BEST PRACTICES IN RURAL POLICY

A Review of Literature

Undertaken for the

Eastern Ontario Rural Policy Project

March 31, 2007

TABLE OF CONTENTS

Part of the Eastern Ontario Rural Policy Project:
A Project Led by the Eastern Ontario Wardens Caucus (www.eowc.org)
In Partnership with the Community Futures Development Corporations (CFDCs)
of Eastern Ontario (www.ontcfdc.com) and
the Ontario East Economic Development Commission (www.onteast.on.ca)

1. INTRODUCTION TO RURAL POLICY

This section reviews the highlights and themes from recent literature on rural policy (sometimes referred to as "territorial policy"). This literature can be either theoretical or case study-based, and primarily refers to countries covered by the Organisation for Economic Co-operation and Development (OECD), which include Canada and the United States. Because the study of rural policy is relatively new, this literature is recent and still evolving. In fact, several investigators call for research on specific aspects of rural policy and associated issues such as rural development.

The purpose of this literature review is to provide both a framework for organizing thinking and actions — for senior levels of governments and rural regions themselves— about how to develop and implement effective rural policy. This review also provides an assessment of best practices that appear to be transferable to the current environment in Ontario, Canada.

The literature review was not meant to be exhaustive, but rather concentrated on extracting the most meaningful trends in rural policy formulation and implementation that will help to advance the Eastern Ontario Rural Policy Project (Prosperity Plan) in a timely, focused and strategic manner. To this end, the literature review identifies and answers some key questions at the outset. What is "rural" (and what is "urban")? How are the two related? What forces (for example, global economic change) influence the development of rural regions? Are these influences the same or different as in urban areas?

Answering these questions is essential to developing an appreciation for the possible need for different policy responses for rural areas than urban ones, as well as the prospects for changes in the economic and social circumstances of rural regions based on the development and application of rural policy approaches which have demonstrated – or would most likely have – the greatest likelihood for success.

2. What is Rural?

The definition of "rural" is a key determinant of the extent to which trends from other comparable jurisdictions might be expected to apply in Ontario.

Our review indicates that **population density** is the most common characteristic used to define the extent of "rurality" for any community, area or region.[1] Population density has been chosen as the key defining characteristic of "rural" because this characteristic appears to have a dramatic effect on the economic and social circumstances of any particular area and the mechanisms by which any particular area might experience development success.

> **"The self-evident truth is that being rural is a geographic condition and therefore space must be a fundamental consideration in designing rural development policy."**
> James Hite
> "The Thunen Model and the New Economic Geography as a Paradigm for Rural Development Policy,"
> *Review of Agricultural Economics 19*: 2, p. 231.

Low population density makes it harder for individuals and enterprises to build the critical mass (for instance markets, client bases or supporting organizations) that produces benefits which extend beyond local communities or beyond that region. Low population density also increases the cost of providing spatially-sensitive infrastructure and other public services.[2] Examples would be transportation networks or telecommunications infrastructure which has high threshold costs for participation.

Fundamentally, population dispersion, or isolation owing to topography or distance from transportation networks, can all be attributed to geography— or the location of particular regions in space. Furthermore, by focusing on geographic considerations, it becomes clear that there are degrees of "rurality" or "remoteness."

Throughout this report, the terms "regional", "territorial" and "local" will be used synonymously, referring to the significance of the spatial or location meaning.[3]

[1] In 1995, the USDA reported that the average population density of non-metro counties across the United States was 36.3 persons per square mile or 14 persons per square kilometre.
[2] While population dispersion is a critical element in defining rural areas, other factors can produce isolation, such as topography or the absence of well-developed transportation networks.
[3] This is consistent with usage in Statistics Canada, "Skills, innovation and growth: Key issues for rural and territorial development – A survey of the literature 1980-2003," p. 12, http://www.statcan.ca/english/research/21-601-MIE/21-601-MIE2005076.pdf.

The OECD Definition of Rural

The definition of 'rural' developed by the Organization for Economic Development and Cooperation (OECD), and commonly adopted for the purposes of rural policy in Canada, is based on population density and can be applied to either an individual community or a larger area or region.

- A **community** is classified as "rural" if its population density is less than 150 people per square kilometre.
- **Regions** are classified based on the percentage of their population that lives in rural communities:
  - **Rural and remote** regions have more than 50 per cent of their populations living in rural communities.
  - **Intermediate** regions have 15 to 50 per cent of their population living in rural communities, and tend to contain small cities
  - **Agglomerated** regions have less than 15 per cent of their population in rural communities, since they contain our largest cities. [4]

Defining Rural Regions in Relation to Urban Ones

While rural regions are often differentiated from urban ones in terms of social and economic circumstances and developmental needs, proximity to urban centres – or more precisely, the extent of linkages between urban and rural areas – is often used to define different types of rural regions[5]:

- **Metro-adjacent sub-regions** (regions adjacent to metropolitan centres),
- **Non-adjacent sub-regions** (not adjacent to metropolitan centres), and
- **Northern hinterlands sub-regions**.

The European Commission's *Second Report on Economic and Social Cohesion* (2001) defines three types of regions[6] on the basis of **linkages into the national and international economy.** This typology provides explicit recognition of the relationship between urban and rural economies as well as a greater awareness of potential challenges to and solutions for economic development and integration.

[4] Canadian Rural Information Service, http://www.rural.gc.ca/cris/faq/def_e.phtml.
[5] ibid
[6] European Commission, *Unity, solidarity, diversity for Europe, its people and its territory: Second report on economic and social cohesion*, adopted January 31, 2001, http://ec.europa.eu/regional_policy/sources/docoffic/official/reports/contentpdf_en.htm See also Anne Green, "Employment restructuring in rural areas," in Doris Schmied (ed.), *Winning and losing in Europe's rural areas*, Burlington, VT : Ashgate, 2005.

Note that these definitions are not based solely on proximity to an urban centre; the degree of infrastructure development, human capacity, and other public service considerations are also included. These three regional types of rural regions are described as:

- **Rural areas that are well integrated** into the overall economy with economic and population growth; often close to urban centres and have high per capita levels of income; jobs are predominantly in industry or services, not agriculture.

- **Intermediate rural areas that are some distance from urban centres** but **with good links** to urban centres and reasonable level of infrastructure; a significant role for agriculture but increasing economic diversity e.g., food processing, business services.

- **Remote rural areas that are sparsely populated** and **remote from urban areas**; remote because of topography (e.g., mountains), highly dispersed and aging populations, poor infrastructure, inadequate services (e.g., health care, education), lower per capita income, relatively unskilled workforce, high employment in agriculture, and weak links with the rest of the economy.

Statistics Canada: The Metropolitan Influence Zone Descriptor

Statistics Canada has created a way to categorize 'rural' areas (those which are not included in either a census metropolitan area (CMA) or a census agglomeration (CA)).[7] Municipalities outside a CMA or a CA are assigned to one of four categories based on the percentage of residents who commute to work in the urban core of *any* CMA or CA. This is known as the **M**etropolitan **I**nfluence **Z**one (MIZ) categorization. Census subdivisions (CSDs) are assigned to four categories are determined based on *degree of influence* that the CMAs and/or CAs have on them: strong, moderate, weak or no influence. CSD assignments are based on the percentage of the resident employed labour force that has a place of work in the urban core(s) of CMAs or CAs. CSDs with the same degree of influence tend to be clustered, forming **zones** around CMAs and CAs that progress through the categories from "strong" to "no" influence *as distance from the CMAs and CAs increases*. In other words, the degree of influence of an urban area is spatially-determined; this particular descriptor is based *only* on flows of commuters from 'rural' areas to 'urban' ones:

[7] A CMA or CA is an area consisting of one or more adjacent municipalities situated around a major urban core. To form a CMA, the urban core must have a population of at least 100,000. To form a CA, the urban core must have a population of at least 10,000.)

- The **strong MIZ** category includes CSDs with a commuting flow of 30 per cent or more (at least 30 per cent of the total employed labour force living in the CSD works in **any** CMA/CA urban core).
- The **moderate MIZ** category includes CSDs with a commuting flow percentage between 5 per cent and 30 per cent (at least 5 per cent, but less than 30 per cent of the total employed labour force living in the municipality works in **any** CMA/CA urban core).
- The **weak MIZ** category includes CSDs with a commuting flow percentage more than 0 per cent, but less than 5 per cent (more than 0 per cent, but less than 5 per cent of the total employed labour force living in the municipality works in **any** CMA/CA urban core).
- The **No MIZ** category includes those CSDs with either fewer than 40 people in the resident labour force (where data suppression rules apply) or no people commuting to work in CMA/CA urban cores.

Understanding that Urban and Rural Areas Are Different

The emphasis on understanding rural areas in relation to urban areas is understandable. In striving for healthy communities and prosperous economies across their jurisdictions, policy makers may be troubled by differences between urban and rural economies. If particular policies prompt social and economic development in urban areas, why do they not have the same effect in rural areas?

For example, while noting that rural regions have not been subjected to extensive research, Michael Porter (Harvard University) reports that there is a significant performance difference between rural and urban areas:

> ***"While there is no truly comprehensive assessment of the performance of rural regions in the literature, researchers have explored many of the relevant measures. The general consensus is that rural areas in the U.S. are underperforming metropolitan areas, and that gap is widening."***[8]

Interestingly, Porter notes that the recent downturn (2004) "may have led to the *perception* (emphasis added) that economic activity in rural regions has been shrinking over the past decade; it has actually grown, but not as fast as metro areas overall."[9] In recent years, researchers like Porter have begun to ask questions concerning what it is about rural areas that leads to these differential outcomes?

