OECD-EC High-Level Workshop Series: Place-Based Policies for the Future

When should be place-based policies used, and how should they be articulated with other policy instruments?

Albert Solé-Ollé, Professor of Economics,
University of Barcelona, asole@ub.edu

Paper presented at Workshop 2: "When should be place-based policies used, and how should they be articulated vis-à-vis the broader policymaking framework, notably fiscal equalisation policies and sectoral investment policies?"

12 May 2023

Place-based policies (PBPs) are a type of policy intervention that focuses on promoting economic development in specific geographic areas. There are various types of (Conventional) PBPs: infrastructure investments, enterprise zones, education and workforce development, etc. These policies can be managed centrally –using either a regional agency or competitive grants - or delegated to subnational governments –with varying degrees of conditionality. In the report we discuss how these policies can be reconciled with what we call (Un-conventional) PBPs, which are policies which in theory have different goals but have also spatial impacts. We first discuss Equalization grants – which aim at ensuring that all governments provide public services at a similar level - and Sectoral Investment policies – which aim at stimulating investment, innovation, and job creation in sectors that are important for country growth. We study whether these policies have an effect on the goals of PBPs and whether PBPs have an effect on the goals of the other policies and derive several recommendations for a better coordination amongst all these policies.

In the case of Equalization grants, we propose: (i) Limiting and clarifying the role of the national government, (ii) Establishing participative cooperation forums, (iii) Providing more stable funding, (iv) Streamlining processes and improve governance, and (v) Choosing the right mix between equalization and regional policy. In the case of Sectoral Investment policies, we recommend: (i) Finding the right balance among different types of projects (redistributive vs transformative), (ii) Using a minimum allocation of funds for lagging regions, (iii) Improving participation, transparency, and evaluation, (iv) Having a country-level policy-framework that includes both the SIPs and the PBPs, and (v) Fine-tuning the role of the centre of government in this scheme.

JEL codes: R11, R12, R58, H77
Keywords: place-based policy, fiscal equalisation, sectorial investment, subnational government

Funded by the European Union

ABOUT THE OECD

The OECD is a multi-disciplinary inter-governmental organisation with member countries which engages in its work an increasing number of non-members from all regions of the world. The Organisation's core mission today is to help governments work together towards a stronger, cleaner, fairer global economy. Through its network of specialised committees and working groups, the OECD provides a setting where governments compare policy experiences, seek answers to common problems, identify good practice, and co-ordinate domestic and international policies. More information available: www.oecd.org.

OECD Centre for Entrepreneurship, SMEs, Regions and Cities on Twitter: @OECD_local

DISCLAMERS

This paper was prepared as a background document for an OECD-EC High-Level Workshop on "Place-Based Policy for the Future". It set the basis for reflection and discussion. The background paper should not be reported as representing the official views of the European Commission, the OECD or one of its member countries. The opinions expressed and arguments employed are those of the author(s).

This publication was produced with the financial support of the European Union. Its contents are the sole responsibility of the author and do not necessarily reflect the views of the European Union.

This document, as well as any statistical data and map included herein, are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

ABOUT THE OECD-EC HIGH-LEVEL WORKSHOP SERIES ON PLACE-BASED POLICIES FOR THE FUTURE

The series of six OECD-EC High-Level Workshops on "Place-Based Policies for the Future" consider place-based policies from the following angles: (1) how place-based policies have evolved; (2) the articulation of place-based policies against other policymaking frameworks; (3) how place-based policies can address current and future societal problems; (4) policy design, measurement and evaluation; (5) governance and coordination; and, (6) what place-based policies are required for the future.

The outputs of the workshops are a series of papers and a summary report that outlines future directions for place-based policies. This work will ultimately be relevant for policymakers at all levels of government who are interested in improving the design and implementation of place-based policies to contribute to equitable and sustainable economic futures.

The workshops support the work of the OECD Regional Development Policy Committee and its mandate to promote the design and implementation of policies that are adapted to the relevant territorial scales or geographies. The seminars also support the work of the Directorate-General for Regional and Urban Policy (DG REGIO) of the European Commission. The financial contributions and support from DG REGIO are gratefully acknowledged.

Citation: Solé-Ollé, A. (2023), "When should place based policies used and how should they be articulated with other policy instruments?", Background paper for the OECD-EC High-Level Expert Workshop Series on "Place-Based Policies for the Future", Workshop 2, 12 May 2023, https://www.oecd.org/cfe/regionaldevelopment/place-based-policies-for-the-future.htm.

Table of contents

BOXES

1 The demand for place-based policies

A general approach to Place-Based Policies (PBPs from now on) defines them as a type of policy intervention that aims to address economic, social, and environmental issues in **specific geographical areas**. A narrower approach defines **PBPs** as a type of economic development strategy that focuses on **promoting investment and job creation in specific geographic areas**, such as a city or region. According to this view, the main goal of these policies is to support long-term **economic development** in a particular location by addressing the unique challenges and opportunities of that area. These policies re-cognize that different regions or localities face different challenges and require **tailored solutions** to address them. They could be policies designed by the national government and allocated to regions, regional policies allocated to cities, or city policies allocated to neighborhoods. For most of the paper, and without loss of generality, we will restrict our-selves to the narrow definition of PBPs and discuss their merits and design challenges from the point of view of economic development. Most examples will also refer to regional policies designed by an upper layer of government[1].

In recent years, there has been a **growing demand for place-based policies** due to several factors.

One of the main drivers of this demand is **rising regional inequality**. Regional economic inequality has been increasing over the past decades due to trade shocks and automation, resulting in income becoming more concentrated in certain places. As a result, some regions have become more prosperous than others, leading to disparities in economic opportunity and outcomes. For instance, a recent report by the OECD finds that regional disparities in GDP per capita have increased over the past decades. Between the mid-1990s and the mid-2010s the ratio of GDP in the top 20% of regions compared to the bottom 20% of regions increased around 30% (OECD 2020). In the European Union, regional disparities in GDP per capita have remained high, and in some cases have even increased, over the past decade (European Commission 2019).

The causes of this rise regional inequality are complex and multifaceted, but two significant drivers are globalization and automation. Globalization has created winners and losers, with some regions benefiting from increased trade and foreign investment, while others have seen their industries and jobs displaced by international competition. Meanwhile, automation has led to a shift away from low-skilled manufacturing jobs, which were once the backbone of many regional economies (Autor et al, 2013 and 2014).

Urbanization is also a significant driver of the demand for place-based policies. As more people move to cities, rural areas can struggle to attract investment and job opportunities, leading to economic stagnation. This has created significant disparities between urban and rural areas, highlighting the need for policies that can ensure that rural areas are not left behind. The rising inequalities found in the reports cited above are to a great extent due to the “increasing concentration of economic activities in cities and to the

[1]Of course, countries differ much regarding their multi-level government settings. They have different levels of govern-ments (i.e., some countries lack a proper regional level and have very powerful local governments), different tasks are decentralized to different levels – not to say that countries differ a lot in the degree of decentralization too. This has surely an impact on the extent and type of place-based policies and on its interaction with fiscal equalization and sectoral investment policies, which is the focus of this paper.

difficulties of small remote regions to keep pace with the national frontier" (OECD 2020). This phenomenon has gained prominence in some countries, such as Spain, where the term 'España vaciada' (empty Spain) has been coined to refer to the depopulation and the abandonment of small towns and villages in many rural areas of the country. The low density of some central parts of Spain has historical roots but has become a more intense phenomenon in the last decades (Gutiérrez et al., 2023).

Another driver of demand for place-based policies is **climate change**. The impacts of climate change and of the **green transition** are spatially localized. The spatial impacts of extreme weather events –and therefore the investment required to improve the resilience of vulnerable communities- are geographically heterogeneous. Not all locations are well-endowed of resources to produce clean energy –solar and wind –, which means that a few places will bear a disproportionate share of the externalities generated by renewable infrastructure projects. Also, the reduction in the use of fossil fuels to generate electricity, power vehicles and manufacture goods will disrupt the regions that are specialized in carbon-intensive industries. For instance, certain mining regions will see its main activity disappear and regions that are specialized in car manufacturing will have to transition towards the production of electric cars. It is important to intervene early and effectively to avoid repeating the globalization-led painful adjustment experienced by manufacturing regions in recent decades (Hanson, 2023).

Economic crises, pandemics, and wars also have localized impacts, calling for a fast response. An important share of the rise of regional inequalities identified by the OECD and European Commission reports mentioned above took place after the Great Recession. The geographic impact of the COVID19 was also very unequal both in the US (Desmet and Wacziag, 2022) and across European countries and regions (ESPON 2022). Finally, the impact of the war of Ukraine has also been different across countries and regions, depending on aspects like energy dependence and disruption in supply chains. These situations call for stimulus and compensatory policies. Place-based policies can help to provide targeted support for affected regions, including economic support, health-care resources, and rebuilding efforts.

Finally, spatial inequalities can fuel the rise of **populism and distrust in institutions**. Place-based policies can help to address these concerns by providing targeted support to regions that have been left behind, reducing disparities and promoting social cohesion. This has become increasingly important as populist movements gain traction in many parts of the world, with demands for more inclusive and equitable policies that can benefit all regions (Dal Bó et al. 2023; Rodríguez-Pose et al. 2023). Similarly, many countries face localized backlash against the policies needed to implement the green transition as, for example, the increase of fuel taxes (Douenne and Favre, 2022) or the sitting of renewable infrastructure projects, as solar and wind farms (Stokes, 2016).

2 The supply for place-based policies

2.1. The case for Place-Based Policies

The traditional justification of Place-Based policies as a development tool is the **reduction of distortions caused by localized agglomeration spillovers**. Under this view there would be an overconcentration of innovative firms and/or of high-skill workers in large cities (Kline and Moretti, 2014b and Fajgelbaum and Gauber, 2020). Also, manufacturing regions affected by negative shocks might enter into a vicious cycle of loss of agglomeration economies, which will exacerbate the crisis (Dix-Carneiro and Kovack, 2017). Moreover, economic adjustment to trade shocks is hampered by the fact that some sectors tend to cluster spatially, and so are hard to initiate in new places. Because of this, after one such shock, the country will end up with too few places specialized in tradable goods. This could justify policy intervention to facilitate the start-up of new tradable and agglomeration prone activities (Venables, 2020).

Some economists are skeptical about the ability to quantify these spillovers and identify the cities that deserve such interventions (Glaeser and Gottlieb, 2008). For this reason, PBPs tend to be justified mainly on the possibility of achieving **large equity gains** (coupled with small efficiency costs), related to the improvement in government **capacity to target clusters of individuals** exposed to the economic shocks (Austin et al., 2018; Gaubert et al, 2021). Other authors do not discuss the main justification behind the use of PBPs, but question its **effectiveness** (Duranton and Venables, 2018). This lack of effectiveness might be due to coordination problems among the governments implementing the PBPs (Kim, 2021), to the benefits being captured by capitalists or by landowners (Erhlich et al., 2016) or to political distortions (Jensen et al., 2015; Slattery, 2020; Slattery and Zidar, 2020). However, we notice that this is a debate that is not settled and that some authors do identify powerful effects of PBPs (Kline and Moretti, 2014a).

Besides, there are at least two **alternatives to the use of Place-Based policies** (PBPs. The first alternative consists of **letting market forces work** –that is, waiting for the spatial reallocation of capital and labor to foster convergence. However, there is no empirical evidence that capital migration towards regions with abundant labor help reduce disparities in regional unemployment (Blanchard and Katz, 1992). There is some evidence that workers respond to regional labor market shocks, but it refers mainly to skilled workers, and even in this case mobility seems to be imperfect (Autor et al., 2013). Moreover, the adjustment of the regional labor market could depress employment rates and living conditions for an extended period of time (Bartik, 2020). After the adjustment, the region experiencing the negative shock could end up with a population which is older, poorer and sicker. This suggests that this solution would be rather painful.

