EUROPEAN UNION

Committee of the Regions

Obstacles to investments at local and regional level

This report* was written by Jürgen Pucher (Project Leader), Haris Martinos and Wolfgang Schausberger (Metis GmbH).

It does not represent the official views of the Committee of the Regions.

*** The Executive Summary was written by the CoR Secretariat-General Unit C2.**

More information on the European Union and the Committee of the Regions is available online at http://www.europa.eu and http://www.cor.europa.eu respectively.

Catalogue number: QG-02-16-984-EN-N
ISBN: 978-92-895-0899-5
doi:10.2863/690909

Contents

List of Tables, Figures and Boxes

Abbreviations

AGS	Annual Growth Survey
CEMR	Council of European Municipalities and Regions
CLLD	Community-led Local Development
CoR	Committee of the Regions
CPMR	Conference of Peripheral Maritime Regions of Europe
CR	Country Report
CSR	Country-specific Recommendations
EC	European Commission
EFSI	European Fund for Strategic Investment
EIB	European Investment Bank
EIPA	European Institute of Public Administration
ESI Funds	European Structural and Investment Funds
EU	European Union
FDI	Foreign Direct Investment
ICT	Information and Communication Technology
ITI	Integrated Territorial Investments
LEP	Local Enterprise Partnership
LRA	Local and Regional Authorities
MS	Member State
MLG	Multilevel Governance
MNE	Multinational Enterprises
NRP	National Reform Programme
OECD	Organisation for Economic Co-operation and Development
OP	Operational Programme
PA	Partnership Agreement
PES	Public Employment Service
PPP	Public-private Partnership
RTD	Research, Technology and Development
RTDI	Research, Technology and Development and Innovation
R&D	Research and Development
SME	Small and Medium-sized Enterprises
TO	Thematic Objective
ToR	Terms of Reference
VET	Vocational Education and Training
WB	World Bank

Executive summary

Introduction

Investment in the EU as a whole and in two-thirds of the Member States remains below the pre-crisis level, and at local and regional level there has been an alarming decline in public investment. The EU response is spearheaded by the Investment Plan for Europe with its main instrument being the new European Fund for Strategic Investments.

With public and private investment levels in the EU still below the pre-crisis level, the persisting 'investment gap' is a key area of concern at all levels, throughout the European Union. This study considers the issues associated with easing or removing obstacles to investment at local and regional level. Its methodology relies mainly on desk research and eight case studies in identifying and removing territorial obstacles to investment in different Member States (IT, PT, UK, SE, DE, PL, SK and EE).

Overview: obstacles to investment and approaches to removing them

The 2016 Annual Growth Survey has accorded priority to 're-launching investment', placing particular emphasis on tackling challenges to investment and initiating a process of identifying and removing obstacles to investment. There is a strong territorial dimension to the whole issue of boosting long-term investment, emanating from the competencies and functions of the local and regional authorities and from the territorial nature of many of the challenges to investment.

The main thrust of the effort advocated by the 2016 Annual Growth Survey is on tackling 'regulatory and administrative challenges' to investment. Such approaches span both public and private investment and have been systematically spelled out by the European Commission, the OECD and the World Bank, backed up with practical advice ('toolboxes') and examples of good practice.

In response to the emphasis placed on improving the regulatory environment, the CoR and the LRA associations have highlighted the need to address also other major constraints to investment, calling for an enhancement of administrative capacity at all levels of government and for flexibility in the existing rules of the Stability and Growth Pact (a ‘golden fiscal rule’ that growth-conducive long-term investments remain separate from current expenditure). They have also underlined the importance of the EU in continuing to provide the framework for adequate funding for ‘quality public investments’, and have expressed concerns about the apparent lack of compatibility between the approach of the European Fund for Strategic Investments (‘demand-driven and with no sectoral or geographical pre-allocations’) and the EU’s commitment to economic, social and territorial cohesion.

Territory-related obstacles to investment

As territory-related obstacles to investment are treated those that have a territorially differentiated impact within countries, are relevant to the functions of the LRAs regarding investment, and there is potential for the LRAs to contribute towards easing or removing them.

A compilation of a ‘draft list of territorial obstacles to investment’ has been undertaken based on a review and analysis of a large number of potential obstacles to investment emerging from recent EU exercises, notably the 2016 Annual Growth Survey and Country Reports, and other sources.

The obstacles covered fall into five groups:

1. *Deficiencies in* ***multilevel governance and public administration****,* including coordination with other levels of government and other sectors.

2. Deficiencies in ***accessing and managing investment funds***, including mismatches between the functions and financial resources of LRAs.

3. Shortcomings in ***public procurement and public-private partnerships***.

4. ***Unfavourable business environment***, due to burdensome regulations and procedures, including sector-specific regulations, and difficulty in accessing SME finance.

5. ***Inadequate preconditions for investment*** (appropriately skilled labour force, transport networks, etc.).

Cross-cutting issues and territorial relevance

LRAs play multiple and often inter-linked roles regarding investment in their area: planner, investor, investment partner, regulator, provider and promoter/facilitator, as well as an overarching role of 'enabler' as envisaged in the new EU investment initiatives. In terms of relevance and extent to which obstacles to investment impede the different roles of LRAs, shortcomings in public procurement/PPP present the most significant challenges, especially on the role of investment partner and enabler.

The scope of these obstacles is extremely wide-ranging and diverse and it is rarely a question of tackling an isolated obstacle to investment. Usually one is confronted with both regulatory and non-regulatory obstacles, with the latter often reflecting financial framework conditions. It is, thus, important to establish a framework that allows a focused approach in addressing obstacles at different levels. Hence, the study considers the main cross-cutting issues and links between obstacles, and maps out the most relevant areas to be addressed from a territorial perspective.

- The central point is the urgent need to fill or at least narrow the investment gap. The business environment suffers from burdensome regulations and procedures, calling for institutional reform and administrative strengthening.

- The new EU investment initiatives and the European Fund for Strategic Investments focus on mobilising private investment and regard the LRAs as enablers of this process, though the LRAs would often have to overcome major institutional and administrative capacity limitations to be able to do so. At the same time, investment in essential public infrastructure and services is falling behind and the fiscal frameworks impede LRAs from fulfilling their obligations. Although the ESI Funds can make a contribution, 'unlocking' them and combining them with the European Fund for Strategic Investments present further challenges.

- This analysis highlights significant weaknesses in administrative capacities and various aspects of multilevel governance, as well as in the fiscal framework of the LRAs, which need to be targeted in order to tackle the investment gap at local and regional level.

- Regarding the territorial relevance of the main obstacles in terms of their impact on regions *within* countries, the highest degree of differentiated impact concerns ‘essential preconditions’ to investment, such as the availability of skills and transport infrastructure.

This analysis offers an EU-level template, as illustrated below, regarding the relevance of the main groups of territorial obstacles in terms of their impact on regions and on the effectiveness of the LRAs in performing their competencies and functions regarding investment in their area.

Conclusions and recommendations

The new EU investment initiatives and the European Fund for Strategic Investments focus on mobilising private investment and removing regulatory obstacles, and regard the LRAs as enablers of this process. However, fiscal regimes also need attention and essential public investments have to be supported.

Many obstacles to investment are territory-related and need to be addressed in ways that take account of their territoriality. Nevertheless, not all them are equally important in terms of their relevance to the competencies and functions of LRAs and the intensity of impact; hence, a more selective and focused approach would be justified from a territorial perspective.

The types of action mostly needed to overcome the obstacles and make the role of LRAs more effective in achieving public and private investment in their area fall into three main categories:

- ***Fiscal and financial framework***
  - Fiscal framework adapted to the investment objectives
  - Correcting functions / financial resources misalignment
- ***Multilevel governance and institutional reform***
  - Better MLG
  - Institutional reform
- ***Administrative capacity building***
  - Organisational strengthening
  - Strengthening specialist expertise

The below table, matching these types of action to the obstacles that are most relevant from a territorial perspective offers a framework at EU level that can be used for establishing more specific packages of action in each country, through a process based on partnership and multi-level governance, which should form part of the European Semester.

Main obstacles	Relevance and impact of each obstacle on regions	Relevance and impact of each obstacle on LRA competences and roles
1. Governance and Public Administration *Deficiencies in quality, efficiency, coordination, etc.*	***MEDIUM***	***MEDIUM*** ***on the LRAs' role as*** **Planners**
2. Accessing and managing investment funds *Deficiencies in managing public investments, functions/financial resources mismatch*	***MEDIUM***	***MEDIUM*** ***on the LRAs' role as*** **Investors**
3. Public procurement and PPP shortcomings	***MEDIUM***	***HIGH*** ***on the LRAs' role as*** **Investment partners**
4. Business environment *Burdensome sector-specific regulations, difficult to access finance*	**LOW**	***MEDIUM*** ***on the LRAs' role as*** **Regulators**
5. Essential pre-conditions *Lack of skilled labour force, inadequate transport and other infrastructure*	**HIGH**	***HIGH*** ***on the LRAs' role as*** **Providers**

1 Introduction

With public and private investment levels in the EU still below the pre-crisis trend, the persisting 'investment gap' is a key area of concern at all levels, throughout the European Union.

This study considers the issues associated with easing or removing obstacles to investment at local and regional level. Its methodology relies mainly on desk research and eight case studies in identifying and removing territorial obstacles to investment in different Member States (IT, PT, UK, SE, DE, PL, SK and EE).

The present final report provides an overview of the post-crisis 'investment gap' and the EU initiatives to boost investment; notably, the Investment Plan for Europe and its principal instrument (European Fund for Strategic Investments) and the priority accorded in the 2016 Annual Growth Survey to re-launching investment. It also outlines the general challenges associated with these initiatives.

Building on the Annual Growth Survey and related European Semester reports, CoR research and analyses, and other relevant references, the report reviews five specific groups of obstacles and presents a list of territory-related obstacles to investment. It proceeds with an analysis of cross-cutting issues and links between obstacles; and with an analysis of their relevance and impact on regions within countries and on the effectiveness and efficiency of the LRAs in performing their competencies and functions regarding investment in their area.

It concludes by considering the types of action mostly needed to overcome obstacles to investment at local and regional level and the contribution of LRAs; followed by a series of proposals regarding recommendations for the CoR to consider in preparing further initiatives on this subject.

1.1 Background and objectives

Public and private investment levels in the EU are still below the pre-crisis trend and this remains a key area of concern throughout the European Union. The first priority of the 2016 Annual Growth Survey (AGS) is the relaunching of investment together with implementing structural reforms and growth-friendly fiscal consolidation. This requires, *inter alia*, practical measures for removing obstacles to investment at all levels and there is the intention on the side of the

European Commission to engage in a dialogue with the Member States on the fuller identification of such obstacles.

There is a strong territorial dimension to the whole issue of boosting long-term investment. The local and regional authorities (LRAs) are responsible for two-thirds of public investment and play a crucial role in determining the environment for private investment. As revealed in the 2016 Country Reports of the European Commission a significant share of obstacles to investment are territory related in the sense that their impact is territorially differentiated and the LRAs can play an important role in easing and removing them.

In its Plenary Resolution on the 2016 AGS, the European Committee of the Regions (CoR) strongly supported the need to prioritise the re-launch of private as well as public investments and, moreover, "considering the European Commission's intention to engage in a dialogue with the Member States on the identification of such obstacles, stresse[d] the need to specifically analyse them at all government levels and to involve the CoR in this process".

In the above context the objectives of this study are to provide the CoR with:

- a list of territory-related obstacles to investment;
- a series of examples of such obstacles and the way that LRAs are involved, and the scope for contributing towards removing them;
- a proposal for recommendations on removing obstacles to investment at territorial level for the CoR to consider in preparing further initiatives on this subject.

The study has sought to address within the scope of the available data the following aspects regarding **territory-related obstacles** to investment:

- obstacles that have a territorially differentiated impact on regions *within* countries;
- obstacles that are of relevance to the functions of the LRAs as regards investment;
- the degree of impact that these obstacles have on regions and on LRA competencies and functions;
- the potential for the LRAs to contribute towards easing or removing them and the degree of their involvement in solutions.

1.2 Methodology, information sources, timetable

The ToR has guided the overall approach. A detailed methodology and work plan were presented in an Inception Report, which was agreed with the CoR. The main tasks were undertaken from late April to early July 2016 and were as follows:

- Review of types of territorial issues and obstacles, their characteristics, and approaches for easing and removing them. This was based mostly on desk research using key EU references[1], CoR reports and position statements[2], OECD[3] and World Bank reports[4], and other sources. The European Commission[5] and a number of LRA associations were consulted and some of them[6] contributed through position statements and research documents.

- Compilation of a draft list of territory-related obstacles based on the above review, especially through an examination of the territory-related challenges to investment identified in the 2016 AGS supporting document and the Commission's Country Reports, supplemented with other sources.

- Preparing the case studies, including proposed selection of case studies and finalisation after consulting the CoR, and general guidelines concerning the specific methodology and output.

- Carrying out eight case studies on obstacles to investment in eight Member States, based mostly on desk research and some consultations with national-level stakeholders, and covering a presentation of the obstacles and their context, analysis of effects and review of relevant solutions, including good practice (as well as a broader assessment reflecting the 'OECD investment principles' and the 'World Bank Doing Business' criteria).

---

[1] SWD Challenges to Member States' Investment Environments (EC 2015), Country Reports (EC 2016), Country-specific Recommendations (EC 2016), Quality of Public Administration Toolbox (EC 2015), Member States' National reform Programmes (2016).
[2] Territorial analysis of the Country Reports and accompanying Communication (CoR 2016), Resolution on the 2016 AGS (CoR 2016).
[3] Effective Public Investments: Principles for Action (OECD 2014), Infrastructure planning and investment across levels of government (OECD 2014).
[4] WB Doing Business 2016.
[5] Secretariat-General of the European Commission.
[6] Council of European Municipalities and Regions (CEMR), European Conference of Peripheral Maritime Regions (CPMR), Association of Netherlands Municipalities (VNG).

- A synthesis of the main findings of the initial review and the case studies and conclusions regarding appropriate types of action for addressing investment obstacles from a territorial perspective.

- Development of recommendations that would be appropriate for CoR to consider putting forward for addressing territory-related obstacles to investment.

1.3 Structure of this report

The main report comprises the present **introduction** (**Chapter 1**) and the following chapters:

Chapter 2 provides an overview of the investment challenges at EU, national and sub-national level, and outlines the EU responses to these challenges and the approaches pursued for removing them.

Chapter 3 examines the main groups of obstacles to investment from a territorial perspective and distils a list of territory-related obstacles to investment.

Chapter 4 presents an analysis of the main cross-cutting issues and links between obstacles, and examines the relevance and intensity of their impact on regions and on the ability of LRAs to perform their competencies and functions regarding investment.

Chapter 5 considers the main types of action to address territory-related obstacles, summarises the general conclusions of the study and puts forward recommendations for the CoR.

Annex I comprises eight **case studies** in identifying and removing territorial obstacles to investment in different Member States of the EU:

- Italy – Local public enterprises and services.
- Portugal – PPP in local and regional public services.
- United Kingdom – Supply of housing.
- Sweden – Skills shortages and mismatches.
- Germany – Local competencies and investment finance.
- Poland – Local spatial planning.
- Slovakia – Transport infrastructure.
- Estonia – Equalisation fund scheme.

Annex II presents the main sources of information used for the main report and the case studies.

2 Overview: obstacles to investment and approaches to removing them

Investment in the EU as a whole and in two-thirds of the Member States remains below the pre-crisis level, and at local and regional level there has been an alarming decline in public investment. The EU response is spearheaded by the Investment Plan for Europe with its main instrument being the new European Fund for Strategic Investments.

The 2016 Annual Growth Survey has accorded priority to 're-launching investment', placing particular emphasis on tackling challenges to investment and initiating a process of identifying and removing obstacles to investment. There is a strong territorial dimension to the whole issue of boosting long-term investment, emanating from the competencies and functions of the local and regional authorities and from the territorial nature of many of the challenges to investment.

The main thrust of the effort advocated by the 2016 Annual Growth Survey is on tackling 'regulatory and administrative challenges' to investment. Such approaches span both public and private investment and have been systematically spelled out by the European Commission, the OECD and the World Bank, backed up with practical advice ('toolboxes') and examples of good practice.

In response to the emphasis placed on improving the regulatory environment, the CoR and the LRA associations have highlighted the need to address also other major constraints to investment, calling for an enhancement of administrative capacity at all levels of government and for flexibility in the existing rules of the Stability and Growth Pact (a 'golden fiscal rule' that growth-conducive long-term investments remain separate from current expenditure).

2.1 The state of investment in the EU

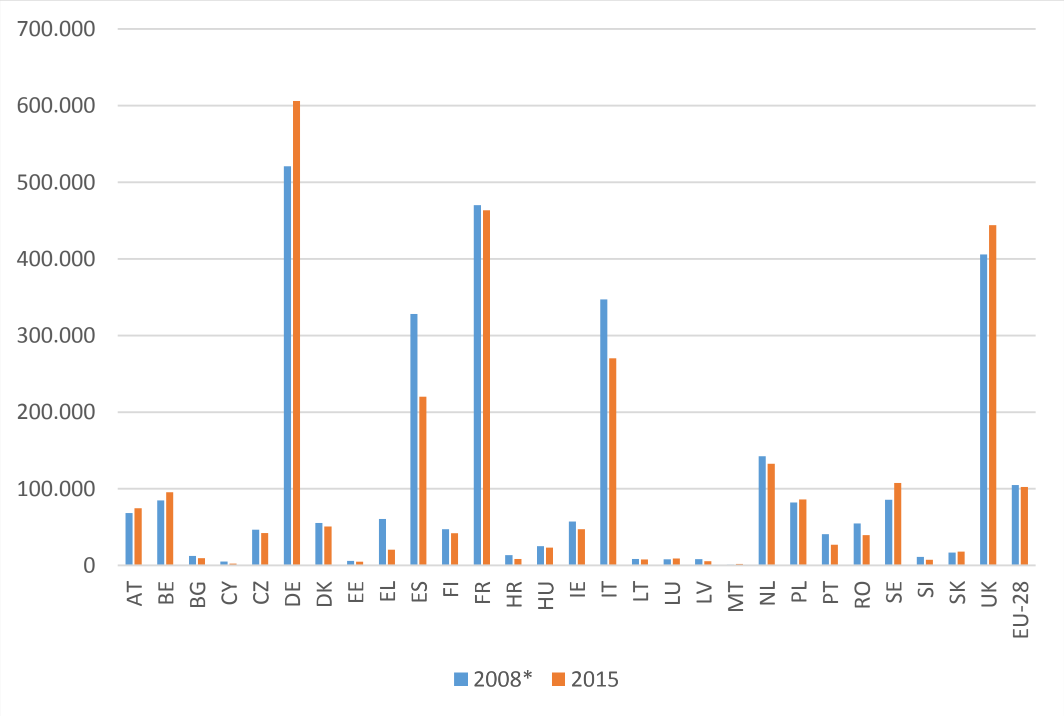
2.1.1 The challenge of the 'investment gap'

Since the global economic and financial crisis, the EU has been suffering from low levels of investment. In the immediate aftermath of the crisis the total annual investment in the EU dropped significantly by around EUR 400 billion or

15% from 2008 to 2009, and still remains below the pre-crisis level by EUR 70 billion or 2.5% in 2015 compared with 2008.

As shown in Figure 1, investment in 19 Member States is still below the pre-crisis level. Six of the Member States that have returned or exceeded pre-crisis investment levels had done so by 2011 (MT, BE, DE, LU, AT, SE) and three succeeded as recently as in 2015 (PL, SK, UK).

Figure 1. Investment in the EU: comparison of investment in 2015 with the pre-crisis level (€ million)



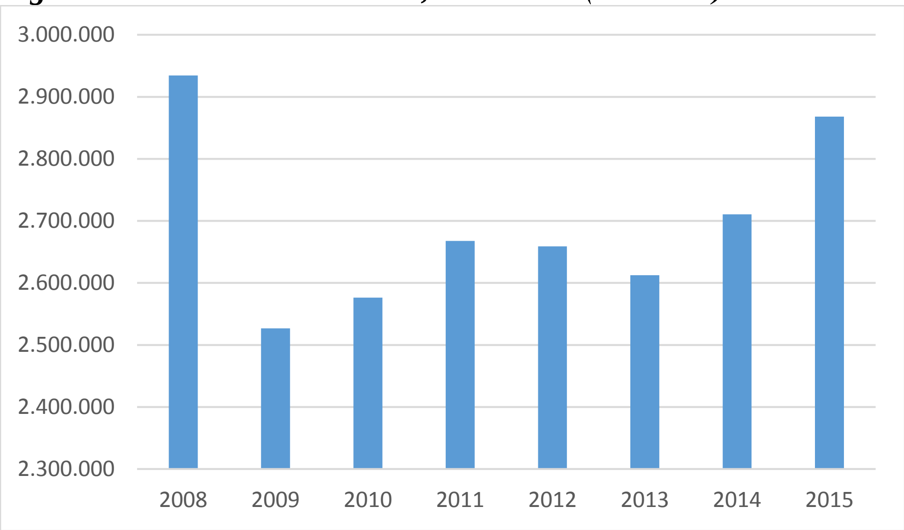
** Pre-crisis peak in 2008, except for EE, EL, IT, LV, MT, UK (2007) and IE (2006).*
Source: Own calculations based on Eurostat data[7].

At local and regional level, there has been an alarming decline in public investment[8]. Over 75% of LRAs have reported that the total (public and private) investment contracted strongly from 2008 to 2014 in their area. In the last year in 31% of the LRA areas, private investment went up and only in 28% public investment did so[9].

The cumulative shortfall in investment in the 2009-2015 period from the peak of 2008 amounts to almost EUR 2 trillion (see Figure 2, below). In the wake of the economic and financial crisis, the EU faces a persisting and cumulative lack of long-term investment, often referred to as the 'investment gap', which is bringing down expectations on long-term growth and job creation.

[7] *http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=tec00011&plugin=1*
[8] CEMR, Reviving local public investments, December 2015.
[9] CoR Survey on obstacles to investment at local and regional level, July 2016.

Figure 2. Investment in the EU, 2008-2015 (€ million)



Source: Own calculations based on Eurostat data[10].

2.1.2 The EU response

It has been generally recognised that a major effort is required to put Europe on the path of economic recovery and bring investment back in line with its historical trends. The response of the European Commission has focused on an **Investment Plan for Europe,** which was proposed in November 2014 as the first major initiative of the then new Juncker Commission. The objectives of the plan are summarised in Box 1.

Box 1. Objectives of the Investment Plan for Europe

- Reverse trends of falling investment to boost job creation and economic recovery – without adding to public debt or straining national budgets.
- Support investment that meets the long-term needs of the economy and increases competitiveness.
- Support investment that helps strengthen Europe's productive capacity and infrastructure, with a particular focus on building a more interconnected single market.

Source: http://ec.europa.eu/priorities/jobs-growth-and-investment/investment-plan_en

The Investment Plan aims at mobilising at least EUR 315 billion of additional investment over three years, to 2018, and bringing investment back to sustainable pre-crisis levels. It seeks to mobilise additional investments in

[10] *http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=tec00011&plugin=1*

Europe with both existing and new tools, creating a better environment for investment and further strengthening the Single Market.

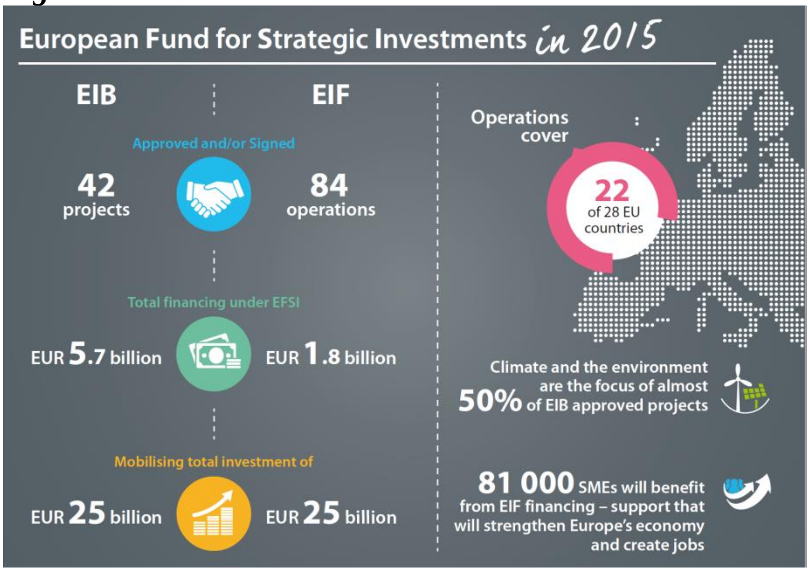
Its principal instrument, the new **European Fund for Strategic Investments (EFSI)** is up and running to support higher risk, higher return projects that would struggle to find financing otherwise. The EFSI is a strategic partnership between the European Commission and the European Investment Bank (EIB)[11] and has already supported in 2015 operations in 22 Member States (see Figure 3, below).

The other components of the Investment Plan are also in place, namely:

- The **European Investment Advisory Hub**[12], aimed at supporting investors and project promoters, has become operational.

- The **European Investment Project Portal**[13] has been launched to advertise potential investment projects to investors based on reliable and simple reference criteria.

Figure 3. EFSI in 2015



Source: http://www.eib.org/attachments/thematic/efsi_in_2015_en.pdf

As already mentioned in Chapter 1, the 2016 Annual Growth Survey (AGS) has accorded priority to **'re-launching investment'**; going beyond the mobilisation of investment funding *per se* into associated structural reforms (see Box 2) and placing particular emphasis on tackling both regulatory and non-regulatory challenges to investment. These challenges vary in terms of their restrictiveness,

[11] http://www.eib.org/attachments/thematic/investment_plan_for_europe_en.pdf
[12] http://www.eib.org/infocentre/videotheque/introducing-the-european-investment-advisory-hub.htm
[13] https://ec.europa.eu/eipp/desktop/en/index.html

complexity and unpredictability, hence, identifying and removing them is part of the efforts to improve framework conditions and remove red-tape and regulatory bottlenecks, as part of the so-called ‘third pillar’ of the Investment Plan for Europe.

Box 2. AGS 2016 - Re-launching investment

(i)	The progress made on mobilising private and public investments and the selection of the strategic projects under the Investment Plan for Europe need to be accompanied by an improved investment and regulatory environment at national as well as European level.
(ii)	The Banking Union needs to be completed to reinforce financial stability in the euro area and beyond; work on the Capital Markets Union needs to be accelerated, so that companies have access to increased and more diversified sources of funding and the financial sector can fully support the real economy; stocks of debt holding back financing and investment decisions also need to be addressed.
(iii)	Investment priorities must go beyond traditional infrastructure and extend to human capital and related social investment.

Source: *http://ec.europa.eu/europe2020/pdf/2016/ags2016_annual_growth_survey.pdf*

The AGS also recognises the importance of **investing in human capital**. It makes the case in favour of smart investments in Europe's human capital and performance-oriented reforms of education and training systems, as part of the necessary efforts to restore jobs and sustainable growth. It notes that about 20% of the working-age population has only very basic skills such as literacy or numeracy, and 39% of companies have difficulty finding staff with the required skills.

It further argues that Member States should promote **social investment** more broadly, including in healthcare, childcare, housing support and rehabilitation services to strengthen people's current and future capacities to engage in the labour market and adapt. It notes that support is available from the EU, particularly the ESI Funds. Social investment offers economic and social returns over time, notably in terms of employment prospects, labour incomes and productivity, prevention of poverty and strengthening of social cohesion. Social infrastructure should be provided in a more flexible way, personalised and better integrated to promote the active inclusion of people with the weakest link to the labour market.

2.2 Territorial dimension

Identifying and removing obstacles to investment is essential for achieving an improved investment and regulatory environment at the European as well as at national level. The importance of pursuing this systematically has been highlighted in the AGS which provided a broad categorisation of the main challenges to investment (see Box 3, below) and stated the Commission's intention to engage in a dialogue with the Member States on the identification of such obstacles. This initial list was followed up with specific references to investment challenges or issues in the 2016 Country Reports and provided a basis for the list of territory-related obstacles in Chapter 3.

Box 3. Main policy fields with challenges to investment

(i)	Public administration/Business environment
(ii)	Labour market/Education
(iii)	Financial Sector/Taxation
(iv)	Research, development and innovation
(v)	Sector specific regulation (business services/regulated professions, retail, construction, digital economy/telecommunications, energy and transport).

Source: EC SWD (2015)400.

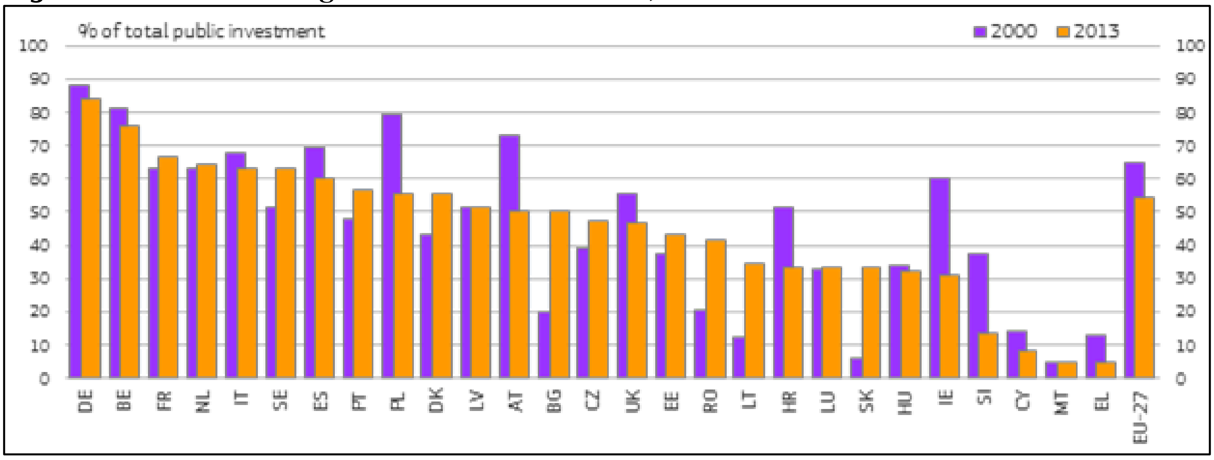
There is a strong territorial dimension to the whole issue of boosting long-term investment, emanating from the roles of the local and regional authorities and from the territorial nature of many of the challenges to investment, as outlined below.

First, the LRAs are responsible for nearly two-thirds of public investment and are the pre-eminent level for public investment in several Member States, as illustrated in Figure 4, below.

Second, the LRAs play an important part in determining the environment for private investment through their multiple roles as contributors to the shaping of the regulatory environment, as well as promoters, intermediaries and partners, notably in Public-private Partnerships (PPP). This has been highlighted in a recent analysis[14] of the 2016 Country Reports of the European Commission, which has shown that a significant share of obstacles to investment are territory related.

[14] 2016 European Semester: Territorial analysis of the Country Reports and accompanying Communication, CoR, April 2016.

Figure 4. Sub-national governments' investment, 2000 and 2013



Source: 6th Report on Economic, Social and Territorial Cohesion[15] *(p.147).*

Overall, a territorial dimension is slowly but steadily emerging in the European Semester in terms of territorial issues raised in the Country Reports (CR) and territory-related country- specific recommendations (CSR). There is also a higher visibility of territorial issues in the National Reform Programmes (NRP). Nevertheless, the role of the LRAs in the European Semester and, specifically, its potential in tackling investment obstacles are still insufficiently recognised and formalised, largely due to the great diversity at national and sub-national level of institutional arrangements, competencies, traditions, resources, etc.

Embedding the principle of partnership in the European Semester and strengthening the involvement of LRAs are generally seen as a positive development, which could make a crucial contribution to the effectiveness of the Semester and the achievement of the EU 2020 goals. A range of improvements in this direction was identified by a recent CoR study[16], which made the case for a formal Code of Conduct that would underpin such improvements.

As outlined above, the 2016 AGS has launched a review of obstacles to investment at country level. Each Member State has been requested to engage in a dialogue with the European Commission, based on an initial tentative list.

In its Resolution on the 2016 Annual Growth Survey, the CoR, "considering the European Commission's intention to engage in a dialogue with the Member States on the identification of such obstacles, stresses the need to specifically analyse them *at all government levels* and to involve the CoR in this process"[17].

[15] http://ec.europa.eu/regional_policy/sources/docoffic/official/reports/cohesion6/6cr_en.pdf
[16] A Code of Conduct on the involvement of the Local and Regional Authorities in the European Semester.
[17] http://toad.cor.europa.eu/AgendaDocuments.aspx?pmi=RmFYXXWy9u8IZ7pSi4%2fGZUmyxsAZDhjNdLxAYnYqvwQ%3d&ViewDoc=true

As a first step, the CoR analysed the Country Reports to identify **territory-related obstacles to investment**, i.e. obstacles that:

- have a territorially differentiated impact *within* countries, and
- the LRAs could help to ease or remove them.

This analysis drew on the Commission's report accompanying the 2016 AGS[18] and several other reports, including the results of the 2015 CoR/OECD consultation of sub-national governments on infrastructure planning and investment across levels of government[19].

Its findings confirmed that there is a great deal of diversity across Member States in investment patterns and barriers to investment and there is no one-size-fits-all solution. Nevertheless, it was able to establish that, with reference to the main policy fields in which investment challenges appear (see Box 3, above), the territory-related obstacles come into three main groups:

- Governance / Public administration / Public procurement:
  - Public administration, administrative burden and governance issues.
  - Public procurement / PPPs.

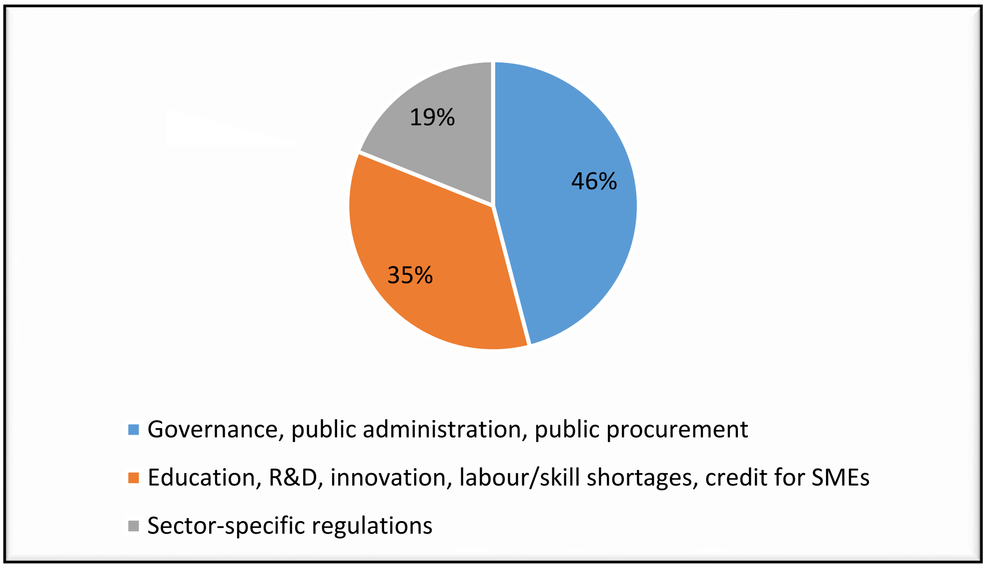
- Education / Labour market / Research, development and innovation.

- Sector specific regulation:
  - Retail
  - Construction
  - Digital economy / Telecommunications
  - Energy
  - Transport

An analysis of the Country-specific Recommendations established that 37 out of the 51 territory-related CSRs issued in 2016 deal with obstacles to investment and 31 out of them are directly addressed to the local and regional authorities. This analysis also offers a broad indication that nearly one-half of the territory-related CSRs dealing with obstacles to investment concern 'governance, public administration and public procurement' (see Figure 5).

[18] EC SWD(2015)400.
[19] https://portal.cor.europa.eu/europe2020/pub/Documents/oecd-cor-jointreport.pdf

Figure 5. Territory-related CSRs concerning obstacles to investment



Source: Own calculations based on CoR territorial analysis of 2016 CSRs.

An analysis of 2016 NRPs[20] has observed a high variability regarding the obstacles to investment and the territorial dimension. The majority of NRPs (21 programmes) include one or more specific elements relating to a territorial dimension. However, only in seven cases, specific reference was made to the territorial perspective on obstacles to investments, mainly by EU-15 countries with a long tradition of regional self-governance.

2.3 Addressing investment obstacles

Notwithstanding the macro-economic challenges to investment, the main thrust of the approaches promoted by the EU and more broadly in the advanced economies (OECD countries), and beyond[21], is on how to address ‘regulatory and administrative challenges’ to investment. These approaches span both public and private investment and have been systematically spelled out by the European Commission, the OECD and the World Bank, backed up with practical advice (‘toolkits’ and ‘toolboxes’) and examples of good practice.

OECD principles of effective public investment

According to the OECD the implementation of recovery packages across OECD countries in 2008-2009 revealed that both national and sub-national actors lack the appropriate tools and governance arrangements to make the best use of

[20] CoR, The role of Local and Regional Authorities in the implementation of Europe 2020 – Analysis of 2016 National Reform Programmes, July 2016.
[21] Countries covered in WB Doing Business.

investment funds. This experience has underlined the fact that the challenges are much broader than just **financing** investment and that the impact of public investment depends to a significant extent on how governments manage it.

The OECD analysis has stressed the importance of the sub-national share of investment in OECD countries (72 % in 2012) and that improvements are needed across all levels of government. It singled out three systematic challenges for the multi-level governance of public investment, concerning co-ordination, capacity and framework conditions, as hindering the achievement of the best possible outcomes. It also stressed that "all countries are confronted by these challenges, whatever the institutional context (in federal countries, or highly centralised countries) since mutual dependency across levels of government for public investment holds true in all countries"[22].

In March 2014 the OECD Council adopted a recommendation on **Effective Public Investment across Levels of Government** organised around three pillars (see Figure 6, below):

- **Co-ordinate public investment across levels of government and policies**. This pillar focuses on the importance of seeking and creating complementarities in policies and programmes across policy sectors, vertically across levels of government, and horizontally among sub-national governments to increase the effectiveness of public investment.

