municipalities are divided into parishes managed by a local assembly (*assembleia de freguesia*), an elected local council (*junta da freguesia*) and its president. They are only in charge of local current administration and maintenance of certain basic infrastructure.

Methodological note: Portugal in the OECD Regional Database

The OECD Regional Database classifies Portugal into:

- 7 TL2 regions (5 mainland regions + 2 autonomous regions in Azores and Madeira), corresponding to the European NUTS 2 classification. Most of the statistical data provided in this report are based on the pre-2002 classification (Figure 0.3).
- 30 TL3 regions (groups of municipalities), corresponding to the European NUTS 3 classification. Most of the statistical data provided in this report are based on the pre-2002 classification (Figure 0.3).

Following this classification, the population of Portugal is divided into:

- 50% living in predominantly urban regions (6 PU regions).
- 24% living in intermediate regions (7 IN regions).
- 26% living in predominantly rural regions (17 PR regions).

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Figure 0.1. **Map of main cities in Portugal**

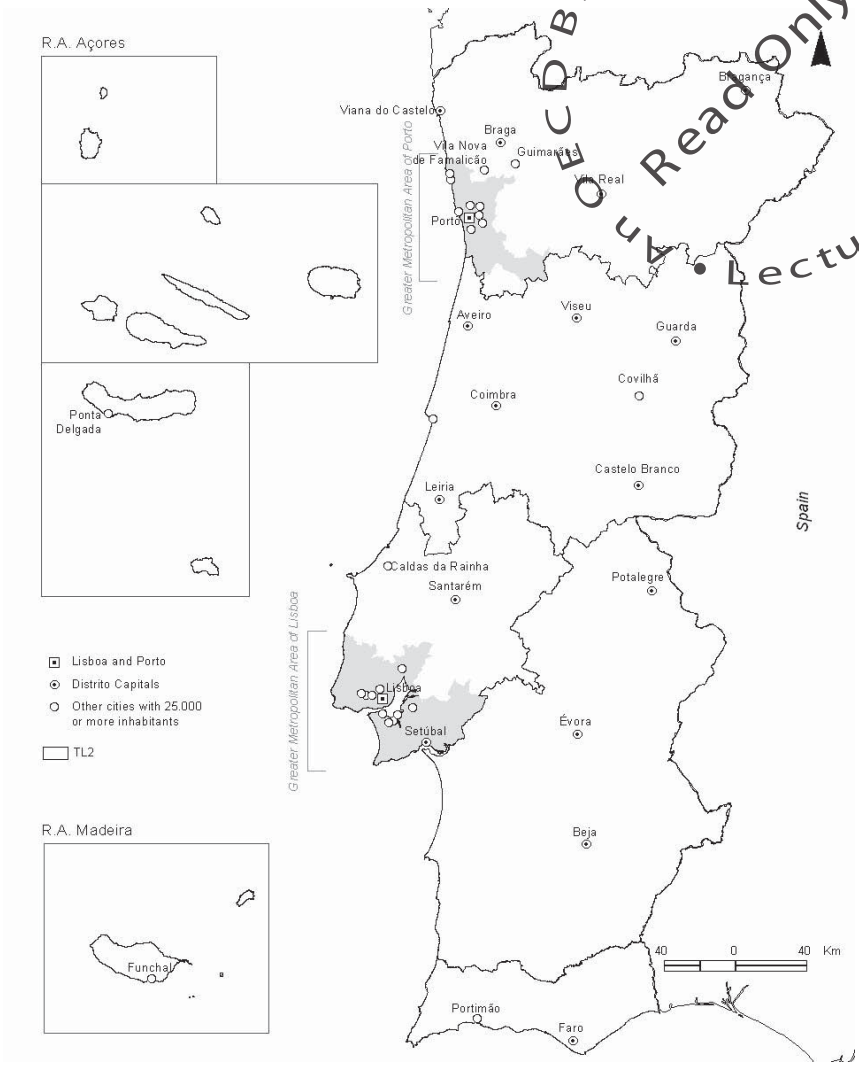

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Figure 0.2. **Map of statistical units in Portugal (TL2 and TL3), NUTS in use since 2002**

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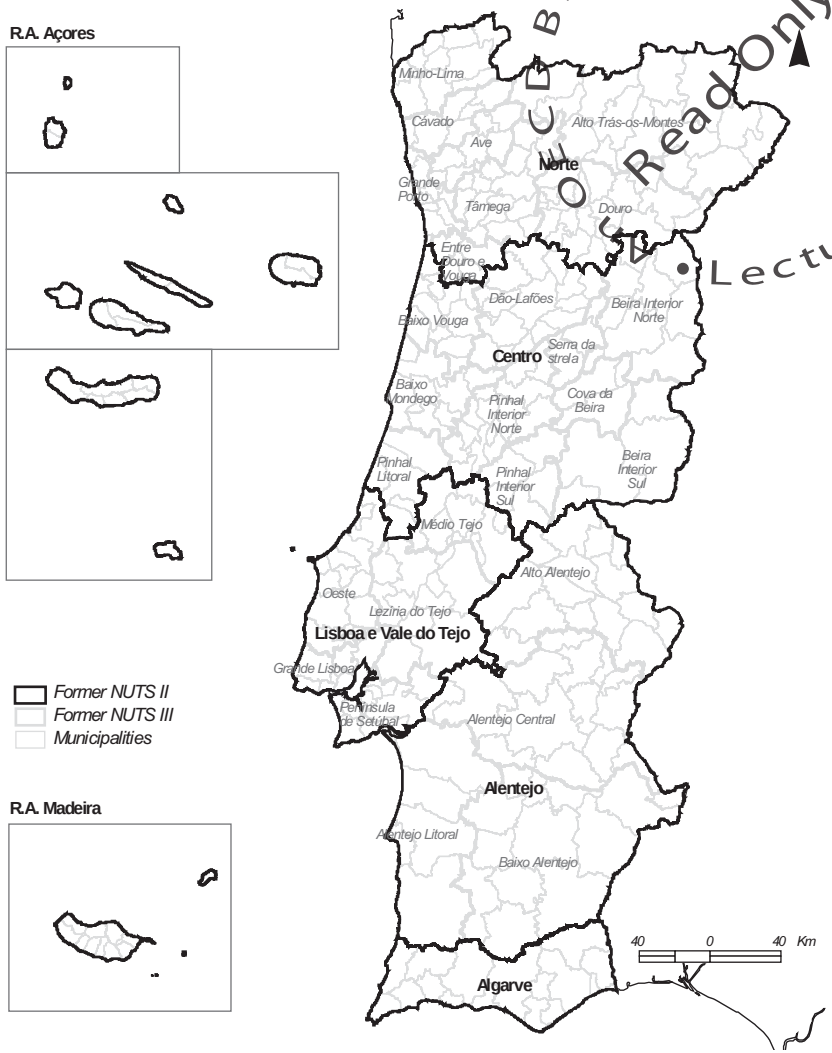
Figure 0.3. **Map of statistical units in Portugal (TL2 and TL3), former NUTS**



Note: The statistical data used in this report are essentially provided for this former classification as it matches the areas administered by the Commissions for Regional Co-ordination and Development (CCDR) and the autonomous regions of Azores and Madeira.

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Figure 0.4. **Map of the 18 districts in Portugal**

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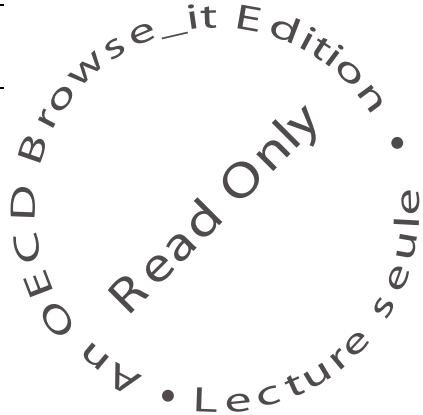

Chapter 1

Why a Regional Policy in Portugal? National Growth, Regional Assets and Challenges

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The encouraging return of growth in Portugal contrasts with the persistence of deep-rooted structural challenges. While the recent recovery of the euro area perked Portuguese exports, sustainable growth depends on the rapid modernisation of the economy *vis-à-vis* new EU members and other emerging players. The competitive edge lost in low-cost labour must be earned back in knowledge and innovation.[1] Such assets for competitiveness are regionally localised in Portugal as in other OECD countries.[2] A limited group of leading regions (mostly on the coast) have turned their assets into drivers of national growth, with further scope to gain international aura. Many other regions struck with specific disadvantages (mostly in the interior) have fallen behind, at the risk of underrating their own endogenous growth potential. This chapter provides a brief overview of Portugal's macroeconomic conditions, and discusses to what extent regional assets and challenges can determine national growth prospects.

1.1. Where does Portugal stand today? The macroeconomic conditions

Portugal is progressively recovering from a prolonged period of slowdown. Since the country's EU accession (1986) and entitlement to the Structural Funds (around 50 billion EUR in 20 years), its growth often outpaced the euro area average (1986-1991 and 1995-1999) (Figure 1.1). Economic performance deteriorated markedly faster than the overall slowdown in the euro area since 2000 and the catching up process plummeted into recession in 2003. Growth picked up in most recent years and outstripped initial forecasts, mostly driven by buoyant growth of net exports rather than domestic demand (Table 1.1).

Despite recent cyclical recovery, a series of structural challenges prevails. Portugal surely needs to fuel its income and growth levels (Figure 1.2) and curb the accelerated rise of unemployment (Figure 1.3). Most importantly, it must upgrade its economy locked in a low-knowledge sectoral specialisation, modest investment in innovation, a relatively low-skilled labour force with one of the slowest paces of catching-up in the OECD area, and a high opportunity cost of tertiary education (Figure 1.4, Figure 1.5 and Figure 1.6). Such pressing challenges linger against the backdrop of fiscal austerity (following the government's efforts to bring the budget deficit back in line with the EU Stability Pact) and in anticipation of potential cutback in Portugal's allocation of Structural Funds in the enlarged EU.

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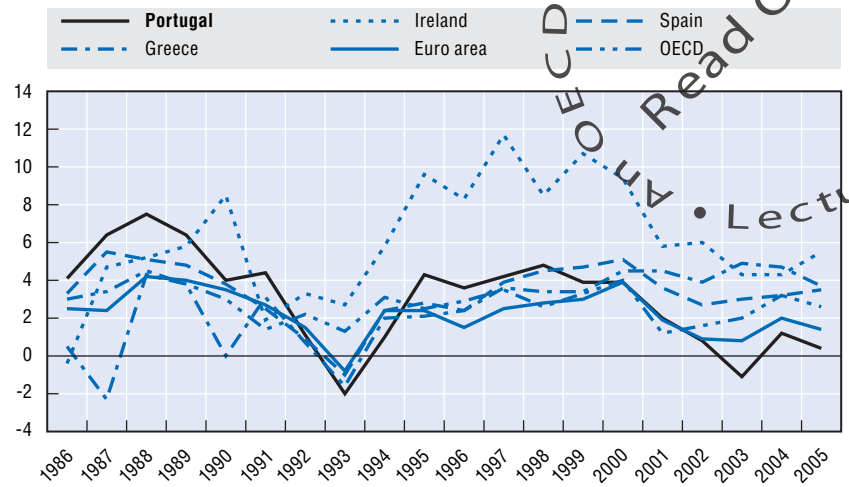
Figure 1.1. **Real GDP growth rate in Portugal, Ireland, Spain, Greece, euro area and OECD (1986-2005)**

Unit: %



Source: Adapted from *OECD Factbook 2007*.

Table 1.1. **GDP and net exports in Portugal**

Change in %

	2004	2005	2006	2007	2008
GDP	1.3%	0.5%	1.3%	1.8%	2.0%
Contribution of net exports to changes in real GDP (percentage of real GDP in previous year)	–1.3%	–0.5%	1.0%	0.9%	–0.1%

Source: *OECD Economic Outlook*, No.81.

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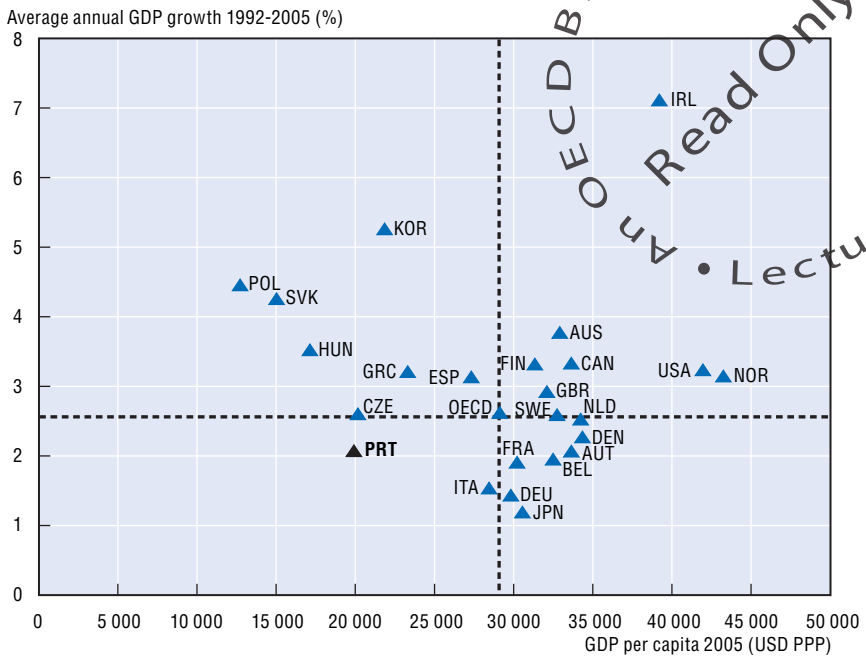
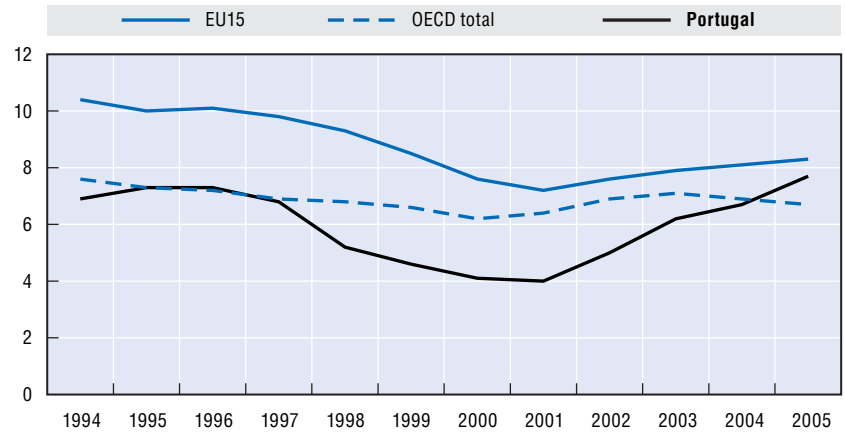
Figure 1.2. **Income and growth levels in OECD countries**



Source: Processed with data from *OECD Factbook 2007*.

Figure 1.3. **Unemployment rate in Portugal, EU15 and OECD (1994-2005)**

Unit: %



Source: *OECD Factbook 2007*.

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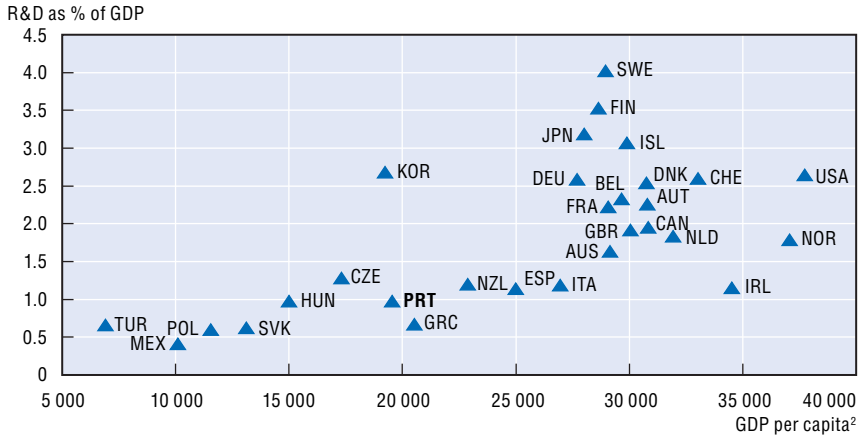
Table 1.2. **Main sectors of specialisation in Portugal**

	Share of national employment in 2003 (%)	Change in share of national employment 1999-2003 (%)	Share of national GVA (gross value added) in 2003 (%)	Change in share of national GVA (gross value added) 1995-2003 (%)
Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods	16.48	4.72%	13.25	–5.95%
Agriculture, hunting and forestry	12.16	0.70%	2.91	–45.52%
Construction	11.04	3.36%	7.06	11.15%
Public administration and defence; compulsory social security	6.96	6.60%	9.30	14.72%
Real estate, renting and business services	5.74	9.75%	14.53	6.89%
Education	5.68	–2.02%	6.94	12.18%
Hotels and restaurants	5.51	4.45%	4.18	14.16%
Health and social work	5.30	6.74%	6.06	24.63%
Textile and clothing	4.84	–15.67%	2.49	–26.18%
Transport, storage and communication	3.78	3.30%	6.83	4.46%
Private households with employed persons	2.83	–2.52%	0.78	10.04%
Other community, social and personal service activities	2.76	1.36%	2.54	36.34%
Agricultural and food industries	2.30	–7.14%	2.51	3.93%

Source: INE, National Accounts (Base 2000).

Figure 1.4. **R&D spending and income levels, 2003**[1]



1. Or latest year available.
2. In USD (PPPs).

Source: OECD Economic Survey of Portugal 2006, Figure 4.5, p. 106.

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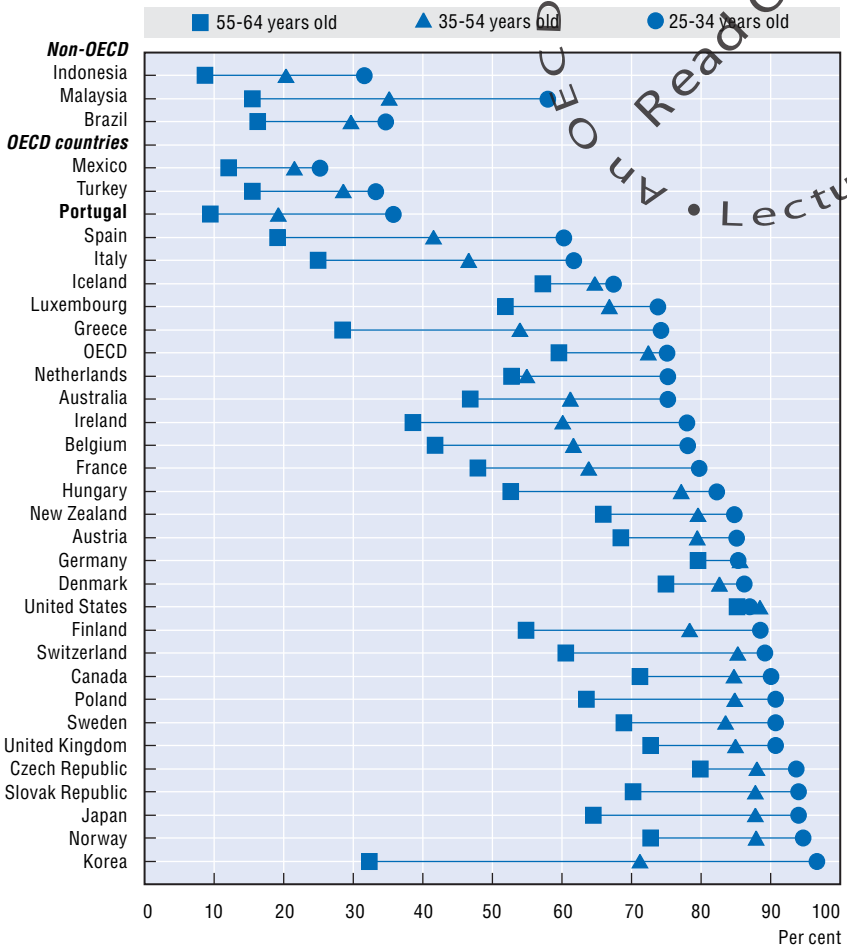
Figure 1.5. **Educational attainment of the working age population in OECD and selected non-OECD countries**

Population with at least an upper-secondary qualification, % of each age group, 2003



Note: 2002 for Czech Republic, Iceland, Italy and Netherlands.

Source: *OECD Labour Market Statistics Database*, *OECD Economic Survey of Portugal 2006*, Figure 1.9.

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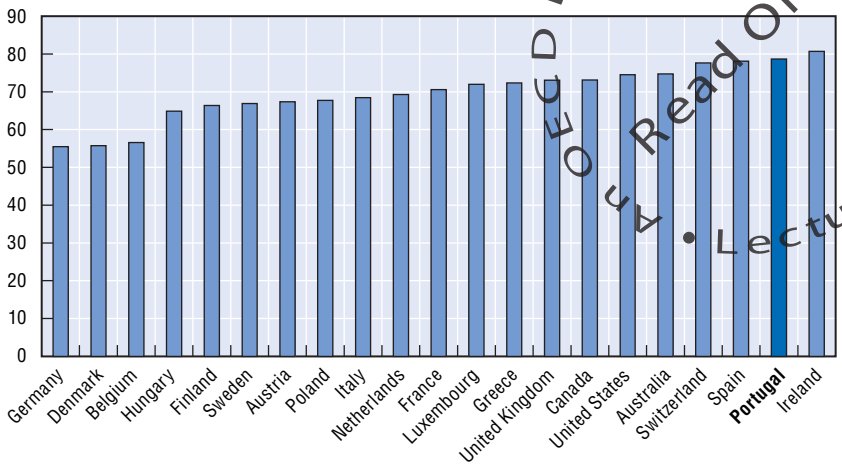
Figure 1.6. **Opportunity cost of tertiary education in OECD countries**

Foregone income while studying[1]



1. Opportunity costs were calculated as the average of net wages and unemployment benefits for an individual who participates in the labour market instead of studying, weighted by the probabilities of being employed or unemployed.

Source: Document prepared for the Working Party N°1 on Macroeconomic and Structural Policy Analysis [ECO/CPE/WP1(2007)6/ANN1] Figure 3.8.

1.2. Why do regions matter in Portugal?

Portugal's structural challenges – raising income levels and breaking the economic lock-in – have a strong regional dimension. National policies have long recognised that *income levels* display regional disparities. It was pointed out more recently that *determinants of income levels* are regional and various. In Portugal as in most OECD countries, regions are not equally equipped with natural endowments (*e.g.*, natural resources, demographic trends, access to global markets) nor economic assets (*e.g.*, human capital, efficient labour market, industrial specialisation, capacity to innovate). The following section assesses regional performances in Portugal, focusing on regional disparities and regional assets for growth.

1.2.1. Regional disparities

Regional disparities in Portugal have long been perceived as a vertical dichotomy between a dense and dynamic urban coast, and a desertified, declining rural interior. Between 1995 and 2006, population density increased markedly in urban regions and in the intermediate regions located next to the urban regions[3] (Figure 1.7 and Figure 1.8). The Portuguese population share living in predominantly urban regions increased by 2 percentage points between 1991 and 2004 while OECD average remained almost unchanged, and

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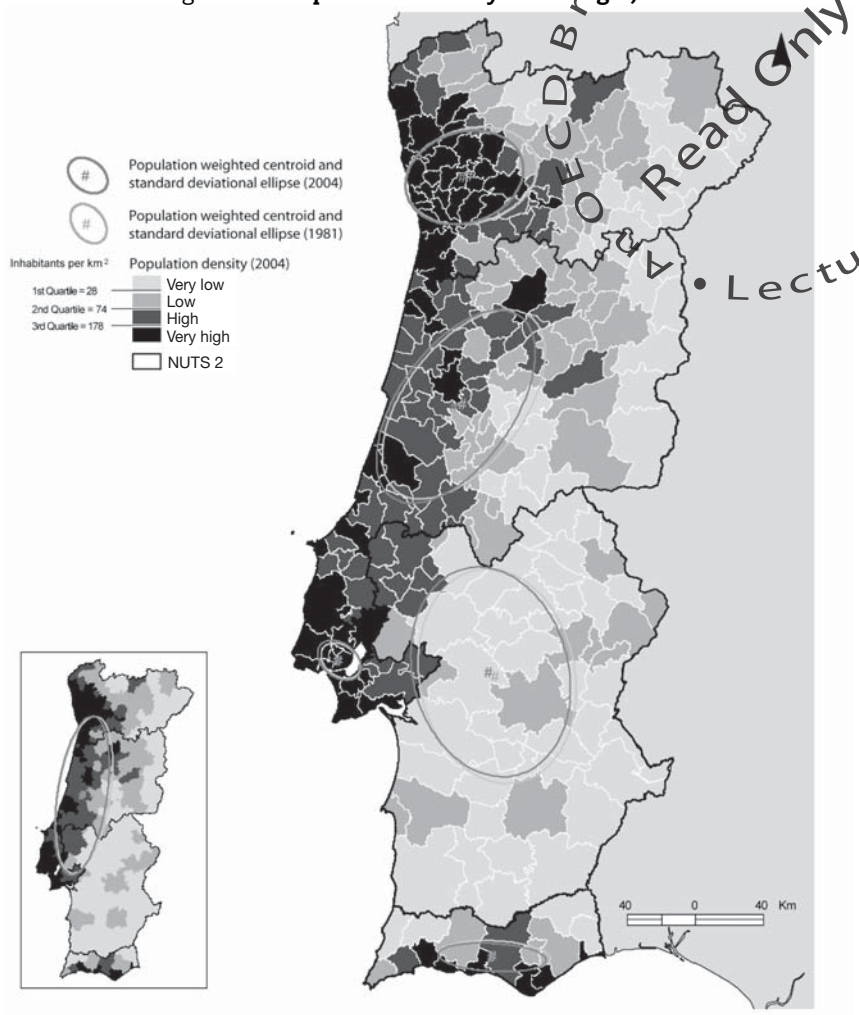
Figure 1.7. **Population density in Portugal, 2004**



Source: INE, Retrato Territorial de Portugal 2004, ed. 2005, p. 25.

it currently exceeds OECD average (50% *versus* 47% in 2004, Figure 1.9). In contrast, the Portuguese population share living in predominantly rural regions decreased by 2 percentage points during the same period, although it remains above OECD average (26% *versus* 23% in 2004, Figure 1.10).

Albeit substantial, the magnitude of regional disparities in terms of GDP per capita in Portugal remains close to OECD average (Figure 1.11 and Figure 1.12). Regional disparities in GDP per capita in Portugal seem linked to the economic cycle. During years of robust economic growth (1995-2000), the regional dispersion increased (σ-convergence indicator); when the economy

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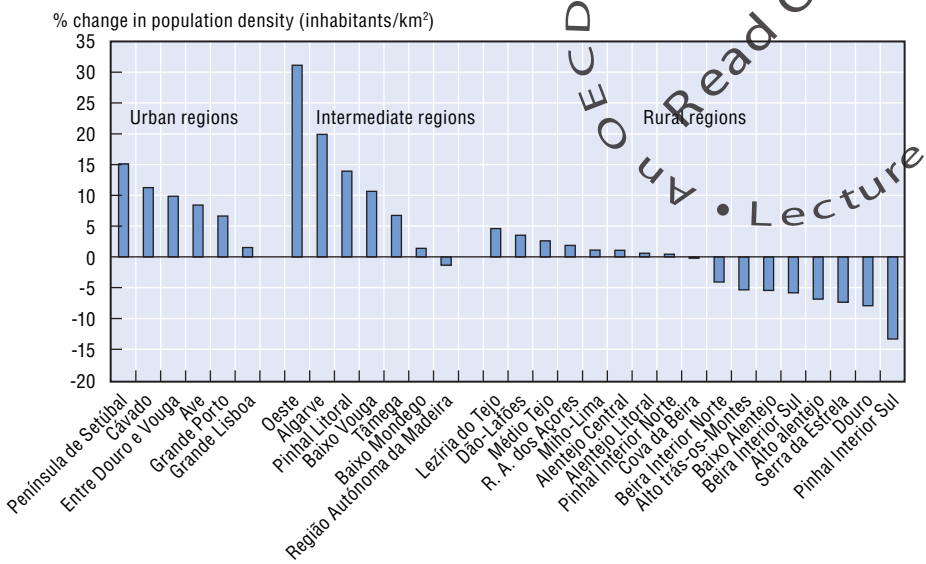
Figure 1.8. **Change in population density in Portuguese TL3 regions between 1995 and 2006**

Unit: %

OECD typology of urban, intermediate, and rural regions



Source: INE, Estimates of Resident Population; Portuguese Geographic Institute (IGP).

slowed down, regional disparities also decreased (Figure 1.13). Due to the large contribution of Lisbon to national output, regional disparities and national growth rates are both highly sensitive to Lisbon's economic performance.

Portugal displays the fourth highest level of regional disparities in terms of GDP in the OECD (Figure 1.14). The Gini index indicating disparities in GDP between all Portuguese TL3 regions is significantly higher (0.57) than the OECD average (0.48). The two largest urban areas in Portugal, Grande Lisboa and Grande Porto, generate alone slightly less than half (43%) of national GDP[4] (Figure 1.15). Regional disparities in GDP are in turn closely linked with the pattern of regional specialisation. Not surprisingly, Portuguese urban regions devote a higher share of their total employment to service activities than rural and intermediate regions[5] (Figure 1.16).

Portuguese regions have registered relatively low growth rates compared with other OECD regions. Compared with all OECD TL3 regions, Portuguese regions are small in terms of GDP size and 77% of them grew slower than OECD average (2.15% per year between 1999 and 2004) (Figure 1.17 and Figure 1.18). This performance is mostly linked with national factors. Among the only three Portuguese regions that surpass the OECD regional average in GDP size (Grande Lisboa, Grande Porto and Península de Setúbal), even the fastest growing region Lisbon remained below OECD average regional growth

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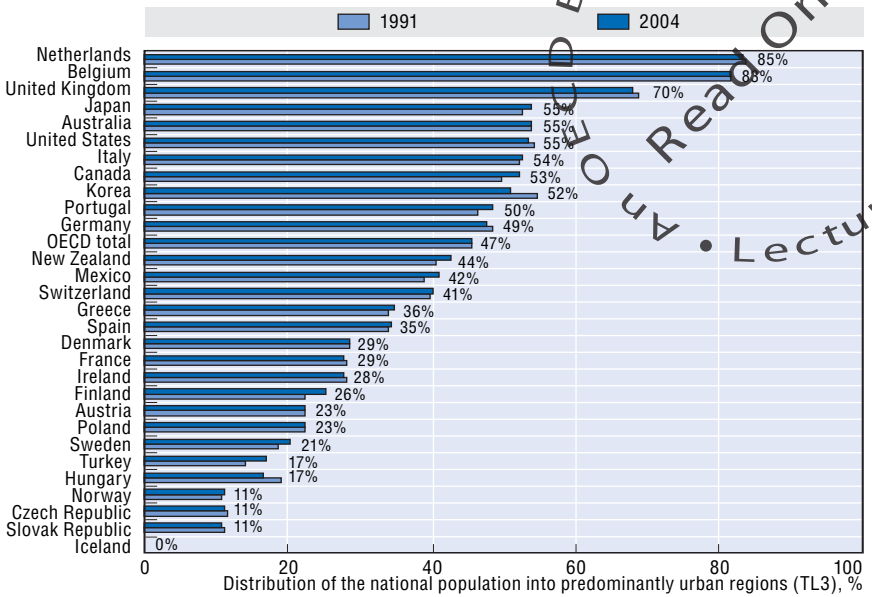
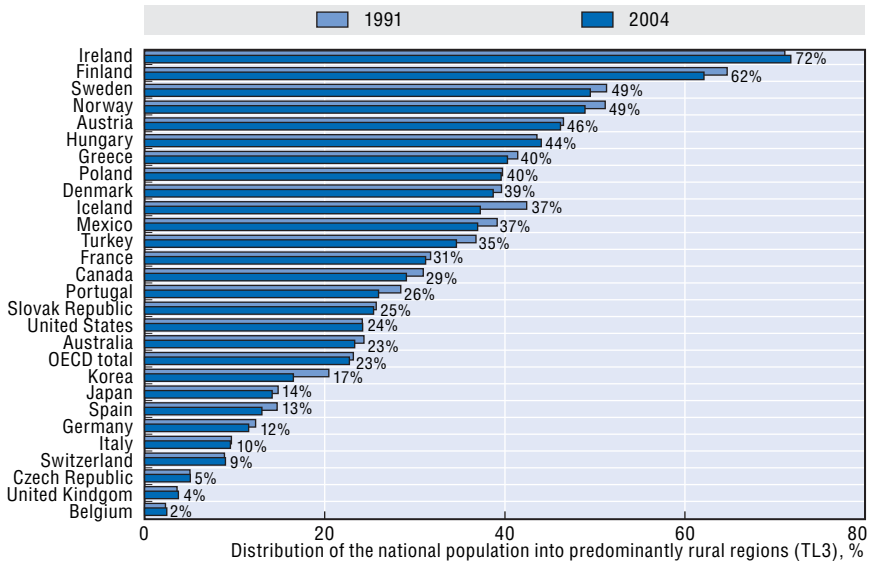
Figure 1.9. **Distribution of the national population into predominantly urban regions in OECD countries**



Source: OECD Regional Database.

Figure 1.10. **Distribution of the national population into predominantly rural regions in OECD countries**



Source: OECD Regional Database.

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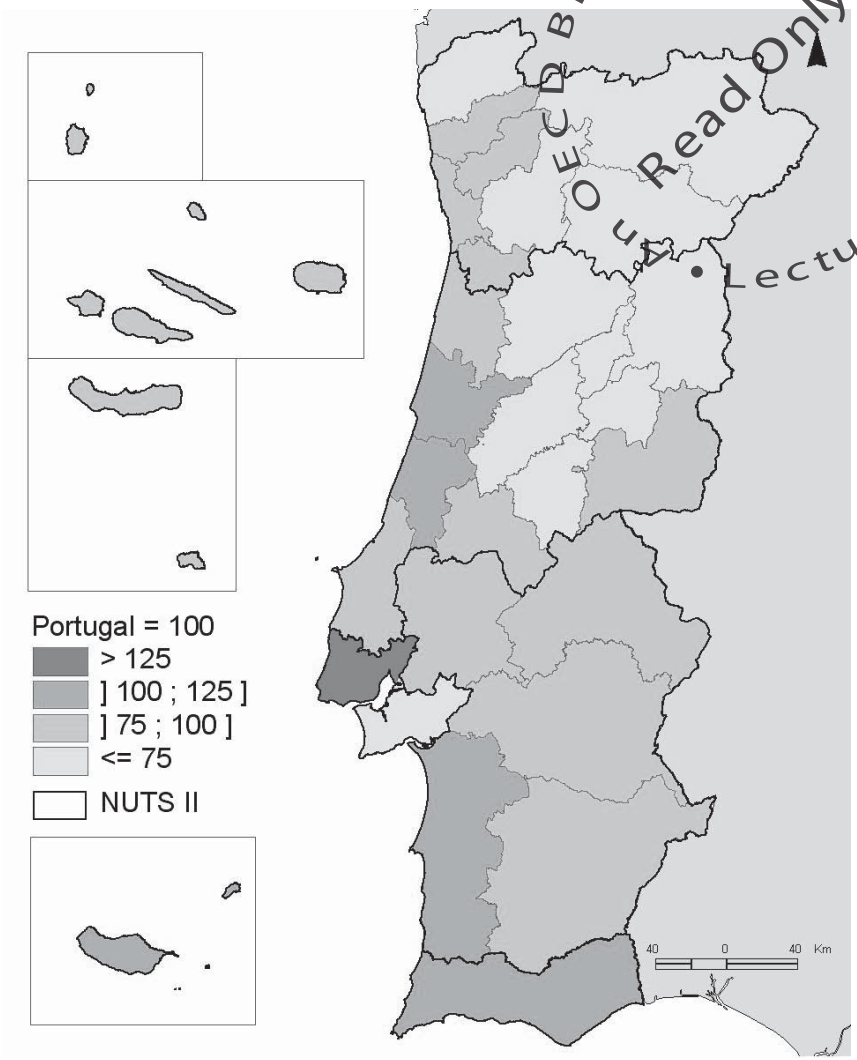
Figure 1.11. **GDP per capita by TL3, 2004**



Source: INE, Retrato Territorial de Portugal 2004, ed. 2005, p. 119.

