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Challenges for Economic Growth of Regions in the Baltic Sea Region Case Study of Latvia

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Challenges for Economic Growth of Regions in the Baltic Sea Region

Case Study of Latvia

ABSTRACT

The Baltic Sea region is one of the most socially, economically and technologically developed regions in the world. The region has a high GDP level, limited social inequality in a global context, leading positions in Doing Business and Global Competitiveness indices. Meanwhile, the region is experiencing rapid aging of society and depopulation of the territories, the region internally has large differences in the development of human capital and productivity rates. The eastern part of the region is expressively dependent on one supplier's power resources; it is experiencing the largest fall as a result of the global economic crisis; and has high unemployment and poverty rates. One of the most prosperous and sustainable macro-regions in the world is facing high challenges in development of balanced and sustainable socio-economic structure inside it.

The report analyzes which factors have promoted or hampered the growth of the regions (at NUTS3 level) of Baltic countries; and what areas of development play a crucial role for further growth. Therefore perspective policy intervention areas for promotion of the region's sustainable economic growth are analysed, - implementation of integrated development planning practice; exploration of advantages of modern regional governance practice; strengthening of business and innovation capacity at the regional level. By using the approach and methodology developed by OECD in the analysis of regional growth factors, calculations have been made about the comparative rates of the 3 Baltic countries – Estonia, Latvia and Lithuania. For the basis of the analysis, 6 indicators were used describing GDP growth, productivity, employment and population. The comparative growth speeds of the regions were analyzed over a period of several years.

Results of the analysis clearly demonstrate the impact left by the global economic crisis on the economy of the regions. It also demonstrates failures of the selected and enforced government's regional policy based on subsidies to support development of infrastructure in the lagging regions of Latvia. The tendencies indicate specific policy implications. The best results may be achieved

by combining different possibilities existing in the regions and by using modern and innovative management tools.

Keywords: regions, economic development, integrated development planning, regional governance

INTRODUCTION AND GLOBAL CONTEXT

The Baltic Sea region is one of the most socially, economically and technologically developed regions in the world. It is characterized by such outstanding examples as the Swedish welfare system, Denmark's determination to become fully independent of fossil power resources by the year 2050, Finland's success in the field of high technology or Estonia's ability to implement e-management solutions effectively. The region has a high GDP level, in the world's context – minor social inequality, leading places in Doing Business and Global Competitiveness indexes.

Meanwhile, the region is experiencing rapid aging of society and depopulation of the territories, the region internally has large differences in the development of human capital and productivity rates. The eastern part of the region is expressively dependent on one supplier's power resources; it is experiencing the largest fall as a result of the global economic crisis; and has high unemployment and poverty rates. On the EU scale, there are both the best performing regions for Summary Innovation Index and the most outperformed regions for Summary Innovation Index.

One of the most prosperous and sustainable macro-regions in the world is facing high challenges in development of balanced and sustainable socio-economic structure inside it. For example, in Latvia there are expressed differences in socio-economic development level between the capital city Riga and the rest of the territories of the country. The majority of economic and social activities are concentrated in the capital city Riga and around it. If the tendency continues like that, the differences in socio-economic development level between capital Riga and the rest of the country will become more acute, thus creating a clear division – the centre and the periphery.

It should be noted that clearly the differences across the regions within countries are often greater than differences between the countries, yet economists, policy makers and international organisations have paid less attention to regional development than national growth. This aspect additionally points to the topicality of the issue, which in the same

way was emphasized by the OECD focusing on the need to pay greater attention directly to the factor analysis of the regional growth.¹

The recent debate on regional policy and development focuses on whether policies should be pro-equity or pro-efficiency, insisting that a trade-off is inevitable. A recent OECD report emphasizes instead that opportunities for growth exist in all regions. It reframes the debate, arguing that national governments should promote growth in all regions. And regions should promote their own growth by mobilising local assets and resources so as to capitalise on their specific competitive advantages, rather than depending on national transfers and subsidies to help them grow.²

At the same time, the author agrees with the opinion that during the last decade we can observe an ongoing change of perspective in territorial policies, more focused on the competitiveness of places than on ensuring traditional support to sectors or income redistribution. As pointed out by the OECD, “territorial policies should contribute to building and maintaining growth engines; facilitate individual and organizational learning to up-grade local skills; and supporting diffusion of new technologies and innovations.”³ And this demands a real paradigm-shift in local development planning and management.