- **Strengthen capacities for public investment and promote policy learning at all levels of government.** This pillar highlights different capacities that should be present at all levels of government to bolster conditions for effective investment and to promote continuous improvement from the strategic selection of investment to its execution and monitoring.

- **Ensure proper framework conditions for public investment at all levels of government.** This pillar emphasises the importance of good practices in fiscal decentralisation, public financial management, public procurement, and regulatory quality at all levels of government.

[22] OECD Recommendation adopted on 12 March 2014.

Figure 6. Principles of Effective Public Investment (OECD)

Source: OECD Toolkit.

EU quality of public administration toolbox

The European Commission has developed and published a wide-ranging ‘toolbox’ for practitioners concerning the Quality of Public Administration. This toolbox aims to help Member States with addressing Country-specific Recommendations (CSR) and with delivering successful strategies and operational programmes. It covers several themes of direct relevance to tackling the challenges to investment at both national and sub-national levels, notably, managing public funds effectively (including public procurement and managing ESI Funds) and enhancing the business environment.

Under **public procurement,** it deals with:

- simplifying procurement;
- cross-border procurement;
- e-procurement, and
- procurement for innovation.

Regarding the **management of ESI Funds**, it provides guidance on:

- structures;
- staffing;
- systems, and
- governance.

The toolbox dedicates a separate theme to **enhancing the business environment**. In that section, it stresses that governments have a duty to ensure robust and fair competition among all enterprises but also to remove potential impediments to business initiative, investment and innovation. It, thus, provides guidance on several aspects:

- Putting business first:
  - streamlining and simplifying ‘red tape’;
  - business-centric administration.

- Streamlining administration for businesses:
  - starting a business;
  - running and growing a business;
  - trading across borders;
  - dealing with insolvency and second chance for honest entrepreneurs.

WB Doing Business

The importance of a conducive business environment is reflected in the well-established assessment of regulatory quality and efficiency of many countries worldwide by World Bank’s annual ‘Doing Business’ reports. The 2016 Doing Business report was the 13th in a series of annual reports and covered 189 countries, using a set of quantitative indicators covering specific aspects (see Box 4, below) and offering an overall ranking regarding the ease of doing business in each country. By implication, improvement against the aspects covered by these indicators will ease or even remove the obstacles confronting enterprises, in doing business and in investing.

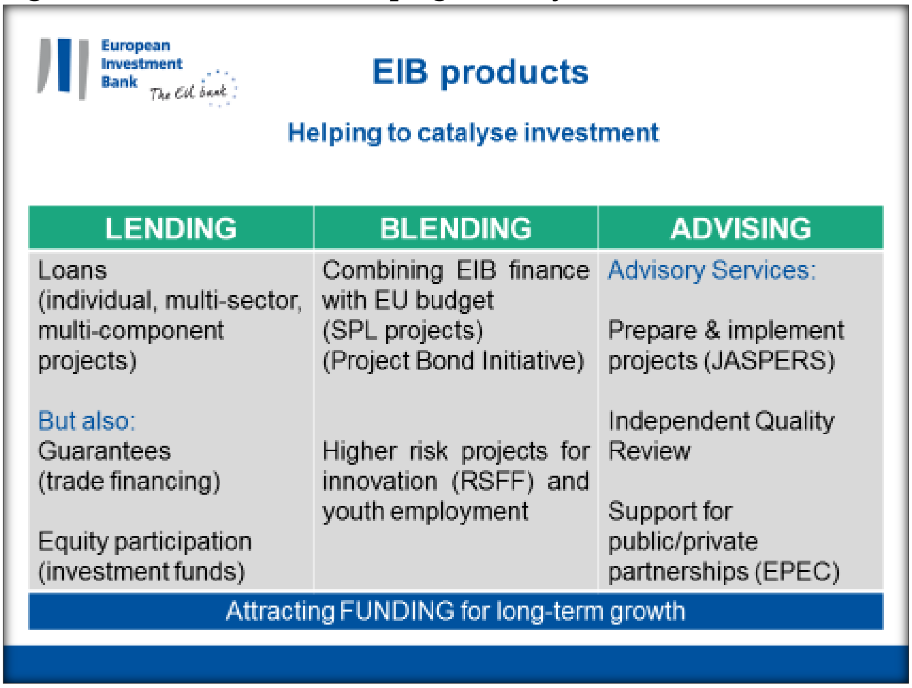
Box 4. WB Doing Business indicators

- Starting a business
- Dealing with construction permits
- Getting electricity
- Registering property
- Getting credit
- Protecting minority investors
- Paying taxes
- Enforcing contracts
- Trading across borders
- Resolving insolvency

2.4 Issues arising

The AGS favours combining the EFSI with other EU funds under Horizon 2020, the Connecting Europe Facility and the ESI Funds, especially as EU programmes are now becoming fully activated in the 2014-2020 period supporting investments in many fields including infrastructure, innovation and knowledge. Similarly, the EIB with its heightened role in the efforts at mobilising investment has been advocating diverse and often novel, from an LRA point of view, methods, e.g. ‘blending’ (see Figure 7).

Figure 7. EIB Products – Helping to catalyse investment



Source: EIB presentation at CPMR conference, Haarlem, 18 February 2016.

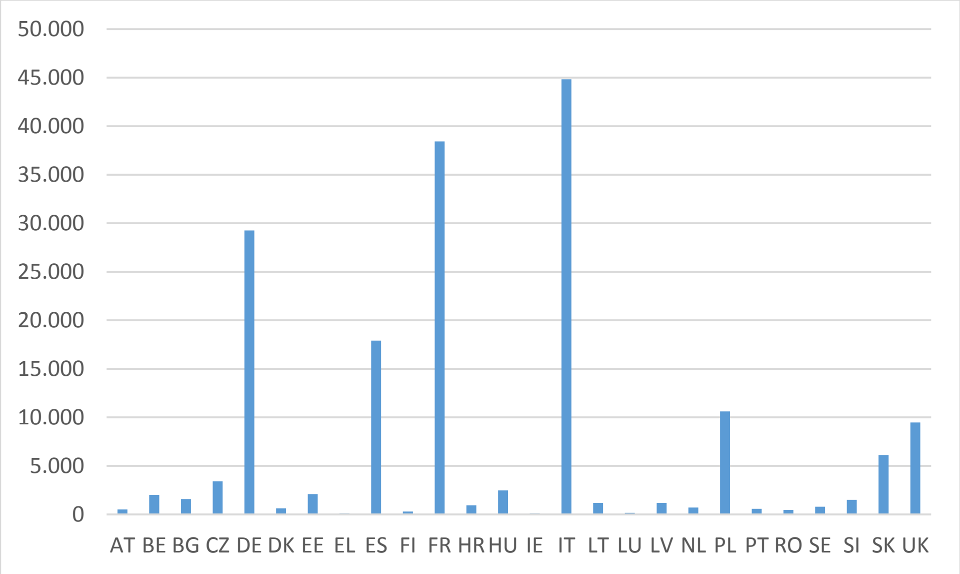
The EU priorities for relaunching investment, outlined in previous sections, have found widespread support but there are several issues requiring attention. From a territorial perspective, both the CoR and the LRA associations have expressed their misgivings concerning the potentially serious implications of the way the EFSI is implemented and the approach championed by the EIB. These implications are seen in terms of ‘cohesion, geography and transparency’[23], as well as in the practicalities of achieving complementarity between ESI Funds and EFSI.

Overall, the shift in emphasis from familiar ‘grants’ under the Structural Funds to a range of largely unfamiliar to LRAs ‘financial instruments’ raises, *inter alia*, two important issues regarding investment at sub-national level.

[23] Karl-Heinz Lambertz, First Vice-President of CoR, speaking at the 7th European Summit of Regions and Cities, 8/9 July 2016, Bratislava.

The first of these issues concerns cohesion policy. The EFSI has been designed as “a very flexible instrument and fully demand-driven: there is no sectorial or geographical pre-allocation” and this begs the question as to whether it is at all connected with or even clashes with the logic of the European Union’s commitment to economic, social and territorial cohesion. For instance, an initial impression of the projects financed by the Juncker Plan is that they tend to be concentrated in Western Europe. Similarly, the latest (May 2016) approved financing for SMEs (see Figure 8) shows that larger and more developed countries are ahead of the pack in benefiting from the EFSI.

Figure 8. SME Financing under the EFSI*



** Number of SMEs potentially benefiting. Financing agreement as at May 2016.*
Source: Own calculations based on data available at http://ec.europa.eu/priorities/sites/beta-political/files/sme_financing_countries_may16_en.pdf

The second issue concerns the ability of LRAs to play a positive role in an increasingly complex field. The importance of raising institutional and administrative capacity of the public administration, particularly at the local and regional levels, has been underlined by the findings of a joint CoR/OECD survey in 2015[24] that revealed that governance challenges for infrastructure investment are particularly prominent at the sub-national level. This point was stressed in the CoR Resolution on the 2016 AGS, which stated that “efficient administrative capacity at all levels of government […] is of paramount importance to deliver on re-launching long-term investments …”.[25]

Thus, tackling the regulatory environment will not be sufficient by itself to achieve a major upscaling in investment. This is implicitly recognised in the AGS which states in connection with the identification of the challenges to

[24] https://portal.cor.europa.eu/europe2020/pub/Documents/oecd-cor-jointreport.pdf
[25] CoR Resolution on 2016 AGS.

investment that “it does neither consider weak demand, nor the decrease in public investment in the wake of fiscal consolidation, as specific policies to be addressed even if they correspond to major causes of low or declining investment and as such investment challenges”.[26] Leaving out such considerations has attracted criticism and representations of LRA associations, such as CEMR, which has argued that flexibility is needed in the existing rules of the Stability and Growth Pact and advocated the introduction of the ‘golden fiscal rule’ that “growth-conducive long-term investments remain separate from current expenditure”[27], which has also been the position of the CoR[28].

Similarly, the Bratislava Declaration[29] has stressed that the investment capacity of regional authorities must be coordinated with EU and national economic cycles and that public budgets supporting quality investments must act in synergy with other financial sources at EU, national and sub-national level.

The Bratislava Declaration has also underlined the importance of the EU in continuing to provide the framework for adequate funding for ‘quality public investments’. This is a crucial concern that is still, however surrounded by uncertainties. As noted in a recent European Parliament briefing on public investment “it is not evident whether and how the EU identifies those with the highest potential for long-term economic growth”[30].

---

[26] EC SWD(2015)400, p. 2.
[27] CEMR Position paper, Reviving local public investments, December 2015.
[28] Reiterated in CoR’s Resolution on the 2016 AGS.
[29] Invest and Connect, 7th European Summit of Regions and Cities, 8-9 July 2016.
[30] http://www.europarl.europa.eu/thinktank/en/document.html?reference=EPRS_BRI(2016)583831

3 Territory-related obstacles to investment

A large number of potential obstacles to investment emerge from recent EU exercises, notably the 2016 Annual Growth Survey and Country Reports, and other sources.

A compilation of a 'draft list of territorial obstacles to investment' is undertaken based on a review and analysis of such obstacles.

It focuses on micro-economic obstacles to investment and especially those that are territory-related.

The obstacles covered fall into five groups:

6. Deficiencies in multilevel governance and public administration, including coordination with other levels of government and other sectors.

7. Deficiencies in accessing and managing investment funds, including mismatches between the functions and financial resources of LRAs.

8. Shortcomings in public procurement and public-private partnerships.

9. Unfavourable business environment, due to burdensome regulations and procedures, including sector-specific regulations, and difficulty in accessing SME finance.

10. Inadequate preconditions for investment (appropriately skilled labour force, transport networks, etc.).

As territory-related obstacles to investment are treated those that have a territorially differentiated impact *within* countries, are relevant to the functions of the LRAs regarding investment, and there is potential for the LRAs to contribute towards easing or removing them.

3.1 Types of obstacles to investment

This chapter provides a compilation of a 'draft list of territorial obstacles to investment' based on a review and analysis of obstacles and challenges or issues that may give rise to obstacles, as identified in different sources. It covers both public and private investment and prioritises two characteristics of obstacles to investment.

First, it focuses on **micro-economic obstacles to investment**, arising when inadequate public governance, a challenging business environment and deficiencies of the public administration at different levels discourage public and private investments. Although macroeconomic obstacles *per se* are outside the scope of this study, obstacles affecting the ability of LRAs to access and manage funding for long-term investment, and to facilitate the private sector's (especially SMEs') access to finance, are very important and they are covered in this report.

Second, it focuses on **territory-related obstacles to investment**, i.e. those that have a territorially differentiated impact *within* countries, they are relevant to the functions of the LRAs as regards investment, and there is potential for the LRAs to contribute towards easing or removing them. However, although a key consideration is the contribution of LRAs, it is accepted that in many cases there should be a multi-level approach to the solution, including at national level and possibly also at EU level.

This review and analysis draws mostly on the following sources that cover systematically all Member States, and on the case studies that were undertaken as part of this study (see Annex I):

- the 2016 Annual Growth Survey and, specifically, the accompanying Commission Staff Working Document SWD (2015) 400 final and its country-specific annexes;
- the 2016 Country Reports of the European Commission;
- the 2016 Country-specific Recommendations of the Council;
- the 2016 National Reform Programmes of the Member States.

Other sources used included:

- the preliminary results of the CoR survey of obstacles to investment at local and regional level (July 2016);
- the results of the 2015 CoR-OECD consultation of sub-national governments on infrastructure planning and investment across levels of government;

- a range of other sources, such as research and position papers by national and European level LRA associations.

A large number of potential obstacles emerge from these sources, as already indicated in Chapter 2. They can be categorised in different ways depending on the selected main parameters, e.g. by economic sectors, public/private investment, etc. In view of the territorial perspective of this study, it is considered appropriate to follow a categorisation that will be of direct relevance to LRAs, both in the analysis and in the conclusions and recommendations.
Accordingly, the following main groups of obstacles are used in this chapter with a view to reflecting as far as possible the typical competencies and functions of the LRAs and the different roles assumed by LRAs in connection with investments in their areas:

1. Governance and Public Administration
2. Accessing and managing investment funds
3. Public procurement and PPP
4. Business environment
5. Essential pre-conditions.

3.2 Review of main obstacles

3.2.1 Governance and public administration

This is a broad group of obstacles regarding governance and public administration. It includes:

- Deficiencies in quality, efficiency and transparency of the public administration, including coordination between different services and sectors within the public administration.

- Lack of coordination with other levels of government and weak multilevel governance.

- Lack of coordination/cooperation with other actors outside the public administration (private sector, civil society, etc.).

Particular aspects also concern public procurement, accessing and managing investment funds, and burdensome regulation and its adverse effects on the business environment. These are considered as separate groups of obstacles in other sections of this Chapter.

The obstacles of this group can affect investment in many different ways. According to the results of the CoR-OECD survey[31], two of the main governance obstacles that impede effective sub-national infrastructure investment are connected with:

- serious shortcomings in the strategic planning for infrastructure investment; and
- the weak monitoring and evaluation of sub-national strategies.

There are several examples of challenges identified in the Commission's 2016 Country Reports and Country-specific Recommendations that illustrate these obstacles.

The **Slovakia** Country Report (SK-CR4.2) states that the fragmented nature and rigid departmentalism of the public administration complicates strategic planning and coordination. It finds coordination between central and local government complicated by the very high number of municipalities (3,000), while their small size may lead to inefficiencies through the duplication of structures.

Similarly, the Council recommends in the case of **Croatia** to reduce the extent of fragmentation and overlap between levels of central and local government. (HR-CSR4)

The Commission's Country Report on **Italy** states that "insufficient coordination and overlapping responsibilities between levels of government increase uncertainty and make decision-making lengthy". This is echoed in the Italy case study which goes on to point out the economic implications of this state of affairs (Annex I, 6.1): "The legal framework in the field of local public service provision is multi-level, complex and evolving continuously. At the same time, the management and accounting procedures are outdated and not transparent, making the tracking of key indicators and processes difficult as well as excluding competition. Hence, local public services can be more costly than necessary, while local economies are forfeiting efficiency gains and innovation".

The persistent nature of such shortcomings is noted in the **Bulgaria** Country Report, which notes that progress in strengthening the role of the administration and efficiency at local level has been limited. (BG-CR4.2)

The specific issues of coordination and cooperation with other sectors outside government have received considerable attention and a partnership approach is

[31] CoR-OECD Consultation of Sub-national Governments (2015).

strongly supported in the ESI Funds and other EU policy areas. However, the support for the partnership principle is not predominantly focused on investment[32], and is not aligned with the aspirations of the new EU investment initiatives.

The overall effect of this group of obstacles is felt in the role of the LRAs to act effectively as the strategic planner for investment in the particular territory. However, it is not confined there but it can also affect its role as promoter/facilitator of investment and partner. It is therefore, a key area of concern that is closely related to issues of institutional and administrative capacity, and multilevel governance.

3.2.2 Accessing and managing investment funds

These obstacles fall into two sub-groups, with broad implications for investment at local and regional level. Both sub-groups have a direct bearing on the role of the LRAs as investor, and to a lesser extent as a promoter/facilitator and partner.

The first sub-group concerns the **planning, designing, submitting and managing public investments, including EU funds.** It is inexorably linked to the human resources and other capacities of the LRAs to perform these functions and as such can be highly differentiated from a territorial point of view.

The Commission's 2016 Country Reports and CSRs provide various illustrative examples of such obstacles and their effects.

The bottlenecks and administrative weaknesses highlighted in the previous section concerning **Italy** also result in a low rate of absorption of EU structural funds. (IT-CR4)

The **Finland** report states that strengthening small municipalities' capacity to plan and carry out investment could benefit both public and private investment. Many of the municipalities are rather small but still need to provide transport, education, health and social services and invest in the related infrastructure. (FI-CR1.2)

In the case of **Croatia**, the absorption rate of ESI Funds has so far been low. A limited number of ready-to-implement projects and their lengthy design and tendering periods are partly causing the slow absorption. (HR-CR2)

[32] E.g. EESC's Opinion on the Future of the EU Urban Agenda, February 2016.

However, it is worth noting that many of the challenges facing LRAs in accessing EU funds go beyond administrative capacity constraints. The complexity, slowness and transparency of shared management approach of ESI Funds and the contrasting EFSI approach (based on decision taking by single EU-level committee) raise serious multi-level governance (MLG) and other issues, as already highlighted in Section 2.4.

The second sub-group of obstacles concerns the availability of investment funds to the LRA level. As already explained above, issues of local taxation or public borrowing constraints are outside the scope of the study, so the obstacles outlined here concern mostly the **mismatch between the functions and financial resources of local/regional governments and inadequacies in equalisation schemes,** and affect regions and localities within countries in a differentiated way.

Several such situations have been identified in the 2016 Country Reports and Country-specific Recommendations. For instance, the Council recommends that **Austria** should correct the "misalignment between the financing and spending responsibilities of the different levels of government". (AT-CSR1) Similarly, decentralised competencies and tasks of local units are not commensurate with their fiscal capacity in **Croatia**. (HR-CR6)

In the case of **Germany,** there is a mismatch between the resources allocated to the different layers of government and their individual investment responsibilities, hampering municipalities' investment (DE-CR1.2). As highlighted in the Germany case study this affects particularly the poorer municipalities which find themselves in a vicious circle with decreasing and ageing population, rising unemployment and a shrinking tax base on the one hand, and rising social expenses on the other. For these municipalities, budgetary constraints do not leave room for infrastructure investment (Annex I, 6.5).

With reference to housing, the **Sweden** Country Report states that municipalities do not have sufficient (financial) incentives to support construction activities. Their tax revenues increase, only moderately and in the mid-term, if at all. The existing municipal equalisation scheme is expected to reduce long-term gains from additional population growth. (SE-CR4.2)

It is apparent from the above examples that these types of obstacle are prevalent in EU-15 as well as in other countries and are indeed very common throughout the EU. The CEMR has recently stressed that "just when the role of towns and regions seems vital […] their financial resources are put into question and we have constantly to fight to defend their capacity to invest and manage local public services …"[33]

3.2.3 Public procurement and public-private partnerships

This group comprises various challenges whose common characteristic is the direct involvement of both public authorities and private actors. In simple procurement cases, the LRA role is that of the investor (in publicly funded projects) with the private sector playing a relatively straightforward role of 'implementer'. However, in more complex procurement cases, including concessions and longer-term arrangements, as well as in the case of more complex financing schemes such as PPPs, the LRAs tend to play the role of the partner.

Several challenges have been reported[34], including:

- Excessive length of procedures, legal framework fragmentation and uncertainty (frequent revision of public procurement law; complexity; lack of transparency; lack of expertise in PPPs, public procurement and project finance; inefficiency of the system of supervision and control).

- Insufficient degree of competition in tendering procedures: (lack of competition in contract awards where there was a single bid/ high use of negotiated procedures without publication of a notice).

- Complexity or inefficiency in the public procurement framework.

- A weak management of PPPs.

These are multifaceted challenges encompassing legal, administrative and financial issues, as well as problems of delays, transparency and even corruption. From a territorial perspective, among all these diverse/specific challenges, one can distinguish two core obstacles to investment that can be summarised as public procurement shortcomings and shortcomings in PPPs.

Public procurement shortcomings

The Council's Recommendation No 4 addressed to **Slovakia**, namely "Increase competition in public tenders and improve supervisory mechanisms in public procurement" is characteristic of the central issues involved. (SK-CSR 4)

[33] CEMR Position paper, Reviving local public investments, December 2015.
[34] EC SWD(2015)400 & CoR analysis.

There are numerous obstacles concerning public procurement that have been identified in the 2016 AGS supporting document[35] and many of them apply to the sub-national level. An example, concerning **Romania**, is that "the lack of stability and fragmentation of the legal framework related to public procurement, deficient checks and balances in the institutional system, the degree of competition in public procurement, and the insufficient administrative capacity of public purchasers, including the lack of expertise of staff at both national and local level, as well as corruption and fraud in public procurement hamper investment".

Another example of a general nature from the 2016 Country Report for **Latvia** states that "Public procurement remains subject to corruption risks, particularly at the local level, where supervision of municipal enterprises lacks independence […] at both local and central level; arbitrary specifications may exclude potential suppliers and favour others".(LV-CR4)

Other cases raise additional aspects. For instance, the Country Report for **Bulgaria** refers to persistent difficulties with public procurement as a major stumbling block for the effective use of ESI Funds in Bulgaria. (BG-CR2) The 2016 Country Report for **Italy** refers to the general weaknesses of Italy's public procurement system and to the fact that the legal and institutional framework is complex and unstable. It also pinpoints some specific shortcomings regarding e-procurement ("The e-procurement landscape is fragmented, with advanced buyers at central level and in some regions while others have yet to start the transition to e-submission"). (IT-CR6)

Although on matters, such as the legal framework and issues such as the frequent changes to public procurement law, the national level is pre-eminent, the sub-national level is extensively involved, making many of the public procurement challenges key territory-related obstacles to investment.

It should also be noted that public procurement is closely linked to countries' and regions' absorption of ESI Funds. From an LRA point of view, the prevailing conditions are too restrictive and hamper investment. This is indirectly recognised by the fact that there is ESI Funds support channelled to improving performance in this respect. For instance, the Italy case study has reported that in the field of public management, public accounting and public procurement a major driver in Italy is the EU cohesion policy and the requirement to comply with the prerequisites of the general *ex-ante* conditionalities. To this end, a joint European Commission/Member State working group was set-up with LRA participation and an action plan was

[35] EC SWD(2015)400.

developed addressing problems of administrative capacity and rationalisation of contracting, major barriers to competition, and a system of controls related to the efficiency of procedures and corruption (Annex I, 6.1).

PPP shortcomings

The AGS supporting document lists several PPP related obstacles, which tend to focus on the lack of expertise and experience in the national and sub-national government levels for handling such complex schemes. These shortcomings and the general unfamiliarity with newer financing models mean that they are used only to a limited extent.

An example from AGS supporting document is the case of **Germany** where the administrative capacity and experience in some Länder, especially with regard to the financial structuring of projects (PPPs, project finance), does not allow for a full leveraging of private investment.

The Commission's Country Report for **Portugal** provides another relevant example and states that "transparency remains a challenge for public-private partnerships, particularly at local and regional level, and as regards concession contracts". (PT-CR4) According to the Portugal case study, this lack of transparency can be attributed to a number of reasons, including:

- lack of data and key performance indicators for defining a service unit and for separating operation and maintenance costs;
- temptation to benefit from the short-term budget benefits at local level, without considering long-term implications;
- poor risk analysis skills and procedures for defining risks, risk allocation and accommodation of later requests for modification of the concession.

When PPPs were selected as an alternative of delivering public infrastructure and services, they became attractive mainly due to the immediate fiscal effect, as they are an off-balance-sheet operation. However, until 2003, there was no proper legal framework to accommodate the PPP 'novelty' and hence the involved parties developed piecemeal approaches. Moreover, at national level, competencies were split between various ministries (Annex I, 6.2).

PPP is often to be perceived mostly as a national level challenge due to legal framework and large projects, which in many countries tend to be within the remit of national authorities or agencies. However, as hinted by the above examples the role of the sub-national level in PPP needs to be better recognised and understood. It is also necessary to appreciate and address the fact that expertise in PPPs and generally, capacity for engaging and managing PPP is in short supply at that level.

3.2.4 Business environment

This is a broad group of obstacles encountered by businesses. They emanate from the regulatory requirements and administrative burdens imposed on them and include:

- frequently changing regulatory framework and lack of stability and predictability;
- burdensome rules, procedures, licences, permits, etc.;
- lengthy and costly compliance requirements, especially for starting a business;
- planning uncertainties and difficult to obtain construction permits, etc.;
- late payment affecting SMEs.

The role of the LRAs is principally that of a regulator, but in many instances, the LRA can be acting also as a promoter and facilitator of investment.

Burdensome regulatory regime

There are many examples to illustrate the challenges confronting businesses due to the general regulatory environment. For instance, in the case of **Belgium** the AGS supporting document[36] has identified areas particularly relevant for ease of doing business the registering of property, dealing with construction permits, enforcing contracts and start-up costs. In the case of **Malta** it has been noted that the time needed to start a business and the administrative burden (including registering property, the costs of enforcing contracts, the licensing and permit system) are significant impediments to doing business. It has also be noted that the implementation of the late payment directive is still missing.

A particularly serious point has been made in the case of **Bulgaria**, with the Commissions' Country Report stating that "institutional shortcomings and corruption remain serious concerns among businesses and hence have a negative impact on investment and the overall business climate". (BG-CR4.3)

According to the **Poland** Country report, one of the key factors hampering investments, in particular in construction, is the spatial planning at a local level (PL-CR4.1). The Poland case study has also underlined that the poor

[36] EC SWD(2015)400.

performance of the local spatial planning and permit issuing mechanisms is an important bottleneck in the development of transport, energy and communication networks. Moreover, it affects the potential benefits accruing from the completion of these networks and the opportunities for businesses to locate, invest and expand in areas served by these networks.

This poor performance is attributed to many different factors, including: poor administrative capacity at the local level; frequent and *ad-hoc* changes in the local spatial plans; and, a lack of precise delimitation of competencies and responsibilities. The effects of the above are delays, poor planning, revoking of decisions, as well as a loss of ESI Funds (Annex I, 6.5).

Late payment to SMEs is a matter of concern in several countries and is reported as such by some 70% of LRA stakeholders[37]. **Spain** is one of the countries with the longest payment delays by public authorities and between businesses, according to the Commission's Country Report.

The 2016 Country Reports of the Commission provide illustrations of progress in reducing regulatory burdens. It is noted that **Portugal** continues to tackle major regulatory burdens on business through measures for legislative and administrative simplification, both at central and local level. Measures have been taken to cut unnecessary red tape for businesses and adopt better regulation principles, although progress is slow in certain areas and there are still implementation hurdles at local level. (PT-CR4)

Burdensome sector-specific regulations

Some sectors are particularly affected by regulatory constraints, which have a significant impact on investment. This may result from the operation of general regulatory regimes, such as the spatial planning and construction permits systems, or from sector-specific regulations, e.g. regarding business services/regulated professions or digital economy/telecommunications.

The AGS enclosed document has considered investment challenges in six sectors in the Member States of the EU and these are summarised in Figure 9, below. It shows that such challenges are widespread, especially in the energy and construction sectors, which are confronted with constraints in nearly 80% of the Member States.

[37] Preliminary results of CoR survey of obstacles to investment at local and regional level, July 2016.

Figure 9. Investment challenges: Sector specific regulation

Sector specific regulation	AT	BE	BG	HR	CZ	DK	FI	FR	DE	HU	IE	IT	LV	LT	LU	MT	NL	PL	PT	RO	SK	SI	ES	SE	UK
Business services / Regulated professions	✓	✓						✓	✓	✓	✓	✓							✓		✓	✓	✓		
Retail		✓				✓	✓		✓										✓				✓		
Construction		✓	✓		✓	✓	✓			✓	✓	✓	✓	✓	✓	✓	✓	✓		✓	✓	✓		✓	✓
Digital economy / Telecommunications			✓	✓				✓		✓	✓	✓						✓		✓			✓		✓
Energy		✓	✓		✓		✓	✓	✓	✓		✓	✓	✓		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Transport									✓			✓		✓				✓	✓	✓	✓	✓	✓	✓	

Source: Own analysis of information provided in the AGS/SWD.

Among the sectors examined above, **‘construction’** and **‘retail’** are the ones with a high degree of territoriality in terms of sub-national differentiation of regulatory impacts.

In the case of the construction sector the AGS enclosed document includes the example of the **Czech Republic** where “permitting procedures are complex and lengthy, often leading to significant delays. The issuance of permits is dispersed among a large number of authorities, creating a significant administrative burden for investors and prolonging the procedures”. A further example from the **United Kingdom** highlights the obstacles affecting specifically the supply of housing: “The shortage of land and delays in the operation of the planning system are regularly cited by builders as the major constraint on the supply of new homes […] Developers and builders regularly cite concerns about the efficiency, effectiveness, transparency, predictability and costs in their use of the planning system. (UK-CR2.1)

According to the UK case study, although the planning system and the availability of land with permission for housing development are seen as key obstacles, there are many other associated issues that are being debated, including: ‘affordability’ and social housing, local infrastructure and services, integrated large-scale development, as well as labour availability and capacity in the house building sector. With all levels of government – central government, devolved administrations and local government – involved, these issues raise a whole host of questions regarding governance and the role of the public sector, especially LRAs, in the field of housing (Annex I, 6.3).

Regarding obstacles affecting investment in the retail sector, the AGS enclosed document[38] includes the examples of **Denmark** stating that “restrictive retail establishment regulations for large outlets (including bans on outlets above a certain surface area and strict rules on outlet size and location) hold back investment. A further example related to planning and zoning issues is Finland,

[38] EC SWD (2015)400.

which has a high level of regulation and operational restrictions applying to retail establishments. "In particular, there is strict regulation of large-scale outlets. These regulations constitute an entry barrier and are therefore also detrimental to investment". (FI-CR1.2)

Difficult to access finance

Difficulties in accessing finance is a crucial and general issue, especially for SMEs. It is widely acknowledged at all levels, including some three-quarters of LRA stakeholders who responded to a recent CoR survey[39]. Two cases stand out:

- difficulty to access finance for SMEs,
- difficulty to combine multiple public and/or private funding channels.

The recently (re)launched Single Market initiative of the Commission[40] has recognised that SMEs and start-ups find it difficult to secure funding and prioritised helping SMEs and start-ups to grow. Accordingly, a quarter of the EFSI guarantee will be used to support innovative SMEs and midcaps, to ensure more and faster access to risk finance for start-ups[41]. As already discussed in Section 3.2.2, there is also considerable scope for obtaining such support from the EU structural funds but, again, various obstacles need to be overcome.

The specific obstacles that such measures seek to overcome are illustrated in the case of **Belgium** where, according to the Commission's Country Report, policy measures have been taken at both federal and regional level to give SMEs easier access to credit and foster private investment, including: microcredit, spin-off funding, access to equity, venture capital and business angels, and specific investments in creative industries. (BE-CR1.2)

A typical assessment of the weight attached to this issue is the case of **Estonia**, where access to capital for entrepreneurs is considered a main challenge by the National Reform Programme 2016[42].

However, in addition to obstacles concerning access to 'generic' sources of finance, there can be difficulties in accessing or combining different special

[39] 78% agree to varying extent to 'difficult access to credit' and 73% to 'lack of equity capital (preliminary results of CoR survey of obstacles to investment at local and regional level, July 2016.
[40] Commission Communication 'Upgrading the Single Market: more opportunities for people and business' (October 2015).
[41] *Ibid*, p. 5 and footnote 9.
[42] National Reform Programme Estonia 2020 (Approved by Government 05.05.2016), p. 19.

funding schemes reported by a vast majority of LRAs[43]. In this respect, the Commission's Country Report for **France** noted in connection with R&D that "there has been an inflation and instability of public schemes supporting innovation […] As a result, the support system is complex, targets an overly ambitious number of policy goals, and lacks clarity for companies. In addition, the subnational level is playing an increasing role […] but there is no sufficient confluence between R&D national policy and the regional specialisation strategies developed locally".

3.2.5 Essential pre-conditions

These obstacles represent a different type from those considered in previous sections. Broadly speaking, they concern mostly public investments, which enable further investment by the private sector. Such well-recognised pre-conditions for economic development include the availability of an appropriately skilled labour force and employment policies to support it, and well-developed transport networks and other infrastructures, notably ICT.

Both these fields have a strong territorial dimension, because the prevalence of these conditions is geographically differentiated within most counties, as well as due to the considerable involvement of the LRAs as providers and/or promoters.

Lack of appropriately skilled labour force

The AGS enclosed document has identified challenges in education, skills and lifelong learning in one half of the EU Member States.

A general challenge concerns **education and VET qualifications being insufficiently aligned with labour market needs,** as for example in the case of **Romania** but also **Poland** ("Vocational education and training programmes and lifelong learning are not sufficiently adjusted to market needs")[44]. Similar concerns are also expressed in the preamble of the Council's Recommendation on **Sweden,** which highlights that the country has experienced a sharp decline in the educational performance of 15 year-olds and warns that deteriorating outcomes of school education risk putting pressure on Sweden's competitiveness and innovation capacity in the long-run.

Several countries are faced with **skills shortages**. These include **Ireland**, where some skills shortages have emerged with the "renewed economic growth and the dynamism of the IT sector", and the **United Kingdom** where demand is rising

[43] 87% agree to varying extent (preliminary results of CoR survey of obstacles to investment at local and regional level, July 2016).
[44] EC SWD(2015)400.

rapidly for skilled professional in the area of ICT but supply is not keeping pace. Spain is also experiencing skills shortages in some sectors, such as in science and technology. Similarly, the Commission's Country Report on Estonia has noted that "labour and skill shortages are considered a barrier to higher investment in specific sectors […], for example IT". (EE-CR1.2)

However, skills shortages are not confined to newer skills / ICT or higher skill levels. For example, the AGS accompanying document states that in the case of Latvia "there is evidence of skills shortages in sectors such as machinery, ICT, food processing, health care and textiles, weighing on investment".

There are also countries facing **skills mismatches**, such as **Italy** where "high shares of both over-skilled and under-skilled workers are an obstacle to investment".

The Sweden case study has looked into several inter-related aspects. In recent years, the country has been facing skill shortages in various sectors of the economy, as well as issues of educational attainment. The large number of people of immigrant background has been putting stress on the education and labour market and the high influx of refugees in the past year presented a huge new challenge.

However, the government response saw this not only as a problem but also as an opportunity. Based on Sweden's highly developed and longstanding active labour market, education and immigrant integration policies, the government launched the 'Fast track - a quicker introduction of newly arrived immigrants'. This has the dual objective of helping newly arrived immigrants to find quickly a workplace that is relevant to their education, experience and interest and, at the same time, addressing the labour shortages that affect many sectors. The fast track policy has been developed and is being implemented through a strong partnership and multilevel governance approach involving government agencies, LRAs and social partners (Annex I, 6.4).

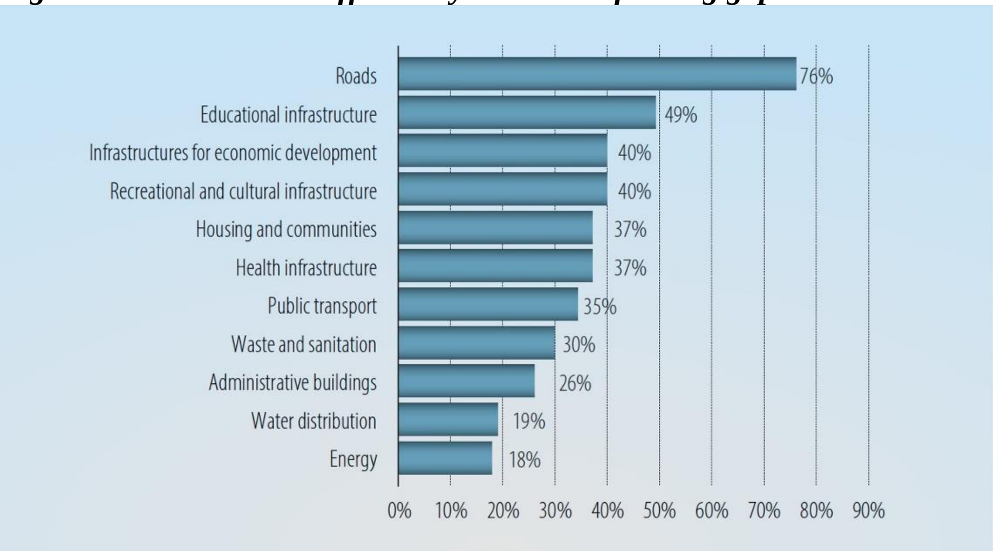
Inadequate transport and other infrastructures

Although this topic has not been specifically covered in the AGS under challenges to investment, it is an established area of support under the EU cohesion policy and structural funds. It covers various forms of basic infrastructure and as indicated in the OECD recommendation on Effective Public Investment Across Levels of Government[45] the road infrastructure is pre-

[45] Adopted on 12 March 2014.

eminent, as shown in the following figure, largely reflecting the allocation of competencies across levels of government.

Figure 10. Sectors most affected by LRA-level funding gaps



Source: Results of CoR-OECD survey, 2015.