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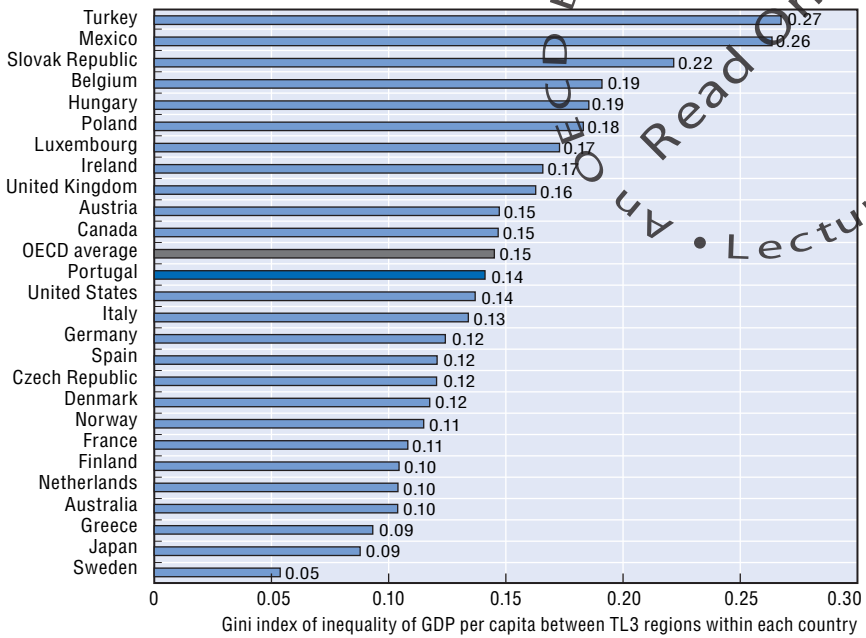
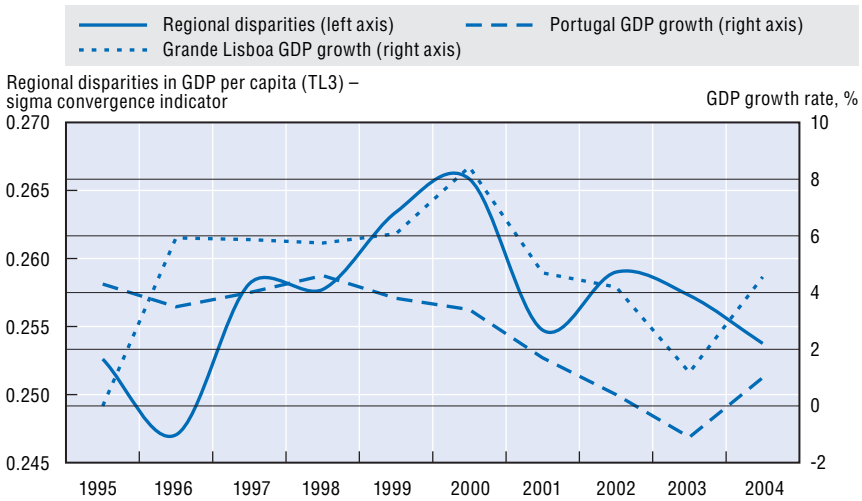
Figure 1.12. **Gini index of inequality of GDP per capita across TL3 regions in OECD countries, 2003**



Source: *OECD Factbook 2007*.

Figure 1.13. **Regional disparities in GDP per capita, national growth rate and Lisbon growth rate, 1995-2004**



Source: Calculations based on OECD Regional Database and *OECD Factbook 2007*.

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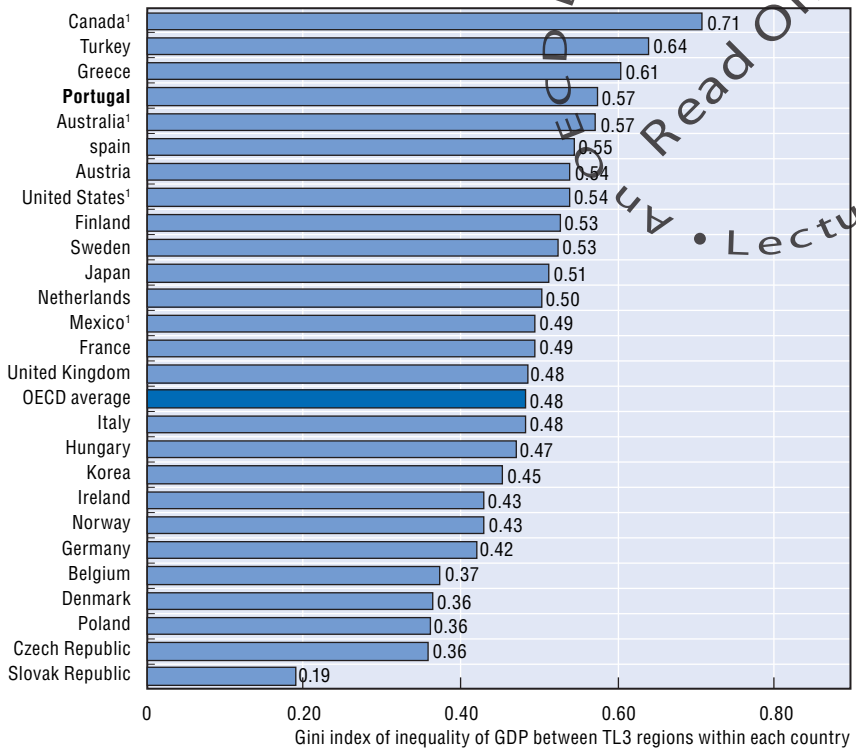
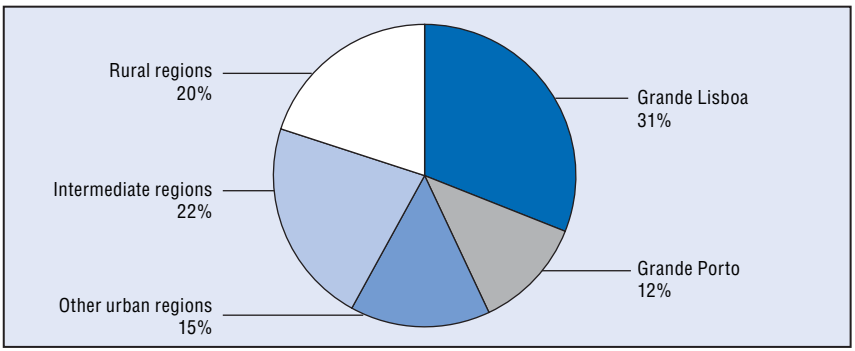
Figure 1.14. **Gini index of inequality of GDP across TL3 regions in OECD countries, 2004**



1. TL2 regions.

Source: OECD Regional Database.

Figure 1.15. **Breakdown of national GDP by type of region, 2004**



Note: Calculated on the basis of market prices. Data for 2004 are preliminary (base 2000).

Source: INE Regional Accounts.

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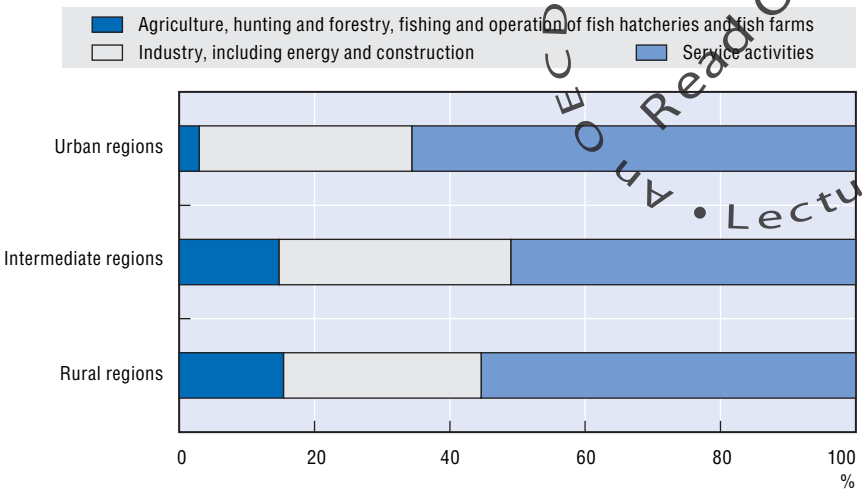
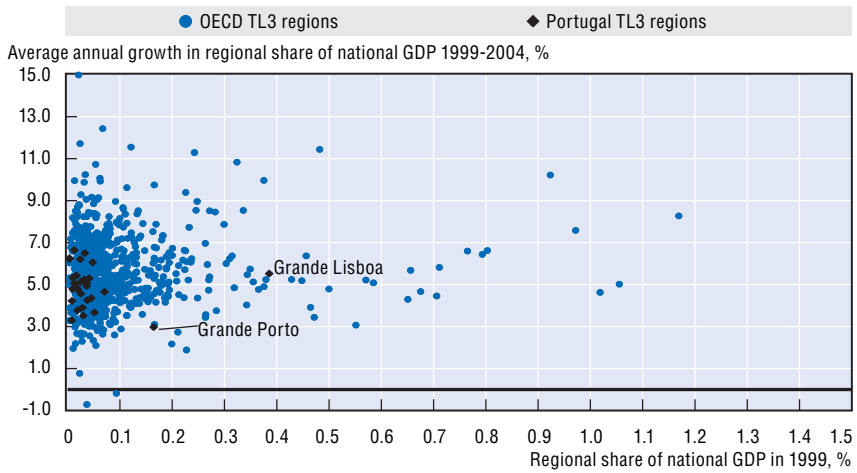
Figure 1.16. **Share of employment in agriculture, industry and services by type of region in Portugal, 2004**

Unit: %



Note: Data for 2004 are preliminary (base 2000).
Source: INE Regional Accounts.

Figure 1.17. **Growth of regional share of national GDP in Portugal and OECD countries**



Source: OECD Regional Database.

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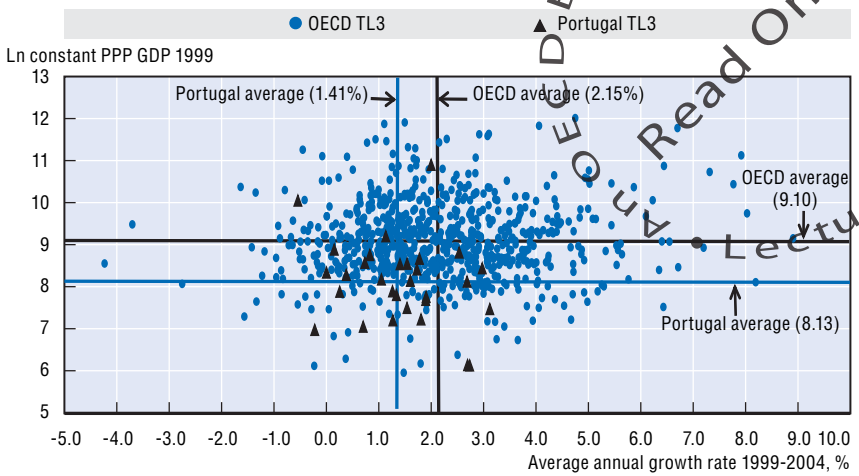
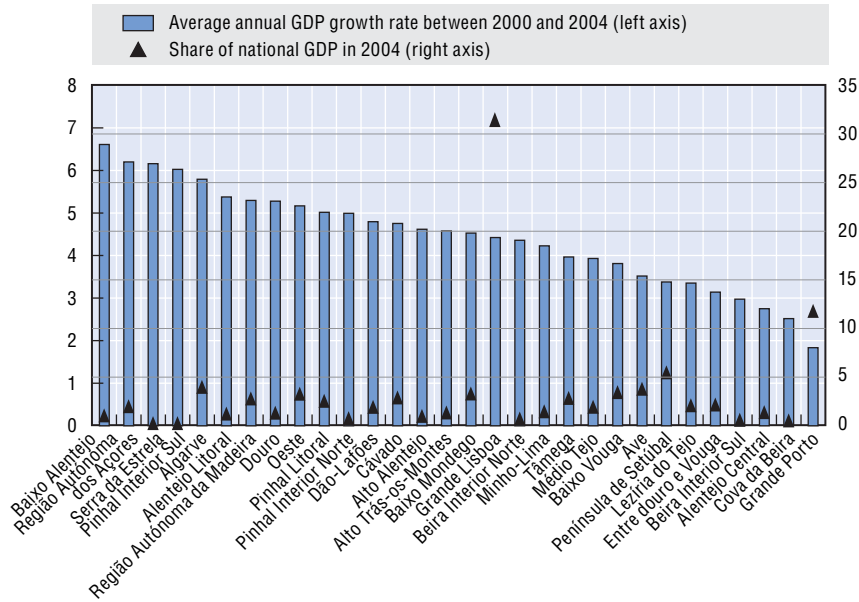
Figure 1.18. **GDP growth in TL3 regions in Portugal and OECD countries, 1999-2004**



Source: Calculations based on OECD Regional Database.

Figure 1.19. **GDP growth by TL3 region**

Unit: %



Note: Calculated on the basis of market prices. Data for 2004 are preliminary (base 2000).
Source: INE Regional Accounts.

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with 2.0% per year, followed by Península de Setúbal (2.13%) and Grande Porto (which actually declined by 0.54%). Among the remaining 27 Portuguese regions, only 6 regions (Algarve, Região Autónoma dos Açores, Serra de Estrela, Pinhal Interior Sul, Região Autónoma da Madeira and Baixo Alentejo) grew faster than OECD average.

In Portuguese regions as in other OECD regions, productivity accounts for the largest part of the difference in GDP growth rates between the regions and national average. According to the OECD methodology (see Annex 1.A1 for detailed explanation), differences in GDP growth between the regions of a given country and national average can be decomposed into five factors: differences in productivity, differences in employment rates, differences in participation rates, differences in age activity rates, and differences in population growth. In the 50 fastest growing regions in the OECD, the factor accounting for the largest part of the difference between regional and national GDP growth rates was productivity, and to a lesser extent, participation rate and age activity rate. In the 50 slowest growing regions in the OECD, the main factor was the decrease in productivity (Figure 1.20). When this methodology was applied to Portuguese TL3 regions (Figure 1.21), and especially to two fast growing regions and two slow growing regions of similar size (Figure 1.22), productivity stood out as the main factor of GDP growth difference. Low productivity and specialisation in low productivity sectors may be due to a combination of factors, closely linked to a region's competitive assets (both reproducible and irreproducible). The following section discusses the variety of assets for growth in Portuguese regions.

1.2.2. Regional assets for growth

Regional disparities are closely linked with regional assets for growth. Compared with other OECD countries, Portugal exhibits an average level of regional disparities in GDP per capita, an average level of employment growth, but the third highest level of regional disparities in terms of unemployment rate (Figure 1.23 and Figure 1.24). High employment growth was therefore uneven across Portuguese regions, suggesting that employment opportunities – rather than just income levels – vary across regions. Employment opportunities are in turn largely determined by the existence of assets for growth. In Portugal as in many OECD countries, assets for growth are territorially concentrated and their nature differs across regions (*e.g.*, knowledge and innovation capacity, attractiveness). The following section underlines that: i) only a limited number of Portuguese regions have exploited their assets, and such regions could contribute even better to national growth if their weaknesses were properly addressed; ii) many other regions suffer from specific handicaps and have been unable to contribute fully to national growth despite their distinctive potential.

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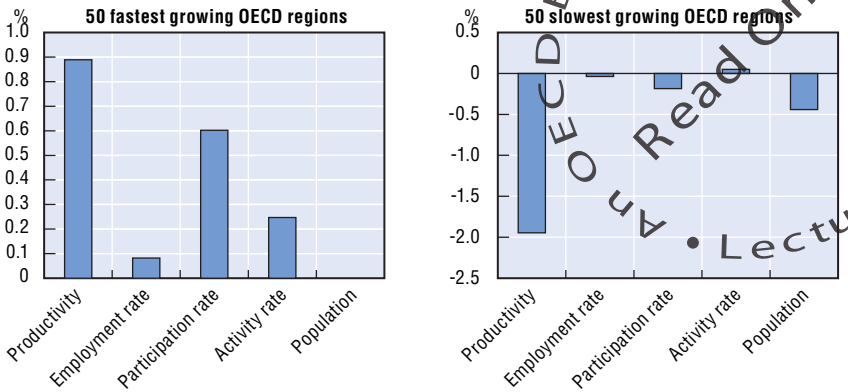
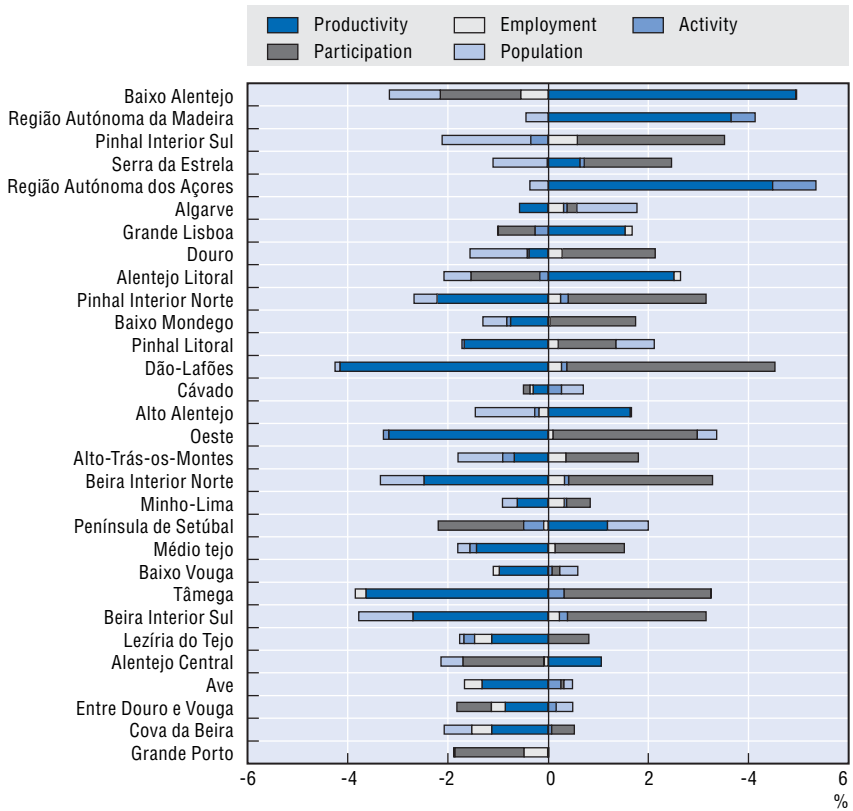
Figure 1.20. **Decomposition of GDP growth differences in the 50 fastest and 50 slowest growing OECD TL3 regions, 1999-2004**



Source: Calculations based on OECD Regional Database.

Figure 1.21. **Decomposition of GDP growth differences between Portuguese TL3 regions and national average, 1999-2004**



Source: Calculations based on OECD Regional Database.

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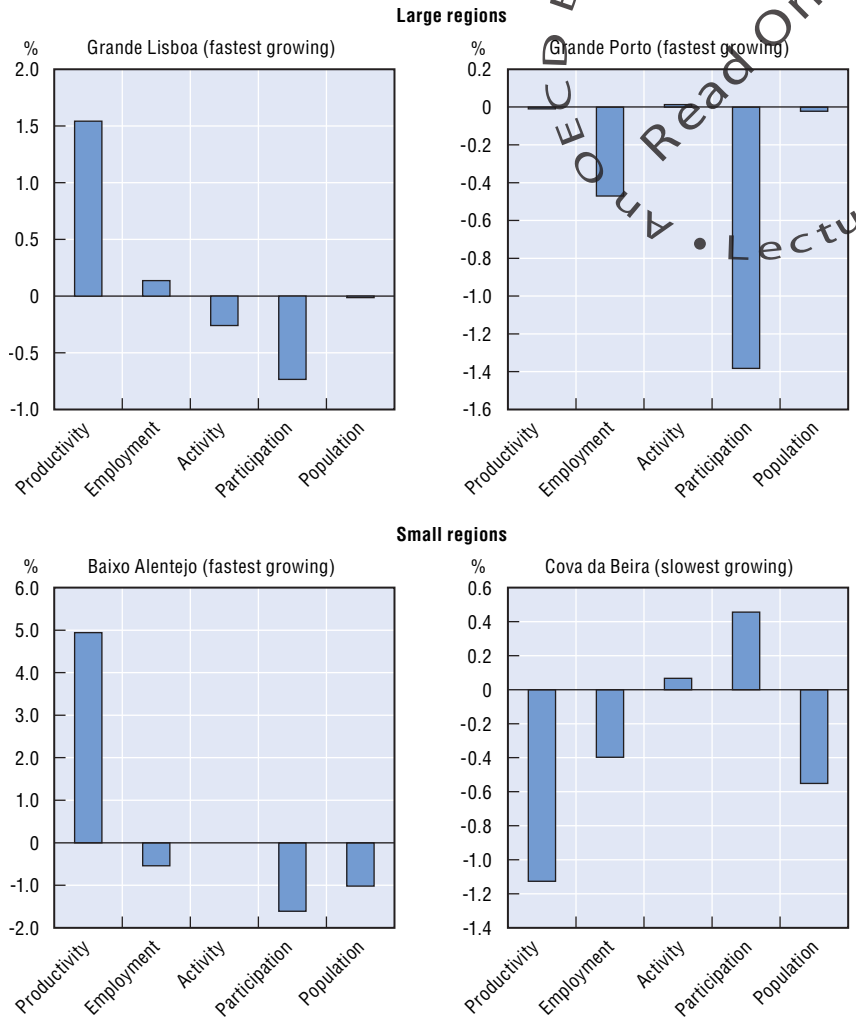
Figure 1.22. **Decomposition of GDP growth differences in Portuguese TL3 regions of similar size, 1999-2004**



Source: calculations based on OECD Regional Database.

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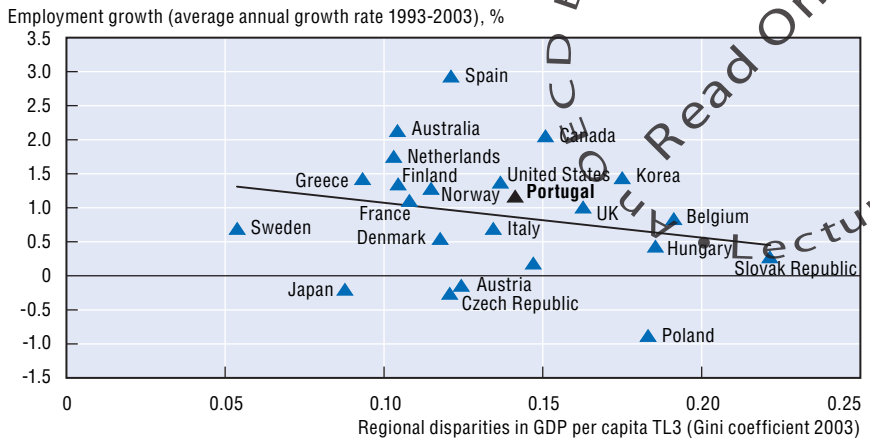
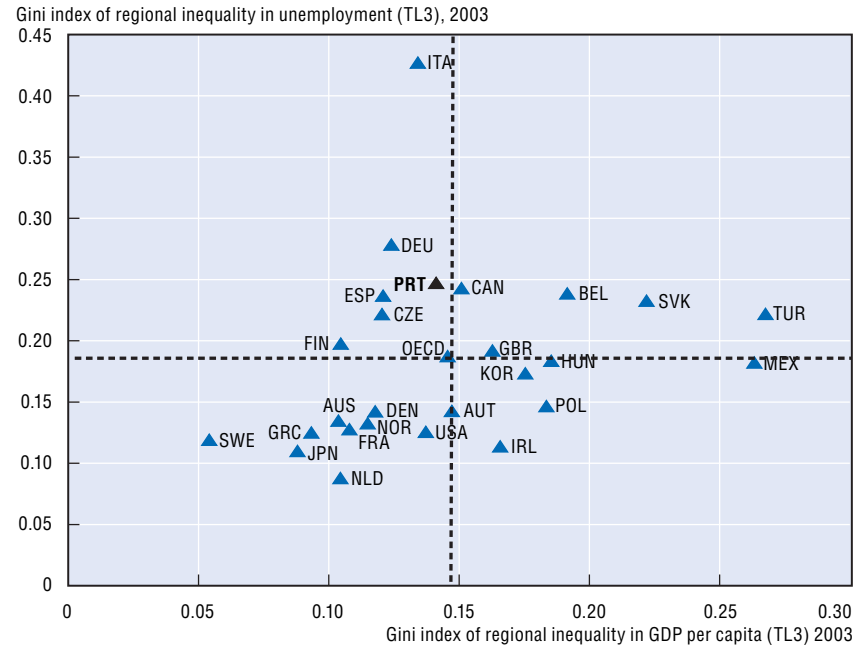
Figure 1.23. **Regional disparities in GDP per capita and national employment growth in OECD countries, 1999-2003**



1. Turkey, Mexico and Ireland were taken out of the sample as they were outliers (income too low in the first two and growth too high in the latter). No data available to include Switzerland, New Zealand and Iceland.

Source: Calculations based on OECD Regional Database.

Figure 1.24. **Regional disparities of GDP per capita and unemployment rate in OECD countries, 2003**



Source: Processed with data from *OECD Factbook 2007* and *OECD Regions at a Glance 2007*.

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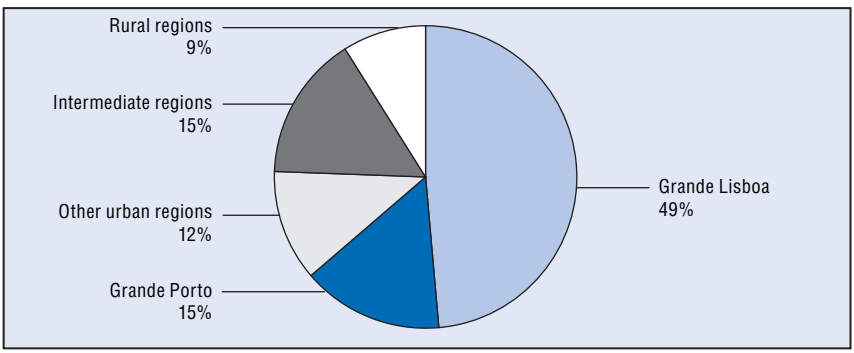
Strengths in leading regions

***a)* An excellence pole in the capital.** As in many OECD countries, the capital region leads national growth in Portugal. Lisbon (Grande Lisboa) concentrates almost a third of national GDP and was the only urban region[6] that maintained a relatively high growth rate during the 2000-2004 period (see previous Figure 1.19). It hosts the vast majority of political decision-making bodies, headquarters of the largest corporate groups, and high value-added activities (*e.g.*, real estate, financial activities, business services). Lisbon accounts for half of national R&D expenditure, which is highly concentrated in public research laboratories (Figure 1.25). The city exploited its rich historical and architectural heritage to expand quality tourism, while industrial activities thrived in the adjacent Península de Setúbal (*e.g.*, steel and chemical industries, ship repairing and engineering). Lisbon is the only mainland Portuguese region that after being eligible for EU Structural Funds for two decades, performed well enough to be upgraded into a Competitiveness and Employment region in the 2007-2013 period (Figure 1.26). At the international level, Lisbon is the only Portuguese region that figures among the 78 largest OECD metropolitan regions,[7] although it ranks among the poorest and has scope to build up its international stance (Figure 1.27).

***b)* A large polycentric industrial region.** While the capital pioneers in high-end activities, Portugal retains a number of key manufacturing industries. An export-oriented industrial reservoir expanded on the north coast around the greater metropolitan area of Porto.[8] The web of small and medium-sized cities absorbed abundant inflows of low-skilled labour, and SMEs have continued to specialise in traditional sectors (*e.g.*, textile and clothing, footwear, automobile parts, plastic moulds, leather, cork, furniture, mechanic construction and light engineering).

Figure 1.25. **Breakdown of national R&D expenditure, 2002**



Source: Ministry for Science, Technology and Higher Education – Observatory for Science and Higher Education.

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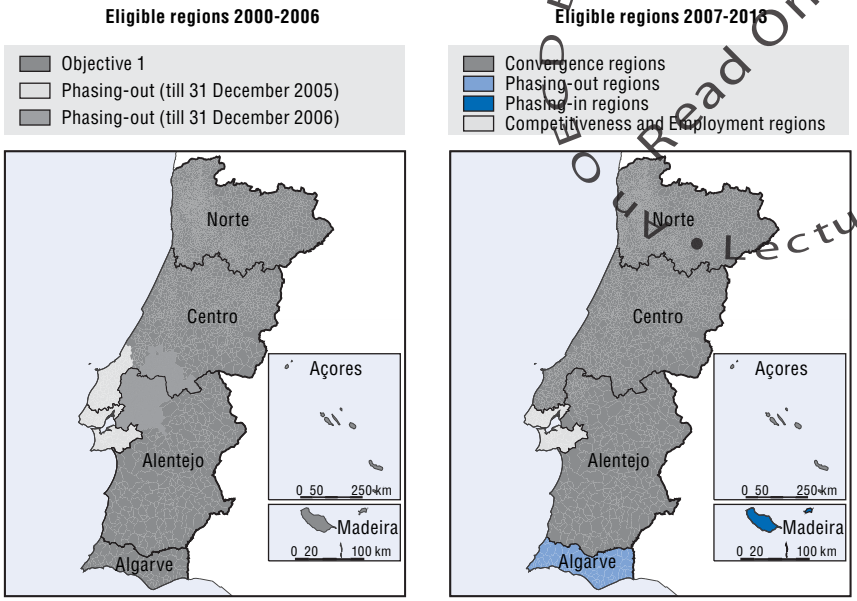
Figure 1.26. **Portuguese regions eligible for the EU Cohesion Policy, 2000-2006 and 2007-2013**



Source: EU Info Regio, Factsheet October 2006.

The nucleus of Porto offers business services, while two major commercial ports – Leixões and Viana do Castelo – supply export-import logistics. This vast industrial region enjoys high-speed railway connection to the capital Lisbon along a coastal strip of innovative cities (*e.g.*, Aveiro, Coimbra, Leiria). It is also endowed with a promising international airport (Sá Carneiro) and good highway connections.

The region's relatively low productivity and rising unemployment (Figure 1.28) raised concerns about future growth prospects. Grande Porto attracted relatively more population than Grande Lisboa in recent years and concentrates about 12% of national GDP, but it registered the lowest growth rate in Portugal over the 2000-2004 period (see previous Figure 1.19). Although the region has ridden on historical assets in terms of entrepreneurial spirit, industrial knowledge, and export functions, the surge of emerging countries is expected to further erode the cost competitiveness of manufacturing activities. Innovation capacity will therefore determine the region's resilience.

c) A dynamic tourism platform. Tourism activities prospered not only in Lisbon but also remarkably in the southern region of Algarve – one of the largest contributors to the national economy (4% of national GDP) and one of the fastest growing regions in Portugal during the 2000-2004 period. Both domestic and international markets bolstered the expansion of beach tourism and the recent

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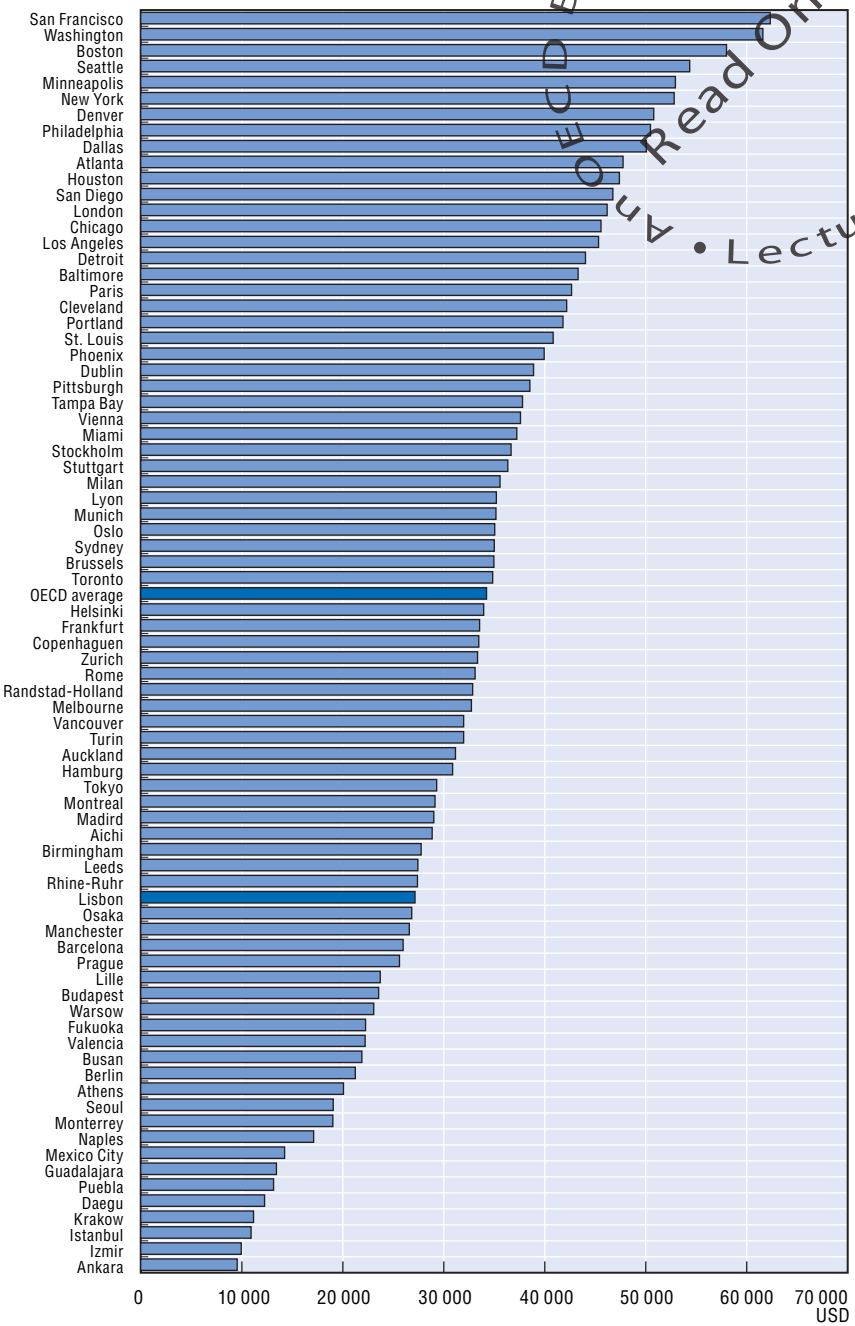
Figure 1.27. **Ranking of 78 OECD metropolitan regions by GDP per capita (PPP), 2002**



Source: OECD (2006), *Competitive Cities in the Global Economy*, Figure 1.9, p. 47.