The second solution consists of **improving the social safety net**, targeting the **individuals experiencing distress** instead of the **regions affected by the economic shock** (i.e., those that lost jobs, or that fell into poverty). This could entail expanding the generosity of unemployment insurance and other income transfers, which for instance was done in many countries both after the Great Recession and during the pandemic. This solution will cushion these individuals from the shock and have evident effect on the quality of living. Although they are not explicitly designed to promote growth, they can help revamp the regional economy because they improve the ability of individuals to search for a job and to acquire new skills through training. Improving access to health care and to elderly and childcare might also help in this respect

(Hanson, 2023). Notice that in countries where these policies are provided and funded centrally, this solution does not imply the targeting of specific regions. Of course, there will be spatial redistribution, since regions with more exposed individuals will be allocated more funding, while regions with a more buoyant economy will pay more taxes (Bosch et al., 2010). In countries where the provision of these services is decentralized, the ability to sustain this social safety net in the regions hit by the shock depends on the existence of **equalization transfers**. In some countries, as the US, where there are no general-purpose transfers of this kind, the provision of these services in poor regions depends on a fragmented array of earmarked block grants and on the operation of other federal instruments, and the generosity of these programs tend to vary widely across states. It is probably because of this, that some US economists have proposed the use of **spatially varying subsidies** to individuals, justified on the basis of a superior effectiveness in targeting clusters of exposed individuals (Austin et al., 2018; Gaubert et al., 2021).

In any case, the purpose of this paper is not to settle this debate. The focus from now on is not on whether PBPs are necessary or not (we already dealt with this issue in the pre-sent section) but on which is the exact policy mix that we should use. We will first describe what we call **'Conventional Place-Based policies'**, which are those policies that are explicitly targeted to a specific region with the aim of promoting growth, and that fit better with the definition provided so far in the paper. Then, we will describe what we call '**Unconventional Place-Based policies'**, which are policies that have a spatially differentia-ted impact, and can have an effect on regional development, but that were not explicitly designed with this purpose in mind. In this category, we will include the **Equalization grants** mentioned above. We will also discuss the effect of **Sectoral Investment policies**, which are other policies pursued by the national government with the aim of promoting development at the country level, and that can also have a spatially differentiated effect. After describing these policies, we will discuss whether these other types of policies are substitutes or complements of Conventional Place-Based policies, and how the design of the different types of policies can be reconciled.

2.2. (Conventional) Place-Based policies

We define **(Conventional) Place-based policies** as a type of economic development strategy that focuses on **promoting investment and job creation in specific geographic areas**, such as a region or a city. The main goal of these policies is to support long-term **economic development** in a particular location by addressing the unique challenges and opportunities of that area[2]. However, it is worth noting that these policies often have other complementary goals as, for example, attenuating the possible **spillovers** generated by a decentralized approach to regional economic development. For example, as discussed below, regional development might be also achieved by assigning general funds to sub-national governments. However, under this decentralized approach, there is the risk that the funds are used to fund beggar-thy-neighbor policies as, e.g. subsidies to attract firms (Slattery and Zidar, 2020) or are not allocated to projects that gene-rate positive spillovers on the other regions (Acemoglu et al., 2015).

There are various types of **conventional PBPs** that have been used over the years. One common type is **infrastructure investments**, which can include improvements to transportation networks, broadband access, and utilities. These types of investments can help to attract businesses to the area and support economic growth. This is an instrument widely used by the EU and members countries as part of their regional policy. Within the current 2021-2027 budget period, the EU has allocated approximately 49% of the total structural funds budget to investments in infrastructure (https://www.fondoseuropeos.hacienda.gob.es). There is empirical evidence that infrastructure investment is capable of improving

[2] Admittedly, this is a somewhat narrow definition. One could envision a broader array of goals of place-based policies, related to the improvement of welfare of specific places, to the compensation for localized externalities, or to the accommodation of 'smart degrowth' strategies in the case of shrinking regions. Besides of this, however, most exam-ples of real-world place-based policies still refer to policies fostering regional and local development and are usually measured in terms of its impacts on investment, job creation or unemployment.

regional productivity, especially when departing from a low level of infrastructure stock (see De La Fuente et al, 1995, for evidence from the 1980s for Spain). Of course, the marginal impact of investments in infrastructure may wane over time as the capital stock approaches its optimal value (see Fernald, 1999) or might be reduced due to a regional allocation that is too redistributive (De La Fuente, 2002; Castells et al., 2005; Solé-Ollé, 2013) or politically biased (Castells et al., 2005; Curto et al., 2012).

Another type of traditional PBP is the use of **enterprise zones**, which are designated areas where businesses can receive tax breaks and other benefits to encourage investment and job creation (Neumark and Young, 2020). **Education and workforce development** programs are also commonly used PBPs, aimed at improving education and workforce training to help individuals acquire the skills needed to compete for high-paying jobs (Bartik, 2022). Other examples of traditional PBPs include **community development** initiatives, **subsidized lending for real estate developers**, or **grants for small business development** (see Neumark and Simpson, 2016, for a more detailed characterization of Place-Based policies). Box 2-1 provides selected examples of Place Based Policies used in different OECD countries. Some of the policies target regions while others focus on cities or neighborhoods.

Box 2-1. Examples of Conventional Place-Based Policies by country

United States:

Empowerment Zone Program (1993-2004) was a federal initiative that provided tax incentives and grants to economically distressed communities to encourage investment and create jobs.

Community Development Block Grant (CDBG, 1974-present) is a federal grant program that provides funding to local governments for community development activities such as affor-dable housing, infrastructure improvements, and job creation.

European Union:

Cohesion Policy (1986-present) is a long-term EU strategy aimed at reducing economic disparities between regions and promoting sustainable development.

European Regional Development Fund (ERDF, 1975-present) is a financial instrument supporting investments in infrastructure, research and innovation, and SMEs in less developed regions of the EU.

United Kingdom:

Enterprise Zones (1981-present) are designated areas that offer tax breaks and other incentives to attract new businesses and create jobs.

City Deals (2012-present) are agreements between the UK government and cities to give them more control over funding and decision-making for economic development.

France:

Territorial Contracts (Contrats Territoriaux, 1983-present) are agreements between the state and local authorities to implement development projects in areas with economic and social difficulties.

Urban Free Zones (Zones Franches Urbaines, 1996-present) are designated areas with tax breaks and other incentives to encourage businesses to invest and create jobs.

Italy:

Casa del Mezzogiorno (1950-present) is a regional development program aimed at reducing economic disparities between southern and northern Italy. The program includes investments in infrastructure, education, and job creation.

Germany:

Solidarity Pact (Solidarpakt, 1995-present) is a financial transfer system that redistributes funds from economically stronger regions to weaker ones.

Joint Task for the Improvement of Regional Economic Structures (GRW, 1991-present) is a grant program that supports investments in economically underdeveloped regions of Germany.

Spain:

Interterritorial Compensation Fund (Fondo de Compensación Interterritorial) is a financial transfer system that provides funds to less prosperous regions of Spain to reduce economic disparities.

Neighborhood Plan (Pla de Barris, 1997-present) is a place-based policy in Catalonia that provides funding for social and economic development projects in disadvantaged urban neighborhoods.

Notice that these policies can be used in combination to create a **comprehensive approach** to promoting economic development in a particular area. A comprehensive approach to PBPs is necessary because each region has different needs and characteristics that require tailored interventions. No single policy instrument is likely to be effective in addressing all the complex issues facing a particular region. Moreover, this comprehensive approach would help implement the **'big push' policies** needed to effectively jump start local development (see more on this in section 3.1.1). A good example of this approach is the EU Next Generation Funds, which is a package of extraordinary recovery and resilience measures to address the economic and social challenges caused by the COVID-19 pandemic, and which includes investment in digital infrastructures, ecological transformation, training and education, research and innovation, and strengthening the healthcare system. Each Member State has to prepare its own Recovery and Resilience Plan, which will define the specific priorities and projects to be financed with these funds. However, it is pertinent to note that even the place-based policies that have a comprehensive approach on paper, can be a mere accumulation of different instruments that are not so well integrated with each other.

Also, it's worth noting that while some Place-Based Policies are **designed and managed centrally** others are **delegated to subnational governments.** Actually, there is a spectrum of possibilities that go from more decentralized to more centralized PBPs:

- In a fully **centralized** approach, the design and implementation of the PBP is carried out by the national government. The national government might be able to implement a spatially differentiated policy through the creation of a **specific agency for the target region** as, for example, in the cases of the Tennessee Valley Authority in the US (Kline and Moretti, 2014a) or the Casa del Mezziogiorno in Italy (D'Amico, 2022). A variety of tax incentives, loans and grants to private agents can also be used, as in the Empowerment Zone Initiative in the US (see Box 2-2). The feasibility of a centralized solution has been recently enhanced by the use of **competitive grants** allocated directly to private actors, which are widely used in the case of EU's Next Generation or the new industrial policies of the US federal government.
- A fully decentralized approach consists of the **allocation of funds by formula** coupled with complete autonomy in the selection of projects by recipient governments. An example of such an approach is the Community Development Block Grant (CDBG) in the US (see again Box 2-2). However, in most cases, decentralization involves the use of **earmarked grants** aimed at funding

previously selected projects. Oftentimes, there is a minimum and/or a maximum amount of funding allocated to each recipient government. The criteria for selecting projects is quite general sometimes, reflecting overall policy priorities of the donor government, and very specific in other occasions. These grants are usually earmarked for capital spending, which traditionally has been considered to have a stronger impact on regional development. The traditional design of regional policy instruments in countries like Germany, Spain, or in the EU follows closely this design.

Box 2-2. Examples of Comprehensive and Centralized Place-Based Policies

Example 1: Comprehensive PBP: European Union's Smart Specialization Strategy (S3).

This policy aims to promote regional economic development by focusing on each region's strengths and opportunities (Interreg-Europe, 2020)

The S3 approach is comprehensive in that it involves a combination of policy instruments, such as grants, loans, tax incentives, and technical assistance, to address the specific needs and characteristics of each region. For instance, a region that specializes in high-tech industries may receive funding for research and development, while a region with a strong tourism sector may receive support for infrastructure and marketing.

The S3 approach also involves a participatory process that engages local stakeholders, including businesses, universities, and civil society, in developing the regional strategy. This participatory approach ensures that the strategy is based on a shared understanding of the region's strengths and weaknesses and that the policy instruments are tailored to the local context.

Example 2: Centralized policy: Empowerment Zone Initiative, US

An example of a place-based policy that is managed centrally is the Empowerment Zone Initiative in the United States. This initiative was launched in 1993 to provide targeted support to distressed urban and rural communities across the country (HUD, 1999).

Under this initiative, designated "Empowerment Zones" receive a package of tax incentives, grants, and other forms of financial assistance to promote economic development and job creation. The initiative is managed centrally by the federal government, with a specific set of eligibility criteria and a competitive application process.

Once a community is designated as an Empowerment Zone, a local council is established to oversee the implementation of the policy. However, the overall management of the initiative, including the selection of eligible communities, the design of the policy instruments, and the evaluation of its impact, is centralized within the federal government.

Example 2: Decentralized policy: Community Development Block Grant (CDBG), US

The CDBG program is a federal grant program that provides funding to local governments and states to support community development activities such as affordable housing, infrastructure improvements, and economic development. While the program is managed at the federal level by the Department of Housing and Urban Development (HUD), the implementation of the program is decentralized and managed at the local level. (https://www.hudexchange.info/ programs/cdbg/)

Each year, HUD allocates funds to states and local governments based on a formula that takes into account factors such as population, poverty rates, and housing overcrowding. Local governments then use the funds to support projects that align with their own community development priorities and needs.

Whether the PBPs is centralized or decentralized might matter for its articulation vis a vis Equalization grants or Sectoral Investment policies. Decentralized PBPs are usually channeled to subnational governments through earmarked grants and, therefore, feed directly the subnational budget and they might end up complementing or substituting other sources of funding, as general grants or subnational own revenues. Centralized PBPs are allocated directly to final users by the national government and, therefore, are more naturally embedded in the policy and budget framework of the national government. Of course, some of the recent PBPs strategies –as the EU's Next Generation Funds of the US New Industrial Policies- are very complex and have both centralized and decentralized components at the same time.

