

14. Cooperation and Knowledge-pooling in Clusters: Designing Territorial Competitiveness Policies

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1. INTRODUCTION: THE NEED FOR A NEW REGIONAL POLICY IN EUROPE

The demand for a radical shift in regional policies aimed at increasing economic and social cohesion has emerged all over Europe. Several factors have been involved.

First, traditional incentive policies, which have so far played an essential role both in national and European Union (EU) policies, have proved to be of limited effect, while being conducive to dangerous rent-shifting wars (Puga 1998; Cheshire and Magrini 1999). Strong regional divergences persist in Europe. While productivity and income gaps among European states have diminished, gaps among regions, after a reduction, have either remained unchanged or have increased. More than 80 million Europeans, about one-quarter of the EU population, live in regions with a per capita income below 75 per cent of the EU average.

Second, recent events make the implementation of a new policy more urgent. European Monetary Union has taken away traditional macro-stabilisation tools such as exchange rates and interest rates and it has made it even more urgent for lagging regions to increase their territorial competitiveness by matching the positive externalities of advanced regions and offering capital 'credible prophecies' of higher profits.

Third, current cohesion policy in Europe, while helping to reduce development differentials among member states and to hold up democracy in Greece, Portugal and Spain, have so far failed to reduce gaps between European regions. A reform of cohesion policy is now called for to improve the quality and effectiveness of public investments, to eliminate cumbersome procedures and to implement subsidiarity.

Finally, the enlargement of the EU by 12 new countries is on its way: these countries have an average per capita income that is about one-third that of the

EU-15. The success of enlargement relies to a great extent on an effective European regional policy to be implemented in these new areas.

For all lagging regions of Europe, a strong need thus exists to resort to a 'new regional policy' aimed at increasing territorial competitiveness by providing local public goods and by making full use of the resources of the area. In this new policy, a crucial role must be played by appropriate actions aimed at developing existing and would-be clusters.

Experiments of this new policy have been carried out since the early 1990s both at European (namely urban and leader EU programmes) and national level (Ministero dei Lavori Pubblici 2001). This chapter outlines this new policy and does so by referring to a wide experiment now being carried out in the Italian Mezzogiorno.

The Italian Mezzogiorno – 8 out of the 20 Italian regions with 21 million inhabitants (36.2 per cent of total Italian population) – represents a very good testing ground for discussing a new regional policy, owing to both the persistent failure of past policies and the existing market trends (Barca 2001a).

Domestic per capita gross national produkt (GNP) is still about 67 per cent of Italian levels and the EU (about the same post-war differential). The active population is only 53 per cent of the total population, against 59 per cent in Italy as a whole and 68 per cent in the EU; the unemployment rate is about 21 per cent (11 per cent and 9 per cent, respectively) in the other areas. Agriculture still produces about 5.2 per cent of value added, against 3 per cent in Italy as a whole, and about 2 per cent in the EU. Public administration is very inefficient, as measured by any standard of services to citizens and firms. The variance of all these features among different Mezzogiorno areas is very high.

Since 1992-3, profound changes have taken place in the Mezzogiorno economy and society that have created new opportunities for its development. They have followed three concurring events: (1) the end of a 40-year top-down economic policy;¹ (2) a strong tightening of law enforcement with the extension of measures in favour of collaborators ('*pentiti*'), from family protections to reduction in sentences; and (3) the beginning of a radical devolution of political and administrative power.

After 1995, the turnover rate – birth rate net of death rate – of southern non-agricultural enterprises started rising and became higher than in the centre-north (3.2 per cent against 2.5 per cent in the year 2000). An increase in the competitiveness of Mezzogiorno enterprises also took place, as shown by a strong and continuous rise since 1993 both in exports and in the inward flows of foreign tourists (about 10 per cent growth a year in real terms). Since 1997, after a long period of stagnation, GDP growth was affected and rose to an average of about 2-2.5 per cent a year. Employment started rising again

after the beginning of 1999 (Bodo and Viesti 1997): by the summer of 2002 unemployment rate had fallen to 19 per cent, with employment in the service and industrial sector growing by about 3 per cent per year.

A strengthening also took place in the local agglomerations of firms. Even in the first half of the 1990s, when employment fell in the whole of the south by more than 6 per cent, employment increased in 102 out of the 365 local labour systems² into which the area can be divided. This brought to the national policy forum the perception that several agglomerations of firms with economic prospects have indeed been around for a long time in the Mezzogiorno, as recent research clearly shows (Brusco and Paba 1997).

In spite of these new signals, a much higher growth is both warranted by the high unexploited potential of the area and needed for the risk of a vicious circle to be avoided. Following Italy's entry into the European Monetary Union in 1998, a new policy was devised to address the issue. This policy includes a new approach to developing existing and would-be clusters.