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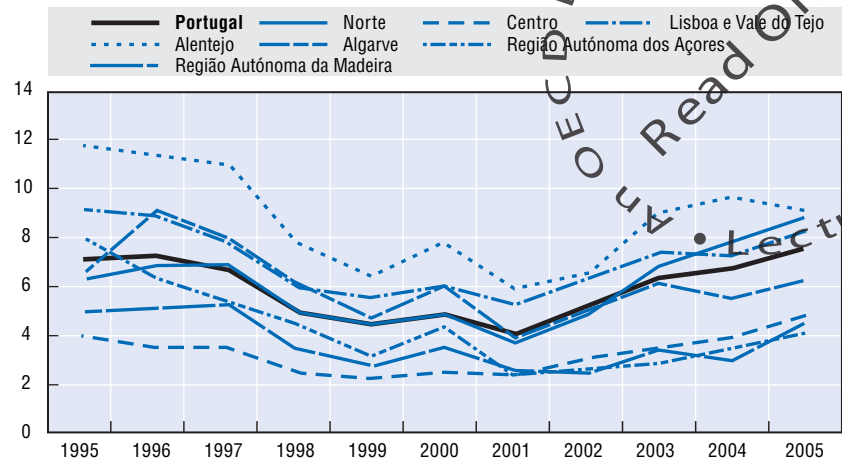
Figure 1.28. **Unemployment rates by TL2 region**

Unit: %



Note: There was a break in Labour Force Survey data in 1998.

Source: INE Labour Force Survey.

development of leisure and sport activities (such as golf). Tourism has rapidly overtaken other sectors in the region, including traditional agriculture and the processing industry (a minor part remains active in foodstuffs, beverages, tobacco products, non-metal minerals). The continued proliferation of tourism resorts and facilities provided generous employment opportunities, as construction-related jobs more than doubled between 1995 and 2003. However, the impending saturation of this growth pattern has infused uncertainty over sustainable development prospects and questioned the region's margin to devise alternative or complementary activities.

Abundant tourism amenities also account for the bulk of the regional economy in the two autonomous regions of Madeira and Azores. Such amenities constitute valuable assets for national growth; in particular, Madeira has become a national excellence pole in terms of tourism. At the same time, these regions – especially Azores – feature typical weaknesses calling for specific attention (*e.g.*, ultra-peripheral remoteness, lack of agglomeration effects to develop new activities). The pace of recent growth in the Azores suggests that tourism can partially compensate for the region's ultra-peripheral status.

Challenges in lagging regions

In contrast with urban coastal regions, most regions located in the interior of the country have struggled at length against rural exodus, population ageing, and shortage of dynamic economic activities. The lack of critical mass has often hampered public service delivery and contributed to marginalisation

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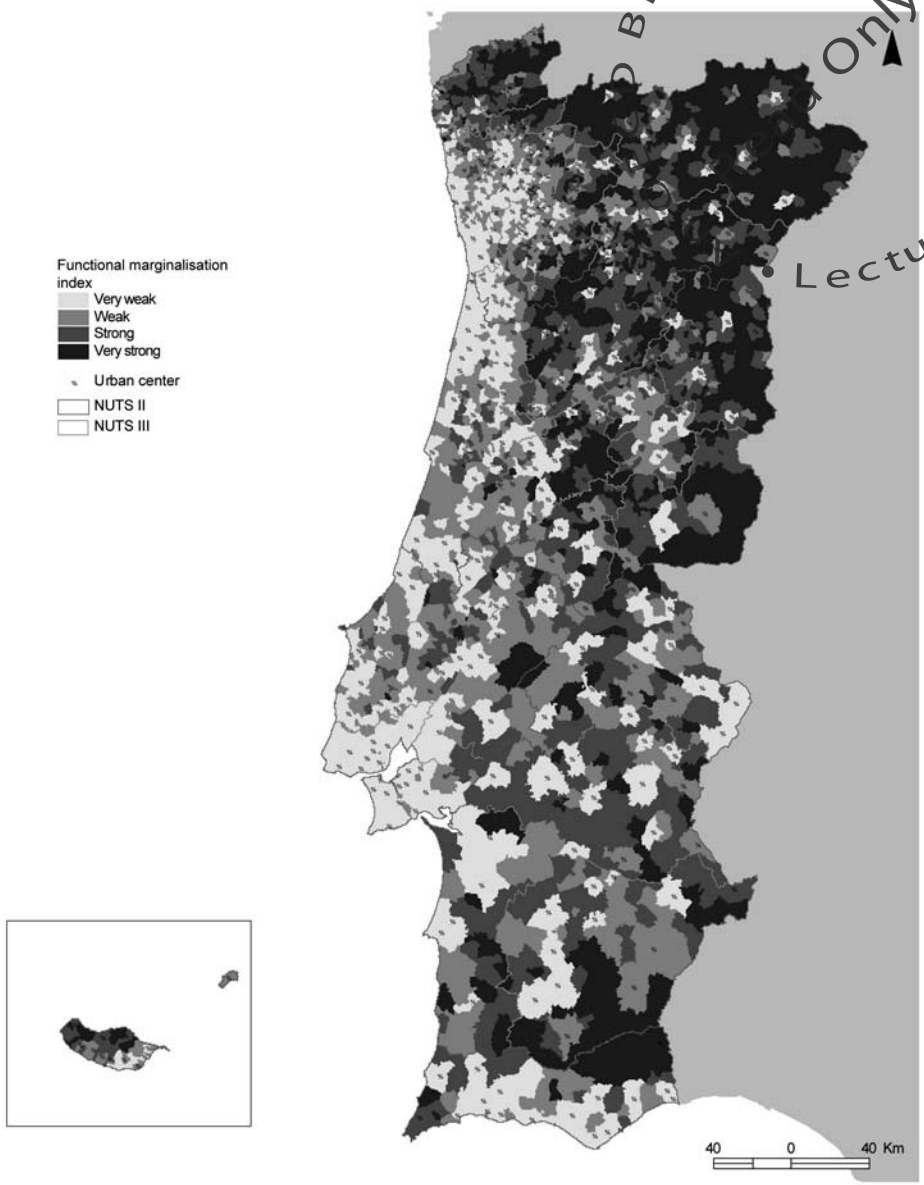
Figure 1.29. **Functional marginalisation index, 2002**



Note: The functional marginalisation index takes into account the distance required to have access to a total of 117 goods and services, and the degree of specialisation of the goods and services. The classification used in the map (ranging from very weak to very strong marginalisation) is based on quartiles of *freguesias*. More detailed information is available in INE (2004) *Sistema urbano: áreas de influência e marginalidade funcional*.

Source: INE, *Sistema urbano: áreas de influência e marginalidade functional*, ed. 2004.

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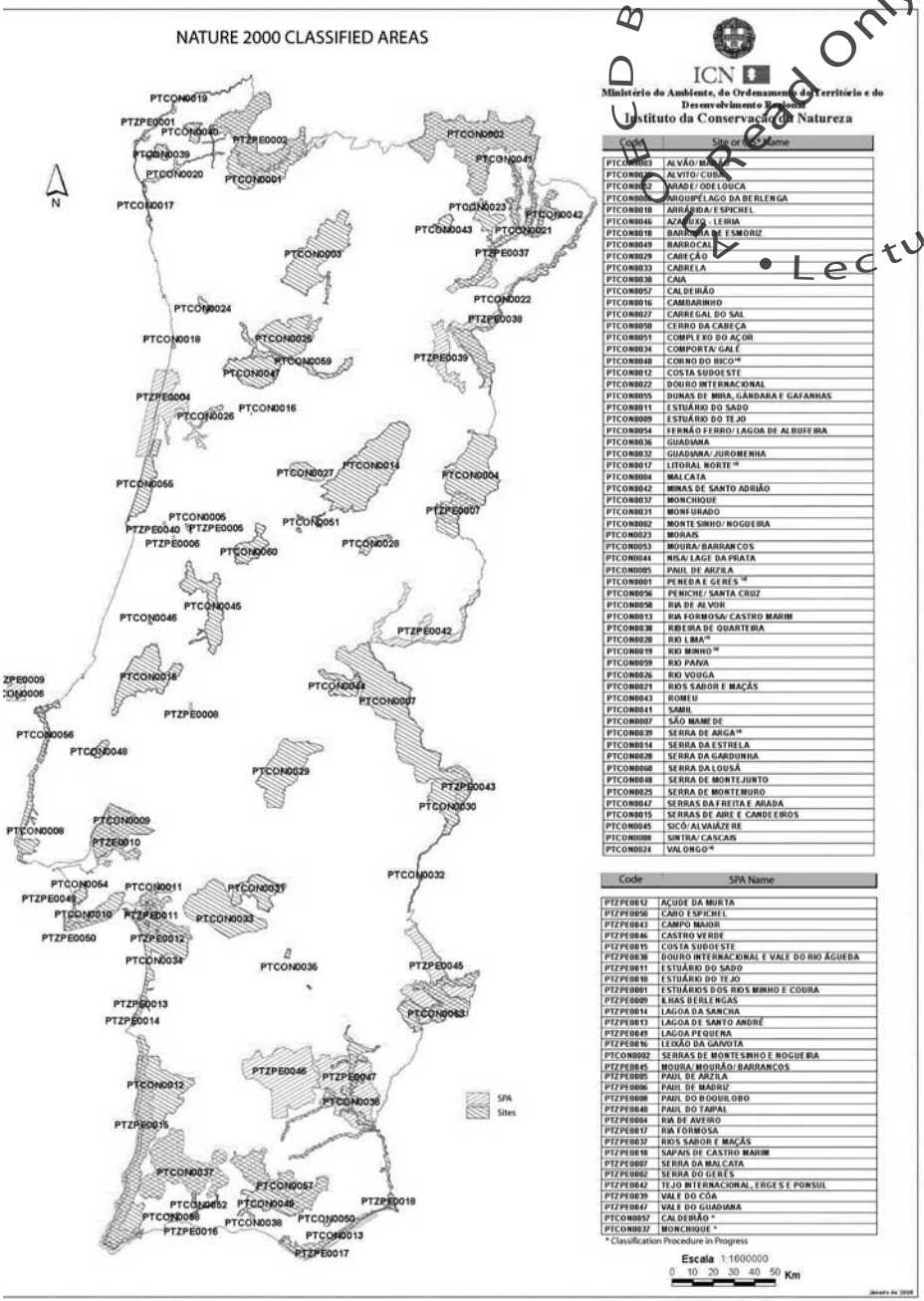
Figure 1.30. **Map of the EU Natura 2000 network in Portugal**



Source: Plano Sectorial da Rede Natura 2000 (*www.icn.pt/psrn2000/conteudo_plano.htm*).

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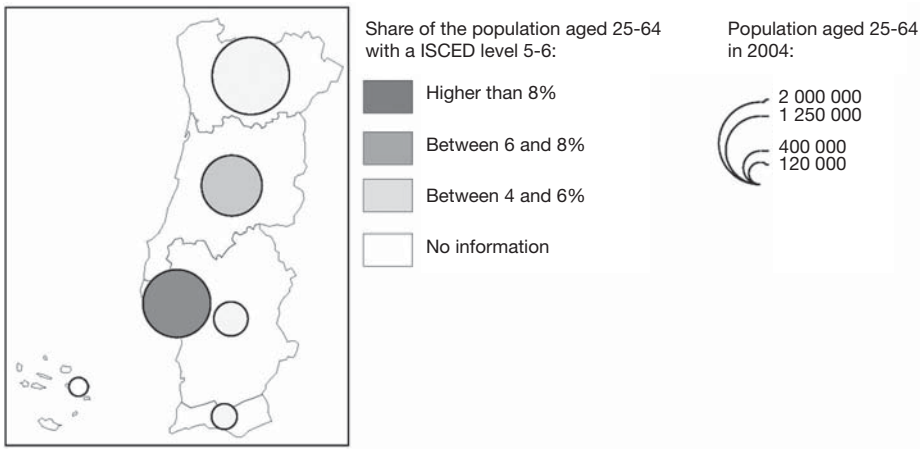
(Figure 1.29). It is acknowledged that agriculture, once a vital provider of jobs and income, is facing challenges. Rural areas that fall under the 20% of Portugal's territory protected by the EU Natura 2000 network face additional constraints related to land use; at the same time, severe environmental requirements also imply that these areas store up potential for sustainable development in the long term (Figure 1.30). Diversification of rural economies based on under-developed endogenous resources (*e.g.*, natural and cultural amenities) has become a priority, especially with regard to low levels of density that are expected to stabilise or deteriorate over the next 20-30 years.

Key factors to diversify and regenerate rural economies remain in short supply. A possible explanation could be that most of these regions are entrenched in a low value-added sectoral specialisation because their workforce is low skilled, but also because their workforce has little incentive to upgrade their educational attainments[9] (Figure 1.31, Table 1.3, and Table 1.4). Higher skilled workers have more chances to be unemployed in these regions (*e.g.*, workers with a first stage of tertiary education encounter unemployment rates of 8.0% in Norte, 8.7% in Centro, and 7.4% in Alentejo, *versus* national average of 6.6% in 2005). The odds for unemployment attached to higher education even increased between 1998 and 2005 (*e.g.*, the unemployment rate for the highest level of skills increased three times more than national average in Norte: +3.9 percentage points *versus* +1.3 percentage points). Therefore, action to break the vicious circle of decline will need to link rural diversification and human capital factors into a comprehensive strategy.

Figure 1.31. **Share of the population aged 25-64 with higher education by TL2 region, 2004**



Source: OECD Regional Database.

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Table 1.3. **Educational attainments by TL2 region, 1998 and 2006**

% of labour force over 15 years

	1998	2006		1998	2006
PORTUGAL			**Alentejo**		
Low	83.44	75.96	Low	87.91	81.08
Medium	10.39	13.97	Medium	7.17	12.32
High	6.17	10.07	High	4.92	6.59
Norte			**Algarve**		
Low	86.60	79.69	Low	85.45	75.61
Medium	8.64	12.09	Medium	9.69	15.66
High	4.76	8.23	High	4.95	8.73
Centro			**Açores**		
Low	84.58	78.52	Low	89.14	83.06
Medium	9.82	12.81	Medium	7.56	10.82
High	5.59	8.66	High	3.30	6.12
Lisboa e Vale do Tejo			**Madeira**		
Low	78.07	69.42	Low	88.34	80.35
Medium	13.29	16.82	Medium	9.05	12.19
High	8.64	13.76	High	2.61	7.46

Note: Low = from pre-primary to lower secondary education. Medium = from upper secondary to post-secondary non-tertiary education. High = tertiary education.
Source: INE Labour Force Survey.

Table 1.4. **Unemployment rate by educational attainment and by TL2 region**

Unemployment rate in 2005 (%)

	No education	Primary education	Lower secondary education	Upper secondary education	Post-secondary non-tertiary education	First stage of tertiary education	Second stage of tertiary education
TOTAL PORTUGAL	**4.6**	**7.6**	**9.1**	**7.9**	**11.4**	**6.6**	**1.5**
Norte	5.7	8.5	11.3	9.7	7.3	8.0	3.9
Centro	1.0	3.8	7.4	5.7	13.5	8.7	0.0
Lisboa e Vale do Tejo	6.7	9.7	8.8	8.1	14.5	5.3	0.5
Alentejo	11.7	9.5	10.0	6.7	11.3	7.4	4.4
Algarve	4.3	6.7	6.6	5.8	1.3	5.6	0.0
Açores	2.4	4.3	5.5	3.2	3.0	2.9	0.0
Madeira	4.7	4.4	4.0	6.5	4.9	3.9	0.0

Growth of unemployment rate between 1998 and 2005 (percentage points)

	No education	Primary education	Lower secondary education	Upper secondary education	First stage of tertiary education	Second stage of tertiary education
TOTAL PORTUGAL	**2.0**	**2.7**	**3.0**	**1.0**	**3.0**	**1.3**
Norte	3.5	3.9	4.8	1.2	3.6	3.9
Centro	0.5	1.4	4.1	0.3	6.4	0.0
Lisboa e Vale do Tejo	1.8	3.4	2.4	1.5	1.5	0.5
Alentejo	2.6	1.5	2.0	–2.3	4.3	–0.3
Algarve	0.2	0.2	–1.3	1.0	3.0	0.0
Açores	0.5	0.0	–1.9	–1.9	1.3	0.0
Madeira	3.1	0.7	0.1	1.0	2.3	0.0

Note: No data available for post-secondary non-tertiary education level in 1998.
Source: INE Labour Force Survey.

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1.3. Conclusion

Portugal has a large scope to derive full advantage from EU membership and serve as Europe's gateway to Latin America and to Africa. The current economic recovery and political stability have opened a rare opportunity to build sustainable growth capacity and address chronic weaknesses (*e.g.*, education). Levers of growth and impediments are both anchored in and different across regions. Nation-wide ambitions to modernise the economy must therefore consider and exploit regional characteristics in order to bear fruit. Regional policy offers a tool to conjugate structural reforms in territories.

The implementation of a competitiveness agenda with limited public funds in Portugal calls for two types of considerations. First, competitive assets such as knowledge and attractiveness must be tapped where they are located in order to trigger spillover effects in a national positive-sum game. Second, regions suffering from individual handicaps and not yet able to play their part in national growth need targeted support to access basic public services, with a view to buttress further efforts to capture differentiated regional competitive advantages. The following chapter will explore to what extent regional policy can help translate a broad competitiveness roadmap into an effective network of growth in Portugal.

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ANNEX 1.A1

Methodology for decomposition of GDP growth differences

The share of region *i* in the total GDP of the OECD can be written as:

$$\frac{GDP_i}{GDP_{OECD}} = \frac{GDP_i}{GDP_j} * \frac{GDP_j}{GDP_{OECD}} \quad (1)$$

where *j* denotes the country of region *i*. The GDP share of region *i* in country *j* is then equal to:

$$\frac{GDP_i}{GDP_j} = \frac{GDP_i / E_i}{GDP_j / E_j} * \frac{E_i / LF_i}{E_j / LF_j} * \frac{LF_i / WA_i}{LF_j / WA_j} * \frac{WA_i / P_i}{WA_j / P_j} * \frac{P_i}{P_j} \quad (2)$$

where P, *E*, *LF* and WA stand, respectively, for population, employment, labour force and working age (15-64) population. Therefore, the GDP share of region *i* in country *j* is a function of its GDP per worker (GDPi/Ei), employment rate (Ei/LFi), participation rate (LFi/WAi), age-activity rate (WAi/Pi) and population (Pi), relative to, respectively, the GDP per worker (GDPj/Ej), employment rate (Ej/LFj), participation rate (LFj/WAj), age-activity rate (WAj/Pj) and population (Pj) of its country.

By substituting equation (2) into equation (1), taking the logarithm and differentiating it, one obtains:

$$(g_i - g_j) = (g_{p,i} - g_{p,j}) + (g_{e,i} - g_{e,j}) + (g_{lf,i} - g_{lf,j}) + (g_{wa,i} - g_{wa,j}) + (g_{p,i} - g_{p,j}) \quad (3)$$

or, equivalently:

Difference in GDP growth between region *i* and the country *j*	=	Growth difference in GDP per worker between region *i* and country *j*	+	Growth difference in the employment rate between region *i* and country *j*	+	Growth difference in the participation rate between region *i* and country *j*	+	Growth difference in the age-activity rate between region *i* and country *j*	+	Growth difference in population between region *i* and country *j*

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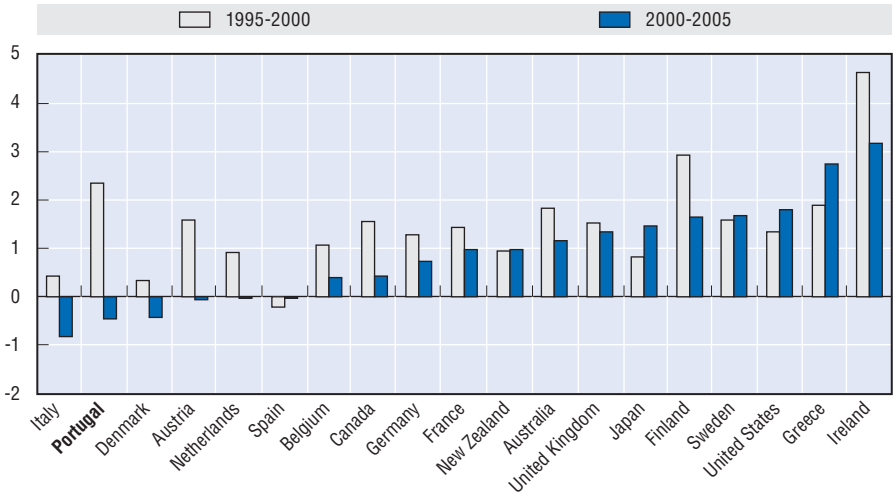
ANNEX 1.A2

National background figures

Figure 1.A2.1. **Average annual growth of multi-factor productivity in OECD countries, 1995-2000 and 2000-2005**

Unit: %



Source: OECD Factbook 2007.

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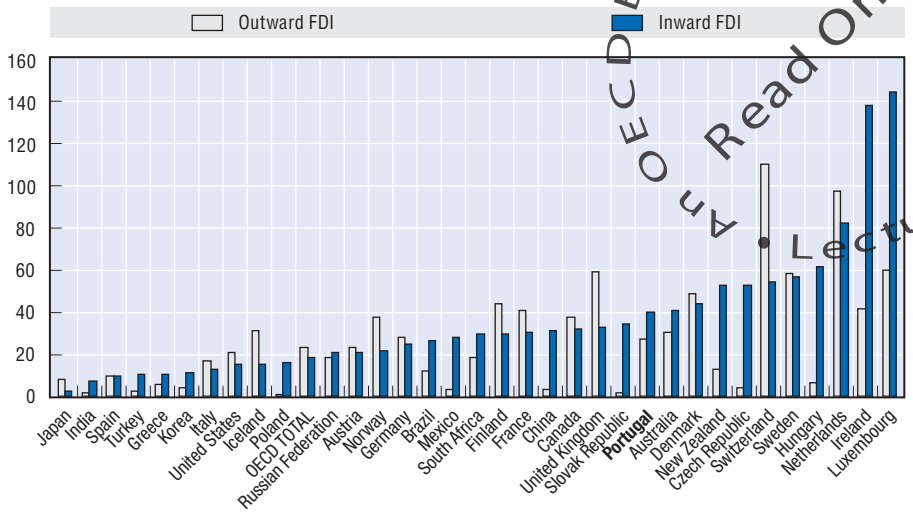
Figure 1.A2.2. **FDI stocks in OECD countries, 2004 or latest year available**

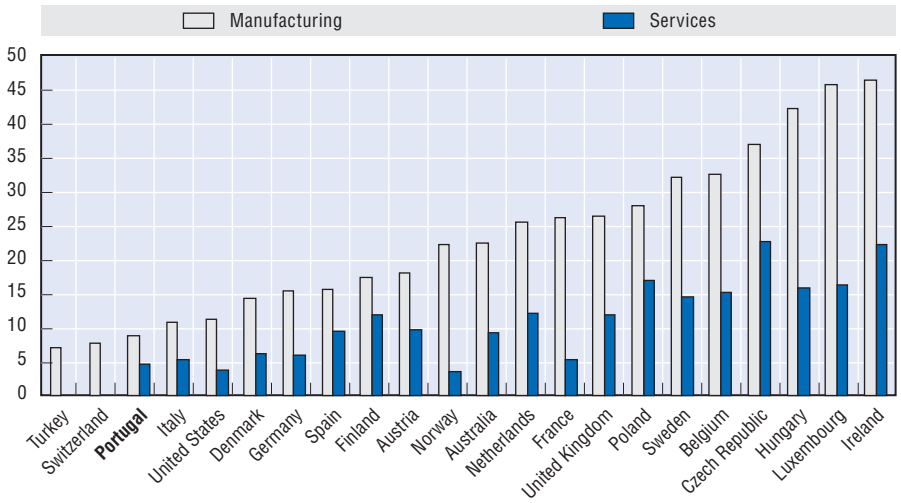
Unit: % of GDP



Source: OECD Factbook 2007.

Figure 1.A2.3. **Employment in manufacturing and services in affiliates under foreign control, 2004 or latest year available**

Unit: % of total employment



Source: OECD Factbook 2007.

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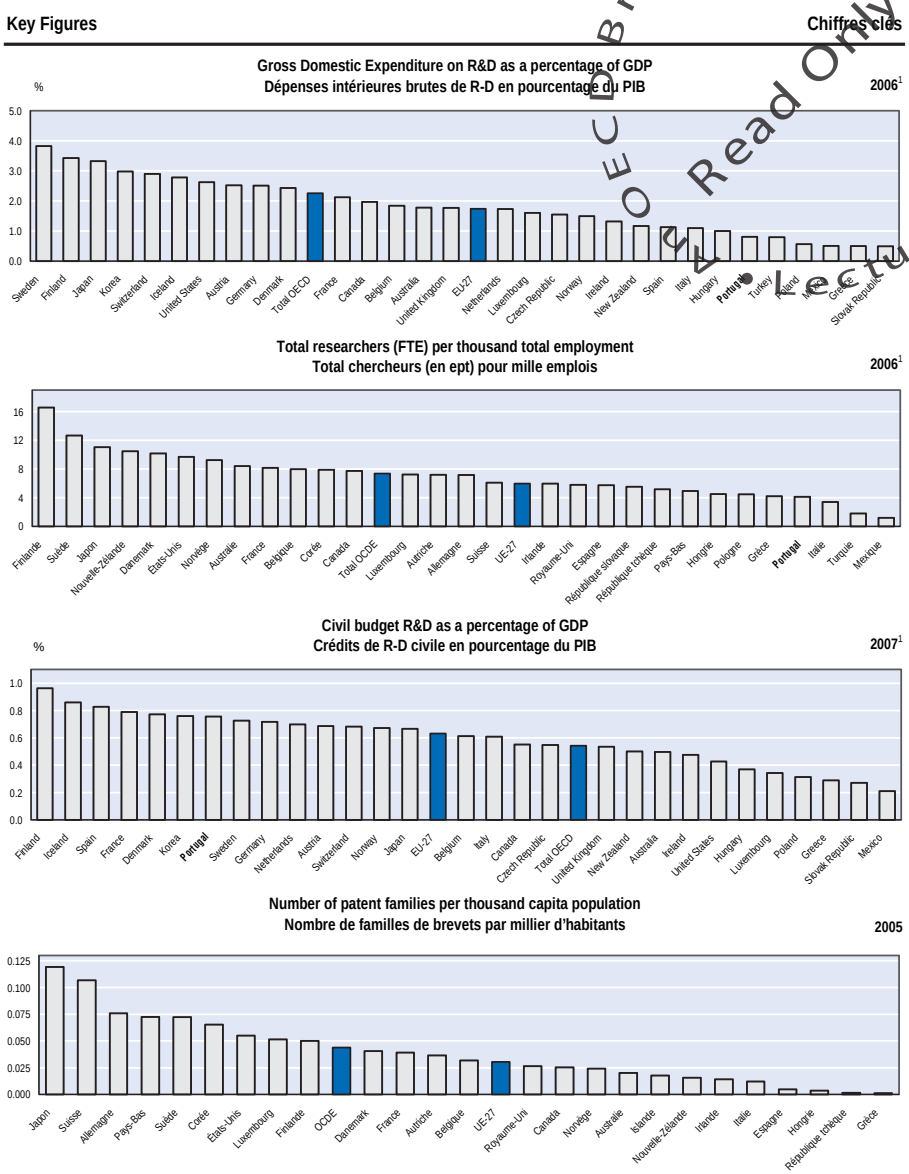
Figure 1.A2.4. **Indicators on R&D**



1. Or latest year.

Source: *OECD Main Science and Technology Indicators 2007*, p. 15.

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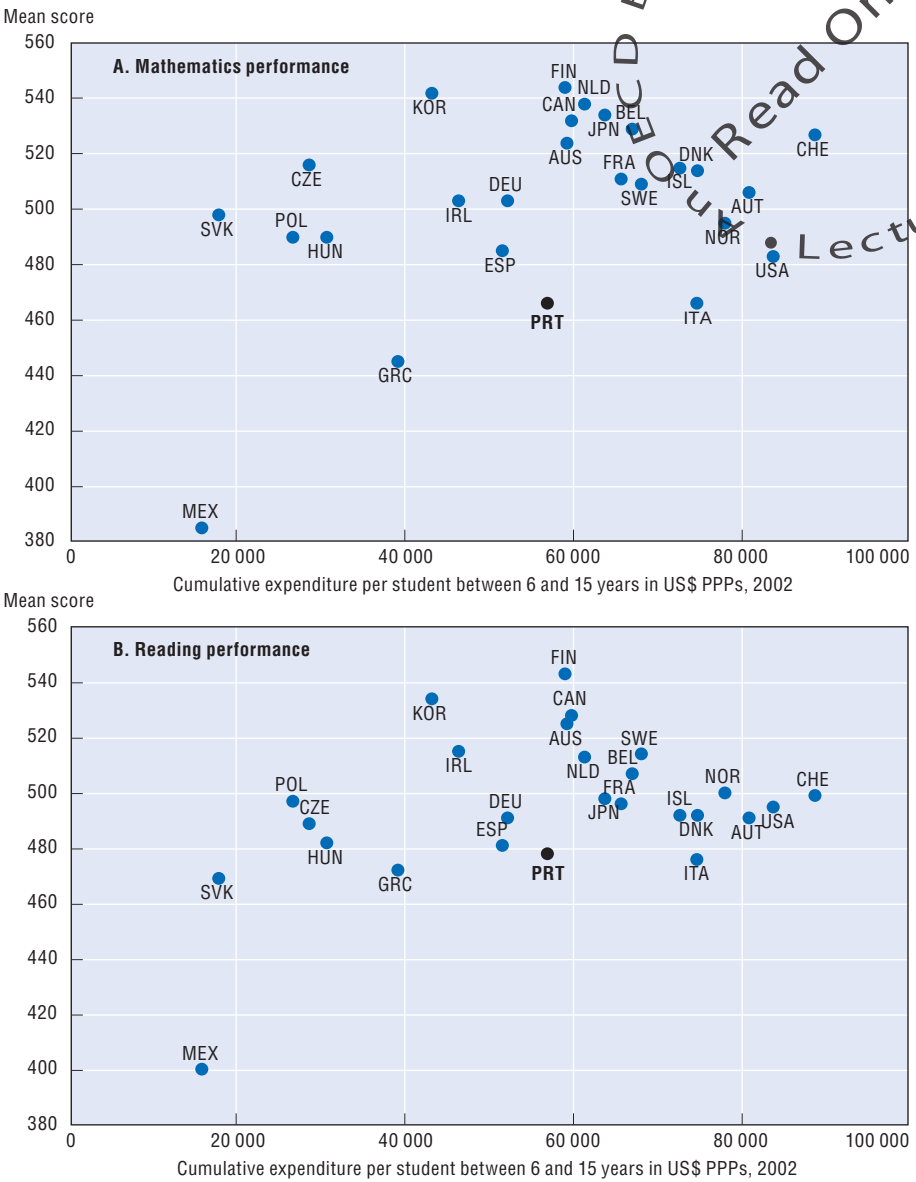
Figure 1.A2.5. **PISA results and national spending per student (up to 15 years old) in OECD countries, 2003**



Source: OECD, Learning for Tomorrow's World: First Results from PISA 2003; OECD, *Education at a Glance* (2005). *OECD Economic Survey of Portugal 2006*, Figure 3.6, p. 76.

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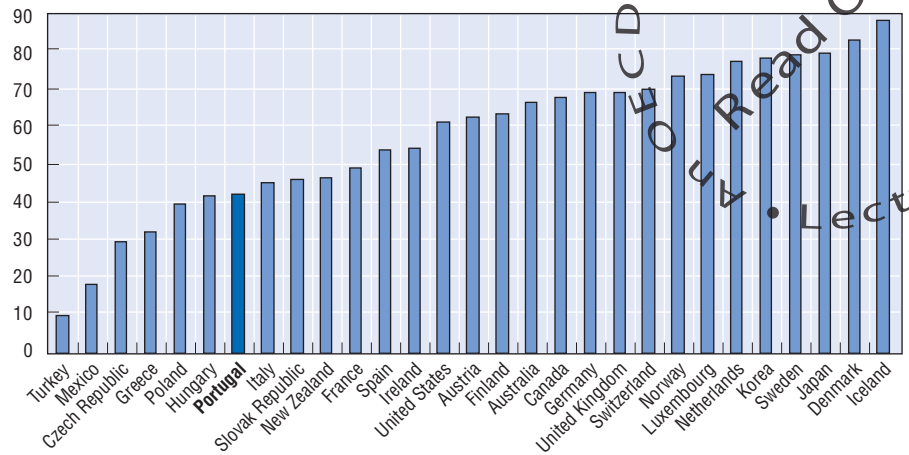
Figure 1.A2.6. **Households with access to home computer, 2005 or latest year available**

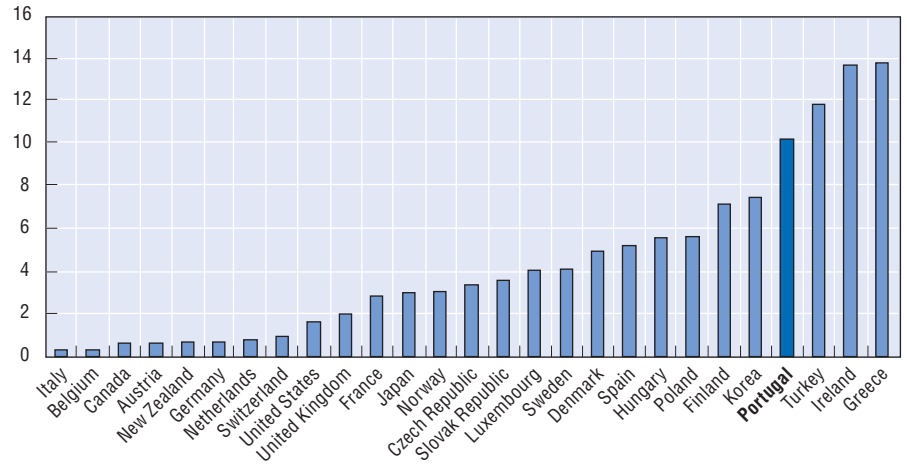
Unit: % of total number of households



Source: OECD Factbook 2007.