2.3. (Unconventional) Place-Based policies

2.3.1. Equalization grants

Equalization grants are **financial transfers from a national government to sub-national governments** aimed at reducing fiscal disparities between regions or municipalities within a country. The main goal of these grants is to ensure that all governments can **provide public services at a similar level**, regardless of their fiscal capacity, provided they exert the same tax effort. Statements similar to this are found in the Constitutions or in the Basic Laws that regulate the finances of subnational governments in most countries (see, for example, the cases of Canada, Australia, Germany or Spain). Of course, the implementation of the formula used to compute these grants might deviate from this goal (more discussion on this point below).

The **taxonomy** of equalization grants can be divided into two categories: general purpose and specific purpose grants. **General purpose grants** aim to **adjust for differences in fiscal capacity** (and sometimes spending needs) between jurisdictions and **can be used for any purpose** deemed necessary by the receiving jurisdiction. Examples of countries that use general purpose grants include Australia, Canada, Germany, and Spain. Some of these grants are horizontal, with contributions from high fiscal capacity governments funding the grants received by low fiscal capacity units. Other grants are vertical, being therefore funded by the national government; these grants can be allocated only to some regions (as in Canada) or to all units (as in Spain). In some countries (e.g. Germany) horizontal and vertical grants coexist. Besides some commonalities among countries, each one has its specific design. Differences amongst countries depend to a great extent on the traits of the multilevel government system (i.e., layers of government, number of units in each layer, specific services that have been decentralized, national regulation over basic traits of these services) but also on idiosyncratic institutional and historical features. For a more detailed comparison of Equalization grants across countries, see for example, OECD (2007 and 2021). It is worth noting that these grants are usually managed by one administrative unit, located in the Ministry of Finance.

Specific purpose grants, on the other hand, are **earmarked for specific policies** such as education, healthcare, or social services. They are mostly **allocated on a needs basis**, taking into account factors such as population, demographics, and delivery costs. Sometimes, specific purpose grants also account for differences in fiscal capacity. Some of these grants are open-ended matching grants –the final amount depending therefore on the spending choice of the subnational government- while others are close-ended block grants of a fixed amount. There is also a large variety of designs, both across counties and also across programs. Each grant is usually managed by a different administrative unit of the national government.

The United States is an example of a country that uses specific purpose grants for fiscal capacity equalization (ACIR, 1964; Baicker et al., 2012). Only between 1972 and 1986, the U.S. had its own fiscal equalization policy in the form of the General Revenue Sharing (GRS) program. There are several historical, social, and institutional traits of the US might explain this exceptionalism (Béland and Lecours, 2014). In recent crises, however, there have been some proposals to reintroduce the idea (Galbraith et al., 2020). In any case, US states do provide general revenue assistance to the cities and school districts, although the degree of equalization achieved is probably very heterogeneous.

It is important to note that the **reduction of fiscal disparities** achieved by equalization grants depends on the **type and size of the grant**, as well as the **design** of the formula, which depends on the revenue sources included, as well as whether the grant provides total or partial equalization. Partial equalization refers to the share of the differences in fiscal capacity that are intendedly eliminated by the formula or, in other words, to the sha-re of tax revenues that subnational governments are allowed to retain and that, therefore, it is not equalized (OECD 2001). Notice, however, that the effective degree of equalization might differ from the one stated in the main formula, due to the existence of other funds and provisions embedded in the system. For example, Spain applies in theory a 25% retention rate for regional fiscal capacity, meaning that only three-quarters of the regions' fiscal capacity is equalized. In practice, however, status quo rules (that prevent any region losing revenues with respect to the previous period) and ad hoc funds make the partial equalization provision irrelevant and might even generate over-equalization (López-Laborda et al., 2023). Similarly, in order to limit its impact on the federal budget, Canada introduced in 2009 a ceiling to the total amount of vertical equalization grants allocated to the recipient provinces, with an obvious impact of the degree of equalization.

It is worth also to remember that the degree of inter-regional redistribution achieved by public budgets in each country does not depend only on the equalization grants allocated to subnational governments. Fiscal flows between a given region and the center depend also on how the rest of the budget (national taxes and spending programs) is allocated spatially (Bosch et al., 2010). For example, the centre might sit national public goods (e.g., museums, garrisons, general administration) in specific regions or cities, and this will clearly have an impact on the local economy and on the welfare of the residents.

All these aspects will matter when analyzing the interaction between Place-Based policies (PBPs) and Equalization grants. In particular, if there are no Equalization grants or if the degree of equalization is low, the role of PBPs might be enhanced, since lagging subnational governments might lack the resources needed to make decentralization work. On the other hand, a high retention rate might be important to provide the right incentives to subnational governments to develop its tax base. We will further develop these arguments in section 3.

2.3.2. Sectoral investment policies

Sectoral investment policies are a set of policies that aim to **stimulate investment, innovation, and job creation in specific sectors** of strategic importance for a country's economic growth. These policies are designed to provide targeted support to industries that are deemed critical to a country's economic success. Box 3 provides a taxonomy of Sectoral investment policies and some examples from OECD countries.

It is important to note that these policies are not mutually exclusive and **can be used in combination** to support the development of specific sectors or industries. In recent years there has been a rise in this type of **comprehensive policies**, as for example:

Stimulus packages that aim to encourage economic activity and job creation through the combination of many different programs. For example, the United States' American Recovery and Reinvestment Act of 2009 provided funding for infrastructure projects, education, and training programs to promote economic recovery following the Great Recession (Wilson, 2012).

Industrial policies that focus on promoting the development of the industrial sector. A prominent example can be seen in the European Union's Industrial Policy Strategy (2000).This policy aims to promote the growth of a modern, sustainable, and competitive industry in Europe through the combination of several different public policies and initiatives as: support for Digital Transformation and Green transition, investment in research and innovation, access to finance for small and medium-sized enterprises (SMEs) and startups, and the promotion of skills and education in science, technology, engineering, and mathematics (STEM).

These types of policies have experienced a recent revival, both in the US and in the EU. In the US, "Bidenomics" centers on what it is called and "modern American industrial strategy" (Brookings Institution, 2022) while in the EU the New European Industrial Policy and the EU's Next Generation EU recovery plan have a similar focus (European Commission, 2022). These policies had also become more popular among academics, although not all economists are equally enthusiastic (see Delong, 2022, for a positive view, and Munger, 2022, for a more critical one). A couple of recent papers have documented the boom of these types of policies across countries (Juhász et al., 2022) and the large impact they had in some countries (see Lane, 2022, on South Korea).

Green transition policies aim at addressing climate change and other environmental challenges. For example, the European Union's Green Deal aims to promote the transition to a carbon-neutral economy by 2050 through investments in renewable energy, sustainable transport, and circular economy initiatives. It is difficult to separate the surge in this policy from the revival in industrial policy commented above. Green transition policies are, to a great extent, policies aimed at restructuring the manufacturing sector, hen-ce the coining of the new term "Green Industrial policy". Governments might have started using this tool after understanding the devastating effect that decarbonization might have on specific sectors as, for example, car manufacturers. Also, this type of policies, that provide direct subsidies to address environmental problems, might have been chosen by governments after realizing that other solutions (carbon taxes) were facing political backlash (see van Reenen, 2022).

Box 2-3. Taxonomy and examples of Sectoral Investment Policies

Research and development (R&D) and innovation policies, such as funding and incentives for R&D activities, as well as funding or support for startups, incubators, and accelerators. These policies are designed to encourage the development of new technologies and products, as well as the growth of innovative businesses.

Example: The Science Foundation Ireland (SFI) (2003). Promotes and funds scientific and technological research in Ireland. Aims to develop talent, create world-class research centers, and translate research into commercial and social impact. SFI provides funding for research projects and infrastructure, supports training and education programs for researchers, and promotes collaboration between academia and industry.

Investment promotion policies, which seek to attract investment to specific sectors or industries through tax incentives, subsidies, or other forms of support. These policies are designed to encourage both domestic and foreign investment in key industries, which can lead to job creation and economic growth.

Example: Invest in Denmark (1994). A government agency that promotes foreign direct investment (FDI) in Denmark, by giving guidance and assistance to foreign companies interested in investing in Denmark, including information on Denmark's business climate, infrastructure, workforce, and other factors relevant to investment decisions. The agency also offers customized investment solutions, such as financial incentives, and helps foreign companies navigate legal and regulatory requirements.

Infrastructure development policies, such as support for the development of transportation or telecommunications infrastructure in specific sectors or industries. These policies are designed to improve the competitiveness of these sectors and enable them to take advantage of new technologies and opportunities.

Cluster development policies, which seek to support the development of clusters of related businesses in specific sectors, through funding for networks and collaborations. These policies are designed to encourage the growth of industries through cooperation and shared resources.

Example: Innovation Cluster for Artificial Intelligence (AI) in Quebec, Canada (2017). Brings together industry, academic, and government partners to support the development and commercialization of AI technologies. The cluster provides funding, expertise, and networking opportunities to AI start-ups and established companies.

Workforce development policies, which seek to develop the skills and knowledge of workers in specific sectors or industries through training and education programs. These policies are designed to ensure that workers have the necessary skills to succeed in key industries, which can lead to job creation and economic growth.

Example: Australian Government's Industry Training Hub program (2019). Targeted training and education programs to young people in regional areas of Australia. The Industry Training Hubs bring together employers, schools, and training providers to identify local skills needs and develop tailored training programs to meet those needs.

It is important to notice that Sectoral Investment Policies in general, and the comprehensive types of policies mentioned above in particular, aim at promoting economic growth at the country level and/or other **national public goods** (e.g., reduction of greenhouse emissions). However, these initiatives may also take the **spatial impact of the policy** into consideration. For example, in order to maximize the impact on the overall economy, stimulus packages focus on regions with high multiplier effects. Industrial policies should be targeted also to regions with some comparative advantage (e.g., already specialized in the car industry, in the case of subsidies to battery factories), or to regions with declining industries (e.g., retraining programs for workers in declining industries or incentives to attract new business to unused factories after a factory shutdown). Green policies are targeted to areas with more potential for growth (e.g., regions with wind and solar resources).

For example, the 'new industrial policies' introduced in this area, both in the US and in Europe, do actually have an important **place-based approach**. They deliberately target interventions towards particular locations. The idea is to boost the broader economy by directly helping local economies, engaging with the local needs of industries and admitting that success relies on the geographical concentrations of talent, suppliers and know-ledge. According to a report by Brookings (2022), there are at least 19 place-based industrial policy programs in the new Biden legislation, that account for a 2.3% of total funds. Although this share seems small, these programs will account for $77 billion of spending in 2027, which is a lot more than the largest place-based program in the US history (the Tennessee Valley authority, that spent around $9 billion for a period of five years).

Finally, recall that we already explained that conventional PBPs also have some goals beyond regional development (e.g., dealing with spillovers). However, these added goals are probably of a secondary nature. Sectoral Investment policies' main goal has a national scope; however, as secondary goal, many of these policies have the same intent than conventional PBPs.

3 Reconciling place-based policies with other policies

Designing and implementing Place Based Policies (PBPs) can be challenging, especially when it comes to reconciling them with other policy instruments. In this text, we explore two challenging questions regarding the design and implementation of Place Based Policies.

How to reconcile Place-Based Policies and Equalization Grants? Equalization Grants (EGs) main goal is to promote equal access to public services, but they might also have some impact on long-run regional development. PBPs primary goal is to focus on long-run development of specific regions, but it can also have an impact on sub-national budgets (especially when implemented trough earmarked grants). Also, both PBPs can EGs may have secondary goals, related, for example, to the attenuation of the effects of interregional spillovers. How can the two policies, PBPs and EGs, be better aligned in order to achieve all these goals?

How to reconcile Place-Based Policies vs Sectoral Investment Policies? Sectoral Investment Policies (SIPs) aim to promote national public goods, such as economic growth and the green transition. However, PBPs may not always align with SIPs, as they primarily focus on specific regions rather than on the entire country. If we give preeminence to the provision of the national public good, we might be harming the lagging regions, while if we insist in earmarking resources to poor regions, we might reduce the effectiveness of the policy. How can we reconcile both policies and achieve both goals?