We can observe that an increasing number of countries look “for a paradigm-shift in policy-making, grounded in the analysis of the failure of policy driven by compensation to correct structural problems.”⁴ To achieve any progress it appears to be crucial to implement a governance reform. There is a need not for a formal reform, but for a real change in the mindset of the leaders of regions and local governments.

In 2009, the OECD emphasized that “traditional policies based only on infrastructure provision or schooling are not sufficient for this task; instead a more comprehensive policy is called for, one that integrates these two policies in a co-ordinated agenda across levels of government and that foster business development and innovation”.⁵

Therefore this report will first analyze which factors have promoted or hampered the growth of the regions (at NUTS3 level) of Baltic countries; and what areas of development play a crucial role for further growth. In the continuation, the author

¹ OECD, How Regions Grow. Trends and Analysis., OECD Publishing, 2009

² OECD, How Regions Grow. Trends and Analysis., OECD Publishing, 2009

³ Pezzini M., Main trends and policy challenges in OECD regions: metropolitan region in a global context, 2009

⁴ Pezzini M., Main trends and policy challenges in OECD regions: metropolitan region in a global context, 2009

⁵ OECD, How Regions Grow. Trends and Analysis., OECD Publishing, 2009

will look at 3 possible policy areas for promotion of the region's sustainable economic growth, - (1) implementation of integrated development planning practice, (2) exploration of advantages of modern regional governance practice and (3) strengthening of business and innovation capacity at the regional level.

FACTORS DETERMINING REGIONAL DEVELOPMENT

For several decades, the trend of growing regional disparities has been one of the main focal points for research in regional development. The questions “how to decompose factors of growth” and “what are the most important or powerful components of growth” have been for long time a challenging issue for development planners and leaders of region and for regional economists and researchers. However, several recent OECD researches⁶, generally provide fairly clear indications based on the analysis of more than 200 OECD TL3 (NUTS2) and more than 800 OECD TL2 (NUTS3) level regions.

The OECD report described the general trends in regional growth and analysed its key components. It holds an examination of trends in regional GDP, GDP per capita, productivity, employment and population changes for two levels of regions within OECD countries for the period 1995-2005. The report proved that “innovation and other growth determinants have a very strong geographic – or spatial – dimension that ultimately explains why some regions grow and not others”.⁷ The main finding of the research is that regional growth rates are closely interrelated with productivity and innovation rates and they are followed by accessibility of infrastructure, number of population and unemployment rates.⁸

Results of a similar research emphasize the significant and reasonable impact of human capital on growth, although this effect is not significant across all specializations featuring policy and institutional variables. There is a significant link between long-term

⁶ For example, the one published in 2010 “How Regions Grow” and the results published in February 2011 of the research “The Policy and Institutional Drivers of Economic Growth Across OECD and Non-OECD Economies”

⁷ How Regions Grow. Trends and Analysis., OECD 2009, Paris

⁸ How Regions Grow. Trends and Analysis., OECD 2009, Paris

development and patent right protection, trade and financial liberalization or taxation policy.⁹

The author of this report, by using the approach and methodology developed by OECD in the analysis of regional growth factors, has made calculations also about the comparative rates of the 3 Baltic countries – Estonia, Latvia and Lithuania. They are not included and analyzed in OECD research because at the time when it was conducted, none of the 3 Baltic countries had become an OECD member yet. But the selection provided by the research is a very presentable basis of comparisons. For the basis of the analysis, 6 indicators were used describing GDP growth, productivity, employment and population. The comparative growth speeds of the regions were analyzed over a period of several years.

Compared to OECD total rates, the regions of the Baltic countries would potentially be included in the group of regions which have managed to increase their GDP part against the total selection and thus the share of their economies was growing in the global context. Individual rates also indicate similar tendencies as the group's average rates. GDP and productivity during recent years tended to increase, as have employments rates. Meanwhile, it can be seen that it is lower productivity growth which differs the most from the strongest 20 regions.

It is necessary to look at 2 additional factors which most frequently impact the productivity growth. These are innovations, which we can fix as the summary innovation index, and direct foreign investments. The summary innovation index is an influential ratio which is frequently used for preparation of the country's competitiveness and attraction factors. Latvia, Lithuania and Estonia lag behind the EU average rates. Meanwhile, Estonia has managed to attain comparatively better results. And subsequently we also see that the Estonian economy is stronger and more sustainable than the economies of its Baltic sisters. When analyzing the index dimensions, we see that, for example, Latvia, and especially its regions which do not include the capital Riga, substantially lag behind in the number of innovators, and in the company and research link rates. In the underdeveloped regions, there is low business activity level, as well as expressively low private sector investments in R&D activities.