This chapter is structured as follows. An analytical background of the new territorial competitiveness policies is provided based on an assessment of what conditions must be satisfied for an agglomeration to deliver significant externalities (section 2). The institutional design of the new policy is then discussed (section 3) and a focus is made on the specific issue of how local governments can devise the local partnership necessary to implement projects aimed at increasing territorial competitiveness (section 4). The experiment presently being carried out in the Italian Mezzogiorno is then discussed (section 5) and some lessons are drawn (section 6).

2. AGGLOMERATIONS AND EXTERNALITIES: A NEW PERSPECTIVE

The new economic geography (NEG), purported by Krugman at the cost of some drastic simplifications (David 1999), has given 'macro respectability' and revised long-standing ideas of development theory and several streams of thoughts on economic geography.³ It links the development opportunities of an area to its ability to attract mobile resources with strong bargaining power (that is scarce resources): entrepreneurs, capital and skilled labour.

Together with relative prices, NEG emphasises those cumulative factors of an area that, once set into motion, attract mobile resources and by doing so tend to perpetuate themselves as a source of superior profitability of that area. Agglomerations' externalities are such cumulative factors. They stem, according to NEG, from the size of firms' agglomeration: both from the volume of 'demand' for consumer goods and intermediate inputs set into

motion by the scale of the agglomeration; and from the ‘supply’-side effect (Marshallian factor) of ‘labour pooling, input specialization’ – accumulation of idiosyncratic knowledge by input suppliers – and ‘technological spillover’, or ‘knowledge pooling’ – as we would call it, to capture the concept of information-sharing that is needed to devise local projects.

As a result of these factors, initial conditions matter since they can set an area on either a virtuous or a vicious path. The same is the case for exogenous events and in particular for economic policy that can change those initial conditions. This is all well known. But it is also where problems start. What kind of policy is warranted by this way of reasoning?

2.1 The Old View

We might be led to think that the safest way forward is for economic policy to devise incentives directed at backward areas that can compensate for whatever profit differential they have accumulated relative to areas with agglomerations. The idea is to use incentives in order to create ‘artificial agglomerations’, relying on the fact that agglomerations, once set into motion, can become self-sustainable thanks to the externalities they develop, so that incentives can be removed. Incentives are not asked here to play the traditional role of making up for failures of the capital market to finance profitable but uncertain business, but rather the role of making up for failures of firms to coordinate and to invest altogether in a given area and then to produce new agglomeration externalities. This policy has been and still is often implemented (Cheshire and Magrini 1999). As the Italian Mezzogiorno experience shows – through as diverse schemes as ‘Development Poles’, ‘Landing Areas’ or this ‘Territorial Contracts’ – this has occurred at great cost and with dubious results. The reasons for these failures are clear-cut.

First, in order to achieve their purported results, incentives must be discretionally directed at specific areas. Since it is not at all clear which criteria should preside over the territorial allocation – agglomerations’ externalities can arise in several sectors and contexts – this lends itself to unaccountable inefficiencies and, most of all, to state capture by private interests. Attempts to make the choice of areas dependent on objective parameters – as in the choice made by the European Commission of the areas that are entitled to be exempted from the ban of state aid to firms – can reduce the latter problem; but it cannot take into account many local conditions that do not lend themselves to be captured by parameters.

Second, and more important, policies aimed at compensating accumulated disadvantages via incentives and creating artificial agglomerations are bound to degenerate into rent-shifting wars: different states and internal territories fight to attract firms and set into motion virtuous externality circles, and therefore attract rent creation, with no effect on total welfare. Furthermore, in

this war, unless a financial compensatory mechanism exists, backward areas have a disadvantage since their smaller financial resources reduce the weapons they can use in attempting to shift rents (Puga 1998); on the other hand, if central compensation is at work, it is bound to fall under the growing criticism of advanced areas, that is its political sustainability is low.

To sum up, the logic of sectoral incentives runs contrary to the reduction in competitive barriers, is bound to lead backward regions into a zero-sum rent-shifting war, and assumes a centralised knowledge about opportunities in the various territories that is simply not available.

2.2 An Alternative View

An alternative exists to this renewal of incentive policies. This alternative, which could represent a pillar for a new regional policy, emerges when, by drawing from many insights of pre-NEG theories – those contributions that David (1999) pulls together under the label of ‘old economic geography’ – it is realized that no direct, unavoidable relation exists between agglomerations and agglomerations’ externalities. For a given agglomeration, externalities can vary widely, depending on other factors.

This is first the case of demand externalities. For a given agglomeration, its consumer demand externalities depend on how dispersed the residence is of the workers employed in the agglomeration; that in turn depends on urban planning, cultural factors and other features linked to the local government provision of public services. It is also the case of supply-side externalities.

For a given agglomeration, supply-side externalities depend on whether market and informal relations exist among the firms making up the agglomeration: whether those firms purchase inputs from each other, exchange or share clients, exchange information on practices and technology, pool labour in order to improve matching, share business services. For the success of the agglomeration, it is also extremely relevant whether its firms pool their knowledge in order to ascertain the needs of the area for infrastructure and immaterial public investments (in training, research and networks) and to devise projects to be submitted to local governments. For input specialisation, labour-pooling, technological spillover and knowledge-pooling to exist, ‘economic proximity’ is needed. Physical proximity certainly helps economic proximity, but it does not necessarily imply it.