We try to provide some answers to these two questions in the coming sections. Designing and implementing PBPs can be challenging, especially when it comes to reconciling them with other policy instruments. However, by carefully considering the trade-offs and potential synergies between different policies, it might be possible to design effective and sustainable policies that promote economic growth, reduce territorial inequalities, and ensure equal access to public services.

3.1. Place-Based policies vs Equalization

Traditionally, policy design has followed economist Jan Tinbergen's approach of **using a different policy instrument to target each specific economic goal**. This acknowledges that there is no single policy instrument that can effectively achieve multiple economic goals simultaneously. Therefore, when focusing on the primary goals of these policies, **Place-Based Policies (PBPs)** should be used to **promote economic development**, while **Equalization Grants (EGs)** should be used to **reduce fiscal disparities**, to ensure subnational governments are able to deliver the services assigned to them. The consideration of the secondary goal (i.e., dealing with the consequences of spillovers) of these policies might provide further arguments for their separation.

However, an alternative approach to policy design has emerged that recognizes **that policies designed to achieve one goal may have unintended consequences, both positive and negative, on other goals.** Moreover, policymakers face the reality that resources are limited, and allocating more resources to one policy instrument means less resources are available for another. Policymakers should account for these **interactions** when designing the policies. They must consider the potential **synergies and trade-offs** of each policy instrument and the effects they may have on achieving multiple goals simultaneously. Therefore, they should account for the possibility that **EGs may have an effect on economic development**, and **PBPs might have an effect on fiscal inequalities**. Of course, the extent of the interactions depends on the design of specific EGs and PBPs as, for example, the existence and equalization power of EGs or the degree of decentralization of PBPs. Moreover, coordinating efforts can be challenging because EGs are under the management of the Ministry of Finance, while PBPs usually fall under the responsibility of different administrative units.

Below we will examine in detail these two assertions. Two notifications are in order here. First, notice that in the case of PBPs, most of the arguments refer to policies implemented through the use of **earmarked grants** to subnational governments. The reason is that this type of PBPs is the one where the interaction with the autonomous fiscal decisions of subnational governments is more likely. At some point we are going to discuss how these interactions can be attenuated by using a more centralized approach to PBPs. Second, the discussion focuses mostly on the conflict between the main goals of the two policy instruments. At the end of the section, we will review the evidence regarding the effect of both policies on the ability to deal with **spillover effects**.

3.1.1. Do Equalization grants have a positive effect on economic development?

The answer to this question is not straightforward, and there are arguments for both yes and no, which are reviewed below. In Box 4 we provide several pieces of empirical evidence which substantiate these answers.

YES. Equalization grants (EGs) can **unlock the potential of subnational governments to develop the economy**. EGs are a complement to decentralization because they provide sub-national governments with the **resources needed to spend** in infrastructure, education, healthcare, and other public goods. By providing quality public services, the living environment of a region or a city can be improved, which can help to retain and attract skilled workers, entrepreneurs, and businesses. This could certainly contribute to regional economic development.

YES. Furthermore, EGs provide the **fiscal flexibility** required to **respond to local economic conditions and priorities.** This allows sub-national governments to tailor their policies and spending to promote growth based on the unique needs and strengths of their region. With EGs, sub-national governments can overcome the constraints of limited resources and competing demands on their budgets. Recall that one of the main benefits attributed to decentralization is the higher ability of subnational governments to adapt their policies to local demands and needs (Oates, 1972). However, this advantage can be clearly undermined by the lack of resources of subnational governments with limited fiscal capacity.

YES. Since EGs are not earmarked, there can be **more incentives to manage them well**. The idea is that in this case, the choice of a bad project has a high opportunity cost: not being able to finance a better project, which could have been selected because the subnational government has total autonomy over the use of resources. This does not happen in the case of PBP grants: in this case, the goal of the subnational government is just to fulfill the requirements of the call. The subnational government will apply for projects that never would have been funded with general grants (because the benefits are lower than those of alternative uses, or because of different political time horizons between grantor and grantee), provided they have a positive benefit (or a benefit that it is larger than the cost of applying). Of course, this would not be true if the center (through the setting of priorities and good implementation of the call) is able to select the best projects and monitor its implementation.

Unfortunately, it is difficult to obtain credible empirical evidence regarding the previous three points. After several decades of studies on the impact of decentralization on the quality of services provided and on growth, we don't have definitive answers on this issue[3]. This is mostly due by the difficulty of the object of study: decentralization is a concept that is difficult to measure and there is rarely an exogenous source of variation that is able to establish causality. Moreover, notice that the arguments advanced above do not refer to decentralization per se, but to a certain kind of decentralization, the one that is accompanied with enough resources for lagging regions, or that provides enough incentives to pursue development policies. Box 3-1 review a few studies that bring some light on these issues. It is a very selected literature review based on whether the study brings some light to the exact question we posit and whether the results are minimally credible. As you will realize, there is some evidence in favor of the arguments, but we can't' say it is conclusive or that it allows to quantify the effects in any reasonable way.

Box 3-1. Evidence of the effect of Equalization grants on economic development

Equalization and migration: Kessler et al. (2015), Henkel et al. (2022): these two papers provide evidence that an increase in fiscal transfers across regions reduce migration and result in a slowdown of economic convergence.

Equalization and growth: There are a large number of papers on the effects of decentralization on growth, but the results are rather inconclusive or very heterogeneous (see Martínez-Vázquez and McNab, 2003, for a survey). However, they do not address the specific question we are interested on, which is: does decentralization, coupled with enough resources to provide the services that are competence of subnational governments, has a positive effect on the quality of services provided and/or on growth?

Two pieces of research that bring some light on this issue are Salinas and Solé-Ollé (2018) and Rodríguez-Pose et al. (2022). The first paper studies the impact of partial decentralization of education in Spain on educational outcomes. The results suggest that decentralization lead to a reduction in early drop-out rates and that this effect is much stronger in high-revenue regions; these are the regions winning from an (ill-computed) equalization formula. Therefore, the result suggests that decentralization works better when recipients get enough funds. In the second paper, the authors study whether the existence of unfunded mandates mediate the effect of decentralization of growth with data from a sample of countries. The paper finds that the effect of decentralization on growth is much lower when unfunded mandates are higher. This means that for decentralization to work subnational governments need to have access to enough resources, given their responsibilities.

Equalization and growth incentives: There are no papers that explicitly look at the effect of equalization on the incentives to bias spending towards programs that are deemed to have an effect on regional development. Maybe the only paper doing something similar is the one by Federe (2012), although it is not clear from the interpretation of the results whether this is a good or a bad thing in the case of Canada (whether this is encouraging to much or not enough development efforts).

In a related paper, Kappeler et al. (2013) look at the effect of revenue decentralization on the incentives to spend on infrastructure using cross-country data. The paper finds that subnational governments that rely more on tax revenues (and less on grants) spend more on productive infrastructure (and find no effect in the case of social infrastructure). Notice that studying the effect of the share of revenues coming from taxes is not the same than looking at the effect of revenue retention rates, as influenced by equalization formulas. However, the authors provide some arguments (and report some correlations) that suggest that countries with more revenue decentralization tend to have a lower degree of

[3] Clearly, there is a substantial amount of very interesting research on the effects of decentralization on the quality of services and on growth. For an excellent review of this literature see Chapter 4 in OECD (2019).

equalization. From the paper, however, it is not totally clear whether the results are a good of a bad thing, from the point of view of the whole country.

This paper is related to other contributions that emphasize the perils of grant financing for growth, starting from the seminal contribution of Weingast (2009), who coined the term 'marginal retention rate'. See also Gadene (2017), Martinez (2023) and Brollo et al. (2013) for papers that provide credible evidence regarding the adverse effects of grant financing on the subnational government incentives to perform (although not necessarily on growth). In any case, if the above answers are correct, EGs would be successful in achieving their objectives and it is possible that we might not need PBPs anymore. Unfortunately, the literature also provides some negative answers to the above question, which are detailed in the following paragraphs.

NO. There are situations where **quality public services might not be enough** to promote development. For instance, lack of capital and skilled labor, lack of agglomeration economies, and an inadequate infrastructure stock might hinder development. In these cases, a **'big push'** might be necessary to help the region escape a **'poverty trap'**, calling for PBPs to complement the effects of EGs[4]. This concept is related to the 'cumulative causation' mechanism proposed by Myrdal (1957), according to which an initial external stimulus, such as a large-scale investment, can trigger a self-reinforcing cycle of growth and development. This idea is consistent with the view that justifies PBPs as a way to reduce the distortions created by agglomeration spillovers. For instance, the market might not provide enough incentives to invest in activities that achieve high productivity through agglomeration activities in places that lost an historic advantage (Venables, 2020). The evaluation of the Tennessee Valley Authority by Kline and Moretti (2014b) provides some empirical support for the 'big push' theory.

NO. Equalization grants (EGs) **can deter migration and halt economic convergence.** The improvement in the quality of public services resulting from EGs can lead to a better quality of life and reduce the incentives for migration (Hansen et al. 2011). This means that while we cannot completely get rid of EGs, we need to complement them with PBPs that foster development in specific regions. However, some authors suggest that although reduced migration might be bad for growth at the national level, it might be good for welfare if some cities are overpopulated (Henkel et al., 2022). According to these authors, the optimal solution probably involves **partial equalization**, understood as an equalization grant that less than fully compensates for the gap between own fiscal capacity and average fiscal capacity. In this approach, regional inequalities are tackled by a combination of economic mobility (still incentivized by the partial nature of the equalization system) and the access to a basic bundle of public services guaranteed by the equalization program, without the need to resorting to the use of PBPs.

NO. Another argument against EGs is that they can **reduce the incentive of subnational governments to improve their own productive capacity**, which can ultimately slow down eco-nomic growth. EGs reduce the responsiveness of subnational revenues to economic growth. The specific design of the formula used for EGs determines the extent of this effect. For example, Dalbhy (2002) shows theoretically how the Canadian equalization grant reduces the re-venue-generating effects of any tax base enhancing expenditures, just as it offsets the reduction in the base from a tax increase. This biases the provincial government tax mix in favor of taxes with tax bases lower than the standard and reduce the recipient's government expenditures on tax-base generating activities. Some empirical evidence in favor of each statement can be found in Smart (2007) and Federe (2014). In Box 4 we present some additional evidence regarding the link between tax retention rates and incentives to promote growth.

[4] We might want to pay separate attention to regions that are shrinking and that don't have some realistic growth prospects. In this group, instead of trying to support growth which has no long-term prospects, one could focus on "smart shrinkage", i.e., accommodating the local and regional public services to existing and future population.

However, note that if retention rates are too high, we might run into a different kind of a problem. We can have a **'race to the bottom'** in the case of tax rates, or competition to raise subsidy rates, which are also bad outcomes. This happens because the subnational government cutting tax rates or increasing subsidies is going to benefit from all revenues generated by the increase in the tax base. EGs might attenuate these problems, although many authors suggest that partial equalization would be sufficient (Bucovetsky and Smart, 2003; Hendriks et al., 2008). Look at Esteller-Moré and Solé-Ollé (2003) for evidence on the effect of EGs in taming tax competition in Canada. In any case, the more equalization we have, the lower will be the role of market forces in ensuring convergence, and the higher the role for PBPs. Moreover, notice that PBPs, which generally involve a centralized allocation of resources (even if the implementation is decentralized), are less vulnerable to competitive behaviors. That is, the national government might exercise the control of the program to veto any project which involves the use of public funds to attract firms from other regions. As we said, a well-designed EG in theory should tame the incentives of this action. However, EGs are not always well-designed[5] and, in any case, centralized control provides a double-check against these damaging practices. A good example are EU Next Generation funds, which came with a set of regulations related to EU state aid policy that make difficult the targeting of subsidies to attract specific firms[6].

NO. The **low quality of government** in some undeveloped regions can mean that resources are not used effectively. This can undermine the potential impact of EGs and other development programs. In these cases, there might be a need for conditionality in the use of grants to ensure that they are used appropriately and effectively[7]. There are some papers that already document that the impact of decentralization on growth depends on the quality of government (OECD, 2020). Notice, however, the literature that evaluates the effectiveness of regional policy instruments also finds that the positive effect of the policy is conditional on aspects as the level of human capital of the region and the quality of government (Ehrlich et al., 2013).