⁹ OECD Economic Department Working Papers No.843, The Policy and Institutional Drivers of Economic Growth Across OECD and Non-OECD Economies. New Evidence from Growth Regressions, OECD, Paris, February 14, 2011

Additionally, foreign direct investments are also significant, but do not enter sufficiently into the underdeveloped regions. It is widely acknowledged that foreign direct investments have played a crucial role in the economic growth of several countries, but they have often had uneven localisation within countries.¹⁰

In June and July of 2009, 500 major European companies were surveyed by asking them where in the forthcoming years they were planning to localize their investments. The Latvian capital Riga in this research has been marked by a symbolic 9 companies which mentioned the name of Riga. Riga is the only city among the three Baltic countries which was named in this survey. There is a risk of whether as a result of economic crisis and subsequent legislator's decisions the choice will be changed, or that these investments will be directed to other countries. This research emphasized 4 main factors for business development: (1) access to the global market; (2) qualified labour force; (3) quality of telecommunications (4) transport links.¹¹

When evaluating quality of labour force it appears that in Latvia the number of students per 10000 residents is one of the highest in the world. Irrespective of the fact that the number of population has decreased in Latvia, the number of people wanting to study has increased from 46 thousand in 1990 to 125 thousand in 2010.

However, irrespective of the high level of the number of students in Latvia, the expected amount of innovations and business initiatives are not following, which indicates shortcomings in the total innovation system. But during the global economic crisis of 2008-2010 the unemployment level at its highest point reached almost 20% according to the EuroStat evaluation, or 17.3% according to the registered unemployment data (in March 2010). Youth unemployment is particularly acute, it is close to the 40% level, and as a result of the crisis at the end of the year 2010 already 37% of the registered unemployed residents were without work more than 6 months. This indicates a significant structural unemployment situation.

One of the effects and tendencies facing Latvia is emigration. Sociological surveys carried out in the second half of 2009 show results of the question to the society: "in case the material condition of your family worsened, which three of the mentioned actions would

¹⁰ Pezzini Mario, Main trends and policy challenges in OECD regions: metropolitan region in a global context, 2009, OECD

¹¹ European Cities Monitor, 2009, Cushman & Wakefield

you take first?" the majority of the people would want to search for possibilities to work in another job or better paid job. But, given the high unemployment level of 2009-2010, the residents have no real possibilities to do it. But much fewer people are ready to start entrepreneurial activities or self-employment. Only about 13% of Latvian residents mention commencement of business activities as the preferred choice for ensuring family subsistence. This creates large challenges for sustainability of the state and municipal finances because under circularization of high unemployment and increasing emigration, the load on social budgets substantially increases.

It is worth mentioning that the unemployment rates are very different among the Latvian regions and, for example, in February 2011 varied from 10.9 % of the registered unemployment level in the Riga region to 22.8% of the registered unemployment level in the remotest region of Latgale. During last years the differences between regions by GDP per capita have grown. This clearly demonstrates the impact left by the global economic crisis on the economy of the regions. As well as demonstrates the failure of the selected and enforced government's regional policy based on subsidies to support development of infrastructure in the lagging regions of Latvia.

POLICY IMPLICATIONS

The tendencies described above indicate specific policy implications. In order to ensure the future growth, rather than economic and demographic stagnation of the regions of Latvia, it is necessary to have new, competitive, productive companies, which are oriented to high added value. These aspects indicate the necessity on the national level to develop a new Innovation system development program. In addition, several possible and necessary actions are also visible on the regional and local level. Upon such conditions, the regions and municipalities should intensively search for solutions to add to the national policy.

The local dimension of entrepreneurship is critical. "Entrepreneurship is one of most direct ways to create jobs, increase incomes, facilitate adjustment to economic change and underpin economic competitiveness in a given area. (...) New firm formation is also a key vector for innovation. (...) Where national policies exist to fuel such drivers of growth, local area-based strategies can orient them better to meet local needs. To be

effective, policies must take into account the various location-specific factors and tailor business assistance schemes to local conditions.”¹²

We know that the municipal and regional competence may be divided into 2 large groups: (1) provision of public services and (2) improvement of economic growth of territory, including support for entrepreneurship. In day-to-day activities, the Baltic countries’ municipalities traditionally are more oriented to the first of them – provision of public services – starting from street maintenance to development of a school network, provision of social services to supporting folk groups or elaborating a local development programme. But much less attention and resources are allocated to the issue of the competence of municipalities to develop entrepreneurship, create new jobs, and attract investors. This is observed both in the work of municipalities, as well as in the understanding of residents and the arising targets for the heads of municipalities.