A group of firms whose physical location is used only to serve the local market or a single large firm but not to establish interaction and cooperation among each other does not produce supply-side externalities. Becattini (1979, 1998) calls these firms unembedded or ‘camped’ in their territory. It is the existence of those relations, the embeddedness, that turns an agglomeration into a ‘local system’ or cluster.

Equipped with this view, we can now return to the Mezzogiorno case.

The potential comparative advantage on the Mezzogiorno in terms of firms' agglomerations has been largely underestimated in the past. As recent studies of similar clusters of successful firms in the south and in the Italian north-east show (Mazzola and Asmundo 1999; Omiccioli 2000), agglomerations in the Mezzogiorno boast an export propensity and labour quality no different from those in the rest of the country. Where they fail is in their propensity to build a strong network of formal and informal relations within the clusters, in their rootedness in the local institutional environment (Signorini 2000).

Firms in the Mezzogiorno's clusters buy less from each other and specialise less than in the centre-north (Mazzola and Asmundo 1999), subcontractors have less diversification of clients and are less often exposed to final demand (Omiccioli 2000); firms also fail to cooperate in setting up common high-quality services, in creating risk-sharing institutions that allow for lower credit costs, in lobbying together for local agreements that make specific improvements in their business environments. They prefer to deal with firms outside the cluster (Viesti 2000), and to negotiate individually with local counterparts, perhaps in the case of public administration, with the aim of involving them in some self-deal.

The reason for this differing behaviour largely lies – as interviews show (again Mazzola and Asmundo 1999) – in the lack of trust relations inside the clusters, in the very fact that these links have never been established.

Formal and informal relations necessary for economic proximity to occur strongly depend on past history. A strong path-dependency exists, since the start of formal and informal relations is costly. But a closer look allows us to pinpoint factors that at any time can influence the establishment of such relations:

- ? the very perception of agglomeration as such by its members, beyond, if this is the case, existing administrative boundaries;
- ? the effectiveness and the speed of the local court system in sanctioning contracts, which is a prerequisite for exchange relations to be established in the area;
- ? the diffusion of business networks that facilitate the establishment of informal relations and the exchange of private information among firms;
- ? whether the local government offers local private agents the opportunity to come together, pool their knowledge and devise proposals for public projects of general interest.

Once we have recognised that market exchange, cooperation and knowledge-pooling are necessary to turn an agglomeration into a 'local system' and to produce agglomerations' externalities, we can draw two important policy conclusions.

First, a new ground opens up for enacting regional policies. Rather than devising interventions to create 'new' agglomerations, we can start from 'existing' agglomerations – when they indeed exist – and devise policies aimed at empowering them with the conditions to develop cooperation and knowledge-pooling.

Among these policies are the following actions: (a) modernisation of the judiciary system so as to favour the development of contractual relations inside the agglomeration; (b) modernisation of local administrations, with the introduction of accountable procedures for the selection of local projects, so as to create an incentive for firms in agglomerations not to interfere individually with the decision process and rather to pool their knowledge together and to lobby by means of local associations to enact public projects enhancing their profitability; (c) institution building, whereby private and public local actors are encouraged to come together and to create partnerships; (d) adequate urban planning; and (e) incentives for networking, making full use of new information technologies, offering high-quality small firms operating in the agglomeration the opportunity to market the 'diversity' of their products with distant consumers.

Borrowing the expression from Cheshire and Magrini (1999), we call these actions 'territorial competitiveness policies' (TCPs). Many of them are aimed at increasing the 'relational capital' of the agglomeration.

The second conclusion concerns the different welfare content of this policy for territorial competitiveness relative to the old regional policy largely based on incentives.

Territorial incentives policies are openly aimed at reallocating firms from one territory to another: insofar as they produce additional externalities by 'artificially' increasing the scale of a given agglomeration, they are just shifting these externalities from one territory to another, with no improvement in general welfare. Actually, welfare can be reduced if some of the negative effects of incentive policies were to apply.

A very different situation holds for territorial competitiveness policies: state intervention is aimed at turning potential externalities into effective ones; with no 'artificial' reallocation taking place. Capital and entrepreneurs will move only if truly superior opportunities arise; general welfare is then increased.

There is obviously no guarantee that TCPs will succeed. They are indeed complex, and very knowledge-intensive and the knowledge that they require is held mostly by local private actors. A strong discretionality of the state – both central and local governments – is required in order both to assess which specific interventions are more suitable to any agglomeration and to implement them.

These are hardly features that should prevent governments from pursuing TCPs. They are in fact nothing but essential functions of the state – largely in its ‘minimal’ version – that are to be aimed at specific territories: law and order, education, provision of public services, institution building, urban planning, market regulation and planning (not necessarily financing) of infrastructure.