[8] Porter with Ketels, Miller and Bryden, Competitiveness in Rural U.S. Regions: Learning and Research Agenda, February, 2004, p.7
[9] Ibid, P.11

3. THE RELATIONSHIP BETWEEN URBAN AND RURAL ECONOMIES

As the definitions in the preceding section indicate, "rural" and "urban" cannot be separated. Answering the question "What is rural?" also answers the question "What is urban?" Rob Greenwood, a highly respected analyst of rural policy from Memorial University of Newfoundland, describes the relationship as "symbiotic" [10] while Michael Porter of Harvard University, who is famous for his work on cluster theory, describes the relationship as "imbedded." In a recent analysis of rural demographics, Ontario's Institute of Agri-Food Policy Innovation (IAFPI) noted that "Rural Ontario is heavily affected by the changes in the cities and the impacts are particularly noticeable for rural areas near large urban centres." [11]

INFLUENCE OF URBAN AREAS ON ADJACENT RURAL AREAS

Porter notes that the influence of urban areas on rural ones is likely to be multi-faceted. In addition to providing a source of employment for rural residents, urban areas with strong growth and high wages appear to stimulate those same parameters in adjacent rural areas. Porter notes that "there is a clear and statistically positive relationship between metro and non-metro wage levels *within an economic area*" (emphasis added). In other words, metropolitan regions with higher wages stimulate higher wages in adjacent rural areas. More distant rural areas may, but do not always derive the same strong economic growth or increased wage rates as their counterparts nearer the urban regions.[12] Porter speculates that absolute size of rural economies may be as important as proximity to an urban centre, and has called for further research on this question.

The relationship between urban and rural economies can be seen in the pattern of population growth in Ontario from 1996-2001. In that period, the population of Ontario grew by 6.1 per cent. This was driven primarily by growth in urban Ontario (6.8 per cent) while rural and small town Ontario grew by 1.5 per cent.[13] However, within the rural and small town category, population growth or decline varied in relation to the influence of the urban area (as measured by the proportion of persons commuting from the rural area to the urban area for work). In those rural areas most strongly influenced by an adjacent urban area, population growth was 4.1 per cent; in the areas moderately influenced by the urban area, population fell by 0.1 per cent and where the influence was weak, population fell by 2.9 per cent. Interestingly, in areas where there was no influence from an urban area ("isolated rural and remote areas"), population rose by 11.6 per cent. In other words, the population growth in rural areas is influenced by distance from urban centres.

[10] Storey and Greenwood, *Newfoundland and Labrador Rural Dialogue Discussion*, 2004.
[11] David Sparling and Delia Bucknell (October 2006). *Ontario's changing population*. Institute of Agri-Food Policy Innovation, Guelph, Ontario, http://www.iafpi.ca/pdfs/Rural_Demographics.pdf.
[12] Porter et al, op. cit., page 16
[13] Understanding Freefall: The Challenge of the Rural Poor, a report to the Senate of Canada, December 2006, p. 34

4. External Forces With Particular Impacts On Rural Regions

Analysts studying rural policy tend to focus on two global economic trends as having the most impact on rural policy processes: globalization and the ICT revolution, and the growing importance of "place" (which can have both positive and negative implications for rural regions).

Globalization and the ICT revolution

Over the past three decades, globalization and the information communications and technologies (IT) revolution have swept the developed world. These strongly interrelated forces have brought deep and lasting changes to how we work, where we work and how we relate to the world around us. At a local level, globalization is apparent in increased competition for jobs, residents and income.[14]

> **"There is little doubt that globalization is the driving force behind the quest for new rural policies."**
> Mark Drabenstott, "Five themes in the future of rural policy", in OECD, *New approaches to rural policy: Lessons from around the world*, p. 94.

While there is no universally accepted definition of globalization, the OECD characterizes it as "a process of closer economic integration of global markets: financial, product and labour." [15] To some extent, integration is the result of international agreements, such as the General Agreement on Tariffs and Trade (GATT) and continental trading blocks such as NAFTA that have opened up markets to competition around the world.

Integration has also accelerated because a growing number of countries, formerly isolated from world markets because of ideological or political constraints, are now competing in the global economy to advance their own economic interests. While deregulation is a characteristic of globalization — for example in energy markets — regulation has also increased to ensure that goods traded across borders meet consistent standards; this is particularly evident for agricultural products in the European Community.

[14] Scott and Johnson, "New governance and the changing face of rural America," in Thomas G. Johnson, Daniel M. Otto and Steven C. Deller (eds.), *Community policy analysis modeling*
[15] http://www.oecd.org/document/30/0,2340,en_2649_201185_37478942_1_1_1_1,00.html.

The impact of globalization has been dramatic for both urban and rural economies. Within sectors, there have been waves of mergers and acquisitions, as multi-national companies become bigger and more vertically integrated. As part of the merger and acquisition process, local firms or branch plants – often in rural areas – have been acquired or moved where labour is cheaper, leaving residents with limited choices for alternative unemployment or the often difficult decision to seek employment beyond the local area. As a result, to some extent, depopulation of rural areas is the result of an insufficiently "thick" labour pool.

The explosion of information and communications technologies over the past three decades has increased the speed and frequency with which people, ideas, goods and capital move around the world. In the developed world at least, the resulting structural shifts are often dramatic as automated manufacturing processes eliminate many low-wage, unskilled jobs in manufacturing, shifting the requirements to fewer but more highly skilled, knowledge-based jobs.

At both national and provincial policy levels, openness to and integration with the global economy has delivered rapid and fundamental shocks to our economic system. An open (trade-oriented) economy would presumably expect these shocks from time to time. However, in the contemporary global economy, domestic governments have less manoeuvring room to use taxation and regulation as finely-tuned policy instruments, since obligations to international agreements on competition and access take precedence. Most notably for the purposes of this review, industrial policy has shifted away from direct subsidies to declining sectors or incentives to lure to a particular jurisdiction. Instead, jurisdictions strive to design and implement policy instruments that will create a favourable climate for new inward-flowing investment.

> **"These broad conclusions about rural economic development are, by and large, not surprising. The United States has the need and opportunity to lead in this field. Advances in thinking on competitiveness and regional economic development over the last decade provide an opportunity to now examine rural regions in new ways"**
>
> Michael Porter
> Competitiveness in Rural U.S. Regions: Learning and Research Agenda, 2004

Consequently, state policies on economic development now are highly focused on:

- Improving accessibility to markets, and the ability to compete in those markets;
- Enhancing productivity to maximize value extracted from inputs, such as labour and capital;
- Stimulating innovation as the key driver to productivity;
- Improving transportation, and information and communications infrastructure to facilitate timely and global market access;
- Increasing educational standards and skill levels as jobs become more highly-skilled and knowledge-based; and
- Promoting entrepreneurship as a means of unleashing innovation and competitiveness.

THE IMPORTANCE OF "PLACE"

As the global economy has developed, competitive advantages have become "localized." or tied closely to geographic location. "Place" matters in a globalized world not only because "place" can offer competitive advantages that cannot be easily replicated, but also because regions and communities provide a sense of identity and rootedness in a fast-moving world. These two attributes of place have been described as "twin anchors of continuity and diversity."[16]

For example, a region's economic activity may coalesce around a unique combination of geographic, cultural, economic and social assets that, in combination with access to the open global market through ICT and public infrastructure, gives the region a competitive advantage --- perhaps one that cannot easily be replicated in a particular market niche.

> **"The important message is that it is decisive how the global is being translated into the local. Successful localization requires the recognition of the local (respectively regional) peculiarities and the strengthening of local/regional economies and networks."**
>
> Doris Schmied, "Winning and losing in Europe's rural areas," in Doris Schmied (ed.), *Winning and losing : The changing geography of Europe's rural areas,* Aldershot, Hants, UK ; Burlington, VT : Ashgate, 2005, p. 3-4.

In other words, place is now the source of differentiation and possible competitive advantage. This does not mean that other economic factors (cost of labour, natural resources etc.) play no role. Rather, quality of place has now joined those factors as an important decision-making criterion. Place now "matters"; in recognition, sectoral policies in many jurisdictions are now driven by sensitivity to attributes of a particular territory, rather than a "one size fits all" mentality.

[16] Jeremy Millard, "Rural areas in the digital economy," in *Winning and losing: The changing geography of Europe's rural areas*, p. 92 (CHECK)

PLACE PUTS NEW EMPHASIS ON REGIONAL ANALYSIS

The growing importance of "place" has placed additional emphasis on territorial or regional competitiveness. The competitiveness of any particular region or territory is rooted in several lines of thinking and analysis:

- While globalization encourages the mobility of firms, the flip side is that manufacturing enterprises that rely heavily on the cost of inputs may choose their **locations based on where their end markets are located or where raw materials are sourced**, to reduce transportation costs, or where highly-skilled labour is readily available. Multi-national firms may also choose locations in multiple jurisdictions as a way to mitigate risks from factors as diverse as political stability, variability of climate, currency exchange rates, or labour conditions. Regions must know what it is that makes them attractive to these firms.