The 2016 Country Reports of the European Commission have also identified inadequacies in the transport infrastructure of some countries as obstacles to investment, including:

- **Latvia** where "public roads are in poor condition due to limited public investment" and this has an adverse effect on regional development. (LV-CR7)

- **Slovakia** where a fragmented road transport network "harms investment, especially in the Central and Eastern regions, and aggravates the regional economic divide". (SK-CR7)

The latter is considered in greater detail in the Slovakia case study, which has highlighted the inadequacies of the secondary and tertiary road networks at regional level and local roads at municipal level. The case study spelled out the regional disparities associated with the state of transport infrastructure. It also underlined the link between the poor state of the road network and the substantial investments required with the fiscal capacities of LRAs (Annex I, 6.7).

3.3 List of territorial obstacles to investment

The previous sections have reviewed the main groups of obstacles to investment, which are considered to be territory-related. These are summarised in Table 1, below. Chapter 4 provides a cross-cutting analysis and a further examination of their territorial aspects.

Table 1. List of territorial obstacles to investment

1. Governance and public administration
1.1 Deficiencies in quality, efficiency and transparency of the public administration, including coordination between different services and sectors within the public administration.
1.2 Lack of coordination with other levels of government and weak multilevel governance.
1.3 Lack of coordination/cooperation with other actors outside the public administration (private sector, civil society, etc.).
2. Accessing and managing investment funds
Deficiencies in planning, designing, submitting and managing public investments, including EU funds.
Mismatch between the functions and financial resources of local/regional governments and inadequacies in equalisation schemes.
3. Public procurement and PPP
3.1 Public procurement shortcomings: ▪ Excessive length of procedures, legal framework fragmentation, complexity and uncertainty. ▪ Insufficient degree of competition in tendering procedures.
3.2 PPP shortcomings: ▪ Legal framework uncertainties. ▪ Lack of expertise in PPPs and weak management of PPPs.
4. Business environment
4.1 Burdensome general regulatory regime: ▪ Frequently changing regulatory framework and lack of stability and predictability. ▪ Burdensome rules, procedures, licences, permits. ▪ Lengthy and costly compliance requirements, especially for starting a

business. ▪ Planning uncertainties and difficult to obtain construction permits, etc. ▪ Late payment affecting SMEs.
4.2 Burdensome sector-specific regulations
4.3 Difficult to access finance: ▪ Difficult to access finance for SMEs. ▪ Difficult to combine multiple public and/or private funding channels.
5. Essential pre-conditions
5.1 Lack of appropriately skilled labour force
5.2 Inadequate transport infrastructure

4 Cross-cutting issues and territorial relevance

A horizontal analysis of the main findings of the review of obstacles and the eight case studies seeks to contribute towards a framework that allows a focused approach in addressing them at EU and MS level. It covers the main cross-cutting issues and links between obstacles, and maps out the most relevant areas to be addressed from a territorial perspective.

The central point is the urgent need to fill or at least narrow the investment gap. The business environment suffers from burdensome regulations and procedures, calling for institutional reform and administrative strengthening but the LRA fiscal regimes also need attention, as there are often no incentives for attracting and supporting businesses. The new EU investment initiatives and the European Fund for Strategic Investments focus on mobilising private investment and regard the LRAs as enablers of this process, though the LRAs would often have to overcome major institutional and administrative capacity limitations to be able to do so. At the same time, investment in essential public infrastructure and services is falling behind and the fiscal frameworks impede LRAs from fulfilling their obligations. Although the ESI Funds can make a contribution, ‘unlocking’ them and combining them with the European Fund for Strategic Investments present further challenges.

This analysis highlights significant weaknesses in administrative capacities and various aspects of multilevel governance, as well as in the fiscal framework of the LRAs, which need to be targeted in order to tackle the investment gap at local and regional level.

Regarding the territorial relevance of the main obstacles in terms of their impact on regions *within* countries, the highest degree of differentiated impact is observed in the case of ‘essential preconditions’, such as the availability of skills and transport infrastructure.

LRAs play multiple and often inter-linked roles regarding investment in their area: planner, investor, investment partner, regulator, provider and promoter/facilitator, as well as an overarching role of ‘enabler’ as envisaged in the new EU investment initiatives. In terms of relevance and extent to which the obstacles impede the different roles of LRAs, shortcomings in public procurement/PPP present the most significant challenges, especially on the role of investment partner and enabler.

This analysis offers an EU-level template regarding the relevance of the main groups of territorial obstacles in terms of their impact on regions and on the effectiveness of the LRAs in performing their competencies and functions regarding investment in their area.

4.1 Towards a sharper focus

A number of topics stand out from the general review of obstacles in the previous chapters and in the eight case studies in Annex I, cutting across different aspects of the obstacles and revealing multiple links between them. This should be borne in mind when drawing conclusions and developing recommendations, together with two key observations.

The first observation is that the scope of obstacles is extremely wide-ranging and very diverse especially if, on top of the specific obstacles listed in Section 3.3, one includes 'challenges' which may amount to impediments depending on other factors. This is illustrated in the UK case study (Annex I, 6.3), where much of the debate has focused on the planning system as an obstacle to releasing land for housing development, while issues of capacity and skills in the housebuilding sector and funding of local infrastructure also impinge.

A further observation is that it is rarely a question of tackling an isolated obstacle to investment. Usually one is confronted with both regulatory and non-regulatory obstacles, with the latter often reflecting financial framework conditions. They are both hugely important and cannot be ignored in any attempt to tackle the obstacles, as has already been stressed in Section 2.4. The balance between these two strands has a central place in examining obstacles and exploring solutions. Similarly, as highlighted in Section 2.1, the public/private relationship in investment is central to the EU initiatives to relaunch investment and needs to be prominent in any analysis or prescription regarding the easing or removing obstacles to investment.

It is, therefore, essential to map out the most relevant areas that need to be addressed, from a territorial perspective, in order to allow a more focused approach to be developed towards easing and removing investment obstacles. This is explored in the following two sections. The first considers cross-cutting issues and links between obstacles and highlights their significance with reference to the starting point of 'plugging' the investment gap. The second explores the territorial relevance of the main obstacles in terms of their impact on regions *within* countries and on the different roles of LRAs regarding investment.

4.2 Cross-cutting issues and links between obstacles

As outlined in Chapter 2, the **investment gap** is very wide and reducing it – let alone filling it – is one of the biggest challenges facing the EU at all levels. Therefore, the approach adopted by the new EU initiatives[46] in the field of investment does not present an 'either/or' dilemma between public and private investment but a case for getting the most from both. In many respects, looking at the links and balance between public and private investment one observes almost a continuum and it is difficult to draw a hard dividing line. The case of complex procurement and PPP in Portugal and the example of UK housing underline this point, and they have been explored in the case studies of Annex I.

The **regulatory environment** is a crucial interface between the public and the private sectors. The regulatory framework concerning business activities and private sector investment tends to be complex and burdensome, with a lack of stability and predictability becoming a negative factor for investors. This is something that is readily accepted by a large majority of LRA stakeholders[47].

However, multiple levels and parts of government tend to be involved in the regulatory environment, including the sub-national level. Business regulations (e.g. tax collection, insolvency) are mostly in the hands of central government, at least in unitary states. The direct involvement of the LRAs is mainly in the implementation of some of the regulations, but they also play a big role in some sectors, such as construction and retail, mostly through their functions as spatial planning authorities.

Therefore, as far as the regulatory environment is concerned key aspects in addressing investment obstacles relate to MLG and administrative capacities[48]. However, it is also worth noting that fiscal considerations can be an important factor influencing the approach of LRAs in shaping the business environment at sub-national level. For instance, the case study on Estonia has noted in connection with the fiscal equalisation scheme that "there is no incentive for municipalities for attracting enterprises or creating jobs" (Annex I, 6.8).

The EU new investment initiatives aspire to a 'holistic' approach encompassing all types of EU investment instruments - notably both the ESI Funds and the EFSI, - and the main thrust of the efforts, spearheaded by the EIB, is on **'catalysing' private investment.** The idea is to "get more by the investment

[46] EC Investment Plan for Europe and 2016 AGS.
[47] Some 90% agree to some extent that burdensome rules and procedures affect private businesses in their area. Preliminary results of CoR survey of obstacles to investment at local and regional level, July 2016.
[48] Lack of administrative capacity is reflected in several obstacles summarised in Table 1, including obstacles 1.1, 2.1, 3.1, 3.2 and 4.1.

being paid back where possible" using the EFSI and to "keep the grant component of ESI Funds for bits that cannot be repaid". Early indications suggest that a high multiplier of 1:15 is being achieved and that ESI Funds supports "more SMEs, more innovation and more innovative infrastructure"[49]. The last point is associated with a longer-term reorientation of economic development in the EU towards a so-called 'digitally interconnected third industrial revolution'[50].

Notwithstanding the reservations expressed from an LRA point of view regarding the policy implications of the ESI Funds approach and methods, which were outlined in Section 2.4, this approach brings to the forefront new challenges. The LRAs are called upon to adopt a new and broader role as **'enabler'**, which implies overcoming institutional and administrative capacity obstacles. They need, *inter alia*, to overcome the major limitations that exist at LRA-level in terms of expertise and experience in new financial instruments.

The magnitude of this challenge is illustrated by the fact that so far only a tiny minority of LRAs are well informed, have participated or plan to participate in projects under EFSI[51]. This largely reflects the very limited use of 'financial engineering instruments' made under ESI Funds in the 2017-2013 period, where around 95% of investments were implemented using non-repayable forms of aid[52]. Although there have been successful cases of using JEREMIE and JESSICA in both EU-15 (e.g. UK) and EU-13 (e.g. Mazovia Region, Poland) this approach has not been taken up by the large majority of LRAs. The considerable problems encountered in connection with the use of PPPs in Portugal serve to underline the length of the road the LRAs are expected to travel.

It should be stressed that there are deep concerns among LRAs about public finance for **essential investment and public services**. The dual emphasis on using financial instruments and 'repayable investment', and on prioritising 'innovative infrastructure' leaves these concerns unanswered. Two key areas of concern are about fiscal constraints and ESI Funds.

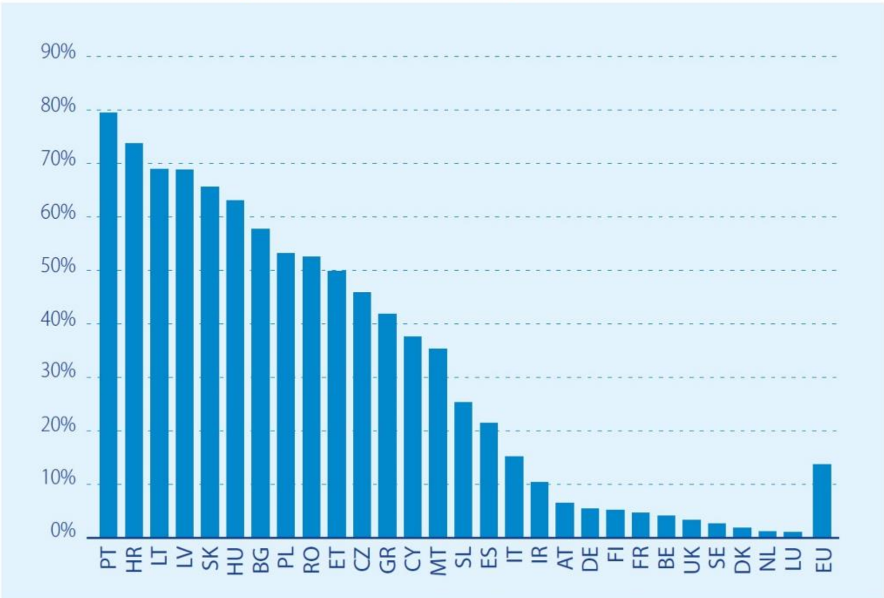
---

[49] Wilhelm Molterer, EFSI Managing Director speaking at the 7th European Summit of Regions and Cities, 8/9 July 2016, Bratislava.
[50] Jeremy Rifkin, Smart Regions Smart Cities: A Digitally Interconnected and Ecologically Sustainable Third Industrial Revolution Across the European Union, 7th European Summit of Regions and Cities, 8-9 July 2016, Bratislava.
[51] Well informed: 7%; Submitted projects: 7%; planning to submit projects: 11%; CoR Survey on obstacles to investment at local and regional level, July 2016.
[52] Integrated projects for Urban and Rural development: 94.3%; education infrastructure : 95.8%; health infrastructure: 96.9%; childcare infrastructure: 97.4%; other social infrastructure: 95.2% (EC, *Ex post* evaluation of cohesion policy programmes 2007-2013 - Work Package Ten: *Ex post* evaluation of Urban Development and Social Infrastructures, October 2015).

Fiscal regimes, including equalisation schemes are proving inadequate in view of the severity/complexity of the situation and, as shown in the case studies on Germany and Estonia, the smaller and poorer municipalities are hit hard. As already discussed there are serious practical limitations "to bridge the financing gap"[53] through private investment, such as at least the lack of experience and expertise at local and regional level in financial instruments. The Slovakia case study, has specifically pointed out that realistically there is no potential for using PPP for the secondary and tertiary road network. Thus, *ad hoc* solutions, like the special fund of EUR 3.5 billion established in Germany to support investment in municipal infrastructure, seem to predominate (see Germany case study, Annex I, 6.5).

It is not only the LRAs, which advocate the need for investing in 'basic' infrastructure. The 2016 AGS stresses that Member States should promote social investment more broadly, including in healthcare, childcare, housing support and rehabilitation services to strengthen people's current and future capacities to engage in the labour market and adapt. It notes that support is available from the EU, particularly the ESI Funds. Indeed, many Member States are largely dependent on ESI Funds for public investment, as shown in the following figure:

Figure 11. Proportion of ESI Funding in public investment 2014-2016



Source: European Commission, 2015.

However, **'unlocking ESI Funds'** is posing several challenges.
First, there is plenty of evidence that the amounts available from the ESI Funds are far from sufficient to meet the known needs, particularly in EU-13[54]. There

[53] http://www.oecd.org/effective-public-investment-toolkit/Effective-Public-Investment-Brochure.pdf
[54] Iskra Mihaylova, MEP, Chair of EP's Committee for Regional Development, speaking at the 7th European Summit of Regions and Cities, 8/9 July 2016, Bratislava.

are also indications that Member States, in line with Commission thinking, have not prioritised such investments in their PAs and OPs, as explained in the Slovakia case study (Annex I, 6.7).

Second, there is a past record of low absorption of ESI Funds in some countries (e.g. Italy, Croatia) and early indications that an overall low absorption characterises the early stages of the 2014-2020 period. This raises diverse issues. On the one hand, it underlines the need for administrative capacity building, while on the other hand there are calls from the LRAs for 'simplification', since the current regime is too cumbersome, slow and exposes the LRAs to the risk of high financial penalties and other disincentives[55].

Therefore, in this field, not only the fiscal framework needs to be addressed but it is also important to find ways to improve access to EU funds through strengthened LRA capacities and better MLG.

The state of play with MLG is, indeed, a major horizontal issue. The review of obstacles in Chapter 3 has identified frequent references to fragmentation, overlaps and insufficient coordination between different levels of government in connection with strategic planning and monitoring of investments.

However, there are also good examples of MLG and working in partnership, like Sweden's 'fast track' policy and the Northern Ireland housing forum in the UK (Annex I, 6.4 and 6.3, respectively) and in Portugal central/regional level cooperation is now taking place in PPP (Annex I, 6.2). It is worth noting that in all these cases the LRAs are part of the solution to removing obstacles. Indeed, in the case of the Bratislava Region and its pragmatic solution to public procurement constraints (through a series of framework contracts) the solution has come from an LRA (Annex I, 6.7).

It should also be noted that the ESI Funds (and the associated *ex-ante* conditionalities for the 2014-2020 period) have been a positive influence, with benefits reported not only in the case of EU-13 but also in the case of Italy (Annex I, 6.1). Moreover, there are general provisions in the ESI Funds, such as the provision for Integrated Territorial Investments (ITI), which can contribute towards an integrated approach involving different levels and sectors.

In summary, there are significant weaknesses in administrative capacities and various aspects of MLG, as well as in the fiscal framework of the LRAs, which

[55] A vast proportion of the project applicants' effort is aborted since very few of the developed projects are approved; there are long delays as the managing authorities are not subject to deadlines like the LRAs/project applicants; etc.

stand out and need to be addressed in order to fill the investment gap at local and regional level.

4.3 Territorial relevance and differentiation

4.3.1 Relevance and impact on regions

Among the territory-related obstacles considered in Chapter 3, some groups of obstacles have potentially a greater degree of differentiation in terms of their impact on regions *within* countries. It is beyond the scope of this study to assess in a quantitative way the degree of such differentiation, however, it is possible to provide a broad qualitative indication, as outlined below (also, shown as ‘high’, ‘medium’ or ‘low’ degree of differentiated impact on regions in Figure 12).

The group of obstacles concerning **essential pre-conditions** stand out as highly territorial. This reflects the state of endowment of the regions in terms of skills, and transport (and other basic) infrastructure. As shown in the Sweden case study, which examined skills issues and related policies, there can be significant regional variations, skills deficit/surplus or mismatch (Annex I, 6.4).

The Slovakia case study has referred to disparities between the Bratislava region and the rest of the country but also to the fact that the western regions outside Bratislava have had consistently higher growth in the last decade than their eastern counterparts. It highlighted that “transport infrastructure is perceived as one of the determining factors of the regional disparities between regions […] since the regions with better accessibility (located in the western part of the country) have experienced constantly higher economic growth” (Annex I, 6.7).

The impact of this group of obstacles broadly reflects the disparities within and between Member States, which are recognised and addressed by the EU cohesion policy. As such, it can be considered to be the group of obstacles with potentially the most differentiated impact on regions.

The impact of two other groups of obstacles on regions can also vary significantly, namely those regarding:

- **accessing and managing investment funds, and**
- **governance and public administration.**

The former, depends on various factors regarding the availability and access to investment funds. The capacity of LRAs to access and manage funds can vary widely and, generally, it is more limited in the case of small municipalities as already mentioned in the example of Finland (see Section 3.2.2.). As mentioned in the Commission’s Country Report on Finland, many of the municipalities are rather small but still need to provide transport, education, health and social services and invest in the related infrastructure. Strengthening small municipalities' capacity to plan and carry out investment could benefit both public and private investment.

The mismatch between functions and fiscal resources highlighted in Section 3.2.2 can have a greater effect on particular categories of areas, as demonstrated in the Germany case study (Annex I, 6.5). Many of the poorer German municipalities suffer a mismatch between competencies and investment finance. They find themselves in a vicious circle with decreasing and ageing population, rising unemployment and a shrinking tax base on the one hand, and rising social expenses on the other. This obstacle has a territorial dimension since municipalities in some regions, mainly in some North-western and Eastern Federal States, are markedly more affected than others.

Similarly, as shown in the Estonia case study, it is the smaller municipalities that are affected. A planned local government reform involving voluntary and government-initiated mergers tries to foster consolidation of the many small municipalities in Estonia, with a minimum of 5,000 inhabitants. The measure is expected to level financial disparities between municipalities and reduce discrepancies between local revenues and responsibilities (see Annex I, 6.8).

The group of governance and public administration obstacles can also have a geographically differentiated impact due to deficiencies in the quality and efficiency of sub-national governments, as well as different attitudes and affective cooperation with other sectors. However, the degree of differentiation within countries is lower in the case of coordination between levels of government, since they are generally determined by common rules, at least in unitary states.

In the case of the two other groups of obstacles, the impact on regions is less differentiated, namely those regarding:

- **the business environment, and**
- **public procurement and PPP.**

In the case of the former, as far the regulatory environment is concerned, the prime responsibility for rule-setting rests with the national level and therefore the geographical differentiation depends on the implementation by the LRAs. However, in matters such as local spatial planning and the issuance of construction permits, the LRAs play a major role. As noted in the Poland and

UK case studies these regulatory functions are considered to be hampering investment, in the construction sector and in the supply of housing, respectively (Annex I, 6.3 and 6.6).

Regarding the latter, there is no evidence of variable application of PPPs at sub-national level, but variations in public procurement can occur. For example, in Spain, the region of Galicia has developed a web platform for public procurement procedures for all public entities, including municipalities, with the aim of integrating all public entities and private companies in a one-stop shop for public procurement. Similarly, the Slovakia case study (Annex I, 6.7) has described how the Bratislava self-governing region has addressed public procurement challenges by setting up framework contracts, through its specialised agency (Regionálne cesty Bratislava), using external providers for road works and other public services.

4.3.2 Relevance and impact on competencies and functions of LRAs

As already indicated in Chapter 3, the wide range of legal competencies LRAs and the different functions they perform, in practice, mean that the **LRAs play multiple roles regarding investment**. For this reason it is not always feasible to separate them, nevertheless, even allowing for overlaps, the main roles encountered in connection with public and private investment can be summarised, as follows:

- **Planner**: participating in multi-level strategic planning and leading at sub-national level, as well as the principal player in major local development projects.

- **Investor**: often the principal player in public investment such as basic infrastructure and public services at sub-national level.

- **Investment partner**: through PPP-type schemes, complex procurement, or even as a provider of local infrastructure.

- **Regulator** of private investment and business activity as the public authority responsible for spatial planning and construction permits, and for the implementation of other regulations and issuance of licences.

- **Provider** of ‘basic infrastructure’, which may also represent ‘enabling infrastructure’ for private investment, such as an appropriately skilled labour force, good transport infrastructure, etc.

- **Promoter / facilitator**: leading or participating in efforts to attract new private or public investment in their area and facilitating new investments by providing information and advisory support to investors.

These roles can be matched fairly clearly to the main groups of territory-related obstacles, based on the examination of these obstacles in Section 3.2 and this is illustrated in Figure 12, below.

In broad terms, the first group of obstacles (governance/administration) corresponds to the role of planner, the second (accessing funds) to investor, the third (public procurement/PPP) to investment partner, the fourth (business environment) to regulator, and the fifth (essential pre-conditions) to provider. The role of promoter or facilitator through information and advisory support can be associated with several groups of obstacles depending on the approach (proactive or otherwise) adopted by the LRA.

The new EU investment initiatives, as exemplified by the EFSI, place much importance on the LRA role as **'enabler'**. This is often described as fully encompassing, from setting objectives to creating conditions for investors, and can indeed be treated as an overarching role comprising all the specific roles described above.

Although these roles are in most cases inter-connected they still provide a useful reference framework in seeking solutions to overcoming obstacles that will be best aligned with the potential of LRAs to function effectively in this field. In this context, it is also useful to take into account the **'height' of the obstacles**. As for the degree of impact on regions, it is possible to establish a broad qualitative indication, as outlined below, using as the main criterion the degree to which observed obstacles impede LRAs from performing effectively and efficiently their competencies and functions. Figure 12, below, indicates this degree as 'high', 'medium' or 'low'.

The highest obstacles are observed in two cases:

- **public procurement and PPP and the role of LRAs as investment partner, and**
- **essential preconditions and the role of the LRAs as provider.**

It has already been explained in Sections 2.4 and 4.2 that LRAs are confronted with a huge challenge in their role as investment partners, largely due to their lack of capacity, experience and specialist expertise. This is compounded by an often unstable legal framework and uncertainties with the EFSI and other new instruments. The LRAs are far from established in this role and the new approach advocated by the EU amounts to a ‘new start’ for most of them.

As regards the role of LRAs as provider, there are significant inadequacies in essential public infrastructure, in both EU-15 and EU-13 countries, as highlighted in the Germany and Slovakia case studies, and an alarming shortfall in investment as discussed in previous sections. These conditions amount to a high hurdle for LRAs.

There are hurdles also in the case of the availability of appropriately skilled workforce. However, the role of provider does not normally fall primarily within the remit of the LRAs but involves significant national level competencies, for instance, through the Public Employment Service.

In most other cases the degree to which observed obstacles impede LRAs from performing effectively and efficiently their competencies and functions can be classed as ‘medium’ (see Figure 12, below):

- **Governance and public administration and the role of LRAs as planner:** although weaknesses in partnership and MLG are generally recognised[56] and there are well acknowledged deficiencies in administrative capacities the nature of the challenge is that of ‘improvement’ rather than of a ‘new start’.

- **Accessing and managing investment funds and the role of LRAs as investor:** although this is an important area, public sources provide a minority of total investment[57] and in the current EU thrust on re-launching investment the LRAs are not regarded as the main investors, *per se*, but as ‘enablers’.

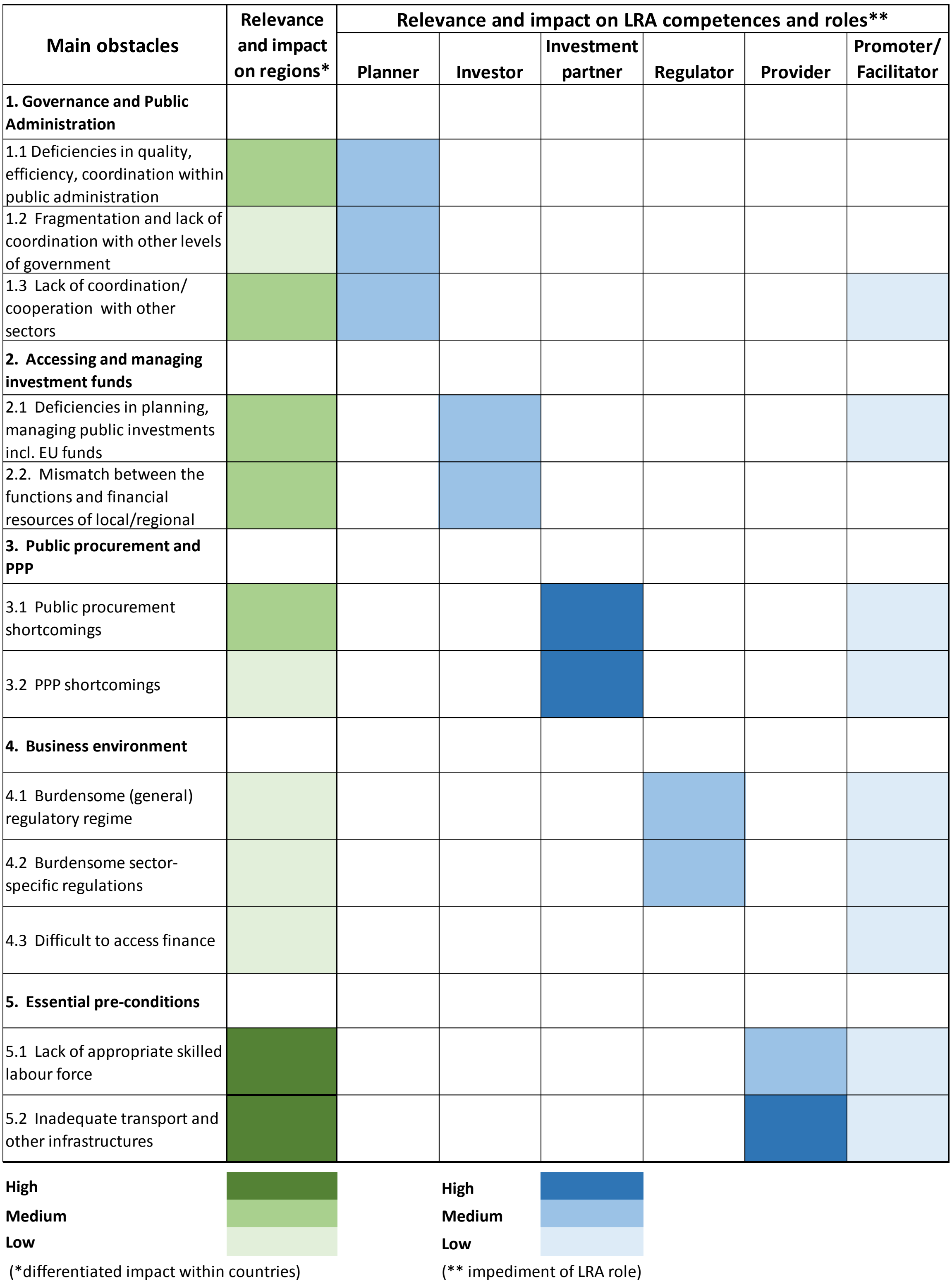
- **Business environment and the role of LRAs as regulator:** the LRAs are not pre-eminent in rule setting but play an important role in implementing regulations and this is particularly relevant in the case of local spatial planning and permissions.

Finally, the identified obstacles do not impede in any major way the ability of LRAs to play the role of **promoter and facilitator** of investment. This information-and-advice role impinges on various types of obstacle and can be performed more-or-less effectively within the pertaining parameters.

[56] For instance, 25 NRPs include a clear reference to coordination frameworks between different levels of government.
[57] For EU-28 in 2012-2014 private investment amounted to 16.5% and public investment 2.9% of GDP.

The overall mapping out of the relevance of the obstacles to investment in terms of their impact on regions within countries and on the competencies and roles of LRAs is presented in Figure 12. A broad indication of their degree of the impact is also provided. This offers an EU level template that can be adapted to the particular circumstances of each Member State.

Figure 12. Relevance and impact of territory-related obstacles



5 Conclusions and recommendations

The types of action mostly needed to overcome the obstacles and make the role of LRAs more effective in achieving public and private investment in their area fall into three main categories:

- **Fiscal and financial framework**
  - Fiscal framework adapted to the investment objectives;
  - Correcting functions / financial resources misalignment.

- **Multilevel governance and institutional reform**
  - Better MLG;
  - Institutional reform.

- **Administrative capacity building**
  - Organisational strengthening;
  - Strengthening specialist expertise.

Matching these types of action to the obstacles that are most relevant from a territorial perspective offers a framework at EU level that can be used for establishing more specific packages of action in each country, through an MLG process, which should form part of the European Semester.

A targeted approach can be pursued within these three fields of action, which are also the basis for the study's proposed recommendations to the CoR.

5.1 Main types of action to address territorial obstacles

The previous chapter mapped out the obstacles to investment in terms of their relevance from a territorial perspective, together with an indicative assessment of their impact on regions and on the ability of LRAs to perform their competencies and functions. This provides a framework within which a focused approach can be pursued for easing and removing the highest obstacles.

Chapter 4 also highlighted a number of key challenges that need to be addressed in order to tackle these obstacles. The **types of action** that are mostly needed to overcome the obstacles and make the role of LRAs more effective to achieve public and private investment in their areas fall into three main categories, which are outlined below (see also Table 2). Within each category, there is the potential for a sharper approach, with actions targeted on removing specific key obstacles. These actions will be addressing directly obstacles as they affect the

LRAs and they will be indirectly contributing towards mitigating their effects on the regions.

First, adjustments should be made to the **fiscal and financial framework** within which the LRAs pursue their investment related functions. This is an essential step to ensure that LRAs can play an effective role as investor/provider and investment partner, and to some extent - especially through the latter - as an investment 'enabler'. Specific actions could be targeted to the adaptation of the fiscal framework to investment objectives and to correcting misalignments between LRA functions and resources.

Second, there should be improvements to **multilevel governance and institutional reform.** As noted in Chapter 4, the functioning of MLG is problematic in several key areas, above all in allowing the LRAs to play an effective role as planner, coordinator and generally 'enabler' of investment in their area. Improvements to MLG and related institutional reforms can also contribute towards overcoming other obstacles including those affecting the role of LRAs as regulator and provider. Actions could be targeted on improving MLG arrangements regarding strategic investment planning, skills and infrastructure, as well as institutional reforms to engage private actors and ensure stability and better regulation.

Third, **administrative capacity building** will be crucial for addressing a whole family of related obstacles[58]. It will, particularly, help the LRAs to overcome shortcomings in public procurement and PPPs and, generally, to play an effective role in promoting investment and combining different financial instruments and acting as an 'enabler'. Targeted actions could cover both organisational strengthening (e.g. special units managing EU funds, e-procurement platforms) and strengthening specialist expertise in PPP and innovative investment instruments, and better regulation of private sector activity.

[58] Lack of administrative capacity is reflected in several obstacles summarised in Table 1 and Figures 12 and 13, including obstacles 1.1, 2.1, 3.1, 3.2 and 4.1.

Table 2. Main types of action and LRA contribution

Type of action	LRA contribution (level / capacity*)
Fiscal and financial framework	**low**
Fiscal framework adapted to the investment objectives	advocacy
Correcting functions / financial resources misalignment	advocacy
Multilevel governance and institutional reform	**medium**
Better MLG	legal + advocacy
Institutional reform	legal + fiscal + advocacy
Administrative capacity building	**high**
Organisational strengthening	admin + legal + fiscal
Strengthening specialist expertise	admin + legal + fiscal

* *Administrative capacity; Legal competencies; Fiscal autonomy; Advocacy of solutions based on LRA experience.*

The direct **contribution that the LRAs can make** to these solutions will vary considerably, as indicated in Table 2, above. It will be the greatest in the case of administrative capacity building, where the necessary actions can be instigated and implemented mostly within the LRAs remit, in administrative, legal and fiscal terms. Nevertheless, support from EU and national levels could be valuable.

The LRA contribution will be significant in MLG improvement and institutional reform but in this case, much of the action will need to be shared with other levels and parts of government. The LRAs could contribute through both their legal competencies and active advocacy relying on the wealth of their knowledge of problems and practical solutions. In the case of institutional reforms, they could also rely on their fiscal autonomy.

The LRA contribution will be much smaller in connection with the fiscal and financial framework where the decisions will have to be taken at national and even EU level. Their direct contribution will be mostly through active advocacy of practical adjustments to the framework.

The potential contribution of different types of action to removing obstacles to investment is illustrated in Figure 13, below.

In most instances, a combination of actions would be desirable, as in the case of the obstacles that represent the highest impediments to LRAs functions in investment:

- Regarding public procurement and PPP, it would be appropriate to pursue administrative capacity building (specialist skills, systems, etc.), as well as adjustments to the fiscal framework (to match investment objectives), and appropriate MLG improvements (to the extent that public procurement depends on national-level regulation).

- Regarding transport and other essential infrastructures, it would again be appropriate to have improvements in all three categories, to ensure sufficient investment funds, planning and management capacities, and effective coordination with other levels and sectors.

The scheme outlined above and illustrated in Figure 13, below, provides an indicative template at EU level that can be used for establishing more specific packages of action in each country. The process of identifying, weighing and prioritising obstacles, and then targeting actions towards easing or removing them should be a fully-fledged multi-level governance task in the context of the European Semester. This is in line with the position already presented by the CoR regarding the involvement of LRA in the European Semester[59].

The **general conclusions** can be summarised, as follows:

- A large category of obstacles to investment are territory-related and need to be addressed in ways that take account of their territoriality.

- Not all the territorial obstacles are equally important in terms of their relevance to the competencies and functions of LRAs and the intensity of impact; therefore, a more selective and focused approach would be justified from a territorial perspective.

- The types of actions outlined in this report are of EU-wide relevance and as such provide a broad canvas or menu for more specific packages of action in each country.

- The solution to the most pressing of the issues arising from the territorial obstacles is not necessarily in the hands of LRAs; indeed, crucial obstacles linked to the fiscal framework and MLG need to be tackled at higher levels.

- Further study on the relative weight and impact of the investment obstacles across the EU could provide a valuable input to the LRAs and other levels in addressing these issues.

[59] CoR, A Code of Conduct.

Figure 13. Territory-related obstacles, LRA roles and potential actions

Main obstacles	LRA competences and roles* / Types of action** / LRA contribution***					
	Planner	Investor	Investment partner	Regulator	Provider	Promoter/ Facilitator
1. Governance and Public Administration						
1.1 Deficiencies in quality, efficiency, coordination within public administration	○					
1.2 Fragmentation and lack of coordination with other levels of government	◇					
1.3 Lack of coordination/ cooperation with other sectors	◇ ○					○
2. Accessing and managing investment funds						
2.1 Deficiencies in planning, managing public investments incl. EU funds		○ ◇				○
2.2. Mismatch between the functions and financial resources of local/regional		△ ◇				
3. Public procurement and PPP						
3.1 Public procurement shortcomings			○ △ ◇			○
3.2 PPP shortcomings			○ △ ◇			○
4. Business environment						
4.1 Burdensome (general) regulatory regime				○ ◇		○
4.2 Burdensome sector-specific regulations				○ ◇		○
4.3 Difficult to access finance						○
5. Essential pre-conditions						
5.1 Lack of appropriate skilled labour force					○ △ ◇	○
5.2 Inadequate transport and other infrastructures					○ △ ◇	○

***Impact on LRA competencies and roles**

High

Medium

Low

****Types of action**

Fiscal & financial framework △

MLG & institutional reform ◇

Administrative capacity building ○

*****LRA contribution**

Low

Medium

High

5.2 Recommendations

5.2.1 Fiscal and financial framework

A. Fiscal framework adapted to investment objectives

The 'golden fiscal rule' that growth-conducive long-term investments remain separate from current expenditure should be introduced in the rules of the Stability and Growth Pact and the Treaty on Stability, Coordination and Governance. Joint technical working between the EC / MS / LRA should prepare appropriate technical options.

Brief description

A fiscal framework adapted to the investment objectives is a key OECD principle. The LRA associations have strongly criticised the current restrictions and in common with the CoR have advocated the introduction of the 'golden fiscal rule' that growth-conducive long-term investments remain separate from current expenditure. A suitable technical formulation needs to be established jointly by the EC, MS and LRAs to be incorporated, as appropriate, in the legal framework.

Good practice or indicative proposals

The Association of Netherlands Municipalities (VNG) has elaborated a technical solution to this issue. This is based on the premise that the rules of the Stability and Growth Pact and the Treaty on Stability, Coordination and Governance pose unnecessary restrictions on the level of public investment of local and regional governments. This in turn leads to weaker economic growth and rising unemployment levels. The VNG proposal envisages a solution that will enable local and regional government to retain their public investment levels, while at the same time maintaining a sound national budget policy. The Medium Term Objective of the Stability and Growth Pact should guarantee a fixed real deficit for local and regional public investments. This solution respects the rules of the Stability and Growth Pact and the Fiscal Compact as well as the budget surveillance of the European Commission and the Council. In 2017, the European Commission will publish a White Paper about the incorporation of the Treaty for Stability, Coordination and Governance into the Stability and Growth Pact. This amendment will mitigate the problem with local and regional public investment.

Activities (and responsibilities)

- Joint EC/CoR task force or experts' report on technical options (by LRA associations).

B. Correcting functions / financial resources misalignment

Many LRAs do not have the financial resources for essential investment in local infrastructure and public services, which they are statutorily required to provide.