But high discretionality and high knowledge content of TCPs suggest that great care should be put into their institutional design, both in allocating decision making among different levels of government; and in designing the relations at local level between public and private actors; an issue to which we concentrate on in the next section.

3. TCP GOVERNANCE

In order to draw the most suitable institutional framework for devising and implementing TCPs, the following five features can be pinpointed:

1. TCPs are strongly ‘knowledge-based’: knowledge is largely held by private agents; public agents must extract this knowledge, combine it and use it in order to devise and implement projects.
2. General knowledge is certainly needed (new technologies, information on international opportunities and quantitative methods for evaluation), but the distinctive feature of TCPs is the need for ‘local knowledge’ (on agglomerations’ boundaries, failures of its relational features, existence of unused resources, and so on). Local knowledge is particularly necessary for any local project to be properly devised and implemented: as pointed out by Cheshire and Magrini (1999), only local coalitions have the knowledge to devise agglomeration-enhancing projects, and the incentive to actually reveal information – each member of the coalition to the others – to be pooled together in the project.
3. Since knowledge is dispersed among many local and central agents, the necessity arises for ‘knowledge pooling’ to take place through negotiations, both horizontally at local level and vertically between local and central agents.
4. Since specific TCPs projects are complex and of a highly integrated, multisectorial nature, high reliance is needed on ‘ex ante evaluation’ to be performed via feasibility studies: public administration can largely rely on the market to perform these studies, but it must have in-house capability to allocate, monitor and make use of these studies.

5. Finally, public administration, both at central and local level, must be 'highly credible' in devising and enacting policy and in performing functions listed at points 3 and 4.

The first consequence we can clearly draw is that TCPs must be largely devised by local governments. They only have the knowledge and the credibility to pool together local coalitions of private agents capable of devising projects: they only can enact the institution-building activities that can increase the economic vicinity of an agglomeration (Trigilia 1999). Furthermore, the subsidiarity principle is particularly relevant here in allowing a better monitoring by the local political market on the coherence of government. If this policy is implemented all over a national area, the incentive of local governments to act properly is increased by territorial competition among different administrations. On the other hand, there are three classic effects that reduce the efficiency of such a strong devolution of decision power in devising and enacting TCPs.

First, some externalities can fall, as we suggest, beyond the limits of administrative boundaries, suggesting the need for cooperation among local governments. Second, some interventions of TCPs can still degenerate into rent-shifting wars: this could be the case of several territories all investing in the development of similar niche products exceeding existing demand, or in the direct transport communication between local and global markets. Finally, renegotiation of allocation rules can more easily take place at local level between local government and local private agents: the monitoring of the political market could be too slow to prevent it.

A rather traditional solution comes first to mind in order to come to terms with these different problems.

According to this solution, devolution must not take place in those areas of TCPs where strong indivisibility or wide externalities exist. All policies aimed at increasing relational capital should instead be devolved, leaving to local governments the chance to cooperate whenever the appropriate area of intervention exceeds administrative boundaries.

As for the renegotiation issue, a single central administration should be left the responsibility of monitoring the implementation of the general rules through which TCP resources are spent. Monitoring should be mostly of a diagnostic nature, aimed at assessing performance while policy is being enacted and at providing technical assistance whenever it is deemed necessary: this approach can also ensure fair competition among local governments that happen to be endowed with different starting conditions. Targets should possibly be introduced or performance indicators should be devised so as to allow local political markets to judge their local governments with fairness and homogeneous standards. Sanctions and rewards could be

attached to these indicators. These targeting and monitoring mechanisms become even more useful when 'local government' is indeed made of two different levels of government: regional and municipal, the former endowed with the power to allocate resources among projects, the latter to devise and submit these projects.

The institutional framework that arises from this solution is reminiscent of 'new' public management, a system of public management that has been increasingly experimented with in several industrial countries. As in that model, allocative and managing functions are entrusted to some 'agency' institutions (local governments), while the 'principal' (a single central administration) retains the monitoring power, through targets. This scheme already represents significant progress, especially for countries where the accountability of regional policies have long been extremely inadequate. But it can hardly be the whole story.

In the many countries (mostly Anglo-Saxon) where new public management has been more widely experimented, it has become clear that a full contractualisation of relations between different levels of government or among branches of the same level cannot suffice (O'Donnell and Sabel 2000; Dente 1999). The conceptualisation and execution of policies cannot be fully separated, making the very principal-agent paradigm inadequate. Targets cannot be fully verified or they can bias local governments' actions. The paradigm of incomplete contracting, whereby agents cannot delegate functions to each other by means of verifiable contracts, seems appropriate. Informal cross-cutting is necessary both at the horizontal level (among branches of each level of government) and at the vertical level (among levels of government). These concerns are particularly relevant for the case of TCPs, where local knowledge plays such an extensive role.