Figure 1.A2.7. **Average annual growth of the motorway network in OECD countries, 1992-2005**

Unit: %



Source: OECD Factbook 2007.

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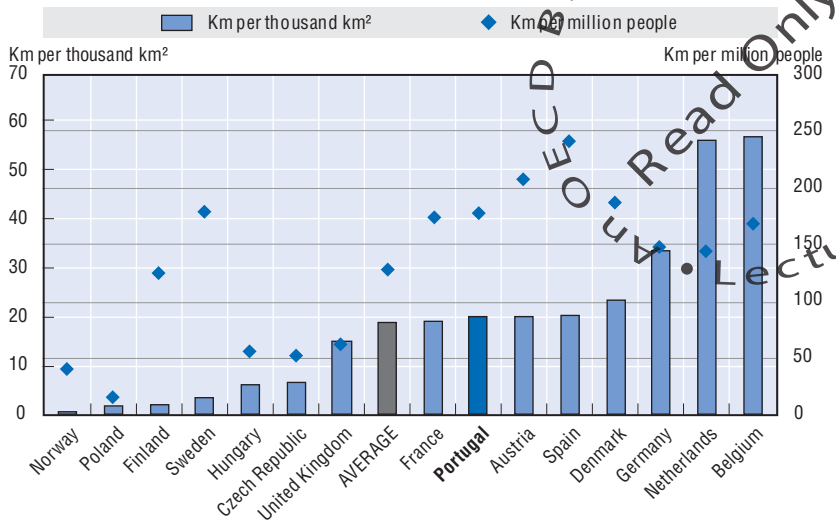
Figure 1.A2.8. **Density of the motorway network in OECD countries**



Source: Eurostat.

Notes

1. See recommendations of *OECD Economic Survey of Portugal 2006*.
2. See conclusions from the OECD High-Level Meeting on regional development in Martigny, Switzerland (2003), and OECD document "Strategic Assessment of Regional Policy: An Issues Paper" [GOV/TDPC(2007)4].
3. All urban and intermediate regions are located on the coast or nearby. Urban, intermediate, and rural regions are defined according to the OECD Regional Typology (less than 15%, between 15 and 50%, and more than 50% of their population respectively lives in rural communities). A rural community is a community with a population density below 150 inhabitants/km^2.
4. However, Grande Lisboa and Grande Porto display quite different patterns of specialisation and competitiveness.
5. Data given for the three main sectors (agriculture; industry; services).
6. Along with Cávado.
7. The Greater Metropolitan Area of Lisbon (GAML, defined by the law 10/2003 of 13 May 2003) encompasses the following municipalities (*concelhos*): Alcochete, Almada, Amadora, Barreiro, Cascais, Lisboa, Loures, Mafra, Moita, Montijo, Odivelas, Oeiras, Palmela, Sesimbra, Setúbal, Seixal, Sintra and Vila Franca de Xira.
8. The Greater Metropolitan Area of Porto (GAMP, defined by the Law 10/2003 of 13 May 2003), previously called the Metropolitan Area of Porto (AMP), encompasses the following municipalities (*concelhos*): Espinho, Gondomar, Maia, Matosinhos, Porto, Póvoa de Varzim, Valongo, Vila do Conde, Vila Nova de Gaia, and since January 2005, Arouca, Santa Maria da Feira, São João da Madeira, Santo Tirso and Trofa.
9. This paragraph presents a broad analytical hypothesis based on TL2 data; there were no data available at TL3.

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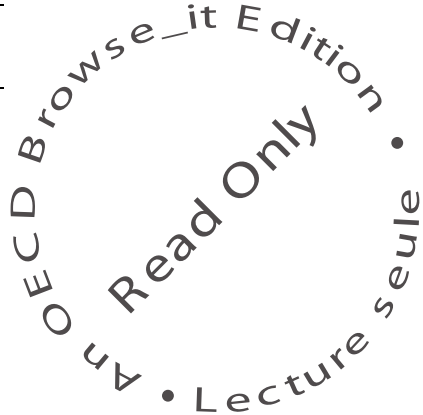

Chapter 2

Regional Policy as a Tool to Enhance Portugal's Competitiveness

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2.1. Introduction

Portugal faces an unprecedented opportunity to invest in long-term assets for competitiveness. The cyclical upsurge and the strong political commitment to pass structural reforms are offering a unique momentum for Portugal to catch up with higher-income countries before emerging players (such as new EU member states) take over. Public funding to do so, however, remains limited in the present period of fiscal deficit reduction. Policies to upgrade human capital and nurture knowledge-based activities must therefore be based on a particularly cautious choice of projects.

Regional policy stands out as a major tool to implement the competitiveness agenda in Portugal. Selecting the most appropriate actions for growth requires an exchange of information and insights between multiple actors, which is a difficult process to achieve without a regional policy. Activating growth levers such as university-firm linkages and environmental capital that are anchored in the different Portuguese regions will be pivotal to achieve the government's top priorities in terms of growth and job creation. Efforts to unlock regional competitive potential will also attend to national equity and cohesion concerns by triggering a dynamics of renewal in lagging regions. The Portuguese government's recent initiatives to better territorialise structural policies need to be further developed and to be coupled with appropriate mechanisms to capitalise on locally concentrated knowledge.

This chapter discusses to what extent regional policy can contribute to the overarching goal of building a more competitive Portugal. First, the chapter examines the progress made by Portugal on the path towards regional policy. Second, it turns to the role of regional policy as a tool to support an endogenous dynamics of innovation. Third, it looks at regional policy as a tool to ensure sustainable development.

2.2. Portugal on the path towards regional policy

For a long time, public measures known under the label of regional policy in Portugal have consisted mostly in the implementation of EU regional cohesion policy. As many other EU countries, Portugal gave priority to supporting poorer regions through massive transfers to finance infrastructure and basic public services, with a view to reduce regional income disparities. Yet today, low-density rural regions still lag behind larger urban regions and their declining productivity dims national growth prospects (see Chapter 1).

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Recent years have marked a turning point in Portugal's history of regional policy. The latest shift of EU regional policy towards the Lisbon Strategy has called for significant adjustment in Portugal's practice of regional policy. When drafting its National Strategic Reference Framework (NSRF) – a comprehensive document required by the European Commission to assess how each country will use EU Structural Funds over the 2007-2013 programming period (Box 2.1) –, Portugal has been challenged to reposition its regional policy on a new mix of cohesion and competitiveness objectives. The Portuguese NSRF complied officially with EU requirements to earmark funds for Lisbon-related expenditure. The decision to streamline future investment down to three thematic Operational Programmes with proactive headings (Territorial Enhancement,[1] Human Capital, and Factors of Competitiveness) also demonstrates the government's will to upgrade the economy (Table 2.1). Yet, the new programming period is unfolding amid some concern over the right balance to be struck between equity and growth objectives, as indicated for example by some policymakers' reference to national research on distinct indices of "cohesion" and "competitiveness" (Figure 2.1 and Figure 2.2).

In parallel to EU-driven evolution, Portugal's recent explicit attempt to design a regional policy at the national level has been the reform of spatial planning. Portugal followed various OECD countries (such as France and Japan) in considering spatial planning as the closest policy to regional policy, due to the focus on the territorial distribution of resources and the specificities of different types of regions. After decades of limited use of spatial planning,[2] Portugal has just adopted a wide-ranging instrument called the National Spatial Policy Programme (NSPP), which aims at assessing the national territory, forecasting possible development trends, and proposing lines of action (Box 2.2).

Such recent strides have certainly brought Portugal closer to achieving an effective regional policy. First, the preparation of the NSRF for EU authorities and the elaboration of the NSPP on a national initiative have implied a phase of regional diagnosis aimed at identifying competitive advantages and development challenges across the country. For example, the NSRF includes an extensive analysis of regional disparities, cohesion, and competitiveness. Second, the NSRF and NSPP exercises triggered a useful process of discussion and consultation among different actors involved in regional development, both at the horizontal and the vertical level:

- At *the horizontal level*: initially imposed by the European regulation as a technical document, the NSRF (and more precisely, the Portuguese choice to streamline the 12 sectoral Operational Programmes under CSF III down to 3 Thematic Operational Programmes in the current NSRF) has stimulated interministerial dialogue in Portugal, namely via the creation of the NSRF Co-ordination Team within the central government.

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Box 2.1. **Portugal's National Strategic Reference Framework (NSRF 2007-2013)**

After the European Council decided in spring 2005 to focus on re-launching the Lisbon Strategy, Community Strategic Guidelines for Cohesion (CSG) were adopted in 2006 and require future cohesion policy to target resources on three priorities: improving the attractiveness of member states, regions and cities; encouraging innovation, entrepreneurship, and the growth of the knowledge economy; and creating more and better jobs. In response, all member states have been preparing a National Strategic Reference Framework (NSRF), which describes how each country proposes to implement these priorities on its own territory.

The European Commission approved Portugal's NSRF on 2 July 2007. Portugal will receive 21.5 billion EUR of EU cohesion funding over the 2007-2013 programming period. In accordance with EU rules, at least 60% of the funding available for the "Convergence" objective and 75% of the "Regional Competitiveness and Employment" objective were earmarked for Lisbon-related investments (even going beyond the minimum threshold, since effective earmarked expenditures amount to 83% and 78% respectively).

The Portuguese NSRF proposes five national strategic priorities: to improve the population's skills; to promote sustainable growth; to guarantee social cohesion; to ensure the development of the territory and the cities; and to improve governance efficiency. Five structural principles of investment will apply: concentration; selectiveness; economic viability and financial sustainability; territorial cohesion; and strategic monitoring.

The five national strategic priorities will be implemented through a set of Operational Programmes:

- 3 Thematic Operational Programmes (OP): "Territorial Enhancement" (financed by the ERDF and the Cohesion Fund) to finance transport and environment projects; "Human Capital" (financed by the ESF) to promote human qualification; and "Factors of Competitiveness" (financed by the ERDF) to promote innovation and modernise the economy;
- 7 Regional Operational Programmes (ROP), one for each NUTS 2 region, including autonomous regions (financed by the ERDF);
- 2 Regional Operational Programmes (ROP), one for each autonomous region (financed by the ESF);
- 6 Territorial Co-operation Operational Programmes (cross-border, transnational, interregional);
- 2 Technical Assistance Operational Programmes (one financed by the ERDF and the other by the ESF).

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Table 2.1. **Financial plan for NSRF 2007-2013 Operational Programmes**
Unit: million EUR (between brackets, % of total line)

		EU funds	National public funds	TOTAL public funds (EU + national)	TOTAL including private funds
Mainland	**Human Potential**	**6147 (69.3%)**	**2636 (29.7%)**	**8783 (99.0%)**	**8868 (100%)**
	Thematic OP for Human Potential	6147 (69.3%)	2636 (29.7%)	8783 (99.0%)	8868 (100%)
	Factors of Competitiveness	**6008 (55.7%)**	**1437 (13.3%)**	**7445 (69.1%)**	**10780 (100%)**
	Thematic OP for Factors of Competitiveness	3104 (54.8%)	686 (12.1%)	3789 (66.9%)	5661 (100%)
	Regional OP (mainland)	2905 (56.7%)	751 (14.7%)	3656 (71.4%)	5120 (100%)
	Territorial Enhancement	**7518 (34.0%)**	**3163 (14.3%)**	**10681 (48.2%)**	**22144 (100%)**
	ERDF	4458 (64.0%)	1852 (26.6%)	6310 (90.5%)	6969 (100%)
	Thematic OP for Territorial Enhancement	1599 (65.0%)	660 (26.8%)	2259 (91.9%)	2459 (100%)
	Regional OP (mainland)	2859 (63.4%)	1192 (26.4%)	4051 (89.8%)	4510 (100%)
	Cohesion Fund[1]	3060 (20.2%)	1311 (8.6%)	4371 (28.8%)	15176 (100%)
Autonomous Regions	**Regional OP (autonomous regions)**	**1602 (70.1%)**	**444 (19.4%)**	**2046 (89.5%)**	**2285 (100%)**
National	**Technical Assistance**	**137 (85.1%)**	**24 (14.9%)**	**161 (100.0%)**	**161 (100%)**
	Territorial Cooperation	**99 (72.8%)**	**37 (27.2%)**	**136 (100.0%)**	**136 (100%)**
	TOTAL	**21511 (48.5%)**	**7741 (17.4%)**	**29253 (65.9%)**	**44374 (100%)**

1. Including 170 million EUR of Cohesion Fund for the two autonomous regions.
Source: NSRF 2007-2013.

- *At the vertical level*: each of the NUTS 2 regions was asked to prepare its own "Regional Strategy 2015" under the direction of its CCDR (Commission for Regional Co-ordination and Development, deconcentrated body of the central government at the regional level in mainland territory); these regional strategic documents served as inputs to the Regional Operational Programmes (ROPs) and helped to adjust the Thematic Operational Programmes of the NSRF. The concomitant preparation of the NSPP and the Regional Spatial Plans (PROTs) has also increased interactions between national and regional levels.

Portugal was therefore able to use EU-related obligations to open up national policy-making practices. A recent OECD report on the European Union found that the European regional cohesion policy has had a positive impact overall but would need some reform in order to maximise its impact.[3] The main areas for improvement include: *i*) clearer objectives for regional policy within the overall macroeconomic context of the EU, *ii*) better targeting of instruments to a more limited set of priorities, and *iii*) more effective implementation and performance management. In Portugal as in many EU countries, the translation of the Lisbon Agenda into concrete actions results in

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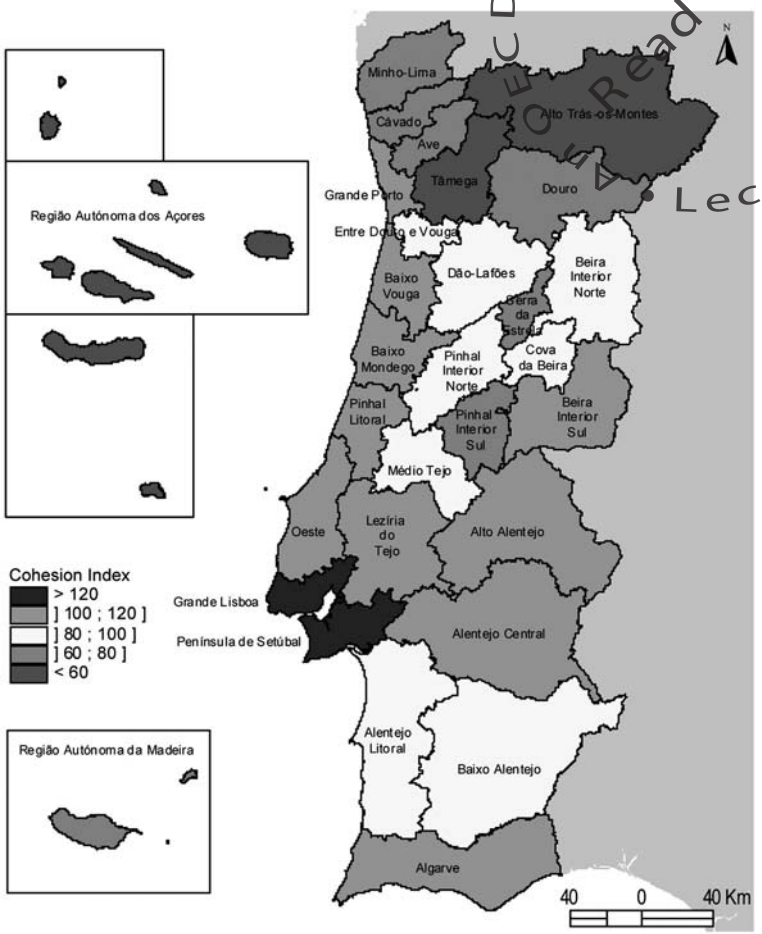
Figure 2.1. **Map of Portuguese regions classified according to the "Cohesion" index**



Note: The Cohesion index is a synthetic index, which is obtained from the average of 15 indicators reflecting social and economic cohesion at three stages: conditions, process and results. For more detailed information, please refer to Augusto Mateus (2005).

Source: Augusto Mateus 2005.

a wide range of programmes covering a diverse set of policy fields, which could make co-ordination and coherence difficult. The Portuguese government made laudable efforts to adopt a more transversal approach to regional development via the NSRF exercise. The diversity of plans and programmes related with

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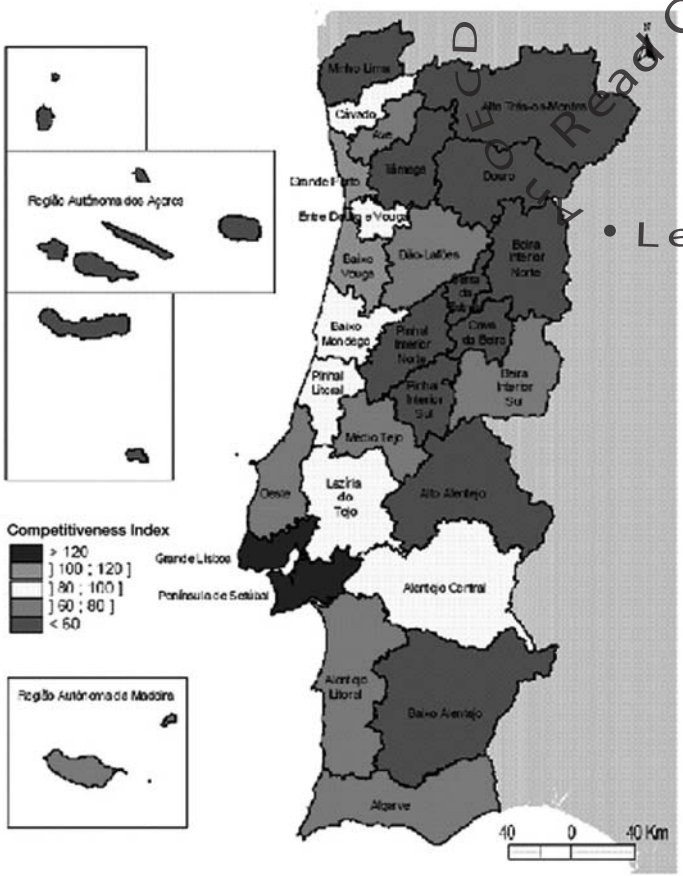
Figure 2.2. **Map of Portuguese regions classified according to the "Competitiveness" index**



Source: Own calculations (Cf. *As Grandes Questões Conceptuais e Metodológicas*, Volume I)

Note: The Competitiveness index is a synthetic index, which is obtained from the average of 20 indicators reflecting competitiveness at three stages: conditions, process and results. For more detailed information, please refer to Augusto Mateus (2005).

Source: Augusto Mateus 2005.

regional development in the current policy framework reflects the complex adjustment of sectoral plans to regional specificities (Table 2.2).

Building on this initial groundwork, Portugal could reflect on how this nascent regional policy links into national policy goals and what contribution the different strands of regional policy can expect to make to growth and structural change. Despite the recent pick-up in GDP growth, rising

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Box 2.2. **Portugal's National Spatial Policy Programme (NSPP)**

The National Spatial Policy Programme (NSPP – *Programa Nacional da Política de Ordenamento do Território* or PNPOT in Portuguese) was designed as a tool to "know national territory; forecast its future; and act for spatial planning and territorial development". After a task force was set up in February 2003, the technical proposal was put together in 2005, followed by a public participation process in 2006. The parliament voted the law approving the NSPP in July 2007 (published as Law No. 58/2007 on September 4th, 2007).

The NSPP is composed of two parts:

1. A report identified 24 "territorial and spatial planning challenges" (in terms of natural resources and risk management; urban and rural development; transportation, energy and climate change; territorial competitiveness; infrastructure and collective services; civic culture and spatial planning) and put forward a vision for Portugal 2025 ("a well-planned and sustainable territory; a competitive, integrated and open economy; an equitable territory; a creative society with a sense of citizenship").
2. An action programme proposes 6 "strategic objectives" (preserve and value biodiversity, landscapes and cultural heritage; reinforce territorial competitiveness and international integration; promote the polycentric development of territories; ensure territorial equity in the provision of infrastructure and collective services; expand networks and ICT infrastructure; reinforce spatial planning quality and efficiency), in turn developed into 36 specific objectives and 197 measures.

At the same time, Regional Spatial Plans (*Plano Regional de Ordenamento do Território* or PROTs in Portuguese) are being prepared in order to cover all NUTS 2 regions. They are elaborated by the Commissions for Regional Co-ordination and Development (CCDRs), *i.e.* the deconcentrated bodies of the central government (Ministry for Environment, Spatial Planning and Regional Development) in the five mainland NUTS 2 regions, and by the regional governments in the two autonomous regions of Azores and Madeira. The CCDRs organise plenary and sectoral sessions to discuss the PROTs, and municipalities are invited to participate via commissions. The PROTs have a binding power over municipal development plans (PDMs) elaborated by municipalities.

Note: Further information about the Portuguese NSPP is available on *www.territorioportugal.pt*.

unemployment figures recall that the government's top priority lies in adjusting the national economic pattern to the demands of global competition. A reductionist understanding of regional policy as an isolated policy that only fulfils redistributive functions for the sake of equity would mean missing an

Table 2.2. **Examples of sectoral policies related with regional development in Portugal**

	Urban policy	Rural policy	Tourism policy	Environment policy		Infrastructure policy
Main plans/programmes	POLIS XXI[1]	National Strategic Plan – Rural Development[2] (PRODER for the mainland; PRODERAM for Madeira; PRORURAL for Azores)	National Strategic Tourism Plan (PENT)[3]	Municipal Waste Strategic Plan (PERSU II)[4]	Strategic Plan for water supply and urban wastewater[5] (PEAASAR II)	High Speed Railway Plan Road network plan Logistic platforms plan Ports strategic guidelines Airports strategic guidelines[6]
Ministry	Ministry for Environment, Spatial Planning and Regional Development: Secretary of State for Spatial Planning and Cities	Ministry for Agriculture, Rural Development and Fisheries Regional governments	Ministry for Economy and Innovation, Secretary of State for Tourism	Ministry for Environment, Spatial Planning and Regional Development: Secretary of State for Environment	Ministry for Environment, Spatial Planning and Regional Development	Ministry for Public Works, Transport and Communications
Time frame	2007-2015	2007-2013	2006-2015	2007-2016	2007-2013	
Territorial scope	Mainland	Mainland Autonomous regions	Mainland Autonomous regions	Mainland	Mainland	Mainland
Typology of areas/regions	3 types of areas: • Urban neighbourhoods • Networks of cities • City-regions	3 typologies: • Typology of European regional policy: "Convergence" regions and "Competitiveness and Employment" regions. • Typology of defavourised zones (EU) – mountain areas, areas with specific handicaps and other defavourised areas. • Rural and non rural areas (Portuguese typology based on OECD methodology).	Ongoing reform of the 19 "tourism regions"			5 regions and 18 districts for road plan and transport management by the civil service

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Table 2.2. **Examples of sectoral policies related with regional development in Portugal** (cont.)

	Urban policy	Rural policy	Tourism policy	Environment policy		Infrastructure policy
Key objectives/strategic principles	• Urban regeneration • Urban networks for competitiveness and innovation • Regional integration	*Strategy objectives:* • Increasing the competitiveness of agricultural and forestry sectors • Promoting sustainability for rural areas and natural resources • Revitalising rural areas economically and socially *Transversal objectives:* • Reinforcing territorial and social cohesion • Promoting effective intervention in sectoral and territorial management from public, private and associated agents	Developing 10 strategic industries: • gastronomy • cultural touring • well-being and health • nature • big events • residential tourism • city short breaks • golf • nautical sports • sun and beach	• Promoting municipal waste prevention • Increasing municipal waste recycling levels • Diverting municipal waste from landfill	• Providing water supply and wastewater services with quality and continuity • Providing sustainable public water supply and wastewater services • Promoting a tax policy including the total recovery of service costs taking in consideration the economic capacity of communities • Promoting the protection of environmental values • Increasing the percentage of population with access to water supply and wastewater services	Increasing the accessibility of territories and improving mobility of population, reducing time travel and reducing operational costs
Budget	1.5 billion EUR	4.97 billion EUR	Not available at this stage	1 billion EUR	3.6 billion EUR	Not possible to estimate a total

1. More information available on: *www.dgotdu.pt/PC*.
2. More information available on: *www.gppaa.min-agricultura.pt/drural/*.
3. More information available on: *www.turismodeportugal.pt/Português/turismodeportugal/estrategianacionalparaoturismo/Pages/EstrategiaNacionalparaoTurismo.aspx*.
4. More information available on: *www.maotdr.gov.pt/Admin/Files/Documents/PERSU.pdf*.
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opportunity to serve the overall goal of stronger national growth. In line with the "paradigm shift" debate within OECD countries, Portuguese regional policy could be used as a cross-cutting tool to implement and to empower a set of mutually reinforcing structural policies geared towards higher growth. In order to be effective, structural change needs to have strong and differentiated impact on Portuguese regions, which calls for a proactive role of regional policy. The following sections will discuss more in detail how regional policy could contribute to two major pillars of national development: innovation and sustainable development.

2.3. Regional policy as a tool to foster innovation

2.3.1. The emergence of a regional dimension in innovation policy

Portugal has started to address the previous lack of a consistent and systemic innovation policy at the national level. Growing awareness of the country's overall weak performances in terms of innovation, illustrated by benchmarking tools such as the European Innovation Scoreboard (EIS), has prompted the government to try to close the scientific and technological gap compared with other European countries. While innovation had often been a blurred responsibility between the Ministry for Economy and the Ministry for Science and Technology, it leapt recently to the forefront of the policy agenda. A National Council for Innovation will be created soon, to be chaired directly by the Prime Minister and based on three existing institutions (the Technology and Science Foundation, the Innovation Agency, and the IAPMEI-Institute for Small and Medium-Sized Firms and Investment).[4] An earlier flagship initiative called the Technological Plan (*Plano Tecnológico*) also put forward a wide-ranging strategy to modernise the Portuguese economy and was generally welcomed as a promising package of long-overdue measures for competitiveness[5] (Box 2.3).

Recent efforts to develop a stronger national innovation policy in Portugal will need to be supported by regional tools. While national innovation policy and regional policy were quite separate policy fields until recently, the reorientation of regional policy in many OECD countries has led to a more sophisticated awareness of regional innovation dynamics. Broadly speaking, the new approach to regional policy in the OECD focuses on making domestic firms more competitive, which in turn means emphasising innovation and better use of the knowledge available in the region. Portugal is no exception, particularly given the limited flows of FDI into the country and the need to support and develop competitive indigenous firms.

The emphasis on innovation in regional policy is mirrored by the increasing attention paid by science and technology policymakers to region-level sources of innovation and to place-based collaboration among a wide range of stakeholders. It was gradually recognised that innovation policy needs to act not only on the

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Box 2.3. **A horizontal innovation strategy: the Technological Plan (*Plano Tecnológico*)**

The Technological Plan (*Plano Tecnológico*) is a flagship strategic agenda based on three lines of action:

- knowledge (not only higher education but also adult training and skill building);
- technology (e-government, ICT, broadband);
- innovation (adapting the productive fabric to the demands of the globalised economy).

Since it was presented publicly in November 2005, the Technological Plan was monitored and revised. An interministerial commission (composed of representatives from the main ministries involved) and an advisory council (including businessmen, academics and policymakers) were established to follow up on the implementation of the Technological Plan. It is currently being implemented through 112 measures covering the three lines of action (38 measures for knowledge, 24 measures for technology, 50 measures for innovation) and serving five transversal priorities (a strengthened scientific and technological base; a better organised competitive base; a modernised public administration; a favourable business environment; a qualified population). Examples of measures include:

- Placing Portugal on the front line of broadband coverage: the entire national territory has been covered with access to broadband Internet, notably all public schools (since January 2006) and 73% of public administration departments (2006 data).
- Helping families to have better access to information society via tax benefits and the Universal Mail Box.
- Strengthening the internationalisation of the scientific system: partnerships were signed with top-class US universities (*e.g.*, MIT); a joint Portugal-Spain International Research Institute was set up.
- Making the labour market more efficient: the web portal NetEmprego was launched in June 2006 to facilitate job search.
- Simplifying relations between citizens and public administration: programmes such as SIMPLEX (administrative simplification) and PRACE (reform of public administration); Direct Social Security, Single Car Document (launched in October 2005), Citizen Card, Rapid Start-Up service (it is now possible to create a company in less than one hour).
- Supporting innovative companies: the incentives offered in the pre-existing programme PRIME (*Programa de Incentivos à Modernização da Economia*) were adjusted to support business clusters.
- Endowing companies with young and high-skilled managers: InovJovem programme (by June 2006, a total number of 1906 young management graduates had been oriented towards SMEs), InovContacto programme (a total number of 296 young graduates were offered an opportunity to work abroad in 2006).
- Preparing youth for the knowledge society: enhancing English classes in primary schools, promoting technological literacy via competence certificates, offering training programmes for teachers.
- Retraining active population: the *Novas Oportunidades* programme was strengthened; it now provides adult training courses and dual certificate courses, and it increased the number of validation and certification centres.

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supply side (production of knowledge) but also on the demand side (diffusion and absorption of knowledge); not only on technological aspects (new products and processes) but also on organisational aspects. Such "soft" capital factors are by nature anchored in specific places. The general transition in orientation across the OECD can therefore be summarised as: *i*) a shift of goals from scientific basic research to innovation and commercialisation of research (with evaluation based on strategic and structural criteria, as opposed to purely scientific criteria), *ii*) less funding of individual R&D projects run by specific institutions and more emphasis on joint projects and research themes, and *iii*) stronger marketing of linked competencies across actors (business, research, governance).

In this regard, the Centres of Expertise programme in Finland offers a particularly inspirational experience (Box 2.4). Although Finland is different from Portugal in the sense that it invested much earlier and more generously in innovation, it provides an interesting perspective on how to serve efficiently a national priority (innovation) via region-based incentives, even in the absence of an elected regional level of government.

Portugal faces a window of opportunity to boost national innovation through regional policy. The current period offers Portugal a particularly appropriate time to act because most major plans will start to be implemented. For example, most of the impact of the Technological Plan is expected to materialise in the 2007-2013 programming period via the funding of the Operational Programme "Factors of Competitiveness" and the Regional Operational Programmes. Many sectoral plans related with regional development that were announced lately are also waiting to be translated into concrete measures over the next seven years or so (see previous Table 2.2).

2.3.2. Strengthening co-operation within the regional innovation system

A key policy issue in Portugal will be how to promote joint activities between publicly funded or managed knowledge assets and private firms. This is particularly required in Portugal considering the country's extremely low levels of business R&D expenditure. Over the past few years, OECD countries introduced various measures to enhance collaboration between R&D institutions. According to the EU Trend Chart, such measures fall into four main categories: 1) fostering research consortia between science and technology organisations, universities and firms for the development of new products, processes and systems; 2) technology transfer offices; 3) industrial property support offices; and 4) specific instruments to promote co-operation between firms. These have had mixed results, with the industrial property support offices considered the most effective instrument at national level.

Inspired by the well-known experience of competitiveness poles (*pôles de compétitivité*) in France, the Portuguese government is currently working on an

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Box 2.4. **Revealing place-based competitive capacities: the Centres of Expertise in Finland**

Finland's top-class position in numerous international competitiveness rankings is widely attributed to massive investment in R&D, innovation and education. Finland was among the first OECD countries to develop a national innovation system. The government's decision to set up a Science and Technology Policy Council – a key body chaired by the Prime Minister – demonstrates the powerful political drive towards innovation. The Centres of Expertise programme illustrated Finland's effort to move from a science and technology-focused innovation system towards a broader-based innovation system, building on local knowledge and in better connection with regional development concerns.

In response to the severe economic recession in the early 1990s, the government first established the Centres of Expertise programme in 1994 to create new jobs and promote training in knowledge-based sectors. The programme started as an urban policy initiative, with the first eight Centres being in the largest urban regions in Finland before the programme was expanded to smaller urban centres in 1999 and in 2003. From the very beginning, the key concept was to exploit the triple helix model of collaboration between university, industry and government, on the basis of local endogenous assets. Although the programme often worked in conjunction with regional technology centres or science parks, promoting sophisticated technology did not constitute a goal *per se*. The notion of expertise is not restricted to high technology, as some of the fields of expertise include tourism, culture or environment.

The Centres of Expertise programme is managed by an Interministerial Committee (administrated by the Ministry of Interior's department of regional development). The Interministerial Committee launches a tendering process to select projects according to the calibre of expertise, the innovative nature and potential for growth of the proposed projects, the partnership among project participants, and a long-term regional commitment. The Centres compete for basic state funding, which forces them to continuously improve the quality of their project.

By the end of 2006, 22 Centres of Expertise were distributed across the country with 45 fields of expertise (ranging from biomaterials and high-tech metal to chamber music). Over 5 000 companies took part each year in the elaboration and implementation of the projects. Basic state funding was relatively small (approximately 50 million EUR in total) but it had an impressive leverage effect of more than ten to one (the total project volume for 1999-2006 was 578 million EUR). It was estimated that the programme generated 13 000 high-skilled new jobs and over 1 300 new businesses. From the central government's viewpoint, one of the programme's greatest advantages was that it boosted the efficiency of public spending by focusing limited resources on clearly defined regional strengths and by clarifying regional specialisations (therefore avoiding overlaps in R&D investment).

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initiative called "Competitiveness and Technology Hubs". One of the key challenges of the programme will be to build stronger links between public R&D and private industry, with a pivotal role to be played by research institutes, universities and higher education institutions. Looking across OECD countries where similar policies have been introduced, the methods used include: promoting co-location of R&D generators alongside private firms (in science parks and similar structures); promoting joint R&D and pushing universities and research labs to emphasise commercial applications; and supporting open innovation platforms and privately managed R&D centres.

Region-level innovation policy in Portugal will need to place a strong emphasis on collaborative (as opposed to individual) research projects. For example, the Knowledge Clusters in Japan and the Georgia Research Alliance programmes in the US both exploit universities as cluster hubs and they use research units within the university to develop multi-actor research projects.[6] In most other programmes in OECD countries, if universities and research institutions are not the hub they are at least important network partners. There are also explicit requirements or preferences in project selection for a minimum number of actors of each type involved in these collaborative projects. At the same time, appropriate incentives need to be set up because some potential partners may be discouraged by the transaction costs involved and the possible ambiguities regarding intellectual property rights from joint projects involving both public and private actors.

2.3.3. Building on existing specialisations and clusters

The Portuguese economy has good opportunities to promote innovation by providing targeted public goods both in traditional and more advanced regional specialisations. The transition in regional policy towards capitalising upon local assets argues in favour of policies that strengthen existing regional specialisations and clusters. These specialisations and clusters are often based on collective advantages, accumulated skills and practices embedded in the local labour force, or draw on specific local resources or infrastructures. They are also contingent upon factors such as firm size and structure, the use of advanced technologies, and the use of networking as a business practice.

