Governing together: An international review of contracts across levels of government for regional development

Claire Charbit
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GOVERNING TOGETHER: 
AN INTERNATIONAL REVIEW OF CONTRACTS ACROSS LEVELS OF GOVERNMENT FOR REGIONAL DEVELOPMENT

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OECD

Contracts are a key tool for vertical co-ordination, enabling dialogue and capacity building across levels of government. They are frequently used for regional development policy in OECD and non-OECD countries. Drawing on contract theory and a variety of national experiences, this paper identifies three main types of contracts between central and subnational governments according to their objectives: i) empowerment; ii) delegation; and iii) policy-sharing contracts. The differentiation of contracts depending on their objective is based on two key factors: the maturity of decentralisation and the capacity of national and subnational governments. It is expected that with the development of subnational /central government capacities (or both), and with the increasing maturity of decentralisation, contracts can shift from one type to another. The paper concludes by suggesting enforcement mechanisms for more effective contracts across levels of government.

Keywords: contracts, contract theory, enforcement, multi-level governance, regional development

JEL classifications: H7, K12, R1, R5, H5.

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The opinions expressed are those of the authors.

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Introduction

The design and implementation of regional development policies involve both central and subnational governments. They are linked by interdependencies of various kinds, such as: i) institutional, since regional development policy is a shared responsibility across central and subnational governments\(^2\), with the latter gaining greater autonomy as a consequence of institutional reforms, in particular decentralisation; ii) financial, when central and subnational governments are co-funders of public spending in regions; iii) socio-economic and environmental, when public policy decisions taken at upper levels of government have an impact on lower levels and vice versa (Charbit 2011; Charbit and Michalun 2009).

These interactions call for co-ordination across levels of government to address multi-level governance gaps (Box 1). Overlaps, duplications, lack of technical and financial capacity, amongst other factors, lead to ineffective public actions, as well as inefficient public investment in hard and soft infrastructures, thereby reducing the capacity to boost regional growth, address inequalities and improve social and environmental conditions. The OECD Council Recommendation on Effective Public Investment across Levels of Government, through Principle \(^3\), encourages countries to adopt effective instruments for co-ordination across central and subnational governments.

**Box 1. Multi-level governance gaps**

Multi-level governance is used to characterise the mutually dependent relationships – be they vertical, horizontal, or networked – between public actors situated at different levels of government (Charbit and Michalun, 2009, p.8). OECD (2011a) reports that multi-level governance consists of the “explicit or implicit sharing of policymaking authority, responsibility, development and implementation at different administrative and territorial levels, i.e.: i) across different ministries and/or public agencies at central government level (upper horizontally); ii) between different layers of government at local, regional, provincial/state, national and supranational levels (vertically); and iii) across different actors at the subnational level (lower horizontally)”.

Charbit’s (2011) identifies seven “gaps” to effective public policy design and implementation in decentralised contexts. These gaps are closely linked to one another and consist of:

<table>
<thead>
<tr>
<th>Gap</th>
<th>Description</th>
<th>Actions needed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Information gap</td>
<td>Asymmetries of information (quantity, quality, type) between levels of government, either voluntary or not</td>
<td>Instruments for revealing and sharing information</td>
</tr>
<tr>
<td>Capacity gap</td>
<td>Insufficient scientific, technical, infrastructure capacity of subnational actors, in particular for designing appropriate strategies</td>
<td>Instruments to build local and regional capacity</td>
</tr>
<tr>
<td>Funding gap</td>
<td>Unstable or insufficient revenues undermining effective implementation of responsibilities at subnational level</td>
<td>Shared financing mechanisms</td>
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<tr>
<td>Policy gap</td>
<td>Silo approaches by sectoral ministries and agencies</td>
<td>Mechanisms to create multidimensional/systemic approaches at the subnational level, and to exercise political leadership and commitment</td>
</tr>
<tr>
<td>Administrative gap</td>
<td>&quot;Mismatch&quot; between functional areas and administrative boundaries</td>
<td>Instruments to reach “the appropriate scale”</td>
</tr>
<tr>
<td>Objective gap</td>
<td>Different actors have different and often contrasting objectives creating obstacles for convergent targets</td>
<td>Incentives to align objectives</td>
</tr>
<tr>
<td>Accountability gap</td>
<td>Difficulty to ensure the transparency of practices across the different constituencies</td>
<td>Institutional quality measurement; incentives to strengthen the integrity framework at central and local level; incentives to enhance citizens involvement</td>
</tr>
</tbody>
</table>


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\(^2\) Among OECD countries, Belgium is an exception, as regional development policy is a competence of the regions.

This paper focuses on contracts across levels of government as one of the mechanisms to respond to vertical co-ordination challenges. These tools are all the more relevant as a consequence of decentralisation trends and increasingly differentiated regional governance, whereby regions have distinguished authoritative competences compared to others within the same country (see Hooghe and Marks, 2016). National and subnational governments can co-ordinate their relationships through contracts, intended as “any arrangements that reorganise the rights and duties of governments, other than by way of the constitution” (OECD, 2007: 10). In some countries, contracts are agreed upon by regions and supranational governments (e.g. European Commission).

This paper\(^4\) aims to provide a framework for understanding the use of contracts depending on the objective in question, namely: i) empowerment; ii) delegation; and iii) policy-sharing contracts. Contracts formalise roles and responsibilities of central and subnational governments, which are meant to evolve according to their respective level of capacity and maturity of the decentralisation. The paper highlights that evaluation and enforcement are key for enhancing the effectiveness of contracts across levels of government.

**What is a contract?**

Within the principal-agent framework, contracts are designed so that “the outcomes produced through the agent’s efforts are the best the principal can achieve, given the choice to delegate in the first place” (Kiewiet and McCubbins, 1991 in OECD, 2009). However, there is a variety of situations characterised by less dependent and hierarchical relationships among independent agencies, whose interactions need to be co-ordinated. Contracts allow entities to redesign and transfer their rights between one another. They differ from the market and the hierarchy as co-ordination mechanisms, being the first based on price co-ordination and the second on authority (Brousseau, 2008). Bounded rationality of the parties, transaction costs and non-verifiability of information make contracts incomplete and subject to renegotiation (Williamson, 1975, 1985; Grossman and Hart, 1986; Hart, 1995). Interesting insights on the issue of ex-post adaptation, interpretation and renegotiation of contracts are provided by the recent Contract as Reference Points Theory (CRPT) (Hart and Moore, 2008 in Brousseau, 2017).

Contracts define mutual obligations of parties, which have to agree on: an assignment of rights of decision among the parties (*Authority*); a distribution of contributions, including funding, human capital, assets, etc. (*mutual duties*) and on mechanisms that guarantee the correct implementation of each party engagement and solve disputes (*Enforcement*) (OECD, 2007).