Each level of government – as well as each branch of any level – has some of the knowledge needed for enacting general guidelines, but much of it is 'tacit', in the sense that it cannot be transferred via formal procedures but only via informal interaction with other levels of government or branches. Furthermore, a great deal of knowledge is unavailable to public agents; only private agents, both local and external to the area, are privy to it. Inside knowledge of this kind can only be 'produced' and made available for devising territorial projects only via interactions among several agents.

This has two implications. First, for any good result to be achieved, different levels of government, as well as being linked by hierarchical relations, must also cooperate with each other. Second, in order to avoid serious distortions, targets must be set by an upper level through technical and political consultation with the lower levels and their implementation must be followed by all levels through continuous diagnostic monitoring.

The move towards new public management must be accompanied with the establishment of a strong and operational institutional partnership between levels of government. While contractualisation of relations among different level of government (via targeting, incentives and monitoring) is necessary, these relations must be governed by a partnership network that allows these 'incomplete contracts' to be completed via a technical partnership.

Both at central and local level, different sectorial branches of government will then cooperate in devising *ex ante* evaluations needed to assess the feasibility of integrated projects. Together with this horizontal partnership, a vertical partnership must also be established among central and local governments: to establish and monitor targets (and, by doing so, to give meaning to them) to develop standards and methods for evaluating local projects, to monitor major feasibility studies, to implement projects and devise compensatory mechanisms for the differentiated impact on local interests.

Together with institutional partnership, social partnership at local level between private and public agents plays a crucial role in implementing TCPs. The design and implementation of local TCP projects requires local knowledge to be extracted by local authorities from several private agents, to be combined and tuned into projects.

TCP-like experiences that have taken place during the 1990s allow us to investigate problems and solutions that arise from the partnership on which the new approach relies. Some lessons of general interests ensue.

4. IMPLEMENTING PUBLIC-PRIVATE PARTNERSHIP⁴

A simple stylisation is helpful in evaluating the issues that local governments have to face in implementing cooperation among private agents.

Let us assume that the local government is faced with two private agents both of whom have the knowledge that the government deems necessary in order to devise a project. Let us also assume that neither one nor the other agent - nor the local government - knows exactly how much of the knowledge which is useful for the local project is held by the other agent: this can be represented by assuming that both agents are knowledgeable but that each of them - and the government - assumes, with some likelihood, that the other agent is either ignorant or knowledgeable. Finally, let us assume, as is often the case, that: (a) the value of the project is minimal if none of the two agents reveals knowledge, while it is maximised if both agents reveal; and (b) each agent can appropriate some of that value, so that he is better off if both of them reveal and worse off if he reveals and the other agent does not reveal.

A cooperative game can then be set by the local government with the attempt to make both agents reveal their knowledge. The governance of the social partnership will then be aimed at reducing the chance to widen partnership to ignorant agents, increasing reciprocal trust among agents (possibly through signalling) and creating the right incentive for each of them to reveal.

Direct experience of several Mezzogiorno projects as well as the findings reported and commented in Rossert (2000) allow us to pinpoint five relevant factors that local governments should take care of in setting up local partnerships.

Partner selection A reduction in the (perceived) likelihood of including ignorant agents in the process increases the chance that all private agents reveal their knowledge and that good projects are designed. Similarly, the inclusion of 'cooperative' agents, that is agents known to be more likely to reveal knowledge, or 'natural born leaders', that is agents capable of creating team-like situations, contributes to the same result.

Local governance can help in these directions by setting up a competitive enough process through which participants get 'selected' to sit at the partnership table. Results from the Mezzogiorno experience of 'territorial pacts'⁵ show that a correlation exists between the success of public action and the openness of partnership (DPS 2001).

Access must not be restricted to members of well-established associations of interests. On the contrary, it should always be challenged by newcomers and representatives of less established interest groups. The latter might well have an incentive greater than average in using a partnership in order to advance their weaker position.

As for the associations themselves – whether business, union or class action groups – their members will have a greater chance to improving their well-being, the more their representatives sitting at the table care to enhance members' interest rather than their own as association bureaucrats. Competitive selection of association managers therefore becomes crucial. Failures of many experiences in the Italian Mezzogiorno depends on such competitive selection being completely lacking.

Timing and deadlines A tendency might arise in a partnership – once repeated interaction is allowed for, as is often the case – of diluting negotiation and postponing decisions about whether to reveal knowledge or not; every partner waiting for the other partners to make the first step. This tendency is increased if the political market rewards politicians more for the announcement and start up of partnership tables than for these tables actually producing tangible results.

Local governance can improve results by fixing deadlines and attaching costs to any time delay, such as the reduction of financial resources made available by the regional or national government. For sanctions to be effective, information on their existence and procedure must be widespread so as to turn administrative sanctions into political ones. Credibility of the regional or national government must be enhanced in order to strongly reduce the likelihood of renegotiations of those sanctions.

The Mezzogiorno experience shows that the working of territorial pacts was basically brought to a halt between 1996 and 1999 by the lack of central government credibility in setting deadlines. As soon as credibility was somehow restored (see section 5) most existing pacts became operational. Drawing from these lessons, a substantial reserve premium linked to targets and deadlines was introduced on a major scale for the implementation of EU regional policy (see section 5).