One appealing feature of the cluster approach in the context of regional policy is that it seems to be applied both in advanced regions with dense knowledge infrastructures and in non-core or former industrial regions. For example, in leading regions with a portfolio of economic activities, the policy goal is often to support specialisation in a subset of these sectors or clusters. In other regions where traditional manufacturing industries are strongly embedded, cluster policies are designed to help the region diversify into new activities or change the value structure of current specialisations. This shift in regional policy acknowledges that the industrial base in both leading and lagging regions is

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undergoing transformation and the policies offer a way to improve the linkages and facilitate the transformation.

Like many large OECD metropolitan regions, the capital region of Lisbon obviously concentrates modern R&D complexes (such as the Tagus Park), top-level universities and pioneering firms – thereby producing and using most of new knowledge in Portugal. In contrast, the industrial region spread around Porto, for example, has displayed sluggish GDP growth and a persistent rise of unemployment over the past few years; but it hosts remarkable examples such as Guimarães, a medium-sized city that has strived to reverse the trend of industrial decline and to achieve a new development vision for itself (Box 2.5). This individual success story is not necessarily representative of all Portuguese regions' innovative capacity. However, it suggests that local actors possess unique knowledge about their region's intangible assets and are able to design creative solutions. This means that the central government's recent impetus to put in place a more systemic innovation policy does not need to start from scratch; it has local stepping stones to build on.

2.3.4. Focusing policy support to help restructure key sectors

Portugal has already seen some evidence of the major progress induced when a nation-wide economic policy meets locally embedded capabilities. A region sometimes hosts well-performing *producers* of knowledge (leading universities, in Coimbra, Minho, and Porto for example), or well-performing *users* of knowledge (dynamic SMEs, such as in those in Leiria specialised in ceramics, plastics and moulds); the two groups may even co-exist (for example, Aveiro is known for its active university and its SMEs excelling in ceramics, mechanic construction, automobile parts, and furniture) but without an appropriate interface to meet and exchange their respective knowledge. Carefully designed national support can trigger substantial improvement when it provides such missing linkages between local players. For example, a national economic development programme like the Programme of Incentives for the Modernisation of the Economy (*Programa de Incentivos à Modernização da Economia*, PRIME) successfully contributed to upgrading a traditional industry such as footwear by exploiting the geographic proximity of firms and their ability to collaborate (Box 2.6). Similarly, further advantage could be taken of other recent projects including the European Excellence Centre in Human Tissue Engineering in the Ave Park, the Iberian Centre of Nanotechnologies in Braga, the creation of the Nokia R&D Centre in Aveiro, and the co-operation processes that have been institutionalised between some university-industry interfaces (such as the INESC with the Fraunhoffer Institute).

Replicating the success of the footwear initiatives depends on providing the right flexible supports to help firms cope with increased competition in their main markets and reach out to access new expanding markets outside Europe.

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Box 2.5. **A local strategy for renewal: the example of Guimarães**

Guimarães is a medium-sized city of around 60 000 people, located in the Norte region (15 minutes from Braga, 30 minutes from Porto, 60 minutes from Galicia in Spain). Considered to be the historical cradle of the Portuguese nation, the city was classified as UNESCO heritage in 2001 but other parts of the old town continue to suffer from severe urban deterioration. Its traditional economic base has made the city particularly vulnerable to industrial decline and unemployment has soared (13.7%) well above the level in the Norte region (8.8%) and national average (7.6%). In order to respond to the need for a new development model, the municipal government launched a comprehensive strategy building on the city's various assets, ranging from arts and culture to science and technology.

In order to implement the vision of **a historical and cultural city**, the municipal government initiated an ambitious urban rehabilitation policy. It purchased land and former industrial facilities in particularly distressed areas and remodelled them into cultural amenities. For example, the Couros district (a 10-hectare area traditionally devoted to leather treatment and tanning, progressively abandoned to degradation and pollution) was refurbished into an impressive *Complexo Multifuncional de Couros* (including high-quality tourism hotels, educational facilities, and a cultural centre). Revamped by this forward-looking image, Guimarães was also chosen to represent Portugal's candidacy to host the European Cultural Capital 2012 and is currently working on fleshing out its project.

The University of Minho (created in 1974, around 5 500 students) worked in close collaboration with the municipal government to upgrade the city into **a science and technology city**. Several innovation centres are now operating in an effort to draw specifically from the city's historical assets (*e.g.*, the Civil Engineering Centre specialised in the restoration of historical monuments and traditional building techniques) and from its previous economic base (*e.g.*, the Living Lab specialised in e-mobile health, considering that the city is trying to overcome the crisis of the traditional textile industry by taking advantage of the workers' manual dexterity and develop a new industry of medical devices). A 10-hectare science and technology park called the AvePark will also open in January 2008 (*www.avepark.pt*). The project is based on a partnership between public and private shareholders (City of Guimarães: 51%; University of Minho 20%; other public actors: 10%; private actors: 19%).

A key factor of success was the **collaborative governance structure** that managed the new development strategy, which involved primarily the municipality of Guimarães and the University of Minho, but also the central government, the CCDR of Norte, and various representatives of the civil society and the business community (including geographers, designers, journalists, etc.).

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Box 2.6. **National support, local knowledge sharing: the successful example of the footwear association in Portugal**

The Portuguese footwear industry is dominated by small and medium-sized firms, which are concentrated in the south of the Porto region in the Santa Maria da Feira-São João da Madeira-Oliveira de Azeméis area. Such firms usually lack the resources to carry out radical innovation. During the 2000-2006 period, the central government ran the PRIME programme (*Programa de Incentivos à Modernização da Economia*) to modernise the economy by upgrading traditional industries among other strategic axes. The programme was recognised as being particularly efficient in the case of the footwear industry because it put in place a comprehensive scheme of incentives that mostly supported the overall business environment (56% of the incentives, *i.e.* around 45 million EUR) compared with direct support to enterprises (44% of the incentives, *i.e.* around 35 million EUR). A key partner for the implementation of this programme was the national footwear association (APICCAPS*). This association has used the programme to help firms upgrade the skills of their workforce, for example by running an industry-specific training centre and conducting large-scale R&D projects that would benefit a wide array of member firms due to the economies of scale. The association also promoted proactive benchmarking by supporting visits to international fairs and exhibitions. Encouraging firms to develop a close relationship with customers, suppliers, competitors and institutions allowed for the constant introduction of changes in processes and product designs.

* See the Portuguese National Footwear Association's website on *http://www.apiccaps.pt*.

Regional and local level policymakers across the OECD see an increased demand for support from small and medium-sized firms that have strong technological capacity and are anxious to capture new markets. Successfully managing this transition is crucial for regions because in practice many supplier firms are vulnerable. Some are highly specialised and can sell their expertise to other companies in the same industry or cross over into other industries. Others, however, are contract manufacturers whose output can often be replicated at lower cost by producers in emerging economies. Such firms in local supplier networks need help to move their businesses out of basic product or commodity supply (which is now increasingly undertaken by firms in countries like China), and to upgrade into higher value or more specialised products. An example of a policy to upgrade existing firms and support labour force reconversion is the EDA Center for Economic Diversification in Michigan (US), which provides a range of services funded in part by the Department of Commerce and delivered through the University of Michigan (Box 2.7).

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Box 2.7. **EDA Center for Economic Diversification, Michigan**

Funded in part by the US Department of Commerce, Economic Development Administration (EDA), the EDA University of Michigan Center for Economic Diversification was established to help the Michigan economy become more diversified. The Center's main goal is to assist communities and companies so that they become innovative, flexible, efficient and globally competitive. The support is provided through a range of analysis such as feasibility analyses, market analyses, strategic implementation, operations planning, and impact and performance analysis in five different areas: economic diversification, industrial facilities revitalisation, minority business development, professional education and training activities, and international exporting and global competitiveness.

Economic Diversification activities involve strategic and due diligence initiatives for local communities, firms and entrepreneurs in order to identify and analyse opportunities for economic and community development project, new technological and emerging industrial sectors as well as new market niches in traditional industrial sectors. *Industrial Facilities Revitalisation* activities are for example strategic advice for re-use of closed facilities. *Minority Business Development* is assistance to newly formed and minority-owned firms so that they can benefit from the technological, educational, and research resources of the University of Michigan. *Professional Education and Training* activities include: information, briefings, and seminars addressing corporate diversification as well as international market opportunities. The *International Exporting and Global Competitiveness* area supports companies with expertise and information resources available within the University of Michigan regarding new market opportunities.

In Portugal as in several OECD countries, policy action has tended to underestimate the role of small firms. Recent OECD research in three major global industries (ICT, automotive, and pharmaceuticals) shows clearly that in major global industries, the role of SMEs has not diminished; on the contrary, small firms are often the prime source of innovative ideas that are integrated into other products or brought to the market in their own right by large firms. There are diverse reasons for this, including:

- Many of the most important innovations in manufacturing are adapted from other sectors outside the main competences of the manufacturers in that sector (*e.g.*, the increasing importance of computer software in cars, the use of data processing in biopharmaceuticals, etc.). In some cases, this demand for expertise is met by large companies such as Microsoft, which work extensively with car makers, but it is also an opportunity for SMEs that can often be more agile in adapting existing technologies.

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- Large firms in R&D-intensive industries are seeing the productivity of their in-house research decline and are looking for ways to improve output and share risk, such as by cost sharing with SMEs instead of having to internalise product development.
- Small firms are often more aware of niches or emerging markets, for example, finding solutions to new legal or regulatory requirements.

A key dilemma for Portuguese regions will be how to invest in R&D in such a way that at least part of the benefit is captured within the region. With looser networks that involve firms with more global reach, it is unclear how to estimate the return on investment made by the public sector in support of private initiatives. At a strategic level, some OECD countries have created regional innovation system institutions that try to maintain links between different actors. For example, the Brainport initiative in the Eindhoven region (Netherlands) fulfils this system supporting function (Box 2.8).

Box 2.8. **The Brainport initiative in Eindhoven, the Netherlands**

Three comprehensive programmes have been initiated in the Eindhoven region during the past 15 years: Stimulus, Horizon, and most recently Brainport. The Brainport Programme aims to strengthen the economic development and the knowledge infrastructure of the Eindhoven-Leuven-Aachen triangle. It is public-private funded by its triple helix partners and is run in parallel with activities of the regional economic development agency (REDE). The initiative covers 21 municipalities in southeast Brabant but has a wider geographic scope than the boundaries of its constituent municipalities.

Brainport works as a development platform promoting vertical collaboration between governments and authorities on different levels. It also supports horizontal collaboration between companies and research and knowledge institutes within the region, and between different regions. The major role of Brainport Eindhoven is to enable and to facilitate strategic economic development. Issues on the agenda are: promotion of open innovation (collaboration on an international level between companies and research institutions), creation of centres of excellence, a balanced labour market, attracting venture capital, improvement of manufacturing companies' conditions in order to attract new investment, and strengthening the knowledge exchange between medium-sized and small firms.

2.3.5. Identifying local capacity in practice: the importance of programme design

Identifying and exploring further local strengths could be a decisive input to Portugal's innovation policy. Thanks to its broader view of the national territory as

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a whole, the central government has the necessary insight to detect other potential good practices based on a synergetic local community (like Guimarães) or concentrated industries (like the footwear industry in the north). In this respect, the experience of other OECD countries shows that an incentive-based competitive process provides an efficient tool to foster valuable regional specialisations. A well-designed competitive process will not only encourage the disclosure of hidden capabilities in various territories and promote regional clustering experiences; in a relatively small country like Portugal, the selective support for projects could also help reduce sterile internal competition across regions on overlapping niches, and ultimately clarify the functional division of labour among regions in view of overall national competitiveness. For example, the new urban policy (POLIS XXI, mentioned earlier in Table 2.2) has started to encourage inter-urban complementarities by launching a competitive process to select five "urban networks" as a pilot phase of the programme (the "urban networks" must be based on a long-term vision and a strategic programme supported by a partnership between municipalities, firms, R&D centres, universities, entrepreneurial associations and other key urban actors).

Considering that the Competitiveness and Technology Hubs initiative is presently being sketched out, it is too early to evaluate its impact. The announced purpose is to identify the regions where innovative projects are located, to select the most convincing projects, and to concentrate public support on them. From the start, precautions are envisaged to avoid the frequent mistake of sprinkling scarce public resources in redundant regional specialisations. For example, there are concerns that too many regions might aspire to becoming a biotechnology pole, regardless of their own competitive advantages and realistic chances of success. The government has decided to check potential candidates first by organising a series of informal meetings with relevant regional and business actors, before launching a call for projects (ideally by the end of 2007). For example, the announced creation of the Health Competitiveness Pole in the North (involving excellence firms as BIAL and research centres of Minho, Porto, Coimbra and Lisbon) could be a promising initiative.

OECD experience suggests that different selection mechanisms may entail varying transaction costs, which can be compared with the benefits of different options. Selection mechanisms tend to be either competitive (based on an open competition, a call for proposals or similar) or non-competitive (the recipients are designated), top-down or bottom-up (Table 2.3 and Box 2.9). There are strategic reasons for using these different types of mechanisms based on parameters such as programme goals, policymaker knowledge about the provenance and quality of potential participants, and ambitions for leveraging additional funds.

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Table 2.3. **Rationale for different selection mechanisms**

Mechanism	Rationale
Competitive	• When best participants not clear upfront • Gauge motivation of participants • Value of "label" effect • Longer term spillovers for groups not selected
Limited number	• Clear prioritisation of resources • Value of "label" effect
Top-down	• Clear targets (strategic, quantitatively identifiable) • Coherence with other programmes
Bottom-up	• When best or possible participants not clear upfront • Information best obtained by self-identification • Gauge motivation of participants
Combination	• Best choice in a pre-defined universe • Lower level of government best placed to select • Collaboration across levels of government required • Special additional considerations in cluster selection

Source: OECD (2007), *OECD Reviews of Regional Innovation, Competitive Regional Clusters, National Policy Approaches*, OECD, Paris.

2.3.6. Building linkages across regional innovation poles

Once identified and promoted, local innovative capabilities could yield more effective results if they are connected with each other and explore inter-regional complementarities. Pooling interrelated knowledge and helping firms to embrace larger markets via regional networking initiatives could compensate for the potential hollowing out of certain regions due to asymmetries of information and agglomeration economies. Finland, which is similar to Portugal with relatively small urban areas (apart from the capital), adopted proactive networking mechanisms to make the most of each region's expertise and use it to fuel nation-wide growth: it reformed the Centres of Expertise Programme to give stronger focus on national and international networking, and it developed the Regional Centre Programme to promote a network of functional regions (Box 2.10). In Sweden, cross-sectoral cluster initiatives were encouraged, for example in packaging (bringing together pulp and paper, design, ICT, and surface technology). As an outcome of Visanu and the Invest in Sweden Agency, the National Packaging Project is run by the national research institute STFI Packforsk.[7] In the US, the Georgia Research Alliance serves as the nexus of the regional innovation system across different high-technology clusters with a strong R&D focus.

These various experiences suggest that building linkages – both across sectors and across regions involved in related industries – not only helps to achieve critical mass but also to develop new business opportunities. The Portuguese government could go even further by helping regions to benchmark themselves against each other and within the European map of regional specialisations. For example, it could look into ways to connect its national

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Box 2.9. **Examples of competitive selection processes used in OECD countries**

Most programmes that have a strong innovation focus in OECD countries used a competitive selection process. This is consistent with the purpose of such programmes, which is to support the highest quality proposed projects that are promising sources of economic growth. Examples of such programmes in OECD countries include Sweden's VINNVÄXT (150 applicants), the French *pôles de compétitivité* programme (105 applicants), Germany's BioRegio, InnoRegio and BioProfile programmes. The Georgia Research Alliance in the US does not have a one-time call for proposals but has an on-going competitive selection process. Even when lagging regions are an explicit target, some programmes include a competitive selection progress to identify the best public investments within the target group. Germany's InnoRegio, while targeting the lagging Eastern *Länder*, selected only 23 out of 444 applying networks. Other programmes open to lagging regions also included a competitive process (*e.g.* the SPL programme in France).

The structure of these competitions often recognises that although there may be a critical mass of firms, many potential applicants to a competition would need time to prepare an effective application. As such, some programmes are based around a pre-selection or multi-stage selection process. For example, the Czech Klastry programme provides Phase 1 funding to the initiating group to identify other potential partners in the cluster initiative. Funding therefore covers studies and other expenses in the development of the group prior to the funding of more substantial collaboration. The first round of VINNVÄXT funding also included a two-stage process such that a subset of candidates received funding to further develop their proposals.

One of the explicit goals of Norway's Arena Innovative Networks was to have a highly flexible procedure for selection that allowed different points of entry. If an idea for a project needed development, the group could enter at Stage A and receive funding for a preliminary study. If the group was a bit more advanced, it could enter at Stage B directly with a preliminary project. If the initiative was truly advanced, it could enter at Stage C for a main project. A similar staged process was also used for the InnoRegio Programme in Germany.

Competitiveness and Technology Hubs programme with EU-related tools such as the Seventh Framework Programme (FP7) and the Technology Platforms.

In parallel with intangible linkages, synergies and interrelationships between different regional innovative poles could be further supported by more adequate connectivity and accessibility. Portugal has registered remarkable improvements in terms of infrastructure endowments over the last decades; yet it was often pointed out that past investments tended to concentrate vertically on the urban coast. Plans for future transport investment are attempting to better balance nation-wide coverage by emphasising more horizontal linkages

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Box 2.10. **Towards greater networking: the reform of the Centres of Expertise and the Regional Centre Programme in Finland**

The reform of the Centres of Expertise

The Centres of Expertise have, almost without exception, attained a powerful regional – and often national – status. In the international arena, however, they still remained fairly small-scale operators. Following the initial phase focusing on the identification of regional development needs and the aggregation of expertise, there was growing awareness that international competition required greater visibility and larger critical mass. It was acknowledged that future success would depend on the regions' capacity to network with international top-level expertise hubs through concrete co-operation projects.

For the new 2007–2013 period, the programme remains a regional cluster model based on a tendering process, but with stronger focus on international and national networking. A new strategic concept called the Competence Cluster was introduced. A Competence Cluster means a group of 4-7 Centres of Expertise that are located in different areas, have complementary fields of expertise (which can be defined as a branch, technology, expertise or application), and form together a network to achieve common strategic objectives. Each Competence Cluster has a co-ordinator placed in one of the member Centres of Expertise. The co-ordinator is responsible for mutually approved tasks on a contractual basis. The Competence Cluster presents the advantage of pooling together currently scattered resources, increasing the critical mass required for R&D investment, and creating new channels of information and expertise distribution. The national alliance of the best Centres of Expertise diverts attention away from internal competition towards a common response to international competition. In December 2006, the Government approved 13 nationally significant Competence Clusters and 21 Centres of Expertise for the 2007-2013 period.

The Regional Centre Programme

The Regional Centre Programme (RCP) aims at establishing a co-operative network of regional centres covering every region and province in Finland. The programme is based on the premise that a network of regional centres will result in a better balanced development pattern and enhanced international competitiveness of the country as a whole. It is also a way for the government to clarify the division of labour within the country in order to facilitate an efficient allocation of public resources. The national strategy states that "each province must have at least one urban region which offers a competitive location for various types of business and a diversified local job market. In addition, the provinces must have successful smaller urban regions, strong municipal centres and rural regions, whose businesses are efficiently networked both within the province and outside" (Finnish government, 15 January 2004).

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Box 2.10. **Towards greater networking: the reform of the Centres of Expertise and the Regional Centre Programme in Finland** *(cont.)*

The Ministry of Interior is responsible for the national co-ordination of the Regional Centre Programme. Municipalities apply for the programme in groups, and decide jointly on the management and co-ordination of the programme for their own region. The government finances up to 50% of the costs, while the applicant (group of municipalities) has to finance the remaining half. The Ministry of Interior orients the funding to the Regional Councils (joint municipal bodies), which supervise the implementation of the programme in their respective region. Regional Councils then issue the actual payments to the Regional Centres. The networks facilitate greater interplay between central and regional actors, businesses, the education sector, and the research community. Regional Centres exchange experiences on themes such as innovative action, prosperity, education and culture. Regional Centres in their respective networks focus on specific development needs and possibilities for different types of regions (*e.g.*, large urban regions, industrial regions, rural regions).

The number of regional centres went from 34 during the first programming cycle (2001-2006) to 35 during the forthcoming second cycle (2007-2010). The government's annual funding for the regional centres is about 9 million EUR, with an average of 240 000 EUR per centre and per year (ranging between 150 000 and 500 000 EUR). This financing covers management costs (*e.g.*, administration, co-ordination, information and publicity). Substantial projects are financed by other sources such as the EU Structural Funds.

Evaluations indicated that the first cycle (2001-2006) had the following outcomes: municipalities became more aware of their own role with regard to the regeneration of their region; they have learnt to engage into goal-oriented co-operation by mutual agreement; private and public actors have strengthened their links; there were improvements in terms of intra-regional convergence, employment creation, and population increase (especially in small regional centres and medium-sized provincial centres). The second cycle (2007-2010) will focus on business-oriented development, specialised expertise, and new operating modes for innovative activities.

(Figure 2.3, Figure 2.4 and Figure 2.5). Cross-checking such plans with a map of inter-regional economic interdependencies (including cross-border) could help pinpoint key missing linkages, drive future physical investment into areas that indicate the greatest return on investment, and ultimately contribute to better balanced national development.

Efforts to re-launch the growth dynamics based on regional innovation, however, may run into a complex policy debate. Given its relatively compact geography, the Portuguese national territory was rapidly partitioned by

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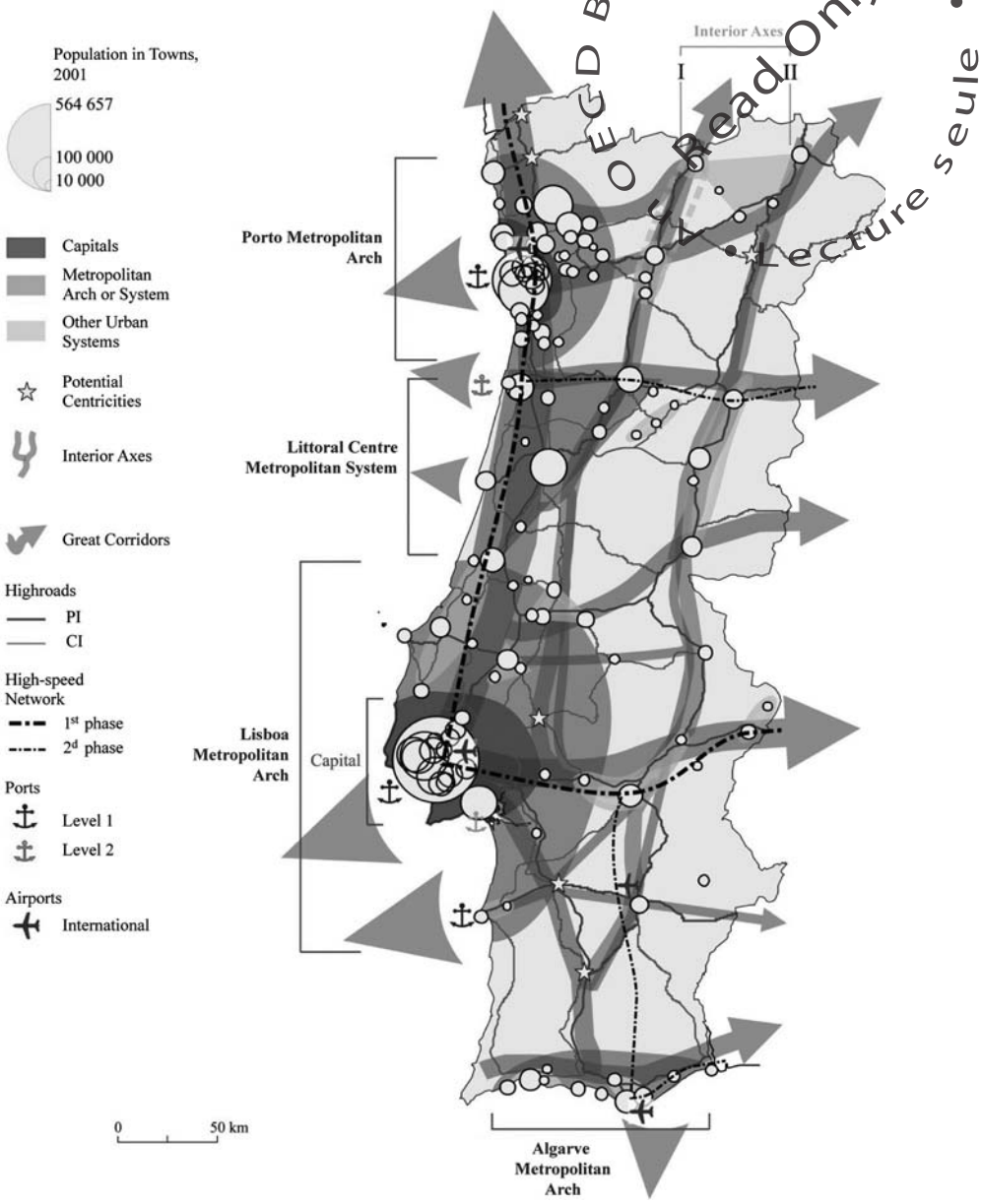
Figure 2.3. **Urban system and accessibility plan**



Source: National Spatial Policy Programme 2007.

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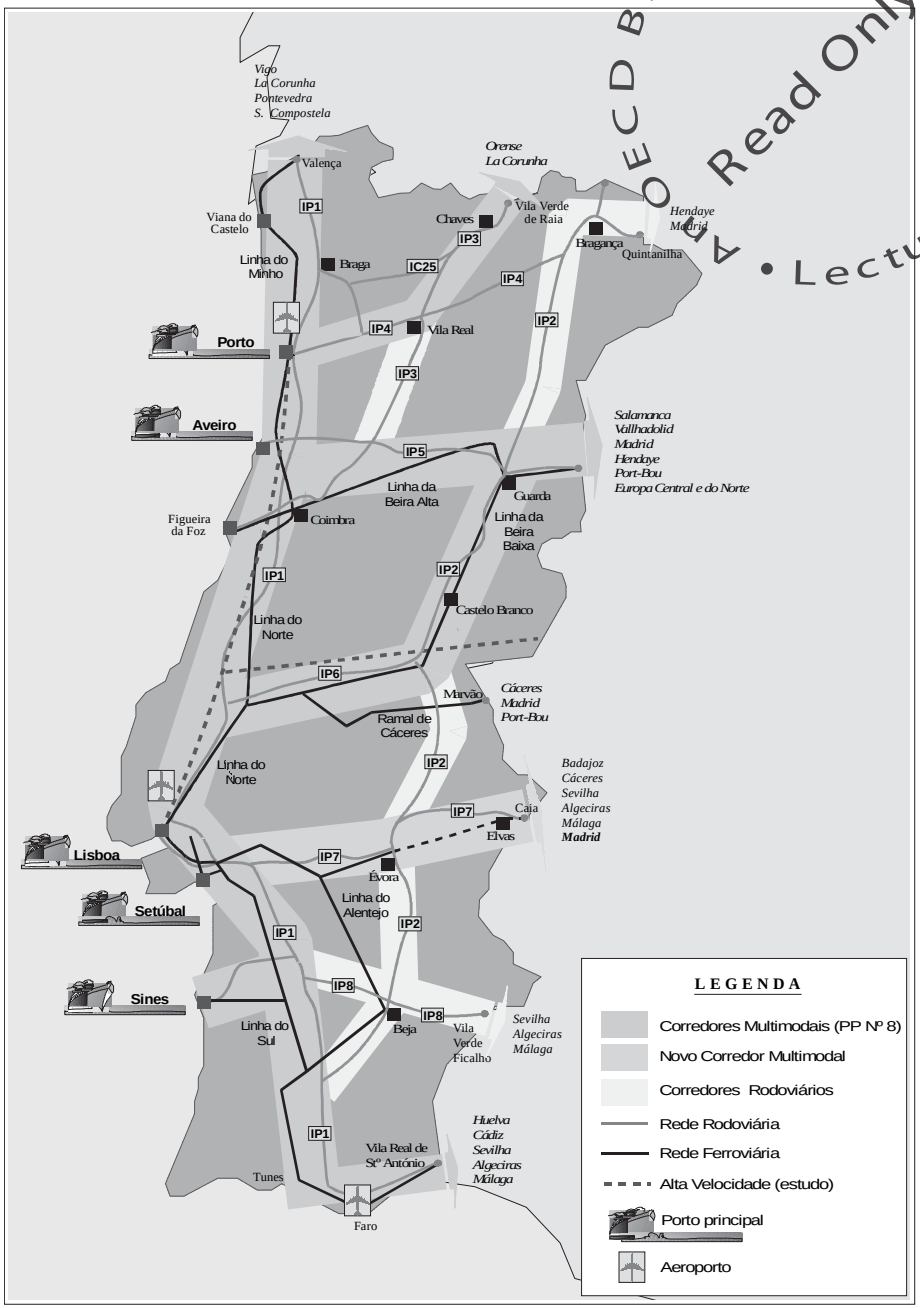
Figure 2.4. **Main transportation networks in Portugal**



Source: POAT 2000-2006.

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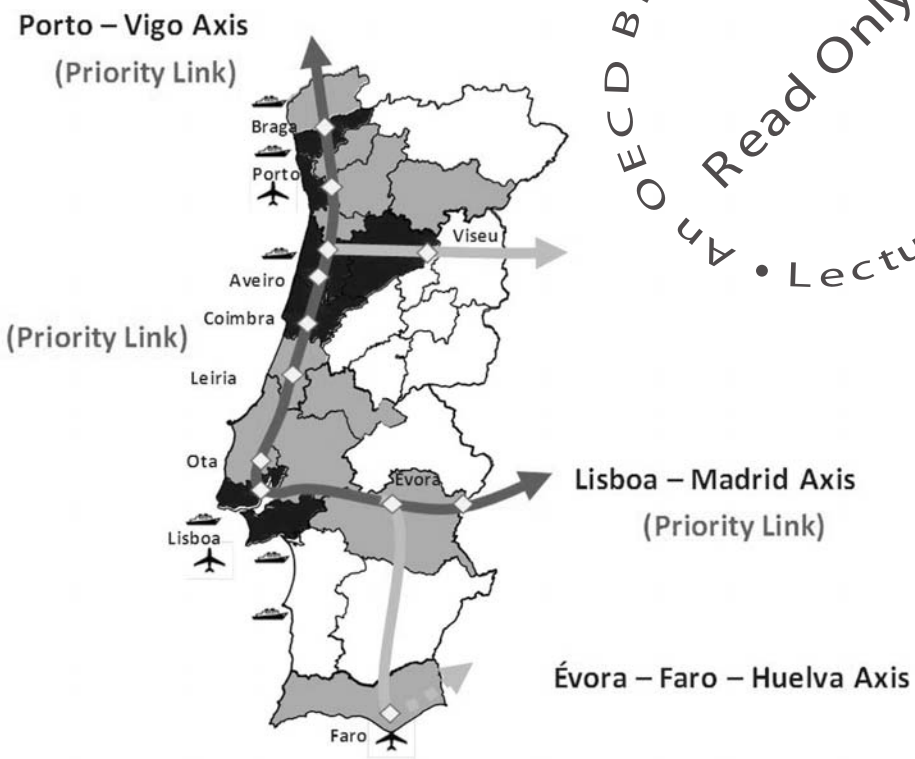
Figure 2.5. **Main investments planned for high-speed railway network**



Source: RAVE.

agglomeration effects, and there are mounting concerns over the possible eviction of certain disadvantaged regions out of the growth route. At a time when some OECD countries are struggling to curb the negative externalities of their rapid industrialisation (*i.e.*, congestion, pollution) in view of new global challenges such as climate change, Portugal still owns relatively preserved environmental assets and territories to be developed. The following section suggests that regional policy can support the overall sustainable development of Portugal.

2.4. Regional policy as a tool to support sustainable development

Amidst recurrent calls for competitiveness-oriented measures, the future of certain regions (mostly rural) has emerged as an increasingly disconcerting policy issue in Portugal. In stark contrast with urbanised or urbanising areas, the majority of Portuguese rural areas are struggling against a typical vicious circle, which spirals respectively through the decline of traditional agriculture, accelerating population ageing, exodus of younger workers, persistent fall of population density, and the erosion of the critical mass required to maintain public services and nurture alternative economic activities.

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A major difficulty stems from the fact that current sectoral policies tend to convey contradictory signals to economic agents in rural regions. For example, it is increasingly difficult to combine two opposing policy goals such as keeping farmers afloat in rural areas (a major preoccupation of the Ministry for Agriculture) and rationalising the offer of public services (priority of other ministries such as the Ministry for Education and the Ministry for Transport) (Table 2.4). The multi-dimensional nature of rural development challenges is also evident in the overlap between the Mainland Rural Development Programme (managed by the Ministry for Agriculture) and the various programmes to promote both competitiveness and cohesion in low-density areas (respectively PROVERE and the Multi-Purpose and Proximity Services Network, two very recent programmes prepared by the Ministry for Environment, Spatial Planning and Regional Development) (Box 2.11,

Table 2.4. **Example of policy dilemma in rural regions**

	Preserving rural territories	Rationalising public services
Objective	Helping farmers to remain in rural regions	Streamlining public service investment, focusing on a smaller number of units most capable to meet the needs of the population with higher quality service
Examples of measures involved	Providing income support to farmers	Closing schools that fail to pool a viable number of students Shutting down underexploited transport linkages
Ministries involved	Ministry for Agriculture	Ministry for Education Ministry for Transport
Main source of funding	EAFRD	Structural Funds and national funding

Box 2.11. **The Mainland Rural Development Programme**

The Mainland Rural Development Programme runs over the 2007-2013 period and focuses on low-density areas. It makes a distinction between three categories of zones: defavourised zones, Natura 2000 zones, and rural zones (with some obvious overlapping between the three categories: for example, 94% of "rural zones" are located in "defavourised zones"). The Mainland Rural Development Programme will be financed by the EAFRD (total of 3.5 billion EUR).

The Mainland Rural Development Programme proposes four lines of action: "promoting competitiveness; promoting knowledge and skill development; promoting sustainable rural development; and promoting the economic dynamisation of the rural world".

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Box 2.12 and Box 2.13). Current doubts about the chances of survival of the Portuguese rural world illustrate the failure of a mono-sectoral approach to address complex development issues on the long term.

Box 2.12. **Exploiting endogenous resources in low-density areas: the PROVERE programme**

PROVERE (Programme for the Economic Valorisation of Endogenous Resources) is a programme promoted by the Secretary of State for Regional Development of the Ministry for Environment, Spatial Planning and Regional Development. The programme is still in an embryonic phase of preparation and many aspects remain to be determined. The ultimate objective is to offer selective support for bottom-up initiatives that valorise specific local resources, mainly in low-density areas (although the area does not have to be continuous, considering the weakness of the institutional fabric).