Beyond incentivising parties to adopt compatible behaviour, contracts are tools for dialogue and for learning. They can help identify common targets, set clear objectives, share information and make credible engagements. Contracts serve to ensure that national-level policy decisions and regional priorities cohere and “synergetically” contribute to national development targets (OECD, 2010a).

In an optimal scenario, the engagement of parties through a contract is performed through several steps (Figure 1):

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\(^4\) A first version of this paper has been drafted in response to the request of the Chilean Sub-secretariat for Regional Development (*Subsecretaría de Desarrollo Regional y Administrativo, SUBDERE*) to learn from international experiences concerning the use of contracts across levels of government, as tools for multi-level co-ordination of regional development policies. The OECD Regional Development Policy Division (Centre for Entrepreneurship, SMEs, Local Development and Tourism) has extensively analysed through *ad hoc* studies and national reviews, the theme of contracts across levels of government, providing also a number of examples of their implementation.
The consultation initiates the dialogue between central and subnational governments, both contributing to shared policy objectives. The consultation phase aims at establishing priorities and actions, by assessing regional development needs, as well as possible impacts on different categories of stakeholders. Several actors can be involved in the consultation, including private and non-profit sectors and civil society. Although rarely performed, the evaluation of previous contractual experiences can help design the next generation of contracts. In France, a two-year long consultation allowed the central and the regional government to agree on the “State-Regions Contracts” (Contrat de plan État-région, CPER).

The negotiation/signature leads to the formal agreement between central and subnational governments. The contract is negotiated between independent authorities, with elected legitimacy to intervene in public functions. They can be represented by “gatekeepers”, governmental actors engaged in the negotiation and implementation phase, such as inter-ministerial bodies, specific ministry or deconcentrated bodies (for the central government) and leaders of regional, provincial and local authorities (for the subnational government): an example of the former is in France the ex-Inter-Ministerial Delegation for Territorial Planning and Regional Attractiveness (Délégation interministérielle à l’aménagement du territoire et à l’attractivité régionale DATAR), now merged into a General Commissariat for Territorial Equality (Commissariat general à l’égalité des territoires), in charge of horizontal coordination across sectoral ministries for regional development policies. As for the latter, in the case of contracts between central government and associations of municipalities, the Mayor of one of them, can be granted authority to represent the others (e.g. Pato Region in Colombia).

Before engaging discussions across levels of governments for specific targets, countries may need to position each stakeholder’s role in “institutional mapping” for national policies, allowing a better understanding who does what and with what means. As it will be shown in the paper, some contracts are explicitly made to allocate roles and responsibilities within decentralisation reforms.
The implementation phase involves a number of “operational actors”, such as local, provincial or other subnational institutions, as well as firms, associations, private actors and non-profit organisations. The dialogue between the two “gatekeepers” can be facilitated by an “intermediary agent”, such as: the Prefect in France, designated by the central government to represent central ministries in regions; the National Planning Department (DNP) in Colombia, an administrative body, which, among others tasks, sets priorities, coordinates central governments and departments and monitor the implementation of contracts called Contratos Plan.

Enforcement and evaluation are two important components of the contracts. Enforcement mechanisms aim to solve possible conflicts and ensure that each party fulfils the commitments. The enforcement can be internal (performed by the parties) or external (e.g. a judge, a group of peers, international agencies, citizens and other stakeholders). The evaluation aims to assess impacts to ultimately learn from success and failures. It is crucial for informing, prioritising and negotiating terms of contracts in the following period. Enforcers and evaluators should guarantee a neutral and independent process (Kaufmann and Kraay, 2008).

Contracts for regional development can be mono-sectoral or multi-sectoral. Typically, examples of mono-sectoral contracts are those agreed upon for infrastructure building. In this case, it is rather straightforward to define objectives, enforce contracts and evaluate short and mid-terms results. On the contrary, multi-sectoral contracts involve several policy domains: for instance, they might aim to address unemployment challenges, with implications for labour markets, education, private investments and innovation policies. Given this complexity, the objectives of multi-sectoral contracts are less likely to be clearly defined before the signature of the contract. This therefore implies a collective "discovery process", which will necessitate co-operation among actors.

Depending on the complexity of the issue, the availability of information to each party and the way in which co-ordination issues will be dealt with, the literature distinguishes between two contrasting logics: transactional vs relational contracting (OECD, 2007). In transactional contracting, the respective duties of the parties can be stated ex ante (before the contract signature) with the challenge consisting of enforcing the respective obligations through appropriate incentives. In this case, a Principal-Agent type of relation occurs. Conversely, relational contracting leads parties to co-operate ex post (after the signature of the contract) and to design a governance mechanism to facilitate implementation of negotiated actions (Table 1). In practice, most contracts incorporate both transactional and relational dimensions: for instance, contracts with commitments to reach certain specified targets (transactional contracts) can foresee “open-ended” obligations, to be revealed in the implementation phase (relational contracts); and a relational contract, set to explore innovative solutions in policy making, can include clearly specified and pre-identified measurable targets (OECD, 2007). According to Bradford (2017), hybrid contracting provides flexibility over time by connecting short-term projects to longer term goals and adaptability in space, customising support to communities.

Table 1. Transactional vs. relational contracting

<table>
<thead>
<tr>
<th></th>
<th>Transactional</th>
<th>Relational</th>
</tr>
</thead>
<tbody>
<tr>
<td>Information availability</td>
<td>Upfront</td>
<td>Over time</td>
</tr>
<tr>
<td>Co-ordination of problems</td>
<td>Stated before the signature</td>
<td>Solved after the signature</td>
</tr>
<tr>
<td>Complexity of the issue</td>
<td>Generally mono-sectoral</td>
<td>Generally multi-sectoral</td>
</tr>
<tr>
<td>Enforcement</td>
<td>External</td>
<td>Often bilateral/ Third party</td>
</tr>
<tr>
<td>Challenges</td>
<td>Risks</td>
<td>Uncertainty</td>
</tr>
</tbody>
</table>

Contracts are frequently used for regional development policy in OECD countries. The OECD Regional Outlook Survey 2015 showed that 23 out of 30 OECD surveyed countries use contracts as tools for vertical co-ordination (Figure 2). In-depth research at regional level carried out by the OECD in 2012 showed that contracts can be complementary tools to both formal (i.e. conditionality) and informal arrangements (i.e. platforms for policy exchange or working groups). In unitary states, contracts, usually in the form of long-term agreements, are often used to empower subnational governments or delegate tasks within the framework of decentralisation policies. In federal states, contracts often agreed for short periods of time are complementary to existing legal frameworks, setting co-operation on specific tasks (OECD, 2007).