Accountability and uniqueness A strong incentive for local agents to take a partnership seriously and to reveal knowledge comes from their truly believing that no alternative ways will be provided by the state to design and select local projects. If, on the contrary, a partnership is perceived as being merely formal – just a way to comply with formal procedures – and agents believe that the local government or other levels of government will separately carry out ‘direct consultations’ with other agents in order to build local projects, a very strong deterrent to cooperative behaviour will arise.

Local governance of a partnership can strongly enhance chances of success by increasing negotiation’s visibility and accountability and making a strong commitment to the uniqueness of that negotiation. Drawing from the experience of 1994-9 territorial pacts, the implementation of EU-financed local integrated projects in the new 2000-2006 programming cycle has increased accountability and the credibility of uniqueness.

Project evaluation For local partnership to work, agents must truly believe that an effort will be made to select only good projects, that is governments – regional governments in the Mezzogiorno case – which have the responsibility to select from projects submitted by several local governments, must use well-established evaluation procedures. If that is not case, neither private agents nor local governments will have enough incentive to go through the procedure itself: the agents will not reveal, and the local government will not bother to set the partnership table properly. The very recent experience of integrated territorial projects being implemented in the Italian Mezzogiorno provides a set of clear-cut principles to follow.

Local governance of a partnership should be accompanied by an appropriate mix of contracts and a partnership between the local and the

regional government. Clear-cut criteria will have to be announced *ex ante* by the regional government regarding the selection of local projects; at the same time, the regional government will have to work in cooperation with local governments in order to continuously and transparently adjust and finalise those criteria.

The implementation of proper evaluation procedures also allows local governments to establish a well-defined language through which knowledge can be better extracted from agents at the negotiation table.

Care should also be taken in avoiding any rigid pre-allocation of resources by the regional government. If resources are fully committed, that is the regional government's mission is to allocate resources by a given date, an incentive exists for local governments to collude, not to embark in a costly, long and uncertain local partnership and to directly aim at their 'share' of resources by submitting to the regional government superficial projects.

Cross-cutting among professional skills Finally, the Mezzogiorno experience shows that the success of a local partnership depends on whether local governments command skills different to those of urban planners, scientists, economists, sociologists and lawyers (to mention only the main ones).

Extracting knowledge from local private agents and global ones (managers of large corporations, public utilities, financial companies, and so on) and pooling it together into successful projects needs the joint filter of those different skills. Local governments rarely have all these skills among their administrative and technical ranks and need to rely on external assistance (consultancy). But for that assistance to be fruitful, the local government, possibly through the support of regional and national governments, needs to have in-house skills capable of orienting and supervising the assistance itself.

A network of evaluation units composed of assorted skills is presently being set up in all regions of the Italian Mezzogiorno (DPS 2001). These criteria represent principles of good practice in partnership, both horizontal and vertical, both social and institutional. Whether this good practice is implemented or not largely depends on local governments. The quality of public administration is emphasised once again in the implementation of TCPS.

5. IMPLEMENTING TCPS IN THE MEZZOGIORNO⁶

The objective and the institutional design of a new territorial competitiveness policy were put into action in the Mezzogiorno 2000-2006 Plan drawn up by the Treasury's Department for development policy (DPS-Dipartimento per le

politiche di sviluppo). The opportunity to devise the new policy arose when the Mezzogiorno was assigned €22 billion of European funds – €45 billion, once national co-financing is included – to be spent in the years 2000-2006 for public investments and/or for incentives.

The Mezzogiorno Plan addresses three main priorities: (1) strengthening communication; (2) making natural and cultural resources accessible; and (3) fostering agglomerations. A fourth policy – increasing competition – is advocated, but falls beyond the reaches of the Plan.

The target of ‘fostering agglomerations’ plays a central part in the Plan. It absorbs about 50 per cent of total resources while a further 25 per cent is allocated to natural and cultural resources, whose increased accessibility strongly contributes in enhancing the competitiveness of agglomerations focused on the production of goods and service for tourist consumption.

Rather than trying to create new agglomerations or pinpointing preferential areas for development or incentives, policy was aimed at enhancing formal and informal relations inside existing agglomerations. This can increase the returns on investments inside agglomerations and set in motion a virtuous circle of inward investments.

Except for the judiciary sector, where existing EU regulation prevents structural funds from being spent, all means to increase agglomerations’ relational capital receive special attention. Thirty-three per cent of the total Plan’s resources is assigned to ‘local development’ (Table 14.1). Resources for incentives have been drastically reduced compared to the past, both in order to avoid a depletion of resources available to truly change the economic and social context and in order not to give public administrators too much room for manoeuvre in discretionally allocating subsidies to firms. The government later partly bypassed the latter problem altogether by introducing an automatic tax deduction for all firms investing in the area. A large share of resources for local development is then allocated to comprehensive projects submitted by local partnerships to finance training, research and infrastructures linked to specific firms’ needs. Effective territorial pacts have therefore a relevant role to play.