The envisaged methodology is based on a call for projects, a pre-selection of preliminary projects, an evaluation of the projects by "peering committees" composed of experts and representatives of Ministries, and a final selection of projects. Projects are planned to be financed by the Operational Programmes of the NSRF 2007-2013.

Box 2.13. **Rationalising the supply of basic public services in low-density areas: the Multi-Purpose and Proximity Services Network**

The Multi-Purpose and Proximity Services Network is an initiative promoted by the Secretary of State for Spatial Planning and Cities of the Ministry for Environment, Spatial Planning and Regional Development in co-operation with other government bodies. The initiative aims at implementing an innovative method to provide basic public services in low-density, less favoured areas. Public services concerned are education, health, employment and social security, agriculture and rural development, environment, administrative/legal/fiscal issues. The planned network includes a combination of mobile service units (travelling in a vehicle equipped with the Internet), fixed multi-service centres (face-to-face attendance and call centre), and the Internet. Each mobile service unit consists of a multi-skilled team that received specific training. Governance of the local projects will involve municipalities (municipal councils), CCDRs, and local development associations. Around 40 Multi-Purpose and Proximity Services projects are expected to be implemented through the 2007-2013 Regional Operational Programmes (Norte: 15; Centro: 15; Alentejo: 7; Algarve: 3).

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One of the most realistic options could be to increase people's mobility so as to facilitate their access to concentrated public services, while encouraging local actors to build on endogenous resources and develop alternative economic activities.[8] In addition to the fact that Portugal is a relatively small country, the considerable expansion of transport infrastructure during the three EU Community Support Frameworks (1989-1993, 1994-1999, 2000-2006) has translated into even shorter distances between the different regions (see the "virtual deformation" of the national territory in Figure 2.6). Portugal could turn the geographic proximity of its regions into a national asset to foster a network of functional economic regions. This restructuring approach needs to be combined with efforts to synchronise the supply of public services (*e.g.*, not closing unsustainable schools before making sure that a 'concentrated' school in an adjacent area is available to take over the students).

A major avenue for rural development could be to explore territorial attractiveness. Besides authoritative economic studies that concluded that the tourism sector could offer an alternative source of regional growth in Portugal,[9] the experience of other OECD countries shows that rural regions are increasingly developing a strategy of differentiation and looking into ways to valorise their unique amenities.[10] On top of their general qualities (*i.e.*, green spaces, pollution-free air, lower cost of housing, etc.), Portuguese rural regions could further tap their unique history and traditions to develop activities related with cultural and rustic tourism (as opposed to beach tourism, which displayed signs of saturation in the south, for example). Sport and leisure tourism also offers interesting options as long as it meets strict environmental standards (to avoid problems raised by the rapid development of golf tourism in the Algarve region). There are additional opportunities to capitalise on the brand of the Iberian peninsula through cross-border collaboration (*e.g.*, following the example of the Euro-region linking the north of Portugal and the region of Galicia in Spain). Continuous exchange of information between central and local actors could help the former to complement their knowledge on the overall potential tourism offer (Figure 2.7) and help the latter to find appropriate niches based on differentiated assets.

Recent nation-wide reforms to encourage entrepreneurship and streamline administrative procedures will help to liberate further creative energy in devitalised regions and should be actively promoted. For example, the possibility to set up a new firm in less than one hour (the "On the Spot Firm" initiative launched in 2006) is expected to introduce a more responsive business culture and marks a significant step forward, considering that Portugal used to display the highest obstacles to business creation among OECD countries until recent years but registered noticeable progress (Table 2.5).

A better diffusion of information about existing cases of local renewal could trigger similar initiatives in other parts of Portugal.

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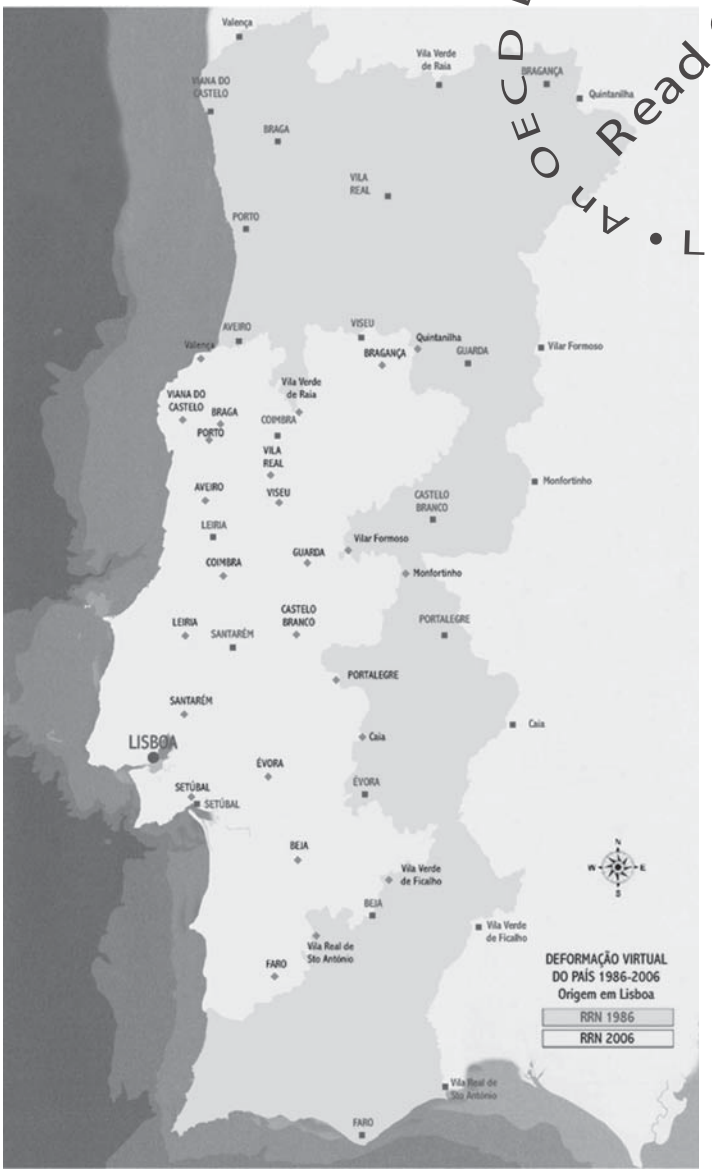
Figure 2.6. **Map of virtual deformation 1986-2006 due to reduction of travel time**



Note: Distances between provincial capitals and Lisbon were reduced in the exact proportion of the reduction of real travel time between 1986 and 2006. This map was produced following the Model of Analysis and Strategic Planning of the National Road Network, supported by computer application for Transport Planning EMME2.

Source: Estradas de Portugal, EPE published in INE, Portugal 20 Years of European Integration (2007).

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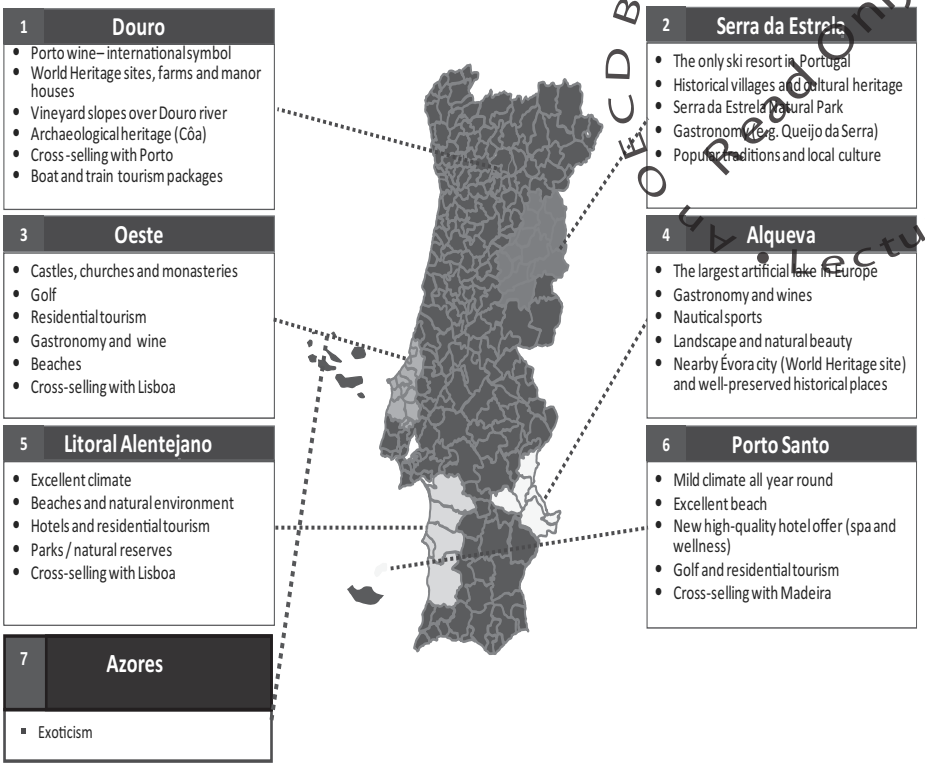
Figure 2.7. **National plan on regional distribution of tourism offer**



Source: National Strategic Tourism Plan 2006-2015.

Table 2.5. **Cost of business creation in 2007**

	Number of procedures	Time (number of days)	Cost (% of per capita income)
Spain	10	47	15.1
Germany	9	18	5.7
Italy	9	13	18.7
Portugal	**7**	**7**	**3.4**
Netherlands	6	10	6
UK	6	13	0.8
US	6	6	0.7
France	5	7	1.1
Denmark	4	6	0
Finland	3	14	1
Canada	2	3	0.9
OECD	6	14.9	5.1

Source: World Bank (*www.doingbusiness.org*).

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By sharing evidence of what was done elsewhere, regions could gain the necessary confidence to break the spiral of decline and to search proactive solutions. The first step in this direction for policymakers is to create new positive expectations among agents. In practice, a few exceptional examples of dynamic rural regions in Portugal are already visible and could be more broadly communicated through a process of inter-regional learning. The city of Mértola, located in a remote and low-density part of Alentejo, illustrates clearly how local leadership was able to promote trust in local potential, encourage citizen participation, foster the creation of interfaces, and facilitate the exchange of experiences (Box 2.14). On the long term, helping weaker regions to capitalise on existing social capital could be a less costly and more effective policy option than *ad hoc* cash injections, which might perpetuate a pattern of overreliance on public funding.

Box 2.14. **Searching for endogenous development potential in low-density areas: the example of Mértola**

Mértola is a small city of around 8 000 inhabitants located in the region of Alentejo. The city suffers from many problems commonly encountered in rural regions (ageing population, unemployment, lack of critical mass) but the municipal government refused to consider such problems as a fatality. Mértola does not aim at being just a "surviving territory", but it ambitions to become a "developing territory" that shapes its own future. Drawing on its history, the municipal government decided to create a new development vision according to the motto "roots in the past, eyes in the future". In order to achieve this objective, local actors are collaborating to develop a new economic pattern based on local assets (*e.g.*, tourism, traditional products, social economy, renewable energy). There are efforts to rationalise settlement patterns (less cities but bigger) and develop new urban-rural networks. Significant investment is devoted to territorial marketing, notably to consolidate Mértola's image as a hub of Islamic history and art in Portugal (museum, festival, etc.).

This endogenous development approach was supported by a practical modernisation of governance mechanisms. In particular, the municipal government works in close collaboration with ADPM, a local non-profit development association for the protection of Mértola's heritage. The association staff is composed of around 30-40 people, who are remunerated via EU-funded projects. The main objective of ADPM is to defend Mértola's endogenous resources (knowledge about local potential) and to bridge the gap between public and private sectors. They have launched several successful initiatives (Monte do Vento for education, Cria(c)tivos for investment in the rural world, Terras do Pulo do Lobo).

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Portugal should seize the opportunity of developing new rural activities to serve overall sustainable development objectives. Some rural regions have taken promising initiatives to develop alternative activities based on specific regional potential, such as the wine sector in the Douro region or the agro-food industry in the Alentejo, and the government is usefully backing such projects by promoting them *vis-à-vis* domestic and international investors (Box 2.15). The government has also sponsored a few very large projects such as the Alqueva lake tourism venture in the Alentejo under the form of strategic projects of national interest called PIN (Box 2.16). This type of projects can be compared with similar initiatives in France for example (Box 2.17). Beyond indispensable efforts to co-ordinate environmental and economic concerns, further action to develop weak regions calls for additional considerations. For example, PIN projects tend to focus primarily on large-scale investment. It would be equally important to carefully monitor to what extent such investment builds on local endogenous assets and what mechanisms could help embed external knowledge and trigger spin-offs in the local economic

Box 2.15. **The Alqueva Irrigation Project**

The Alqueva Multi-Purpose Project (EFMA) has been recognised as being of potential national interest in the Alentejo region. It has an agricultural component called the Alqueva Irrigation Project, which will cover approximately 110 000 hectares in Alentejo Central and Baixo Alentejo.

Once in full use, the Alqueva Irrigation Project will promote the implementation of competitive agricultural systems, which are expected to have a significant economic and social impact on the region and on the country as a whole. The potential wealth created by the Alqueva Irrigation Project was estimated at approximately 300 million EUR per year, which represents 48% of the regional agricultural output (Alentejo) and 9% of the national agricultural output (2005 estimates). The additional employment generated might reach 1 000 to 3 000 annual labour units. The Alqueva Irrigation Project is thus expected to help settle population in Alentejo by diversifying employment opportunities and increasing wealth creation.

In terms of the environment, the Alqueva Irrigation Project will be implemented in a way that will be compatible with the sustainable use of resources and in compliance with existing natural values. It is expected to help tackle desertification by promoting a sustainable use of soils by resident rural population that directly or indirectly benefits from irrigation.

The Alqueva Irrigation Project (secondary irrigation infrastructures) is co-financed by the EU through the EAFRD (PRODER – Rural Development Programme – Mainland Portugal).

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Box 2.16. **The creation of the AICEP and PIN projects**

Following the general reform of public administration in Portugal (PRACE programme), the recent merger between API (Portuguese Agency for Investment) and ICEP (Institute for Investment, Trade and Tourism) into the AICEP (Business Development Agency) was considered a useful move to better integrate FDI and trade policies.

The AICEP will continue to oversee the projects of national interest (PIN). There are currently 63 PIN projects in Portugal (as of the end of 2006), which are estimated to account for 13.4 billion EUR and more than 55 700 jobs. Almost half of the PIN projects focus on tourism (49%), while the remaining half is distributed among energy (16%), chemical and petrochemical (8%) and pulp and paper (6%) industries. Regionally, Alentejo and Lisbon represent 71% of total investment value and the highest job creation figures (40 000 jobs) (Table 2.6).

PIN projects must fulfill criteria related to their scale (their value must be above 25 million EUR) and their nature (structural investment projects, with evidenced value-added). The Committee for Evaluation and Follow-Up is composed of top-level officials from various entities (representatives from the Prime Minister, the Ministry for Economy, the Ministry for Environment, the President of the Environmental Institute, the Directorate General for spatial planning and urban policy) and meets every two weeks to monitor the environmental sustainability of the projects.

Table 2.6. **PIN projects**

	Number of projects	Value of investment (million EUR)	% of total	Number of jobs	% of total	Unemployment rate
Norte	9	1 133	8.5	7 707	13.8	8.4
Centro	12	1 150	8.6	1 345	2.4	5.1
Lisbon	11	3 421	25.6	25 606	46.0	8.1
Alentejo	21	6 116	45.8	15 263	27.4	8.9
Algarve	9	1 432	10.7	5 786	10.4	5
Madeira	1	113	0.8	n.a.		5

Source: PIN team, INE, Employment Statistics, 2nd trimester of 2006.

fabric, rather than pursuing one-shot investment that "travels light" and leaves little durable benefit behind. The link between policies for regional economic development, spatial planning, environmental sustainability, investment attraction but also decentralisation needs to be investigated more carefully, as shown by the example of France (Box 2.18).

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Box 2.17. **Supporting specific strategic projects: the *Opérations d'Intérêt National* (OIN) in France**

The concept of *Opérations d'Intérêt National* (OIN) was created in 1983 at a time when the French government was decentralising urban planning competencies and at the same time facing the challenge to maintain the State's prerogatives regarding strategic territories. According to urban planning laws, when the central government designates an area as an OIN, the municipalities located within this area lose part of their own competencies in urban planning. This means that the central government gains stronger influence on the local planning process. Due to the key role of the central government, the OIN project is usually managed by a public agency that oversees the territory covered by the OIN. In 2007, about 10 OIN projects are being implemented.

Box 2.18. **Better articulating FDI policy and regional economic development policy: the example of the Invest in France Agency (*Agence Française pour les Investissements Internationaux*, AFII)**

In France, concern over potential contradictions between FDI policy and spatial planning policy was tackled by the recent reformulation of the Invest in France Agency's mandate. The objectives of the Invest in France Agency (*Agence Française pour les Investissements Internationaux*, AFII) now include explicitly spatial planning issues and the economic development of less developed territories or territories and firms undergoing a crisis.

AFII was established in 2001. At that time, it reported to the Minister of the Economy, Finance and Industry, and to the Minister of Regional Development. The Agency's objective is to attract long-term international investments that generate economic growth and employment opportunities. Its responsibilities include promoting the French territory to international investors and opinion leaders, prospecting internationally mobile investment projects, acting as a broker between investing businesses and local authorities, economic development organisations, government bodies and service providers, co-ordinating site selection proposals presented to the French regions, monitoring international investment flows and site selection factors.

The Agency collaborates with local authorities and with the support of partners in the business community. Currently, 60 people staff the Invest in France Agency's Paris headquarters, while an additional 80 work for its international network of 22 field offices, also called Invest in France Agencies.

Within the Agency's headquarters, the Committee for the Orientation and Follow-up of the Projects (*Comité d'Orientation et de Suivi des Projets*, COSPE) is in charge of identifying the sites that are best able to meet the investing

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Box 2.18. **Better articulating FDI policy and regional economic development policy: the example of the Invest in France Agency (*Agence Française pour les Investissements Internationaux*, AFII)** *(cont.)*

company's requirements. In addition to specialists from the Agency itself, the Committee's members include representatives of DIACT, the Ministry of Industry, the Foreign Trade Division of the Ministry of Economy and Finance, regional economic development bodies, the corporate community, and other actors involved. The Committee meets at least once a week, and whenever urgent information on a specific project is required.

The Agency is managed by a President and a Board of Directors, which includes seven representatives of various ministries (including the Ministry of Economy, Finance and Employment, the Ministry of Regional Development, the Ministry of Foreign Affairs, the Ministry of Technology), four representatives of local authorities, four members with special expertise in international investment, and two representatives elected by the Agency's staff.

In November 2006, four new strategic priorities were formulated, among which two are related with spatial planning and economic development targeting high value-added territories as well as less developed territories:

- "actively participate in spatial planning policy by fostering innovation and growth of the competitiveness poles on the one hand, and supporting the diversification of industry in fragile territories, regarding international competition, on the other hand";
- "give foreign investors a better knowledge of the economic and social reforms implemented by the French government".

In addition, two major measures have been taken to facilitate policy integration.

First, DIACT has become a member of the committee in charge of analysing foreign investment projects. It contributes its knowledge on the state of development of the different territories and it makes suggestions to match investment projects and specific territories. AFII is free to propose these suggestions to the regions, which then make the final decision. Regions are aware that they compete with other French and European regions, and they have to evaluate the advantages and risks they take by proposing a less dynamic territory within their region.

Second, AFII is now participating in the intersectoral committee for economic mutations, in which all ministries come together on a weekly basis to examine companies or territories that are confronted with particular difficulties. AFII can therefore share information with government policymakers about a foreign investor they know that may be interested in bailing out these companies or territories.

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2.5. Conclusion

Portugal stands at a decisive crossroads on its development path. The country enjoys a unique location at the south-western tip of the EU and privileged access to envied markets such as Latin America and Africa. It has substantial potential to increase its productivity and to specialise in sustainable development-oriented activities. Building on past achievements (*e.g.*, physical infrastructure, basic education), it could give a fresh impetus to innovation and consolidate its catching-up process towards knowledge-based economy, or risk to let emerging economies tackle its position on low-end products. In a context of EU enlargement where the 2007-2013 programming period might offer the last external support to nurture endogenous growth capacity, the government will need to pass salutary reforms. Regional policy will help send a powerful stimulus into the economy and liberate local creativity. The Portuguese territory should no longer host an accidental collision of sectoral policies but become a field to foster an integrated strategy for growth and collective improvement. During the elaboration of recent reforms, the government showed strong commitment towards a renewed agenda for competitiveness compatible with environmentally sustainable development; such efforts need to be pursued throughout the implementation phase. The following chapter will discuss the governance mechanisms required in regional policy to bring various actors together, to promote capacity building, and to ensure overall policy coherence.

Notes

1. "Territorial Enhancement" will mostly fund projects in transport and environment.
2. In the past, the effective impact of sectoral policies in terms of spatial planning was not monitored thoroughly.
3. See OECD (2007), *Economic Survey of the European Union*, OECD, Paris.
4. This ongoing initiative is expected to be completed in early 2008.
5. The close link between the Technological Plan and the Lisbon Strategy also translated into a positive institutional reform that placed both under the responsibility of a new co-ordination cabinet (GCELPT, *Gabinete de Coordenação da Estratégia de Lisboa e do Plano Tecnológico*), which reports directly to the Prime Minister.
6. More detailed information on these examples in OECD (2007), *OECD Reviews of Regional Innovation, Competitive Regional Clusters, National Policy Approaches*, OECD, Paris.
7. More detailed information is available on the STFI website (*www.stfi.se*).
8. Regional development policies need to adapt to the fact that it will be extremely difficult to reverse demographic trends in low-density areas in the near future before a new demographic cycle begins.
9. For example, see article from Elias Soukiazis and Sara Proença "Tourism as an Alternative Source of Regional Growth in Portugal", Documento de Trabalho, September N°34, Coimbra 2005.
10. See OECD (2006), *The New Rural Paradigm*, OECD, Paris.

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Chapter 3

Reforming the Governance of Regional Policy in Portugal

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3.1. Introduction

Portugal has launched an ambitious agenda of reforms geared towards competitiveness and faces a narrow window of opportunity to implement it. The challenge of modernising the economy while continuing to curb the fiscal deficit highlights the importance of seeking the most efficient allocation of public spending through a new paradigm of regional policy. In order to make the best possible choice among public investment opportunities available across the national territory, Portuguese policymakers are challenged to overcome possible temptations to maintain activities or behaviours that are dictated by path dependency but no longer suitable to bolster national competitiveness. Public authorities are increasingly required to differentiate their intervention according to the specific assets of each region and to capitalise on the knowledge distributed across a wider range of actors. There has been growing awareness that Portugal's traditionally centralised governance framework faced limits and lacked mechanisms to counterbalance asymmetries of information across actors. Governance reforms will therefore determine the success of new regional policy in Portugal. The government's strong commitment to generate structural change has motivated recent initiatives which are heading in a promising direction. Now the reforms need to be fully implemented and to go further in order to deliver the expected outcome. This chapter first analyses how the current Portuguese framework has addressed the new governance needs induced by new regional policy, then it discusses suggestions for further headway.

3.2. New governance needs for new regional policy

In Portugal as in many OECD countries, the paradigm shift in regional policy has shed new light on the value of locally embedded knowledge and social capital. Portugal's present efforts to implement a new regional policy based on specific local opportunities for development entail new requests in terms of governance, which can be summarised in four main categories: a new division of labour between actors; incentives to reveal knowledge and capacities; more appropriate scales for defining development strategies; and fiscal instruments to support subnational development strategies. The following section assesses to what extent the current governance framework in Portugal fulfills these four categories of requests.

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3.2.1. A *more efficient division of labour between actors*

In many OECD countries, new regional policy stems from the recognition that all actors bring their own distinctive knowledge into the policy-making process. While former attempts of regional policy mostly saw the central government dominate the decision process and apply an almost final product to the different territories, more recent initiatives for place-based development increasingly aim at leveraging local action (both public and private). This shift involves a more efficient distribution of roles between actors according to the unique knowledge that each of them has accumulated. The *central* government has a broad overview of national development and the control over public resources but it is not necessarily aware of specific local assets. *Local* governments are likely to have access to local knowledge but they tend to miss an overall strategic vision. Finally, both central and local governments usually lack the *private* sector's knowledge to anticipate how and where firms decide to invest. The transition from a centralised and top-down governance scheme towards closer exchange of information across actors throughout the policy-making process implies that the central government moves up to the "meta" level of a strategy maker,[1] which focuses on providing guidelines for a national strategy of regional policy and on bringing together a broad spectrum of actors (*e.g.*, local governments, business sector, academic and research institutions, citizen associations).

The importance of tapping differentiated and complementary knowledge of various actors has recently gained more recognition in Portugal but will need to be further translated in practice. In institutional terms, the importance of regional policy seemed to be acknowledged relatively early at the national level as Portugal is one of the few OECD countries endowed with a specific ministry in charge of regional development (Ministry for Environment, Spatial Planning, and Regional Development). At the same time, the existence of a dedicated ministry alone cannot be expected to guarantee knowledge sharing across central, local and private actors. In practice, Portugal remains the second most centralised country in the OECD area according to an indicator commonly used for international comparisons (*i.e.*, the share of total public revenues and expenditures generated at subnational levels, Figure 3.1). Looking at the same indicator in dynamic terms, Portugal registered almost no change in the distribution of revenues and expenditures between the national and subnational levels over the 1995-2005 period (Figure 3.2). Responsibilities are either under the authority of the central government or shared between central and municipal levels (Table 3.1). Overall, resources and competencies remain mostly vested in the central level, which suggests that the policy-making process still relies heavily on central government knowledge. Growing awareness about the limits of this governance framework has prompted a wide variety of recent reforms (notably the 2007 reform of the Local Finance Act, to be discussed later in the chapter).[2]

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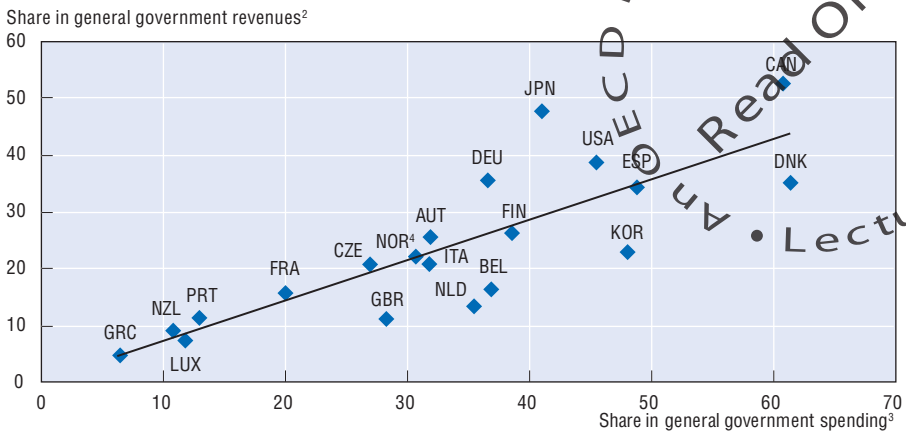
Figure 3.1. **Subnational shares of total tax revenues and expenditures, 2005**[1]

Unit: % of national total



Note: Decentralisation is measured by the changes in the share of sub-national governments in total public revenues and spending.

1. Or latest year available: 2003 for Canada and New Zealand, 2004 for Japan and Korea.
2. Excluding transfers received from other levels of government.
3. Excluding transfers paid to other levels of government.
4. The share of subnational revenues is expressed in per cent of total government mainland revenues.

Source: OECD National Accounts database; Statistics Norway; Statistics Canada; US Bureau of Economic Analysis.

At the subnational level, Portugal is characterised by supposedly influential but actually dependent municipalities, and the absence of an elected intermediate regional level (except in the two autonomous regions of Azores and Madeira). Portuguese municipalities are relatively large in terms of average population size compared with other OECD countries (Figure 3.3) and mayors usually enjoy strong political clout. However, the share of municipalities in total government budget and in the total number of public servants remains modest. The number of municipalities has remained relatively stable in the long run (1898-2004) while the number of parishes (*freguesias*, basic units within municipalities in charge of minor administrative tasks) increased (Figure 3.4). An asymmetrical type of regionalisation exists in Portugal. Two regions, Azores and Madeira, have been endowed with the status of autonomous regions with respect to their distinctive geographic characteristics (peripheral islands). These two regions elect their own regional government and regional assembly. In contrast, the Portuguese mainland has no elected intermediate level between the central government and municipalities. The five mainland "regions" (Norte, Centro, Lisboa e Vale do Tejo, Alentejo, and Algarve) were initially set up for planning purposes and became the geography for EU Structural Funds management. The five regions are currently administered by the central government via the

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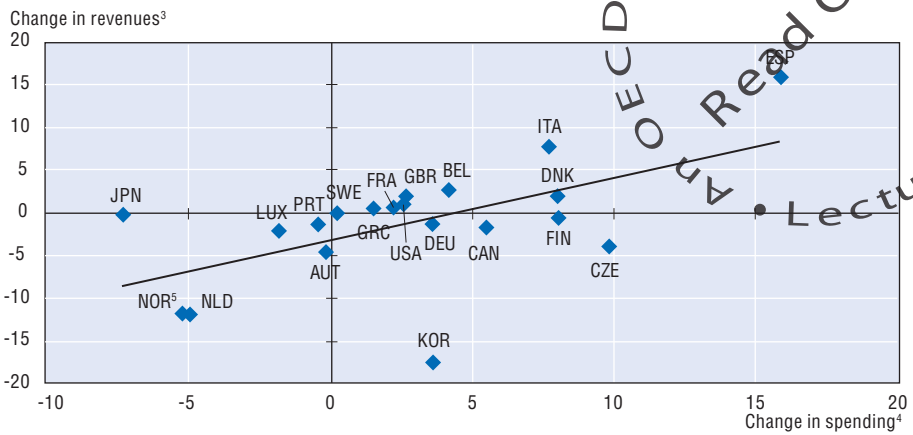
Figure 3.2. **Percentage change in subnational share of national total revenues and expenditure, 1995[1]-2005[2]**

Unit: %



Note: Decentralisation movement is measured by the changes in the share of sub-national governments in total public revenues and spending.

1. Or earliest year available: 1996 for Japan, 1999 for Portugal, 2000 for Greece and Hungary.
2. Or latest year available: 2003 for Canada and New Zealand, 2004 for Japan and Korea.
3. Excluding transfers received from other levels of government.
4. Excluding transfers paid to other levels of government.
5. The share of subnational revenues is expressed in per cent of total government mainland revenues.

Source: OECD National Accounts database; Statistics Norway; Statistics Canada; US Bureau of Economic Analysis.

Commissions for Regional Co-ordination and Development (CCDR), which are the deconcentrated bodies of the Ministry for Environment, Spatial Planning and Regional Development. The role of the CCDR has expanded over time (Box 3.1). Presently, their responsibilities are strikingly complex and demanding, including regional spatial planning, environmental issues, regional development, and technical support to local governments. In contrast with increasing and multi-dimensional responsibilities, the financial and human resources of the CCDR have declined following national fiscal constraints.[3] All five commissions have the same administrative structure (six departments, between 13 and 16 divisions, and one "multidisciplinary team") composed of civil servants.

Mechanisms to integrate the knowledge of different actors in the decision-making process exist but remain to be clarified. A large part of recent efforts to promote intergovernmental dialogue in Portugal were induced by the requirements of the EU regional cohesion policy. For example, while the Portuguese government was elaborating the National Strategic Reference Framework (NSRF) in view of the 2007-2013 EU Structural Funds programming period, each of the regions was asked to draft its own "Regional Strategy 2015"

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Table 3.1. **Distribution of competencies between the central government and municipalities in Portugal**

Function	Competent authority	
	Central government	Municipality
Education		
Pre-school education	X	X
Primary education	X	X
Secondary education	X	
Vocational and technical	X	
Higher education	X	
Public health		
Hospitals	X	
Health protection	X	
Social welfare		
Kindergarten and nursery	X	X
Family welfare services	X	X
Welfare homes	X	
Social security	X	
Housing and town planning		
Housing	X	X
Town planning	X	X
Regional/spatial planning	X	X
Environment, public sanitation		
Water and sewage	X	X
Refuse collection and disposal	X	X
Slaughterhouses	X	X
Environmental protection	X	X
Consumer protection	X	X
Culture, leisure and sports		
Theatres	X	X
Museums and libraries	X	X
Parks and open spaces	X	X
Sports and leisure	X	X
Traffic, transports		
Roads	X	X
Transports	X	X
Urban road transports	X	X
Urban rail transports	X	X
Ports	X	
Airports	X	X
Economic services		
Gas	X	
Water supply	X	X
Agriculture, forest, fishing	X	X
Electricity	X	X
Economic promotion	X	X
Trade and industry	X	X
Tourism	X	X

Source: EU Handbook of Regional Structures for Territorial Co-operation, 2006.

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Figure 3.3. **Average size of municipalities in OECD countries, 2006**
Unit: number of people per municipality

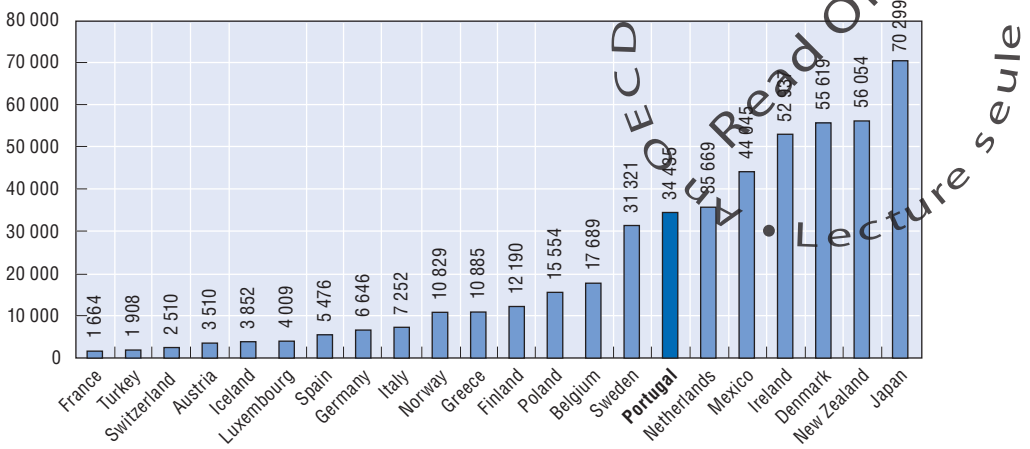
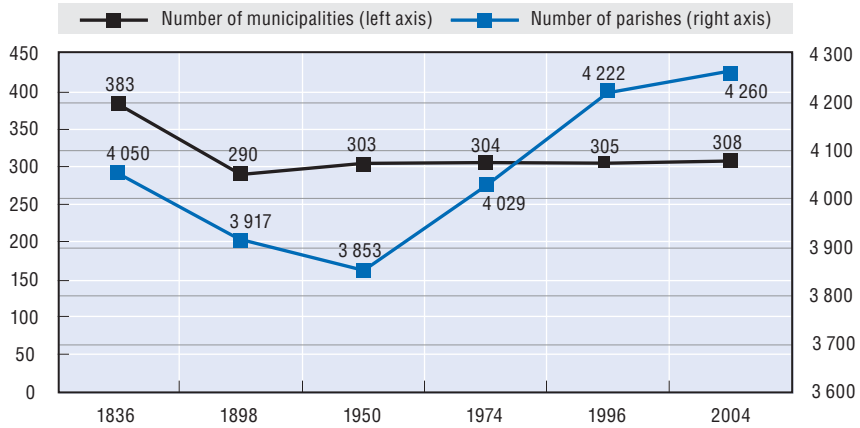


Figure 3.4. **Number of municipalities and parishes in Portugal**



Source: Council of Europe.

under the direction of its corresponding CCDR. These regional strategic documents shaped the Regional Operational Programmes of the NSRF and helped to adjust the Thematic Operational Programmes. The regional documents usually displayed a set of ambitious and appealing objectives for development. While formal procedures for consultation exist, it will be crucial to reinforce the commitment of key regional actors (*e.g.*, municipalities, universities, business sector, chambers of commerce, NGOs) in the implementation of strategies. For instance, each CCDR is supposed to be endowed with a

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Box 3.1. **Chronology of the Commissions for Regional Co-operation and Development (CCDR)**

1969: creation of Planning Commissions.