The Commission should consider the key issues arising from such functions/resources mismatches and/or inadequacies of equalisation schemes, together with the national authorities and LRAs in the framework of the European Semester, and it should present a systematic assessment for each Member State in its 2017 Country Reports.

Brief description

A large number of obstacles have been identified concerning mostly the mismatch between the functions and financial resources of local/regional governments. The Commission's 2016 Country Reports have identified such issues in the case of Germany, Sweden, Austria, Croatia and other countries. There are similar obstacles arising from the inadequacies in equalisation schemes. The complexity of these types of challenges has been illustrated in the case studies regarding Germany and Estonia (Annex I, 6.5 and 6.8, respectively).

Good practice or indicative proposals

The solutions to these obstacles will have to be pursued country-by-country as there is no single model to be applied everywhere. However, there is plenty of relevant experience and scope for sharing good practices. For instance, the OECD toolkit has made reference to the experience of Finland[60]: "In the context of the implementation of the EU fiscal compact, the government developed a new steering system for local government finances, to be implemented from 2015. Its aim is to ensure that, in future, municipalities' responsibilities match the available funding. If they are given new responsibilities, either existing ones are to be cut or more funding is to be provided".

[60] OECD Toolkit, p. 25.

Activities (and responsibilities)

- EC to conduct a systematic ‘misalignment between financing and spending responsibilities’ audit as part of the 2017 Country Reports.
- Expert report to document key issues and best practices EU-wide, as an input to LRAs engaged in the above audit. (CoR with LRA associations).

5.2.2 Multilevel governance and institutional reform

A. Better MLG

Strategic investment planning, skills measures and transport infrastructure are crucial areas concerning long-term investment. The effectiveness of the efforts of the LRAs (and other actors) tend to be undermined by weaknesses in multilevel governance.

MLG arrangements should be reviewed and all levels of government, from EU to local authorities, need to work together to ensure a coherent approach in key areas regarding investment: longer-term planning horizons, priorities setting, investment funding sources, complementarity of actions.

Brief description

Multilevel governance is a broad topic. The relevant improvements, which are of significance in removing investment obstacles, should be prioritised and a targeted approach should be followed. In this context, better MLG should mean above all less fragmentation and closer coordination in key areas and the improvement efforts should focus on:

- Strategic investment planning;
- Skills and employment policies;
- Infrastructure investment planning;
- Accessing ESI Funds and coordination with EFSI.

The MLG dimension is also important in dealing with the mismatches between functions and financial resources of LRAs.

Good practice or indicative proposals

There is a plethora of relevant coordination and cooperation models to inform this type of actions. The OECD has outlined various approaches and examples regarding effective instruments for coordinating across national and sub-national levels of government. The case of the ‘fast track’ policy in Sweden is an example of good practice. Based on Sweden's highly developed and longstanding active labour market, education and immigrant integration policies, the government launched the 'Fast track' policy with the dual objective of helping newly arrived immigrants to quickly find a suitable job and, at the same time, addressing the labour shortage that affect many sectors. This policy has been developed and is being implemented through a strong partnership and multilevel governance approach involving government agencies, LRAs and social partners (Annex I, 6.4).

Activities (and responsibilities)

- In the first instance, this action should be progressed within the framework of the European Semester (i.e. through the relevant CR, CSR and NRP).

B. Institutional reform

Mobilising private actors and financing institutions to diversify sources of funding for investment is a top priority at all levels in the EU. Two essential conditions are the need for stability, simplification, better regulation and the strengthening of sub-national institutional capacities.

The national, regional and local government levels need to work together to promote practical partnership solutions.

Brief description

The thrust of this action is on establishing institutional arrangements and creating capacities (in conjunction with the recommendations concerning organisational strengthening) that can engage and facilitate private investment, as well as enhance public investment. Such a focused approach, should seek to meet two key OECD principles:

- Mobilise private actors and financing institutions to diversify sources of funding and strengthen sub-national capacities.

- Stability, simplification, better regulation: strive for quality and consistency in regulatory systems across levels of government, to promote a regulatory framework conducive to both public and private investment at the sub-national level.

Good practice or indicative proposals

There are many relevant examples of good practice. In the UK, the focus has shifted to functional economic areas through the launch of the Local Enterprise Partnerships (LEPs)[61]. These partnerships between local authorities and businesses decide on local priorities for investment in roads, buildings and facilities. Another example is the Housing Supply Forum in Northern Ireland involving coordination and planning across levels of government and sectors, and strong partnership working (Annex I, 6.3). Partnership models are also strongly supported by the ESI Funds in the 2014-2020 period, notably through Integrated Territorial Investments (ITI) and Community-led Local Development (CLLD).

Activities (and responsibilities)

- Targeted advisory support, e.g. through national LRA associations, using ESI Funding if available.
- Learning community/network (CoR support platform).

5.2.3 Administrative capacity building

A. Organisational strengthening

The LRAs need to have appropriate organisational arrangements, including operational systems that will enable them to operate efficiently and effectively in key areas currently affected by obstacles to development, such as special units for accessing and managing investment funds and e-procurement platforms.

Although in some cases individual LRAs can do so on their own, support at Member State and EU level would be valuable and should be made available.

Brief description

The LRAs need to ensure that their internal organisation and systems are in a position to operate efficiently, effectively and transparently in aspects currently constrained and adversely affecting investment in their area. A targeted approach is more likely to achieve tangible results, focusing on a limited number of priorities, for example:

- Special units for managing EU and other investment funds; and

[61] OECD Toolkit p. 17.

- e-procurement platforms.

As highlighted in the EC toolbox in connection with ESI Funds, pubic administrations must ensure that they have the systems, procedures and equipment to fulfil their management roles[62].

Good practice or indicative proposals

An example presented by the OECD in the context of the principle of promoting transparency and strategic use of public procurement is from Spain. At regional level, Galicia has developed a web platform for public procurement procedures for all public entities, including municipalities. The goal is to integrate all public entities and private companies in a one-stop shop for public procurement. Collaborative procurement across levels of government as well as at the regional level can also help improve procurement capacity (e.g. purchasing alliances, networks, framework agreements and central purchasing bodies).

Another sub-national level example is from the Slovakia and concerns the Bratislava self-governing region. The Region has established a specialised agency (Regionálne cesty Bratislava) and through it has set-up framework contracts using external providers for road works and other public services (Annex I, 6.7).

Activities (and responsibilities)

- Targeted advisory support, e.g. through national LRA associations, using ESI Funding if available.
- Learning community/network (CoR support platform).

B. Strengthening specialist expertise

The LRAs need to reinforce the expertise of their officials with new and specialist skills required for the complex tasks linked to investment across the full life cycle of projects.

Although some of the larger authorities may be able do so on their own, sharing of experience and knowledge and systematic support at Member State and EU level would be valuable.

[62] EC Toolbox, p. 127.

Description

The lack of specialist skills in LRAs is a major drawback for both public and private investment in their areas. A targeted approach, again, would be appropriate. Top priority should be accorded to skills regarding:

- PPP and innovative financial investment schemes, including those supported through the EFSI (and including finance for SMEs);
- public procurement;
- better regulation of private sector activity, notably dealing efficiently and transparently with issuing of permits and licencing.

Good practice or indicative proposals

This is in line with the OECD principle of reinforcing the expertise of public officials involved in public and private investment projects at sub-national level. The OECD toolkit has stressed that "sub-national governments are increasingly involved in complex tasks linked to investment across the full life cycle of projects […] They also increasingly use more complex financial instruments, which require new competencies and new more networking-type skills not previously held in many sub-national governments"[63].

The EC toolbox also covers this topic extensively. It stresses the need for sufficient capacity in key skill-sets, especially analytical and programming capacity to develop and deliver results oriented programmes and projects.

Activities (and responsibilities)

- Training courses at EU level, e.g. through the European Institute of Public Administration (EIPA).
- Learning community/network (CoR platform).

[63] OECD Toolkit, p. 20.

6 Annex I: Case studies

6.1 Italy - Local public enterprises and services

In Italy, traditionally public services are provided at local level by organisations of various legal forms, which are owned/controlled to a larger or lesser degree by the municipalities.

The local public enterprises tend to be powerful local factors, as they are a major local employer and often enjoy local monopolies. Since mayors exercise great power in the nomination of their management, they can also be subject to undue political influence.

The legal framework in the field of local public service provision is multi-level, complex and evolving continuously. At the same time, the management and accounting procedures are outdated and not transparent, making the tracking of key indicators and processes difficult as well as excluding competition. Hence, local public services can be more costly than necessary, while local economies are forfeiting efficiency gains and innovation.

In the field of public management, public accounting and public procurement a major driver in Italy is the EU cohesion policy and the requirement to comply with the prerequisites of the general *ex-ante* conditionalities. To this end, a joint European Commission/Member State working group was set-up with LRA participation and an action plan was developed addressing problems of administrative capacity and rationalisation of contracting, major barriers to competition, and a system of controls related to the efficiency of procedures and corruption.

6.1.1 Background

The Italian economy consists of three major sectors: large but relatively few private corporations, numerous small businesses, and a substantial public sector. The last one includes local public enterprises and local public services, which are the focus of this case study.

The Commission's Country Report 2016 on Italy[64] states inter alia: "...Italy shows the widest variation across EU regions in terms of quality and impartiality of public services. [...] This represents an additional challenge for Italy: to improve the overall level of efficiency of its national public administration and

[64] European Commission, SWD(2016) 81 final.

simultaneously reduce the variation between regions. […] Nearly 8,000 local state-owned enterprises in Italy weigh on the efficiency of the economy and public finances".

Italy historically has had a unitary system of government which relatively recently has undergone a phase of federalisation and devolution. The country had in 2004, apart from the 20 regional governments, 103 provincial governments, and some 8,000 municipalities[65]; the last two constitute the local government. They are responsible for the provision of a great array of public utility and social services ranging from water supply and sewage, waste disposal, local public transport, local road maintenance, child and youth education, services for special groups, municipal policing, building planning and control, recreational activities regulation, environmental protection and monitoring, etc.[66] There are more than 400.000 employees at the local level[67].

In the 1990s, Italy entered a discourse on rendering public administrations more accountable in terms of the management of public resources. This was also extended to cover the need to contain public spending and public debt in line with the Maastricht accords, as well as the need to 'reformulate' the 'social contract' between the public administration system and the citizens under a 'value for money' point of view (although efficiency is not always a guarantee for perceived quality)[68].

Overall, there is a tendency to treat local public service providers as companies regulated by private law regardless of ownership (public, private or mixed) especially for 'services of economic interest'. For some sectors in 'services of no economic interest', such as culture, forms that are more flexible are possible: direct management by the local government, special undertakings and consortiums, or companies wholly owned by local government. Other possibilities include direct assignment to institutions, associations or foundations where the local government is member or founder. While many of these forms have managerial advantages (e.g. direct management), they are considered to distort competition and risk negating any efficiency gains[69].

[65] Groppi, 2004.
[66] Rolla, 2002.
[67] Argento et al., 2010.
[68] lo Storto, 2016.
[69] Argento et al., 2010.

Table 3. Organisational forms of local public service providers in Italy, 2010

Organisational form	Number	Percentage
Institution	16	1.43
Special undertaking	185	16.54
Consortium	11	0.98
Foundation*	16	1.43
Association*	15	1.34
Cooperative*	32	2.86
Limited company*	193	17.26
Stock company*	650	58.13

*Source: Argento et al., 2010. * Governed by private law*

The legal framework applicable to local public service provision is multi-level, complex and evolving continuously taking into account EU, national and local laws as well as sectoral provisions[70]. It is also characterised by volatility and uncertainty due to the discussions on the nature of public services, the drive for efficiency and the exploration of the limits of public services provision externalisation initiatives in local public service provision, including 'corporatization', collaborative arrangements among municipalities, PPPs and contracting. While larger cities rely on 'corporatization', smaller municipalities prefer contracting and municipal associations.

Service provision relationships between local governments and the organisation forms under private law are regulated by service contracts. Hence, local government is at the same time procurer, regulator and (wholly or partially) shareholder. This may cause conflicts of interest especially in the case of utilities like water, waste and transportation where *quasi* monopoly exists.

The legislator has given extensive powers to the elected mayors. Hence, they can nominate the members of the executive board, the general manager, the heads of offices and services, etc. The shareholders' meeting usually appoints the nominees, especially when the shareholder is the municipality itself. While a municipal council does not participate in the management of a company, political intervention is not uncommon.

6.1.2 Analysis

The Commission's Country Report 2016 on Italy mentions the following investment challenges from a **macro-perspective**:

[70] Argento, 2008.

- overall decline of investment as a share of GDP (both for public and private sector) after the sovereign debt crisis due to the fiscal adjustment pursued by the public sector;

- liquidity bottlenecks due to falling demand on the one side and tight financing conditions on the other resulting from financial fragmentation and rising non-performing loans;

- slow recovery of investment driven by machinery and equipment while construction is also catching up;

- underdeveloped capital markets particularly for innovative young firms which lack collaterals;

- overall high labour and corporate taxes with complicated rules for R&D tax incentives;

- low quality of Italian regulations, frequent changes to the legislation and slow enforcement due to lengthy proceedings leading to legal uncertainty;

- inefficient public administration, regulatory overlaps and slow judicial system with antiquated provisions, e.g. on insolvency matters; and

- most state-owned enterprises involved in local public services provision are sheltered from competition and this may result in underinvestment in important sectors of the economy.

These observations match well with the Index of Economic Freedom[71] report, which attests political interference, bureaucracy, corruption, high taxation, inflexible labour market, complex regulatory framework and a high cost of conducting business. There is ample research explaining the reasons that cause institutions in Italy to be slow in reforming, including the following[72]:

- Universities did not until recently offer public management courses, while an administration academy in the French tradition is also missing.

- The management and cultural tradition of Italian public sector organisations did not readily adapt to modern management systems, they strictly adhere to norms and are often driven by formalities.

[71] http://www.heritage.org/index/country/italy
[72] Grossi, 2007.

- There are no experienced public managers, especially at the regional and local level. Managers either come from finance departments, hence finding difficult to switch from the accrual logic of private finances to the cash-flow logic of the public sector or are embedded already in the local government and thus fail to induce reform and innovation.

- Public administrators and mayors usually have an educational background in law or social and political sciences and usually lack business skills.

- The transition from the public to private management systems is still at an early phase in comparison to other countries.

- Public service administration was and is conceived as a state monopoly focusing on the delivery of the service and not on users, costs, tariffs or satisfaction.

- The relationship between public service providers and their ‘customers’ was defined by the traditional relationship between a ‘father state’ and its subjects rather than citizens.

The effects of the obstacles can be:

- of a **direct** nature:

  - for **public bodies** in having to invest more than is needed to establish and maintain public services;
  - for **private enterprises and citizens** in having to accept poorer services due to the lack of market corrective factors;

- of an **indirect** nature:

  - for **public bodies**, especially in areas lagging behind, the poor quality of public services can lead to the decision to relocate and hence reduce revenues through taxation and foregone growth and also to the deterioration of their position in better endowed regions;
  - for **private enterprises** in failing to acquire contracts to provide public services;
  - for **local economies** in forfeiting efficiency gains and innovation.

6.1.3 Solutions

Solutions to the 'deficiencies of local public enterprises and local public services' as an obstacle to investment and growth cut across three domains, namely:

- local self-government and state devolution;
- public management and public accounting;
- public procurement.

As a general remark, the Italian central administration is aware of the obstacles encountered and created through the provisions of local public services.

The structure of the Italian state is a mature one with well-established stakeholders. This is advantageous in terms of capacity and capability, but also implies that there are no quick and easy solutions, since lengthy consultations, formulation and decision procedures are to be respected. Government initiatives (new legislation and regulation, incentives etc.), even when they are generally recognised as heading in the right direction, have to prevail over systemic inertia and poor capacity at the regional/local level.

In the field of public management, public accounting and public procurement, a major driver in Italy is the EU cohesion policy and the requirement to comply with the prerequisites of the general *ex-ante* conditionalities.

To this end, in 2013, a European Commission / Member State joint working group was formed on the reform of the public procurement system. Participants were drawn from central government – mainly those responsible in the matter of public procurement, including the National Anti-Corruption Authorities – the Conference of Regions and Autonomous provinces and the Institutional Table in charge of implementing the new directives in order to reach those objectives.

The remit of the group included:

- complexity of the legal and institutional framework;

- administrative capacity and rationalisation of contracting;

- major barriers to competition (duration of concessions, administrative costs, variations, incorrect application of the in-house criteria and public-public cooperation, etc.);

- system of controls related to the efficiency of procedures and corruption.

An action plan was developed containing the proposals for solutions to the problems, together with a programme for implementation.
Topics of the action plan were:

- Rationalisation, simplification and streamlining of procedures through: a) possible, ‘targeted’ regulatory measures aimed at regulating complex cases or issues, b) formulation of guidance documents, with specific reference to the spread of knowledge and the correct use of rules provided by the new EU directives on public procurement and concessions, with particular reference to the use of new electronic communication, negotiation and purchase of works, services and supplies.

- Greater openness to competition and increased transparency mechanisms through: a) establishing systems of aggregation / centralisation of procedures related to public procurement; b) diffusion processes of centralisation of procurement procedures in specific ‘points’ with the necessary technical and legal expertise to provide support to the contracting authority; c) preparation of instruments for ‘turnkey’ contracts, easily adaptable and replicable by each contracting authority for use in simpler tender procedures and ‘ordinary’ purchases.

- Strengthening of administrative capacity through: a) training activities; b) guidance and support at all levels involved, through the organisation of thematic seminars, dissemination of appropriate application methods and guidelines; the preparation of interpretative notes and guidance on complex cases; c) identifying and exchanging successful practices between administrations, as well as sharing knowledge behaviour considered ‘incorrect’ and/or having negative implications for the application of the relevant legislation.

- Analysis of specific cases of alleged non-compliance found during inspections, in order to reach a clear interpretation of the legislation in force and applicable, shared with the competent services of the European Commission.

- Prevention of compliance failures through: a) the establishment for each Managing Authority and the persons in charge of public procurement, a special structure dedicated to the verification of the correct interpretation and implementation of the legislation on public procurement; b) continuous coordination, particularly of complex cases, with the national coordination body responsible for the Partnership Agreement for the 2014-2020 period.

Actions at local and regional level can concentrate also on:

- the overall improvement of capacity and performance of local administration in terms of regulation, decision making and coordination;

- the introduction of state of the art operational and financial management approaches in the provision of public utilities and services;

- the systematic and universal introduction of procedural and operational standards in the provision of public utilities and services.

6.1.4 Conclusions

Italy has a unitary system of government, which recently has undergone a phase of federalisation and devolution. A great number of public utilities and social services are the responsibility of the local and regional authorities.

Local and regional authorities use a broad range of institutional forms to deliver these public utility and social services distinguishing between ‘services of economic interest’ (usually using a legal body form operating under private law) and ‘services of no economic interest’ (using institutions or special undertakings).

The local public enterprises are an important political factor since they are a big local employer and often enjoy local monopolies. They are subject to institutionalised public control through the local mayor who enjoys extensive rights over them, and thus can be subject to undue political influence. Any reform attempts need to take this into account, otherwise their results will be negligible and short lived.

The legal framework in the field of local public service provision is multi-level, complex and evolving continuously. At the same time, the management and accounting procedures are outdated and not transparent, making the tracking of key indicators and processes difficult, as well as excluding competition.

A paradigm shift in the local public enterprises is necessary. This has to be comprehensive, ranging from the skills of the personnel involved to the introduction of private-sector-type management and accountability and customer relations practices, to the curbing of monopolistic local markets.

At central government level, awareness is abundant and many reform steps are being implemented. Yet the local level needs to be taken on board for the reform of the public services delivery system. Reforms at local level might be associated with a loss of power; hence, they should be accompanied by the communication of potential gains, such as efficiency gains, innovation and growth.

Good practice

In the field of public management, public accounting and public procurement a major driver in Italy is the EU cohesion policy and the requirement to comply with the prerequisites of the general *ex-ante* conditionalities. General Conditionality 4 on Public Procurement is crucial since it can stop any expenditure of cohesion funds.

To this purpose a joint EC/MS working group was set-up with LRA participation and operated successfully in a coherent way, albeit under time pressure due to the need for the Italian PA and OPs to be approved, and put into effect an action plan for addressing *inter alia* problems of:

- administrative capacity and rationalisation of contracting;
- major barriers to competition;
- system of controls related to the efficiency of procedures and corruption.

Assessment of obstacles and responses

OECD Principles of Effective Public Investment	Assessment	Remarks
A. Co-ordinate public investment across levels of government and policies:		
1. Invest using an integrated strategy tailored to different places.	Fully fulfilled	The Italian state has an elaborate setting of regional and sectoral development strategies and incentive mechanisms.
2. Adopt effective instruments for co-ordinating across national and sub-national levels of government.	Partially fulfilled	The process of devolution is a continuous one; nevertheless, jurisdiction overlaps, delayed secondary regulation and lack of capacity at sub-national level make co-ordination cumbersome.
3. Co-ordinate horizontally among sub-national governments to invest at the relevant scale.	Partially fulfilled	As above

B. Strengthen capacities for public investment and promote policy learning at all levels of government:		
4. Assess upfront the long-term impacts and risks of public investment.	Not fulfilled	There are no instruments and procedures in place at local level; priority is the provision of the service and the satisfaction of the demand (rather than the need).
5. Engage with stakeholders throughout the investment cycle.	Not applicable	
6. Mobilise private actors and financing institutions to diversify sources of funding and strengthen capacities.	Not applicable	
7. Reinforce the expertise of public officials and institutions involved in public investment.	Partially fulfilled	Large deficits exist at regional level
8. Focus on results and promote learning from experience.	Partially fulfilled	Large deficits exist at regional level
C. Ensure proper framework conditions for public investment at all levels of government		
9. Develop a fiscal framework adapted to the investment objectives pursued.	Not applicable	
10. Require sound and transparent financial management at all levels of government.	Partially fulfilled	Deficiencies in sound and transparent financial management at local level lead to poor public services and utilities and to higher charges.
11. Promote transparency and strategic use of public procurement at all levels of government.	Partially fulfilled	Overall, the public procurement is complex and contradictory. Lack of transparency and operational standards does not allow for a consistent ranking of tenders.
12. Strive for quality and consistency in regulatory systems across levels of government.	Partially fulfilled	Overall, the regulatory system is complex and contradictory; legal uncertainty remains high.

WB Doing Business	Assessment	Remarks
1. Starting a business.	Difficult	The difficulty affects private enterprises wishing to enter the local public services market. Lack of transparency and operational standards make private enterprises incapable to compete with the publicly owned providers.
2. Dealing with construction permits.	Not applicable	
3. Getting electricity.	Not applicable	
4. Registering property.	Not applicable	
5. Getting credit.	Not applicable	
6. Protecting minority investor.s	Not applicable	
7. Paying taxes.	Not applicable	
8. Enforcing contracts.	Difficult	As above. Lack of transparency and operational standards make dispute outcomes unpredictable.
9. Trading across borders.	Not applicable	
10. Resolving insolvency.	Not applicable	
Overall assessment (WB country rank).	45 (2016)	

6.2 Portugal – PPP in local and regional public services

The lack of transparency in public-private partnerships (PPP) and concession contracts in Portugal present obstacles to investment and growth. The lack of transparency in the case of PPPs at local and regional level can be attributed to a number of reasons, including:

- lack of data and key performance indicators for defining a service unit and for separating operation and maintenance costs;

- temptation to benefit from short-term budget benefits at local level, without considering long-term implications;

- poor risk analysis skills and procedures for defining risks, risk allocation and accommodation of later requests for modification of the concession.

When PPPs were selected as an alternative of delivering public infrastructure and services, they became attractive mainly due to the immediate fiscal effect, as they are an off-balance-sheet operation. However, until 2003, there was no proper legal framework to accommodate the PPP ‘novelty’ and hence the involved parties developed piecemeal approaches.

Competencies were split between various ministries until a centralised PPP unit, the Unidade Técnica de Acompanhamento de Projetos (UTAP) was created in 2012 at the Ministry of Finance and absorbed all the separate entities. The experience with UTAP has been positive. Moreover, the UTAP has started to assist regional authorities in public procurement. The challenge for the next years is to transfer the knowledge accumulated at the central level to the local government level.

6.2.1 Background

The Portuguese economy is still recovering in the aftermath of the sovereign debt crisis in the Eurozone. It was and still is characterised by a high degree of external indebtedness, which put into question the sustainability of public finances, leading to the financial assistance of the EU, ECB and IMF in 2011.

The programme of economic and financial adjustment ended in 2014 and is considered a success, allowing Portugal to regain access to financing in international debt markets. The programme is considered to be useful in restructuring the external balance, reducing the structural primary budget deficit and consolidating public finances. Perspectives for growth are looking promising.

In this context, PPPs can be seen as a useful tool. Apart from the usual reasons for entering a PPP (access to know-how, risk sharing, faster availability of infrastructure), they offer valuable flexibility in times of fiscal consolidation both due to the fact that they help overcome temporary financial bottlenecks at the local level (through the use of private capital, and the transfer of payments in the future in smaller batches), and do not count in the public debt at the macro level.

Portugal tried to improve its infrastructure using different approaches. Health and education relied more on straightforward public investment whereas water and sanitation, ports, highways and energy relied on private investments compensated by concessions to the private sector and end-user tariffs or tolls for the service. In recent years, the health sector also turned towards PPP enabling innovative models going beyond the ‘classical’ construction and management of the infrastructure and expanding to medical services.

Overall, Portuguese PPPs have been a success, especially those administered at central level and making use of the services of dedicated units such as UTAP, the taskforce on PPP at the Ministry of Finance, although UTAP only covers a set of PPPs managed by central government.

However, the experience at local and regional level were more mixed. Particularly, there have been a lack of transparency in the case of PPP concessions in Portugal at the local and regional level and this can be attributed to a number of reasons, including:

- Lack of data and key performance indicators for defining a service unit and for separating ‘operation and maintenance’ costs from other costs (e.g. capital costs).

- Temptation to benefit from the short-term budget benefits at local level, without considering or being able to conceptualise long-term implications.

- Poor risk analysis skills and procedures for defining risks, risk allocation and accommodation of later requests for modification of the concession.

- Disregard for the financial principle of separating the investment decision from the financial decision due to the abundance of private capital seeking investment opportunities on the one side and the political incentive of demonstrating ‘progress’ and pushing many projects through.

- Intentional exclusion of the competition through non-transparent risk assessment and allocation, or initial compensation arrangements that make the investment not feasible (in the knowledge that these will be re-negotiated later) or monopolistic advantages to the private partner.

This lack of transparency can lead to a misallocation of resource, the negation of learning processes based on inevitable mistakes and the deterioration of public services or the need for unanticipated increases in end-user tariffs and tolls.
Nevertheless, at any rate, PPP is expected to remain the only alternative for large infrastructure investments for many sectors taking into account the path

public finances will follow in the process of fiscal consolidation. This acknowledgement puts a specific strain to public administrations operating through PPP to become transparent and efficient.

6.2.2 Analysis

The Commission's Country Report 2016 on Portugal[73] mentions the following investment challenges:

- Overall investment contraction due to the crisis; investments are however expected to rise again especially in the private sectors as uncertainty in global markets and deleveraging needs are expected to diminish.

- Former concentration of investments in non-tradable sectors, which suffered over proportionally from declining investment and on the other hand slow growth in tradable sectors due to the high level of corporate debt.

- Structural barriers to investment especially for SMEs and delayed payments by the public sector in commercial transactions.

- Inflexibility of the labour market and wage setting system.

- Complexity and unpredictability of administrative procedures, unnecessary administrative burden and restricted access to some regulated professions, poor regulation principles and competition bottlenecks in the service sector. Although the situation has improved dramatically in the last few years, most of the improvements targeted only the central administration.

- In the RTD sector in Portugal significantly increased the number of persons with tertiary education and science and engineering graduates. However, the country is underperforming in science-business cooperation, in the commercialisation of knowledge and in the formulation of incentives to improve cooperation between public research organisations and the business sector.

These observations match well the Index of Economic Freedom[74] report, which praises the recent structural reforms but also mentions the inefficient and oversized government sector, the need for better managing public finance and

---

[73] European Commission SWD (2016) 90 final.
[74] http://www.heritage.org/index/country/portugal

reforming loss-making state-owned enterprises. In any case, the indebted public sector is forced to rely on alternative investment sources including PPPs.
In addition, the European Commission also points out the transparency issues on PPPs particularly at local and regional level, and as regards concession contracts. The report points out that "…PPPs in the water sector, for instance, and at regional and local level, are thus excluded and remain unsupervised despite significant fiscal risks. Authorities are aware of these loopholes and concur with the need to find a solution, but no concrete timeline has yet been put forward."[75]

The effects of the obstacles can be:

- of a **direct** nature:
  - for public bodies involved in PPPs due to the non-realisation of the expected benefits, the need to burden the risks at the end of the day, the deterioration of public services and the political accusations in case the failure is attributable to poor judgment rather than intention;
  - for private enterprises involved in PPPs due to poor planning and risk assessment leading to the need for costly concession modifications or the obligation to provide the service below cost (e.g. when the concession provides only for 'operation and maintenance' compensation) or in the worst case for the termination of operation.
- of an **indirect** nature:
  - for public bodies due to political accusations in case the failure is attributable to poor judgment rather than intention, hence nullifying an otherwise useful tool and due to the opportunity costs arising from funds misallocation;
  - for private enterprises which are either excluded from competing for the concession, or are receiving low quality services or are confronted with unnecessary high or erratic tariffs and tolls.

6.2.3 Solutions

The Portuguese government has introduced a series of reforms and initiatives, related to overall public administration efficiency but has not fully addressed the PPP transparency issues. As mentioned in the EU Country-specific

[75] European Commission SWD (2016) 90 final.

Recommendations,[76] "...a revised framework for public-private partnerships (PPPs) entered into force on 1 June 2012. The government has renegotiated several road PPPs. [...]. As regards water concessions at local level and railway PPPs, the Court of Auditors expressed a negative opinion of the way the state had managed the contracts. Existing legislation does not empower UTAP, the Ministry of Finance's taskforce for PPPs, to cover concessions, regional and local PPPs or even central government PPPs/concessions in the water/sewerage/waste businesses (or any concession given to SOEs by law in an in-house relationship). The authorities are aware of these loopholes and agree there is a need to find a solution. However, no concrete suggestions or timeline has yet been proposed."

Hence, the action at local and regional level can concentrate on:

- Scrutiny of the justification and the number of PPPs. In the past, a very high number of projects (and investment) were conducted in a short period of time. Since the public sector does not have the necessary management skills or resources to set up and follow up the complex PPP contracts and processes, the number of PPP projects should be adjusted.

- Standards and rules to be used from the local and regional authorities can be further developed in the context of Law 86/2003 and the framework for PPP assessment, aiming to eliminate the exact reasons leading to lack of transparency, e.g. rules on the decision for the use of PPPs against other types of public investments, forecast models for risks and costs, codification and monitoring of causes of renegotiation.

- Formation of peer exchange processes and 'communities of practice' at the local and regional level and capacity building based on lessons learnt and mistakes made.

- Revision of public sector procurement and contractual management in order to better integrate the cycles of negotiation, management and renegotiation of PPP taking into account the need to operate on reference units, performance, outputs and outcomes instead of simply managing inputs and providing a service. Here, too, many public procurement officials appear to be confronted with a 'novelty'. The stability of the framework defined by the project ToR is considered paramount in 'classical' public procurement, but in the case of a PPP this can be counter-productive, since the framework needs to be negotiated, often and in a transparent way.

[76] COM(2016) 342 final.

6.2.4 Conclusions

PPPs will continue to be an important tool for delivering public services and infrastructure in Portugal. For some years, they might even be the principal or only tool.
There is a major discrepancy between central government, which is already relatively efficient and capable, and the regional/local level, where the situation is more problematic. This needs to be addressed.

The popularity of PPP due to short-term benefits should be contained and, instead, long-term impacts should be taken into account in the decision making process.

Data and key performance indicators should be used in order to quantify the impact and risk allocation, and allow for transparency. Renegotiation should be considered as an integral part of the process and risk assessment and sharing must be adjusted accordingly to maintain a pre-defined level of services and equitable prices.

There are limits to the top-down guidance and peer exchange processes and ‘communities of practice’ at local and regional level need to be further developed.

Good practice

When PPPs were chosen as an option for delivering public infrastructure and services, they became attractive mainly due to the key fiscal characteristic, as an off-balance-sheet operation. However, authorities have underestimated the regular future payments burden, the complexity of the contracts, the need of benchmarking their operations and the inevitable negotiations. Until 2003, there was no proper legal framework to accommodate the PPP novelty and hence involved parties developed piecemeal approaches.

Until 2012, competencies were split between the Ministry of Finance (in the General Directorate of Treasury and Finance and the state management company Parpública) and sectoral ministers (most often transport and health). This led to a dispersion of resources and lack of coordination and failure to create a coherent framework and intuitional learning.

Parpública acted as a technical assistance provider and facilitator with the task to advise, promote, and evaluate PPPs and develop high quality public services. The General Directory of Treasury and Finance monitor PPPs and focus on the long-term budget impact and fiscal sustainability.

The PPP technical team at Parpública was subsequently discontinued and following international best practices[77] a centralised PPP unit, the Unidade Técnica de Acompanhamento de Projetos (UTAP) was created in 2012 at the Ministry of Finance and absorbed all the above separate entities. The experience with UTAP has been positive. Apart from supporting the Ministry of Finance, UTAP has also started to support the Ministry of Interior (in connection with a civil protection and emergency PPP) and is assisting regional authorities in public procurement. The challenge for the next years is to transfer the knowledge accumulated from central to local government level.

Assessment of obstacles and responses

OECD Principles of Effective Public Investment	Assessment	Remarks
A. Co-ordinate public investment across levels of government and policies:		
1. Invest using an integrated strategy tailored to different places.	Partially fulfilled	The potential and benefits of PPP have been correctly identified; however, the PPP is still considered as a one-size-fits-all solution. Further specifications are needed.
2. Adopt effective instruments for co-ordinating across national and sub-national levels of government.	Partially fulfilled	Although the capacity at central government level is high, the same standards do not apply to the local level.
3. Co-ordinate horizontally among sub-national governments to invest at the relevant scale.	Not fulfilled	There is no horizontal exchange related to the transparency obstacles.
B. Strengthen capacities for public investment and promote policy learning at all levels of government:		
4. Assess upfront the long-term impacts and risks of public investment.	Not fulfilled	The level of expertise at local and regional level is low and it leads deliberately or inadvertently to less transparency.
5. Engage with stakeholders throughout the investment cycle.	Not fulfilled	As above
6. Mobilise private actors and financing institutions to diversify	Fully fulfilled	PPPs are *per se* doing that

[77] OECD,2010.

sources of funding and strengthen capacities.		
7. Reinforce the expertise of public officials and institutions involved in public investment.	Partially fulfilled	The level of expertise at local and regional level is low and it leads deliberately or inadvertently to less transparency.
8. Focus on results and promote learning from experience.	Partially fulfilled	Lack of transparency, poor definition of the parameters and monitoring of the PPP are hampering the focus on results and the learning process.
C. Ensure proper framework conditions for public investment at all levels of government:		
9. Develop a fiscal framework adapted to the investment objectives pursued.	Partially fulfilled	The fiscal framework is actually promoting the use of PPP; however, the fiscal impacts on the long term are neglected in favour of the short-term benefits.
10. Require sound and transparent financial management at all levels of government.	Partially fulfilled	The level of expertise at local and regional level is low and it leads deliberately or inadvertently to less transparency.
11. Promote transparency and strategic use of public procurement at all levels of government.	Partially fulfilled	The level of expertise at local and regional level is low and it leads deliberately or inadvertently to less transparency.
12. Strive for quality and consistency in regulatory systems across levels of government.	Partially fulfilled	There is a gap between the quality and consistency standards at central and at local level.
WB Doing Business	**Assessment**	**Remarks**
1. Starting a business	Difficult	Lack of transparency makes a new entry into a PPP arrangement difficult either due to impossible risk assessment or due to improbable requirements from the public partner.

2. Dealing with construction permits.	Not applicable	
3. Getting electricity.	Not applicable	
4. Registering property.	Not applicable	
5. Getting credit.	Easy	The basic incentive for a PPP is the securing of funds. This aspect is not influenced by the lack of transparency.
6. Protecting minority investors.	Not applicable	
7. Paying taxes.	Not applicable	
8. Enforcing contracts.	Not applicable	
9. Trading across borders.	Not applicable	
10. Resolving insolvency.	Difficult	Lack of transparency makes risk assessment and risk allocation difficult. Due to the public nature of the services, a termination of the operation is not very probable; however, deficiencies in the concession and inflexibility for modifications can lead to insolvency. In such a case, the clearing of pending liabilities and obligations, vis a vis the private partner bearing the risk, its creditors and the public partner owning the assets can be very complicated.
Overall assessment (WB country rank).	46 (2016)	

6.3 United Kingdom – Supply of housing

Housing in the UK raises multiple issues covering macro-economic concerns, such as households' borrowing and risks to stability, and major territorial divergences in demand and supply, house price growth and house price-to-income ratio (and the concomitant issue of 'affordability'). The UK government and the sub-national levels of government are seeking to address these issues and have already taken various measures.

A key challenge is the significant gap between supply and demand. This is proving persistent and, in view of the population growth trends in the UK, represents a longer-term challenge. Accordingly, the European Council, in its 2016 Country-specific Recommendations, has recommended that the UK should "take further steps to boost housing supply".

Although the planning system and the availability of land with permission for housing development is seen as a key obstacle, there are many other associated issues that are being debated, including: 'affordability' and social housing, local infrastructure and services, integrated large-scale developments, as well as labour availability and capacity in the house building sector.