**Figure 2. Vertical co-ordination instruments in OECD countries**

| National level regional development agencies | 14 |
| National representatives in regions         | 18 |
| Contracts or other agreements               | 23 |
| Project co-financing                        | 26 |
| Consultation forum or other form of regular dialogue | 26 |

*Source: OECD Regional Outlook Survey 2015. The total number of respondents is 30.*

Contracts can adapt to complex situations and to the socio-economic and environmental characteristics of regions (e.g. leading and lagging regions, urban and rural areas, regions endowed with abundant or scarce natural resources). It is essential for contracts to specify the regional development priorities they are covering, possibly through a careful assessment of needs and opportunities. Regional policies aim to enhance growth, well-being and development at territorial level. As such, they differ from allocative policies, such as fiscal equalisation, that aim at redistributing public resources in a more equitable way, allowing subnational governments, for instance, to provide access to quality public services for all citizens (Blöchliger and Charbit, 2008). This does not imply that regional development policies lack equalising components. Contracts for regional development can include equity targets through two approaches: i) eligibility conditions: such as in the case of EU cohesion funds, which are allocated according to whether region per capita GDP is below/above 75% of the European average; ii) co-funding rate: this can be differentiated according to the wealth of each partner region. In France, the funding share of the central government varies from 39% (Ile-de-France) to more than 63%.

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6 The OECD regional questionnaire on sub-national public investment concerned the following regions: Basilicata (Italy), Brandenburg (Germany), British Columbia (Canada), Galicia (Spain), Skåne (Sweden), Victoria (Australia), Wielkopolska (Poland).

7 Conditionalities may be defined as a type of governance arrangement whereby a government takes, or promises to take, certain policy or institutional actions, in return for which a higher-level government authority or an international institution will provide specified amounts of financial and/or technical assistance (OECD, 2013a).
Three types of contracts

This paper identifies three main types of contracts between central and subnational governments according to their objectives: i) empowerment; ii) delegation; iii) policy-sharing contracts (Figure 3). It identifies the reasons why a contract takes place; the framework conditions; and implementation strategies. Contracts can be agreed upon to:

- **empower subnational governments**: during early stages of decentralisation, contracts can help subnational authorities to develop new capacities and gain greater autonomy in dealing with regional development policies;

- **delegate the implementation of tasks**: the central government sets the objectives and delegates the implementation of specific tasks to a capable subnational government. Delegation is based on the assumption that regional and local actors are better positioned to implement national policies at the local level. It can lead to more efficiency in public spending;

- **share policies**: central and subnational governments co-operate in order to fulfil competences that are either overlapping or not fully addressed (e.g. new domains in environmental policies). In both cases, a contractual mechanism may favour information sharing and mutual understanding, while reducing transactional costs and generating trust for future endeavours. Both central and subnational governments may seek to innovate in specific areas, thereby building new capacities and new approaches to policy making. In this case the contract acts as a tool for collective learning.

Figure 3. Three main objectives for contracts across levels of government

The differentiation of contracts depending on their objective is in turn based on two key factors: the “maturity of decentralisation” and the “capacity of national and subnational governments” (Table 2). It is expected that with the development of subnational /central government capacities (or both), and with the increasing maturity of decentralisation, contracts can shift from one type to another, possibly even leading to a situation in which such contracts are no longer needed to co-ordinate across levels of government. Over the last fifteen years, decentralisation trends have shaped relations across levels of government in
various ways: funding, planning, implementation are often carried out by different levels of government for common projects or programmes; policy making responsibility is progressively more distributed across levels of government (Charbit and Gamper, 2014). As a consequence, specific capacities can be developed, either during the early stage of decentralisation or later in the process to deal, for example, with new policy domains and innovation. They could consist of producing and gathering data and information; ensuring adequate technical and managerial expertise; implementing long-term policies, executing public investment and evaluating results.

**Table 2. A framework for typologies of contracts across levels of government**

<table>
<thead>
<tr>
<th>Type of contract</th>
<th>Decentralisation stage</th>
<th>National government capacity</th>
<th>Subnational government capacity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Empowerment</td>
<td>Early stage</td>
<td>High</td>
<td>Low</td>
</tr>
<tr>
<td>Delegation</td>
<td>Mature decentralisation</td>
<td>Sufficient/ High</td>
<td>Sufficient/ High</td>
</tr>
<tr>
<td>Policy-sharing</td>
<td>Mature decentralisation</td>
<td>High/ in development</td>
<td>High/ in development</td>
</tr>
</tbody>
</table>

Source: Elaboration by the authors.

**Empowerment contracts**

Empowerment contracts serve as a tool for transferring responsibilities to subnational governments while gradually building capacities for policy implementation (Table 3). They allow subnational governments (e.g. regions) to acquire in the middle-long run the necessary capacities to develop their own strategy and co-ordinate with lower levels of government (e.g. municipalities) or private actors. Contracts contribute to the building of local capacity by valorising the role of local decision makers in targeting initiatives and using untapped potential. Central governments can include specific incentives as conditions of their signature, consisting in partnering with private actors, involving neighbour local governments, or adopting specific regulations, etc.

Relational contracts with transactional elements are suitable for empowerment contracts as the latter allows for effective monitoring. Once completed, the empowerment process should lead the relationship between the central and the subnational government to evolve into a policy-sharing one. Gradually, responsibilities should shift from higher to lower levels of government to avoid the risk of generating overlaps of responsibilities at central and subnational level in the long run.

**Table 3. Empowerment contracts**

<table>
<thead>
<tr>
<th>Objectives</th>
<th>Transferring responsibilities to subnational government/ capacity building</th>
</tr>
</thead>
<tbody>
<tr>
<td>When to use it</td>
<td>Early stages of decentralisation/ lagging regions</td>
</tr>
<tr>
<td>SNG capacities</td>
<td>Low and/or not at the right scale</td>
</tr>
<tr>
<td>Contracting logic</td>
<td>Relational with transactional elements</td>
</tr>
</tbody>
</table>

Empowerment contracts may concern all regions lacking in expertise at the early stages of decentralisation or “regionalisation” processes:

In France, State-Regions Contracts (*Contrat de plan État-région, CPER*) initially aimed at building regional capacities, as part of the regionalisation process. The first generation of contracts was launched in 1984. Contracts resulted from long negotiations between elected regional (and local) authorities and the regional “Prefect”, representing the central government and its different ministries at regional level. In practice, parties agreed upon objectives, implementation, and funding of specific tasks. Contracts could also imply financial transfers from central to local governments. In twenty years of implementation, from the first to the fifth generation of State-Region Contracts, regions have gradually replaced the central
government in local development planning. Regional decision-making progressively included new fields, larger budgets and new actors (i.e. representatives of civil society, entities at metropolitan level, etc.) (OECD 2007, 2014b, 2014c). The State-Region Contracts 2015-2020 have five priorities: transport; higher education; digitalisation; innovation; and ecological and energy transition. A total of 30 billion EUR will be made available. Following the changes imposed by the Law NOTRe in 2015 involving new competences for regions and the subsequent merging of regions (from 22 to 13) in 2016, revisions occurred to reallocate priorities and take into account the new geography of regions, consisting in particular of a renewed vision of strategic infrastructures. In addition, in 2016, the French government launched new contracts, the State-Metropolis Pacts, aiming at empowering new subnational entities: the metropolitan areas (“MAPTAM” Law, 2014). Contracts will support urban innovation at the metropolitan scale through financial partnerships in key investment areas.