1979: the Planning Commissions became the Commissions for Regional Co-ordination (CCR).

1986-1989: the functions of the CCR were widened to regional spatial planning and environmental issues.

2003: the CCR merged with the deconcentrated units of the Ministry for Environment and Spatial Planning (DRAOT) and became the Commissions for Regional Co-ordination and Development (CCDR).

2006: new organic law of the Ministry for Environment, Spatial Planning and Regional Development.

2007: decrees to define the organic structure of the CCDR.

consultative body called the Regional Council (*conselho regional*), where municipalities, parishes, universities, and NGOs are represented and communicate their opinion on strategic choices. However, evidence of consultations conducted through this channel was weak. In its current configuration, the CCDR remains an ambiguous regional level that operates as an efficient deconcentrated arm of the central government rather than a bottom-up regional voice.

3.2.2. Incentives to reveal competitive assets

Acknowledging the existence of an "informational gap" between central, local and private actors about regional opportunities for development leads to the issue of setting appropriate incentives for actors to reveal their knowledge. While regional policy calls for a differentiation of strategies according to the specific strengths of each region, all assets and competencies should not be expected to manifest themselves automatically, precisely because actors are not always aware of how and where their own knowledge could be useful. In order to identify specific growth opportunities and to develop place-based policies aimed at tapping them effectively, practical mechanisms are required to stimulate all knowledge holders into contributing to regional policy-making.

Portugal exhibits a particular rationale for setting knowledge-revealing incentives. As a relatively small country confronted with public spending constraints, Portugal cannot realistically pretend to turn all its regions into international excellence poles, nor afford a single economic specialisation (which would make the country too vulnerable to shifts in global demand).

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There is a keen need to detect and exploit niche activities, which target global, national but also quite often regional (and cross-border) markets. In few cases, niches might emerge spontaneously, but this is likely to require a given lapse of time. In the Portuguese context where the economy needs faster and stronger growth to meet globalisation challenges, a proactive approach is necessary to help disclose niches.

Information about existing or potential niches is often anchored among key local and regional actors such as firms and business associations, chambers of commerce, banks and financial institutions, universities, and local development associations. In Portugal, such groups exist, and occasionally their number is even quite high. For example, 741 business associations are currently registered, both of national and regional scopes (53.7% and 46.3% respectively), and covering a wide range of industries from manufacturing to service activities. However, their efficiency in serving as interface institutions and the quality of their interaction with policymakers are estimated to be unclear (apart from a few documented exceptions, such as the footwear association referred to in Chapter 2), which indicates the lack of adequate measures to trigger constructive dialogue.

Recent initiatives in Portugal have started to recognise the benefit of providing regional actors with adequate incentives. Portugal had already experienced positive results with the Programme of Incentives for the Modernisation of the Economy (*Programa de Incentivos à Modernização da Economia*, PRIME), a national economic policy that aimed at upgrading traditional industries by encouraging the valorisation of locally embedded capabilities (*e.g.*, the geographic proximity of footwear manufacturing firms and their ability to collaborate). The government just announced a new generation of regional policy programmes that will focus on exploiting regional assets through various incentives. The programmes include the "urban networks for competitiveness and innovation" proposed by the new urban policy POLIS XXI for the 2008-2015 period, the Programme for the Economic Valorisation of Endogenous Resources (PROVERE) aimed at supporting the competitiveness of low-density areas, and the call for projects to launch a series of Competitiveness and Technology Hubs based on the French model of *pôles de compétitivité* (see Chapter 2). Such programmes herald a promising approach, although they have been presented very recently and detailed information about the scope of incentives remains limited at this stage.

3.2.3. Appropriate scales for defining development strategies

Regional policy has led decision-makers to rethink the most appropriate scale for elaborating a development strategy and implementing related public investment. Experience in OECD countries shows that "institutional miracles" do not exist. Drawing an optimal matrix that would define to which scale

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competencies and resources for each public good should be decentralised (or centralised) might be ideal but highly complex. This is linked to the simple fact that the efficiency of public spending varies across sectors and across countries according to a broad range of factors (both exogenous and endogenous). More realistically, identifying and exploiting specific opportunities for development implies addressing functional interdependencies and the search for a critical mass. In many OECD countries, and especially in unitary countries, regionalisation (in terms of governance) has occurred as an attempt to define development strategies at a more adequate level and to attach the political accountability corresponding to this decision-making level. A common pattern often found in OECD countries is that *regions/provinces* are in charge of defining the overall development strategy, while *municipalities* associate via various intermunicipal collaboration mechanisms to carry out common projects with efficiency objectives.

In Portugal, the search for a more appropriate scale was translated into a strong impetus from the central government to harmonise most of its own deconcentrated bodies within the existing scale of the five mainland regions, which were (as mentioned earlier) an administrative creation largely motivated by planning purposes and became responsible for the management of EU Structural Funds. Within the framework of the ongoing Programme of Public Administration Reform (PRACE), the objective in the long term is to co-ordinate all of the central government's territorialised action under the same umbrella geography. For example, as a consequence of the PRACE, the Ministry for Agriculture already established its regional directorates following the same geographic regions as the Ministry for Regional Development. In the meantime, an "intersectoral co-ordination council" was just created within each CCDR with a view to facilitate collaboration between the Ministry for Environment, Spatial Planning and Regional Development and other ministries. Regional directors of various ministries are thereby expected to participate in co-ordination meetings, although the practicalities to enable effective dialogue have not been determined yet (*e.g.*, who will set the agenda of meetings, how to organise the discussion, to what extent the outcome of the discussion may influence decision-making). This procedure reflects the central government's strong concern for the co-ordination of its own action at the regional level. As shown by the example of France, where regional prefects represent the central government in the regions (as well as departmental prefects at the subregional level) and co-ordinate the regional action of eight line ministries, this type of organisational choice contributes to ensuring the coherence of regional policy but leaves little room for integrating the specific local knowledge of stakeholders other than the central government.

Similarly, the Portuguese government has initiated a powerful drive to group municipalities at the existing NUTS 3 statistical level. The 2003 laws had

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proposed the possibility to create intermunicipal associations on a voluntary basis at flexible geographic levels (Box 3.2). Several intermunicipal associations were created but did not cover the whole national territory. The current government has emphasised the revision of the 2003 laws as a major priority in the field of local administration. The first new drafts of the laws are currently being discussed with the National Association of Municipalities and are expected to be submitted to the Parliament in 2008. Through its proposed reform of intermunicipal collaboration mechanisms, the central government is sending two parallel messages to municipalities: first, to rationalise public infrastructure projects for proximity services (*e.g.*, primary education) at the supramunicipal level via intermunicipal associations at the NUTS 3 level; and second, to join other intermunicipal collaboration institutions to valorise each municipality's specific assets if relevant. Currently, all municipalities are engaged in joining intermunicipal associations for general purposes at the NUTS 3 level. The government used two types of incentives. First, municipalities that associate themselves at the NUTS 3 level have been given the possibility to collect local taxes themselves (property tax) rather than have the central government collect them and rechannel them. Second, municipalities that associate themselves and prepare a territorial development programme at this level will have the possibility to manage part of certain Operational Programmes of the NSRF following the existing procedure of EU "global grants" – a possibility that was offered far earlier in other EU countries but was introduced in Portugal just recently.

Box 3.2. **Intermunicipal collaboration mechanisms in Portugal**

Municipalities can associate into:

- **Metropolitan areas (under 2003 laws):**
  - **greater metropolitan areas (GAM)**, which are required to include at least 9 municipalities with a total of at least 350 000 inhabitants. Lisbon and Porto, which had been designated for the first time as metropolitan areas in 2003;
  - **urban communities (ComUrb)**, which are required to include at least 3 contiguous municipalities with a total of at least 150 000 inhabitants and are aimed at co-ordinating investments of supra-municipal interest, and co-ordinating actions between the municipalities and the central administration and territorial management services.
- **Intermunicipal associations**, which under 2003 laws were voluntary and not attached to a particular geographic scale, are under the proposed reform only allowed at NUTS 3 level for a general purpose (intermunicipal associations for a specific purpose, such as water treatment, are planned to be allowed at other geographic scales, not necessarily NUTS 3).

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Portugal's choice to better co-ordinate the territorialisation of central government action according to a pre-existing standardised map has the merit of offering a rapid solution to reduce inconsistencies between sectoral policies on a given territory. From the perspective of new regional policy, however, harmonised deconcentration and multi-level governance (in which the central level transfers responsibilities to subcentral levels) are not exactly the same. When it comes to targeting the unique opportunities for development entrenched in specific areas and designing differentiated strategies to foster regional competitiveness, it is questionable to what extent the government should enforce a predefined map of geographic regions rather than focus on promoting flexible collaboration based on local knowledge within functional areas. In the current governance framework, local actors with clear ideas and potential for common projects might find themselves locked in artificial boundaries while concrete mechanisms and incentives to exploit functional synergies beyond such boundaries remain limited. Portugal will need to solve the trade-off between harmonising the areas of public intervention for administrative and planning purposes, and allowing for a flexible geography for regional competitiveness issues.

Few OECD countries tied intermunicipal collaboration mechanisms to clear targets, and when they did, targets concerned population size (aimed at reaping economies of scale for public service delivery) rather than predetermined administrative perimeters. Municipalities might be tempted to engage into opportunistic intermunicipal collaboration with the primary goal of receiving the grants promised by the central government but no motivation to use collaboration as a tool to improve the efficiency of public service delivery (especially if the predetermined administrative perimeters do not reflect historical identity or functional economic areas). This risk seems minor in Portugal as the "rewards" attached to intermunicipal collaboration are limited to the possibility for municipalities to enjoy higher fiscal autonomy and to participate in EU Structural Funds management.

3.2.4. Fiscal instruments to support subnational development strategies

Existing fiscal instruments to support subnational spending in Portugal remain more focused on reducing the negative impact of regional disparities than on promoting the positive impact of regional specificities. At a minimum, regional policy should aim at giving citizens equal access to a basic set of public goods and services regardless of their location; the new paradigm for regional policy recommends going further. Addressing the social and economic concerns of specific territories with a competitiveness objective implies that policies not only need to consider territories that are affected by industrial change or struggling against structural difficulties, but also to support the so-called "engines of growth"

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or leading regions. Different countries have adopted different combinations of place-based policies for equalisation and competitiveness. The overall idea is that cohesion policies contribute to creating conditions that are necessary for growth but not sufficient, and thus they need to go together with competitiveness policies. Incentivising subnational authorities to define their development projects, contributing to their learning process, participating in building their innovation policy, among others, are possible ways to orient central support towards competitiveness. Should budget resources be unlimited, there would be no immediate reason to replace equalisation tools with competitiveness tools. In a context of budgetary constraints, however, the central government would need to improve the efficiency of essential public service financing, and at the same time, to use this result to support competitiveness-oriented projects. A key issue is therefore to assess how policies in Portugal have changed both to improve the performances in funding essential public service delivery (which remains heavily dependent on central government resources and standards) and to stimulate the shift of subnational strategies towards competitiveness.

In general, local governments in Portugal have little fiscal autonomy and rely heavily on grants coming from the central government (Box 3.3). Wide disparities exist across NUTS 3 regions, especially between the two largest urban regions (Grande Lisboa and Grande Porto) and the rest of the mainland, and also within the mainland (see Annex 3.A1 for detailed fiscal data). Portugal is confronted with a vast group of rural or intermediate regions located in the interior part of the country, with low population density and poor economic performances. Such regions subsist thanks to generous equalisation transfers from the central government. The current fiscal system in Portugal has a highly redistributive nature, especially because of the two funds used to aid the most "needy" municipalities (the General Municipal Fund called FGM, and the Municipal Cohesion Fund called FCM).

The reform of the Local Finance Act in January 2007 introduced various measures to bolster local autonomy and to better support rural areas. Measures were taken to expand municipal competencies (notably via the creation of a Municipal Social Fund called FSM, an earmarked grant to finance specific expenditures in education, health and social policy) and to increase municipal revenues (via the possibility for municipalities to receive up to 5% of the national income tax). Additional action was taken to reinforce intermunicipal solidarity by increasing the amounts dedicated to the two equalisation funds mentioned previously (FGM and FCM). While the reform brought about significant improvements (including further measures to enhance municipal accountability and new rules for public-private partnerships), the following aspects might require particular consideration in the future:

- Changes in the law might sometimes work at cross-purposes. For example, the increase in the FCM should help disadvantaged municipalities; at the

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Box 3.3. **Subnational government revenues in Portugal**

Subnational government revenues in Portugal are derived from five sources: 1) the PIE (Participation in Central Taxes), a large block grant; 2) local taxes and fees; 3) borrowing; 4) EU Structural Funds; and 5) special grants used in exceptional circumstances or to fund capital projects.

1) A major revenue source is a large block grant called PIE (Participation in Central Taxes). Since the revision of the Local Finance Act in January 2007, the PIE for municipalities is composed of:

- a general grant called the Financial Equilibrium Fund (FEF), which corresponds to 25.3% of the revenues derived from personal income tax (IRS), corporate income (IRC), and value-added tax (IVA). The FEF is distributed across municipalities according to the following mix:
  - 50% under the FGM (General Municipal Fund). The FGM is distributed according to the following formula:
    - *a)* 5% equally throughout all municipalities;
    - *b)* 65% in direct proportion to the population (weighted), and the average number of nights spent in hotel establishments and camping sites, with the resident population of the Autonomous Regions weighted by the factor 1.3;
    - *c)* 25% in direct proportion to the area weighted by the altitude of the municipality and 5% in direct proportion to the area attributed to the 2000 Natura Network and protected area; or
    - *d)* 20% in direct proportion to the area weighted by the altitude of the municipality and 10% in direct proportion to the area attributed to the 2000 Natura Network and protected area, in municipalities with over 70% of its territory attributed to the 2000 Natura Network and protected area.
  - 50% under the FCM (Municipal Cohesion Fund): the FCM is the most redistributive part of the PIE.
- a specific grant called the Municipal Social Fund (FSM), which is an earmarked grant to finance specific expenditures in education, health and social policy that will be transferred from the central government to municipalities
- a possible participation of up to 5% of the personal income tax (IRS) levied in the jurisdiction of each municipality
- The PIE for parishes is distributed through the Parish Financing Fund (FFF).

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Box 3.3. **Subnational government revenues in Portugal** *(cont.)*

2) Local taxes and fees represent about one third of local government revenues in mainland Portugal. There are four main local taxes: a real property tax, a tax on the sale of property, a municipal vehicle tax, and a tax on corporate income (called *derrama*). Municipalities have very little discretion in the setting of tax rates (only the real property tax and the *derrama* are elective; municipalities can impose a rate between 0.2% and 0.8% in the former, and between 0 and 10% in the latter). In addition, municipalities can set their own fees for services such as waste collection, drinking water supply, public transport, and electricity.

3) Municipalities can resort to borrowing (on the short term to solve temporary difficulties; on the medium and long term to carry out investment or to recover from a financial disequilibrium). Given the continuous efforts of the central government to abide by the EU Stability and Growth Pact, municipalities are also required to restrict their borrowing. A few exceptions have been allowed to promote local sustainability, for example for loans concerning urban rehabilitation programmes. A fund of municipal regularisation was established for municipalities that do not comply with the limits of net debt.

4) EU Structural Funds**.**

5) Special grants can be allocated by the central government to municipalities on a case by case basis, in exceptional circumstances (such as public disasters) or to finance capital investment (where both the central and the municipal governments contribute to the funding).

same time, the formula for the FGM was modified to put more weight on the population density criterion, which presumably supports urban (and likely wealthier) municipalities. While this reform reflects the government's willingness to take different territorial concerns into account, it is unclear at this stage to what extent the impact of fiscal equalisation will be improved.

- The system might need to address "poverty traps" because it might create an incentive for municipalities to maintain a lower collection of revenues. By proposing municipalities on a voluntary basis to keep 5% of the income tax generated in their jurisdiction in exchange for a reduced amount of transfers from the central government, and probably more autonomy in delivering certain local public services, the central government is likely to receive positive reactions from richer municipalities that could use this first step to reinforce the dynamics of local creation of wealth, but negative answers from poorer municipalities which would prefer to depend on transfers. In order to orient local strategies towards the identification and exploitation of local

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opportunities, this incentive could be extended to all municipalities instead of being proposed on a voluntary basis.

- Finally, the reform intends to give more competencies to municipalities which means that inputs used in the equalisation formula (such as access to medicine) may become a variable that is more under the control of municipalities. A key issue for the success of the reform will therefore lie in how to implement successfully the measures to foster local autonomy while avoiding opportunistic behaviour that might endanger national cohesion.

In practice, the disincentive effect that fiscal equalisation may generate on subcentral tax effort largely depends on the wider economic objectives of subcentral governments and their voters. Depending on their power to shape local and regional economic and fiscal policy, the local citizen or firm may be in favour of policies that stimulate investment and employment in the local and regional economy (since this will increase total disposable income), even if additional tax revenue is entirely equalised away. The constituency may accept a fiscal zero-sum game under the condition that firms grow, that people get jobs or that new residents settle in the jurisdiction. This argument reduces the impact of measures which are limited to arrangements in the equalisation formula or funding mechanisms. The choice of fiscal instruments should be associated to the very nature of their objective. Equalisation objectives do not lead to the same type of fiscal instruments as regional competitiveness objectives. The latter are better supported by specific grants which are often negotiated through specific governance mechanisms. In some OECD countries, these types of arrangements have even influenced the funding of essential services. It is the case in Italy, where a reform is currently being implemented and will lead to adopting target mechanisms, matching grants and performance indicator systems to address the challenges of some southern regions in delivering basic services (waste management, primary education, etc.).

3.3. Reforming the governance of regional policy

The forthcoming phase of implementation of recent initiatives will determine the impact of new regional policy in Portugal. A major part of regional policy outcome in the next few years will depend less on multiplying new reforms than on maximising the effectiveness of ongoing reforms. Many of the initiatives currently underway pursue a salutary objective (such as better co-ordination of sectoral policies and more participatory decision-making). Once fully achieved, such reforms could make a significant contribution to building a more responsive and dynamic policy-making culture in Portugal. In order to bring about effective and durable change, the current strong political momentum should be used to create positive expectations among agents around shared goals and to foster concrete collective action. Portugal was able to seize

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the opportunity of the elaboration of the NSRF 2007-2013 to communicate the government's determination and to initiate intergovernmental dialogue. The policy message must now be translated into pragmatic mechanisms and behaviours. The following section offers insight on recommended avenues for action in three areas: enabling actors to better exploit their own knowledge; fostering collaborative practices, both at the horizontal and vertical levels; and promoting continuous learning through monitoring and evaluation.

3.3.1. Enabling actors to better exploit their own knowledge

Setting up clear targets and credible incentives could help further encourage local actors to reveal their specific knowledge and development potential. This could be particularly valuable for the success of regional innovation policy. Better diffusion of information about existing examples of locally driven renewal could motivate similar initiatives in other regions of Portugal. Through a process of inter-regional learning about what was successfully done elsewhere (*e.g.*, the new development strategy in the city of Mértola assessed in Chapter 2), a greater number of regions could learn to trust their capacity to break the vicious circle of decline and to search for proactive solutions. The effectiveness of the Competitiveness and Technology Hubs programme in Portugal will also be determined by the government's ability to put in place a set of clear selection criteria, appropriate financial incentives, and evaluation mechanisms. These complementary dimensions of programme design have in the past raised issues for some OECD governments trying to balance competing objectives (Box 3.4).

At the same time, the most marginalised regions should not be ignored. Differentiated mechanisms should be put in place to avoid creating a culture of assistance and avoid discouraging these regions from valorising their own potential over time. In Sweden for example, a typology of regions has been set up to help the central government to apply different types of regional policies according to the type of region. Some regions still enjoy traditional support from the central government with respect to equity in terms of access to essential public service delivery, while other regions benefit from specific support addressing competitiveness targets. In Japan, it seems that the differentiation is based more on infrastructure policies: while rural areas would benefit from central government investment, metropoles, which are not subject to the same market failures, would be able to use private investment to finance their infrastructure. The forthcoming implementation of Portugal's recent programmes to support low density areas (such as the Multi-Purpose and Proximity Services Network) could draw practical tips from similar experiences in other OECD countries, which established creative ways to deliver public services in sparsely populated rural areas and to increase their efficiency (Box 3.5 and Box 3.6).

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Box 3.4. **Targets and incentives in regional innovation programmes in OECD countries**

The economic rationale for public intervention in terms of regional innovation serves to define the different choices regarding programme targets. Those targets may be *places* (leading regions, lagging regions, hub areas), *sectors* (dynamic, exposed, strategic, social significance) or *specific actors* or groups of actors (universities, SMEs, multinationals, etc.). They could also be a combination of these different target categories. The targets then need to be clearly identified in order to ensure that the resources available for the programme are adequate and that goals are achievable. There are clear tradeoffs to be made in selecting the different targets.

Focusing on leading regions that drive national growth is arguably an efficient means to boost national economic performance. However, lagging regions detract from social cohesion and can act as a drag on national growth. Supporting dynamic sectors may give them a competitive edge with important technological spillovers for the wider economy, while refocusing exposed sectors to new opportunities can preserve employment and promote restructuring of regional economies. Improving opportunities for certain priority sectors helps to focus resources but often involves predicting the evolution of volatile and fast-moving product markets. On the other hand, providing a blanket cluster programme for all sectors or regions can dilute available resources and focus.

While a competitive selection process can contribute to the importance of a "label", the number selected in the process must also be limited. Those programmes seeking to support leading regions or industries are often more strict in the selection process and the numbers funded. The Norwegian Centres of Expertise programme is seeking specifically to limit the number of selected clusters such that the label effect would be important enough to attract international attention. The Swedish VINNVÄXT programme in its first round selected only 3 full recipients and 7 partial recipients out of 150 initial applicants, with the second round selecting 5 out of 23. While France did select a very large number of poles, they developed a four-tier labelling system: 6 were "international", 9 were "internationally oriented", 15 were "inter-regional" and 37 were "regional".

The capability and credibility of the bodies that make selections plays a role in the programme's public perception and hence the effectiveness of this label. The involvement of private actors appears to be an important source of credibility in this process. The Georgia Research Alliance in the US, for example, serves as an expert body to select the most relevant research projects to support growth. While state legislators vote to allocate the funding to the Georgia Research Alliance, its Board members are representatives

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Box 3.4. **Targets and incentives in regional innovation programmes in OECD countries** *(cont.)*

from universities (many are private entities) and industry. Most countries have selection committees comprised of both public and private actors. In cases where the selection process is performed entirely by civil servants, the process is more subject to debate. In France, for example, the lack of private sector involvement in the selection committee has been raised by the policy's critics. However, France does have a committee to ensure the integrity of the pole label. In Sweden, the fact that the programme designation was national, and not only regional, was observed in evaluations to play an important role in cluster legitimacy.

One additional benefit of competitive selection procedures is that sometimes, even for candidates that do not get selected, the process resulted in network building and action plans. Sweden's VINNVÄXT programme only accepted a small fraction of the applications received. When Sweden's subsequent Visanu programme was introduced, many of these groupings who had already worked together on a VINNVÄXT application applied to Visanu and were selected. Some networks have also worked together to reapply for subsequent VINNVÄXT funding rounds. The same result was found in Germany. Unsuccessful applicants to the BioRegio and InnoRegio programmes have gone on to develop their projects on the basis of other funding mechanisms. The momentum that was generated by the BioRegio competition led to the expansion of support to biotechnology via the BioProfile programme to a larger number of regions, many of which had been unsuccessful applicants for BioRegio.

3.3.2. Fostering collaborative practices

Vertical collaboration

The intergovernmental dialogue that was inaugurated during the elaboration of the NSRF and the NSPP in Portugal needs to be further developed throughout the implementation phase. In many EU countries, the NSRF experience both encouraged collaborative practices and revealed the persistence of missing linkages or opportunities to tap higher synergy effects. In France for example, the elaboration of the NSRF contributed to changing the nature of the collaboration between national and regional actors, and mechanisms to modernise the implementation and management of the NSRF are currently under consideration (Box 3.7). The implementation of the NSRF in Portugal could open a relevant opportunity to build more contractual arrangements, taking into account the advantages and drawbacks that have characterised contractual practices in various OECD countries (Box 3.8).

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Box 3.5. **Different modes of access to services in rural areas in Finland**

Transportation services: bringing people to services. In Finland's sparsely populated rural areas, the reduction in public transport has meant that private car use has become essential for rural residents and the importance of the taxi network has increased. Both alternatives, however, imply higher costs of accessing services. Taxi operations have replaced services that have been lost. Special village transport services to village centres are a new and increasing form of transport. Taxi operations are a viable solution in municipalities with a sparse population base that do not have enough customers for a bus service or if bus timetables cannot be arranged to serve inhabitants.

Mobile services: bringing services to the people. In the sparsely populated areas of Eastern Finland, some of the public and private services have been provided through mobile service units, the most frequent cases being mobile shops, mobile libraries, but also some innovative services such as mobile gyms (as the "Power Vehicle" – Woimavaunu – in the Pyhäselkä municipality) or a voting bus (in the municipalities of Eno and Pyhäselkä, in North Karelia) or nurses visiting patients at their home in several municipalities. However, due to the declining population and cuts in public budgets, these services have also undergone a process of rationalisation. The number of mobile shops in North Karelia has declined "drastically" and the mobile library service has been reduced, partly because of the declining demand for books but also because there have been very few new library buses (Aldea-Partanen *et al.*, 2004).

Using innovative routes: the opportunities of ICTs. Modern technology offers new opportunities for rural areas. Information and communication technologies (ICTs), particularly broadband, stand out as a new and necessary public good that can bring significant opportunities to rural areas, providing not only access to information, but also services that until now were largely thought to be urban (OECD, 2006). Some examples in Finland include:

- **Tele-education.** The coverage of fixed external connections to tele-education facilities in comprehensive schools rose from 54% to 90% between 2000 and 2005, and in upper secondary schools from 97% to 100% in the same period.
- **Health sector.** ICTs have allowed access to specialised services that could not be provided by other means in rural areas. The aim of the tele-medicine project was to make broadband services available to hospitals, particularly in terms of imaging (processing of digital X-rays). Archiving and remote viewing of digital X-rays is the most bandwidth-intensive telecommunications application used in hospitals.

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Box 3.5. **Different modes of access to services in rural areas in Finland** *(cont.)*

- **Other government services.** Since 2005, the government set a project for the provision of telecommunications in libraries and Citizen Service Offices. In 2006, EUR 500 000 were devoted to support procurement of high-speed telecommunication connections and up-to-date customer terminals for mobile libraries, libraries in small municipalities, rural areas and sparsely populated areas, and Citizen Service Offices. While the project got off to a good start, the goals have not been quite achieved (Ministry of Transport, 2007).

Source: Aldea-Partanen, Andra, Lehto, Esko, and Jukka Oksa (2004), Access to Services in rural Finland: Examples for Kainuu and North Karelia, *http://cc.joensuu.fi/~alma/deserve/raportit/rep04-finland.doc*; Ministry of Transport (2007), "National Broadband Strategy Report"; OECD (2006),"Investment Priorities for Rural Development: Key Messages", OECD International Rural Development Conference, Edinburgh, Scotland, 19-20 October, *www.oecd.org/dataoecd/33/26/37865696.pdf*.

Box 3.6. **Examples of multi-service points in rural areas in OECD countries**

Finland has accumulated significant experience in multi-service points since 1993. Currently, there are about 207 Citizen Service Offices in Finland, but their functions differ a great deal from each other, ranging from only handing out forms to providing full service. The Citizen Service Offices deliver services (whether public, private, non-for profit or mixed) from a single outlet. They also allow holistic customer service, which is easier to provide at a single point than if the customer had to contact several authorities. This system has had positive impact in terms of improving access to certain services in rural areas, where citizens are typically required to commute to service delivery sites. The objective of the Citizen Service Offices system is to offer citizens a single outlet for services that can be managed jointly, i.e. municipal, district court, tax and work administration, National Pension Institute and other regional and local authorities. The services provided through Citizen Service Offices includes reception and handing out of documents, advice concerning the institution of proceedings and processing of matters and support in the use of electronic services. By means of joint, customer-oriented service and efficient use of information technology, the aim is to ensure a sufficient and high-quality service network, to increase the productivity of the local service network and to reduce costs.

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Box 3.6. **Examples of multi-service points in rural areas in OECD countries** *(cont.)*

In **Scotland (United Kingdom)**, the idea of a one-stop shop has been applied in a wide range of services, including education, social work, information, business support and community services. A recent study on 10 one-stop shops in different rural contexts of Scotland found that: they are usually viewed positively by providers, staff and clients; they usually provide new or better quality services and make them more accessible; and sometimes they tackle very complex cross-cutting areas – such as those of social deprivation, youth, and provision of services in remote and scattered communities – which would otherwise not be dealt with by the existing service providers. They are therefore helping to bring together government and other providers on the ground. The study also found that a number of important issues need to be taken into consideration in the design, layout, location, financing and staffing of one-stop shops, and that community involvement and ownership is vital from the start.

Australia instituted the Rural Transaction Centres (RTC) Programme to help small communities establish locally run and self-funding centres, which either introduce new services or bring back services that were no longer available in rural towns. Recently, the RTC programme was integrated into the Australian government's new streamlined Regional Partnerships programme. Since their initial creation in 1999, over 200 RTCs have been approved for assistance. An RTC programme field consultant assists in an initial community consultation and feasibility study. The RTC is therefore tailored to meet community needs but not compete with other planned services, and usually includes: financial services, postal and telecommunications access, federal state and local government services, insurance and taxation, printing and secretarial capacity. These centres employ from one part-time employee to four full-time staff members. Funding from the central government covers the capital costs of establishing a RTC and subsidises its operating costs during its early years of operation if necessary.

Source: OECD (2006), *The New Rural Paradigm: Policies and Governance*, OECD, Paris.

Still, it should be noted that a contractual approach constitutes a feasible approach if both parties have enough autonomy to be credible partners in a negotiation. A contract between levels of government, which refers to the bilateral agreement between national and subnational governments concerning their mutual obligations, is: an assignment of decision-making rights among the parties (authority); a distribution of contributions (mutual duties); and mechanisms to guarantee the enforcement of their mutual duties.

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Box 3.7. **Learning to move from centralised planning towards regional partnership: the example of France**

France has long been characterised by centralised investment planning. Until the end of the 1980s, the Commissariat Général au Plan (CGP) used to elaborate 5-year national plans that determined heavy investment for post-war reconstruction and the modernisation of the economy. When France became eligible for EU Structural Funds and the European Commission at that time did not require recipient countries to draft any equivalent of an NSRF, the national plans shaped the implementation of the Structural Funds. During the decentralisation movement in the 1980s, the national plans were regionalised via the Contrat de Plan État-Région (CPER), which became the national financial counterpart of the Structural Funds. Since then, national long-term planning practices have progressively given way to stronger regionalisation.

For the first time, the elaboration of the NSRF for the 2007-2013 programming period has offered a tool for strategic debate between national and local actors, not only on the implementation of EU Structural Funds but also on the preparation of future CPER. The NSRF was elaborated in close collaboration with local actors. Seven interregional meetings were held at the end of 2005; local feedback to the NSRF was discussed in public and integrated into the second draft of the NSRF. An important preliminary phase of three months was devoted to territorial diagnosis (from March to May 2006). The Regional Operational Programmes were elaborated in parallel (from March to July 2006), drawing from other regional strategic documents such as the Regional Economic Development Plans (SRDE) or the Regional Spatial Planning and Development Plans (SRADT, comparable with the Portuguese PROTs).

In order to avoid the past mistake of scattering European funds, the NSRF pursued concentration and selectivity of public investment. But considering the size and the diversity of the French territory, it was rapidly recognised that the concentration and selectivity process would become effective only if it was handed over to the regional level. The French central government is progressively shifting its role towards the so-called "Etat-stratège", *i.e.* a government providing a strategy, information, tools and good practices. According to the principle of subsidiarity, the central government no longer focuses on deciding unilaterally which projects should be financed, but on helping regional partners to determine the best projects themselves. The underlying assumption is that deconcentration and decentralisation are key processes to build stronger technical capacity.

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Box 3.7. **Learning to move from centralised planning towards regional partnership: the example of France** *(cont.)*

Lessons learnt from the elaboration phase will therefore be applied to the implementation phase. In order to ensure better collaboration between national and regional authorities, programming and follow-up committees will be co-chaired by the representative of the central government in the regions (*préfet*) and the president of the elected regional authority (*président du conseil régional*). The programming and follow-up committees will be the same for all funds to better articulate the different investments. The committees will be composed of representatives of the central government, the elected regional authority, social partners, and the business and associative sector. In terms of evaluation, each region will evaluate the implementation and impact of its own Regional Operational Programme, while the central government's interministerial body in charge of regional competitiveness – DIACT – will coordinate the evaluations in order to harmonise indicators at least partially, provide benchmarking and assess the national impact of the Structural Funds.

Analysis of contracts between levels of government for regional development policy in OECD countries has shown that they are not only helpful in managing relationships between levels of government, which is necessary due to the interdependencies between different levels, but they do so without modifying the Constitution. They are also often used as tools for implementing decentralisation in practice and in a progressive way, based on the mutual learning processes they induce. In particular, they are usually more oriented towards framework contracts for unitary countries moving towards greater decentralisation, which can thus maintain an important role for the central government without renouncing to exploit local sources of knowledge (France) or with the specific objective of supporting capacity building at the subcentral level (Italy). Contracts are also used in federal countries but for more specific projects. In Portugal, the objective of expanding contracts between managing authorities of the Operational Programmes and associations of municipalities to the Portuguese territory during the 2007-2013 period could be a step forward to improve policy coherence, compared with contracts which are currently concluded between municipalities and ministries on an individual basis.