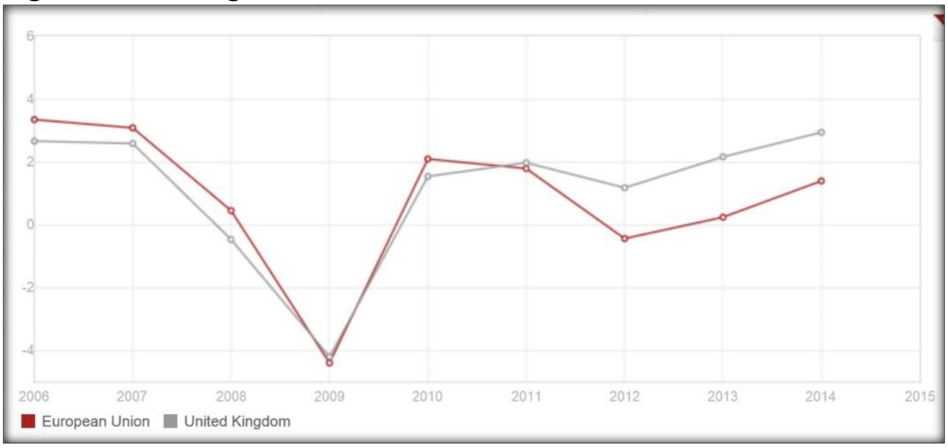
With all levels of government – central government, devolved administrations and local government – involved, these issues raise a whole host of questions regarding governance and the role of the public sector, especially LRAs, in the field of housing.

6.3.3 Background

Economic growth has been strong in recent years as the United Kingdom emerged from recession to grow above long-run averages. Its GDP has grown faster than the EU as a whole (see Figure 11, below) and its unemployment rate at 4.9%[78] is among the lowest in the EU. However, the level of public and private investment in the United Kingdom has remained low[79], consistently below the EU average.

[78] Eurostat, April 2016.
[79] EC SWD(2016) 96 final.

Figure 14. GDP growth, EU and UK



Source: http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG/countries/EU-GB?display=graph

The housing sector presents multiple challenges ranging from macro-economic issues, such as macro-prudential issues and risks to stability, to territorially differentiated issues among which a persistent gap between supply and demand is centre stage. Housing demand continues to outstrip supply and this is reflected in high and rising house prices. The shortage of housing is most acute in the rapidly growing regions of London and the South East.

The territorial differentiation of the housing challenges is particularly pronounced and has been underlined in the Commission's 2016 Country Report on the United Kingdom. The divergence in growth of house prices across regions remains significant, with house price growth strongest in the East of England (10.2 % in the year to November 2015) and in London and the South East of England (9.8 % for both) and weakest in Scotland and the north east of England (both 0.4 %). House price levels in London remain well above those in all other regions reflecting in part the additional pressures from foreign buyers.

Moreover, the house price-to-income ratio, differs greatly by region, with houses in London and the South East of England significantly less affordable than elsewhere in the UK and raising social issues, impacting on public services (key worker housing) and acting as a break to recruitment. Indeed, the implications of insufficient housing could be much wider, affecting even the stagnating UK productivity, especially in geographical areas of high economic growth.[80]

In this context, the European Council has recommended that the United Kingdom should, in 2016 and 2017, **"take further steps to boost housing supply, including by implementing the reforms of the national planning policy framework"**.

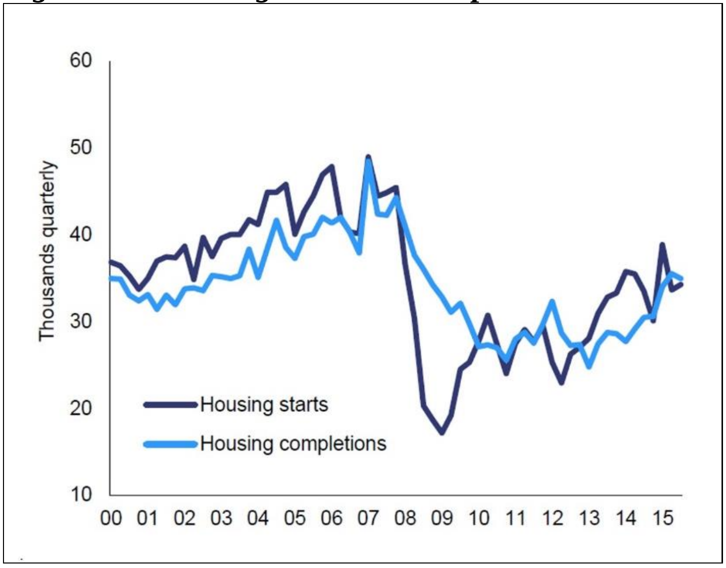
[80] EC COM(2016) 348 final.

This recommendation is addressed to the authorities of the United Kingdom, but it should be noted that policies and measures concerning housing are distributed at different government levels. As stated in the UK National Reform Programme[81] "most aspects of public policy relating to housing, including planning law, are the responsibility of the devolved administrations" in Northern Ireland, Scotland and Wales. However, "most financial services policies which have an impact on housing are not devolved matters, but in some cases […] they apply in England only, with the devolved administrations receiving funding to permit them to develop schemes which best fit local priorities".

6.3.4 Analysis

While there is a general consensus that a significant increase in housing supply is necessary, there are differences in the importance attached to different factors influencing supply and to the means by which such an increase can be achieved. The current position and recent trends are illustrated in the following graph, which shows that housing starts and completions have been growing fairly steadily in the post-crisis period but are still well below the 2007 peak.

Figure 15. Housing starts and completions



Source: UK Department for Communities and Local Government.

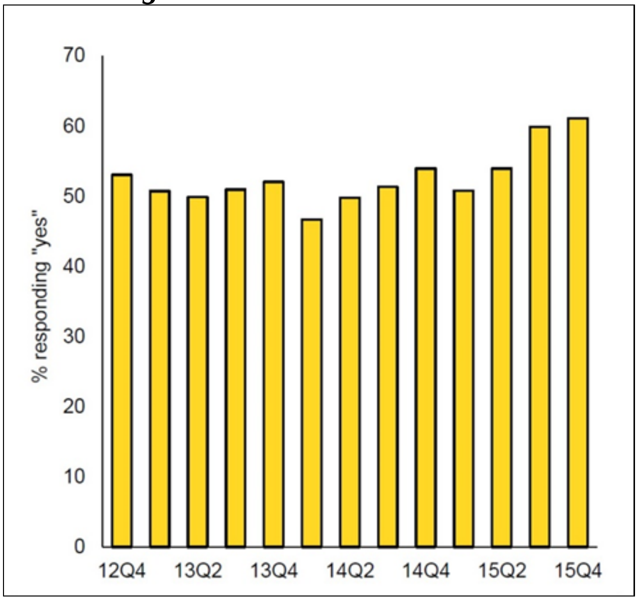
The Commission's 2016 Country Report on the UK has noted that **there is still a gap between the demand for and supply of housing** and that the recent rise in housing completions needs to be sustained, and extended, if there is to be a material narrowing of the gap between supply and demand.

[81] http://ec.europa.eu/europe2020/pdf/csr2016/nrp2016_uk_en.pdf

New supply is currently at around 150,000 units per year and will have to rise significantly, just to meet the projected increase in population to 69 million by 2024 from 65 million in 2014.[82] According to official projections, an average of 220,000 households would be formed per year between 2012 and 2021. Similarly, the Local Government Association (LGA), which represents the local authorities of England, has provided evidence regarding the need to build 250,000 new homes per year[83], and this will represent a nearly doubling of the new supply over the annual average of around 130,000 that has been achieved in the last ten years or a 67% increase over what was achieved in 2015.

Both government and the private sector house builders have identified a shortage of land and delays in the operation of the planning system as the key constraint on the supply of new homes. Concern about the constraints posed by the planning system reached their highest level in three years in late 2015. Developers and builders regularly cite concerns about the efficiency, effectiveness, transparency, predictability and costs in their use of the planning system (see Figure 13, below).

Figure 16. Planning system as limiting factor in the housing sector



Source: RICS Construction market survey.

The allocation of land between competing uses, including residential construction, is determined by the planning system. The policy setting out the principles that guide the planning system, and key features of its operation, is decided at national level and is set out in the National Planning Policy

---

[82] Office for National Statistics, *National Population Projections*, http://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/populationprojections/bulletins/nationalpopulationprojections/2015-10-29

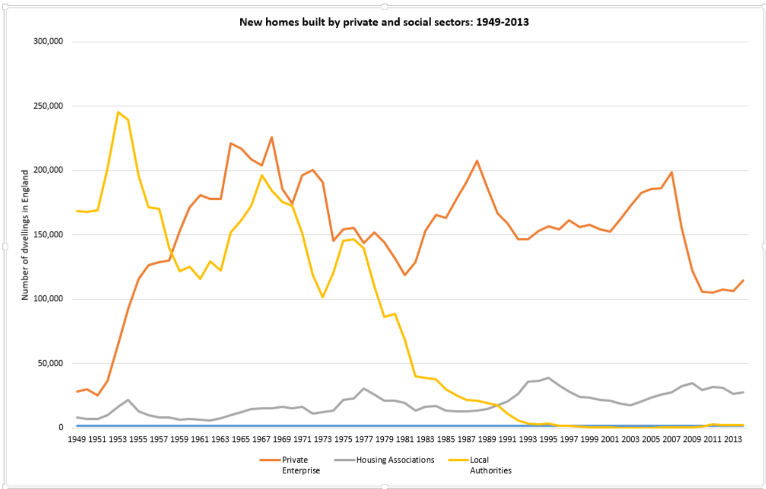
[83] http://www.local.gov.uk/housing

Framework (NPPF)[84]. However, each of the devolved regions in the UK has responsibility for planning policy and ultimately planning permissions are granted by the local authorities on the basis of local plans.

The English local authorities do not share this analysis. The Local Government Association (LGA) has pointed to the larger picture and argued that the most significant reasons why England has failed to build the required number of housing units are: “the withdrawal of the public sector as a provider”, “the workings of the land market” and “England's shrinking construction sector”.

- **The public sector:** Between the late 1940s and 1950s, local authorities built more homes than the private sector and until the late 1970s they were building 100,000 homes a year. Following a series of policy measures introduced in the late 1970's-1980's housebuilding by local authorities fell, but neither the private sector nor housing associations have been able to compensate for the reduction in local authority led housebuilding.

Figure 17. New homes built by private and social sectors: 1949-2013



- **The land market:** A large proportion of the land is highly protected (as National Parks, Areas of Outstanding Natural Beauty, green belt, etc.) and this means that readily developable land is scarce and expensive. Against this background “it's easy to blame planning for not delivering the number of homes we need” but research by the LGA shows that there has been “an 11% increase in residential planning applications compared to a year ago and a record 475,647 homes in England have been granted planning permission but have yet to be built”.[85]

---

[84] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/6077/2116950.pdf
[85] http://www.local.gov.uk/documents/10180/5854661/L14-61+Planning+and+growth-the+facts_26.pdf/def17fe1-6b80-4308-a1fd-69044bdb9493

- **The construction sector**, particularly housebuilding, fares badly during every recession. The 2007-2008 recession lead to the loss of 250,000 jobs and housebuilding is now concentrated in fewer hands, and there has been a significant hollowing out of the construction workforce. The Commission's UK 2016 Country Report has reported growing evidence that the ability to raise construction levels may be impeded by a shortage of labour, which is varied and wide-ranging from managers to carpenters, joiners, bricklayers, electricians and so forth. The proportion of builders who consider that the availability of skilled and unskilled labour is a constraint on production has increased from none at the end of 2010 to up to 60 % in 2014 depending on the type of labour.

6.3.5 Solutions

The government's response has been multi-faceted covering planning policy, land and funding for housing, as well as direct delivery, with the dual objective, according to the UK NRP, "to support housing supply and low cost home ownership"[86] as outlined below.

Regarding planning, the government has set out a number of new policies in relation to planning policy, including strengthening provisions in the National Planning Policy Framework (NPPF) to require local authorities to plan for housing need in their local areas and facilitate a rise in supply. It has also introduced legislation in the *Housing and Planning Bill*, which, became law in May 2016[87] providing new powers for action in the event that a local authority has not produced a plan by early 2017.

Other major measures announced since May 2015, include:

- delivering 400,000 'affordable' homes by 2020-2021 including 200,000 'affordable' starter homes, 135,000 shared ownership homes through the Help to Buy scheme, 10,000 homes that will enable tenants to save for a deposit while they rent and 8,000 specialist homes for elderly or disabled people;

- providing GBP 1.2 billion to facilitate the construction of 30,000 affordable starter homes on brownfield land over five years;

[86] UK NRP, pp14-19.
[87] http://www.legislation.gov.uk/ukpga/2016/22/pdfs/ukpga_20160022_en.pdf

- improving the efficiency of the system of 'permitted development rights' under which planning permission for change of land use can be obtained (e.g. from non-residential to residential purposes);

- contributing to the development of a 'garden city' at Ebbsfleet through the investment of GBP 310 million;

- supporting large housing developments of at least 1,500 housing units near large infrastructure developments (under the Large Sites Infrastructure Programme); and

- releasing sufficient public sector land to support construction of 160,000 homes over the five years from 2015.

Bearing in mind that outside England most aspects of policy relating to planning and housing are the responsibility of the devolved administrations, it is worth noting the complementarity of efforts (regarding increasing the supply of housing) and the variations in emphasis (notably, the stress placed on social and affordable housing).

For instance, in May 2016 the newly (re-)elected **Scottish Government** announced that it would adhere to its "pre-election pledge to build at least 50,000 affordable homes during this Parliament" and that "at least 35,000 of these would be for social rent".[88] It subsequently also announced that it will reform the planning system in Scotland to deliver more homes and speed up the planning process, working with local authorities, developers and community groups.[89]

Similarly, the **Northern Ireland Executive** is committed to delivering social and affordable housing and has set out a comprehensive package of measures. Partnership working has been promoted in Northern Ireland and, in January 2014, a Housing Supply Forum was established, bringing together key stakeholders from across the public and private sectors[90].

In England, the English local authorities are collaborating with central Government "on a local government land ambition, working with their partners to release land with the capacity for at least 160,000 homes and helping to support the Government's policy on [social housing] regeneration"[91].

[88] http://news.scotland.gov.uk/Speeches-Briefings/Priorities-speech-Taking-Scotland-Forward-24f8.aspx
[89] http://www.gov.scot/Resource/0050/00502867.pdf
[90] UK NRP, p. 17.
[91] http://www.local.gov.uk/housing

The pursue of solutions to overcome obstacles in order to increase substantially the supply of homes in the UK, especially in parts of the country with the greatest current and projected shortages, raise a large number of pertinent issues. Two major groups of issues stand out.

The first group concerns **governance**. A central and well acknowledged field is planning (in both its 'strategic' and 'spatial' planning senses) which involves all levels of government in the UK, and where there is an absence of well-established and smoothly functioning multilevel governance arrangements. Additionally, there are resource-related governance issues concerning housing finance and housing land. The latter concerns primarily publicly owned land but it may also go beyond, for instance, in connection with facilitating development of brownfield sites.[92]

The second group concerns **the role of the public sector and specifically of LRAs**. The government measures imply that the increase in housing supply will be achieved by the private sector (developers and house builders) once the land supply and appropriate parameters (i.e. incentives and requirements) for 'affordable' private home ownership are in place. The perspective of other levels (as indicated above in the case of the Scottish Government and English local authorities) places a greater emphasis on the role of the LRAs, including the historic role of the public sector as a provider or supporter of social housing.

A more general rethink of the roles of the public and private sectors is called upon by the general limits of what the private developers and house builders can offer. A recent report on 'Funding housing and local growth' has argued that house builders build homes on relatively small and less risky sites and that "building more homes, upgrading our worn out infrastructure, and promoting local economic growth together demand radical changes in the way major development projects are designed, promoted and financed".[93] The need to see large scale house building as part of a more comprehensive and integrated developments has become highly visible in last few years with a renewed interest throughout the UK in 'garden cities'[94], reflecting the tradition and massive experience in building 'new towns' in the post-WWII period. To some extent, this has also been recognised, albeit hesitantly, by the government in its support for one 'garden city' (at Ebbsfleet, GBP 310 million). Another step in the same direction is the Large Sites Infrastructure Programme which recognises that locally-led large scale housing schemes are complex and offers support to

[92] The government has set ambitious targets for building on brownfield sites. Some organisations have even suggested that development on brownfield land could enable the construction of around 1 million new homes in England www.cpre.org.uk/resources/housing-and-planning/housing/item/download/3847
[93] Falk (2014).
[94] For example, Wolfson Prize for new garden cities competition, http://www.bbc.co.uk/news/uk-29056829

schemes that cannot raise the significant upfront capital that is needed to pay for major infrastructure – roads, bridges, schools, utilities, power supplies …”.[95]

6.3.6 Conclusions

There are multiple issues concerning the housing sector in the UK. They include major territorial divergences in demand and supply, house price growth and house price-to-income ratio (and the concomitant issue of ‘affordability’).

A key challenge is the significant gap between supply and demand. The UK government’s response and the EU Council’s recommendations have focused, above all, on the obstacle presented by the availability of land with permission for housing development. The government has already taken various measures to support housing supply and low cost home ownership.

Other levels of government have a crucial role to play in planning, facilitating and delivering housing developments, but although they are sharing the same general aspirations with the government there are no well-established and smoothly functioning multilevel governance arrangements in place.

Moreover, the current approach towards achieving a substantial increase in annual supply from 150,000 units in 2015 to 250,000 relies above all on the private sector (developers and house builders) to deliver, against a background of capacity concerns (notably labour shortages). There are also doubts about their capacity to undertake alone larger-scale developments which require a more integrated approach[96] – encompassing housing, local infrastructure and services – on the lines of ‘garden cities’[97], as inspired by the experience of the British new towns in the post-WWII period.

Easing or removing the obstacles to achieving a substantial increase in housing supply, thus, involves a large number of inter-connected issues and relevant actions, which, need to be addressing the following crucial areas:

- Putting in place effective multilevel governance arrangements that will be conducive to strategic planning in the field of housing at national, regional and local level.

[95] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/469396/LSIP_Prospectus_-_CME_-_FINAL.pdf

[96] A case made, for example, regarding the City of Oxford, Turley (2016).

[97] Or other variants, e.g. the creation of large-scale ‘garden communities’ as proposed by local authorities in Essex, Edgar (2016).

- Establishing effective partnership working between different public and private actors at local level to allow the planning and realisation of small and large development schemes.

- Strengthening the role of LRAs and taking steps to enhance the capacity of the private sector (apprenticeships) as a pre-condition for upscaling the supply to the estimated levels.

Good practice

The following case has been presented in the UK's 2016 NRP and represents an example of good practice in coordination and planning across levels of government and actors, and strong partnership working in the field of housing.

Northern Ireland stakeholder focus: The Housing Supply Forum

The Housing Supply Forum and Developer Contributions initiatives provide positive examples of the Northern Ireland Executive working effectively with stakeholders to shape new and evolving policy instruments to address particular housing needs.

The Housing Supply Forum, for example, included representatives from housing, planning and regional development, the construction industry, financial institutions, academics and housing professionals. The forum, through a series of meetings and bespoke focused workshops, capitalised on the wealth of collective knowledge and expertise of the members to seek workable solutions to improve housing supply in a sustainable way.

In gathering evidence for the Developer Contributions study, stakeholders were involved on an ongoing basis. For instance, stakeholders directly influenced the research tender specification, provided evidence for the study through workshops/one-to-one interviews and the supply of data and were provided with the opportunity to debate the research findings before the research was made public.

Assessment of obstacles and responses

OECD Principles of Effective Public Investment	Assessment	Remarks
A. Co-ordinate public investment across levels of government and policies:		
1. Invest using an integrated strategy tailored to different places.	Not fulfilled	Government sets vague framework, up to other actors to deal with different places

2. Adopt effective instruments for co-ordinating across national and sub-national levels of government.	Not fulfilled	Ditto
3. Co-ordinate horizontally among sub-national governments to invest at the relevant scale.	Not fulfilled	Ditto
B. Strengthen capacities for public investment and promote policy learning at all levels of government:		
4. Assess upfront the long-term impacts and risks of public investment.	Fully fulfilled	
5. Engage with stakeholders throughout the investment cycle.	Partially fulfilled	
6. Mobilise private actors and financing institutions to diversify sources of funding and strengthen capacities.	Fully fulfilled	
7. Reinforce the expertise of public officials and institutions involved in public investment.	Fully fulfilled	
8. Focus on results and promote learning from experience.	Partially fulfilled	
C. Ensure proper framework conditions for public investment at all levels of government:		
9. Develop a fiscal framework adapted to the investment objectives pursued.	Not fulfilled	Insufficient funding to meet the objectives
10. Require sound and transparent financial management at all levels of government.	Fully fulfilled	
11. Promote transparency and strategic use of public procurement at all levels of government.	Fully fulfilled	
12. Strive for quality and consistency in regulatory systems across levels of government.	Not fulfilled	Planning inconsistencies a key issues
WB Doing Business	**Assessment**	**Remarks**
1. Starting a business.	Very easy	Reflecting WB ranking
2. Dealing with construction permits.	Very difficult	As assessed by the house building industry
3. Getting electricity.	Easy	Reflecting WB ranking
4. Registering property.	Easy	Reflecting WB ranking
5. Getting credit.	Very easy	Reflecting WB ranking
6. Protecting minority investors.	Very easy	Reflecting WB ranking

7. Paying taxes.	Very easy	Reflecting WB ranking
8. Enforcing contracts.	Easy	Reflecting WB ranking
9. Trading across borders.	Easy	Reflecting WB ranking
10. Resolving insolvency.	Very easy	Reflecting WB ranking
Overall assessment (WB country rank).	Very easy	Ranked 6

6.4 Sweden – Skills shortages and mismatches

The availability of an appropriately skilled labour force is a precondition for investment and economic development. Sweden has been facing labour shortages in various sectors of the economy, as well as issues of educational attainment. The large number of people of immigrant background has been putting stress on the education and labour market.

The high influx of refugees experienced in the past year had a number of social and economic consequences for Sweden and presented a huge new challenge. The government response saw this not only as a problem but also as an opportunity.

Based on Sweden's highly developed and longstanding active labour market, education and immigrant integration policies, the government launched the 'Fast track - a quicker introduction of newly arrived immigrants'. This has the dual objective of helping newly arrived immigrants to find quickly a workplace that is relevant to their education, experience and interest and, at the same time, addressing the labour shortages that affect many sectors.

The fast track policy has been developed and is being implemented through a strong partnership and multilevel governance approach involving government agencies, LRAs and social partners. It has already established fast tracks for 16 professions and 11 more are currently in preparation.

6.4.1 Background

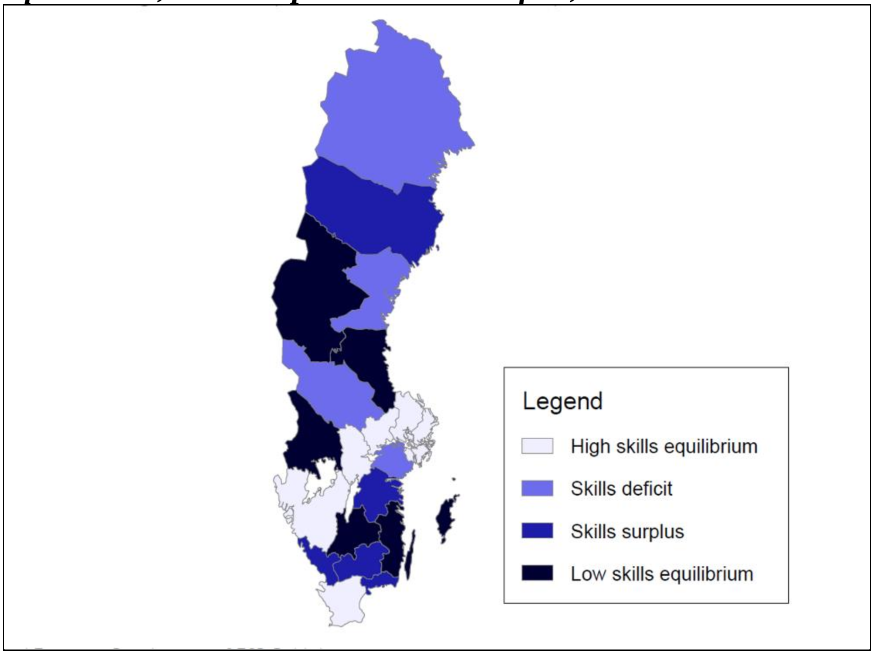
Economic growth in Sweden has been accelerating since the crisis reaching 3.6% in 2015, among the highest in the EU. It is forecast to remain robust in 2016 supported by rising household consumption, solid investment and increasing government consumption. Similarly, the Swedish labour market has shown resilience during the crisis and employment recovered quickly compared with other Member States. Currently, Sweden has the highest employment rate in the EU at 80.4 %, while overall unemployment is below the EU average at 7.4 % in 2015.[98]

Although the EU's country-specific recommendation for Sweden[99] focuses on housing issues, it also flags up educational performance and the successful labour market and social integration of refugees as high priority issues with *inter alia* longer-term implications for the Swedish economy.

The Commission's 2016 Country Report on Sweden has highlighted a **polarisation of educational attainment among young people.** On the one hand, the share of tertiary graduates is rising and is at an all-time high, reaching nearly 50% in 2014 for 30-34 year olds, well above the EU average. On the other hand, the share of young people (20-24 years-old) with low educational attainment remained substantial and stable at around 13 % over the last decade and the share of young people who do not qualify for a 'national programme' which aims to prepare students for future studies or the labour market has continued to rise over recent years.

This is compounded by skills mismatches and significant regional variations. According to the OECD, many Swedish counties suffer from a skills mismatch, as shown in the following figure:

Figure 18. Counties with high-skills equilibrium, low-skills equilibrium, skills surplus and skills deficit, 2011



Source: OECD (2014), Job Creation and Local Economic Development, OECD 2014.

[98] EC SWD(2016) 95 final.
[99] EC COM(2016) 347 final.

Sweden is also experiencing a **decline in school education outcomes** as evidenced by the sharpest decline in the performance of 15 year-olds of any OECD country, as measured in the OECD's Programme for International Student Assessment (PISA) survey, and the largest decline in mathematics performance of Year 8 students (14-15 years-old) between 1995 and 2011 of all OECD-EU countries. A continuous decline in school education outcomes could translate into declining skill levels among adults in the future.[100]

A further skills-related concern arises from the **falling number of new graduates in science and engineering,** placing Sweden below the EU average. This negative trend is particularly concerning when taking into consideration the high level of business R&D investment in the country. If this trend is not reversed, Sweden may suffer from a shortage of human resources in science and technology in the future. This could negatively affect the productivity and innovation performance of the country and could also become a barrier to R&D investments.

Although the labour market situation in Sweden is generally good, **a large share of unemployed people is from vulnerable groups** and therefore faces multiple barriers to entering the labour market. In particular, low-educated and low-skilled young people and people with a migrant background struggle to get a foothold on the labour market.

Currently the main focus is on **the ability of the Swedish labour market to absorb the current very large influx of migrants:** more than 80,000 refugees were registered in Sweden in 2014 and this number increased to 163,000 persons in 2015 (almost 1.7 % of the total population). Sweden takes the second largest number of refugees in the EU in absolute terms and is the Member State with the highest number of refugees relative to its resident population (and is the OECD country with by far the largest inflows of asylum seekers relative to its population).[101]

6.4.2 Analysis

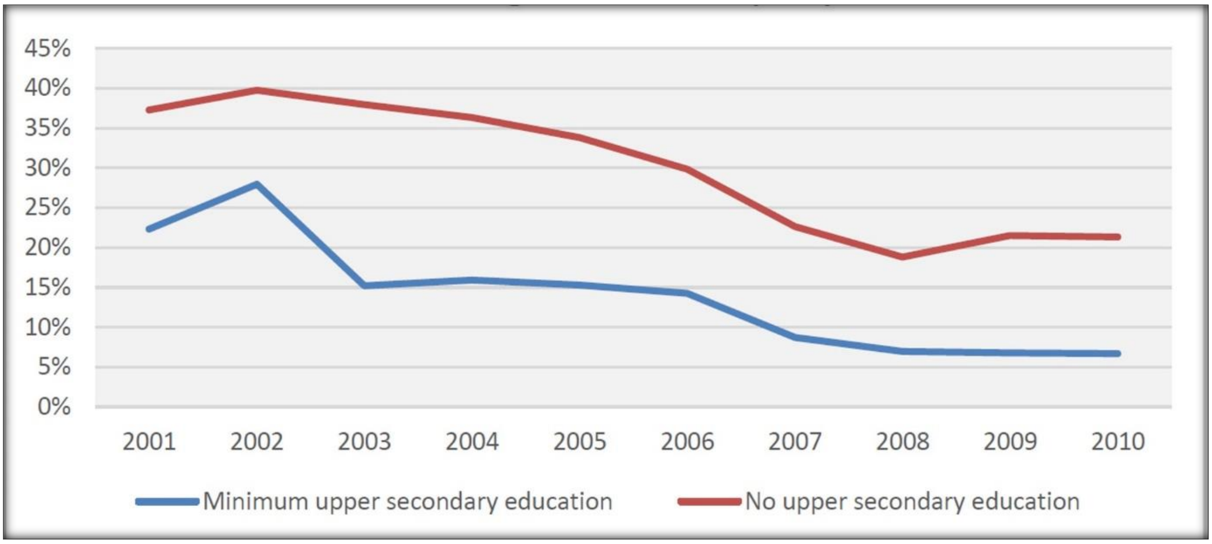
In Sweden, the labour market functions well with a strong involvement of LRAs and social partners. It is underpinned by long-established active labour market policies and a strong commitment to a skilled workforce through education. Maintaining a high level of skills and further developing human capital are widely recognised as essential for sustaining growth and maintaining the competitiveness of the Swedish economy. Assuring a proper supply of highly

[100] EC SWD(2016) 95 final.
[101] OECD (2016).

skilled human capital, in particular in science and engineering, is vital to boosting the innovation performance of the Swedish economy and to attracting business investments.[102]

Education is also seen at a more basic level as extremely important for accessing the labour market, and is at least as important for remaining there. Failure to complete upper secondary education increases the risk of again becoming unemployed. This is supported by a recent longitudinal study of a particular cohort (people born in 1981 with specific performance at upper secondary school and first steps into the job market) by SALAR[103] which identified a big difference in the proportion of those who completed upper secondary school and those who failed to complete upper secondary education, who are unemployed (see figure, below).

Figure 19. Percentage of unemployed with/without upper secondary education



Source: Education – the key to employment, SALAR.

As already indicated, Sweden has a high proportion of foreign-born population and it is estimated that about half of them originally came to Sweden as refugees or as the family of refugees.[104] Against this backdrop, Sweden has highly developed and longstanding integration policies and considerable policy efforts have been devoted to helping integration. Sweden is at the forefront of developing policies to promote all aspects of migrant integration. Instruments include a two-year introduction programme with Swedish language and other job-related training, a comprehensive system validating qualifications, and help with finding housing.

[102] https://www.oecd.org/policy-briefs/sweden-employment-boosting-job-creation.pdf
[103] Education – the key to employment, Swedish Association of Local Authorities and Regions, 2016.
[104] OECD (2016).

The main challenge for the Swedish labour market is to integrate the increasing number of economically and socially vulnerable people and the recent influx of refugees, the government has risen to the challenge and has introduced a new ‘fast track’ policy, which is at the confluence of well-established active labour market/education and immigrant integration policies. This addresses the issues not merely as a ‘problem’ but also as an opportunity to deal with shortage of labour in many industries by helping newly arrived.

In this whole field of skills and related policy areas, including immigrant integration, both LRAs and other parts of government are involved, and a whole host of **governance and coordination challenges** arise. For instance, secondary vocational education has been prolonged from two to three years and responsibility transferred to the municipalities, however, the curriculum is controlled by the government. According to the Commission’s 2016 Country Report on Sweden, “the decentralisation of the school system has been carried out without ensuring that local capacities are in line with the new responsibilities. Since the mid-1990s, the school system and its financing have been decentralised, putting municipalities at the forefront of implementing nationally set goals and requirements in school education. Evidence suggests that this move towards increased local autonomy has not been matched by clear measures to ensure accountability. The lack of clarity as to roles and responsibilities at various levels of the education administration continues to have a negative impact on student performance”.

Effective cooperation between municipalities and the public employment service is also important since there is *de facto* a dual employment policy system in operation (85% of municipalities have active labour market programmes). However, as noted in the Commission’s report on Sweden, financial incentives for accessing active labour market programmes are not fully aligned between municipalities and centrally financed employment services, limiting the outreach capacity.

In the new fast track policy, both the regional authorities (county councils) and the municipalities are actively involved, together with many other actors from the public and private sectors: the former, as major employers in the health care sector; the latter as both employers and social welfare providers.

Another crucial role for the municipalities (as a planner or provider) is in the housing sector, where provision of social housing for refugees is a pressing issue, but also more generally with shortages of affordable housing in the big cities acting as a constraint on recruitment of highly skilled staff.

6.4.3 Solutions

Based on Sweden's strong track record in active labour market, education and immigrant integration policies, the government was able to respond fast to the new influx of refugees in March 2015 by launching the 'Fast track - a quicker introduction of newly arrived immigrants'[105]. This has the dual objective of:

- helping newly arrived immigrants to quickly find a workplace that is relevant to their education, experience and interest; and at the same time;
- addressing the shortage of labour that exist in many sectors.

According to the Swedish Minister for Employment and Integration, Ylva Johansson, "the fast track will help employers find the opportunity to obtain people with the right skills, while newly arrived immigrants get to work in their profession".

The various fast tracks have been developed through tripartite talks between the Swedish Public Employment Service (PES) and other government agencies and LRAs, and the social partners. The purpose of the talks was to work with the social partners and to identify forms and measures for making the best use of valuable skills possessed by newly arrived immigrants with education or experience in shortage occupations so that they can be matched more quickly with the needs of industries and enterprises.

Fast tracks that have already been presented for several professions, including:

- Building services engineers
- Building services technicians
- Chefs
- Construction engineers
- Meat cutters and Butchers
- Painters
- Professional drivers
- Professions that require registration in health and medical care, such as:
    - Doctors
    - Nurses
    - Dentists
    - Pharmacists/dispensers
- Teachers/preschool teachers

[105] http://www.government.se/articles/2015/12/fast-track---a-quicker-introduction-of-newly-arrived-immigrants/

- Distribution electricians and electrical engineers
- Mechanical technicians, mechanical engineers, etc. in the wood industry
- Social scientists
- Social workers

Further fast tracks in preparation include the following professions:

- Agronomists
- Assistant nurses
- CNC machine operators
- Distribution technology technicians
- Engineers
- Forestry workers
- Industrial workers
- Machine drivers
- Machine operators
- Managers in the construction sector
- Mechanics (cars, lorries, coaches)

The support offered through the fast track can cover:

- Swedish language training will start as early as at the asylum centres.
- Early assessment of the experience, skills and motivation of newly arrived immigrants.
- Validation and assessment of education and professional skills according to industry-specific requirements.
- Vocational and study guidance.
- Fast track and employment matching.
- Swedish language training that is relevant for the professional area.
- Supplementary educational initiatives as necessary.
- Language training/supplementary courses will be combined with a work placement or job.
- Language support, supervisors and mentors at the workplaces.

6.4.4 Conclusions

Skills issues in Sweden and the potential obstacles to investment and longer-term threat to growth are well understood but nuanced. Many of these issues are associated with the large number of people of immigrant background. The EU Country-specific Recommendations in 2016 have flagged up educational performance and the successful labour market and social integration of refugees as high priority issues with *inter alia* longer-term implications for the Swedish economy.

Sweden has highly developed and longstanding active labour market, education and immigrant integration policies. The LRAs play an important role but there are also challenges regarding multilevel governance.

Sweden already has a high proportion of foreign-born population about half of them being originally refugees. The recent influx of refugees presents serious and multiple challenges as well as opportunities, which are actively being pursued through a 'fast track' policy that demonstrates an exemplary partnership and multilevel governance approach.

This policy has the dual objective of helping newly arrived immigrants to quickly find a workplace that is relevant to their education, experience and interest and, at the same time, addressing the labour shortage that affect many sectors. More than 25 professions are covered by fast tracks, which are already established or are in preparation.

Good practice

The fast track policy has many noteworthy elements of partnership and multilevel governance across many sectors of the economy, which represent good practice. Some examples of fast tracks are summarised below.

Fast track for professions requiring registration in health and medical care

The social partners and the Swedish PES have produced a fast track for the twenty-one regulated professions in health and medical care. The fast track is based on the major groups of newly arrived immigrants in the area – doctors, nurses, dentists and pharmacists – and the goal is for the path into the labour market and a licence for newly arrived immigrants in these professions to be predictable, legally secure and as short as possible. It is particularly relevant to the competencies of the regional authorities (county councils) in this sector.

Fast track for teachers and preschool teachers

For this fast track, PES schemes for newly arrived immigrants, e.g. work experience, can be combined with Swedish language for the workplace and supplementary education. It means that individuals will be able to enter a school or preschool through work experience and employment. The fast track is being established in cooperation with the social partners, including the Swedish Teachers' Union, the National Union of Teachers, the Swedish Association of Local Authorities and Regions, and Almega, the employers' organisation for the Swedish Service Sector.

Fast track for social scientists and social workers

The fast track for newly arrived social scientists – including economists and lawyers – means that the various measures of the PES can be used in parallel. For example, work experience can be combined with lessons in Swedish for the workplace and a supplementary education programme at a higher education institution.

The fast track for social workers targets newly arrived immigrants with a degree in the area of social work. It offers a combination of work experience, lessons in Swedish at the workplace and a supplementary education programme at a higher education institution, with the aim of supplementing foreign education as necessary for a Swedish degree in social work.

Assessment of obstacles and responses*

OECD Principles of Effective Public Investment	Assessment	Remarks
A. Co-ordinate public investment across levels of government and policies:		
1. Invest using an integrated strategy tailored to different places.	Fully fulfilled	
2. Adopt effective instruments for co-ordinating across national and sub-national levels of government.	Fully fulfilled	
3. Co-ordinate horizontally among sub-national governments to invest at the relevant scale.	Fully fulfilled	

B. Strengthen capacities for public investment and promote policy learning at all levels of government:		
4. Assess upfront the long-term impacts and risks of public investment.	Fully fulfilled	
5. Engage with stakeholders throughout the investment cycle.	Fully fulfilled	
6. Mobilise private actors and financing institutions to diversify sources of funding and strengthen capacities.	Fully fulfilled	
7. Reinforce the expertise of public officials and institutions involved in public investment.	Fully fulfilled	
8. Focus on results and promote learning from experience.	Fully fulfilled	
C. Ensure proper framework conditions for public investment at all levels of government:		
9. Develop a fiscal framework adapted to the investment objectives pursued.	Fully fulfilled	
10. Require sound and transparent financial management at all levels of government.	Fully fulfilled	
11. Promote transparency and strategic use of public procurement at all levels of government.	Fully fulfilled	
12. Strive for quality and consistency in regulatory systems across levels of government.	Not applicable	
WB Doing Business	**Assessment**	**Remarks**
1. Starting a business.	Not applicable	
2. Dealing with construction permits.	Not applicable	
3. Getting electricity.	Not applicable	
4. Registering property.	Not applicable	
5. Getting credit.	Not applicable	
6. Protecting minority investors.	Not applicable	
7. Paying taxes.	Not applicable	
8. Enforcing contracts.	Not applicable	
9. Trading across borders.	Not applicable	
10. Resolving insolvency.	Not applicable	
Overall assessment (WB country rank).	8 (2016)	

***** *In connection with the 'fast track' policy.*

6.5 Germany – Local competencies and investment finance

Many of the poorer German municipalities suffer a mismatch between competencies and investment finance. They find themselves in a vicious circle with decreasing and ageing population, rising unemployment and a shrinking tax base on the one hand, and rising social expenses on the other. For these municipalities, budgetary constraints leave no room for infrastructure investment.