The Regional Growth Agreements, in Sweden, were signed between the Ministry of Trade and Industry, regional authorities and country administrative boards to introduce a “regional lens” for a range of sectoral policies of the central government. Contracts were instruments for enhancing horizontal and vertical co-ordination, by aligning the priorities of the regional strategic programmes to the central government’s overarching goals (OECD, 2013a). The scheme was successfully applied in Skåne, Sweden.

Empowerment contracts can be implemented in specific regions lacking institutional, technical and managerial capacity, considered as bottlenecks for regional development. Some examples concern contracts for lagging regions:

Contratos Plans in Colombia are tools for territorial development and help selected lagging areas in improving services (education, health care, and water sanitation) and infrastructure, such as road connectivity. Interventions are focused on the poorest areas within a departamento (equivalent to regions), (OECD, 2014c). These are multi-year binding agreements between the central government and either departamentos, provinces or group of municipalities that have to comply with the National Development Plan. The National Planning Department (DNP) coordinates the ministerial work for contract implementation. The Contrato Plan requires departamentos to co-finance policy intervention. On average, 70% is financed by the national government and 30% by departments. To date, seven pilot tests have been carried out in nine departamentos. In 2012-2013, they were introduced in 17 areas of intervention for an overall population of six million people in different parts of the territory (OECD, 2014d).

In line with a long history of regulated multi-level governance through contracts, the Italian Government in 2016 launched the Pacts for the South. A total of 16 Pacts have been signed for eight regions (Abruzzo, Molise, Campania, Basilicata, Apulia, Calabria, Sicily, and Sardinia), seven metropolitan cities (Naples, Bari, Reggio Calabria, Messina, Catania, Palermo, Cagliari) and for the City of Taranto (Institutional Development Agreement - Contratto Istituzionale di Sviluppo, CIS - of Taranto). Contracts aim to achieve economic growth, employment and environmental sustainability goals. The Pacts for the South define priorities, actions for implementation, and responsibilities of parties. A steering committee (Cabina di regia) has been created for supporting the proper management of national and European funds (Cohesion Funds 2014-2020) and providing technical support. The Agency for Territorial Cohesion is responsible for co-ordination and monitoring of the Pact implementation. Progress should be verified every six months. Sanctions are foreseen, should objectives not be achieved.

Empowerment contracts can help subnational governments in dealing with new tasks related to territorial and social dimensions and can be accompanied by financial incentives:

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8 It includes Invitalia, the National Agency for inward investment and economic development, owned by the Italian Ministry of Economy; the Department for Cohesion Policy and the Agency for Territorial Cohesion.

In Poland, Regional contracts have been negotiated and agreed between the central state (the Ministry for Regional Development) and regional governments. They aimed at being a learning device for regional authorities to deal with EU Structural Funds in a multi-level governance setting. Regions received a budget for investment in a range of policy fields, such as road infrastructure, health-care, educational facilities, sports infrastructure, and tourist and leisure/cultural facilities (OECD 2008a, 2013a, 2013b). Later on, regional contracts became “territorial” ones for the implementation of the National Regional Development Strategy for 2010-2020. They aim to create synergies between all regional policy instruments having a territorial dimension (OECD, 2014b).

The Brazilian “Federal pacts” (Pactos Federativos) are the result of a negotiation process between states and municipalities. Federal authorities first engage state governors through “road trips” (e.g. caravana de educação, caravana de saúde) designed to illustrate the objective of the contracts for different sectors, such as healthcare and education. Once the state adheres to the initiative, financial incentives might be available. An example is the “Pact for Life” (Pacto pela Vida) launched in 2008 by the Ministry of Health. It defined 11 priorities concerning healthcare for the elderly, reduction of infant and maternal mortality rates, strengthening basic healthcare, etc. Each objective was associated with specific actions and budget (OECD, 2013c).

While enabling capacities, empowerment contracts should be set within the context of a central government vision for regional development. The role of the central government would consist of: providing relevant guidelines through the existence of a national strategy for regional development; ensuring consistency with regional strategies to support the learning process of subnational governments gradually gaining autonomy in decision-making; properly engaging regions in the priority setting (e.g. an issue identified in the Institutional Contract for development in Southern Italy - see Venanzi and Gamper, 2012). Intermediate steps of evaluation and adaptation strategies could help remove unnecessary constraints in contract implementation (e.g. in Poland, the short length of Regional Contracts did not match the long term objectives of regional strategies, OECD, 2013a).

**Delegation contracts**

Through delegation contracts, central governments set objectives and delegate the implementation of specific tasks to a capable subnational government, with the aim of adapting national policies to specific local contexts. Contracts aim to avoid a one-size-fits-all approach and leave scope for adapting policies to territorial characteristics, while overcoming institutional fragmentation. Contracts can comprise silo approaches and favour a territorial focus for development, taking into account the specific assets and needs of each region. Delegation contracts are based on the assumption that regional and local actors are better positioned to implement national policies at the local level, owing to their proximity to specific populations or territories targeted by the delegated policies.