Some papers, however, suggest that the effect improves when the implementation of regional policy is carried out by a **centralized agency** (D'Amico, 2020). There is also a lot of optimism in more centralized options, like the use of **competitive grants**, which are extensively used by EU Next Generation funds and also by the industrial policy of the Biden administration. However, there is still not a lot of evidence regarding its effects. An example is the paper by Ghirelli et al. (2013), which evaluates the long run effects of the EU ERC program (which allocates research funds competitively) on the universe of applicants of the 2007-2013 period. The results suggest that obtaining an ERC grant leads to positive long-term effects on scientific productivity and on the capacity to attract other EU funds. However, the impact is not huge, and it is difficult from the results to judge the systemic effects of the policy and its cost-effectiveness. More research is clearly needed to reach a clear conclusion.

---

[5] For example, in the case of Spain, the equalization formula does not include a proper calculation of tax capacity for some taxes (e.g., the inheritance tax) and instead uses a calculation based on outdated tax collections. Because of this, a reduction in the tax rate that generates an increase in the tax base of the inheritance tax (an strategy followed by Madrid in recent years) does not have any real impact on the equalization funds received (notice that they should have decreased if tax capacity was computed in the right way). This may be one of the reasons some regions are pursuing such an aggressive competitive strategy (see Agrawal et al., 2019 and 2022).

[6] This is unless the EU Commission specifically lifts these requirements for some projects. For example, large subsidies to the building of electric battery factories are generally not subject to them. This decision comes after an evaluation by the EC and the states about the opportunity to do it. In the case of battery factories, it comes after the design of the map of production of the electric car in Europe. Having said that, the application of the EU state aid regulation is an additional administrative hurdle which is making the implementation of EU Next Generation projects very difficult (see Baena et al., 2023, for a discussion of the Spanish case).

[7] Admittedly, in some cases, the normative regulation of public services assigned to subnational governments can take care of this. For instance, this could be implemented through minimum standards for services that are monitored by national government agencies and citizens as service users. However, it is less clear how to implement this approach in the case of regional development policies (or PBPs more generally).

Another important point is the possibility of **conditioning the allocation of these grants** to the achievement of some objectives related to the **improvement of the management of the funds** and, more generally, to the introduction of **reforms that improve the quality of government.** (Spahn, 2012) One example of such a mechanism is the new Conditionality Mechanism introduce by the European Union in 2021 to ensure the good use of EU funds managed by national authorities, which complement previous tools at the disposal of the EC, that eventually allow the suspension of programs or of the reimbursement of their costs (European Parliament, 2023). However, the key question here is the credibility of the punishments available in this and other cases or the ability of the grantor government to condition future funding to past performance (Spahn, 2012).

The introduction of this conditionality seems more feasible in the case of PBP earmarked grants (as the case of EU funds above illustrates) than in the case of general purpose EGs. This is because general-purpose grants aim at guaranteeing social citizenship rights while earmarked grants aim at achieving certain goals. Having said this, it is also possible to retain the disbursement of general-purpose grants in the event the recipient government does not fulfil some basic obligation as, for example, transparency or payment to providers.

NO. Myopic local voters may choose to use the resources provided by EGs (which are not earmarked) on immediate **consumption rather than on investment** in productive activities or saving for the future[8]. This is particularly true when EGs are used to fund public sector jobs or subsidize inefficient firms. As a result, the intended benefits of EGs may not be fully realized. This point is developed by D'Amico (2022) in relation to regional development funds; he argues that projects with short-run costs (layoffs) and long-run benefits (restructuring of the economy) can only be implemented centrally. He finds some evidence of this for the case of Italy: in regions with a majority of unskilled workers, regional policy projects are biased towards sectors intensive in low-skill (high-skill) workers when decision-making is allocated to regional governments vs to a centrally controlled development agency. This argument is even more relevant when we have in mind the allocation of general grants to subnational governments. After all, even regional policy grants to subnational governments are subject to some degree of conditionally and central control.

These last two arguments clearly call for the use of PBPs to complement the use of EGs. By expanding the resources targeted through PBPs, we are making the access to funds to subnational governments conditional on its use for certain purposes, allegedly more related to economic development. Besides of this, the access of resources could also be linked to reforms that improve the quality of government, an aspect that I will address again later.

Summing up, according to the arguments developed in this section, Place-based policies (PBPs) are needed for several reasons. Firstly, if policymakers believe that a 'big push' is required to promote growth and development in particular areas, PBPs may be necessary. In this case, EGs can be a complement of PBPs, but they might not be enough to provide the impulse needed to jump start the local economy. Secondly, in some cases Equalization grants (EGs) are going to be very strong –because of constitutional and political imperatives-, completely halting the migration channel. In this case, one could not rely at all on market forces to achieve convergence, so PBPs may provide an alternative approach to development. Thirdly, if no EGs exist, PBPs are going be the only available development instrument. Fourthly, when subnational governments cannot be trusted to pursue growth, PBPs may be necessary to promote development. Fifthly, PBPs can be used to incentivize structural reforms and improve quality of government, especially in the case of subnational governments with low institutional quality. However, it should be noted that the effects of PBPs on local development very modest in some contexts and, in any

[8] A nuance to this idea comes from the fact that in many countries EGs are allocated for operating expenditure. Notice, however, that there are productive government activities (as education and workforce training) where operating expenditure is very important. Moreover, in many countries (and specially at the regional rather than at the local level) EGs are allocated for all sort of expenditures.

case, highly heterogeneous (see, for example, Becker et al., 2010, 2012; Ehrlich et al., 2013, on the effect of EU regional policy and D'Amico, 2020, on the Italian case).

Finally, remember that earmarked grants (which are often used to implement PBPs) tend to have a secondary goal, related to the **internalization of positive spillovers**. In theory, when the benefits of a policy spill over a region's boundaries, an open-ended matching grant could be used to internalize spillovers and provide enough incentives to subnational governments to spend on this program (Oates, 1972). An example of this type of grant are the capital grants that subsidize the construction of interstate highways in the US. More generally, the use of earmarked grants allows for the coordination of the actions of different governments, potentially increasing the effectiveness of PBPs. See Spahn (2012) for a more general discussion of the advantages and drawbacks of conditional grants, and of their general role as intergovernmental coordination devices.

However, as Bird and Smart (2009) note, most of these grants are not open-ended; certainly, the earmarked projects grants used most of the time to implement PBPs are not. This means, that most of the time, earmarked grants are not explicitly designed for the purpose of internalizing spillovers[9]. As an alternative explanation, they suggest that they are used because there is a **demand for accountability to the national governments** by voters. This is not necessarily a bad thing, especially when facing important societal challenges (e.g., economic crises, pandemics, climate change), since voters tend to attribute the ultimate responsibility to the national government. Conditionality allows to put less weight to accountability towards voters and more on accountability towards the national government. In theory, the national government could monitor the implementation of the projects and reward good performance. In practice, evaluation of the performance of many of these PBPs is going to be difficult and it is also politically difficult to punish bad performance or to link future funding to past performance (Spahn, 2012).

Finally, notice that the main risk of pushing conditionality too much is the loss of autonomy of subnational governments, the micromanagement of the policy from the center and, eventually, a failure to tailor the projects to the local demands and needs. Moreover, it is worth noting that the failure of subnational government to pursue the right development policies is highly heterogeneous (Boffa et al., 2016). There is going to be always a subset of regions, with high administrative capacity and good governance, that can do things well. Not surprisingly these regions tend to be the more affluent ones. Therefore, even if on average the country benefits from centralization, the harm to the local autonomy of these regions can be large. Therefore, some sort of asymmetric approach might be advisable. This could be achieved by a reduction in the degree of equalization –which would allow affluent regions to manage more grants- coupled with an increase in the among of PBPs specifically assigned to lagging regions –which ensures the targeting of resources to these regions, which could be subject to tighter conditionality conditions.

3.1.2. Do Place-Based Policies have a positive effect on subnational budgets?

What we mean by a positive effect on subnational budgets is whether these funds alleviate or intensify the level of fiscal stress faced by subnational governments. Obviously, these effects will happen mostly in the case of decentralized PBPs, that are channeled in the form of earmarked grants to local governments.

In theory, these funds should have a neutral effect on subnational fiscal stress if they are earmarked for specific types of spending that do not negatively impact other programs or tax collection. However, if this is not the case, these funds could either alleviate or worsen the level of subnational fiscal stress. The literature provides arguments in favor of both a yes and no answer to this question, which we will outline below.

[9] Certainly, there is also some nuance in this case. For example, even if the funding mechanism is not an open-ended grant, significant national investments (e.g., transport or digital infrastructure) are designed taking into account potential spatial and network externalities.

YES: Place-based policies (PBPs) implemented through earmarked grants are often **fungible**, which means they **function similarly to general-purpose grants** in practice. This means that PBPs may not achieve their intended goal of stimulating specific types of spending that are identified as good for growth. Notice, however, that this can be good if the **center is unable to identify the needs and strengths of the region**. Of course, in this case, providing general purpose grants would be even better, since this would save on administration costs.

The downside of this approach is that, if PBPs go to lagging regions, adding (fungible) PBPs to Equalization grants (EGs) might be **over-equalizing** fiscal resources, which in turn might increase the discontent amongst donors regarding inter-regional redistribution. Since PBPs are not achieving its goal, poor regions are not catching up, but residents there benefit from better public services or lower taxes than resident in donor regions. This is especially true when PBPs funding comes at the expense of the amount allocated to EGs. Notice that the concept of over-equalization that I am using here refers to providing an amount of Equalization grants that is larger than the one suggested by a well-designed equalization formula.

Of course, donors might also contest the mere concept of equalization and/or might be unhappy about having to contribute to regional policy funds. There are some papers studying to which extent economic factors are important to explain secessionist demands by rich regions. For instance, both Muñoz and Tormos (2015) and Desmet et al (2022) show that identity aspects are paramount in this context, but that economic factors do have an independent effect. Some theory papers also suggest that partial equalization could play a role in preventing secession (Le Breton and Weber, 2003). We are not aware of any (theoretical or empirical) paper looking at the effects of unconditional and permanent redistribution (e.g., equalization) vs conditional and transitory redistribution (e.g., regional policy) on the legitimacy of the union and/or on the demand for inter-regional redistribution. However, from what we know about preferences for inter-personal redistribution, paternalistic reasons often make people prefer in-kind to cash subsidies as an instrument to help the poor (Liscow and Pershing, 2020). Residents in rich donor regions might prefer grants to poor regions to be earmarked and conditional rather than general.

The point, however, is that Equalization grants (if well designed) are based on a clearly defined and transparent equity concept. Regional policy grants (if well designed) are also based on a clearly defined concept and, in any case, are dedicated to specific expenditure programs that are supposed to spur growth. Hence, they should not be fungible and should be evaluable and transitory. If they are not, and for the sake of transparency, it would be better to use the available funds to increase general purpose grants.

Clearly, **over-equalization may occur for different reasons**. Take the case of Spain. The main issue there is that the equalization formulas embedded in the regional financing system use an array of funds, not all clearly related to the concept of equalization (López-Laborda et al., 2023). Some of these rules are introducing regional policy goals in the formula by the back door, giving extra resources to lagging regions (on top of those needed for the equalization of fiscal capacity). Also, when the system was created at the beginning of the 1980s, there was a deliberate decision of not including public investment in the computation of spending needs, and of channeling these resources through regional policy (the so-called 'Interterritorial Cooperation Fund') which was allocated only to lagging regions. This amounts to a reduction of the vertical equalization fund (the amount of money that the national government feeds into the system, and which is allocated to the regions on a needs basis) while increasing the amount allocated to regional policy, which is allocated only to the poorest regions. Notice that this had the effect of increasing general funding to poor regions without any sort of conditionality. Hence, it had the effect of making funds allocated with regional policy criteria totally fungible.