- **Michael Porter's** work on industrial "clusters" is built on the notion that capacity for regional innovation is often driven by **broad but geographically concentrated networks** of companies, suppliers, service firms, academic institutions, and organizations in related industries that, together, bring new products or services to market. In a review of regional economic performance in the United States, Porter concluded that "performance is strongly influenced by the *traded* clusters which appear to shape wages in local industries. Regional economic performance is strongly affected by the strength of clusters and the vitality and plurality of innovation." [17] He suggested that **regional analysis must become far more central to policy development** on competitiveness and economic development.

- The "**new economic geography**" attempts to explain why industries cluster in certain countries and regions, and emphasizes that place-based amenities (such as history, landscape, cultural backgrounds) tend to draw in skills, labour and capital. For examples, since information and communications technologies plus transportation networks make it far easier to work or operate a business in a location of one's choice, talented people including entrepreneurs, well-off workers and retirees are drawn to certain locations because of place-based amenities.

[17] Michael E. Porter, "The economic performance of regions," *Regional Studies,* Vol. 37, Nos. 6&7, pp. 549–578, August/October 2003.

- **Entrepreneurship** is seen as a strong driver for job creation, prosperity and innovation. Because small and medium-sized enterprises (SMEs) tend to be more labour-intensive than capital-intensive,[18] it is especially important that the region in which an entrepreneur seeks to build an enterprise has the **education and skills** base required for that business. Furthermore, entrepreneurs and SMEs tend to rely on the immediate region for business services such as accounting, marketing, recruitment and financing, thus creating more economic activity, drawing in new firms working in the same sector, and thus forming the basis of geographically-specific clusters.

- The challenge for entrepreneurs and SMEs in rural regions is, however, that economic imperatives behind globalization dictate that **rural regions must "produce what will sell, not sell what they produce."** Typically, rural regions do not have sufficiently large domestic markets for many of the goods and services that entrepreneurs might wish to produce. Success is therefore dependent on either linking/selling into markets further afield (sell what they produce) or fashioning a business that matches the needs of the local market (producing what will sell). In a rural region, the latter approach may appear to be the easier of the two, but entrepreneurs are key to implementing either one.

Implications for Rural Regions:

For rural areas, the net effect of understanding these drivers should lead to a greater emphasis on:
- Knowledge and objective assessment of regional (rural) capital – both physical and human;
- Support for place-based amenities which attract or retain talented people;
- Support for local/regional networks – often linked to networks beyond the region – as spurs to innovation;
- Encouragement for entrepreneurs;
- Labour force development, including measures to counterbalance at least some of the inevitable migration of labour to urban centres;
- Market analysis and development (often in conjunction with urban markets) for specific enterprises.

[18] See Ernesto Sirolli, "Ripples from the Zambezi: Passion, Entrepreneurship and the Rebirth of Local Economies", 1999, page 3: "The human scale of small enterprises, their bond with the community, the fact that they use proportionately more labor and intelligence than raw materials, makes them easy to propose to even the most environmentally conscious communities."

A Focus on "Place" Does Not Guarantee The Elimination of Regional Disparities

Regional disparities are a persistent problem for national and sub-national governments. While case studies and refined economic theories now emphasize the importance of "place" in attracting, developing and sustaining prosperous regional and hence national economies, the application of place-based strategies – by themselves – are no guarantee of positive economic results. In fact, regional disparities may persist because of certain basic market forces that create a detrimental domino effect in rural areas.

In its literature review on how human capital is dispersed geographically, Statistics Canada discovered that even in regions with location advantages, a number of place-oriented forces work against rural regions:

- Physical, technological and human resources tend to concentrate in urban areas because of economies of scale ("agglomeration economies"), declining costs of communication, and reduced transportation costs.

- Left unrestrained by government intervention, market forces will produce an uneven distribution of human capital (defined as education, training and skills) as workers are drawn to higher-paying jobs in urban areas.

- Given the tendency of educated and skilled labour (especially young people) to migrate to urban areas (following capital and jobs), rural areas are left with little incentive to invest in their human capital. In fact, in these areas, a large share of the return on investment from educating and training rural residents might actually be enjoyed by urban areas.

- Investing in industries or sectors does not entirely reduce the risk of capital flight to lower-cost regions or urban areas, despite efforts to "root" industry in specific regions.

Implications for Rural Regions:

To the degree that a rural region can offer lower cost land and labour, combined with easier access to natural resources and raw materials, globalization could work to the benefit of that region. However, if the region has a modest-sized local market for the particular good or service and limited access to markets outside the region, it may be difficult to justify capital investments to achieve economies of scale in production enterprises or to even scale up a prototype for commercial purposes. Given that rural areas are often some distance from intermediaries who could help rural firms gain access to larger markets, their products may be at further "market intelligence" and transportation cost disadvantages. The degree of disadvantage may depend in part on the availability of information and communications infrastructure, "mass transportation" alternatives such as public transit, rail, and highway connections, and the size of the local labour pool, especially in the more highly-skilled job markets.

WHY SHOULD RURAL POLICY MATTER TO DECISION-MAKERS?

"How can we be clear about what needs to be done if we do not understand the way the rural economy works, and what, if any, the unique economic implications of being rural are? Consciously or not, practitioners and scholars alike have in their heads a paradigm of a generic rural economy. Even if we are only vaguely aware of the paradigm, that paradigm, however muddled or amorphous it may be, determines how we see the world, what we think is important, and what we think will work." [19]

As the quotation above suggests, in thinking about the purpose and design of rural policy, we must confront some possible assumptions that policymakers may make about rural regions:

- Do we assume there is a logical economic progression between rural regions and urban regions, with rural regions destined— with the right kind of support albeit over a longer timeframe—to become just like urban regions? Or is there a point at which this "trickle-down" transformation ends?
- Do we believe that rural regions are holding themselves back from this kind of prosperity, either through resistance to change or lack of understanding of the path to prosperity in the contemporary urbanized economy? Or are they held back by policies which work well in urban areas but not in rural ones?
- Are rural regions destined to be backwaters or "economic basket cases," lacking sufficient inherent physical, human, or natural resources to create value in a global economy? Or do rural regions have sources of significant "territorial capital" in today's economy, and therefore the potential to compete within and outside a particular jurisdiction?

> **"We cannot point to any case where centrally-inspired initiatives or heavy external investment have led to the enduring success of local economies."**
> OECD,
> The New Rural Paradigm
> p. 129

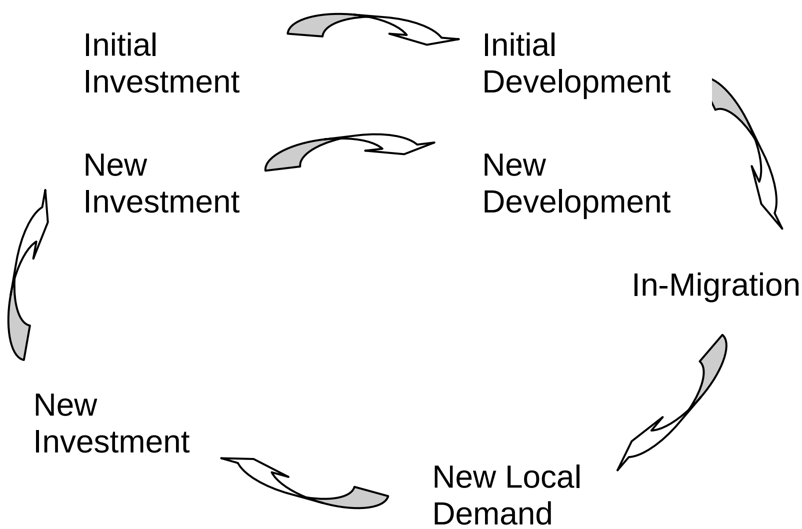
Our choice of assumptions determines the likelihood that a rural policy will be formulated at all, as well as the specific direction and content of that policy. At its heart, rural policy has one key question: is there sound justification for a different kind of public (government) intervention in rural economies and communities? Related policy questions that flow from this overarching question are:

- What are the most fundamental objectives of government policy?
- What problems can only be addressed through government policy rather than market forces?
- What levers does government have at its disposal to address these problems?

[19] James Hite, "The Thunen Model and the New Economic Geography as a paradigm for rural development policy," *Review of Agricultural Economics 19*, 2: p. 230.

RURAL REGIONS AS UNDER-UTILIZED SOURCES OF CAPITAL AND ECONOMIC ACTIVITY

By aiming to help each region develop its unique mix of territorial capital, rural policy attempts to stimulate innovation, and hence prosperity and competitiveness. However, to realize this policy objective over the longer term, government must allow market forces to determine where inward investment will locate. For example, if a firm is drawn to a certain region because its distinctive form of territorial capital best offsets one or more risks of investment, then the investment is far more likely to "stick" in the region, attract similar investments, and thus create a cycle of self-reinforcing growth. This dynamic, cumulative model of economic growth has been described as shown in the diagram below:



Some caution must be exercised, however, in applying findings from literature on knowledge-based or innovation-driven economies to rural areas. An OECD report warns that "the emphasis on innovation and knowledge … appears to rest on an assumption that regions have at least moderate levels of 'knowledge infrastructure' and that local enterprises have some innovative capacity." [20] Hence, cluster-oriented policy measures such as science parks or industry-research linkage programs tend to be more suited to more advanced regions that already display tendencies toward high-tech industries and higher-wage jobs. [21] In short, policy-makers must not assume that all regions possess the attributes necessary for successful application of cluster-oriented policies. The transferability of policy approaches from urban to rural environments is discussed in more detail in Section 7.