**Table 4. Delegation contracts**

<table>
<thead>
<tr>
<th>Objectives</th>
<th>Central government delegates tasks or a policy to subnational governments</th>
</tr>
</thead>
<tbody>
<tr>
<td>When to use it</td>
<td>In the context of national strategy for efficiency gains</td>
</tr>
<tr>
<td>SNG capacities</td>
<td>Sufficient to replace the central government in carrying out certain tasks</td>
</tr>
<tr>
<td>Contracting logic</td>
<td>Transactional or mixed</td>
</tr>
</tbody>
</table>

Delegation contracts occur when constitutions or legal frameworks allow for subnational governments to fulfil the task to be delegated. It is often supported by financial incentives from the central government:

The “Devolution Deals” in England are cross-government arrangements between central and subnational government, which involve the devolution of powers and resources, previously allocated at central level, to city regions and metropolitan areas. Since 2014, a total of 12 Devolution Deals have been
secured\textsuperscript{10} (Local Government Association, 2016). The Devolution Deals foresee the creation of new governance and administrative arrangements, such as mayors and combined authorities\textsuperscript{11} (Sandford, 2016). Alternative arrangements to the elected mayoral model have been also suggested, such as a reduction in councillor numbers; district council mergers; or the creation of unitary authorities (National Audit Office, 2016)\textsuperscript{12}. As part of these devolution deals, concerning transport, education, healthcare and services, the government has announced new additional investment funding of \£246.5 million a year (National Audit Office, 2016). The regions, cities or metropolitan areas are required to put in place an extensive programme of evaluation, agreed at the outset with HM Treasury (Local Government Association, 2016). An independent panel, commissioned by the central government and the local areas, will assess if investment funding meets objectives and contributes to national economic growth. However, the central government does not intend to use macro-indicators for the assessment of the Devolution Deals (National Audit Office, 2016). According to certain authors, there are some obstacles to an effective devolution of powers, due to the fact that there is a limit to the extent to which subnational priorities can actually be prioritised and addressed; powers assigned to mayors are negotiable and strategy documents are subject to approval and expenditures audited (Bentley G. and Pugalis L., 2016).

When delegation contracts are employed for specific activities (i.e. infrastructure building) they are transactional ones. In this case, the “principal” is able to determine precisely ex ante what will be the outputs to be delivered and then anticipate how to solve ex post problems, which may possibly arise:

The “Sustainable Neighbourhood Contracts” (Contrats de quartiers durables), in the Brussels-Capital Region were introduced in 1993 to delegate the renovation and improvement of traditional neighbourhoods to municipalities. Contracts had a 7 year timeline. Projects included the construction of public parks, production of low energy homes, energy savings, waste reduction and air quality initiatives, rationalisation of consumption, and promotion of neighbourhood heritage (OECD, 2014b). Since 1994, these contracts served to build 1,718 homes and renovated 90 sites of public equipment and infrastructure (Ministère de la Région de Bruxelles-Capitale, 2016). Three contracts were in place in the City of Brussels for the period 2012-16 (Ville de Bruxelles, 2016).

In The Netherlands, rural contracts, aimed to implement the national goals included in the “Agenda for a living Countryside” at the subnational level (OECD, 2013a). Signed in 2006 by the central government and provinces, contracts were based on precise criteria, instruments and sanctions. The national rural policy described exactly how provinces could achieve their goals. Performance targets were agreed between the national government and the provinces during a negotiation process that resulted in a seven-year contract. Targets were then monitored through performance indicators (OECD, 2008b).

Delegation contracts can also be of a relational type when the role of subnational government is that of implementing broader national strategies involving multiple sectors:

\textsuperscript{10} In East Anglia, Greater Lincolnshire, Greater Manchester, Liverpool City region, London, North East Combined Authority, Sheffield City Region, Tees Valley, West of England, West Midlands Combined Authority, West Yorkshire Combined Authority.

\textsuperscript{11} In 2017 a mayor will be directly elected in Liverpool, Greater Manchester, Sheffield and the North-East. New mayoral combined authorities have been proposed in the Tees Valley, West Midlands, and North Midlands. According to the Local Democracy, Economic Development and Construction Act 2009 and the Cities and Local Government Devolution Act 2016, Combined Authorities are a legal structure set up by local authorities, with or without a directly-elected mayor (Sandford, 2016).

\textsuperscript{12} The National Audit Office reports that: the Cornwall devolution deal is the only deal where planned transfers of powers are to a single local authority area. In all other deals announced to date, powers will transfer to either the mayor or combined authority, spanning multiple local authority areas. These areas have been agreed because they are considered to represent functional economic areas that reflect labour markets and offer sufficient economies of scale. (National Audit Office, 2016, p. 18).
In Québec, Canada, the Rural Pacts establish responsibilities for rural development between the government and elected representatives of the Regional County Municipalities (Municipalité Régionale de Comté, MRCs). The Rural Pacts concern multi-sectoral activities: from education, to health care and culture. The provincial government decides the general policy directions while the local actors design and implement rural measures. These Pacts allow for flexibility in defining local assets and resources to be mobilised to promote local growth. The Ministry of Municipal Affairs and Land Occupancy (Ministère des Affaires municipales et de l’Occupation du territoire, MAMROT) plays an important role in assisting and monitoring commitments made by MRCs (OECD 2010b). The Rural Policy for 2014-2024 foresees greater decentralisation and the use of “Pacts Plus”, devoted to the implementation of forward-looking projects concerning new domains and innovations in local services (MAMROT, 2013).

In Europe, the “Leader Initiative” and so-called “Community-Led Local Development” approach by the European Commission are also cases of delegation contracts increasingly used since the early ‘90s. These contracts must be implemented by the local community. They can concern urban and rural areas and be financed through several EU funds simultaneously. The New Regional Policy (NRP) in Switzerland is largely based on four-year contractual arrangements between the Confederation and Cantons to ensure alignment between national and regional programming. Individual programmes must align to the broader multi-year programme and meet a number of criteria, including concrete evidence of efforts towards sustainable development. The contract lays out the programme’s objectives, key milestones, management processes, timetable and financing. In some cases, cantons may be required to return funds if the target is not achieved (OECD, 2010a, OECD, 2011b, OECD, 2014b).

Delegation contracts are often both transactional and relational in nature and characterised by co-funding approaches that involve central governments in local spending. Grants act as strong incentives for effective delivery of the outcomes expected by central government and their earmarked character can help encourage local actors to clearly set ex ante goals (i.e. transactional contract). Delegation contracts may however face the risk of “strategic” behaviour13 of subnational authorities, whereby they manipulate the provided means to deliver general interest goods to pursue their own interests. Conversely, there is also the risk that subnational governments would be mere executors of tasks vis a vis specific outcomes, thereby limiting the scope for place-based policies. A certain degree of flexibility would enable a learning process and thus allow a development of adequate policies to fit local needs. In addition, the use of properly adapted incentives would motivate local government to be as efficient as possible in the execution of delegated tasks.

**Policy-sharing contracts**

Policy-sharing contracts allow common decision making, dialogue and collective innovation. This favours information sharing, mutual understanding and generates trust across levels of government. Such contracts allow sharing of financial and political risks by unlocking potential support from third parties (e.g. financial institutions) (OECD 2005, 2007). Contracts for policy-sharing are mostly relational ones, as implementation procedures are chosen in co-operation and rely on a negotiation process.