NO: **Co-financing requirements** generate fiscal stress, especially in regions with low fiscal capacity. While co-financing might help reduce the fungibility of PBP grants, it can be challenging for subnational governments to meet this requirement, leading either to fiscal stress or to difficulties in the absorption of the funds allocated to fiscally weak governments. This is actually another reason why it is important to combine Equalization grants (EQs) with PBPs. Once fiscal capacity is equalized, there is no reason why poor regions will face higher difficulties in finding the additional funds required for co-financing –especially when equalization accounts for capital spending needs. In a situation where there is no equalization of fiscal capacity and there is a real worry by the grantor about the difficulty of recipient government to absorb the funding, the solution ends up being a very a low degree of co-financing. This is the case with the Next Generation EU funds, which tend to finance a very high share of the selected projects (100% in some cases). Of course, without local resources involved, the subnational incentives for good management might be muted, as we already discussed in the previous section. In this case, one would have to rely entirely on the ability of the grantor to select good projects.

NO: Volatility of funding is also an issue with PBPs. Oftentimes, the PBPs arise as a part of a stimulus package or an extraordinary effort to transform the economy and, because of this, the policy is not stablished as permanent. This means that subnational governments have no certainty that the funds available in the present will be there also in the future. This reality shortens planning horizons and biases spending decisions towards new investments rather than maintenance. This leads either to crumbling infrastructure or to fiscal stress in the future. A similar bias exists towards the hiring of temporary workers to complete these projects, which also leads to layoffs, too many temporary contracts, or to fiscal stress. In general, recipients would prefer to receive a lower amount of funding in exchange for more stability.

The funding obtained through EGs are in theory more stable. However, the volatility of EGs or of general grants (Boadway, 2004), and even of some types of tax revenues (Solé-Ollé and Viladecans, 2018), is also an issue in some countries. Of course, volatility is bad not just because of the side effects on subnational budgets; volatility generates peaks of funding that are more difficult to absorb by subnational governments (due to lack of administrative resources) and even by the local economy (due to lack of spare resources). This has an effect on the effectiveness of PBPs. This is a real worry in the case of the EU Next Generation funds; the huge inflow of resources coupled with high energy prices mean that there are not enough firms interested in executing some of the projects (see, e.g., "240 million in unfinished works due to deserted bids", La Razón 15/03/2023). In fact, one of the adverse side effects of PBPs are their potential inflationary effects in a period with high inflation as the one we are currently experiencing.

NO: Red tape is another issue with PBPs, as subnational governments need to spend scarce resources to get the funds. This issue is more problematic the more centralized is the PBP. Earmarked grants allocated by formula that allow subnational governments to select the projects are not problematic from this point of view. Project grants require some effort in the identification and preparation of the projects. However, the good thing is that many of the projects are awarded, since there are minimum amounts of funding allocated to each subnational government. Coordination meetings and technical assistance helps align the vision of grantor and grantee. The level of effort is higher in the case of competitive grants and the risk of not obtaining any reward is much higher, since there are high changes the effort in preparation of the project will not pay.

However, the extra cost of project preparation can force subnational governments to improve planning and evaluation, which is a positive aspect of PBPs. This positive aspect, however, is conditional on these programs having some stability. If this is the case, subnational government would have incentives to develop a pipeline of viable projects, because they know that they will be asked for proposals at regular intervals. Anecdotal evidence from the execution of the EU Next Generation funds in Spain suggest that the subnational governments that have been more successful in having their projects awarded are those that they already had a pipeline of viable projects (that is, in an advanced design phase). Notice that this issue would be more worrisome if there is no equalization, the reason being that in this case poor regions will have less administrative capacity than the rich ones[10]. This is another reason that EGs might be a complement to PBPs. Even in this case, however, being able to mobilize projects often depends on the

[10] One way to deal with this issue is the launching of special grants aiming at help in the identification and preparation of projects.

structure of the economy (having a strong manufacturing sector) than on the administrative capacity of the subnational government alone.

NO: Encroachment is a risk with PBPs, as the center may decide over responsibilities assigned to subnational governments using its spending power. This blurs the attribution of responsibility to different layers and erodes accountability. Of course, this might not be very problematic if the grants are designed as performance grants and therefore properly evaluated. This might also be less of a problem in cases where subnational governments are implementing policies in areas of national government responsibility (e.g., climate action). However, in other cases, the design will totally blur the attribution of responsibility for the success or failure of the project.

NO: Political favoritism is also a risk with PBPs, as they are not formula-based like EGs. The center might allocate funds based on political incentives, such as to aligned governments and to places with competitive elections. This is bad for democracy gene-rally and erodes accountability at the subnational level. Of course, this is also bad for the effectiveness of PBPs: project selection based on political connections is likely to come at the expense of their effectiveness. There is evidence that project grants and public investment are allocated disproportionately to regions or localities with high electoral clout. See for example, evidence regarding the allocation of infrastructure investment in Spain based on electoral considerations (Castells and Solé-Ollé, 2005, 2012) and of the allocation of capital projects grants to municipalities also in Spain (Solé-Ollé and Sorribas, 2008; Curto et al., 2018). It is important to notice that these are not totally discretionary programs. They are subject to formulas that allocate part of the funding to regions and municipalities. However, there is always some room for discretionarily through the selection of specific projects.

It is worth noticing that the use of competitive grants to allocate funding is seen as a promising way to limit political discretion and overcome this classical criticism of place-based policies and, more generally, industrial policies (Munger, 2022, and Palladino, 2023). The optimism is partly based on the lack of evidence regarding political biases in the allocation of the ARRA funds in the US (Dube et al., 2014) and partly based in the characteristics of the processes used to allocate the new competitive grants. Notice, however, that even theoretically competitive allocation of resources might be manipulated in countries with weak institutions (see for example Zihua and Slie, 2022, for evidence of the effect of political connections of research funding in China, and Branstetter et al., 2023, for the lack of impact of China's industrial policies on productivity). Moreover, it is not clear how competitive are competitive grants in the case of the funding of very big projects (e.g., the sitting of a big battery plant).

Summing up, EGs are formula based and therefore less susceptible of political favoritism. PBPs are very vulnerable to this threat, although new institutional arrangements, based on the use of competitive grants, may alleviate this concern. More evidence is however needed regarding this issue.

In conclusion, PBPs may have some adverse effects on the fiscal stress faced by subnational governments. PBPs may improve the situation of subnational finances in situations where they are highly fungible. However, they might also generate some negative side effects of subnational finances due to its larger volatility, red tape, encroachment, and favoritism. Ultimately, whether the negative effects dominate over the positive ones depends on the specific context and how they are implemented. To minimize the negative effects of PBPs on the workings of subnational governments, its design and implementation has to be improved.

3.2. Place-Based Policies vs Sectoral Investment Policies

Place-Based Policies (PBPs) have the goal of promoting economic development in **specific regions**, while Sectoral Investment Policies (SIPs) aim are targeted at **specific economic sectors**, with the aim of **promoting growth at the country level**. Therefore, SIPs are a **national public good**, while PBPs are a

local public good. Hence, we have again two different goals that we address with two instruments. How can we reconcile the use of these two instruments? We need to explore whether there are any synergies or trade-off between them. With this purpose in mind, below we analyze whether each instrument is able to contribute or not to the goal implicitly assumed to the other instrument. Can PBPs also contribute (in a positive or negative way) to overall country growth? And, can SIPs have an effect on the growth of lagging regions? A positive answer to these questions will call for an integrated design and implementation of both policies.

As we will see below, the answer to these questions rest on the specific design of PBPs and SIPs. Paramount in this design is the role assigned to the central vs the subnational governments. We will also address this issue below.

3.2.1. Do Place-Based Policies have an effect on overall country growth?

The question of whether Place-Based Policies have an effect on overall country growth is not clear-cut, as there are arguments in favor or against this statement.

NO: Investing in lagging regions can help reduce regional disparities, but it **may go against the maximization of national growth**. National growth requires investing in more prosperous and dynamic regions, which may have a higher return on investment. So, in principle, there might be an equity-efficiency tradeoff in the design of these policies. There is some evidence on this trade-off for the case of transportation policies. As show in Castells and Solé-Ollé (2005) and Solé-Ollé (2012) the regional allocation of infrastructure investment in Spain is too redistributive, in the sense that it is disproportionally allocated to lagging regions instead than to region having a low levels of capital stock relative to GDP. This allocation reduced the effect of infrastructure investment in overall country growth. It might be argued that this outcome is natural. After all an important share of infrastructure investment in recent decades in Spain has been funded by EU Regional Policy, which has a clear redistributive component. Notice, however, that according to Solé-Ollé (2012), the redistributive strength of infrastructure investment is not explained in the main by the redistributive nature of EU funds. Other aspects, as the ideology of the party ruling at the center or its electoral incentives might be important.

YES: PBPs can have an effect on overall country growth if the allocation of the funds takes into account the **spillovers and network effects** of the policy. Continuing with the analogy with transport policies, infrastructure investment in lagging regions might actually contribute to enhance market access in the whole country. In fact, there is important evidence that the construction of some network infrastructures (as e.g., the high-speed train) has mainly benefited large urban regions (Albalate and Bel, 2012).

YES: On the other hand, **place-based policies can unlock the potential of lagging regions**, which can have a positive effect on overall country growth. For example, investing in regions that have recently been affected by deindustrialization can help mobilize underutilized resources, such as human capital, infrastructure, and natural resources. This can create new opportunities for economic growth and development, which can benefit the entire country. As we have explained previously, this is actually the approach of the new industrial policy initiatives both in the US and Europe. The success of these industrial policies is assumed to depend on the capacity to mobilize local resources and agents that are spatially clustered. Notice, however, that although these policies are spatially targeted, they are allocated to regions with some transformative potential. These might be regions that are at risk of facing shock related to decarbonization and digitalization, but not necessary structurally poor regions. Therefore, there is a risk that these new PBPs pit historically poor regions against other deserving regions (Suedekum, 2023). The solution to this conundrum rest on ensuring that the policy is effective in fostering structural transformation at the country level. This will generate a win-win solution, where the additional tax revenues generated can fund additional PBPs for structurally lagging regions and/or a more generous equalization system. Unfortunately, there is the risk that the design of the policy is compromised in order to compensate these losing regions. One example of this would be the national government subsidizing the location of a new factory in a place where agglomeration economies are not fully exploited.

YES: Another benefit of place-based policies is that they can **help win political support for Sectoral Investment Policies (SIPs)**. These plans aim to promote economic growth and development in specific sectors or regions. By investing in lagging regions, governments can demonstrate their commitment to reducing regional disparities and promoting inclusive growth. This can help build support for SIPs among politicians, business leaders, and the general public, which can help ensure their success. This is not necessarily a bad thing, since it is paramount that the new policies can achieve the national goals that are pursuing, even if some additional cost hast to be paid. The issue, as we described in the previous paragraph, is whether this cost refers only the allocation of some additional funding to some regions, or entails a decision that does not seem efficient from the point of view of the goal of the policy.

3.2.1. Do Sectoral Investment Policies affect the growth of lagging regions?

The question of whether Sectoral Investment Policies have a positive effect on the growth or welfare of lagging regions can be answered in two ways: NO and YES.

NO: Unless sectoral investment policies **explicitly incorporate the goal of promoting growth and welfare in lagging regions**, they may not have a positive effect on these regions. In fact, merging both policies can **detract funding explicitly allocated to poor regions**. This is because sectoral policies may prioritize investment in more prosperous and dynamic regions, which may have a higher return on investment. This is a point already raised above and there is no magic solution for this. This means that these programs can not totally substitute for traditional PBPs (like regional policy grants). Even if it makes sense to integrate sectoral policies with PBPs in terms of planning, some of the constraints on the spatial allocation of traditional PBPs (e.g., definition of regions deserving assistance) need to be kept. This is the way EU Next Generation Funds work. The resources allocated to regions within a country are influenced by the rules of the different regional funds that feed the policy. It is unclear, however, how the new funds allocated to this program will at the end affect the amount of funds allocated to lagging regions. In any case, there is the need to balance the traditional goals of regional policy with the new goals of selecting the projects that are more transformative from the point of view of the whole country.