The obstacle has a territorial dimension since municipalities in some regions, mainly in some North-western and Eastern federal states, are markedly more affected than others.

To ease the situation, the German Federal Government set up a special fund of EUR 3.5 billion for the period 2015-2018 to support investment in municipal infrastructure, with a focus on hospitals, transport, IT and educational infrastructure, urban development, energy efficiency infrastructure and climate protection. In the second half of 2015, an additional EUR 2 billion was earmarked for the period 2016-2019, destined for local public transport, social housing, energy-saving renovations of buildings, and energy efficiency in industry and in the municipalities.

6.5.1 Background

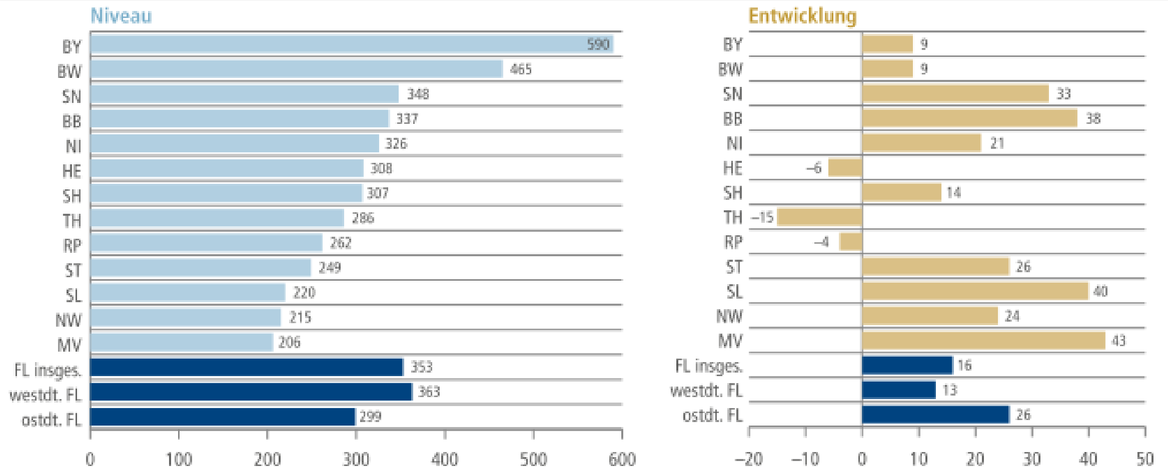
Municipalities in Germany are responsible for large parts of infrastructure in their area, including municipal transport infrastructure. In this sector, the federal government has only limited legal possibilities to contribute. A 2014 in-depth review identified a public investment backlog concerning infrastructure, education and research, especially at the municipal level. Net investment has remained negative and gross fixed capital formation related to GDP at municipal level showed a ten-year downward trend. A moderate increase in recent years was offset by falling federal investment, whereas investment by the federal states remained stable[106].

There are marked differences between richer and poorer municipalities in this respect. This clearly hints at a structural problem since 83% of the municipalities that belonged in 2000 to the 25% with the lowest investment remained below average in 2013[107]. Broken down according to federal states, the highest municipal investment levels are in Bavaria (EUR 590 per inhabitant on

[106] Country Report Germany 2016, p. 44-48.
[107] Martin Greive, Diese Städte schwimmen im Geld, andere verarmen, Die Welt 21.10.2015 (http://www.welt.de/147860927).

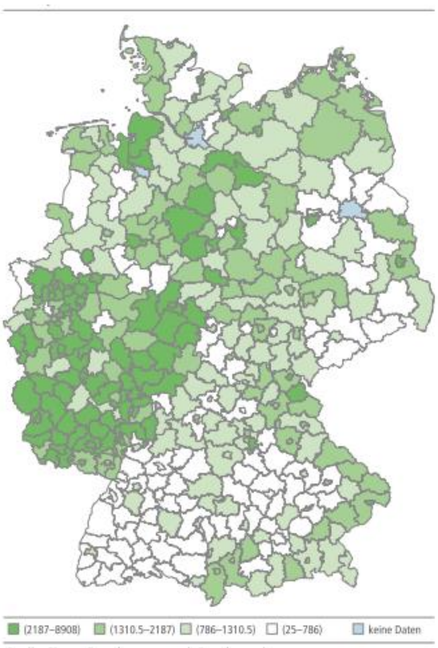
the average in 2014) and Baden-Wuertemberg (EUR 465), with the lowest in North Rhine-Westphalia (EUR 215) and Mecklenburg-Western Pomerania (EUR 206)[108].

Figure 20. Municipal investment per inhabitant according to federal states (EUR per inhabitant)



Source: Bertelsmann Stiftung[109].

Figure 21. Municipal debt per inhabitant (average at county level)



Source: Bertelsmann Stiftung[110].

[108] Arnold. F. et al., Kommunaler Finanzreport 2015 (Bertelsmann Stiftung), p. 28.
[109] Arnold. F. et al., Kommunaler Finanzreport 2015 (Bertelsmann Stiftung), p. 50.
[110] Arnold. F. et al., Kommunaler Finanzreport 2015 (Bertelsmann Stiftung), p. 104.

The investment backlog of German municipalities amounts to EUR 132 billion according to KFW[111]. Municipal investment was reduced from 1.7% of GDP in 1992 to 0.8% in 2013. Between 2003 and 2013, municipal depreciation exceeded investment by EUR 46 billion. If the investment level of Bavarian municipalities is used as benchmark, investment in Germany would have to be raised by EUR 14.4 billion p.a., i.e. by 65%[112].

A striking example can be taken from a 2015 study of the Deutsches Institut für Wirtschaftsforschung. Munich County, one of the richest regions in Germany with only 3% unemployment invested EUR 724 per citizen in 2013. On the other hand side, Wilhelmshaven (unemployment 13 % in 2013) invested EUR 35 per inhabitant in 2013[113].

The municipality of Wilhelmshaven in Lower Saxony illustrates the problem. It has been founded in the mid-nineteenth century as a military port for the Kingdom of Prussia (named after King Wilhelm I) and remained in this function until 1945. A trading infrastructure was never developed and the few artisans that had been attracted by the military base left. Since there had never been a dedicated policy to attract business, structural problems remained. In the 1960s and 1970s, a power plant, an oil refinery and a PVC plant were established providing improvement. However, the main industrial flagship, the producer of typewriting machines Olympia started cutting back on staff in the late 1970s. Today, unemployment rate is at 11.4%. People have to leave the region in order to find employment[114].

Social expenses in Wilhelmshaven are high, especially for unemployment and welfare benefits[115]. Wilhelmshaven has been one of the cities with the highest 'Hartz IV' housing benefit payments since 2008 and at the same time one of the

---

[111] Kreditanstalt für Wiederaufbau - KfW (development bank owned by the German government and the federal states).

[112] Martin Greive, Diese Städte schwimmen im Geld, andere verarmen, Die Welt 21.10.2015 (http://www.welt.de/147860927).
The problem also prevails at the national level. In its 2016 economic survey of Germany, OECD acknowledged low unemployment, low-income inequality and high standard of living. However, challenges have been identified because of low infrastructure investment levels and an ageing demographic structure - OECD, Economic Survey of Germany 2016 (www.oecd.org/eco/surveys/economic-survey-germany.htm -.

[113] Martin Greive, Diese Städte schwimmen im Geld, andere verarmen, Die Welt 21.10.2015 (http://www.welt.de/147860927).

[114] Vic Losen, Wilhelmshaven - Probleme und Chancen, Blog 09.07.2013. (http://suite101.de/article/wilhelmshaven-probleme-und-chancen-a56254#.V1bXqb6P9f4) https://statistik.arbeitsagentur.de/Navigation/Statistik/Statistik-nach-Regionen/Politische-Gebietsstruktur/Niedersachsen/Wilhelmshaven-Stadt-Nav.html

[115] Vic Losen, Wilhelmshaven - Probleme und Chancen, Blog 09.07.2013. (http://suite101.de/article/wilhelmshaven-probleme-und-chancen-a56254#.V1bXqb6P9f4).

lowest fiscal revenues[116]. For 2035, a demographic decline of 20% is forecast, from 78,000 to 63,000[117].

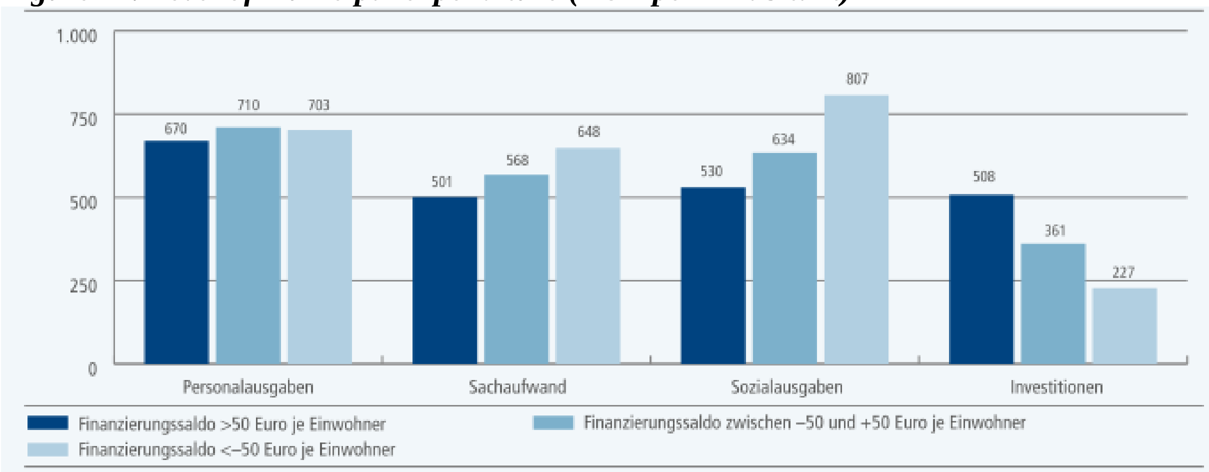
6.5.2 Analysis

The main reason for the reduced scope for financial manoeuvring by the municipalities is social expenditure. Budgets of rich and poor municipalities alike have to earmark between 53% and 56% of their expenses for staff costs and operating costs. However, whereas rich municipalities have about the same shares for social services and investment, poorer municipalities need 34% of the budget for social expenditure, leaving only 10% for investment[118] (see table below). Even though tax revenues are rising in Germany, social expenses are rising at an even faster rate. The municipalities with the lowest tax income also have the highest expenses for housing allowances. Only in Bavaria, municipal expenses for investment are higher than those for social services[119].

Table 4. Level of municipal expenditures and government budget balance

Type of expenditure	Government budget balance per inhabitant		
	> +50 EUR (“positive”)	between + 50 EUR and -50 EUR	< -50 EUR (“negative”)
Social expenditure	530	634	807
Investment	508	361	227

Figure 22. Level of municipal expenditure (EUR per inhabitant)



Source: Bertelsmann Stiftung[120].

---

[116] René Geißler, Kommunaler Finanzreport - In Niedersachsen wachsen die Unterschiede, Pressemitteilung Bertelsmann Stiftung, 14.08.2015.

[117] Wilhelmshaven schrumpft gewaltig. Wilhelmshavener Zeitung 26.05.2015.
Wilhelmshaven shares this tendency with a few other large cities in Lower Saxony; however, the major trend rather consists in declining population for rural areas and population gains for large cities like Hamburg.

[118] Martin Greive, Diese Städte schwimmen im Geld, andere verarmen, Die Welt 21.10.2015 (http://www.welt.de/147860927)

[119] Arnold. F. et al., Kommunaler Finanzreport 2015 (Bertelsmann Stiftung), p. 9-10.

[120] Arnold. F. et al., Kommunaler Finanzreport 2015 (Bertelsmann Stiftung), p. 55.

According to the constitutional principle that spending responsibility follows administrative responsibility, federal legislation can impose tasks on municipalities without providing the respective funding[121].

The revenue autonomy of municipalities is limited. About one third of income is raised by joint taxes shared between the federation, the federal states and the municipalities (personal income tax, corporate income tax, and value added tax). In this way, municipalities are very limited in increasing their revenues and can make adjustments almost exclusively via reduction of expenditures. Two thirds of municipal revenue comes from the federation and the respective federal state as well as administrative fees. The local trade tax (‘Gewerbesteuer’) is the most important tax for which municipalities autonomously set the tax rate. This type of tax does not seem well suited to the task since its tax base is mobile, cyclical and unevenly distributed between municipalities.

In 2009/2010, the economic crisis led to massive losses in trade tax revenues, just at the moment when social expenses started to rise. More suitable for funding would be the municipal real estate tax (‘Grundsteuer’) with its immobile base. However, it accounts for only 15% of municipal tax revenues (2014). A further challenge is that parts of municipal revenues depend on transfers from the federal state a level at which similar problems and inequalities apply. Financially weaker federal states also have few options for increasing their revenues and consequently cannot support their municipalities in the same way as richer federal states[122].

Many German municipalities have to take recourse to short-term loans (‘Kassenkredite’, ways and means advance) that are not balanced by any investment. Wilhelmshaven quadrupled these credits during the economic crisis of the past years. The instrument is intended to help municipalities in cases of short-term liquidity shortages, however, it is increasingly used to finance structural deficits (e.g. in North Rhine-Westphalia), notably, to repay investment loans since this is currently cheaper due to exceptionally low interest rates. This will put the municipalities in a risky position when key interest rates start rising again. There are marked differences between federal states and different regions. Municipalities in e.g. Bavaria, Baden-Wuerttemberg and Saxony practically do not use the instrument, whereas in Hessen, Rhineland-Palatinate, North Rhine-Westphalia and Saarland this type of debt accounts for more than EUR 1,000 per inhabitant. There seems to be a positive correlation with high debts at the federal

[121] Country Report Germany 2016, p. 50.
[122] Country Report Germany 2016, p. 52-53.
Arnold. F. et al., Kommunaler Finanzreport 2015 (Bertelsmann Stiftung), p. 10.

state level - leading to lower transfers to the municipalities - as well as with low municipal investment levels[123].

Municipal budgets are highly dependent on external factors like economic strength, demography, tasks imposed and administrative structures. These factors vary greatly among localities, regions and federal states. At the same time, they are highly stable over extended periods. This results in a perpetuation of the gap between rich and poor municipalities[124]. Poor municipalities are trapped in a vicious circle. It is not possible for them to upgrade their infrastructure in order to improve their competitive standing since the high social expenses caused by structural deficits take their budgetary leeway away.

6.5.3 Solutions

The German Federal Government set up a special fund of EUR 3.5 billion for the period 2015-2018 to support investment in municipal infrastructure. Recently, an additional EUR 2 billion has been earmarked for the period 2016-2019. However, concerning municipal road infrastructure and local public transport, there are still large funding gaps, especially in financially weak municipalities. An expert group proposed solutions including a permanent National Investment Pact for Municipalities complementing the temporary funds as well as a specialised infrastructure advisory body for supporting LRAs in the planning procedure[125].

Federal government has increasingly taken over funding of social benefits, including long-term unemployment benefits, welfare benefits and part of the housing allowances. The federal government set up support for social services at municipal level with an amount of EUR 4.5 billion for 2015-2017, partly by increasing the municipalities' share in value added tax revenues, and EUR 5 billion annually as from 2018[126].

An idea would be the taking over of what is known as 'Hartz IV' housing benefits by the national government. They have to be carried by the municipalities

[123] René Geißler, Kommunaler Finanzreport - In Niedersachsen wachsen die Unterschiede, Pressemitteilung Bertelsmann Stiftung, 14.08.2015.
Country Report Germany, p. 50.
Country Report Germany 2016, p. 50-54.
Arnold. F. et al., Kommunaler Finanzreport 2015 (Bertelsmann Stiftung), p. 8-10, 58.
[124] Arnold. F. et al., Kommunaler Finanzreport 2015 (Bertelsmann Stiftung), p. 8.
[125] Country Report Germany 2016, p. 46-48.
[126] Country Report Germany 2016, p. 51.

Federal states implemented in the crisis years of 2009 and 2010 programmes for the financial stabilisation of their municipalities, mainly based on raising revenues and reducing expenditure requiring, however, considerable return services by the municipalities. There have been large differences between the federal states and the outcome has not yet been assessed[127].

The focus of municipal taxes could be shifted from the highly volatile local trade tax to a more stable local land tax in order to provide a more reliable base for municipal income[128].

At federal state level, negotiations have been underway between the federal government and the federal states since 2014 aiming at equalising regional differences via a horizontal allocation of the federal states' share in the joint value added tax revenue. However, this would not increase the revenue autonomy of the federal states[129].

According to the research institute DIW, the fiscal revenues of municipalities are included into the formula of the equalisation scheme between federal states ("Finanzausgleich") with a weight of 64%. If the figure could be raised to 100%, the poorer federal states would receive EUR 2 billion p.a. more; an amount they could hand over to their municipalities[130].

Further solutions could target municipal enterprises that are responsible for a large part of municipal infrastructure investment. A recent DIW study for the water and energy sector has shown that unlike municipal governments, they have kept their investments at an adequate level sufficient for the needs and on par with private energy and water providers. In the last ten years, there has even been an upward trend in investment by municipal enterprises. Additionally, there is no direct correlation between regional demographic changes or financial strength and investment could be found. An additional advantage cited by the DIW experts is independence of short-term political bargaining and more transparent cost-benefit analyses[131].

---

[127] Arnold. F. et al., Kommunaler Finanzreport 2015 (Bertelsmann Stiftung), p. 10-11.
[128] Country Report Germany 2016, p. 52-53.
[129] Country Report Germany 2016, p. 53.
[130] Martin Greive, Diese Städte schwimmen im Geld, andere verarmen, Die Welt 21.10.2015 (http://www.welt.de/147860927)
[131] Marcel Fratzscher, Ronny Freier and Martin Gornig, Kommunale Investitionsschwäche überwinden. DIW Wochenbericht 43/2015 „Öffentliche Investitionen", p. 1020.
https://www.diw.de/de/diw_01.c.517464.de/themen_nachrichten/kommunale_infrastruktur_in_deutschland_muss_deutlich_gestaerkt_werden.html
Astrid Cullmann, Maria Nieswand and Caroline Stiel, Kein Rückgang der Investitionen in der kommunalen Energie- und Wasserversorgung. DIW Wochenbericht 43/2015 „Öffentliche Investitionen", p. 1047. Martin Greive, Diese Städte schwimmen im Geld, andere verarmen, Die Welt 21.10.2015 (http://www.welt.de/147860927)

Another solution cited by the Country Report could be the PPP (public private partnership) models. They are subject to a lively and often critical discussion in Germany. At a municipal level, PPP solutions exist in a wide variety of sectors, e.g. sports and firefighting infrastructure, but also for municipal roads. Advantages cited are faster and more efficient project implementation, attraction of private capital and life-cycle cost orientation. Critical issues mentioned are high costs, the highly specialised skill level required at LRA level and potential disadvantage for local SMEs. A key point for the attractiveness of PPP models is the possibility to bypass ‘debt brakes’ and the Maastricht criteria. The DIW study mentioned above, argues that public investment outsourced via extra-budgetary financial constructions has not succeeded in balancing the investment backlog caused by the municipal budgets *sensu stricto*[132].

Concerning the example of Wilhelmshaven, hope is set on the new deep-water container port at Wilhelmshaven, the Jade-Weser-Port that opened in 2012. The new port will be the only German port and one of only 12 ports worldwide suited for the largest container ships of 15,000-20,000 TEU[133]. Experts expected that 2,500 to 5,800 new jobs could be created by the new port with additional jobs with the existing industries. After a start below expectations, the port handled 427,000 TEU in 2015[134]. By comparison, Hamburg handles 8.8 million TEU and Bremen 5.8 million. TEU[135]. Another economic policy focus of Wilhelmshaven is tourism, especially day visitors to the North Sea[136].

6.5.4 Conclusions

Many German municipalities are trapped in a vicious circle. Demographic decline and high unemployment rates result in sinking tax revenues and rising social payments. This leads to rising public deficits and reduces budgetary leeway for investment.

---

[132] Country Report Germany 2016, p. 48. Dr. Marion Henschel und Hans Christian Kattwinkel, Verfügbarkeitsmodelle: Investitionsstau beheben.
https://www.partnerschaften-deutschland.de/fileadmin/Daten/OEPP_im_Fokus/Strassen/JB_PPP_2011_Henschel_121.pdf
Johannes Zuber, Pleiten, Pech und Pannen, Deutschlandradio 03.02.2015
http://www.deutschlandradiokultur.de/oeffentlich-private-partnerschaften-pleiten-pech-und-pannen.976.de.html?dram:article_id=310179
Martin Gornig, Claus Michelsen und Kristina van Deuverden, Kommunale Infrastruktur fährt auf Verschleiß. DIW Wochenbericht 43/2015 „Öffentliche Investitionen“, p. 1026.

[133] Twenty-foot container equivalent unit; a common maritime forty-foot container equals 2 TEU.

[134] Vic Losen, Wilhelmshaven - Probleme und Chancen, Blog 09.07.2013 (http://suite101.de/article/wilhelmshaven-probleme-und-chancen-a56254#.V1bXqb6P9f4)
https://de.wikipedia.org/wiki/JadeWeserPort

[135] https://www.hafen-hamburg.de/de/news/hafen-hamburg-im-jahr-2015---34497
http://de.statista.com/statistik/daten/studie/29970/umfrage/containerumschlag-vergleich-von-hamburg-und-bremen/

[136] Vic Losen, Wilhelmshaven - Probleme und Chancen, Blog 09.07.2013 (http://suite101.de/article/wilhelmshaven-probleme-und-chancen-a56254#.V1bXqb6P9f4)

The investment backlog in turn perpetuates the structural disadvantages of the municipalities affected.

Main revenue base that can be influenced by the municipalities is the local trade tax. However, besides being volatile in nature, the tax again reflects structural deficits of economic underdevelopment.

Various ideas for solving the problem are under discussion at present, mostly focusing on transfer payments from the national level.

However, alternative ideas should be taken into consideration, too. They range from changing municipal funding structures (shift to local land tax, changing the formula for equalisation payment) over focusing on municipal enterprises instead of municipal governments to extending PPP financing.

Good practice

For easing the mismatch between competencies and investment finance in poorer municipalities, the German Federal Government set up a special fund of EUR 3.5 billion for the period 2015-2018 to support investment in municipal infrastructure. Focus is on hospitals, transport, IT and educational infrastructure, urban development, energy efficiency infrastructure and climate protection.

In the second half of 2015, an additional amount if EUR 2 billion has been earmarked for the period 2016-2019. This is destined for local public transport, social housing, energy-saving renovations of buildings, and energy efficiency in industry and in the municipalities[137].

[137] Country Report Germany 2016, p. 46.

Assessment of obstacles and responses

OECD Principles of Effective Public Investment	Assessment	Remarks
A. Co-ordinate public investment across levels of government and policies:		
1. Invest using an integrated strategy tailored to different places.	Partially fulfilled	Discussions on how to solve discrepancies
2. Adopt effective instruments for co-ordinating across national and sub-national levels of government.	Partially fulfilled	Fiscal equalisation mechanism exists; however responsibilities and budgets at LRA level not always well-balanced
3. Co-ordinate horizontally among sub-national governments to invest at the relevant scale.	Partially fulfilled	Reform of equalisation mechanism under discussion
B. Strengthen capacities for public investment and promote policy learning at all levels of government:		
4. Assess upfront the long-term impacts and risks of public investment.	Fully fulfilled	
5. Engage with stakeholders throughout the investment cycle.	Fully fulfilled	
6. Mobilise private actors and financing institutions to diversify sources of funding and strengthen capacities.	Partially fulfilled	Extension of PPP models is discussed
7. Reinforce the expertise of public officials and institutions involved in public investment.	Partially fulfilled	Ideas on how to increase capacity at municipal level are discussed
8. Focus on results and promote learning from experience.	Fully fulfilled	
C. Ensure proper framework conditions for public investment at all levels of government:		
9. Develop a fiscal framework adapted to the investment objectives pursued.	Fully fulfilled	
10. Require sound and transparent financial management at all levels of government.	Fully fulfilled	
11. Promote transparency and strategic use	Fully fulfilled	

of public procurement at all levels of government.		
12. Strive for quality and consistency in regulatory systems across levels of government.	Fully fulfilled	
WB Doing Business	**Assessment**	**Remarks**
1. Starting a business.	Very difficult	
2. Dealing with construction permits.	Easy	
3. Getting electricity.	Very easy	
4. Registering property.	Difficult	
5. Getting credit.	Easy	
6. Protecting minority investors.	Difficult	
7. Paying taxes.	Very difficult	
8. Enforcing contracts.	Very easy	
9. Trading across borders	Easy	
10. Resolving insolvency.	Very easy	
Overall assessment (WB country rank).	15 (2016)	

6.6 Poland - Local spatial planning

Instability in spatial planning, especially at local level, as well as over-regulation and regulatory and administrative inconsistencies, present obstacles to growth in Poland.

The poor performance of the local spatial planning and permit issuing mechanisms is a significant bottleneck in the development of transport, energy and communication networks. It ultimately affects the potential benefits to be gained from the completion of these networks, with enterprises deciding to locate, invest and expand in the areas served by these networks.

This is due to many different reasons including:

- poor administrative capacity at the local level;
- frequent and *ad-hoc* changes in the local spatial plans;

- lack of precise delimitation of competencies and responsibilities.

The effect of the above are delays, poor planning, revoking of decisions and, in the case of the ESI Funds, loss of funds.

The Polish spatial planning system is under constant revision and improvement. The government introduced a series of reforms and initiatives in the 2000s and there is still considerable scope for improvement, especially regarding the delimitation of competencies and responsibilities, strengthening the role of spatial planning as an instrument of pro-active spatial policy, and acceleration and simplification of procedures.

6.6.1 Background

The Polish economy has experienced a long period of macroeconomic stability and rapid economic development, making it attractive for foreign direct investment in a broad array of sectors (approx. USD 14 billion in 2014[138]). During the recent crisis, the economy slowed down but did not experience a recession.

The key factors in this development were the proximity to the main European markets, the low labour costs combined with the good skills of the labour force, the size of the internal market itself and the business-friendly political situation (with investment protection treaties, numerous incentives, Special Economic Zones, government grants and local tax exemptions).

Funding sources have been widely available mainly through the expansion of European financing institutes in the country and the inflow of the ESI Funds after the accession in 2004 (Poland being one of the biggest recipients).

However, the years of rapid growth are over, since efficiency gains have already materialised and growth rates are bound to even out in order to maintain the *status quo*. Simultaneously a twofold demographic transition is taking place: large urban centres are growing and becoming younger, while rural areas are shrinking and becoming older.

The big challenge for Poland will be to move from a low-cost/low-technology investing opportunity to an innovation pole and high technology economy in a territorially balanced way.

[138] UNCTAD, 2015.

To this end the Commission's 2016 Country Report on Poland[139] points out that "investment in high quality infrastructure, including for transport, communications and energy, is critical to sustaining Poland's growth potential. Despite sizeable investment in recent years, bottlenecks and deficiencies in transport, energy and communication networks persist. Weaknesses in the managerial and administrative capacity negatively affect the timely implementation of much needed investment projects in the railway sector and other transport, energy and telecommunication infrastructure."

Hence, the challenges for Poland are related to:

- Technological issues related to efficiency investments e.g. on more efficient electricity generation facilities and low marginal costs.[140]

- Managerial issues, related to the capacity of the administration at national and regional level to plan, implement and monitor physical infrastructure in a territorial balanced way.[141]

- Paradigm shift issues, allowing the administration and the private sector to envisage the infrastructure needs not only as satisfying the current needs but accommodating the desired move away from the low-cost/low-technology framework (e.g. through the transition to low carbon industries).[142]

The importance of public investment in the quantity and quality of public infrastructure, for a positive impact on growth in the medium and in the long run for economies in transition engaged in a catching up process, has been discussed in numerous occasions in general[143] and specifically for Poland[144]. The Polish Partnership Agreement is acknowledging this fact in the ESI Funds allocation for transport, energy and communication.

EU cohesion policy in Poland

The Polish Partnership Agreement 2014-2020 with a budget of EUR 77.6 billion (reflecting also the Polish National Reform Programme as well as the Council Recommendations) underlines the need to catch-up with 'Western' Europe and to reduce infrastructure gaps in transport, energy sector, environmental utilities,

[139] SWD(2016) 89 final.
[140] Abrell and Rausch (2016).
[141] Stepniak and Rosik (2013).
[142] Igliński et al. (2016).
[143] e.g. Paleologos and Polemis (2012).
[144] Rutkowski (2009).

telecommunications, as well as enhancing the regulatory environment and public administration services.

The main instruments to close those gaps are the ERDF OP Digital Poland, the ERDF/CF co-financed OP Infrastructure and Environment and the 16 Regional OPs. The total budget for the relevant thematic objectives (TO) is approximately EUR 47 billion.[145]

During the negotiations with the Commission and in the course of examining the ESI Funds *ex-ante* conditionalities it has been testified that most policy and legal requirements were in place or in the course of being fulfilled (e.g. the Energy Efficiency Act, the Transport Development Strategy including the investment plan for projects co-financed from EU funds or the National Broadband Plan and the Policy Paper on digital development of Poland).Therefore, all macro-conditions are set.

However, investment activity is hampered by poor public administration, lengthy contract enforcement, ineffective spatial planning, especially at the local level, as well as over-regulation and regulatory and administrative overlaps in issuing construction permits.

Planning framework and competencies

The spatial planning system in Poland, as in all former communist countries, underwent a fundamental transformation. As a rule, the *raison d'être* of planning had been the establishment and functioning of the central planned economy and excluding the private sector. Types of plans, hierarchy, content and procedural forms were rigidly defined. Many of the current spatial planning authorities' directors received their academic education under these conditions.

Following the fall of communism the "…previous repressive tolerance for private property ownership was replaced by the opposite condition of a strict protection of property rights. In other words, the transition from communism to capitalism has created a critical juncture with a complete reversal in the equilibrium between the property-right regime and the land-regulation regime."[146]

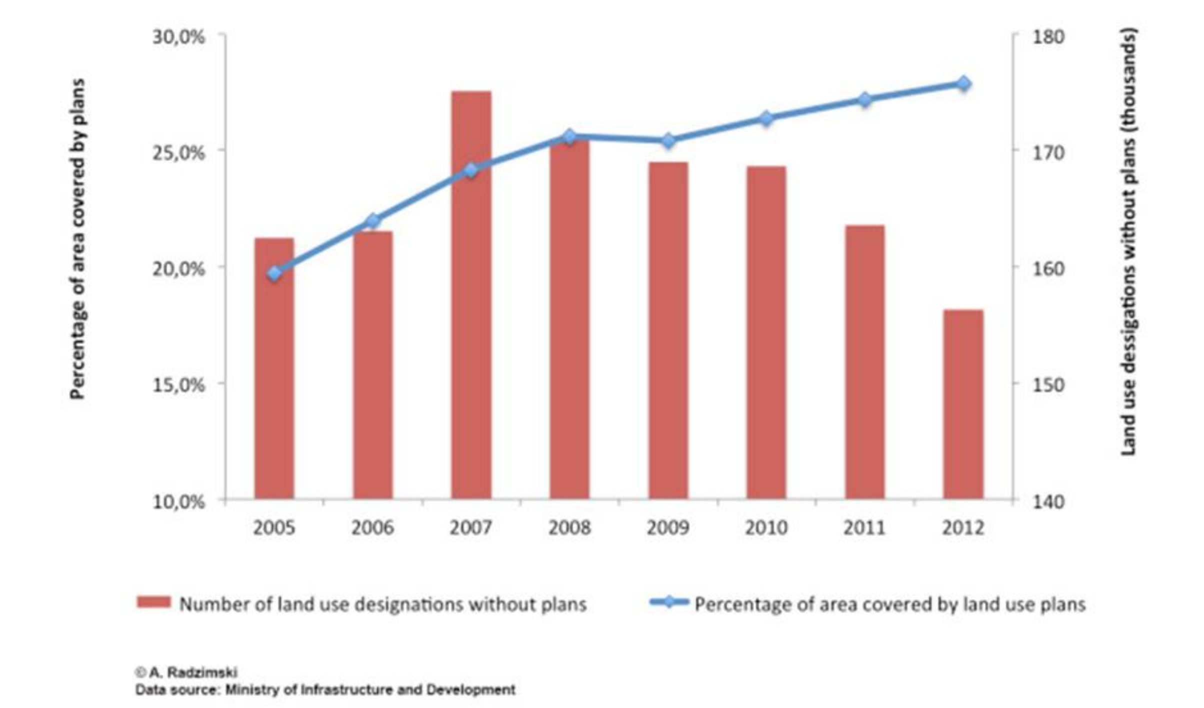
After 1989, the planning system was transformed. Parliament passed the Act on Territorial Self-Government in 1990 and the Act on Spatial Planning and

[145] TO2 'Enhancing access to, and use and quality of, ICT', TO4 'Supporting the shift towards a low-carbon economy in all sectors', TO6 'Preserving and protecting the environment and promoting resource efficiency' and TO7 'Promoting sustainable transport and removing bottlenecks in key network infrastructures'.
[146] Halleuxa et al. (2012).

Management in 2003 and its reform in 2009, which replaced the former regulations. Local authorities *inter alia* acquired legal entity and were endowed with a wide spectrum of tasks. In the late 1990s, voivodships and district self-governments were established.

Local spatial management plans are the basic instrument of spatial planning policy in Poland. They are regulations binding on the territory of a local authority and form a fundamental and exclusive instrument to implement planning decisions. Any construction permission may be granted on the basis of such a plan or, in case of its absence, on the basis of the established Conditions of Development and Spatial Management (a large proportion of Polish municipalities still lack local spatial management plans after the abolition in 1994 of all older plans). As a stopgap, measure an instrument was introduced that allowed the *ad hoc* designation land uses based on the general provisions of the planning legislation. This instrument has been used extensively; for instance, 180,000 such decisions were issued in 2007 alone.[147] The fundamental instrument for implementing spatial planning objectives on different planning levels is the procedure of agreement, "...which is – notably to the annoyance of investors – a very complex, bureaucratic and time-consuming procedure to adopt plans".[148] Yet the situation is gradually improving (see figure below):

Figure 23. Development of land use designations and land use plans in Poland 2005/2012



Source: Radzimski, A., 2015.

[147] Radzimski, A. (2015).
[148] Ebert et al. (2012).

The Council of Ministers is responsible for spatial planning at national level, while municipalities and the voivodship boards are in charge at local and regional level. A hierarchy of spatial plans – in the sense of lower level to higher level compliance obligation – does not exist. Only local spatial management plans have a binding effect between the state and its citizens.

6.6.2 Analysis

The Commission's 2016 Country Report on Poland[149] mentions *inter alia* the following investment challenges:

- While the substantial drop in private investment determined overall investment trends, public investment continued to rise. The resilience of public investment can be explained by needs relating to underdeveloped infrastructure, e.g. roads, along with the availability of EU funds.

- The combination of a relatively low investment rate with high economic growth suggests comparatively high efficiency of investments especially taking into account the low baseline in many areas.

- Low labour costs encourage a predominantly labour-intensive development model for the business sector; geographic location, functioning of the public administration, sector-specific issues concerning construction, energy, transport and the digital economy (e.g. ICT connectivity or railway infrastructure) are also important decision factors.

- Publicly and privately funded investment projects in transport, energy and telecommunication infrastructure are being delayed, made more costly or in some instances even blocked by weaknesses in the managerial and administrative capacity of relevant institutions and by a lack of clear and stable strategic vision for the future development of certain sectors.

- Low coverage of and instability in spatial planning, especially at the local level, as well as over-regulation and regulatory and administrative inconsistencies that impede the issuing of construction permits.

The causes for these challenges have been discussed in the previous section. The spatial planning system in Poland is experiencing the same problems that have already been encountered in Western Europe. They have been addressed through non-formal cooperation, contract-based spatial plans, public private partnerships (PPP), public participation and other innovations in local governance. In the

[149] SWD (2016) 90 final.

case of Poland, the legacy of the post-WWII past still creates obstacles, although they are gradually diminishing.

What is important to stress here is that Poland will need a continuous flow of public investments in the infrastructure networks to maintain growth. Apart from their direct demand and growth effects, these investments are absolute necessary for the location of enterprises especially in less favoured areas.

The effects of the obstacles can be:

- of a **direct** nature:
  - for **public bodies**, one the one hand there is the need to commit substantial resources to provide the pre-requisites for an investment decision while, on the other hand, there is the risk of fund losses and 'sunken' investments in case the public body is implementing the infrastructure themselves;
  - for **private enterprises** engaged in infrastructure delivery or in any other investment the uncertainty of the permit procedure disrupts time plans and in the best case leads to higher costs or in the worst case to the abandonment of the investment.
- of an **indirect** nature:
  - for **public bodies**, especially in areas lagging behind, the delays lead to a potential loss of revenues through taxation and growth and also to the deterioration of their position *vis-a-vis* better endowed regions;
  - for private enterprises the delays influence either their decision to locate in an area or, in case they are already there, to relocate elsewhere due to higher transaction costs and/or unpredictability lowering their profitability.

6.6.3 Solutions

The discussion on introducing changes to the Polish spatial planning legislation is not a new one. The Polish government has already introduced a series of reforms and initiatives. The Spatial Planning Act reform discussion in 2009 aimed at the following changes in comparison to the 2003 act[150]:

---

[150] Ebert et al. (2012).