**Table 5. Policy sharing contracts**

<table>
<thead>
<tr>
<th>Objectives</th>
<th>Managing interdependencies among levels of government to respond to new challenges by sharing risks and responsibilities in a context of lacking, overlapping, or unclear allocation of competences</th>
</tr>
</thead>
<tbody>
<tr>
<td>When to use it</td>
<td>To address new domains, emerging issues or interdependencies across levels of government</td>
</tr>
<tr>
<td>SNG capacities</td>
<td>High</td>
</tr>
<tr>
<td>Contracting logic</td>
<td>Relational</td>
</tr>
</tbody>
</table>

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13 By reason of opportunism economic agents can behave strategically to pursue their self-interest (see Williamson 1975, 2002).
Policy-sharing contracts can be implemented when competences at subnational level are clearly defined but not yet addressed or in situations where a clear allocation of roles and responsibilities across levels of government for shared tasks is necessary:

- In Brazil, in 2011, the National Water Agency (ANA) launched the “National Water Management Pact”, consisting in contractual agreements with each States and the Federal District to improve water resources management at State level. Contracts support the implementation of both federal targets (defined by ANA, common to all states) and state targets (defined by each state, with ANA’s technical support). Targets aim to improve water resources management, in terms of planning, information sharing and policy implementation, pushing the states to fulfill their role in this sector. The ANA made available a financial implementation mechanism, the PROGESTÃO, based on a pay-for-result approach (OECD, 2015)\(^{14}\).

- In Canada, the “Vancouver Agreement” (VA) involved all three levels of government: the Government of Canada (central level), the Government of British Columbia (intermediate tier) and the City of Vancouver (municipal level). The initial agreement was signed in 2000 and renewed in 2005 until 2010. The Tri-partite Urban Development Agreement aimed to address the challenging economic, social and health conditions in the Downtown Eastside area of the city of Vancouver, establishing roles and responsibilities across the government of Canada, the province and the municipality. The agreement addressed issues such as public security, unemployment, and crime, which were not clearly allocated amongst the three levels of the government but generated impacts on all three and on citizens. The partnership constructed by the VA was one based on equality of the three participating governments, using unanimity and consensus as its decision-making rule (OECD, 2007).

Policy-sharing contracts can be observed in contexts of increased regionalisation of policy making:

In France, “State-Regions Contracts” (*Contrat de plan État-région, CPER*) served as a “laboratory” to co-ordinate economic development at regional level. As described above, regions progressively strengthened their role in interacting with sub-regional entities (*départements* and municipalities), through the negotiation of the fourth (2000-2006) and fifth (2007-2013) generations of CPERs. Through the CPERs, regions invested in new areas of competence, gaining experience before having them allocated by law. Policy consistency at regional level also improved. Typically, the fifth generation of CPERs (2007-2013) allowed regions to handle matters related to economic development and transport infrastructure, previously in the hands of the State.

In Spain, the “Collaboration Contracts” (*Convenios de colaboración*) are co-operative agreements between the central government and the Autonomous Communities (ACs). They are negotiated on a sectoral basis and distributed between the different Spanish ministries. Upon signature, central government provides earmarked funds. Contracts can be re-negotiated between the parties without having to restart the process and they are published in the Official Bulletin of the central government. According to the law, each *convenio* must have a monitoring commission responsible for solving problems of interpretation and ensuring compliance with the terms of the deal. There is a wide range of examples of contracts, ranging from the transactional to the relational: several bilateral agreements have been used in the context of promoting Science & Technology between national and subnational governments (OECD, 2011c).

Policy-sharing contracts can help address new areas of policy and favour experimentation. The latter plays an important role, both in dealing with the complexity of environmental policies and in generating

\(^{14}\) Not all the states have the same level of capacity. For some states, in fact, the Pact would fall in the category of empowerment contract. The ANA helps with the development of institutional arrangements and management functions, through technical support.
innovative collaboration among different partners. These types of contracts can typically offer the opportunity to “learn by doing” and help identify good practices to be used for more formal/less experimental next steps. They can also help to build administrative capacity and/or extend that capacity to other places once lessons learnt and good practices identified (OECD, 2007; Charbit and Michalun, 2009):

The “City Deals” in the Netherlands are signed between central and subnational authorities and stakeholders as part of the “Dutch Urban Agenda (Agenda Stat)”. The first City Deal was signed on the subject of the development of a roadmap for the next economy, the second on climate adaptation, and others will follow on sustainable energy, healthy cities and clean technology. The Climate Adaptation City Deal was signed in 2016 between the Ministry of Infrastructure and the Environment, three regional water authorities, five cities (The Hague, Dordrecht, Gouda, Rotterdam and Zwolle) and seven other partners (research centres and companies). The aim is to create a learning environment for climate adaptation at urban level for the next four years. In particular, it promotes innovative ideas to tackle flood risks, to foster an integrated approach between water and spatial planning, and to enhance co-operation in general.\(^\text{15}\)

In Denmark, partnership agreements aimed to link the National Globalisation Strategy with regional growth strategies, foreseeing initiatives from both strategies (OECD, 2010a). The Ministry of Business and Growth enhanced co-operation on projects and facilitated dialogue, but without budgetary implications. Initially, regions submitted a project “wish list” for approval to the relevant ministry. The partnership agreements that followed allowed sharing goals at central and subnational level, but did not go beyond the form of “light” documents of mutual intent (OECD, 2012).

Since regional development policy is a shared responsibility across levels of government, policy-sharing contracts are the dominant mechanisms used to align national and regional strategies in mature decentralised contexts. In federal countries, they are complementary tools to improve co-operation on tasks that are not well defined by existing legal frameworks or to strengthen implementation. The alignment between national and regional strategy objectives is not an easy task. A typical example concerns infrastructure, whereby regional plans might be not aligned with the broader national strategy on transport networks (e.g. as in the case airports construction). To achieve alignment, lengthy negotiations are often needed to identify appropriate compensation mechanisms, which cannot be replaced solely by earmarking or conditional grants. It is also essential for this type of contract to maintain dialogue between levels of government throughout the duration of the contract and ensure a comprehensive and continuous learning process. Last but not least, it is crucial that citizens and the business sector are consulted, actively engaged, and well informed of the content of the contract to facilitate their adhesion and interest. Risks of “strategic behaviour” may rise when one party aims to transfer the burden of the decision making and cost of the implementation to the other party. In this case, the solution is to envisage a revisable negotiation procedure (see section on enforcement below). Moreover, there might be the risk of duplication and high transaction costs in situations where the allocation of roles is too rigid\(^\text{16}\).


\[^\text{16}\] Contracts for regional development can help solving conflicts when two or more parties are all empowered as “policy makers” on the specific domain subject of the contract. In Italy, the interpretation of what constitute the so called “concurrent policy” (i.e. for which nor the central government or the regions have “exclusive” role) often generates conflicts that are solved through contracts.
**Evaluation: Learning from contractual experiences**

**Challenges of contract implementation**

Contracts avoid building new institutions or modifying existing ones, both of which are time-consuming and unpredictable in terms of results. Contrary to contracts between private actors and differently from a competitive market mechanism, such as in the case of procurement, contracts across levels of government manage an unavoidable co-operation, as they must deal with one another to achieve policy goals (OECD, 2007). However, contracts are subject to several challenges:

- **Strategic behaviour and opportunism**: One of the main challenges for a contract to be effective is to guarantee the credibility of commitments and their verifiability, which implies the need for enforcement and evaluation. In some cases, it is difficult to measure the actual performance of contracts, especially in the case of relational contracts, for which criteria for the achievement of delegated tasks are more difficult to be clearly identified *ex-ante*. As a consequence of incomplete contracts, strategic behaviour and the “opportunism” of one party might lead to administrative inefficiency, redundancy of infrastructure provision, and misalignment of development policies across levels of government. Transparency and integrity are crucial to avoid these risks.