[20] OECD, *Building competitive regions: Strategies and governance*, 2005, p. 9.
[21] *Ibid.*

UNDERSTANDING REGIONAL SUCCESSES

While alleviating regional disparities—chronic and perhaps growing in severity—is a reasonable justification for a rural policy framework, understanding the "trajectory" of success and adapting lessons from successful rural regions may be equally important. .

Just as a homogenous policy approach to stimulating economic performance of rural and urban regions has failed, so too is a "one size fits all" strategy highly inappropriate for the new environment of rural policy-making. For example, when looking across a region or comparing the performance and prospects of regions, decision-makers must ask question such as:

- To what extent are transportation linkages or geographic proximity key assets for regional success? [22]
- What role is played by community cohesion?
- Does immigration play a role?

By understanding what factors have made particular regions successful, rural policy instruments can be more finely-tuned, and therefore, more effective.

[22] The OECD notes that, based on a study published in 2001, manufacturing in Canada is moving to rural areas close to metropolitan areas (*A new rural paradigm,* p. 33).

RATIONALES FOR RURAL POLICY

Given persistent economic and social disparities between urban and rural areas, and the understanding that many of these disparities are rooted in geography and the absence/presence of particular types of capital, policy analysts might well ask what rationale(s) would justify an investment of time and energy in rural policy development. A review of the literature suggests six primary justifications, each of which are described in more detail later in this section:

- **Jurisdictional security and risk management:** governments are trying to cope with shocks to energy supply and price, potential disruptions to the production and flow of essential goods and services, restrictions on movement of citizens through new border regulations, and investment decisions by the financial community and private industry due to international forces such as currency exchange fluctuations. Governments can and do consider rural policy in the light of the contributions that rural areas might make to the political and economic security of the jurisdiction and therefore to the governments' risk management strategies.

- **Resource management**; may be coupled with transition to an **environmentally sustainable society** as citizens make known their expectations that natural resources be utilized for productive purposes, preferably in ways that maintain those resources for future generations and replace the use of non-renewable resources. These expectations are often shared by both urban and rural citizens. As a result, rural policy offers the opportunity for governments to demonstrate to citizens that they can manage all aspects of the economy in a sustainable fashion.

- **Social stability/cohesion:** as market forces shape the structure of the economy, there is almost always a disparity in incomes from one region or area to another. Income disparities between urban and rural areas are already well-established.
  In some cases, the structure of the "middle class" is stretched into a bi-polar distribution (many poor people, many rich people, few in the middle) that analysts often consider highly unstable in social terms. When these disparities follow age patterns, there is the potential for intergenerational conflict. For instance, increased funding for say, long term care could be perceived to come at the expense of students paying higher tuition fees for their education.

The potential for intergenerational conflict also flows out of demographic differences; urban environments may be attractive to a slightly younger age group; rural environments to a slightly older age group. As citizens reach different points in their lives, they may relocate to a new area, bringing service expectations from their former home with them. If this shift takes people from urban to rural environments, the rural areas may not be able to afford to offer the full suite of services to which the migrating citizens have become accustomed.

- **Demand for human-scale environments:** As governments strive to address the challenges of urban congestion and fast-paced lifestyles, rural areas offer a counterbalancing influence. For instance, urban residents often look to rural areas for outdoor recreation, and periods of relaxation, reflection and interpersonal interaction.[23] Yet because citizens are coming from an urban environment, they still want access to modern services (ex. high-speed internet connections, cellular telephone services) even when they are in rural areas. Because population density in the rural areas makes the provision of these services cost-prohibitive on a purely commercial basis, it is in the government's interest to seek solutions and even make direct investments in this infrastructure.

- **Equity in citizenship:** Many citizens and policy-makers would argue that all citizens have the same rights and privileges, and should have the same degree of access to services, regardless of where they live and work. This access is usually expected to cover both public (education and training, health care, social supports, clean air and water) services, and at least some private services (banking/financial services, capital). Through rural policy, governments can ensure that equity in citizenship is maintained.

[23] OECD, The New Rural Paradigm, p. 33

MORE EFFECTIVE PLANNING AND MANAGEMENT OF LAND AND NATURAL RESOURCES

Rural areas have long assumed an implicit responsibility for conscious and careful stewardship of their natural and cultural landscapes, evidenced in attempts to protect soil from erosion, water quality from contamination, natural beauty from degradation or historic sites from neglect.[24] As natural and cultural amenities become a location advantage – both in terms of attracting new investment and stimulating home-grown business development – rural policy can incorporate measures to extract value from these natural advantages while preserving their design and nature since "most rural amenities cannot be reproduced and future demand is unknown." [25]

A rationale for government intervention exists when market forces fail to generate sufficient revenues on private investments that maintain amenities or provide access at a reasonable cost to the consumer while still making the venture profitable. (Examples could be walking trails, ski hills or access to ICT).

Thus, government policy can help to:

- Develop new amenity-based goods or services (e.g., winery tours, museum or theatre networks);
- Optimize supply and demand (e.g., certification of amenity-based products);
- Assign rights of ownership or access where private markets may be more effective at extracting value than public ownership (e.g. mining or forestry); and
- Regulate the quality of natural assets (e.g., spring water that is bottled for the consumer market).

[24] OECD, *The New Rural Paradigm,*
[25] OECD, *The New Rural Paradigm*, op. cit. p. 72.

GREATER PROSPECTS FOR ACHIEVING THE "TRIPLE BOTTOM LINE"

In Europe, a key driver for rural policy is the well-developed concept of sustainable development, also known here as the "triple bottom line" — achieving net positive economic, social and environmental benefits. Rural policy can add value to cross-sectoral policies by integrating economic, social and environmental objectives simultaneously, on the grounds that:

- Many problems of social cohesion or environmental disequilibrium are regional in nature, such as depopulation of rural areas, dealing with brownfields, water quality source protection or remediation, and air quality.

- Regionally-based problems are best addressed on a regional or local basis which enables greater awareness of local needs and a higher degree of community participation in decision-making.

- Given the higher degree of awareness of and sensitivity to local needs and conditions, it is more likely that regionally-based responsibility for implementing sustainable development programs and policies will achieve the "triple bottom line." [26]

[26] *Ibid*, p. 25.

Promoting Social Cohesion

Along with the economic transformation fashioned by globalization, many fundamental social changes can be traced to the effects of a more globally-oriented, integrated, interconnected world. Whole communities have been devastated by changes in patterns of agricultural production or plant closures. Rural youth are drawn to urban areas for education and skills training not available in rural regions, and are compelled to stay in cities because of a wide variety of high-paying, knowledge-based jobs.[27] Youth out-migration, when combined with an aging population, leaves rural regions with a fragile economic and social base.

The net result of these shifts can be social instability.[28] Income disparities between rural and urban economies are already well-established. Differences in demographic profile between rural and urban economies are also well-known.

The impending wave of retiring "baby boomers," who often seek out retirement locales on the basis of cultural amenities, eco-based advantages, or craft industry potential, often bring expectations from urban environments about transportation, public infrastructure standards, lifelong learning opportunities or participatory decision-making that simply do not exist in rural areas. As immigrants are increasingly drawn to large urban areas, rural areas find it difficult to build a more diverse base, or benefit from the education and skills base and entrepreneurial potential that many immigrants can bring to a rural community.

A rural policy framework that encourages the development of territorial capital has the advantage of addressing many of these issues precisely because human capital (youth, retirees, immigrants, entrepreneurs) is such a fundamental part of territorial capital. When combined with a highly decentralized and participatory approach to developing and implementing solutions, greater social cohesion is a highly desirable outcome of rural policy.

[27] This demographic and economic feature has been validated in at least some parts of Eastern Ontario. For example, Andrew Redden's study, *The Out-Migration of Rural Young Adults: A Case Study in the Municipality of Trent Hills, Ontario* (2005) also found that young people left to pursue higher education. This phenomenon is more likely to take place when the rural family has at least some financial resources and to a lesser extent, other family members with higher education. Distance to an urban centre can reduce the likelihood of migration. Access to a wider array of social and recreational opportunities was also confirmed as an influential force on youth migration decision-making. Redden's study also found that young people will migrate even if they were active in and proud of their hometown.

[28] OEDC, The New Rural Paradigm, p. 23

UNDERSTANDING THE NATURE OF REGIONAL DISPARITIES IN RURAL REGIONS

OECD data reveal that rural regions lag behind urban regions in GDP per capita, as an indicator of economic performance. Furthermore, for certain regions, this gap has increased over time resulting in a "vicious circle driving rural decline." [29]

<u>In relative terms</u>, rural regions suffer from:

- Declining and aging population, necessitating in-migration to maintain population and workforce levels.
- Lower percentage of population with post-secondary education compared to the national average; this problem is "particularly significant" for Canada.
- Lower than average labour productivity, which may be partly explained by the above factors, plus a higher unemployment rate or a high proportion of commuters working in other regions.
- Less public sector presence as federal, provincial, and municipal governments, school boards, hospitals and non-governmental organizations consolidate services to more efficiently serve a shrinking population base.

[29] OECD, *The new rural paradigm: Policies and governance*, 2006, p. 12.