- strengthening the role of spatial planning as an instrument of spatial policy;
- more precise delimitation of competencies and responsibilities at the specific levels of spatial planning;
- separating analytical and constituting parts in spatial management plans;
- limiting the range of planning for areas of low complexity of structures and spatial processes;
- increasing the importance of public investments;
- integrating maritime and railway areas in local spatial planning;
- establishing the principle of considering spatial policies in neighbouring areas (including those beyond the country's border) in the process of drafting spatial plans;
- simplification and optimisation of location procedures at local level.

Yet the reform was not fully successful and the updating of the Spatial Planning and Management Act from 25 June 2010 acquired a more incremental stand.

Discussions are still ongoing, albeit at the level of experts and academia since the political bodies are not showing any intention to move soon. A significant reform planned relates to the introduction of an integrated planning and construction law (the Building Code), which aims to introduce planning guidelines that would be implemented in the case of absence of land use plans and also urban zones where permits will be issued in a less elaborated way.

Overall, the bodies involved in the spatial planning reform are aware of the solutions required, however, the reform is an incremental and slow process. Possible improvements could relate to:

- better delimitation of competencies and responsibilities at the specific levels of spatial planning and establishment of vertical (sectoral and regional) and horizontal coordination;
- strengthening the role of spatial planning as an instrument of spatial policy clearly distinguishing planning and long term impact assessment from the regulatory approach (need to accommodate change and options

and provide for consideration of effects beyond administrative boundaries);

- speeding up of the adoption process for the study of the conditions and directions of spatial management and introduction of preliminary ‘land use clearance’ for areas where no complications seem likely;

- simplification of the adoption procedure of local spatial management plans (‘concretisation’ of contents, replacement of agreements by assessments, time limits, penalties);

- adapting planning detail to the circumstances (simplification in areas of low complexity and interaction, acceleration in areas of high interest and demand, special handling of urban functional areas and metropolitan zones etc.);

- simplification and improvement of location and land use designation procedures at the local level in a systematic way and abolition of *ad hoc* spatial planning based on land uses designations.

6.6.4 Conclusions

Poland has been one of the most rapidly developing Central European countries. It has also been and still is one of the greatest EU cohesion policy beneficiaries.

The momentum of growth has been based on a low starting point, and the general advantages of low cost labour and low cost production factors.

As these advantages tend to wither and efficiency gains already tend to be exhausted, Poland will need to invest and improve its transport, energy and communication networks.

A bottleneck in this effort is the issuance of permits and the (local) spatial planning system, which is complex, formalistic, slow and inconsistent, thus delaying or preventing investments, leading to loss of funds and prohibiting the realisation of the development potential of the public and private sector.

The spatial planning system is under a constant revision and improvement process. However, there is room for improvement, especially considering delimitation of competencies and responsibilities, strengthening the role of spatial planning as an instrument of pro-active spatial policy, acceleration and simplification of procedures through the application of programmatic principles.

Assessment of obstacles and responses

OECD Principles of Effective Public Investment	Assessment	Remarks
A. Co-ordinate public investment across levels of government and policies:		
1. Invest using an integrated strategy tailored to different places.	Not fulfilled	There is no integrated strategy. At the local level authorities plan without coordination with other bodies. Conflict resolution is done ex-post and on an ad-hoc basis.
2. Adopt effective instruments for co-ordinating across national and sub-national levels of government.	Not fulfilled	See above
3. Co-ordinate horizontally among sub-national governments to invest at the relevant scale.	Not fulfilled	See above
B. Strengthen capacities for public investment and promote policy learning at all levels of government:		
4. Assess upfront the long-term impacts and risks of public investment.	Not fulfilled	There is no such mechanism in spatial planning.
5. Engage with stakeholders throughout the investment cycle.	Partially fulfilled	Stakeholders are involved in an *ad hoc* basis and especially in cases of land use designations
6. Mobilise private actors and financing institutions to diversify sources of funding and strengthen capacities.	Not applicable	
7. Reinforce the expertise of public officials and institutions involved in public investment.	Partially fulfilled	Expertise is improving; however, the reforms are academia and expert-driven, thus affecting take-up and ownership.
8. Focus on results and promote learning from experience.	Partially fulfilled	The spatial planning system is constantly evolving. The latest reforms are addressing many of the past deficiencies.

C. Ensure proper framework conditions for public investment at all levels of government:		
9. Develop a fiscal framework adapted to the investment objectives pursued.	Not fulfilled	Spatial planning is regarded as a regulatory task; impacts and relation to the fiscal framework are not considered.
10. Require sound and transparent financial management at all levels of government.	Not applicable	
11. Promote transparency and strategic use of public procurement at all levels of government.	Not applicable	
12. Strive for quality and consistency in regulatory systems across levels of government.	Not fulfilled	The regulatory system in spatial planning is partially inconsistent; local plans are the only legal acts. The spatial planning system is however constantly evolving; quality and consistency in a vertical and horizontal manner are expected to gain importance.
WB Doing Business	**Assessment**	**Remarks**
1. Starting a business.	Difficult	This difficulty is related to the delays in physical operation of a business due to delays in the issuance of the construction permit.
2. Dealing with construction permits.	Very difficult	The issuance of construction permit is linked to the designated land use and the local spatial management plan (if available). In case the land use is not clear, the procedure to adopt plans is complex, bureaucratic and time-consuming.
3. Getting electricity.	Difficult	Related to delays in the issuance of construction permits.
4. Registering property.	Difficult	Related to delays in the issuance of construction permits.
5. Getting credit.	Difficult	Related to delays in the issuance of construction permits.

6. Protecting minority investors.	Not applicable	
7. Paying taxes.	Not applicable	
8. Enforcing contracts.	Not applicable	
9. Trading across borders.	Not applicable	
10. Resolving insolvency.	Not applicable	
Overall assessment (WB country rank).	25 (2016)	

6.7 Slovakia - Transport infrastructure

Slovakia is set on a comparatively stable path of economic growth but the positive development trend has not reduced regional disparities. One of the main reasons of slower economic growth in lagging behind regions is the transport infrastructure.

Since 2001, regional authorities have the responsibility for secondary and tertiary roads on their territory. With the set-up of regional master plans for transport at the level of the self-governing regions and their integration into an overarching Masterplan, a new approach towards a structured dialogue between regional and national level has been encouraged.

However, the poor state of the road network requires substantial investments that exceed the financial capacities of the regions. Thus, new approaches based on better equalisation and multi-annual budgets will need to be considered, together with addressing the governance of the existing funds and instruments and strengthening coordination mechanism during the planning and implementation of the Masterplan Strategy.

A very practical obstacle in the implementation of road projects has been public procurement. The Bratislava Region has implemented a practical response. Its specialised agency (Regionálne cesty Bratislava) has set-up framework contracts for works related to the (re)construction of existing and the construction of new roads.

6.7.1 Background

Since the mid-2000s, Slovakia has been amongst the fastest-growing economies in Europe and has made significant progress in catching up with more developed countries. At the time of joining the EU in 2004, GDP per capita was 57% of the EU-27 average. The fast pace of convergence slowed down after 2008 due to the negative effects of the global economic crisis. However, the overall trend remained stable in the post-crisis period and the country stood at 77% of the EU average by 2014. The main contributory factors before the crisis include the introduction of structural reforms, high demand in international markets in combination with the low cost of labour, as well as the accession to the EU.

These factors enabled the country to be competitive in attracting foreign direct investment (FDI), on an annual average of EUR 430 million in the period 2004-2015. There has been high concentration of the FDI to the automotive sector, which is a cornerstone of the national economy. Slovakia, due to investments in the automotive sector is amongst the world's largest producers of cars per capita.[151] Other important sectors, also in terms of FDI, are electrical engineering, machinery industry and chemical industry.

The external convergence of the national economy produced positive effects on all regions, although growth has been faster in the stronger regions, while the weaker regions have seen greater volatility in economic downturns. The economic strength of the Bratislava region is partly due to statistical effects resulting from the location of international and national companies in the capital, but Bratislava is also the main driver of national convergence and significantly contributes to the development of other regions. Disparities between regions outside the capital region are lower, although the western regions (Trnava, Nitra, Trenčín and Žilina) have seen consistently higher growth in the last decade. The regional dispersion of GDP per capita has not reduced, and it now stands among the three highest in the EU.

The role of transport infrastructure

Transport infrastructure is perceived as one of the determining factors of the regional disparities between regions. Slovakia exemplifies the thesis of regional economic growth since the regions with better accessibility (located in the western part of the country) have experienced constantly higher economic growth. One of the principal factors for deciding on the location of investment is accessibility, i.e. the availability of good transport infrastructure. In fact, the FDI

[151] Three well-known car manufacturers are: Volkswagen in Bratislava, PSA in Trnava, and KIA Motors in Žilina; these producers will be joined by Jaguar Land Rover in Nitra in 2018.

shows significant concentration in the western part of the country with better accessibility, which has consequently generated higher economic growth compared to the eastern regions.

The long-term problem is highlighted also in the National Reform Programme (NRP) of Slovakia for 2016. The NRP makes a clear link between economic growth and employment and the availability of first-grade transport infrastructure, in particular road networks. In a medium-term perspective the expansion and rehabilitation of transport infrastructure is a major investment focus.[152] To improve the transport infrastructure network, the government utilises funds available from the EU cohesion policy and domestic financial resources. The investment priorities are as follows:

- construction of motorways in regions which do have limited or no motorway network;
- modernisation of the railway;
- multi-modal approach to transport focusing on solutions for the regions with the highest traffic loads.

However, the regional transport systems can only be functional if well-functioning and well-maintained secondary and tertiary transport networks complement high-grade infrastructure. While, the central state administration has the responsibility for the highways, motorways and first-grade roads, regional authorities are in charge of the secondary and tertiary roads[153]. In contrast with the national level, regions seem to have very limited resources for development and maintenance of secondary and tertiary roads.

The transport infrastructure of Slovakia is marked by the fact that in terms of length about 92% of the network is ranked as secondary and tertiary roads. Thus, the challenge for regional authorities to cope with the rehabilitation and maintenance of the network becomes noticeable.

Planning framework and competencies

Originally, the central state administration in Slovakia was in charge of planning, financing, construction and maintenance of first, second and third grade of road infrastructure. In 2001, newly established regional authorities (self-governing regions) were given some competencies in transport policy. The management of secondary and tertiary roads is in practical terms the key element of transport policy for LRAs. The delegation of competencies was done

[152] It is foreseen to invest on an annual basis 3.5% of the GDP thus clearly surpassing the EU average (2% of GDP).
[153] Local authorities are responsible for local (forth-grade) roads.

without any assessment of actual state of infrastructure and the financial resources necessary for fulfilment of the delegated tasks. The regional authorities were faced with the reality that approximately 35 % of the secondary and tertiary roads are in very poor conditions and the rehabilitation and maintenance of the transport network will be a long-term major investment. The state of individual roads depends on transport loads and weather conditions, thus there are clear differences between regions. It is evident that the construction of new and the maintenance of the secondary and tertiary roads exceeds by far the financial capacities of the LRAs.

Table 5. Transport infrastructure in Slovakia - competencies, actors and policy levers

Level	Competence	Institutions, major policy levers
National	Motorways Railway	*Institutions* ▪ Ministry of Transport, Construction and Regional Development (MoTCRD): overall planning. ▪ NDS (national motorway company): development of the motorway system, including maintenance. ▪ ŽSR (national rail infrastructure provider) – development of railway system. *Major policy levers* Programmes funded from ESI Funds. ▪ MoTCRD is in charge of OP Transport (2007-2013) and OP Integrated Infrastructure (2014-2020). ▪ State budget.
Regional level	Secondary and tertiary roads	*Institutions* ▪ Eight self-governing regions: construction and maintenance of road network. *Major policy levers* ▪ Ministry of Agriculture and Rural Development (MoARD) is in charge of Regional OP (2007-2013) and Integrated Regional OP (2014-2020), regions have function of Intermediate bodies. ▪ Budget of the region (based on mechanism for redistribution of tax revenues).
Municipalities (including towns)	Local roads	2,926 municipalities ▪ No particular policy levers in terms of multilevel governance (MLG). ▪ Municipalities are responsible for construction and maintenance of fourth-grade (local) roads of total length of 25,942 km. Expenses are covered from own resources.

Source: own considerations.

6.7.2 Analysis

Enhancing the accessibility of the country and regions is a top priority of Slovakia. The responsibilities for transport infrastructure are divided between national, regional and local authorities. The Ministry of Transport, Construction and Regional Development (MoTCRD) is the key institution in setting up national transport policy. Strategy documents for the development of better transport infrastructure are elaborated by the Ministry and approved by the government. The same applies for the decisions on the implementation of strategic investments in priority infrastructure projects. Despite the needs for enhancement of national infrastructure in order to support economic growth, the progress made in connecting the western and eastern parts of the country has been limited.

The lack of transport infrastructure has implications on public as well as private investment activities. The major adverse implications of lacking transport investment – i.e. from the perspective of Slovak LRAs mostly in secondary and tertiary roads as well as regional public transport - comprise in economic terms direct as well as indirect effects:

Indirect effects:

- Transport has to be considered as an ‘enabling infrastructure’, i.e. the functioning of transport systems is essential to most economic activities, ranging from the development of settlement areas to almost all kinds of industries, manufacturing, services – transport systems which are in bad repair are unsafe, prolong transportation times, raise the external cost of transport and generally speaking lead to a low attractiveness of an area or region respectively challenge the competitiveness of a region.

- The development of transport systems is quite ambiguous in urban development: the transport systems act as driving forces of urban development and suburbanisation at the same time it is the system where first and foremost the need for further investment based on economic growth becomes apparent.

Direct effects:

- Lack of transport infrastructure can become an obvious limitation to investment since certain types of infrastructure – such as business zones or multi-modal transport hubs such as airports, river ports – depend directly on the quality of connecting transport infrastructure; this is particularly felt in the capital region of Bratislava.

- Limited and lagging public investment in transport infrastructure directly influences the economic prospects in the construction sector which has accounted on average for an annual GDP of EUR 1,117 million in the period 2001-2016[154].

Regional budgets and the scope of the challenge

The priorities of the regions in the field of transport are articulated in the medium-term planning documents such as spatial plans and plans for economic and social development. The specific investment actions in the road infrastructure are approved by the regional government within their annual budgets stemming from own resources and assistance from international institutions. Regions receive financial resources to fulfil their responsibilities through a distribution mechanism of income taxes. Additional financial resources have been allocated for the construction and rehabilitation of the secondary and tertiary roads in EU funded programmes in the periods 2007-2013 and 2014-2020[155]. When elaborating the annual budgets, the regions must firstly cover the mandatory expenses related to their competencies (e.g. secondary schools, social services, etc.). The remaining resources earmarked to transport infrastructure are limited in practice to about 7% to 10% of the annual budgets. Moreover, subnational budgets are exceptionally constrained.[156] The distribution mechanism of income tax cannot reflect the factors, which are crucial for road infrastructure, i.e. in particular, the traffic volumes in economic centres such as Bratislava.

The role of EU cohesion policy

ESI Funds/ERDF represent an ancillary source of funding of the secondary and tertiary roads for the regions. In quantitative terms, Slovakia[157] has indicated to the EC the following targets related to road construction and rehabilitation in the period 2014-2020:

- 170 km of <u>newly constructed</u> road of which126 km are part of the TEN-T network.

- 436 km of <u>reconstructed</u> road which are not part of the TEN-T network (i.e. targeting mostly secondary and tertiary roads); of those the Integrated

[154] See: http://www.tradingeconomics.com/slovakia/gdp-from-construction. The GDP from manufacturing has amounted to EUR 4,279 million in 2015 and from Services to EUR 3,529 million. Constructions ranks third among the major sectors, the remaining sectors are insignificant.
[155] Bratislava region was not eligible for assistance from Regional Operational Programme in 2007-2013.
[156] OECD 2014, p. 22: *In 2012, subnational government expenditures accounted for 17% of general government expenditure (OECD average of 40%).*
[157] See - https://cohesiondata.ec.europa.eu/themes/7

Regional Operational Programme (IROP) covers the following shares – 150 km of reconstructed and renovated roads, 55 km of new roads

The major budget addressing secondary and tertiary roads stems from IROP amounts to EUR 510 million that represents about 7% of the ERDF allocation or 3.7% of the total ESI Funds allocation.

This points at the quantitative challenge: 35% out of about 50,000 km of secondary and tertiary roads have been classified as being in a poor state of repair, i.e. about 17,500 km – thus the quantitative effect of EU cohesion policy is clearly limited given the investment needs. In the negotiations with the EC the rehabilitation of roads was ranked from the EC's side as being of minor relevance due to its limited impact on EU 2020.

Despite its limited quantitative effect, EU cohesion policy had beneficial effects on coordination and a more transparent setting of priorities. The coordination between the various levels and actors involved in the planning and delivery of the transport policy had revealed significant deficiencies in the past. On the one hand, strategic documents at national level were rather descriptive without precise identification of priorities for construction of primary road infrastructure. On the other hand, strategic documents for the transport at the regional level had been missing. In recent years, the multi-level coordination has significantly improved.

As part of the *ex-ante* conditionalities[158] for EU cohesion policy in 2014-2020 Slovakia had to develop a comprehensive plan for transport investment; a requirement which was expanded to the other tiers of government: regional masterplans for transport had to complement the national strategy. These plans assess and quantify the needs in the field of transport infrastructure and identify the investment priorities for investments from ESI Funds.

Regional authorities are directly involved in the management of ESI Funds as Intermediate Bodies for the Integrated Regional Operational Programme (IROP). They are in charge of implementation of priorities for improvement of the road infrastructure at regional level. There is an indicative financial allocation for each region. Support is provided to individual projects on a competitive basis and after approval. An overall allocation of EUR 510 million under IROP is only an additional source of funding to own resources of the regions and cannot address all identified needs. From the current perspective, it seems that the regional authorities have sufficient capacities to develop a project pipeline to utilise fully the available assistance. The envisaged projects focus on

[158] European Commission Directorate-General Regional and Urban Policy, Guidance on Ex-ante Conditionalities for the European Structural and Investment Funds - PART II, 13 February 2014 pp.118, 164, 173.

maintenance and repair rather than on construction of new roads (except for a limited number of so-called white spots). It is important to state that investment into secondary and tertiary roads is seen by the EC as a priority of limited added value even in the 2014-2020 period, therefore it is to be expected that after this period support under the EU cohesion policy to such projects will be discontinued.

Investment projects in transport at the national and regional level are coordinated through the spatial plans of the regions and regional transport plans. Local actors are involved in the preparation of the regional documents.

Implementation difficulties

Most of the regions established specialised agencies to take over regular assessment of the state of regional roads, preparation of the projects and necessary documentation for construction and rehabilitation of roads as well as actual implementation of investment actions. These 'public equivalent bodies', under the management control of the regional authorities contract external service and work providers. The procedure for obtaining land use decision and building permit is rather lengthy and administratively burdensome in Slovakia. However, the regions do not signal any specific obstacles to investments stemming from regulatory or legal frameworks. The situation is different at national level where compliance to the procedures and rules in place often caused major delays in implementation of infrastructure projects. Especially, the assessment of impacts of the same infrastructure projects on environment took much longer than expected. The explanation can be that the bulk of the investment is oriented to the rehabilitation of existing secondary and tertiary roads, not to building new parts of the network, therefore the requirements are not so demanding. Systematic changes to shorten the procedures for land use decision and building permit are currently under preparation.

Changes in the major road infrastructure projects financed from EU funds and delays in the implementation of EU funded projects at national level have still caused uncertainty at the lower levels of administration. Time schedules for road infrastructure projects of national importance are often unrealistic taking into account the experience with preparation and implementation of projects.

Public procurement as challenge

One of the main deficiencies of implementation of transport projects of national importance financed from EU funds has been public procurement. It is considered as a severe impediment to efficient public investment in Slovakia – a fact that is also highlighted in the recent EC survey on Member State Investment

Challenges[159]. The challenge is seen as being less significant from the perspective of the representatives of the regions. This might be partly due to the fact that some regional authorities (e.g. Bratislava region) and their agencies use framework contracts for the rehabilitation of road infrastructure.

6.7.3 Solutions

This case study identifies a number of obstacles to investment in secondary and tertiary roads, which are managed by the regional authorities in Slovakia. However, the key barrier to visible improvement of regional and local road networks are the limited budgets available at LRA level.

Thus, it is evident that the policy makers **need to address the challenge of LRA budgets**. The two most evident approaches would be to:

- Strengthen fiscal equalisation mechanisms. This is also supported by the fact that the share of sub-national government spending in Slovakia is exceptionally low compared to the OECD average[160]. However, so far, there is no political willingness to undertake any significant steps in this direction and on the contrary, the situation for LRAs will be aggravated by the new municipal and regional fiscal rules.[161]

- Introduce multi-annual budgeting in order to allow for longer-term planning and priority setting.

Other proposals include charging (taxation) for secondary roads – a proposal which meets limited political acceptance.

From the current perspective, it seems that regions will have to rely in the longer-term on government financial contributions to cover their investment needs. The new fiscal rules will tend to deepen the dependency of the LRAs on transfers.

Other aspects address the **governance** of the existing funds and instruments.

First, it is evident that the full absorption of the (limited) EU funding dedicated to secondary and tertiary roads in the programme period 2014-2020 should be ensured through the most efficient and transparent approaches to the respective

[159] European Commission, SWD 2015(400), pp. 47-48.
[160] 17% as compared to 40% on EU average cf. to OECD 2014.
[161] OECD 2014, p. 21: Municipalities and regional budget rules prohibit deficit financing of current spending except from own reserves. […] As debt gets high relative to the previous year's revenues, progressive sanctions are imposed: when the ratio exceeds 60%, the central government can levy a fine of 5% of the difference between the debt and 60%. Of 2 926 municipalities, 514 might fall into one of the sanction zones in 2015.

programmes. Problems in this context are – next to public procurement – the high turnover of staff in the public sector and the lack of transparency in project selection[162]. Thus, it remains a top priority for Slovakia to strengthen the absorption of EU funds and to put the implementation system on a sound basis. Regarding the secondary and tertiary road infrastructure, this refers also to the capacities and policy approaches of the self-governing regions, which act as Intermediate Bodies in the IROP as part of EU cohesion policy. The IROP represents the main funding source for regional and local roads, and project selection is driven by project development on competitive basis and the interplay between regional and local policy-making

Second, given the scarcity of funds regions should seek the most efficient and effective construction and maintenance arrangements for the transport infrastructure, such as framework contracts. The detailed assessment of costs prior to contracting, paired with the use of cost benchmarks, are also essential elements. It is evident that maintenance offers considerable scope for savings based on the efficient cooperation between local and regional levels.

Third, strengthening the coordination mechanism during planning and implementation of the Masterplan Strategy, as well as introducing the use of supporting tools such as the transport model that is currently under development, might help to streamline procedures and to establish a system of checks and balances and a more evidence-based approach to decision making. On the one hand, this requires a stronger acceptance of the LRAs by the national authorities, while, on the other hand, it is important to monitor the overall network in order to set priorities efficiently and effectively.

Private funding for this type of road infrastructure appears to be no alternative. At national level, numerous feasibility studies have been conducted for public-private partnership (PPP) projects in transport infrastructure (national roads). So far, only one road has been built through PPP – the R1 Project[163] – consisting of three sections of expressway between Nitra and Tekovské Nemce and the Banská Bystrica Northern Bypass. However, this approach has been heavily criticised in public since the Cost-Benefit Analysis had been based on quite unrealistic assumptions. Currently, it is under discussion as to whether the Bratislava ring (R7) should be built through PPP. Thus, experience with PPP even for national roads is quite limited as the legislation is in place but existing models are scarce.

---

[162] Cf. OECD 2014, p. 20.

[163] A stretch of about 52 km based on a 30 year availability fee-based concession; *inter alia* based on a loan from EBRD (see: http://www.ebrd.com/work-with-us/projects/esia/r1-motorway---slovakia.html); cf. also EBRD 2009.

6.7.4 Conclusions

Lack of investment in transport infrastructure in Slovakia is widely seen as a potential impediment to private investment. From the perspective of regional development, this refers in particular to the lagging regions of central and eastern Slovakia. Nevertheless, the actual state of repair of roads is also challenging in the economic centres such as Bratislava where high traffic volumes shorten the lifetime of roads and transport investment is usually more costly.

The external perception of the challenge is partly due to the focus on major transport infrastructure projects developed and implemented at national level. Generally speaking the major problems in the implementation road projects have been the lack of stable setting of priorities paired with weak planning, preparation and implementation thus leading to a disperse patchwork of projects rather than coordinated results of area-based strategies. Further impeding factors have been the long lead-in times for major transport infrastructure projects and the frequent delays and errors in procurement procedures. The changes in the major infrastructure projects at national level, including delays in completion also had adverse effects on the planning of complementary road network at regional level and on the economic development of the regions concerned.
When analysing the underlying challenges related to transport infrastructure in more detail an even greater challenge relates to the rehabilitation of the secondary and tertiary road networks that falls under the responsibility of LRAs, i.e. the fine-meshed network that has to be seen as key enabling infrastructure for almost all economic activities. This is a network of about 50,000 km of which about one-third is in poor state of repair, while the regional budgets are far too small to cover the investment needs. The key factors behind this challenge are:

- The transfer of competencies from the national to the regional level in the field of transport policy was done without the full knowledge of (or taking into account) the actual conditions of regional road infrastructure and an estimation of financial resources needed for construction and maintenance.

- Currently, the redistribution of income tax represent the key source of financial resources of the regions and these resources are very limited. Regions have to cover mandatory expenses first and the remaining budget can then be used for transport policy (approximately 7-8 % of the overall regional budget).

- The car tax (on the use of cars) was until 2015 collected by the regional authorities and was an important source of income. Since 2016, this tax is collected by the central administration.

- This challenge refers to all types of LRAs: in major economic centres the heavy use of roads shortens the life span of road infrastructure, while in lagging behind regions the low budgets do not allow for major improvements such as bypasses, removal of black spots, etc.

There is therefore, an increasing challenge regarding the maintenance and upgrading of existing (basic) infrastructure at the local and regional level, while the need to upgrade basic 'enabling' infrastructure remains and has obvious direct and indirect implications on private sector investment. The prospect of resolving this crucial issue is rather pessimistic, since such types of LRA infrastructure will hardly attract private funding, such as PPP, as the rehabilitation of basic infrastructure is generally considered a public task. Public debt management will tend to aggravate the situation. Given the highly constrained budgets of LRAs in areas lagging behind, this tendency could in the long-run increase the risk of widening the gap for challenged regions.

EU cohesion policy in Slovakia had a certain beneficial impact, since it helped to improve instruments through improved coordination (Masterplans at regional level):

- In the wake of the *ex-ante* conditionalities for the period 2014-2020 the coordination in transport planning between the national and regional tier has been strengthened.

- It remains to be seen whether the performance in the implementation of the respective programme (mainly the IROP) will improve compared with the 2007-2013 period. Key aspects are the project selection mechanisms and a stronger capacity and guidance in public procurement at the implementation stage.

The main reflections on the role of EU cohesion policy within the range of policy options point at quite divergent goals and risks for LRAs:

- There appears a certain divide between the approach to priorities with strong visibility for EU 2020 and the fact that in many regions across the EU it is increasingly difficult for LRAs to keep sound investment levels in key enabling infrastructure such as regional and local roads.

- Such roads are also a pre-condition for the development of more sustainable forms of (public) transport; it has to be considered as the network that enables most economic activities.

- The perspective on transport within EU cohesion policy, i.e. the inherent focus on TEN-T networks, might even contribute in the end to a further deepening of regional disparities; implicitly transport investment in high-grade networks tends to be concentrated in areas, which so far have benefitted most from economic integration within the EU.

The rehabilitation of regional and local roads remains a challenge for national policy-making. Even a significant enlargement of the budget for regional and local roads within EU cohesion policy could not cover the investment need in a medium to longer-term perspective. Sustainable solutions to this problem require thorough reforms in public administration and new approaches to fiscal equalisation.

Good practice

The 2007-2013 period has revealed major deficiencies as regards the planning and implementation of road projects at LRA level. The requirements of EU cohesion policy – in particular the *ex-ante* conditionality requesting comprehensive transport plans – has led to the development of improved coordination routines between the national and the regional level.

With the setting-up of regional masterplans for transport at the level of the self-governing regions and their integration into an overarching Masterplan, a new approach towards a structured dialogue between regional and national level has been encouraged. The regional plans represent one-step towards sound policymaking and are expected to improve the process of preparation and implementation of transport projects financed from ESI Funds. Analysis of the needs stipulated in the regional masterplans show that most financial resources should be dedicated to the improvement of existing road infrastructure.

A very practical obstacle in the implementation of road projects (and many other types of public investment) has been public procurement. From the perspective of LRAs the challenges relate mostly to the frequent changes of the Public Procurement Act and the resulting legal uncertainties as well as the lack of staff in the institutions, which control and supervise public procurement in Slovakia[1]. This fact entails long waiting times in cases where clarifications are needed. The Bratislava Region has implemented a practical response to the problem. The region has managed to set-up framework contracts for works related to the (re-)construction of existing and the construction of new roads:

- The specialised agency (Regionálne cesty Bratislava) established by the Bratislava self-governing region uses external providers for preparation of the projects and actual construction, rehabilitation and maintenance of the secondary and tertiary roads.
- Given the fact that the annual budget is known the Agency concluded a multi-annual framework contract.
- The framework contract enables the Agency to fulfil its tasks according the time-schedule (planned activities) and flexibly respond to unexpected situations related to the road infrastructure.
- The framework contract has been tendered in line with the public procurement law and significantly reduces the time and resources that would have been needed to procure individual contracts.

Assessment of obstacles and responses

OECD Principles of Effective Public Investment	Assessment	Remarks
A. Co-ordinate public investment across levels of government and policies:		
1. Invest using an integrated strategy tailored to different places.	Fully fulfilled	The strategy and needs for investment in the period 2014-2020 are summarised in the Masterplans of self-governing region. These masterplans creates a basis for using the ESI funds for building and modernization of secondary and tertiary roads.
2. Adopt effective instruments for co-ordinating across national and sub-national levels of government.	Fully fulfilled	Clear competencies division between state and central level and satisfactory coordination mechanism
3. Co-ordinate horizontally among sub-national governments to invest at the relevant scale.	Fully fulfilled	Central level coordinates all important investment in terms of building/modernisation of motorways and expressways with regional level (self-governing regions, cities and municipalities)

B. Strengthen capacities for public investment and promote policy learning at all levels of government:		
4. Assess upfront the long-term impacts and risks of public investment.	Partially fulfilled	Transport infrastructure in Slovakia needs substantial investments in the coming years whereas the majority of financial sources will come out of ESI funds. Failure in administration procedures of the projects (planning, obtaining building permits, public procurement, etc.) can significantly affect long-term impacts and risks of these huge investments.
5. Engage with stakeholders throughout the investment cycle.	Fully fulfilled	Self-governing regions as stakeholders of road infrastructure at the regional level are fully engaged in building/modernization of secondary and tertiary roads in Slovakia
6. Mobilise private actors and financing institutions to diversify sources of funding and strengthen capacities.	Not relevant	Secondary and tertiary road network is clearly understood as public task; experience so far is limited to one stretch of the national motorway system; it appears to be no option for the regional and local road networks
7. Reinforce the expertise of public officials and institutions involved in public investment.	Partially fulfilled	As the self-governing regions do not always have sufficient institutional capacity for planning, public procurement and other tasks related to reconstruction respectively construction of regional and local roads they are often using external services
8. Focus on results and promote learning from experience.	Partially fulfilled	The period 2014-2020 has brought about a more focussed approach on planning (Masterplan has been prepared) and prioritisation on future work
C. Ensure proper framework conditions for public investment at all levels of government:		
9. Develop a fiscal framework adapted to the investment objectives pursued.	Partially fulfilled	Redistribution mechanism according to income tax – clearly insufficient to cover the needs in road investment in economic centres; generally speaking LRAs rely heavily on state transfers to cover their mandatory tasks
10. Require sound and transparent financial management at all levels of government.	Partially fulfilled	Need for improvement in regulatory framework in terms of tax redistribution between central and regional level

11. Promote transparency and strategic use of public procurement at all levels of government.	Partially fulfilled	Long delays in public procurement procedures due to many complaints submitted by companies which did not win/fulfil criteria in the tender; also EC had intervened in the period 2007-2013 with consequences across many EU-funded programmes
12. Strive for quality and consistency in regulatory systems across levels of government.	Partially fulfilled	Need for improvement in regulatory framework in terms of tax redistribution between central and regional level

World Bank Doing Business	Assessment	Remarks
1. Starting a business.	Difficult	No substantial support from state for start-ups (only very limited through Slovak Business Agency)
2. Dealing with construction permits.	Difficult	Obstacles and long procedures to gain the construction permits
3. Getting electricity.	Easy	Given the industrial past no major challenge
4. Registering property.	Easy	No major problems while registering property
5. Getting credit.	Easy	In the last period new instruments (e.g. financial instruments) have been introduced which attract more investors
6. Protecting minority investors.	Difficult	Majority investors have more power and financial sources to better protect them
7. Paying taxes.	Easy	System as such is quite easy to understand
8. Enforcing contracts.	Difficult	Complicate and disputable law enforcement in Slovakia
9. Trading across borders.	Difficult	Different rules for entrepreneurs in EU Member States; alignment of rules is still perceived as an obstacle
10. Resolving insolvency.	Very difficult	Long procedures, complicate legal environment and disputable law enforcement in Slovakia
Overall assessment (WB country rank).		

6.8 Estonia – Equalisation Fund scheme

Shortcomings in the Equalisation Fund Scheme present obstacles to investment and growth in Estonia. The funding of local government in Estonia is largely based on this scheme, which provides for a *quasi*-automatic redistribution of revenues to the majority of municipalities.

The grants are not earmarked and, combined with an absence of legal obligations to support entrepreneurs or investors, there is no incentive for municipalities for attracting enterprises or creating jobs. In this way, the equalisation system creates an obstacle to investment by discouraging municipalities from creating an investor friendly environment.

A planned local government reform aims at consolidating small municipalities *via* voluntary and government-initiated mergers. The measure is expected to level financial disparities between municipalities and reduce discrepancies between local revenues and responsibilities, and create a reduced need for equalisation fund payments. Additionally, the reform entrusts local authorities with the responsibility for the development of local entrepreneurship.

The Operational Programme for Cohesion Policy Funds 2014-2020 includes administrative capacity-building activities at LRA level linked with the reform.

6.8.1 Background

The 15 counties of Estonia are divided into 34 cities and 193 rural municipalities. These vary in size between 400,000 inhabitants for Tallinn to villages with less than 100 inhabitants. More than two thirds have less than 3,000 inhabitants[164].

The remit of local government has expanded in the past ten years. Local transport, maintenance of local roads, primary and secondary education as well as social services are the responsibility of the local authorities with about one-quarter of public spending or approximately 10% of GDP and of public investment[165] carried out by them.

[164] Kraan, D.-J. - Wehner, J. – Richter, K., Budgeting in Estonia, OECD Journal on Budgeting Volume 8 – No. 2, 2008, p. 28.
Coface, Country essentials – Estonia, August 2015, p. 2.
[165] Kraan, D.-J. - Wehner, J. – Richter, K., Budgeting in Estonia, OECD Journal on Budgeting Volume 8 – No. 2, 2008, p. 28.
Smidova, Z. (2011), "Public Sector Spending Efficiency in Estonia: Healthcare and Local Government", OECD Economics Department Working Papers, No. 881, OECD Publishing. http://dx.doi.org/10.1787/5kg86qq1k2vl-en, p. 16.

Municipal revenues come from five sources: local share of the income tax, distributed according to residency (48%), local taxes (12%), earmarked grants - mainly for education (23%), non-tax municipal revenues (10%) and the non-earmarked equalisation grant (7%).

If municipal expenditure exceeds revenues, the equalisation grant mechanism provides for transfers from the state budget covering 90% of the gap. Equalisation grants from central to local government are paid according to a formula based on a calculation of local needs[166] and local tax capacity[167] and are not earmarked for particular purposes. The formula is authorised annually in budget law. It is negotiated annually between central government and LRAs and it is linked to the overall situation of the central government budget. Approximately 200 municipalities receive such grants. Only Tallinn, some municipalities in the surrounding Harju region and municipalities in the Ida-Viru region with its oil-shale mining show higher revenues than expenditures[168].

The current system of automatic financial equalisation does not encourage municipalities to cultivate actively local economic development in order to raise their tax revenues[169]. This is underlined in the Commission's Country Report on Estonia, which states that "the funding principles of local government limit the capacity of the poorest municipalities to better match revenue with their devolved responsibilities. In particular, the Equalisation Fund scheme ensures a quasi-automatic redistribution of revenue to the poorest municipalities. Without any incentives for them to attract enterprises or support job creation, this acts as a disincentive to take such initiatives. In addition local government currently has no legal obligation to support entrepreneurs or potential investors".[170]

---

[166] Estimation based on total population, number of children, number of school-age children, size of labour force, number of elderly and number of disabled, estimated costs of roads and streets

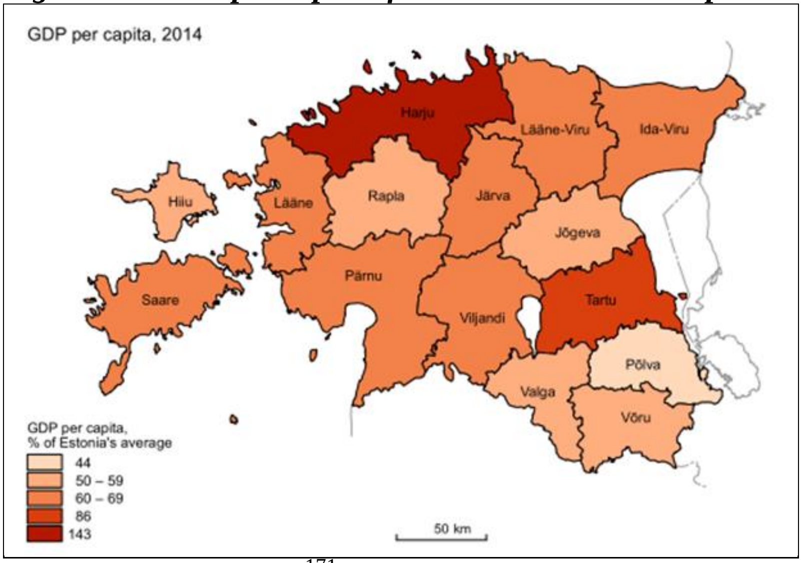
[167] Estimation based on personal income tax, land tax, natural resources fee.