- **Unavoidable transaction costs**: Transaction costs are unavoidable when contracts across levels of government take place. Typically, they increase if there are changing external conditions, such as new political leadership; new regional development objectives beyond territorial competitiveness (e.g. inclusiveness, sustainability); fiscal constraints; reduced available budget of the parties. However, costs can be reduced over time: in relational contracts, high *ex-ante* transaction costs for the negotiation can cut *ex post* transaction costs, due to renegotiation; the repetition of the interaction among the same players can also help lower costs progressively, as the *ex-ante* needed time for the negotiation would be shorter and trust between parties higher. However, even if these conditions can help to limit transaction costs, they cannot be fully avoided.

- **Unbalanced allocation of central and subnational government roles**: Contracts for regional development may tend to overly concentrate on the role of regions, thereby masking the important role of central governments in strategic development, as well as that of sub-regional governments (metropolitan areas, provinces, municipalities, etc.). The role of central government in regional development policy can vary from direct action to strategic foresight. In the absence of national guidance, regional strategies might be inappropriately selected and thus lead to unnecessary investments (e.g. redundancy of transport corridors; regional science parks with too similar research areas, etc.). On the other hand, too rigid and hierarchical approaches can cause information asymmetry, undermining both the fairness and effectiveness of the contract, while limiting scope for place-based policies.

**Ex-post evaluation of contracts**

*Ex-post* evaluation of contracts can help address the above-mentioned challenges for the next negotiation period. Assessing the functioning of contracts and the achievement of expected results could help determine the validity of this co-ordination tool and suggest ways forward. Establishing clear objectives is the first step for a clear evaluation of results. Evaluation should be a key component of contracts themselves. It could improve the terms and implementation of the contract in the next period and ensure more efficient allocation of shared tasks across levels of government (OECD, 2009).

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17 Such characteristics can make enforcement of these contracts more complex as it will be shown in the section below.
When measuring performance, indicators are helpful in identifying: whether or not results have been achieved; whether additional funds are needed; whether a contract should be renewed; and, if agreed ex-ante, whether rewards or sanctions should be distributed. In an incomplete information environment, indicators enhance transparency and accountability, even though policy dimensions and related results are often hard to describe quantitatively or to verify. There is the risk of subnational governments focusing only on specific indicators’ fulfilment rather than on the success of the whole policy (“streetlight effect”\(^{18}\)). Especially in the case of regional development, contracts concern several activities at the same time, each with different levels of complexity. In this perspective, focusing on one performance indicator would not encourage appropriate behaviour. Rewards and sanctions could be better defined based on the whole set of activities to be foreseen for regional development and not only on a specific one (Box 2). In practice, with or without rewards and sanctions, incentives are inevitable when using performance indicators (OECD, 2009). This is particularly true when results of performance indicators are publicly available. The strength of the incentives depends on how information will be used and by whom.

**Box 2. European Cohesion Policy: Rewards and sanctions**

The European Cohesion Policy 2014-2020, which provides a framework for financing a wide range of projects and investments, comprises measurable targets to ensure better accountability. Progress towards achieving targets is to be monitored in terms of financial input/ output, results/outcome indicators, and key implementation steps. The Commission examines the annual implementation report and informs the Member States of its observations within two months of receipt of the annual implementation report. If targets are achieved there is a reward, consisting of a performance reserve. Its aim is to promote institutional capacity-building, co-ordinate financial resources and strengthen the role of monitoring and evaluation practices.

In Italy, under the 2007-2013 National Strategic Reference Framework (NSRF), subnational governments had access to 10% of regional development policy funds, conditional on performance (including 4 % of the EU performance reserve). In case the region would not achieve the target, resources assigned could be reduced by half. Such performance schemes are best accompanied by technical assistance to ensure the quality of data and information collection.


There are only a few available examples of evaluation of contract outcomes. The evaluation of the Vancouver Agreement (VA) (2000-2010) acknowledged that jurisdictional fragmentation was successfully addressed. It assessed the relevance and performance of the contract, in terms of efficiency, effectiveness and economy of the investments pursued within the agreement. The Vancouver agreement strengthened relationships, found collective solutions, and built foundations for future collaborations amongst levels of government. It was successful in engaging the community and developing key relationships with community partners and the private sector. In particular, some projects including job training and entrepreneurial support were seen as highly successful in contributing to the economic revitalisation of the area. The general assessment was that the social capital and trust created by the two generations of five-year contracts, while not easily evaluable, were the main outputs. They even allowed for more spontaneously co-operative practices among stakeholders. Once at this level, a formal contract was no

\(^{18}\) This effect takes place when the indicator system overemphasises a specific type of output (e.g., number of assisted businesses, kilometres of roads, etc.), inducing some actors to implement sub-optimal interventions (e.g., to excessively spread assistance or to extend an infrastructure network beyond what would be efficient) (OECD, 2009).
longer needed to coordinate across levels of government (Western Economic Diversification Canada, 2010). In France, contracts allowed for a progressive capacity building in regions according to the evaluation of the CPERs carried out in 2014 by the Court of Auditors (Cour des Comptes, 2014). Despite decades of contracts and clear progress in terms of regional capacity, the current system for evaluating the last generation of contracts (the same used to evaluate EU contracts) is not considered appropriate by the Court of Auditors. Moreover, there was no single, unified evaluation system, as different regions used different forms of partial evaluations. Information was not shared across regions, hindering the peer learning process.

**Enforcement of contracts across levels of government**

Enforcement aims to ensure that each party fulfils their commitments and deals with conflict resolution (OECD, 2007). In doing so, enforcement mechanisms influence the behaviour of the parties. The enforcement can be internal (performed by the parties) or external, based either on stakeholders' engagement (e.g. citizens, businesses, universities, NGOs, etc.) or on third parties (e.g. a judge, a group of peers, international agencies, media). These approaches are based on two main assumptions characterising contracts between private actors: their possible repetition over time (“repeated game”) and so the risk in cases of misbehaviour of non-renewal of the contract, and the competition among partners, which allows for comparison before contracting, making reputation a strong factor for selecting partners.