Looking for policy responses, first, requires recognising what determines the regional development factors and influences those the most. As pointed out by Mark Lorenzen there is quite some consistency in the theoretical literature that regional competitiveness is provided by a unique local stock of knowledge and way of employing it. Mark Lorenzo concludes that “the strong policy focus on regions and learning tend to disguise the fact that regional competitiveness through localised learning is a sort of modern Krugmanian variety of Ricardian specialisation. (...) Because what drives regional development is competition between regions, there are losers when some regions prosper.”¹³

At the same time it is worth mentioning that Antonio Vazquez-Barquero has defined three ingredients for development: (1) hardware or building and infrastructure; (2) software or personal capabilities, including technical skills, business know-how, capacity to learn and innovate and entrepreneurial attitude; (3) “orgware” or collective organisational capacity, including inter-firm joint ventures, networks, associations and co-operative links between business, government and public institutions.¹⁴

¹² Editor Giguere S., *Local Governance and the Drivers of Growth*, OECD Publishing, 2005

¹³ Lorenzo M., *Regional competitiveness, localised learning and policy*, Workingpaper No:99-13, Department of Industrial Economics and Strategy, Copenhagen Business School, 1999

¹⁴ Vazquez-Barquero A., *Endogenous Development: Networking, Innovation, Institutions and Cities*. Routledge, London, New York , 2002

Results of a recent OECD research “How regions grow” published in 2010 provide us with generally clear references based on the analysis of 818 OECD NUTS3 level regions. The main finding of the research is that regional growth rates are closely interrelated with productivity and innovation rates and they are followed by accessibility of infrastructure, number of population and unemployment rates. The decrease of number of population per se does not mean automatic and unavoidable shrinking and stagnation of the economy. Upon decrease of the number of population the productivity and innovation as well as workforce activity indicators become even more crucial.¹⁵

PROPOSITION 1: to explore advantages of modern governance approach

Analyzing urban development potential and prospects at a national and regional level, it appears that urban development in Latvia is possible not in mutual competition, but in a partnership. Cooperation offers the possibility to find a potential to establish competitive urban clusters (networks), thus contributing to both economic development and providing a wide range of services available to the residents of the surrounding areas, differentiating them from the cities during their profiling and specialization.¹⁶ Urban cooperation gives the opportunity to complement each other and not to duplicate functions.

Several important studies and reports from international organizations on regional development point to paradigm changes in management as an essential provision and agent for growth and competitiveness. With the growth of regions, an increasingly significant role is placed on the development of individual cities and metropolises as well as creating and functioning of models for urban cooperation. Urban development issues go beyond the meaning and boundaries of the notion of regions and states.

One of the general conclusions from recent work conducted¹⁶ by the OECD is that competitive or winning regions exist in all types of regions.¹⁷ But as pointed out by the Head of the Territorial Reviews and Governance Division of the OECD M. Pezzini, “still,

¹⁵ How Regions Grow. Trends and Analysis., OECD 2009, Paris

¹⁶ This is partly grounded on data analysis which shows that Riga is the only city where the market potential is sufficient to be able to compete as a metropolis of Baltic Sea Region. The market potential of other cities including Liepaja and Daugavpils, in turn, has declined in recent years (SRDA, 2008).

¹⁷ OECD, How Regions Grow. Trends and Analysis., OECD 2009, Paris

the world economy is often regarded as taking on the territorial form of an archipelago, in which large cities would be islands, the essential spatial nodes of the global economy”¹⁸.

Assessing trends in urban development, it is necessary to seek and find new and innovative ways to provide urban and regional competitiveness. Urban cooperation gives the opportunity to complement each other and not to duplicate functions. The solution lies in the establishment of urban networks using the resources and capacity of various cities in the region to create a common, pro-development synergy. With cooperation it is possible to find potential to establish competitive urban clusters (networks), thus both contributing to economic development and providing a wide range of services available to residents of the surrounding areas, differentiating them from the cities during their profiling and specialization.