FEW POLICY LEVERS FOR REGIONAL GOVERNMENTS

While globalization offers regions great potential to develop a distinctive position in the global marketplace, it can also exacerbate already entrenched regional disparities or create new ones. If national governments have relatively few policy levers by which to ease their exposure to international economic competition, regions have even fewer options; their exposure is "absolute." This may result in destructive inter-regional competition, massive unemployment, or out-migration.

By helping regions to find the "sweet spot" of competitiveness in a global economy, rural policy can avoid the high costs of non-intervention in what would seem to be an intractable tendency toward regional disparity. These costs may be felt as:

- Social and political unrest as urban areas are overwhelmed by new residents and rural areas are de-populated.

- The high opportunity costs of supporting already successful (likely urban) areas as new workers may be recruited from existing successful enterprises rather than the ranks of the under-employed or unemployed.

- A rush toward investing capital in real estate speculation and construction in cities, rather than more productive uses in under-capitalized rural regions.

- The possibility that economies of scale found in urban areas may turn into diseconomies or environmental risks, such as increased greenhouse gas emissions. [30]

[30] *Ibid.,* p. 153-154.

SUPPORTING SUCCESSFUL URBAN REGIONS/DEMAND FOR HUMAN-SCALE ENVIRONMENTS

As noted earlier, rural and urban regions are symbiotic, this is most apparent in regions that are directly adjacent to urban areas and networked directly into the forces that generate prosperity and growth in the urban milieu. This symbiotic relationship is particularly evident as the knowledge-based economy replaces more traditional economic drivers.

What can rural areas provide to urban areas that will promote prosperity and growth in the knowledge-based economy? The highly-trained personnel on whom the knowledge-based economy increasingly relies increasingly demand a high quality of life, including access to recreational opportunities, peace and quiet and a "green and healthy environment." [31] To the extent that human capital is key for the sustained prosperity of knowledge-based regional economies, and that easy access to water-based recreational opportunities, hiking and bike trails, open countryside, and fresh air is key to attracting and retaining human capital, rural areas adjacent to urban regions will play a key role.

GUARANTEEING CITIZEN'S RIGHTS/EQUITY IN CITIZENSHIP

The notion of equity has not completely disappeared from discussions of rural development policy; however, rather than looking at equity on the basis of inter-regional equality, as has been the case, more recent analyses look at equity on the basis of the individual.[32]

In this respect, equity is equated with citizens' right— rights to live where one wants and to have access to the same level and standard of basis public services that are accorded to other regions. These services include housing, roads, and access to potable water, electricity, health care, and education. Standards many be established independently of territory but the costs to the public purse of meeting those standards may differ dramatically based on territory.

The extent to which basic rights of citizenship must be met before policies directed at improving opportunities to improve citizens' well-being can be introduced is a fundamental debate for public policy. Realizing opportunities inherent in the territorial capital of a regions depends heavily on the educational and skills levels of its residents, high quality and reliable infrastructure (electricity, ICT, road networks), an in-depth knowledge and appreciation of local assets and highly networked and motivated local actors; whether this potential can be unlocked in the absence of meeting and guaranteeing rights to basic levels of public services must the subject of serious deliberation.

[31] Peter Cabus and Wim Vanhaverbeke, "The economics of rural areas in the proximity of urban networks: Evidence from Flanders, *Tijdschrift voor Economische en Social Geografie 94*, 2, p. 233.
[32] See, for example, OECD, *The new rural paradigm,* p. 141-44.

LESSONS FROM OUTSIDE ONTARIO

Traditionally, fairness and equity have been at the heart of regional development policy. Across developed countries, there is a common experience that existing policies directly or indirectly aimed at developing the economic potential of rural regions based on an equity/efficiency trade-off have failed.[33]

EXISTING POLICY APPROACHES HAVE NOT WORKED

Over the past few decades, policymakers have used a range of policy approaches to address regional --- particularly rural --- disparities:

- Laissez faire (let the market rule)[34]
- Stimulate rural development through supportive agricultural policy (primarily commodities)
- Preferential industrial recruitment policy (direct incentives to convince industry to locate in targeted areas)
- Indirect supports by stimulating urban development and anticipating spinoff effects for adjacent rural areas.

Perhaps, the most important lesson to be learned from the experience of other jurisdictions is that we do not know nearly enough about how the economies of rural regions function. Without this knowledge, the prospects of success for "one size fits all" policies – applied across urban and rural areas alike – are slim.

> **"Current policies to improve the disappointing economic performance of rural regions are, by and large, not working. This is increasingly the consensus among policy makers across political parties, not only in the United States but also in many other countries around the globe. Not only is the performance of rural regions lagging, but the gap in performance levels between rural and urban areas seems to be widening."**
>
> Michael E. Porter, Christian H.M. Ketels, Kaia Miller and Richard T. Bryden, *Competitiveness in Rural U.S. Regions: Learning and Research Agenda,* Institute for Strategy and Competitiveness, February 25, 2004

[33] Michael E. Porter, Christian H.M. Ketels, Kaia Miller and Richard T. Bryden, *Competitiveness in Rural U.S. Regions: Learning and Research Agenda,* Institute for Strategy and Competitiveness, February 25, 2004, http://www.eda.gov/ImageCache/EDAPublic/documents/pdfdocs/eda_5frural_5fregions_2epdf/v1/eda_5frural_5fregions.pdf .

[34] Classical economics predicts that, over time, labour and capital flows will equalize between regions. This is based on an expectation that as urban areas offer higher-wage jobs, workers and money will flow into urban areas while market forces seeking equilibrium will push up wages in rural areas. Thus, traditional regional development policies aimed to redress the imbalance between rural and urban wage rates by letting market forces operate in an unfettered way.

Michael Porter's assessment of rural development policies in the United States is that this policy approach has failed, and that the costs of this failure are high and mounting. In Porter's view:

- Public funds are diverted and dissipated at a time when "policies that fail to generate results are getting increasingly hard to defend".
- National productivity and prosperity are "retarded", given that policies have failed to capitalize effectively on the value inherent in the large land mass (80 per cent in the U.S.) and population (20 per cent) in rural regions.[35]
- Economic activity that could be efficiently located in rural areas is diverted offshore or into urban regions, further eroding national prosperity or creating additional costs from urban congestion.

RURAL POLICY HOLDS MORE PROMISE THAN AGRICULTURAL POLICY

There is a strong consensus in the literature – particularly based on experiences of jurisdictions beyond Ontario – that "agricultural policy can no longer be the primary instrument of rural policy."[36] With globalization, agriculture has undergone major structural changes. Employment in the sector has dropped dramatically, the number of farmers – and farms – has declined, family firms have given way to vertically integrated firms tightly integrated into the supply chain, and land holdings are now concentrated into fewer but much larger farms closer to end markets. In the U.S., agriculture is not the leading source of jobs: "Even in farming counties, however, eight out of ten jobs are in non-farm sectors"[37]. At best, agricultural policy can address only one part of rural economies.

Around the world, governments addressed the transformation of agriculture through commodity subsidies and income support for farmers; nowhere has this policy regime proven effective at altering the underlying forces plaguing the sector and in the minds of many policymakers, has resulted in a culture of "dependency." Furthermore, agricultural subsidies do not necessarily benefit other rural residents or businesses, and often result in foregone opportunities "when they tie a region into a particular activity or discourage investment in other sectors."[38] As agricultural subsidies are subjected to scrutiny due to obligations in international trade agreements and as governments seek more effective use of tax dollars, new policy approaches are needed for rural areas - even those in which agriculture is still a significant component of the economy. Within these communities, agricultural producers themselves wish to end the culture of dependency and participate fully in vibrant regional, provincial and national economies.

[35] In OECD countries
[36] OECD, *New approaches to rural policy: Lessons from around the world*, p. 6.
[37] Porter et al, p. 19
[38] OECD, *The future of rural policy: Lessons from around the world,* p. 6-7.

Mark Drabenstott, a well-known expert in rural policy with the Federal Reserve Bank of Kansas City, has noted that rural policy may actually be better for the agricultural sector than agricultural policy.[39]

INVESTMENT ATTRACTION PRACTICES CAN DISTORT MARKETS

Subsidies and incentives to attract industry and investment to low-cost regions or to build critical mass in strategic sectors have also proven ineffective against increased competition, declining profitability, and reduced employment caused by globalization.[40] This practice of "smokestack-chasing" still lingers in practice although it has been denounced in theory and in policy statements.

At the same time as sector-based policies for agricultural and industry lagged behind the forces of globalization, regional economic development policies failed to improve the economic prospects of rural regions. Mark Drabenstott identifies three major problems with federal policy for regional economic development in the United States:

- A high level of **fragmentation** across levels of government, across departments in the same level of government, and between the executive and legislative branches at the federal level.
- An underlying **assumption that all regions will eventually become homogenous** as they develop into *industrial* regions, growing at the same rate in the same direction.
- Given this **belief in the eventual fate of rural regions as industrial regions**, federal investments were made in physical infrastructure (for example, water and sewer works, business incubators, road, rail and air links) rather than infrastructure for a knowledge-based economy.[41]

Consequently, rural or regional policy is now where sectoral policy imperatives and regional economic policy intersect, based on the consensus that the drivers of economic growth are increasingly tied to regionally distinctive assets and markets, and that policies must celebrate regional differences rather than sectoral competition.