Resources for investments in urban areas have also been increased to about 4 per cent, on the basis of the very good results achieved by municipal governments in the last few years. Law enforcement receives 2.8 per cent of resources. A further 1.7 per cent of total resources is allocated to the modernisation of the administrative structures that have the responsibility for implementing the Plan. The accomplishment of some indispensable local administrative reforms is either mandatory, or allows regional governments to score higher points in the competition to get extra funds. A further 10.7 per cent of resources is allocated to training both public and private agents to improve matching of supply and demand for labour inside agglomerations.

Table 14.1 *The Mezzogiorno Development Plan: allocation of financial resources (total public funds = 100)*

Priority axes	Public Funds		Total	Private Funds
	Central Responsibility	Regional Responsibilities		
Natural resources (e.g. water)	0	18.8	18.8	5.6
Cultural resources	0	6.0	6.0	0.9
Human resources				
? Training and active labour market policies	0	10.7	10.7	0.9
? Education	1.8	0	1.8	0
? R&D	4.2	0	4.2	0.8
Local development systems	10.2 ^a	22.7	32.9	0
Cities	0	4.4	4.4	0.7
Communication and networks				
? Tangible and intangible networks	8.3	8.4 ^b	16.7	4.7
? Law enforcement	2.8	0	2.8	0
Technical support to Regions	1.3	0.4	1.7	0
Total	28.6	71.4	100	13.6
Total (million euro)	11,400	28,500	44,500	5,400
Performance reserve (10%)	-	-	4.6	-
Total funds (million euro)	11,400	38,500	44,500^c	5,400

Notes:

^a Data includes resources managed by the Ministry of Industry on behalf of regions allocated through regional ranking.

^b Includes some regional measures for law enforcement.

^c The figure is made up of EU resources (€23.8 billion) and national resources (€20.7 billion) according to the additionality principle.

Source: Ministry of the Treasury – Department for Development Policy (DPS).

The Plan sets guidelines for concentrating resources in territories where natural and cultural resources exist and where increased accessibility could attract significant private investments: maintenance and recovery of natural and cultural resources are linked to interventions (in training, research,

communication and other infrastructures) that are needed to turn those resources into sources of growth and employment. A quarter of all funds is allocated to these targets, more than 5 per cent to cultural resources alone.

In line with the trend towards devolution currently taking place in Italy, the Plan allocates most responsibilities to local governments. But the main thrust of the Plan is not so much devolution as the building of an institutional framework, both collaborative and competitive, among central, regional and local governments, whereby each level acts as a guideline-setting and monitoring authority.

The decision was taken to allocate responsibilities among different levels of governments as follows. Governments of regions were assigned 71.4 per cent of the funds (for all interventions except 'local to global' transport network, law enforcement, research and development (R&D), traditional capital incentives and a specific plan to reduce school drop-out rates) and the responsibility for allocating them among projects.

Municipalities, groups of municipalities and private agents were entrusted with the responsibility of submitting such projects. A relevant role is expected to be played by territorial integrated projects. They are being held on the basis of the experience of 'territorial pacts'. As pointed out in section 4, sometimes these partnerships turned out to be yet another version of the old habit of local actors coming together with dubious projects just to submit pleas for money to 'Rome'; in many other cases, though, projects were knowledge-intensive and envisaged true and innovative cooperation among local actors (Cersosimo 2000).

The central government, as well as being assigned the management of 28.6 per cent of resources, was made responsible for setting general guidelines, monitoring results and allocating the rewards and sanctions linked to these results. Ten per cent of the budget was allocated to distribute rewards. The credibility of the central government's actually playing the arbiter role is enhanced by the existence of a fourth actor: the EU. All the rules of the Plan's governance are in fact turned into internationally binding regulations by the fact that the Plan is negotiated and approved by the European Commission and subsequently monitored by it.

The general target of the Plan is a classical GDP growth target: 'a growth significantly higher than the European one for the whole Mezzogiorno from year 2004', that is no less than 4 per cent a year, if Europe were to grow at 3 per cent. A group of 17 'breakthrough variables' (such as export and foreign investment intensity, share of the black economy, criminality index, labour participation rate, size of employment in business services, and so on) was also pinpointed and target intervals were set for each of them; links between public action and each variable were established and quantitatively assessed in the Plan (Barca and Pellegrini 2000).

The introduction of these targets and the need to assess ex ante the advantages and disadvantages of alternative projects called for ex ante evaluation systems, which the Italian public administration had hardly ever used. Regional governments and central administrations needed to be equipped with technical evaluation units. The latter were then made compulsory and a procedure was set up to ensure the quality of the recruitment process.