YES: However, if sectoral investment policies can generate large regional **spillovers**, they can have a positive effect on the growth and welfare of lagging regions. This is a point that we also have raised before. It calls for a shift in the approach to these policies. Traditionally, subnational governments care about the share of funding that will end up being allocated to their region. This makes sense given that regional politicians are accountable to their voters. Central politicians, however, often have the same approach, because they care about the votes they can get from each electoral district (see Castells and Solé-Ollé, 2005, and Solé-Ollé, 2012, for evidence on the effects of these incentives on the allocation of funds). It is to be seen whether central politicians can move from a 'distributive politics' approach to these policies (which cares about the specific spatial allocation of the funds) to a 'redistributive politics' one (that emphasizes the national public good qualities of this approach). Note that at the end, whether this is the case or not will depend on the ability to ensure the transparency and fairness in the selection of projects, and also on whether the policy is really effective. We have already provided some examples of effective place-based and industrial policies in this paper (Kline and Moretti, 2014b; Lane, 2022; Criscuolo et al., 2019), but there are also examples of failed ones. Frankly, it is too early to say whether these 'new industrial place-based policies' will be able to deliver on their promises.

4 Conclusions / Recommendations

In the paper we have studied different policy approaches to policies that aim at fostering the development of regional and local economies, aka Place Based Policies (PBPs). We have defined and reviewed the conventional approach to PBPs, which consists of allocating resources that are targeted to specific territories and types of policies. These policies might either be centralized (that is designed and implemented by the national government) or decentralized (usually consisting in earmarked grants to subnational governments). We have also identified other policies that are cannot strictly be qualified as PBPs, but that also target resources geographically and therefore can have similar impacts. First, there are the Equalization Grants (EGs), which are general grants that allocate resources to subnational government in order to correct disparities in fiscal capacity and or spending needs. Second, there are Sectoral Investment Policies (SIPs), that are policies aimed at fostering national growth in specific sectors but that also tend to have a spatial component.

We notice that the design and implementation of PBPs is often isolated from that of EGs and SIPs. The reasons are varied; first, the primary goals of these policies are different, and traditionally this has been interpreted as a call for the design of different instruments; second, these policies are usually carried out by different administrative units, which makes coordination challenging. After noticing this lack of integration, we review the different arguments that make this a bad idea. After this review, we are able to provide a suggestive list of policy recommendations that will help to reconcile the design of PBPs with that of EGs and SIPs, and which are listed below.

4.1. Policy recommendations: reconciling Place-Based Policies and Equalization Grants

From the above discussion we can tentatively develop some recommendations regarding how PBPs and EGs should be articulated in practice.

Limit and clarify the role of the national government: To ensure that place-based policies are effective, it is important to have a transparent allocation of funds. This means that the criteria for determining which regions receive funding should be clear and easily accessible to the public. Additionally, the center should provide leadership on the overall direction of the policy, while still allowing for regional priorities to be considered.

Establish participative cooperation forums to facilitate communication between the national and subnational governments. This is especially important because sometimes it is going to be impossible to completely delineate the role of the national and subnational governments.

Provide more stable funding: One of the main challenges of place-based policies is ensuring that funding is sustained over time. This is essential to enable the continuity of projects and to avoid the negative consequences of funding volatility on subnational budgets. Therefore, policymakers should aim to provide more stable funding, whether by extending funding horizons or by providing multi-year funding commitments. This can help to ensure that place-based policies have the necessary resources to achieve their objectives and deliver long-lasting impacts.

Streamline processes and improve governance: In many cases, place-based policies can be burdened by red tape and complicated bureaucratic procedures. This can lead to delays in project implementation and make it harder for subnational governments to access funding. To address this issue, policymakers should strive to streamline processes and make it easier for subnational governments to access funding. Additionally, better governance practices should be established to ensure that funds are used effectively, and that corruption is minimized.

Choose the right mix between equalization and regional policy. A substantial degree of equalization is needed to make regional policy work. However, a partial degree of equalization might provide more incentives to promote growth and leverage the capacities of subnational governments. The fact that this would mainly happen in regions with more resources and high quality of government calls for an increase in the regional funds specifically allocated to lagging regions, which should be transitory, conditional and evaluable. It is important also to set up institutions that allow to establish a dialogue between the areas of the administration taking care of EGs and PBPs.

4.2`. Policy recommendations: reconciling Place-Based Policies and Sectorial Investment Policies

From the discussion in the previous two section, we can highlight a set of recommendations for the integrated design of these two policies:

Finding the Right Balance among Different Types of Projects. To reconcile Place-Based Policies (PBPs) with Sectoral Investment Policies (SIPs) at large, policymakers must find the right balance among different types of projects. While some projects may be crucial for the transformation of the national economy, others may have a high transformation potential at the local level. Ideally, policymakers should prioritize projects that score well on both criteria, ensuring that the benefits of both PBPs and SIPs are maximized and contribute to overall economic growth and development.

Using a Minimum Allocation of Funds for Lagging Regions. This allocation should be conditional on the mobilization of transformative projects that can unlock the potential of these regions. Not only can this approach mobilize political support for PBPs, but it can also attenuate criticisms of 'favoritism' that may arise due to the more degrees of freedom the national government tends to have in this type of policy.

Improving Participation, Transparency, and Evaluation. Policymakers should establish an independent agency responsible for monitoring and evaluating the effectiveness of PBPs and SIPs. This agency should ensure that all stakeholders have a voice in the policymaking process and that the policymaking process is transparent and accountable. Additionally, policymakers should ensure that the agency is adequately funded to carry out its responsibilities effectively.

Having a Country-level Policy-Framework that Includes both the SIPs and the PBPs. This policy-framework should clearly state the goals of each instrument and link them to the relevant agency or government responsible for their implementation. Policymakers should also ensure that the policy-framework is stable both in terms of design and funding. This stability can help ensure that both PBPs and SIPs are implemented effectively and can contribute to overall economic growth and development.

Fine-tune the role of the center of government in this scheme. Given some of the goals of this policies are defined at the country level, it is natural that the national government plays an important role in their design. However, through the discussion we have already identified some of the limitations to a policy approach that relies too much on centralization. For example, the center has difficulties in identifying the potential of specific regions and localities and it has a high temptation to favor some regions that have more political clout when allocating resources spatially. At the same time, subnational governments have clear limitations: they are not interested in pursuing the national-level goals, and they also have some difficulties in implementing the policies they need without the help of the center. Because of this, it is necessary to understand the need to integrate the different levels of government in the policy framework in a balanced way. Below there are some tentative suggestions on the role that should be attributed to the center in this scheme:

- **Act as a policy clearinghouse**, collecting proposals for policies and providing analysis and evaluation of the policy proposals they collect. This can help ensure that policies are evidence-based, effective, and aligned with broader policy goals. Additionally, the national government can provide guidance to other layers of government on how they should establish their own clearinghouse, creating a more coordinated and effective policymaking process.
- **Leadership**. After collecting all the relevant information, the national government can define broad policy goals such as digitalization or green transition and identify mega-projects that can help achieve these goals, such as factories of electric cars or chips. By doing so, the national government can provide a clear direction for policy implementation and ensure that resources are allocated effectively.
- **Design and manage the national policy-framework**, including the allocation of the budget to sectors, government, and regions, and the organization of joint tasks. However, to ensure accountability and effectiveness, the national government can delegate the evaluation of these policies to an independent agency. This can help ensure that policies are evaluated impartially and based on objective criteria, thereby enhancing the credibility and effectiveness of the policy framework.
- **Restrict the number of projects executed from the center**. Instead, the national government can prioritize projects with large spillovers and for which the center has administrative capacity. This approach can help avoid micromanagement from the center and ensure that projects are implemented effectively.
- **Avoid encroaching on regional and local responsibilities**. Instead, the national government can maximize the use of sub-national input in the selection of projects, allowing regions and local governments to have a say in the policymaking process. This can help ensure that policies are more tailored to local conditions and needs, thereby enhancing their effectiveness and acceptability.

The importance of some of the above recommendations stems from the fact that there is a real risk of this new policy framework being used as a recentralization device. One the one side, a larger involvement by the center is possibly a result of voter demand in front of a crisis. There is some evidence that crisis led to a centralization of power, due to the fact that the center government is seen by voters as the level ultimately responsible for the well-being of citizen. However, one thing is the normative recommendation and the other is the positive observation that the center government might be using national threats and demand for policy as an excuse to regain control over many matters that are the responsibility of regional governments. Therefore, it is perfectly possible that the outcome observed is an excessive level of centralization, with micromanagement of decisions which the center is not able to tackle well, and encroachment over subnational responsibilities which can have damaging effects over the working of the multilayer system of government and, ultimately, of democracy.

References

Acemoglu, D., García-Jimeno, C. and Robinson, J.A. (2015): "State capacity and economic development: a network approach." *American Economic Review* 105(8), 2364-2409.

ACIR (1964): *The role of equalization in Federal grants.* Advisory Commission on Intergovernmental relations, Washington D.C.

Agrawal, D. and Foremny, D. (2019): "Relocation of the Rich: Migration in Response to Tax Rate Changes from Spanish Reforms." *Review of Economics and Statistics* 101(2), 214-232.

Agrawal, D., Foremny, D. and Martínez-Toledano, C. (2023): "Wealth Tax Mobility and Tax Coordination." Processed U. of Barcelona.

Albalate, D. and Bel, G. (2012): "High-Speed Rail: Lessons for Policy Makers from Experiences Abroad." *Public Administration Review* 72(3), 336-349.

Austin, B.A., Glaeser, E.L. and Summers, L.H. (2018): "Jobs for the Heartland: Place-Based Policies in 21st Century America." NBER Working Paper 24548.

Autor, D. H., Dorn, D. and Hanson, G.H. (2016): "The China Shock: Learning from Labor Market Adjustment to Large Changes in Trade." *Annual Review of Economics* 8, 205–240.

Autor, D. H., Dorn, D. and Hanson, G.H. (2013): "The China Syndrome: Local Labor Market Effects of Import Competition in the United States." *American Economic Review* 103, 2121–2168.

Baena, P., De la Fuente, A. Alcázar, A., Riesgo, P. and Sicilia, J. (2003): "El Mecanismo de Recuperación y Resiliencia en España: balance provisional y propuestas de mejora." Estudios sobre Economía Española 2003/03, FEDEA.

Baicker, K., Clemens, M, and Singhal, M. (2012): "The Rise of the States: US Fiscal Decentralization in the Postwar Period." *Journal of Public Economics* 96(11-12), 1079-1091.

Bartik, T. J. (2022): "How State Governments Can Target Job Opportunities to Distressed Places." W.E. Upjohn Institute.

Becker, S., Egger, P.H. and Ehrlich, M. (2010): "Going NUTS – The Effect of EU Structural Funds on Regional Performance." *Journal of Public Economics* 94, 9/10, 578-590.

Becker, S., Egger, P.H. and Ehrlich, M. (2012): "Too Much of a Good Thing? On the Growth Effects of the EU's Regional Policy." *European Economic Review* 56/4, 648-668.

Becker, S., Egger, P.H. and Ehrlich, M. (2013): "Absorptive Capacity and the Growth and Investment Effects of Regional Transfers: A Regression Discontinuity Design with Heterogeneous Treatment Effects." *American Economic Journal: Economic Policy* 5/4, 29-77.

Becker, S., Egger, P.H. and Ehrlich, M. (2018): "Effects of EU Regional Policy: 1989-2013." *Regional Science and Urban Economics* 68, 143-152.

Bird, R. and Smart, M. (2009): "Earmarked grants and accountability in government." *Conference on Policies of Grants to sub-national governments: Local accountability or control?* Copenhagen, September 2009.

Blanchard, O. J. and Katz, L.F. (1992): "Regional evolutions," *Brookings Papers on Economic Activity,* 23, 1–75.

Blöchliger, H., Merk, O., Charbit, C., Mizell, L. (2007): "Fiscal equalization in OECD countries." Working Paper 4, *OECD Network on Fiscal Relations Across Levels of Government*.

Boadway, R. and Hayashi, M.: (2004): “An evaluation of the stabilization properties of equalization in Canada.” *Canadian Public Policy / Analyse de Politiques* 30(1), 91-109.

Boffa, F., Piolatto, A. and Ponzetto, G. (2016): “Political centralization and government accountability.” *Quarterly Journal of Economics* 131(1), 381-422.