[39] Mark Drabenstott, "Rethinking federal policy for regional economic development," Federal Reserve Bank of Kansas City, *Economic Review*, 1st quarter 2006, p. 116-120, http://www.kc.frb.org/Publicat/econrev/PDF/1q06drab.pdf.
[40] See OECD, *OECD territorial outlook: 2001 edition,* pp. 21-23 for a review of shifts in industrial policy since WWII.
[41] Mark Drabenstott, "Rethinking federal policy for regional economic development," Federal Reserve Bank of Kansas City, *Economic Review*, 1st quarter 2006, p. 116-120, http://www.kc.frb.org/Publicat/econrev/PDF/1q06drab.pdf.

Economies of Scale May Need A Different Interpretation in Rural Regions

In production economics, the term "economies of scale" describes the situation when cost per unit decreases as quantity of output increases. The equivalent in urban economics is called "agglomeration economics" and describes the benefits that firms enjoy when they cluster together; typically, the benefits of proximity include access to a shared labour pool, knowledge sharing, and access to specialized suppliers.[42]

Some studies of cluster development indicate that there is a self-reinforcing cycle —as critical mass builds, economies of scale improve and returns from agglomeration and knowledge spillovers are realized, thus attracting more firms and associated services to the cluster. However, blind application of this model of building critical mass may be ineffective for some rural regions. The self-reinforcing cycle is most applicable to *regions that are already prosperous or adjacent to urban regions.*

David Wolfe, a leading analyst of cluster development policy in Ontario, noted in a recent paper that cluster development depends heavily on the existence of "absorptive capacity" in the region—in other words, there must be a pre-existing base of industrial receptors that can absorb innovations and technologies developed within the region, thereby building the critical mass and starting the cumulative process of cluster-building.[43] A key question for rural regions to address in formulating their development strategies is: do we have a base of industrial receptors close at hand into which innovations and technologies might flow?

Agglomeration economies are highly dependent on manufacturing and/or innovation-oriented clusters, and the policy approaches aim to mimic the benefits of these types of clustering. Traditionally, rural-based industries or enterprises are dependent on access to urban markets, and often provide products that cannot be obtained within an urban agglomeration. How does cluster theory apply in this context?
In a study of competitiveness in U.S. rural regions, Michael Porter observed that "rural regions are stronger in resource-dependent industries and traditional manufacturing clusters such as processed food, automotive, forest products, furniture making and motor driven products." [44] The markets for these products are no longer limited to the local region; rather, traditional industries in rural regions must rely on quick and efficient transportation access to the larger markets in urban areas, or to urban areas as a gateway to global markets. *The growth of urban areas may depend heavily on access to these bulk material products from rural-based traditional industries*, such as aggregates for road construction.

[42] OECD, *The New Rural Paradigm,* p. 103.
[43] David Wolfe, "Universities and cluster development," paper presented to Conference on Universities and the Powering of Knowledge: Policy, Regulation and Innovation, Ottawa, November 19th, 2006, p. 14.
[44] Michael Porter with Christian H.M. Ketels, Kaia Miller and Richard T. Bryden, *Competitiveness in rural U.S. regions: Learning and research agenda*, Institute for Strategy and Competitiveness, February 25, 2004, p. 25, http://www.winwinpartner.com/_downloads/062104_PorterRuralReport.pdf.

There are several reasons why some rural regions may have difficulty accessing the benefits of agglomeration economies. First, "firms in rural regions typically lack the benefits of agglomeration" because the region is unable to attract a critical mass of firms in the same specialized field. This critical mass would generate spin-off effects of more specialized pools of labour and suppliers. The greater distances between firms located in rural areas also works against the knowledge-sharing that spurs innovation and growth in urban-based clusters.

Some regional development strategies aim to create manufacturing and innovation-oriented clusters in rural regions by promoting the use of ICT as a way to overcome the disadvantages of distance. One study suggests that, in doing so, "the effect of agglomeration might be different (and indeed more dangerous) than what commonly thought so far" and that policy-makers should be aware that such regional policies may actually harm the periphery. [45] In Europe, where some analysts distinguish between local "cores" and local "peripheries" located around or close to a "core," evidence seems to suggest that building agglomerations in core regions works, but creates disparities with the peripheral regions.[46]

> **"Small, isolated rural communities are reliant on the slow building of networks and local knowledge…"**
>
> Debra Davidson
> Rural sociologist
> University of Alberta
> Canadian Geographic
> December, 2006

The rationale for government involvement, therefore, is to create conditions in rural areas that will minimize the disadvantages of distance. Brokering and networking programs, market intelligence services, or access to micro-credit are examples of government policies that can help create the advantages of proximity where critical mass simply does not exist. This is a positive application of agglomeration thinking to rural regions.

Institutions of higher education can play a significant role in rural policy. Porter reports that when curricula at rurally-located institutions move away from a traditional agricultural focus to embrace the types of educational and skills training needs in that particular region (for example, business management, entrepreneurship, industrial skills training), there is a "significant and positive impact on the regional economy".[47] The cited benefits are better-trained workers, increased social capital and knowledge sharing, increased use of information technology, and increased levels of wages and innovation.

[45] http://www.crenos.it/working/pdf/05-10.pdf, p. 30
[46] Steven Brakman, Harry Garretsen, Joeri Gorter, Albert van der Horst, and Marc Schramm, "New Economic Geography, Empirics, and Regional Policy," May 11, 2005, http://www.euroframe.org/fileadmin/user_upload/euroframe/docs/2005/session3/eurof05_horst.pdf.
[47] Porter et al, op.cit., p. 40

TERRITORIAL CAPITAL CAN BE CONSIDERED AS THE MICROECONOMIC BASIS OF COMPETITIVENESS

"A key lesson learned from innovation activities over the past decade has been that the most important tools for fostering innovation are to be found at the microeconomic and local levels." [48]

There is a general consensus in the literature on new directions in rural policy that each region must be treated as distinct, given the unique nature of the "territorial capital" inherent in the combination of natural, human, physical and cultural resources.

More than a decade ago, the US Department of Agriculture developed a classification system for non-metro counties based on the nature and state of their economies[49]. The variation in economic condition is rooted in either the territorial capital within the county or the strong influence of particular policies on the rural environment. In other words, the United States recognized and has been monitoring and responding to economic change across rural America for more than ten years.

The classification system is comprised of:

- **Farming Counties** (residents derive 20 per cent or more of their earned income from agriculture; these counties are geographically concentrated based on natural resource capital)
- **Manufacturing Counties** (30 per cent or more of the counties' revenue comes from manufacturing; concentrated in the eastern half of the country, presumably close to larger markets)
- **Service Counties** (50 per cent or more of earned income is derived from services jobs; no discernable pattern of concentration)
- **Retirement Destination Counties** (experienced 15 per cent or more immigration by people in their 60s or older during the 1980s; concentrated in the south and west, presumably due to climate or other favourable amenities)
- **Federal Lands Counties** (where 30 per cent or more of the land area is owned by the federal government; concentrated in the western half of the U.S. based on patterns of land ownership)
- **Persistent Poverty Counties** (where 20 per cent or more of the population live below the poverty level; these areas also exhibit higher unemployment rates and a predominance of low-skill, low-paying jobs; concentrated in the southeast, southwest and Appalachia regions).

[48] Sylvain Giguere et al., *Local governance and the drivers of growth,* Paris: Organisation for Economic Co-operation and Development, 2005, p. 13.
[49] Best Practices in Rural Development, Office of Thrift Supervision, USDA, 1995,, p. 10

Taking a narrower private sector focus, Michael Porter contends that the prosperity of a region depends fundamentally on the "microeconomic foundations of competitiveness"— that is, the productivity of the firms and enterprises operating in a region which, in turn, rests on the **quality of the region's business environment**.[50] According to Porter, government policies can enhance the "sophistication" of the regional business environment by:

- Improving the quality and availability of specialized labour, and physical, ICT and scientific and technological infrastructure ("input conditions");
- Enhancing the environment to encourage investment and sustained upgrading through policies that improve access to capital, protect intellectual property and encourage co-location of firms in similar industries;
- Encouraging the development of related and supporting industries; and
- Expanding the local customer base, or developing local needs that anticipate national or global demands.

[50] Porter et al., *Competitiveness in Rural U.S. Regions,* p. 37.

Regional Approaches Help Rural Areas Overcome Small Scale and Dispersion

Overcoming the disadvantages of small scale, distance and dispersed population has been a focal point of rural policy debate for some time. A report from the Federal Reserve Bank of Kansas City (2006) suggests that regional (rather than individual community) alliances --- although difficult to build and maintain --- are quickly becoming the tool of choice for rural development.[51]

> **"We cannot point to any case where centrally-inspired initiatives or heavy external investment have led to the enduring success of local economies."**
> OECD,
> The New Rural Paradigm
> p. 129

According to the report, regional alliances:

- Allow rural places to achieve critical mass across traditional boundaries, thereby reaping greater benefits across the region than the collected individual communities could achieve by working independently.
- Encourage urban-rural linkages which permit collaborative ventures (airports and sewage treatment facilities for example) that would be daunting for any community to finance on its own but would deliver benefits beyond that community by improving aspects of regional infrastructure essential for economic development.
- Allow communities to take advantage of *both* similarities and differences in their respective economic assets. For example, some rural areas may have an economic base in manufacturing while others are more focused on agriculture, forestry or the service industry. Yet they may share lifestyle attributes such as natural settings or less hurried lifestyles. The lifestyle attributes may differentiate rural regions from their urban counterparts while recognizing and building on the diversity of rural economies. This diversity can help build networks and support the emergence of customer-supplier relationships within the region itself.
- Encourage stakeholders within the region to remove, harmonize or work around administrative "boundaries" such as local government borders or institutional[52] service areas.