Similarly, a reward system was established to increase the accountability of regions and central administrations and to create a strong incentive for them to implement the new policy with no delay and with a checked quality standard. On top of the general European rules setting non-renegotiable deadlines for the use of resources and creating a 4 per cent reserve fund to be allocated according to strict rules, the Italian Plan set aside an extra 6 per cent of resources to be allocated in 2003 to regions ranked according to their success in concentrating and integrating local actions (quantitatively measured) and implementing a set of 10 administrative reforms.

These innovations represent steps towards the system of new public management. But these steps were accompanied by others aimed at establishing a network of robust institutional partnership.

Committees have been set up for each programme, where central, regional and municipal governments have their seats and where diagnostic monitoring will take place. A similar partnership has been established between public administrations and associations of private agents. Targets for the 10 per cent reward have been set via technical negotiations with regions and will undergo diagnostic monitoring by a technical unit made of regional and central experts.

A national scientific committee was created (with a strong role of DPS) to provide technical support for the creation of evaluation units in each regional and central administration. Monitoring units were created with a mixed composition of both local, regional and central experts (with a strong role of DPS) to supervise the implementation of the major feasibility studies, which will be testing the main projects of the Plan.

6. SOME RESULTS AND A LESSON

The complex nature of the Plan has suggested to concentrate much of the expenses in the years starting in 2003, so as to allow the new projects that are being launched to be properly developed. The ultimate effect of the Plan and the territorial competitiveness policy that it embodies will not be fully appreciated till half of the decade. But right from the beginning, procedural

results – quality of the selection process of evaluation units, quality of the new generation of locally embedded feasibility studies, effectiveness of horizontal and vertical partnership, achievement of targeted administrative reforms, and so on – are becoming known through continuous monitoring and comparison across different regions is being made possible. Preliminary results are analysed in DPS (2001). They can be summarised as follows:

- ? The new cycle of feasibility studies is currently being accomplished in all but one of the Mezzogiorno regions: in spite of permanent drawbacks in the quality of consultancy, the interim monitoring that has been implemented by the Treasury Evaluation Unit has often allowed knowledge pooling to successfully take place at local level.
- ? A first Report on the 10 per cent reserve premium shows a very diversified performance by the Mezzogiorno regions in the implementation of preliminary regulations and internal reforms, and is acting as a strong incentive design to boost the modernisation of public administration.
- ? Five out of eight Mezzogiorno regions have created a new Evaluation Unit via public competition and are going to use these units to establish strong technical partnerships with local coalitions of public and private agents.
- ? Territorial integrated projects are being implemented in all regions: the five crucial issues of section 4 are being dealt with in different ways.
- ? Financial implementation is slow; this depends both on the time and effort needed to modernise administrations, and on the choice of regions to postpone expenditure to the availability of adequate projects.

While these and other results do not allow a proper assessment of the Italian TCP experiment to be made, lessons can already be drawn. Some of them have been anticipated in section 4. Some final points can be added.

The choice of concentrating resources on existing agglomerations and enhancing their relational capital and framework conditions rather than attempting to create new agglomerations in selected areas and making use of incentives to influence firms' location seems to create a very strong incentive for local actors and leadership to design local projects. On the other hand, associations of union, business or citizens interests have not yet proved adequate to the new phase.

Local governments – municipalities, counties, self-organised coalitions of municipalities – are confirmed to be best suited for designing projects to increase territorial competitiveness. Regional governments are best suited for carrying out complex feasibility studies to be used as tools to allow knowledge-pooling, at selecting project proposals submitted by local governments and allocating resources to them. A higher level of government

is best suited to setting general guidelines, pinpointing the main targets and carrying on diagnostic monitoring.

Criteria for project selection should be known in advance so as to create a strong incentive for local governments to implement good partnerships and to extract knowledge from local private actors. A governance system must be put into place that makes these criteria truly accountable and that allows no undue renegotiation to take place. At the same time, there should be a continuous process of adjustment of criteria and rules on the basis of what all levels of government learn by implementing the policy.

Finally, for good partnerships to be established, regional and central governments need to have in-house evaluation capacity. The quality of the public administration is the indispensable tool of Territorial Competitiveness Policies.

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8. NOTES

1. On the early 1950s' success and subsequent failures, see Barca and Trento (1997), Barca (1997) and D'Antone (1997).
2. Local labour systems are defined as territories where there is a high coincidence between place of residence and place of work: see Istat (1997).
3. See Krugman (1995) for a survey. See also Brusco (1975) and Becattini (1979) for the Italian contributions on the Marshallian concept of industrial districts.
4. This section was first presented at the Conference on 'Exploring Policy Options for a new Rural America' held by the Federal Reserve Bank of Kansas City on April 30-May 1 2001 (see Barca 2001b).
5. In territorial pacts, public financing is provided both for incentives and public investments to coalitions of both local governments and private actors that submit local integrated projects (including both private investments and infrastructure). For a critical assessment of this experience, see the special issue of the journal *Stato e Mercato*, winter 2001.
6. For an assessment of the present problems and opportunities of the Italian Mezzogiorno and the new policy that is being implemented, see Barca (2001b).

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