Boone, Ch.. Dube, A., Kaplan, E. (2014): “The Political Economy of Discretionary Spending: Evidence from the American Recovery and Reinvestment Act.” *Brookings Papers on Economic Activity*, 375-428.

Bosch, N., Espasa, M. and Solé-Ollé, A. (eds.) (2010): *The Political Economy of Inter-Regional Fiscal Flows. Measurement, Determinants and Effects on Country Stability*. Studies in Fiscal Federalism and State-Local Finances, Edward Elgard.

Bransettter, G., Lee. C. and Li, G. (2022): “Picking Winners? Government Subsidies and Firm Productivity.” NBER Working Paper 30699.

Brollo, F., Nannicini, T., Perotti, R. and Tabellini, G. (2013): “The Political Resource Curse.” *American Economic Review* 103(5), 1759-1796.

Castells, A. and Solé-Ollé, A. (2005): “The regional allocation of infrastructure investment: the role of equity, efficiency and political factors.” *European Economic Review* 49(5), 1165-1205.

Criscuolo, Ch., Martin, R., Overman, H. and Van Reenen, J. (2019): “Some Causal Effects of an Industrial Policy.” *American Economic Review* 109(1), 48-85.

Curto, M., Herranz, A. and Solé-Ollé, A. (2012): “Pork-barrel politics in semi-democracies: the Spanish ‘Parlamentary roads’, 1880-1914.” *Journal of Economic History* 72(3), 771-796.

Curto, M., Solé-Ollé, A. and Sorribas, P. (2018): “Does electoral competition curb party favoritism?” *American Economic Journal: Applied Economics* 10(4), 378-407.

Dahlby, B. (2002): “The incentive effects of fiscal equalization grants.” *Equalization: Welfare Trap or Helping Hand* 4, Frontier Centre for Public Policy.

Dal Bó, E., Finan, F., Folke, O., Persson, T. and Rickne, J. (2023): “Economics and social outsiders but political insiders: Sweden’s radical right.” *Review of Economics Studies* 90/2, 675-706.

De la Fuente, A. (2002): “Is the allocation of public capital across the Spanish regions too redistributive?” *CEPR Discussion Papers* 3138.

De la Fuente, A., Vives, X., Dolado, J.J., and Fani, R. (1995): “Infrastructure and education as instruments of regional policy: evidence from Spain.” *Economic Policy* 10(20), 11-51.

De Long, B. (2022): “Industrial policy from Engels to Eisenwhower.” www.promarket.org.

Desmet, K. and Wacziarg, R. (2022): “Understanding spatial variation in COVID-19 across UC Countries.” *Journal of Urban Economics; Insights* 127, 103332.

Desmet, K., Ortuño, I, and Özark, Ö. (2022): “Is secessionism mostly about income or identity? A global analysis of 3,003 subnational regions.” NBER Working Paper 20428.

Dix-Carneiro, R. and B. K. Kovak (2017): “Trade liberalization and regional dynamics.” *American Economic Review* 107, 2908–46.

Douenne, Th. and Fabre, A. (2022): “Yellow vests, pessimistic beliefs, and carbon tax aversion.” *American Economic Journal: Economic Policy* 14(1), 81-110.

Dougherty, S. and K. Forman (2021), "Evaluating fiscal equalization: Finding the right balance", OECD *Working Papers on Fiscal Federalism*, No. 36, OECD Publishing, Paris, Duranton, G. and A. J. Venables (2018): “Place-Based Policies for Development.” NBER Working Paper 24562.

Ehrlich, M. v. and T. Seidel (2018): “The persistent effects of place-based policy: Evidence from the West-German Zonenrandgebiet,” *American Economic Journal: Economic Policy*, 10, 344–74.

European Commission (2022): *The EU as an issuer: the Next Generation EU transformation. EU budget policy brief #3,* Publications Office of the European Union, 2022.

European Parliament (2023): “The tools for protecting the EU budget from breaches of the rule of law: the Conditionality Regulation in context.” Policy Department for Budgetary Affairs Directorate-General for Internal Policies.

Fajgelbaum, P. D. and Gaubert, C. (2020): “Optimal spatial policies, geography, and sorting.” *Quarterly Journal of Economics* 135, 959–1036.

Federe, E. (2012): “The incentive effects of equalization grants on fiscal policy.” SPP Research Papers, The School of Public Policy, U. of Calgary.

Fernald, J. (1999): “Roads to prosperity? Assessing the link between public capital and productivity.” *American Economic Review* 89(3), 619-638.

Gadenne, L. (2017): “Tax Me, but Spend Wisely? Sources of Public Finance and Government Accountability.” *American Economic Journal: Applied Economics* 9(1), 274-314.

Galbraith, J. K, Lind, M. and Luby, M.J. (2020): “The Case for Revenue Sharing: Fiscal Equalization and the COVID-19 Recession” in *Resiliency in the Age of Covid: A Policy Toolkit*. University of Texas at Austin LBJ School.

Gaubert, C., P. M. Kline, and D. Yagan (2021): “Place-Based Redistribution.” NBER Working Paper 28337.

Ghirelli, C., Havari, E., Meroni, E.C. and Verzillo, S. (2023): “The Long-Term Causal Effects of Winning an ERC Grant.” *IZA Discussion Paper 16108*

Glaeser, E. L. and J. D. Gottlieb (2008): “The Economics of Place-Making Policies.” *Brookings Papers on Economic Activity* 1, 155–253.

Gutiérrez, E. Moral-Benito, E., Oto-Peralías, D. and Ramos, R. (2023): “The spatial distribution of population in Spain: an anomaly in European perspective.” *Journal of Regional Science* 63, 728– 750

Hanson, G. (2023): “Local Labor Market Impacts of the Energy Transition: Prospects and Policies”, NBER Working Paper 30871.

Interreg Europe (2020): “Smart specialization strategy (S3).” *Policy Brief from the Policy Learning Platform on Research and Innovation*

Jensen, N. M., E. J. Malesky, and M. Walsh (2015): “Competing for global capital or local voters? The politics of business location incentives.” *Public Choice* 164, 331–356.

Juhász, R., Lane, N., Oehlsen, E. and Pérez, V. (2022): “The Who, What, When, and How of Industrial Policy: A text-Based Approach.” Processed Oxford U.

Kappeler, A., Solé-Ollé, A., Stephan, A. and Välilä, T. (2013): “Does fiscal decentralization foster regional investment in productive infrastructure?” *European Journal of Political Economy* 31, 15-25.

Kim, D. (2021): “Economic Spillovers and Political Payoffs in Government Competition for Firms: Evidence from the Kansas City Border War.” Processed, Iowa State U.

Kline, P. and E. Moretti (2014a): “Local economic development, agglomeration economies, and the big push: 100 years of evidence from the Tennessee Valley Authority.” *The Quarterly journal of economics* 129, 275–331.

Kline, P. and E. Moretti (2014b): "People, Places, and Public Policy: Some Simple Welfare Economics of Local Economic Development Programs." *Annual Review of Economics* 6, 629–662.

Lane, N. (2022): "Manufacturing revolutions – Industrial policy and industrialization in South Korea." *Quarterly Journal of Economics*, forthcoming.

Le Breton, M., Weber, S. (2003): "The Art of Making Everybody Happy: How to Prevent a Secession." *IMF Staff Paper* 50(3), 403-435.

Liscow, Z. and Pershing, A. (2020): "Why Is So Much Redistribution In-Kind and Not in Cash? Evidence from a Survey Experiment." *Proceedings. Annual Conference on Taxation and Minutes of the Annual Meeting of the National Tax Association* 113, 1-70

Liu, Z. & Zili, Z. (2022): "Political favoritism towards resource allocation: Evidence of grants by natural science foundation in China." *Emerging Markets Review* 51.

López-Laborda, J., Montes-Nebreda, A. and Onrubia, J. (2023): "Should fiscal equalization and regional policy goals and tools be disentangled?" Paper presented at the XXX Encuentro de Economía Pública, Badajoz 4-5 May.

Martinez, L. (2017): "Natural Resource Rents, Local Taxes and Government Performance: Evidence from Colombia." *Review of Economics and Statistics*, forthcoming.

Munger, M.C. (2023): "The case for Green Industrial Policy." www.promarket.org.

Muñoz, J. and Tormos, R. (2015): "Economic expectations and support for secession in Catalonia. Between causality and rationalization. *European Political Science Review* 7(2), 315-341.

Muro, M., Maxim, R., Parilla, J. and De Souza, X. (2022): "Industrial policy can't ignore geography." www.promarket.org.

Myrdal, G (1957): *Economic Theory and Under-developed Regions*. Duckworth, London.

Neumark, D. and Simpson, H. (2015): "Chapter 18 - Place-Based Policies," in G. Duranton, J. V. Henderson, and W. C. Strange, Elsevier (eds.): Handbook of Regional and Urban Economics, vol.5, 1197–1287.

Neumark, D. and T. Young (2020): "Heterogeneous Effects of State Enterprise Zone Programs in the Shorter Run and Longer Run," Working Paper 27545, National Bureau of Economic Research.

Oates, W.E. (1972): *Fiscal Federalism*. Harcourt Brace Jovanovich, New York.

OECD (2019): *Making Decentralisation Work: A Handbook for Policy-Makers*, OECD Multi-level Governance Studies, OECD Publishing, Paris.

OECD (2020): OECD Regions and Cities at a Glance.

Palladino, L. (2003) "How to Ensure Industrial Policy Promotes Public over Private Gain." www.promarket.org.

Rodríguez-Pose, A. and Vidal-Bover, M. (2022): "Unfunded mandates and the economic impact of decentralization. When finance does not follow function." *Political Studies*, forthcoming.

Rodríguez-Pose, A., Terrero-Dávila, J., and Lee, N. (2023): "Left-behind vs. unequal places: interpersonal inequality, economic decline, and the rise of populism in the US and Europe." *Journal of Economic Geography*, forthcoming.

Salinas, P. and Solé-Ollé, A. (2018): "Partial fiscal decentralization and education outcomes." *Journal of Urban Economics* 107, 31-46.

Slattery, C. (2020): "Bidding for Firms: Subsidy Competition in the U.S." Working paper, UC Berkeley.

Slattery, C. (2023): "The Political Economy of Subsidy-Giving Cailin Slattery." Processed UC. Berkeley.

Slattery, C. and Zidar, O. (2020): "Evaluating State and Local Business Incentives," *Journal of Economic Perspectives* 34, 90–118.

Smart, M. (2007): "Raising Taxes through Equalization." *Canadian Journal of Economics* 40(4), 1188-1212

Solé-Ollé, A. (2013): "Inter-regional redistribution through infrastructure investment: tactical or programmatic?" *Public Choice* 156(1-2), 229-252.

Solé-Ollé, A. and Esteller-Moré, A. (2002): "Tax setting in a federal system: the case of personal income taxation in Canada." *International Tax and Public Finance* 9, 235-257.

Solé-Ollé, A. and Sorribas, P. (2008): "The effects of partisan alignment on the allocation of intergovernmental transfers. Difference-in-differences estimates for Spain." *Journal of Public Economics* 92(10), 27-56.

Spahn, P.B. (2012): "Conditioning Intergovernmental Transfers and Models of Interagency Cooperation for Greater Effectiveness of Multilevel Government in OECD Countries." OECD *Workshop on Effective Public Investment at Sub-National Level in Times of Fiscal Constraints: Meeting the Co-ordination and Capacity Challenges*.

Stokes, L.C. (2016): "Electoral backlash against Climate Policy: a natural experiment on retrospective voting and local resistance to public policy." *American Journal of Political Science* 60(4), 958-974.

Van Reenen, J. (2023): "Industrial policy is a seductive mirage." www.promarket.org.

Venables, T. (2020): "Why some places are left-behind: urban adjustment to trade and policy shocks." Dep. of Economics Discussion Paper Series 903, Oxford U. Press.

Weingast, B.R. (2009): "Second Generation Fiscal Federalism: The Implications of Fiscal Incentives." *Journal of Urban Economics* 65(3), 279-293.

Wilson, D.J. (2012): "Fiscal Spending Jobs Multipliers: Evidence from the 2009 American Recovery and Reinvestment Act." *American Economic Journal: Economic Policy* 4(3), 251-282.