In Latvia, the evenly distributed urban network is seen as an opportunity and a powerful resource that can serve as a basis for creation of urban cooperation clusters in the administration and business sphere. The author sees in the context of the development of Latvian cities and regions the potential for implementation of an integrated governance cluster model. The opportunity is seen to apply the cluster principles in the administration and public service sphere. This means that with the term governance cluster it would be more accurately stated that the area has a single service and function, and implementation field.

In this model, the cities shall knowingly perform or fail any functions, taking into account the specialization and offered services of other cities existing in its territorial cluster. The governance cluster model can contribute to regional scale governance and facilitate accessibility of various public services, attract private investments and stimulate development of business activities. Generally, the cooperation has to be promoted between the cities with emerging economic partnership relations and ensuring that it strengthens the international positions of cities.

Upon the selection of such a model, it should be taken into account that there is a lack of collaboration (horizontal) and cooperation practices at the public administration level in Latvia. Instead, the sectorial and the administrative approach to the territories are dominating. Therefore, the targeted establishment of cooperation practice between

¹⁸ Pezzini M., Main Trends and Policy Challenges in OECD Regions: Metropolitan Regions an a Global Context, 2010, OECD, Paris

different public administration institutions and various levels of management could possibly contribute to the spread of good practice and demonstrate the benefits of cooperation also in the private sector or smaller municipalities. Taking into account the global economic impact, the author considers that the most appropriate model in Latvia should be the establishment of cross-border urban cooperation networks with the aim to establish them as effective economic development clusters.¹⁹

Clustering theory and practice has so far mainly been considered from economic and industrial policy aspects. Analyzing these examples, the opportunity is seen to apply the cluster principles in the administration and public service sphere. This practice, like in business, may provide several advantages and benefits, including the diversification of services, cost reduction, and increase in the attractiveness of the living environment and attraction of economic activities.

This means that, for example, although a separate city in the Vidzeme region does not have enough resources and capabilities (critical mass) to become a development centre in the context of Baltic countries, it is necessary to see where the alternative lies. When not attracting the necessary human resources, innovation and investment, the quality of life for its citizens reduces, and they are slowly leaving for more attractive places for living. Cities should avoid concentration on administrative borders of regions and look at the opportunities for cooperation more widely. Therefore, taking into account scale matters and economic aspects against the shortfall of cooperation traditions, the solution lies in the establishment of urban networks using the resources and capacity of various cities of the Baltic states to create a common, pro-development synergy.

Separate small regional clusters should not be established, but the 9 existing large cities of Latvia can create focal points for Latvian urban cluster. And then, in addition to this, the potential cooperation both at the regional level with the smaller towns and surrounding areas, and cross-border cooperation capabilities, such as Klaipeda in Lithuania, Valga, and Tartu in Estonia should be assessed.

This would mean that a 2-step interaction would be established - targeted cooperation between large cities and the major cross-border partners, and local cooperation with the

¹⁹ Kalniņa-Lukaševica Z., “Urban Development Trends and Challenges in a Context of Globalization”, Conference proceeding, International Conference “Current Issues in Management of Business and Society Development – 2009”, May 7 – 9, 2009 Riga, University of Latvia, 2009

neighbouring regional towns. The target would be not to concentrate on previous more formal cooperation at the regional level, which is being implemented on the scale of the administratively defined planning regions, but to promote very specific, targeted cooperation of municipalities, government institutions and the private sector, that touches very directly and specifically upon the interests of each cluster member, competitiveness and opportunities.

The governance cluster model (based on urban cooperation) can contribute to regional scale governance and facilitate accessibility of various public services, attract private investments and stimulate development of business activities.

The recommendations for the implementation process are as follows: (1) for city leaders - to use targeted co-operation and complementarity potential; (2) to transform from the position of the interests of competition and individual competitiveness into the opportunities provided by the concept of "co-opetition" (cooperation + competition + competitiveness) - to maintain and improve own competitiveness by mutual cooperation; (3) to introduce a concept of "governance cluster" or management cluster, which would indicate deliberate and purposeful cooperation of public service providers and complementarity, using the principle of clusters, borrowed from the business environment in the development of public administration.; (4) as regarding the establishment of clusters, an important role is being given to the ability of central government to step back from strict sectoral planning and implementation of administrative functions. Instead cooperation between institutions of different departments and initiating multi-level collaborative projects would be the preferred choice.