[168] Kraan, D.-J. - Wehner, J. – Richter, K., Budgeting in Estonia, OECD Journal on Budgeting Volume 8 – No. 2, 2008, p. 29.
Smidova, Z. (2011), "Public Sector Spending Efficiency in Estonia: Healthcare and Local Government", OECD Economics Department Working Papers, No. 881, OECD Publishing. http://dx.doi.org/10.1787/5kg86qq1k2vl-en, p. 16-20.

[169] Smidova, Z. (2011), "Public Sector Spending Efficiency in Estonia: Healthcare and Local Government", OECD Economics Department Working Papers, No. 881, OECD Publishing. http://dx.doi.org/10.1787/5kg86qq1k2vl-en, p. 18.

[170] EC SWD (2016) 76 final, Brussels, 26.2.2016, p. 56.

Figure 24. GDP per capita of Estonian counties compared to the national average (2014)



Source: Statistics Estonia[171].

General outlook of the Estonian economy

Following the separation from the Soviet Union in 1990, Estonia became a member of the World Trade Organization (WTO) in 1999, acceded the EU in 2004 and adopted the Euro in 2011. Between 1995 and 2007, it was one of the fastest growing economies in the world (average GDP growth +7.2% p.a.). However, this was partly due to loan-financed domestic demand. Consequently, Estonia was hit hard by the economic crisis in 2008 when the real estate bubble burst (-5.1% GDP negative growth in 2008; -13.9% in 2009). Estonia reacted with austerity measures including cuts to the public sector employees' salaries and unemployment benefits[172].

The country now shows moderate GDP growth that is considered as being sustainable (2014: 2.9%; 2015: 1.1%) and the state budget is close to balance (2014: +0.8%; 2015: +0.4%). A decline in exports due to economic difficulties of its trading partners and low prices for its shale oil is counterbalanced by the service sector leading to a nominal trade surplus. However, real GDP per capita is still lower than in 2007[173]. Structural funds in the period 2009-2013 accounted

---

[171] Statistics Estonia, The economic structure in the counties is changing, News Release No. 136, 17.12.2015, p. 2.

[172] Vadasz, J. – Tébar Less, C., Accession of Estonia to the OECD - Review of international investment policies, OECD 25.03.2010, p. 11.
Schneider, T., Estonia and the European Debt and Economic Crisis – An Overview (Konrad-Adenauer-Stiftung e.V., Estonia Office, January 2013), p. 1-2.
OECD Economic Surveys – Estonia - Overview, January 2015, p. 2.

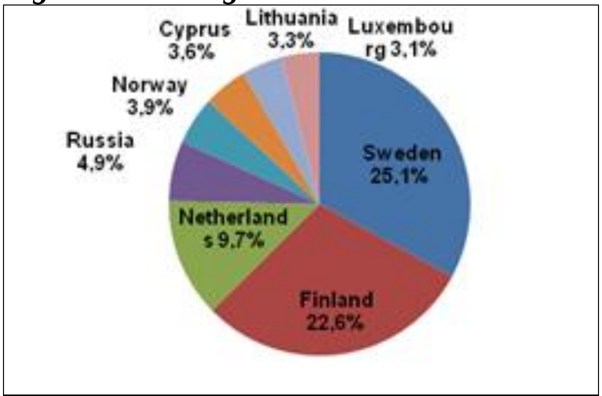
[173] OECD Economic Surveys – Estonia - Overview, January 2015, p. 2.
Schneider, T., Estonia and the European Debt and Economic Crisis – An Overview (Konrad-Adenauer-Stiftung e.V., Estonia Office, January 2013), p. 4.
Country Report Estonia 2016, p. 2. http://ec.europa.eu/economy_finance/eu/countries/estonia_en.htm

for 10% of the Estonian budget. The amount has been raised for the period 2014-2020 making Estonia one of the countries with the highest benefits from EU funding[174].

The main business sectors of Estonia are information and telecommunication, timber and woodworking industry, production of machinery, metalworking, electronics and transport with a growing biotechnology sector[175]. Main trading partners are Sweden (19% of exports; 9% of imports in 2015) and Finland (16% of exports; 15% of imports), followed by Latvia (10%/9%) and Lithuania (6%/9%). Russia accounts for 7% of exports and 6 % of imports[176].

Foreign direct investment (FDI) had peaked in 2005 where the inflow equalled 21% of Estonian GDP. It concentrated mainly on the financial sector, followed by real estate, rental and business activities and manufacturing industries. In 2015, FDI totalled EUR 17.4 billion, mainly coming from Sweden (25.1%) and Finland (22.6%) which are especially dominating the banking and telecommunications sector. FDI is also strongly represented in the electronics and food sector. Russia is ranked fourth among the investors with 4.9%[177]. About 4,700 companies in Estonia are under Finnish ownership, indicating the close relationship with its neighbour[178].

Figure 25. Foreign direct investment in Estonia (31.12.2015)



Source: Bank of Estonia[179].

[174] Schneider, T. – Müller, M., Die Nachbarschaftsbeziehungen der Republik Estland (Konrad-Adenauer-Stiftung e.V., Länderbericht September 2013), p. 1-2.
[175] Aussenwirtschaft Austria – Aussenwirtschaftszentrum Bayern, Exportbericht Estland (Stand: Februar 2014), p. 8.
[176] http://estonia.eu/about-estonia/economy-a-it/economy-in-numbers.html
[177] http://estonia.eu/about-estonia/economy-a-it/economy-in-numbers.html
Vadasz, J. – Tébar Less, C., Accession of Estonia to the OECD - Review of international investment policies, OECD 25.03.2010, p. 11-12.
Aussenwirtschaft Austria – Aussenwirtschaftszentrum Bayern, Exportbericht Estland (Stand: Februar 2014), p. 10.
[178] Schneider, T. – Müller, M., Die Nachbarschaftsbeziehungen der Republik Estland (Konrad-Adenauer-Stiftung e.V., Länderbericht September 2013), p. 2.
[179] http://estonia.eu/about-estonia/economy-a-it/economy-in-numbers.html

In general, Estonia scores well in international rankings on entrepreneurship, e.g. 16th out of 189 countries in the World Bank Doing Business 2016 Report with the lowest scores on protection of minority investors and insolvency procedures. The Small Business Act Fact Sheet 2015 shows Estonia close to EU average, however with low opportunity-driven entrepreneurial activity[180]. Enterprises with more than 100 employees account for more than a third of the total workforce, create about 40% of corporate net value and account for most of the exports. However, SMEs tend to be more dynamic, create more new jobs and earn higher profits[181].

Establishing a new business is relatively uncomplicated, on the average with five procedures to be carried out taking about seven days with low costs[182]. E-government is well developed[183]. Income tax is 21% and the profit of companies located in Estonia is not taxed as long as this is not distributed. However, there are no additional tax incentives for investors[184]. A main point of criticism is long and potentially discouraging bankruptcy procedures[185].

6.8.2 Analysis

Today, among Estonia's main economic challenges are unemployment, emigration and demographic change towards a shrinking and ageing population[186].

The Estonian population declined by 5.5 % between 2000 and 2011. Only the population of the two largest cities (Tallinn and Tartu) increased, whereas all other counties showed a decline. Estonia also has a shrinking working age population. The phenomenon is less marked than the other Baltic States (Latvia and Lithuania), probably because more people commute to Finland than emigrate (22,000 emigrants since 2000 according to estimates). However, according to recent studies about 110,000 people (8% of the population) are seriously considering emigrating. Youth unemployment rate is at 24.4%

---

[180] Country Report Estonia 2016, p. 57-59.
[181] Price, R. W. and A. Wörgötter (2011), "Estonia: Making the Most of Globalisation", OECD Economics Department Working Papers, No. 876, OECD Publishing. http://dx.doi.org/10.1787/5kg9pkmsmltc-en, p. 14.
[182] Ciriaci, D., Business Dynamics and Red Tape Barriers (European Commission, Directorate-General for Economic and Financial Affairs, European Economy, Economic Papers 532, September 2014), Table III.1 based on World Bank figures for 2014.
[183] Vadasz, J. – Tébar Less, C., Accession of Estonia to the OECD - Review of international investment policies, OECD 25.03.2010, p. 12.
[184] Coface, Country essentials – Estonia, August 2015, p. 8.
[185] OECD Economic Surveys – Estonia - Overview, January 2015, p. 16.
[186] Schneider, T. – Müller, M., Die Nachbarschaftsbeziehungen der Republik Estland (Konrad-Adenauer-Stiftung e.V., Länderbericht September 2013), p. 5.

(2012)[187]. It should not be forgotten in this context that one-quarter of the population are Russian citizens and they are insufficiently integrated[188].

According to the OECD, the decline in working-age population together with shortages of skilled labour keep the labour market tight and wage pressure high[189].

FDI is an option for transferring knowledge. High value added FDI can stimulate supply chains and open up export opportunities for other domestic companies. However, it seems that in fact Estonia rather attracts manufacturing FDI in low value-added production because of low costs. This seems to apply especially to Swedish and Finnish multinational enterprises (MNE) whereas German MNEs rather tend to invest in countries with strong supply of skilled labour. Since the foreign investors seem to use Estonian companies mainly for serving the Baltic markets or for exporting to their home markets, FDI contributed less to the internationalisation of Estonian companies than expected[190].

An OECD study points out that FDI should focus on sectors with higher value-adding potential. According to research, FDI in the service industries can generate strong positive effects for the economy. Such knowledge-based and high value-added sectors could be telecommunication, business and financial services, health care, education, transportation/logistics and creative industries. This in turn would require efforts in the areas of education, vocational education and research development technology and innovation (RTDI). For attracting FDI, labour skills are considered as more important than labour costs. The study also underlines that the development of an entrepreneurial culture may need active support by fostering the international development of firms, enable access to funding for SME; however while at the same time avoiding state aid distorting competition[191]. Access to capital for entrepreneurs is considered a main challenge by the National Reform Programme 2016, too[192].

---

[187] Schneider, T., Demographic Trends in Estonia – Primary results and interpretation (Konrad-Adenauer-Stiftung e.V., Estonia Office, January 2013), p. 4.
Country Report Estonia 2016, p. 2.
[188] Coface, Country essentials – Estonia, August 2015, p. 4.
[189] OECD Economic Outlook, Volume 2016 Issue 1, p. 124.
[190] OECD Economic Surveys – Estonia - Overview, January 2015, p. 15.
Price, R. W. and A. Wörgötter (2011), "Estonia: Making the Most of Globalisation", OECD Economics Department Working Papers, No. 876, OECD Publishing. http://dx.doi.org/10.1787/5kg9pkmsmltc-en, p. 13. National Reform Programme Estonia 2020 (Approved by Government 05.05.2016), p. 20.
[191] Price, R. W. and A. Wörgötter (2011), "Estonia: Making the Most of Globalisation", OECD Economics Department Working Papers, No. 876, OECD Publishing. http://dx.doi.org/10.1787/5kg9pkmsmltc-en, p. 13-22.
[192] National Reform Programme Estonia 2020 (Approved by Government 05.05.2016), p. 19.

Business-driven RTDI has decreased to 0.6% of GDP in 2014. Only few companies cooperate with research institutions and the level of patent applications is low. Labour and skills shortages are again considered as the main reasons for this situation[193].

The political fragmentation caused by the large number of relatively small municipalities combined with local government revenues that are insufficiently matched with responsibilities are considered causing varying quality of services at local level. With the economic crisis, local government experienced a 'scissors effect' between sinking tax revenues and increasing welfare payments. Law limits municipal borrowing. It seems doubtful - especially in the case of smaller municipalities - that they can keep up public services at an adequate level. This in turn affects has a negative effect to the provision of social services and undertaking of new measures that could alleviate labour shortage[194].

The situation is aggravated by the lack of minimum requirements and a central monitoring system for municipal public services. Additionally, the provision of transport and ICT infrastructure is uneven across the country since low population density often makes investment unprofitable[195].

Some infrastructure bottlenecks remain that hold back private sector development and hamper mobility. It has been criticised that EU funds were directed towards large infrastructure projects draining funds from smaller rural projects[196]. Enterprises have been supported by the state (Enterprise Estonia, Export Guarantee fund) in order to increase their competitive strength. Ninety per cent of business support in 2010 came from EU funds. However, no permanent positive effects on competitiveness could be proved[197].

---

[193] European Commission, Recommendation for a Council Recommendation on the 2016 national reform programme of Estonia and delivering a Council opinion on the 2016 stability programme of Estonia, COM(2016) 327 final, Brussels, 18.5.2016, p. 4-5.

[194] Country Report Estonia 2016, p. 3, 39 and 56.
Kraan, D.-J. - Wehner, J. – Richter, K., Budgeting in Estonia, OECD Journal on Budgeting Volume 8 – No. 2, 2008, p. 29.
Smidova, Z. (2011), "Public Sector Spending Efficiency in Estonia: Healthcare and Local Government", OECD Economics Department Working Papers, No. 881, OECD Publishing. http://dx.doi.org/10.1787/5kg86qq1k2vl-en, p. 16-20.

[195] National Reform Programme Estonia 2020 (Approved by Government 05.05.2016), p. 24. Country Report Estonia 2016, p. 56.

[196] OECD Economic Surveys – Estonia - Overview, January 2015, p. 17.
OECD Economic Outlook, Volume 2016 Issue 1, p. 124.

[197] Price, R. W. and A. Wörgötter (2011), "Estonia: Making the Most of Globalisation", OECD Economics Department Working Papers, No. 876, OECD Publishing. http://dx.doi.org/10.1787/5kg9pkmsmltc-en, p. 22-23.

6.8.3 Solutions

A planned local government reform involving voluntary and government-initiated mergers tries to foster consolidation of the many small municipalities in Estonia. A minimum of 5,000 inhabitants is set for LRA. The measure is expected to level financial disparities between municipalities and reduce discrepancies between local revenues and responsibilities. A change of local taxation is not planned. With the reduced need for equalisation fund payments, a main disincentive for LRA to attract businesses could be removed. Consequently, the reform entrusts local authorities with the responsibility for the development of local entrepreneurship. Local support for entrepreneurs will be provided by county development centres as local partners of Enterprise Estonia and consist in advice and information on support programmes. The county development centres have drafted coordinated plans to improve entrepreneurial activity in the regions combining existing interventions with new programmes co-financed by EU funds. The Operational Programme for Cohesion Policy Funds 2014-2020 foresees some administrative capacity-building activities at LRA level linked with the reform[198].

Financial incentives for municipalities to merge have already been introduced in 2004 that lead to 27 mergers in 2011[199].

A 2011 OECD study proposes changes to the equalisation scheme by separating mechanisms for revenues and costs, by tightening the scheme, reviewing, earmarking and for block costs replacing nominal costs by real costs. Swedish and Finnish examples are cited. An incentive for increasing the population by differentiating for small population sizes could be introduced in the equalisation formula. The study also proposes to strengthen the revenue raising possibilities of municipalities by enlarging the scope for setting the land tax, e.g. by including buildings into the tax base. Introducing indicators and monitoring quality standards for public service provision could provide arguments for consolidation of underperforming LRAs[200].

[198] Country Report Estonia 2016, p. 3 and 56-58.

[199] Smidova, Z. (2011), “Public Sector Spending Efficiency in Estonia: Healthcare and Local Government”, OECD Economics Department Working Papers, No. 881, OECD Publishing. http://dx.doi.org/10.1787/5kg86qq1k2vl-en, p. 20.

[200] Smidova, Z. (2011), “Public Sector Spending Efficiency in Estonia: Healthcare and Local Government”, OECD Economics Department Working Papers, No. 881, OECD Publishing. http://dx.doi.org/10.1787/5kg86qq1k2vl-en, p. 22-23.

The former Minister for Regional Affairs proposed a new territorial administration system based on 30 to 50 hubs by merging the existing 215 municipalities[201].

The lack of high value-adding FDI has long been a concern of Estonian industrial policy that tries to attract investors via foreign representation and proactive offering of solutions by Enterprise Estonia[202]. Estonia has introduced a smart specialisation strategy combining industrial, educational and innovation policies. It is based on a bottom-up approach involving all stakeholders[203]. Its main components are 'knowledge-based Estonia' and the Entrepreneurship Growth Strategy; however, synergies between these strategies may be insufficient[204].

The National Reform Programme 2016 sees the key to attracting FDI with a strategy for a comprehensive investment environment including export of financial services, raising capacities of county development centres and local governments, creating English-language material, using 'www.eesti.ee' as single contact point, developing a talent programme and improving foreign-language education[205].

Another OECD study proposes subsidising a part of the fixed costs of cooperation and networking of SME *via* the development of clusters in order to overcome the constraints of the small size of the country. Additionally, the OECD calls for a means to integrate the various separate business promotion measures[206].

Government measures to alleviate the skills mismatch are underway (extension of apprenticeship programme, improving capabilities to monitor and forecast skills demand)[207].

---

[201] OECD (2014), "Estonia", in OECD Regional Outlook 2014: Regions and Cities: Where Policies and People Meet, OECD Publishing, Paris, p. 234.

[202] Price, R. W. and A. Wörgötter (2011), "Estonia: Making the Most of Globalisation", OECD Economics Department Working Papers, No. 876, OECD Publishing. http://dx.doi.org/10.1787/5kg9pkmsmltc-en, p. 22.

[203] OECD Economic Surveys – Estonia - Overview, January 2015, p. 15.

[204] European Commission, Recommendation for a Council Recommendation on the 2016 national reform programme of Estonia and delivering a Council opinion on the 2016 stability programme of Estonia, COM(2016) 327 final, Brussels, 18.5.2016, p. 4-5.

[205] National Reform Programme Estonia 2020 (Approved by Government 05.05.2016), p. 20.

[206] Price, R. W. and A. Wörgötter (2011), "Estonia: Making the Most of Globalisation", OECD Economics Department Working Papers, No. 876, OECD Publishing. http://dx.doi.org/10.1787/5kg9pkmsmltc-en, p. 23 and 32.

[207] OECD Economic Outlook, Volume 2016 Issue 1, p. 124.

6.8.4 Conclusions

A fiscal equalisation system with quasi-automatic loss-coverage causes disincentives for municipalities to strengthen their tax base by attracting enterprises.

The proposed solution is a radical local government reform that focuses on the creation of larger entities *via* merging small municipalities.

It is expected that this measure will reduce disparities between the individual municipalities and therefore the necessity of equalisation payments.

There is no intention to change local taxes as source of revenues.

Good practice

A planned local government reform aims at consolidating small municipalities via voluntary and government-initiated mergers (minimum of 5,000 inhabitants for municipalities).

The measure is expected to level financial disparities between municipalities and reduce discrepancies between local revenues and responsibilities. With the reduced need for equalisation fund payments, a main disincentive for LRA to attract businesses would be removed.

Additionally, the reform entrusts local authorities with the responsibility for the development of local entrepreneurship. A key instrument is the county development centres. They act as partners for Enterprise Estonia, providing advisory services to entrepreneurs, non-profit associations and local governments, and information on support programmes to applicants. In cooperation with other relevant local and regional organisations, they draw up coordinated plans to improve employment and entrepreneurial activity in the region, based on the region’s potential and needs. The plans combine existing interventions with proposals for the new region-specific mechanisms to be co-financed from the EU funds.

The Operational Programme for Cohesion Policy Funds 2014-2020 includes administrative capacity-building activities at LRA level linked with the reform.

Assessment of obstacle(s) and responses against

OECD Principles of Effective Public Investment	Assessment	Remarks
A. Co-ordinate public investment across levels of government and policies:		
1. Invest using an integrated strategy tailored to different places.	Partially fulfilled	Criticism of equalisation mechanism and of allocation of EU funds
2. Adopt effective instruments for co-ordinating across national and sub-national levels of government.	Partially fulfilled	Discussions about improving equalisation mechanism
3. Co-ordinate horizontally among sub-national governments to invest at the relevant scale.	Partially fulfilled	Discussions about improving LRA funding mechanism
B. Strengthen capacities for public investment and promote policy learning at all levels of government:		
4. Assess upfront the long-term impacts and risks of public investment.	Partially fulfilled	Allocation of EU funds under criticism
5. Engage with stakeholders throughout the investment cycle.	Fully fulfilled	
6. Mobilise private actors and financing institutions to diversify sources of funding and strengthen capacities.	Partially fulfilled	Discussions on how to improve incentives
7. Reinforce the expertise of public officials and institutions involved in public investment.	Partially fulfilled	Measures for improving capacities underway
8. Focus on results and promote learning from experience.	Partially fulfilled	Allocation of EU funds under criticism
C. Ensure proper framework conditions for public investment at all levels of government:		
9. Develop a fiscal framework adapted to the investment objectives pursued.	Partially fulfilled	Discussions about improving equalisation mechanism in order to improve incentives
10. Require sound and transparent financial management at all levels of government.	Fully fulfilled	
11. Promote transparency and strategic use	Partially	Public procurement of

of public procurement at all levels of government.	fulfilled	LRAs criticised for fostering monopolies
12. Strive for quality and consistency in regulatory systems across levels of government.	Partially fulfilled	Local government reform under discussion
WB Doing Business	**Assessment**	**Remarks**
1. Starting a business.	Very easy	
2. Dealing with construction permits.	Very easy	
3. Getting electricity.	Easy	
4. Registering property.	Very easy	
5. Getting credit	Easy	
6. Protecting minority investors.	Very difficult	
7. Paying taxes	Easy	
8. Enforcing contracts.	Very easy	
9. Trading across borders.	Easy	
10. Resolving insolvency.	Difficult	
Overall assessment (WB country rank).	16 (2016)	

7 Annex II: Main sources of information

General references

CoR, Resolution on the European Commission’s Annual Growth Survey 2016, RESOL-VI/008, 10-11 February 2016.

CoR-OECD, Infrastructure planning and investment across levels of government: current challenges and possible solutions, Results of the OECD-CoR Consultation of Sub-national Governments, 2015[208].

CoR, 2016 European Semester: Territorial analysis of the Country Reports and accompanying Communication, April 2016.

CoR, 2016 European Semester: Territorial analysis of the Country-specific Recommendations, June 2016.

CoR, Survey of Obstacles to investment at local and regional level, July 2016.

European Commission, Annual Growth Survey 2016, Strengthening the recovery and fostering convergence, COM(2015) 690 final.

European Commission, Member States Investment Challenges, SWD(2015)400 final/2.

European Commission, Country Reports 2016[209].

European Commission, Recommendation for a Council Recommendation on the 2016 national reform programmes.

European Commission, Quality of Public Administration, A Toolbox for Practitioners, February 2015[210].

European Commission, Upgrading the Single Market: more opportunities for people and business, COM(2015)550 final, October 2015.

EU Member States’ National reform Programmes 2016.

208 https://portal.cor.europa.eu/europe2020/pub/Documents/oecd-cor-jointreport.pdf
209 http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index_en.htm
210 http://ec.europa.eu/esf/main.jsp?catId=3&langId=en&keywords=&langSel=&pubType=434

OECD, Recommendation of the Council on Effective Public Investment Across Levels of Government, Adopted on 12 March 2014[211].

OECD, Effective Public Investment Across Levels of Government, Principles for Action, 2014[212] ['OECD Toolkit'].

World Bank, Measuring Business Regulations (Doing Business) 2016[213].

Section 6.1 (Italy case study)

Argento, D. (2008) Il dominio del cambiamento nella governance del servizio idrico: una comparazione fra Italia e Paesi Bassi, Cedam, Padova.

Argento, D. et al. (2010) The 'externalisation' of local public service delivery: experience in Italy and Sweden, *Int. J. Public Policy*, Vol. 5, No. 1.

European Commission (2016), Commission Country Report Italy 2016 (SWD(2016) 81 final), Brussels.

European Commission (2016), Recommendation for a Council Recommendation on the 2016 national reform programme of Italy and delivering a Council opinion on the 2016 stability programme of Italy, COM(2016) 332 final.

Groppi, T. (2004) Il Federalismo, LaTerza, Bari.

Grossi, G. (2007) 'Governance of public-private corporations in the provision of local utilities in the Italian case', *International Public Management Review*, Vol. 8, No.1.

Grossi, G. (2007) Accountability and reporting: new developments in Italian Local Governments *Paper presented on International Conference on Government Performance Management.*

lo Storto, C. (2016) The trade-off between cost efficiency and public service quality: A non-parametric frontier analysis of Italian major municipalities, in Cities 51 (2016) 52–63.

Rolla, G. (2002) Diritto Regionale e Degli Enti Locali, Giuffrè, Milano.

[211] http://www.oecd.org/regional/regional-policy/Principles-Public-Investment.pdf
[212] http://www.oecd.org/effective-public-investment-toolkit/Effective-Public-Investment-Brochure.pdf
[213] http://www.doingbusiness.org/~/media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB16-Full-Report.pdf

Valotti, G. (2006) 'I nuovi modelli di corporate governance delle imprese pubbliche locali', in *Elefanti, M. (Ed.): Evoluzione Delle Imprese Pubbliche Locali*, Il Mulino, Bologna.

World Bank (2016), Doing Business 2016 Report Italy.

UHY (2016), Doing business in Italy.

Section 6.2 (Portugal case study)

Abrantes de Sousa, M., (2011), Managing PPPs for Budget Sustainability The case of PPPs in Portugal, from problems to solutions, PPP Lusofonia, Portugal
EIB (2014), Portugal-PPP Units and Related Institutional Framework, European PPP excellence centre, Luxembourg.

European Commission (2016), Country Report Portugal 2016 (SWD (2016) 90 final), Brussels.

European Commission (2016), Recommendation for a Council Recommendation on the 2016 national reform programme of Portugal and delivering a Council opinion on the 2016 stability programme of Portugal, COM(2016) 342 final.

Monteiro, R. S. (2007), PPP and Fiscal Risks, Experiences from Portugal, International Seminar, Budapest.

OECD (2010), Dedicated Public-Private Partnership Units: A Survey of Institutional and Governance Structures, Paris.

Sarmento, J.M., Renneboog, L. (2014), The Portuguese Experience with Public-Private Partnerships, Tilburg University, Tilburg.

World Bank (2016), Doing Business 2016 Report Portugal.

UHY (2016), Doing business in Portugal.

Section 6.3 (United Kingdom case study)

Department for Communities and Local Government, National Planning Policy Framework, March 2012.

Department for Communities and Local Government, Large Sites Infrastructure Programme - CME Prospectus, October 2015.
Edgar, L., How to plan for garden communities, The Planner, July 2016.

European Commission, Country Report United Kingdom 2016, SWD(2016) 96 final.

European Commission, Recommendation for a Council Recommendation on the 2016 national reform programme of the United Kingdom and delivering a Council opinion on the 2016 convergence programme of the United Kingdom, COM(2016) 348 final.

European Social Housing Observatory, Financing of Social Housing, Study of 6 European Countries, Brussels 2013.

Falk, N., Funding housing and local growth, The Smith Institute, June 2014.

HM Government, Europe 2020: UK National Reform Programme 2016.

Local Government Association, Planning & Growth: the facts, February 2014.

Sinnett, D., Carmichael, L., Williams, K., Miner, P., From Wasted Space to Living Spaces, Brownfield land for housing development in England, University of the West of England, November, 2014.

The Scottish Government, 2020: Scottish National reform Programme 2016.

The Scottish Government, Review of Planning: Scottish Government Response, July 2016.

The Stationery Office, Housing and Planning Act 2016.

Turley, Investing in Oxford's Future, Oxford Growth Strategy, May 2016.

Wiles, C., 'Government by ministerial diktat', Inside Housing, 15 June 2016.

World Bank, Measuring Business Regulations (Doing Business).

Consultations:

Dominic Rowles, EU Adviser & Deputy Head of Brussels Office, Local Government Association (LGA).

Serafin Pazos-Vidal, Head of Brussels Office, Convention of Scottish Local Authorities (COSLA).

Section 6.4 (Sweden case study)

European Commission, Country Report Sweden 2016, SWD(2016) 95 final.

European Commission, Recommendation for a Council Recommendation on the 2016 national reform programme of Sweden and delivering a Council opinion on the 2016 convergence programme of Sweden, COM(2016) 347 final.

Ministry of Integration and Gender Equality, Swedish integration policy, Fact Sheet, December 2009.

OECD, Employment and Skills Strategies in Sweden, June 2015.

OECD: Working Together: Skills and Labour Market Integration of Immigrants and their Children in Sweden, May 2016.

National Reform Programme Sweden 2016.

OECD, Job Creation and Local Economic Development, 2014.

SALAR, Education – the key to employment, 2016.

Websites:

Fast track - a quicker introduction of newly arrived immigrants:
http://www.government.se/articles/2015/12/fast-track---a-quicker-introduction-of-newly-arrived-immigrants/

OECD Policy brief: Employment
https://www.oecd.org/policy-briefs/sweden-employment-boosting-job-creation.pdf

Consultations:

Tor Hatlevoll, Senior Advisor, Education and Labour Market Division, SALAR.
Jan-Ove Östbrink, Senior Advisor, Housing and Planning, SALAR.

Section 6.5 (Germany case study)

Arnold. F. et al., Kommunaler Finanzreport 2015 (Bertelsmann Stiftung).

Country Report Germany 2016.
Astrid Cullmann, Maria Nieswand and Caroline Stiel, Kein Rückgang der Investitionen in der kommunalen Energie- und Wasserversorgung. DIW Wochenbericht 43/2015 „Öffentliche Investitionen“, p. 1041-1047.

Marcel Fratzscher, Ronny Freier and Martin Gornig, Kommunale Investitionsschwäche überwinden. DIW Wochenbericht 43/2015 „Öffentliche Investitionen“, p. 1019-1021.

René Geißler, Kommunaler Finanzreport - In Niedersachsen wachsen die Unterschiede, Pressemitteilung Bertelsmann Stiftung, 14.08.2015.

Martin Gornig, Claus Michelsen und Kristina van Deuverden, Kommunale Infrastruktur fährt auf Verschleiß. DIW Wochenbericht 43/2015 „Öffentliche Investitionen“, p. 1023-1030.

Martin Greive, Diese Städte schwimmen im Geld, andere verarmen, Die Welt 21.10.2015 (http://www.welt.de/147860927)

Dr. Marion Henschel und Hans Christian Kattwinkel, Verfügbarkeitsmodelle: Investitionsstau beheben. https://www.partnerschaften-deutschland.de/fileadmin/Daten/OEPP_im_Fokus/Strassen/JB_PPP_2011_Henschel_121.pdf

Vic Losen, Wilhelmshaven - Probleme und Chancen, Blog 09.07.2013 (http://suite101.de/article/wilhelmshaven-probleme-und-chancen-a56254#.V1bXqb6P9f4)

OECD, OECD Economic Surveys: Germany 2016 (www.oecd.org/eco/surveys/economic-survey-germany.htm)

Wilhelmshaven schrumpft gewaltig. Wilhelmshavener Zeitung 26.05.2015.

Johannes Zuber, Pleiten, Pech und Pannen, Deutschlandradio 03.02.2015 http://www.deutschlandradiokultur.de/oeffentlich-private-partnerschaften-pleiten-pech-und-pannen.976.de.html?dram:article_id=310179

Websites:

https://www.diw.de/de/diw_01.c.517464.de/themen_nachrichten/kommunale_infrastruktur_in_deutschland_muss_deutlich_gestaerkt_werden.html

https://statistik.arbeitsagentur.de/Navigation/Statistik/Statistik-nach-Regionen/Politische-Gebietsstruktur/Niedersachsen/Wilhelmshaven-Stadt-Nav.html

https://www.hafen-hamburg.de/de/news/hafen-hamburg-im-jahr-2015---34497

http://de.statista.com/statistik/daten/studie/29970/umfrage/containerumschlag-vergleich-von-hamburg-und-bremen/

https://de.wikipedia.org/wiki/JadeWeserPort

Section 6.6 (Poland case study)

Abrell, J., Rausch, S., (2016), Cross-country electricity trade, renewable energy and European transmission infrastructure policy, *Journal of Environmental Economics and Management* 79(2016) 87–113.

BMI (2016), Poland Infrastructure Report, London.

Ebert, S., Tölle, A., Wdowicka, M., (2012), Planung in Deutschland und Polen aus kommunaler Perspektive. Planungsbegriffe in Europa, ARL/UAM. Hannover, Posen /Planowanie w Polsce i w Niemczech z perspektywy gminy. Pojęcia planistyczne w Europie, ARL/UAM. Hanower, Poznań, URN: http://nbn-resolving.de/urn:nbn:de:0156-54219.

European Commission (2016), Country Report Poland 2016 (SWD(2016) 89 final), Brussels.

European Commission (2016), Recommendation for a Council Recommendation on the 2016 national reform programme of Poland and delivering a Council opinion on the 2016 convergence programme of Poland, COM(2016) 341 final, Brussels.

Halleuxa, J., Marcinczakb, S., van der Krabben, E., (2012), The adaptive efficiency of land use planning measured by the control of urban sprawl. The cases of the Netherlands, Belgium and Poland, *Land Use Policy* 29 (2012) 887–898.

Igliński, B. et al., (2016) Wind energy in Poland – History, current state, surveys, Renewable Energy Sources Act, SWOT analysis, *Renewable and Sustainable Energy Reviews* 64(2016) 19–33.
Paleologos, J., Polemis, M., (2012), What drives investment in the telecommunications sector? Some lessons from the OECD countries, *Economic Modelling* 31 (2013) 49–57.

Radzimski, A., (2015), The system of spatial planning in Poland: time for a change? *AESOP Young Academics,* https://aesopyoungacademics.wordpress.com/2015/05/22/the-system-of-spatial-planning-in-poland-time-for-a-change/ , accessed at 20.06.2016

Rutkowski, A.,(2009), Public investment, transport infrastructure and growth in Poland *ECFIN Country Focus*, 6(11), Brussels.

Stepniak, M., Rosik, P., (2013) Accessibility improvement, territorial cohesion and spillovers: a multidimensional evaluation of two motorway sections in Poland *Journal of Transport Geography* 31 (2013) 154–163.

World Bank Doing Business 2016 Report Poland.

UHY, Doing business in Poland (2016).

UNCTAD (2015), World Investment Report 2015, Geneva.

Section 6.7 (Slovakia case study)

European Bank for Reconstruction and Development (EBRD), Slovakia R1 Expressway – Non-Technical Summary, February 2009.

European Commission, Country Report Slovakia 2016, SWD(2016) 93 final.

European Commission, Recommendation for a Council Recommendation on the 2016 national reform programme of Slovakia and delivering a Council opinion on the 2016 stability programme of Slovakia, COM(2016) 345 final.

European Commission, EU Transport in Figures – Statistical Pocketbook 2015, Brussels 2015.

European Commission, Member States Investment Challenges, Commission Staff Working Document SWD 2015(400), Brussels 2015.

European Commission Directorate-General Regional and Urban Policy, Guidance on Ex-ante Conditionalities for the European Structural and Investment Funds - PART II, 13 February 2014
European Commission Directorate-General Regional and Urban Policy, Public Procurement - Study on Administrative Capacity, Brussels 2016.

Ministry of Transport and Regional Development of the SR, Strategic Plan for Transport Infrastructure Development of the Slovak Republic until 2020, Bratislava 2014.

Ministry of Transport and Regional Development of the SR, Strategic Plan for the Development and Maintenance of Secondary and Tertiary roads, Bratislava 2014.

National Reform Programme Slovakia 2016, Bratislava 2016.

OECD, OECD Economic Surveys: Slovak Republic, November 2014.

Consultations:

Ladislav Csáder, Office of Bratislava self-governing region, Director of Transport Department.

Section 6.8 (Estonia case study)

Aussenwirtschaft Austria – Aussenwirtschaftszentrum Bayern, Exportbericht Estland (Stand: Februar 2014).

Ciriaci, D., Business Dynamics and Red Tape Barriers (European Commission, Directorate-General for Economic and Financial Affairs, European Economy, Economic Papers 532, September 2014).

Coface, Country essentials – Estonia, August 2015.

European Commission, Country Report Estonia 2016.

European Commission, Recommendation for a Council Recommendation on the 2016 national reform programme of Estonia and delivering a Council opinion on the 2016 stability programme of Estonia, COM(2016) 327 final, Brussels, 18.5.2016.

KPMG, EU funds in Central and Eastern Europe – Progress Report 2007-2013.

Kraan, D.-J. - Wehner, J. – Richter, K., Budgeting in Estonia, OECD Journal on Budgeting Volume 8 – No. 2, 2008.
OECD (2014), "Estonia", in OECD Regional Outlook 2014: Regions and Cities: Where Policies and People Meet, OECD Publishing, Paris.

OECD Economic Outlook, Volume 2016 Issue 1.

OECD Economic Surveys – Estonia - Overview, January 2015.

National Reform Programme Estonia 2020 (Approved by Government 05.05.2016).

Price, R. W. and A. Wörgötter (2011), "Estonia: Making the Most of Globalisation", OECD Economics Department Working Papers, No. 876, OECD Publishing. http://dx.doi.org/10.1787/5kg9pkmsmltc-en.

Schneider, T. – Müller, M., Die Nachbarschaftsbeziehungen der Republik Estland (Konrad-Adenauer-Stiftung e.V., Länderbericht September 2013).

Schneider, T., Estonia and the European Debt and Economic Crisis – An

Overview (Konrad-Adenauer-Stiftung e.V., Estonia Office, January 2013).

Schneider, T., Demographic Trends in Estonia – Primary results and interpretation (Konrad-Adenauer-Stiftung e.V., Estonia Office, January 2013).

Smidova, Z. (2011), "Public Sector Spending Efficiency in Estonia: Healthcare and Local Government", OECD Economics Department Working Papers, No. 881, OECD Publishing. http://dx.doi.org/10.1787/5kg86qq1k2vl-en

Statistics Estonia, The economic structure in the counties is changing, News Release No. 136, 17.12.2015.

Vadasz, J. – Tébar Less, C., Accession of Estonia to the OECD - Review of international investment policies, OECD 25.03.2010.

Websites:

http://ec.europa.eu/economy_finance/eu/countries/estonia_en.htm

http://estonia.eu/about-estonia/economy-a-it/economy-in-numbers.html