[51] Weiler, Henderson and Cervantes, Innovative Regional Partnerships in the Rural Tenth District, Federal Reserve Bank of Kansas City, 2006 p. 3
[52] In this instance, "institutional" refers to public, private, non-profit or philanthropic organizations, source: ibid, p.3

This report suggests that the greatest challenges to regional alliances are:

- Creating new networks that stem from shared interests and **cross the boundaries of traditional structures**. Often, an innovative rural partnership coalesces around a fresh set of networks that encourage a shared regional vision.
- Creating **partnerships across space**, overcoming the distances and spatial barriers (for example, multiple jurisdictions competing for the next manufacturing relocation).
- Creating **partnerships across institutions** (public institutions, private sector organizations, not-for-profit agencies, philanthropic organizations) to bring together the capabilities of all for the benefit of all.

SUCCESSFUL APPROACHES START WITH CONSIDERATION OF EACH REGION'S TERRITORIAL CAPITAL

Innovation has a spatial as well as a sectoral dimension.[53] Because it is spatially based, rural policy can unleash the innovative potential of a region, thereby building the basis for a sustainable, self-reinforcing growth pattern. Experts agree that the key to unleashing this innovation capacity is to develop each region's "territorial capital."

Territorial capital is comprised of the expected features of the particular geographic location Geographical location, including climate, topography and access to water, the region/community size and population, the quality and quantity of natural and human resources (especially those that can be applied to producing goods and services), traditions, cultural amenities and quality of life, and the overall "environment" that makes creativity and innovation happen through a combination of institutions, firms, researchers and policy-makers, or unstated rules or customs that allow firms in the same field to help each other.[54]

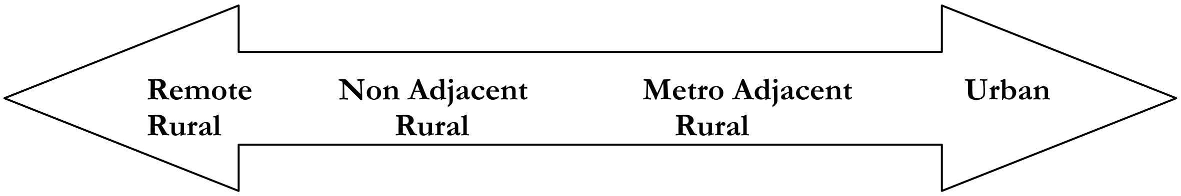
Because each region's territorial capital is different, the innovation strategy for each region must be designed in relation to that territorial capital.

The Importance of Tacit Knowledge: One aspect of territorial capital that has been highlighted as a key driver of innovation – and may vary in its presence across regions – is "tacit" knowledge. Tacit knowledge is knowledge that is transmitted more through training or informal, personal interactions such as those that take place around a water cooler. This type of knowledge may be well transmitted within a region, assuming the existing of the networks and environment described above, but is very difficult to transmit across regional boundaries. While the innovation output of a region is often measured in terms of patents, R&D spending or employment of highly-qualified persons, others argue that innovation is a largely learning-based process that requires constant

[53] Innovation in this sense is based on the definition used by Statistics Canada as the "process of generating, introducing and extracting value from ideas," p. 15.
[54] OECD, *Territorial Outlook: 2001 edition*, p. 15.

feedback among economic players and institutions, including market forces.[55] If the networks or business environment do not exist to facilitate these feedback processes, the region is likely to have lower innovation output.

Regional Economic Development: Considering the Rural-Urban Continuum



Territorial Capital
(ex. geographic area, climate, access to water, size of population)

Low Pop. Density — High Pop. Density
Natural Resources — Urban Infrastructure

Innovation Infrastructure
(Tacit knowledge, Entrepreneurship, Commercialization Services)

Informal Networks — Innovation Parks
Limited Broadband — Comprehensive Broadband

Physical Infrastructure

Emphasis on Roads — Greater Likelihood of Public Transit
Individual Water & Sewer Systems — Public Water & Sewer Systems

Size of Local Markets

Small Local Markets[56] — Large Local Markets
Indirect Access to Export Markets — Direct Access to Export Markets

Financial Capital

Limited Access to Capital — Angel, Venture Capital
(ex. CFDCs, Bank Finance) — Bank and Equity Finance
Limited Ability to Compete for Public Funds — Significant Ability to Compete for Public Funds

Lifestyle Features

Longer, Less Congested Commutes — Shorter, More Congested Commutes
Slower Paced Lifestyle — Faster Paced Lifestyle
Outdoor/Natural Recreation — Group Cultural, Entertainment Services

55 Statistics Canada, p. 16.
56 Porter et al, op. cit., p. 18

Michael Porter summarizes the business environment in rural areas this way:

"There is general consensus in the literature that the business environment in rural areas tends to be weaker than that in metropolitan regions. The lower density of population and economic activity raises the cost of physical infrastructure, makes it harder for educational institutions to specialize while serving the needs of the region, supports a smaller number of local competitors, and creates barriers to achieving a critical mass of related and supporting industries."[57]

Porter's observations echo the findings of the 1995 Best Practices Review by the USDA, which suggested that four key findings ought to underlie rural policy development[58]:

- The diversity of rural areas and the differences in rural needs that flow from this diversity;
- The overall pattern of economic disadvantage in rural areas (rooted in small community sizes and low population densities, the decline of traditional industries, global competition in low-wage, low-skill sectors, and distance as an impediment to linkages with urban economies);
- The growth of "high-amenity" rural areas;
- The absence of a single recipe for rural prosperity even though the potential is considerable and there are logical ways to promote development.

The USDA report recommended the following four principles as components of rural policy:

- Improve the connections between rural and urban areas by improving infrastructure and the dissemination of information and the ability to use it. Advanced telecommunications was cited as one necessary but not sufficient example.
- Encourage and assist rural firms in targeting specialized niche markets.
- Create artificial scale economies to counter the higher costs of government and business in rural areas due to small-scale, low-density settlement patterns. Examples are flexible manufacturing networks or multi-stakeholder purchasing groups.
- Improve the competitiveness of rural firms by enhancing the core skills of both management and labour. The ability to use information, technology and new management techniques were seen as especially important.

[57] Porter et al, p. 39
[58] Best Practices in Rural Development, Office of Thrift Supervision, USDA, 1995., p. 22

RURAL POLICY STARTS WITH UNDERSTANDING THE DYNAMICS OF RURAL REGIONS

"Today, rural leaders need to understand their competitive position,
what their key economic assets are,
and where markets critical to their region are headed."

Drabenstott and Henderson offer three suggestions for senior government policy contributions to rural development[59]:

- Help rural regions craft new competitiveness strategies
- Link ongoing investments in research to these strategies; and
- Build a more effective support system for rural entrepreneurs.

Michael Porter's review of economic competitiveness in rural regions of the United States indicates that there is a need for research on several issues which are central to rural policy formulation.[60] Specifically, he calls for:

- An analysis of the relationship between the prosperity of rural regions and the characteristics and prosperity of the metro areas to which they are adjacent.
- Measurement of rural new business formation, the prevalence of fast-growing companies, venture capital investment, patenting rates and other measures of innovation and economic dynamism across rural and metropolitan regions.
- An analysis of the cost of living in rural areas to better understand their comparative level of prosperity.
- An analysis of transfer payments to better understand the role of redistribution in rural performance.
- Analysis of the patterns of population migration and the relationship of migration to job growth rates in rural vs. urban areas.

Porter's rationale for calling for this research is the realization that existing policy approaches to rural development have not worked. And he is calling for better approaches so that rural America can make a stronger contribution to the national economy.

[59] Drabenstott and Henderson, op. cit. p.4
[60] Porter et al, P. 17

ENTREPRENEURSHIP IS A KEY INGREDIENT FOR REGIONAL GROWTH

There is widespread agreement that entrepreneurship is a key ingredient for regional growth[61]. These individuals are much sought in all regions because they typically introduce new ideas and create jobs. In rural areas, they are also apt to rely on local suppliers for goods and services. One study categorizes rural entrepreneurship according to two dimensions: breadth and depth. Some entrepreneurs, such as those in retail, construction or "lifestyle" services, add breadth to a rural economy without adding depth (in terms of maximizing value, creating high-wage jobs, or generating spin-off benefits to local suppliers). According to this study, the focus for rural policy should be to support "high value entrepreneurs" who create not only jobs, but also wealth and depth of economic activity. Often serial entrepreneurs, this class of owners/managers usually enjoys the flexibility to locate in urban areas, but choose to locate in rural areas because of attractive natural settings and quality of life, and then establish businesses.

While entrepreneurial activity can be found across any economic landscape, those "high value entrepreneurs" tend to cluster in metropolitan areas. Analysts seeking to understand this location phenomenon say it is driven by 1) the metro areas' ability to lower the cost of finding and obtaining specialized labour and inputs, 2) a more fertile climate for knowledge-sharing among entrepreneurs, workers and *financiers*, and 3) a large supply of leaders who can guide the region's *public* and *private* investments in ways that help to fulfill the local vision.[62] (italics added) If rural regions are to be successful in attracting and retaining high value entrepreneurs, they will need to address these aspects of entrepreneurs' location decisions.