PROPOSITION 2: to implement integrated development planning practice

Taking into account that planning of today's policy is more complex, regional government should be able realize at maximum the potential of the new development planning approach to avoid the negative tendencies and overcome the new challenges of the 21st century.

It is important not to exaggerate with the use of impulsive approaches in the policy planning, i.e., "attention should be paid not so much to the making of the image, as to the

realization of measures which are based on identification of local values, and formation and stabilizing thereof”.²⁰

Secondly, in the policy planning process we should avoid enforcement of short-term strategies and taking too high risks. It is necessary to enforce such policy planning measures which would explain short-term and long-term benefits, as well as analyze their impact on the city’s economic growth. Short-term thinking arising from the maximum profit gaining motive characteristic to the ‘entrepreneurialism’ approach, creates a threat to long-term development prospects which, differently from short-term planning, would be able to reach regional and city competitiveness in a stable and sustainable manner.²¹

It is not useful to copy some already existing project/approach developed several years ago because of the fast changing economic situation. By using conclusions about the most effective action models, the Baltic countries need to be able to “to jump over” the unrealized stage, and act from the outset according to the situation of the current moment and of future potential. Therefore it is not of use to copy some of the existing examples exactly as they are. It is important to identify the most topical tendencies, programmes, which have already been realized, by taking into account lessons gained as a result of the crisis.

One of the keys for successful development of the territories is integrated development planning. In Latvian public management, including the regional and local level during the period of time from 1990, the dominant strategy was sectoral interests; planning and implementation were carried out according to the branch principles. In most cases there was no connection between the educational, employment and infrastructure development programmes.

A turning point was the development of the EU Leipzig Charter on Sustainable European Cities and its approval at the level of ministers in 2007. National government in Latvia brought forth a precondition that to attract financing the from EU ERAF urban development programme the cities should develop and present to the interdisciplinary board an integrated city development programme and investment plan.

²⁰ Competitive Cities: A New Entrepreneurial Paradigm in Spatial Development, OECD Territorial Reviews, OECD Publishing, 2007

²¹ Competitive Cities: A New Entrepreneurial Paradigm in Spatial Development, OECD Territorial Reviews, OECD Publishing, 2007

Within the scope of this process a work group, led by the author of this report, developed integrated development planning guidelines. Local governments that have been identified as potential beneficiaries to be able to apply for support in the urban priority are asked to prepare or update existing development strategies so that they are in line with an integrated approach. Currently, based on these guidelines, 16 city development programmes have been developed, the aforementioned principles have largely been taken up also by the regional level while working out the region development strategies.

An integrated approach in development planning ensures coordinated assessment of the spatial, thematic, and time dimension, ensuring coordination of interests among all levels of administration (national, regional, local) and parties concerned (residents, companies, NGOs etc.), using specific (financial) instruments to achieve the goals.²²

The process of the development of guidelines later substantially promoted successful enforcement of them. The development of the guidelines closely involved subsequent users of them – city and regions’ planning specialists. The guidelines were approved by a board, which represented both city and regional political leaders, as well as top officials of several ministries. This board became a platform for discussions in the forthcoming years. All the integrated development programmes were presented and discussed in this authority. It promoted development of the interdisciplinary thinking principle, as well as better coordination between different management levels.

The main benefits of involvement in this process are: (1) establishment of a cooperation network among the urban and regional planning specialists; (2) exchange of experience between specialists and transfer of examples of good practice; (3) simultaneous training process; (4) clear ownership of the idea and process by future users themselves; (4) lower resistance against take-over of new planning practice. This cooperation and experience exchange process was particularly significant because, as it was mentioned also by another author, “one of the most important targets is capacity building for policy actors at the local level, including the increasing use of programme monitoring and evaluation procedures both as a control and learning mechanism.”²³

²² Editors Z.Kalnina-Lukasevica, I.Raugze, I.Ciukša, I.Grīzāne, “Guidelines for elaboration of the integrated development strategy of local government”, Ministry of Regional Development and Local Government of the Republic of Latvia, 2008

²³ Pezzini Mario, Main trends and policy challenges in OECD regions: metropolitan region in a global context, 2009, OECD