During this transition phase from a centralised top-down governance structure towards a multi-level governance pattern, the CCDR have a pivotal role to play. For a long time, the CCDR were submitted to internal organisational

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Box 3.8. **Advantages and drawbacks of contractual arrangements between levels of government in OECD countries**

Contractual arrangements between levels of government present the following advantages:

- Linking regional and local policies to national priorities. Contractual arrangements can accompany further decentralisation while ensuring consistency in public policy making and implementation.
- Contributing to building local capacity. The lower level of government is not being looked upon as the mere recipient of a mandate. On the contrary, its participation in the decision-making and learning process makes it more responsible, and therefore requires a higher level of knowledge and competences from local government representatives.
- Performing a role of legitimisation (although less explicitly). In contrast with government by command, contractual arrangements offer an opportunity for governments to submit their policies to the agreement of other entities (which will have to comply with them) and thereby to re-legitimise their authority. This legitimisation effect applies both to the central and regional levels.
- Helping to cope with institutional fragmentation. Contractual arrangements are meant to provide a tool for improving co-ordination between different ministries that operate at the local level.
- Stabilising relationships. Since the contract sets out long-term commitments, it allows each party to anticipate the decision of its partners with less uncertainty. While the contract is not necessarily a guarantee, it helps reduce opportunistic behaviour and political risk. Since most contracts involve financial commitment over several years, they also help partners to overcome the drawbacks of the annual budgetary principle.
- Sharing the burden of large-scale projects and complex programmes. Contracts facilitate the implementation of major investment projects that would not have been feasible by an isolated level of government.
- Involving and reassuring partners. Sharing the burden means sharing financial and political risks, which can help ease potential reluctance from relevant actors.

At the same time, contractual arrangements have drawbacks:

- Contracts involve transaction costs in terms of negotiation and implementation. A sufficient period for consultation, preparation and negotiation is required before a contract can be drawn up in order to avoid moral hazard risks. In France for example, the upstream phase for the preparation of 2000-2006 planning contracts between the central government and regions (*contrats de plan État-région*) took two years (from 1998 to 2000).

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Box 3.8. **Advantages and drawbacks of contractual arrangements between levels of government in OECD countries** *(cont.)*

- The number of contracts tends to proliferate rapidly (France, Italy and Spain).
- The ministries in charge can oppose resistance to change and be reluctant to give up their prerogatives.
- Contracts may turn out to be unresponsive to change because the parties committed rigidly to fixed long-term programmes, even though the mechanisms of negotiation are supposed to allow for greater flexibility than a hierarchical distribution of duties.
- The question of whether grants from the higher level of government should support capital formation and/or current expenditure remains unclear. Supporting only capital formation may be problematic because the regions may not be in a position to fund their current expenditure after they have invested in fixed capital formation, or they may be tempted to neglect maintenance in order to receive higher capital grants in the future. Moreover, many development programmes aim at soft infrastructure but are technically or financially not considered to be capital formation, and thus are not eligible for grants. Such a bias towards capital formation might lead to neglecting the formation of soft capital such as capacity building.

Source: OECD (2005) *Building Competitive Regions*, OECD, Paris, pp. 83-84.

instability because their institutional model depended heavily on the central government's organisational structure. For example, the CCDR were successively put under the authority of the Ministry for Planning, the Ministry for Internal Administration, and the Ministry for Environment, Spatial Planning and Regional Development. They were also frequently subject to dual oversight. The recurrent volatility of their responsibilities contributed to creating latent tension between them and key local actors (*e.g.*, municipalities, business associations, NGOs). This lack of mutual trust undermined the ability of the CCDR to play a more effective role in terms of strategic co-ordination in the past. The overall reform of public administration (PRACE), the new Local Finance Act, and the ongoing reconsideration of intermunicipal collaboration mechanisms may offer a valuable opportunity to clarify the role of the CCDR as a facilitator and mediator between central and local levels of government. For example, revitalising the consultative bodies (Regional Councils) via less formal and more workable mechanisms to draw on local actors' knowledge

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could help improve the capacity of the CCDR to serve as a tool to ensure national coherence without atrophying regional dynamics. More efficient articulation between the CCDR and the technical authorities in charge of managing Regional Operational Programmes could also contribute to further exploring the co-ordination potential of the CCDR. The recent creation of boards (composed of the president of the CCDR, two representatives of municipalities, and two representatives of the central government) in charge of leading the management of Regional Operational Programmes is expected to improve vertical collaboration, although the role of these boards and the modalities of their integration into the current decision-making process remain to be demonstrated.

Horizontal collaboration

At the central level, Portugal has started to enhance horizontal collaboration but it could still go further. As underlined earlier, Portugal is one of the few OECD countries that have established a specific ministry in charge of regional development, but there are still missing linkages in terms of interministerial collaboration. One major linkage in terms of policy coherence was achieved when the Technological Plan and the Lisbon Strategy were placed both under the responsibility of a new co-ordination cabinet (GCELPT, *Gabinete de Coordenação da Estratégia de Lisboa e do Plano Tecnológico*), which reports directly to the Prime Minister. Another sign of progress was the creation of the NSRF Co-ordination Team within the central government to conduct interministerial dialogue, with the concrete result of streamlining the priorities for the 2007-2013 EU programming period from 12 sectoral Operational Programmes under CSF III down to 3 Thematic Operational Programmes in the current NSRF.

There is still room to improve interministerial collaboration in key areas related to regional development policy, such as policies targeted at low-density areas. For example, a very high level of articulation and synergy will be required between the Programme for the Economic Valorisation of Endogenous Resources (PROVERE) promoted by the Secretary of State for Regional Development of the Ministry for Environment, Spatial Planning and Regional Development, and the Rural Development Plan managed by the Ministry for Agriculture. Regional directorates of the two ministries have been established at the same scale (TL2 regions) but it should not be assumed that the mere concurrence of geographic reach is enough to ensure policy coherence. Given the importance of rural areas in Portugal, it is advisable to connect regional policy and rural policy within a more consistent development strategy.

While the phase of elaboration of policies is now almost over, the forthcoming phase of policy implementation could still offer many opportunities

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to improve horizontal collaboration in Portugal. For example, the Portuguese NSRF put forward the creation of cross-sectoral committees, both at the national level ("thematic rationale centres" called *centros de racionalidade temática*) and at the regional level ("regional dynamics observation centres" called *centros de observação das dinâmicas regionais*). In France, the elaboration of the NSRF also highlighted the need for better intersectoral co-ordination at various junctures. In particular, it was recognised that closer co-ordination between the national authorities in charge of ERDF (DIACT and Ministry of Interior) and those in charge of the ESF (Ministry of Employment) could have been ambitioned. Similarly, it was pointed out that the preparation of ERDF implementation rules could have involved related actors in a more systematic way: the Ministry of Industry and the Ministry of Research, representatives of the business sector, laboratories and universities, etc. It was therefore decided that these ministries will participate together with the DIACT in the national monitoring of the parts of the Regional Operational Programmes dealing with innovation and competitiveness. There is no single institutional model and OECD countries have adopted a variety of governance arrangements, ranging from interministerial commissions to more informal mechanisms for co-ordination.[4]

At the local level, more effective conditions must be created to help municipalities engage into bottom-up functional collaboration. The implementation of place-based policies as opposed to policies targeting administrative delineation often leads to tensions. Since identifying one optimal size remains an unsolvable issue, various instruments to promote inter-municipal co-ordination have been on the policy agenda of many OECD countries (*e.g.*, mergers in Denmark, in Japan; co-operation in France, Spain, etc.). Horizontal co-ordination is more often considered as one mechanism for improving the efficiency of public service delivery rather than an instrument allowing the elaboration of a shared strategic vision for the area, with the exception of the "*pays*" in France for example (Box 3.9). Some vertical arrangements for regional development policy consider that collaboration between local authorities is a prerequisite to the central government's financial participation in selected projects (*e.g.*, Italy).

In Portugal, the rationale, experience and quality of intermunicipal association processes have been uneven and heterogeneous across the country (with a major difference between the north and the south, for example). However, the very nature of regional policy calls for differentiated strategies according to the specific assets of a region, and governance arrangements are meant to support this purpose. The potential value-added of intermunicipal collaboration is often richer than what exists at a given administrative or geographic territory. Without further complicating the recent recomposition

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Box 3.9. **Example of "project territories": the *pays* in France**

In France, in addition to the approach of management-oriented co-operation among municipalities, there is also a determination to develop what is known as "project territories": the "*pays*", the clear purpose of which is to transcend administrative boundaries so that strategies can be formulated. The "*pays*" is neither an administrative entity nor a subnational level of government; it is a light and hybrid structure that reflects a territory characterised by geographic, cultural, economic and social cohesion. The underlying logic of the "*pays*" is to build territorial action on synergies between willing local players, and at the same time, to match the boundaries for these unifying projects to functional areas. A "*pays*" may be formed at the initiative of municipalities or groups of municipalities. A sustainable development council is then created, involving local economic, social, cultural and association representatives. Long processes of discussion are usually needed in order to reach agreements among local stakeholders (private and public) to define their charter for development. The charter often encompasses both social and economic features and is clearly associated to a geographical perimeter. Local partner municipalities and higher levels of government ("department" level, regional council level, or the "prefecture" representing the central government in regions) may contribute to the funding. When co-operation and local dynamics tie in well, the "*pays*" can offer an effective tool to unblock the system's complexities through local action, especially when facilitated by the competences of local actors. They do however appear to suffer from structural difficulties in terms of resources at their disposal.

Source: OECD (2006) *Territorial Review of France*, OECD, Paris.

of NUTS 2 and NUTS 3 levels in Portugal, and in the absence of an elected regional level (in the mainland), more adequate arrangements should be proposed to support the collaborative efforts of municipalities to exploit both material and non-material assets for competitiveness. The participation of private sector and civil society actors (in the committees for consultation and follow-up created recently within the CCDR, for example) also needs to be stimulated via tangible mechanisms of dialogue, in order to prevent consultative bodies from becoming a conventional device inhibited by institutional inertia. A key factor of local democracy will be to increase the accountability of municipalities and to facilitate transparent communication on municipal government action.

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3.3.3. Promoting continuous learning through monitoring and evaluation

The Portuguese government could enhance efficient and responsible multi-level governance by promoting a process of continuous learning at the subnational level through monitoring and evaluation mechanisms. The recent creation of Strategic Advisory Bodies (*Comissão de Aconselhamento Estratégico*)[5] in each mainland region in order to monitor the implementation of Operational Programmes is a promising step forward; their effectiveness will depend on the capacity for dialogue that both the central government and territorial actors will be able to put into practice. An indicator system is being developed by management authorities (at regional and national levels) and national authorities (NSRF Observatory, IFDR and IGFSE). Among various tools used by OECD countries, indicator systems for measuring and monitoring subcentral service delivery have gained prominence. Indicators contribute to enhancing the efficiency and effectiveness of subcentral service delivery by sharing information across levels of government and by increasing the likelihood of achieving national goals for public services delivered at the subnational level. The choice of the objectives that the indicator system will serve (*e.g.*, benchmarking performances, promoting best practices, improving the quality of services, promoting accountability, etc.) determines the type of indicators used (Table 3.2).

Two interesting examples of indicator systems are Australia's Review of Government Service Provision, a comprehensive assessment that provides performance information on 14 areas of public services (Box 3.10); and Norway's KOSTRA system, which collects and disseminates information about local government performance (Box 3.11). Such benchmarking systems also provide information that can be used for evaluating the efficiency of subcentral spending. The Australian Review of Government Service Provision and the Norwegian KOSTRA monitor the extent to which the service achieves the equity, efficiency, and effectiveness goals desired by governments.

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Table 3.2. **Examples of indicators used by different OECD countries to measure subcentral service delivery**

Category		Examples	Country/System
Context	Demographics	• Population, gender, age, marital status, births, deaths	
	Service context	• Irregularities in water distribution	Italy (regional policy)
		• Per capita average expenses for theatre and concerts	
		• Air pollution due to transportation	
Inputs	Materials	• Municipal nursing home beds	Finland
	Staff	• Number of required staff for the service	Turkey/BEPER
		• Numbers and qualifications of teachers	Finland
	Finances	• Net operating expenditures	Norway/KOSTRA
		• Education expenditures	Finland
		• Deflated expenditures and revenues	Netherlands
	Policy effort	• Capital expenditure by level of government and sector	Italy (regional policy)
		• Preparation and approval of territorial and landscape programming documents	
Outputs	Policy outputs	• Number of inhabitants served	Turkey / BEPER
		• Amount of solid waste collected	
		• Visits to physician, dental care visits	Finland
		• Building permits issued	Australia
		• Number of passports, drivers licenses issued	Netherlands
	Service coverage	• Per cent of aged inhabitants receiving home services	Norway/KOSTRA
		• Per cent of children enrolled in kindergarten	
		• Recipients of social services as per cent of the population	
	Efficiency	• Government funding per unit of output delivered	Australia
		• Spending efficiency: Achievement of payment level equal to 100% of previous year's financial appropriation	Italy (regional policy)
		• Children 1-5 years in kindergartens per full time equivalent	Norway/KOSTRA
		• Number of children per teacher	Sweden (education)
		• Cost per user	Sweden (elder care)
Outcomes	Policy outcomes	• Education transition rates	Norway/KOSTRA
		• Response times to structure fires	Australia
		• Improved language skills of immigrants	Netherlands
	Effectiveness	• Effectiveness of outputs according to characteristics important for the service (*e.g.*, timeliness, affordability)	Australia
		• Disease-specific cost-effectiveness measures	Finland (hospitals)
		• Passengers	Netherlands (transport)
		• Share of completion of students in secondary schools	Sweden (education)
	Equity	• Geographic variation in the use of services	Finland (hospitals)
		• Units per 1 000 members of target group	Germany (Berlin)
		• Recipients of home based care as of share inhabitants in different age groups	Norway/KOSTRA
	Quality	• Number of days taken to provide an individual with needed assistance (*e.g.*, youth)	Netherlands
		• Number of different caregivers providing elder home care to a single individual	Denmark
	Public opinion	• User satisfaction with local services	Netherlands

Source: OECD (2006), "Workshop Proceedings: The Efficiency of Sub-central Spending" *www.oecd.org/dataoecd/57/60/38270199.pdf*; 2007 OECD Fiscal Network questionnaire, quoted in "Promoting Performance: Using Indicators to Enhance the Effectiveness of Sub Central Spending", COM/CTPA/ECO/GOV(2007)4/REV1.

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Box 3.10. **Review of Government Service Provision in Australia**

The Review of Government Service Provision was established by agreement of the heads of the Australian and state governments in 1993 to provide information on the efficiency and effectiveness of government services. Generally, public service delivery in Australia is the responsibility of subnational governments, though the national government provides funding to the states in most service sectors. A steering committee of representatives from the central agencies of the national and subnational governments, supported by a secretariat provided by the Productivity Commission, manages the review. Each year, the Productivity Commission issues a report monitoring 14 areas of government service provision which, in 2005-06, represented approximately 60 per cent of recurrent expenditure (approximately 11% of GDP). They are:

Education	Health management
Vocational education and training	Aged care
Police services, court administration	Disability services
Corrective services	Children's services
Emergency management	Protection and support services
Public hospitals	Housing
Primary and community health	Health management

An outcome-oriented framework has been developed to monitor performance in the different service areas in terms of equity (how well a service is meeting the needs of identified "special needs groups"), effectiveness (how well service outputs achieve stated objectives according to characteristics such as access, appropriateness and quality), and efficiency (how well services use resources to produce outputs and achieve outcomes). The Report is used for strategic budget planning, policy development and evaluation, assessing resource needs, encouraging common approaches to data collection, identifying good practice, and facilitating comparison and improvement.

Sources: Country response to "Efficiency of Sub-Central Spending: Questionnaire on Performance Indicators", COM/CTPA/ECO/GOV(2007)2/REV1; SCRGSP (Steering Committee for the Review of Government Service Provision) (2007), "Report on Government Services 2007", Productivity Commission: Canberra; , quoted in "Promoting Performance: Using Indicators to Enhance the Effectiveness of Sub Central Spending", COM/CTPA/ECO/GOV(2007)4/REV1.

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Box 3.11. **Data reporting and information system (KOSTRA) in Norway**

KOSTRA is an information system for conveying data from the municipalities to the central government, between municipalities, and to the public. Launched for all municipalities in 2002, the system transformed the collection, processing, and dissemination of statistical information from local governments. Emphasis is placed on electronic transmission of data by municipalities to the central government. The latter adds value by combining municipal data and producing key indicators on financial figures, productivity, coverage rates, and priorities. At the municipal level, there are about 40 key indicators and an additional 1 000 indicators covering 16 service areas.

The introduction of KOSTRA benefited both the central and subcentral governments. At the central level, the system rationalised data collection and processing, contributed to uniform standards thereby enhancing the comparability of municipalities and service sectors, helped the central government to determine if municipalities are complying with national standards and regulations, and facilitated a common assessment of the local economic situation which is used as the basis of a parliamentary discussion on the transfer of resources to municipalities. For the municipalities, KOSTRA lessened the administrative burden of reporting. It also provided a tool for internal planning, budgeting, and communication at the local level. In addition, it facilitated the sharing of knowledge between municipalities which are able to use indicators for the purpose of benchmarking performance.

While KOSTRA has brought benefits, there are limitations in the current system. First, the large amount of data collected makes ensuring quality challenging. Second, there is a tendency for the central government to request more and more data, causing both the administrative burden and the costs of data collection to rise in municipalities. Municipalities also receive much more data than in the past.

Overall, KOSTRA has been perceived as a very successful information system with potential for further refinement. Looking forward, focus is being placed on collecting data regarding quality of public services and developing indicators of quality. "Soft data" collected outside of KOSTRA (test scores, reading proficiency and user satisfaction for various services, etc.) are gradually being used in combination with data from the KOSTRA system. This will permit policy makers and citizens to assess outcomes as well as outputs.

Sources: OECD (2006), "Workshop Proceedings: The Efficiency of Sub central Spending" *www.oecd.org/dataoecd/57/60/38270199.pdf*, Statistics Norway (2002), "KOSTRA" online at *www.ssb.no/english/subjects/00/00/20/kostra_en/*, quoted in "Promoting Performance: Using Indicators to Enhance the Effectiveness of Sub Central Spending", COM/CTPA/ECO/GOV(2007)4/REV1.

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3.4. Conclusion

Portugal's choice to reform its regional policy requires a set of structural shifts: from income redistribution measures to competitiveness strategies; from hard investment in physical infrastructure to soft investment in the overall enabling environment of public goods; from direct subsidies to incentive mechanisms; from centralised and top-down policy-making to contractual approaches and partnerships. Within the spectrum of OECD countries that are moving at different stages of implementing this paradigm shift of regional policy, Portugal stands out as one of the countries showing the clearest political commitment to pass structural reforms. The government's reformist stance is all the more salient as Portugal's long history of centralised decision-making practices makes it one of the OECD countries confronted with the most demanding task. Many of the reforms that were launched recently to differentiate development strategies according to the specific assets of each region will require some time before yielding visible outcomes, depending on their ability to capitalise on the knowledge and capacities of different actors. This should not alter Portugal's determination to make the best of the present momentum. Reforms will increase their chances of success if they reinforce stakeholder engagement by creating clear positive expectations and they diffuse encouraging results via appropriate tools of communication.

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ANNEX 3.A1

Local fiscal data

Annex Table 3.A1.1. **Local fiscal data**

NUTS 3	Direct revenues				Direct revenues (%)		Indirect revenues				Indirect revenues (%)		Municipal revenues				Municipal revenues (%)	
	1991	1998	1999	2005	1991-1998	1999-2004	1991	1998	1999	2005	1991-1998	1999-2004	1991	1998	1999	2005	1991-1998	1999-2004
Alto Trás-os-Montes	3 420 063	7 625 138	9 887 411	14 844 567	**123**	**50**	395 013	1 187 049	772 583	1 212 871	**201**	**57**	3 815 076	8 812 188	10 659 994	16 057 438	**131**	**51**
Ave	13 243 129	33 943 641	41 716 902	62 229 598	**156**	**49**	1 133 074	3 988 777	4 393 756	5 765 129	**252**	**31**	14 376 203	37 932 418	46 110 658	67 994 727	**164**	**47**
Cávado	10 688 226	27 954 490	31 813 739	47 013 318	**162**	**48**	1 453 148	2 877 605	3 596 058	6 653 207	**98**	**85**	12 141 374	30 832 095	35 409 797	53 666 525	**154**	**52**
Douro	3 667 407	8 898 649	11 814 482	16 995 178	**143**	**44**	531 624	1 415 100	1 089 310	1 065 810	**166**	**–2**	4 199 030	10 313 749	12 903 792	18 060 988	**146**	**40**
Entre Douro e Vouga	8 547 226	23 025 139	28 362 781	34 928 465	**169**	**23**	648 218	1 024 536	955 811	1 059 853	**58**	**11**	9 195 444	24 049 675	29 318 592	35 988 319	**162**	**23**
Grande Porto	80 421 803	186 434 767	217 864 522	267 317 504	**132**	**23**	17 943 361	42 489 525	37 662 917	40 709 926	**137**	**8**	98 365 165	228 924 292	255 527 439	308 027 430	**133**	**21**
Minho-Lima	4 771 117	14 677 986	16 939 945	24 029 587	**208**	**42**	2 181 034	2 837 048	1 614 045	2 153 623	**30**	**33**	6 952 150	17 515 034	18 553 990	26 183 210	**152**	**41**
Tâmega	7 808 078	23 637 863	30 892 150	40 829 432	**203**	**32**	329 301	1 542 812	1 452 978	1 980 392	**369**	**36**	8 137 379	25 180 675	32 345 128	42 809 825	**209**	**32**
Total Norte	132 567 048	326 197 674	389 291 931	508 187 650	**146**	**31**	24 614 773	57 362 451	51 537 460	60 600 812	**133**	**18**	157 181 822	383 560 125	449 829 391	568 788 462	**144**	**29**
Baixo Mondego	11 674 295	32 968 296	39 537 510	51 766 023	**182**	**31**	1 590 427	3 600 563	6 457 398	4 437 474	**126**	**–31**	13 264 722	36 568 859	45 994 907	56 203 497	**176**	**22**
Baixo Vouga	12 435 645	34 971 544	42 801 483	56 552 816	**181**	**32**	1 314 956	2 300 625	2 014 365	4 081 792	**75**	**103**	13 750 601	37 272 169	44 815 849	60 634 609	**171**	**35**
Beira Interior Norte	2 489 590	4 828 922	6 018 530	8 492 248	**94**	**41**	347 273	746 456	480 033	431 254	**115**	**–10**	2 836 863	5 575 378	6 498 563	8 923 503	**97**	**37**
Beira Interior Sul	2 538 238	4 836 314	5 975 978	8 131 262	**91**	**36**	218 374	546 982	437 107	765 489	**150**	**75**	2 756 612	5 383 296	6 413 084	8 896 750	**95**	**39**
Cova Da Beira	1 942 469	5 413 858	6 908 386	9 778 873	**179**	**42**	160 967	1 126 779	973 514	823 378	**600**	**–15**	2 103 436	6 540 637	7 881 900	10 602 251	**211**	**35**
Dão-Lafoes	5 642 033	15 887 446	18 671 337	27 031 197	**182**	**45**	569 946	1 687 104	1 119 273	2 694 764	**196**	**141**	6 211 979	17 574 550	19 790 610	29 725 961	**183**	**50**
Pinhal Interior Norte	1 916 865	6 054 648	7 481 315	9 544 872	**216**	**28**	99 684	590 123	511 647	593 716	**492**	**16**	2 016 549	6 644 771	7 992 962	10 138 587	**230**	**27**
Pinhal Interior Sul	559 736	1 389 441	1 806 132	2 326 835	**148**	**29**	45 500	99 366	42 104	108 690	**118**	**158**	605 236	1 488 807	1 848 236	2 435 525	**146**	**32**
Pinhal Litoral	6 696 846	17 102 124	23 716 558	40 195 913	**155**	**69**	786 160	1 861 683	3 024 531	3 666 034	**137**	**21**	7 483 006	18 963 807	26 741 089	43 861 947	**153**	**64**
Serra da Estrela	787 048	2 535 734	2 465 772	3 181 857	**222**	**29**	72 281	116 544	29 649	29 764	**61**	**0**	859 329	2 652 278	2 495 421	3 211 621	**209**	**29**
Total Centro	46 682 765	125 988 328	155 383 002	217 001 896	**170**	**40**	5 205 568	12 676 225	15 089 619	17 632 356	**144**	**17**	51 888 333	138 664 553	170 472 621	234 634 251	**167**	**38**
Grande Lisboa	208 845 742	406 163 122	523 291 877	658 922 762	**94**	**26**	28 906 017	65 302 336	65 615 113	33 341 643	**126**	**–49**	237 751 758	471 465 458	588 906 989	692 264 405	**98**	**18**
Lezíria do Tejo	7 535 235	20 043 096	23 394 978	36 804 503	**166**	**57**	746 311	1 505 173	2 021 433	2 704 470	**102**	**34**	8 281 546	21 548 269	25 416 411	39 508 973	**160**	**55**
Médio Tejo	5 497 471	15 475 324	19 186 311	27 702 881	**181**	**44**	664 997	1 247 888	699 085	3 284 340	**88**	**370**	6 162 468	16 723 212	19 885 396	30 987 220	**171**	**56**
Oeste	14 374 148	39 111 127	48 658 603	75 726 771	**172**	**56**	2 168 703	5 271 321	6 159 645	6 987 292	**143**	**13**	16 542 852	44 382 448	54 818 248	82 714 063	**168**	**51**
Península de Setúbal	30 065 138	96 884 339	119 742 052	150 162 557	**222**	**25**	5 293 009	16 465 503	15 065 093	32 290 449	**211**	**114**	35 358 147	113 349 842	134 807 145	182 453 007	**221**	**35**
Total Lvt	266 317 734	577 677 008	734 273 820	949 319 474	**117**	**29**	37 779 038	89 792 221	89 560 370	78 608 195	**138**	**–12**	304 096 772	667 469 229	823 834 190	027 927 668	**119**	**25**
Alentejo Central	4 870 357	12 455 263	15 555 372	20 904 927	**156**	**34**	273 321	555 142	607 326	842 385	**103**	**39**	5 143 679	13 010 405	16 162 698	21 747 312	**153**	**35**
Alentejo Litoral	3 455 118	10 254 212	10 710 413	16 250 818	**197**	**52**	384 658	759 480	143 883	1 807 733	**97**	**1 156**	3 839 776	11 013 692	10 854 296	18 058 550	**187**	**66**
Alto Alentejo	2 802 925	6 778 399	7 871 460	12 824 587	**142**	**63**	331 292	763 739	511 183	758 922	**131**	**48**	3 134 217	7 542 138	8 382 643	13 583 509	**141**	**62**
Baixo Alentejo	3 316 093	6 914 396	7 982 412	13 725 163	**109**	**72**	345 642	330 922	114 579	498 732	**–4**	**335**	3 661 735	7 245 319	8 096 991	14 223 895	**98**	**76**

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Annex Table 3.A1.1. **Local fiscal data** *(cont.)*

NUTS 3	Direct revenues				Direct revenues (%)		Indirect revenues				Indirect revenues (%)		Municipal revenues				Municipal revenues (%)	
	1991	1998	1999	2005	1991-1998	1999-2004	1991	1998	1999	2005	1991-1998	1999-2004	1991	1998	1999	2005	1991-1998	1999-2004
Total Alentejo	14 444 494	36 402 271	42 119 657	63 705 494	**152**	**51**	1 334 913	2 409 284	1 376 971	3 907 772	**80**	**184**	15 779 407	38 611 554	43 496 628	67 613 267	**146**	**55**
Total Algarve	34 818 936	74 363 619	96 530 711	205 478 276	**114**	**113**	5 945 786	8 783 891	7 914 556	15 089 823	**48**	**91**	40 764 722	83 147 510	104 445 267	220 868 099	**104**	**111**
Total Mainland	494 830 977	1 140 628 899	1 417 599 121	1 943 692 790	**131**	**37**	74 880 078	171 024 072	165 478 976	175 838 957	**128**	**6**	569 711 055	1 311 652 971	1 583 078 097	2 179 631 748	**130**	**34**
Total Azores	3 253 295	6 681 318	7 067 787	18 484 764	**105**	**162**	168 045	201 235	264 148	1 259 241	**20**	**377**	3 421 340	6 882 553	7 331 935	19 744 005	**101**	**169**
Total Madeira	4 964 984	12 240 785	17 963 678	31 074 762	**147**	**73**	1 812 487	4 362 367	5 251 274	8 753 202	**141**	**67**	6 777 471	16 603 151	23 214 952	39 827 964	**145**	**72**
Portugal	503 049 256	1 159 551 002	1 442 630 585	1 993 252 316	**131**	**38**	76 860 610	175 587 674	170 994 398	185 851 400	**128**	**9**	579 909 866	1 335 136 676	1 613 624 984	2 179 103 717	**130**	**35**

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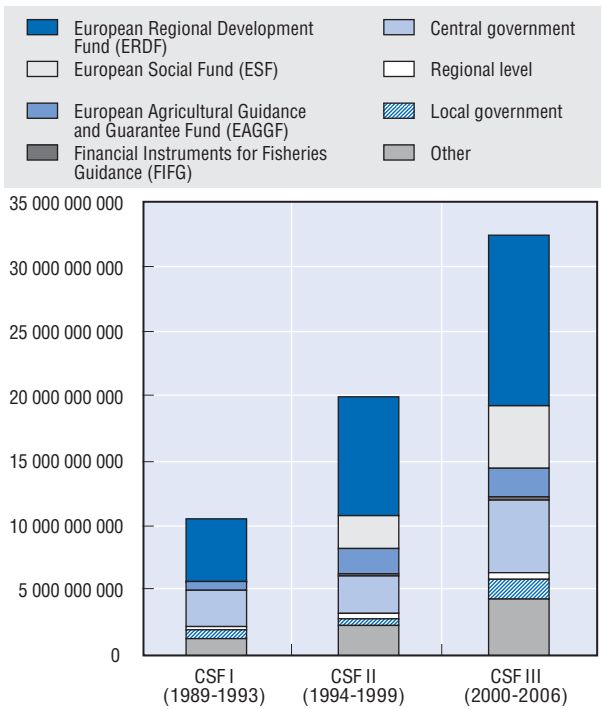
ANNEX 3.A2

Budget of regional policy in Portugal

Figure 3.A2.1. **Budget of regional policy (1989-2006)**
Unit: EUR in current prices



Source: Portugal NRSF 2007-2013.

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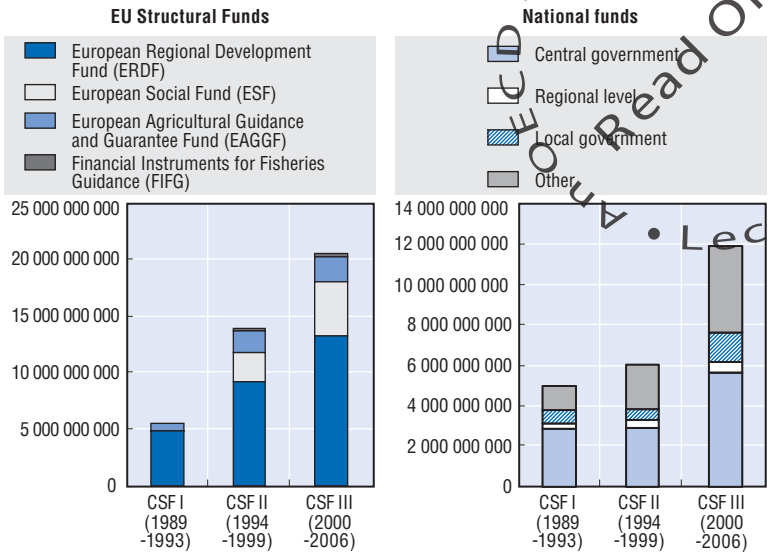
Figure 3.A2.1. **Budget of regional policy (1989-2006** *(cont.)*
Unit: EUR in current prices



Source: Portugal NRSF 2007-2013.

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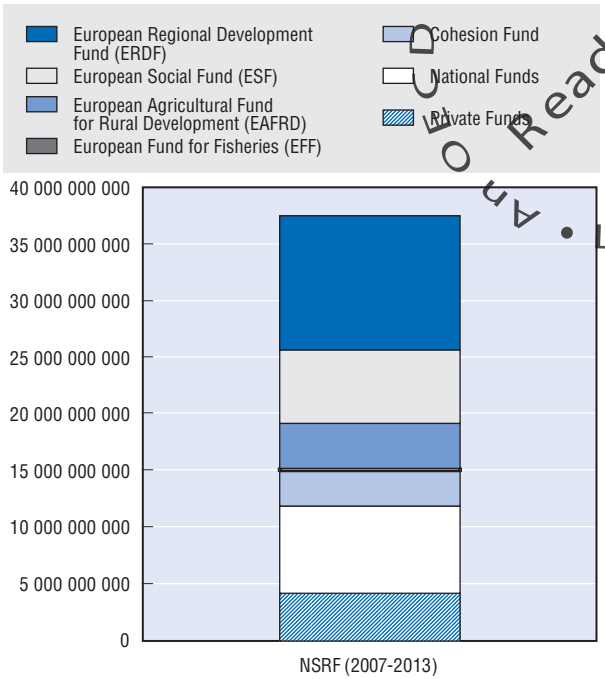
Figure 3.A2.2. **Budget of regional policy (2007-2013)**
Unit: EUR in current prices



Source: Portugal NRSF 2007-2013.

Notes

1. In France, the new role of the central government was coined under the term of "*État stratège*".
2. Detailed analysis of the ongoing reform of public administration on administrative simplification and e-government issues will be available in the forthcoming OECD Review of Administrative Simplification and E-Government in Portugal (to be published in 2008).
3. Between 2003 and 2006, the five CCDR reduced on average about 15% of their staff (with a maximum 23% cut in the CCDR of Lisboa e Vale do Tejo) and nearly 58% of national funding on their investment budget (with a maximum 73% cut in the CCDR of Alentejo).
4. See more detailed examples in OECD (2005), *Building Competitive Regions*, OECD, Paris.
5. The Strategic Advisory Bodies are composed of two representatives of the central government (in charge of regional development and local administration), the chairman of the Regional Operational Programme, one representative of social partners in the region (universities, business community and unions), and one representative of each association of municipalities at the NUTS 3 level.

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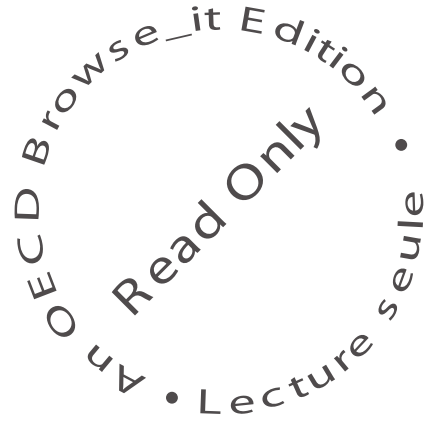

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