Because there is a clear economic bonus to places that are good at fostering entrepreneurs (nations that grow more entrepreneurs tend to experience faster economic growth rates), Drabenstott and Henderson offer several recommendations specifically for rural regions:

- Provide a support system for entrepreneurs (including "coaching" in marketing, accounting, legal and management skills) as an alternative to the wide range of skill sets that already exist for entrepreneurs in urban areas. They note that building a robust regional program can and should involve multiple partners, including philanthropic bodies, colleges and universities, and various levels of government.

- Pay attention to the development of equity capital (as opposed to credit/loans) for rural businesses since transaction costs for traditional investors are higher in rural areas because the opportunities are more widely dispersed and the experience with investment beyond the metropolitan areas is likely to be more limited.[63]

[61] Henderson et al., *Measuring a region's entrepreneurship potential*
[62] This assessment is based on a summary presented by Drabenstott, and Henderson A New Rural Economy: A New Role for Public Policy, 2006
[63] Drabenstott and Henderson are quite clear that "publicly managed funds are not the solution to the problem --- research confirms this". Instead they expect that the most successful models will be those in which public policy

In addition to education, skills training, entrepreneurial supports, and equity capital as well as credit, rural policies must also recognize that high value entrepreneurs still need:

- Access to fast and efficient road and ICT networks;
- Networks that facilitate in-migration to the region; and
- Protection of the quality of life that draws entrepreneurs to the regions.

Immigration is likely to become increasingly important both as a source of potential entrepreneurs and a source of skilled labour for rural regions.

A U.S. study[64] found that entrepreneurial *communities* could be identified by a series of traits:

- A broad definition of community
- An acceptance of controversy
- A willingness to impose taxes to invest in rural infrastructure
- Flexible and dispersed leadership
- Networking possibilities among residents
- Sufficient personal financial resources for collective risk-taking
- A willingness to invest a surplus in local private initiatives.

helps a robust network of philanthropic and private funds emerge, Drabenstott, and Henderson A New Rural Economy: A New Role for Public Policy, 2006

[64] OECD, The New Rural Paradigm, op. cit., p. 129

Governance Models for Implementing Rural Policy

Defining a region may be relatively easy from the perspective of defining the outer boundaries, especially if those outer limits do not disrupt the boundaries of existing governance bodies or other organizations with mandated service areas. Within the region however, the determination of "sub-regions" and the governance models to be employed to guide the implementation of rural policy can be problematic. The main reason for this challenge is that to enhance the prospects of people and organizations within the area working together to pursue common interests, areas should be defined on the basis of one or more economic or social characteristics. Yet these definitions may not match the existing local units of government. As a result, the definition of "local" is a pragmatic one, usually dealt with by "encouraging local units of government in rural areas to organize themselves voluntarily into associations following general framework guidelines with funding incentives to that end."[65]

Defining Areas For Purposes of Regional/Rural Policy Implementation

Whether the definition of sub-regions or areas is done by the local stakeholders themselves based on their regional development vision and aspirations, or is imposed by a higher level of government, a variety of approaches can be used:

Corridor Model: A main corridor (which could be geographic or transportation related) serves as the skeleton for development of communities both along the corridor itself and as offshoots from it. Example: TransCanada Highway or Highway 401 in Ontario.

Small Area Hub Model: The region is organized around several small to medium-sized towns around which act as public and private service centres for the surrounding area. The hubs may have social services, sometimes a hospital, banking or other business services while representing a sizeable portion of employment. Ideally, the hub would be adequately linked to the domestic transportation network. Example: The Irish Spatial Strategy retains rural hubs linked through infrastructure development to "Gateway" cities at a regional level.

[65] OECD, The New Rural Paradigm, op. cit., p. 118

Employment Basin Model (Bassins d'emploi): Sub or micro-regions are defined on the basis of a limited set of economic factors, of which employment patterns are often the most prominent. Example: In France, "pays" are defined on the basis of employment patterns and are known as basins d'emploi.[66]

Regardless of the particular parameters chosen, GIS systems are now used to map the geographic distribution of these parameters and thereby suggest appropriate sub-regional boundaries. If multiple parameters are used, multiple maps can be overlain to determine if there is a boundary definition that reflects the geographic distribution of many of these parameters.[67]

Partnerships as a Potent Tool for Rural Development

The literature reports that partnerships between stakeholders within a region or sub-region have become a key tool in shifting policy focus from reducing disparities to building sustainable economic prosperity. Because partnerships appear to be especially effective in building community capacity, community involvement, innovation and integration of development initiatives, this mechanism is especially well-suited to rural areas where these particular goals are likely to emerge early on the regional agenda. Partly as a result of the short timeframe over which partnerships have been used in regional development, it is not yet clear how strong the impact of partnerships is on job creation, supports to business, or the provision of other community services.

The following chart, which is drawn from the OECD's latest work on rural policy, was originally developed by Moseley (2003). It describes very clearly the factors which contribute to effective partnerships or significantly limit the influence of a region/rural development partnership. In addition to presenting Moseley's work, the OECD notes the additional challenges to building successful regional partnerships on the rural development front:

- Complex, rigid and fragmented national and supranational policies that affect rural development;
- Fragmented decision-making and management at the central level of government;
- Different geographic boundaries as well as different reporting, recording, monitoring and evaluation systems for funding programs of upper levels of government
- Planning partnerships that do not have accompanying partnerships for implementation
- "Partnership fatigue" and bureaucratic overload (for the relatively small pool of leaders in rural areas)

[66] ibid, p. 118
[67] ibid, p. 119

Level of Effectiveness	Factor
Very high level of influence	• Competence and commitment of partnership staff • Successful mobilization of local knowledge about needs/resources of the area • Decision-making being exerted that the local level
High level of influence	• Sectoral heterogeneity of the partners (a mix rather than all from one sector) • Involvement of one or more key actors with leadership skills • Manner in which the partnership was originally initiated • Networking activities of the partnership
Influential	• Community partnership achieved by the partnership • Independence/neutral status of the partnership • Diverse backgrounds/skills of the people representing the partnership organizations • Joint planning undertaken by the partnership
Limited	• Limited legitimacy or democratic accountability • Over-representation in the partnership of the local elite or establishment • Excessive focus on project delivery and on spending the money rather than the strategic pursuit of a coherent program of integrated development • Excessive focus on the short term • Failure to address sufficiently social exclusion and to seek fuller involvement of a wide cross-section of local society • Insufficient transparency in the partnership's operation • Diversion of energy into the pursuit of continuation funding

LINKING LOCAL/REGIONAL EFFORTS INTO A SYSTEM OF VERTICAL CO-ORDINATION

The OECD analysis of the governance systems associated with rural development identify three major "systems", all of which contemplate the need for vertical co-ordination among various levels of government. As is summarized in the following chart, these systems are:

- Centralized systems, in which the most senior level of government involved has an active role in selection of local partnerships and plans.
- Decentralized systems, in which several levels of government as well as other local agencies and organizations share a variety of design and implementation functions
- "Concerted" systems in which several levels of government and other local agencies and organizations work together across virtually all functions.

Vertical Co-ordination by Institutional Model of Governance[68]

<table>
<tr><th colspan="2">Functions in designing and implementing rural development policies</th><th>Centralized Systems</th><th>Decentralized Systems</th><th>"Concerted" Systems</th></tr>
<tr><td rowspan="3">Planning</td><td>Strategic Programming</td><td rowspan="5">National level</td><td rowspan="2">National level</td><td rowspan="2">State with regions</td></tr>
<tr><td>Fund Allocation</td></tr>
<tr><td>Operational Programming</td><td rowspan="3">Regional level</td><td rowspan="2">State with regions, sub-regional authorities, social and economic partnerships</td></tr>
<tr><td rowspan="4">Delivery System</td><td>Rules of Implementation</td></tr>
<tr><td>Choice of beneficiary areas</td><td>Regions with sub-regional authorities</td></tr>
<tr><td>Selection of local partnerships/local plans</td><td rowspan="2">National and partly regional level</td><td>Regional or sub-regional authorities</td><td rowspan="2">Regions or sub-regional authorities or agencies</td></tr>
<tr><td>Approval and funding of individual projects</td><td>Sub-regional authorities or local agencies (sometimes partnerships)</td></tr>
<tr><td></td><td>Control, monitoring and evaluation</td><td>National level (also agencies)</td><td>Any level</td><td>State with regions and sub-regional authorities/local agencies</td></tr>
</table>

[68] OECD, op. cit., p. 131

In comparing the models, the OECD notes that:

> "in centralized systems where the central government has an active role in the selection of local partnerships and plans, the problem of a standard model that does not fit all rural regions is more likely to appear. In either the decentralized or the 'concerted' system, it is difficult for different levels of government to clarify their respective roles and responsibilities."[69]

This same report notes that increasingly, central governments are focusing on establishing the overall strategies, priorities and legal framework for rural policies while evaluating the coherence of the programs in relation to the policy. Intermediate level organizations (regional authorities) are assuming a lead role for particular functions such as program design and implementation, allocation of resources among local communities, monitoring, evaluating and control of local projects, and the negotiation of competences and resources with higher levels of government.

[69] ibid, p. 130