Meanwhile, it should be admitted that this process also had negative side-effects. Due to the fact that on the national level potential beneficiaries of financing from the urban development programme were selected to be only the 16 strongest cities, the other 60 cities were not given a possibility to qualify and thus, naturally, the general trust in the success of the results of the programme decreased. This example confirms the observations made within the OECD research framework that “a more selective re-distribution, concentrating assistance in a limited number of priority regions, faced obstacles, too. It frequently caused rent seeking wars, and even exhausting competition among regions, without necessarily resulting in as attractive a return as predicted for the winners. Moreover, this policy was exposed to significant risk of public failure, as the knowledge of central administrations adopting a top-down approach is often incomplete and not sufficient to identify and shape development projects as well as to appropriately select priority regions.”²⁴

However, as a result of this process the development and investment planning process were modernized. Unfortunately in many cases the link with enforcement of educational programmes and entrepreneurial development in the territory was lacking. It requires comprehensive changes in the territorial economic development management and, in principle, confirms the thesis of Mr. M. Pezzini saying that “the demand for territorial policies often tend to come with the request for changing the traditional strategies and addressing new implementation problems”.²⁵ However, the benefits undoubtedly outweigh the possible hardships faced by the cities and regions during development and realization of integrated development programmes.

This integrated development planning practice with broad involvement of society, businessmen and different management institutions should preferably be continued also in the future by developing and adding to it. Integrated planning practice stimulates agreement of territory development plans with entrepreneurship development priority. Such practice also, due to transparency and predictability during realization of the programmes, provides positive signals to entrepreneurs and potential investors.

²⁴ Pezzini Mario, Main trends and policy challenges in OECD regions: metropolitan region in a global context, 2009, OECD

²⁵ Pezzini Mario, Main trends and policy challenges in OECD regions: metropolitan region in a global context, 2009, OECD

PROPOSITION 3: enhance the entrepreneurship and innovation capacity of regions

Having evaluated the information available in the Latvian municipalities' home pages, having got acquainted with the municipalities' development programmes, as well as analyzing results of a survey - interviews with municipalities' specialists, we can note that the Latvian municipalities use the following instruments for entrepreneurial promotion: separate business incubators, technological parks, entrepreneurial consultative boards, data base of territories available for investments, basic infrastructure development programmes.

When analyzing OECD researches made in 2000-2010 about the economic development of municipalities and performing comparative analysis on this basis, a particularly noteworthy example or instrument appears, which has not been well used by Latvia so far, which is the authority described by OECD with the term Local Development Agency (hereinafter - LDA). Across Europe, local or regional development agencies have become a central feature of regional economic policy, both as innovative policy-makers and as the implementers of programmes and initiatives for strong economic regional development. Their operations depend on the specific situation of cities and regions. The main difference of LDA from establishment of a separate business incubator or technological park is its complex view of development challenges.

The author of this research, by using OECD methodology, in 2010 analyzed the contribution of Northern Italy's Trentino region's development agency Trentino Sviluppo in the fostering development of high added value in the region and its services provided to businessmen. The main conclusions based on the case analysis are following.

Trentino Sviluppo works as an integrated development agency, which successfully realizes the task set for it – to ensure the region's sustainable development and promote entrepreneurship. The LDA's main success factors are: (1) very clearly defined mandate (regional law); (2) effective and flexible organizational form (private joint stock company with the rights to buy and sell properties, shares and parts of other companies, issue loans, etc.); (3) stable high scope financing and real properties; (4) expertise and high quality standards; (5) cooperation with the region's university.

This case study reflects the role of public sector policy in entrepreneurship promotion and effectiveness of activities enforced within the policy. It is important to have professional

and integrated action, to have access to financial resources and to own real estate properties. The region was comparatively less influenced by the effects of the 2009 global economic crises because targeted measures were carried out by precisely reacting to the specific situation. For example, in order to provide current assets for companies significant for the region Trentino Sviluppo during the global economic and financial crisis bought shares and properties of these companies.

In order to develop technological parks, industrial territories, business incubators, the land and real properties owned by the region were used. Lack of properties would have limited LDA possibilities. Thereby lands and real **properties** themselves should be mentioned as a significant precondition for establishment of such an environment favourable to entrepreneurship. The second equally significant precondition for success of an LDA is availability of **financial resources**. The third, but not less important precondition is a **team of professional experts and managers** who have previously managed the agency's properties, as well as consulted new and already existing companies.

In the previous years the situation in the Baltic countries, and particularly in the Latvian regions and municipalities, has not been corresponding to the enforcement of such an integrated approach. Analysis of major advantages and disadvantages of LDAs indicate the weak aspects of the Latvian public management institutions. The existing environment is characterized by only a few of the necessary preconditions, meanwhile noting the presence of several obstructive factors. Additionally, the historical aspect should also be taken into account – that in the Baltic countries until renewal of independence in 1990 the private entrepreneurial culture was not developed, and therefore municipalities and the regional level due to historical reasons lack experience and knowledge. Thirdly, because of the economic and demographic situation in the coming years Latvia will have access to scarce financial resources, which the municipalities and regions could invest in activities to stimulate entrepreneurship and job creation. This points to the necessity to search for alternatives which are equally effective, but less dependent on one specific public financing source.

An important factor is the lack of direct interest or motivation of municipalities in the development of entrepreneurship in their territories. Mayors of municipalities indicate a significant motivation or interest factor - the desire to get direct income into the municipality's budget from the companies working in the territory. Currently the tax basis

of Latvian municipalities' revenues is the personal income tax and real property tax. Heads of municipalities and experts have noted the positive factors if a part of corporate income tax would be directed to the budgets of municipalities. Currently all taxes related to entrepreneurship are counted to the central government's budget income.

International evidence has proved the efficiency of LDAs. In order to successfully use such an entrepreneurial development instrument in Latvia it is necessary: (1) at the national level: to improve the legislative basis, as well as prescribe that a part of corporate income tax is transferred to the revenues of municipalities, thus creating a closer interconnection between the entrepreneurship growth and income of municipalities; (2) at the municipal and regional level: to increase the competence in the economic and employment development area; (3) in order to ensure effective scope of the available resources and entrepreneurial activities, it is necessary to define the proper scale for the work of LDAs, and to pay attention to economic agglomerations in the functional territories, rather than administrative borders of separate municipalities.

CONCLUSION

In order to solve the socio-economic underdevelopment problems of the NUTS 3 level regions of the Baltic countries', **the first group of activities to be performed is the promotion of entrepreneurship or the governance task to promote the territory's economic development. But the other necessary pillar to ensure the regions' socio-economic development is enforcement of modern governance and integrated planning practice.**

The main focus the regional economic development strategies should be laid, as indicated by the above mentioned research about the factors determining the regional development, is improvements in productivity and innovation ability. It is connected with attracting foreign direct investments, establishment of innovative companies and stimulation of their development and closer and more effective link with scientific institutions.

It is needed at the regional and local level to promote entrepreneurship development because "among the policy areas embraced by local development, entrepreneurship is the

area where the local “flittering” and adaptation of national programming perhaps matter most.”²⁶ Meanwhile, the most effective local development agency’s work can be enforced not within the historically set regional administrative territory borders, but in economically functional territories by combining it with the governance cluster approach.

Isolated sectoral action may have unintended outcomes. To achieve enhanced socio-economic growth of regions **a multidimensional response has to be implemented.** The main target areas of policy responses at the regional scale, to promote regional growth and convergence, shall be (1) business environment; (2) human capital formation; (3) infrastructure provision²⁷ – thus contributing to an increase of innovation capacity.

By using the local development agencies as an instrument for entrepreneurship promotion, there is a possibility to substantially improve the business activity rates in the region. Meanwhile, by concentrating resources directly on development of innovative and high added value products and services, the total regional productivity rates will grow. Local development agencies may serve as a direct answer to the necessity to find solutions to add to the national level policy, which would be directed at decreasing unemployment, support for commencement of entrepreneurship activities, improvement of business environment. **The local development agency as an integrated development approach agent can promote acquisition of foreign direct investments, stimulate establishment and development of innovative companies and influence closer and more effective links between the business and scientific institutions.**

It is clear that creation of the region’s sustainable development is not a simple task. Therefore there may not be a standard and simple answer. The best results may be achieved by combining different possibilities existing in the region and by using modern and innovative management tools. **This report proposed using: (1) modern public management practice in the form of the governance cluster, (2) integrated and participation based development planning practice and (3) application of the idea and organisational form of the integrated local development agency as an agent** that has already proved its effectiveness in reaching the region’s sustainable development as a result of combined and agreed actions, **thus providing the necessary answer to the**

²⁶ Editor Giguere S., Local Governance and the Drivers of Growth, OECD Publishing, 2005

²⁷ Garcilazo Enrique, presentation, OECD workshop, “Improving Productivity in Lagging Regions”, Paris, 2010

challenges of the 21st century and post-crises conditions for sustainable development of regions.

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