Although the inclusion of enforcement clauses in the contract allows parties to learn from each other and improve the relation in the next contracting period, as will be illustrated below, the “internal enforcement” has a limited use in contracts across levels of government. The external approach largely depends on the availability of information and the clarity of the allocation of roles amongst the contracting parties. Finally, mobilising “third parties” to assess each party's behaviour is dependent upon their neutrality, independence and competences.

The quality of the institutional environment is a **condition sine qua non** to reduce ex-post implementation risks. Some conditions enable governments to mutually commit in a credible and reliable manner through: existence of clear and robust legal framework; clear allocation of roles and responsibilities across the contracting parties; transparency and integrity mechanisms. Trust is a necessary component for co-operation among contracting parties: the more trust, the lower the need for enforcement. Parties should decide **ex-ante** on procedures for information sharing and collectively analyse failures, so as to prevent conflicts. Nevertheless, in cases of conflict, the resolution should aim to rebuild trust and a common vision for co-operation (OECD, 2007).

**Internal enforcement (by contracting parties)**

Repeated relations, reputation effects, yardstick competition

In contracts across levels of government, such as those illustrated in this paper, parties are inevitably engaged in long-term relations. In practice, this perspective does not seem to lead to the adoption of “repeated games” approaches as reported by the literature. When contracting parties are private ones, repeated games consist of creating, in a fixed time period, consequences on the negotiation between two parties in the following period. Using financial incentives, the “principal” can persuade the “agent” to achieve targets and report on results. Once the information in the previous period is revealed, the level of the financial incentive or grant will be adjusted accordingly. For example, the grant can be smaller in the

19 The literature refers to self-enforcement as a type of enforcement opposed to the judicial one, based on bounded rationality but non opportunistic behaviour, which allows contracting parties to cooperate to solve conflicts (Williamson 1975, 1985). Even in a situation of imperfect information, the contract can be adjusted with the mutual trust and agreement of the parties. Self-enforcement relies on repeated relations and reputation effects (Brousseau and Raynaud, 2007).
next period, but sufficient to leave a rent to the agent. Another scenario could be that if obligations are not fulfilled in period 1, the contract might not be renewed in period 2. The challenge is for the principal to create the right incentives for the agent to behave efficiently and reveal information in exchange for a reward. However, these observations do not seem to threaten discussion of future contracts in relations across levels of government. None of the policy-sharing contract cases based on relational agreements (e.g. CPER in France) reported any examples of repeated games. This means that the implementation of a contract in the period 1 does not have an impact on period 2 because the contract would be signed anyway. Therefore, sunset clauses are needed to avert opportunistic behaviour, which occurs when a party is certain that the contract will be repeated in the following period, even if objectives have not been achieved (OECD, 2007, 2013a).

Reputation effects reduce the risk of non-co-operative behaviour and are seen in the transaction cost literature as creating pressures for self-enforcement of contracts by the two parties (OECD, 2007). However, similar to the repeated games issue, when the contracting parties are public institutions and not private parties, these self-enforcement mechanisms are generally less effective. Moreover, a contract is meant to be a politically neutral tool and, as such, it is difficult to link it to individual behaviours that can be observed by means of the judicial system. The execution of the contract often goes beyond political mandates. As such, there is a long-term responsibility of parties, which is linked to the objectives of the contract and to the general interest of citizens in the region, rather than to the duration of the political mandate of the individual who signed the contract in the first place.

Beyond the case of tenders, competition mechanisms across “agents” (subnational governments) are self-enforcing incentive schemes, which avoid the need for the “principal” (central government) to extract information. Through “yardstick competition” the central government can compare the relative performance of subnational governments that are pushed to behave efficiently (Brousseau, 2008). The risk of benchmarking procedures is to inhibit co-operation and increase regional inequalities. As such, competition mechanisms are more likely to be used among skilled parties. Where contracts are aiming to experiment with innovative approaches (e.g. Spain, Denmark), a selection procedure is used so that the central government can identify the most motivated and committed subnational partner. In situations where empowerment contracts are used, competition mechanisms might create negative effects Thus, benchmarking, rather than benchmarking, would be more beneficial due to its information and experience-sharing capacities.

**Enforcement by external entities**

**Judicial system; peer-pressure**

Third-party enforcement mechanisms can be carried out by a judge, independent agencies, international experts, and/or media. These actors, who externally supervise the behaviour of parties, may be considered as the guarantors of the credibility of the mutual commitment. The third party enforcement strongly depends on the neutrality and independence of the actors, as well as on the structural factors of the country (e.g. legal system, constitutions). The role of the judge varies according to the nature of contracts: when contracts tend to be transactional, the “judge” evaluates ex-post if the duties have been enforced; in relational contracting, since mutual obligations can evolve through time, “the judge should be a mediator (or go-between) rather than a judge per se” (Brousseau, 2008). Information can be extracted from supervision and audits, while judicial procedures can be employed to solve conflicts (OECD, 2007). The judiciary is not a perfect enforcer (e.g. lack of independence and skills) and enforcement devices may be inefficient: from the lengths of process, to errors, and to the absence of choice (Williamson 1975, 1985).

Another form of “external” enforcement is peer-pressure: independent agencies, international experts and media can exhort parties to behave through “revelation” pressure. This form of enforcement is, even where appropriate, rarely used. External enforcement can be employed in all the types of contract described above but in some cases its application can present difficulties. Typically, judicial enforcement
Political accountability through stakeholder supervision

Stakeholders (citizens, business, financial institutions and their associations) can perform a direct social control on the implementation of a contract, enhancing accountability. Supervision/punishment by citizens may replace third-party oversight and overcome weaknesses of judicial enforcement (OECD, 2007): citizens can express their disappointment by not confirming representatives in the next electoral mandate; financial institutes might consider not lending funds and businesses can decide to invest elsewhere. This is a strong incentive for the parties to fulfil obligations. In a way, the “constitutional contract” between the electors and the elected subnational government is the most powerful device to enforce the different contracts agreed by the subnational government including with higher levels of government. The higher the quality of institutions in a country, the less the need for other enforcement approaches. However, the social “control” depends on the “social capital” a specific regional context is endowed with and by the availability of information. Often overwhelmingly complex levels of bureaucracy discourage stakeholder engagement, making their involvement remain on a merely formal level.

Stakeholders’ control can strengthen the accountability of decision makers, and enhance trust. In this case, indicators, even if not linked to rewards or sanctions, represent strong incentives, as the publication of results is a powerful reputation mechanism vis-à-vis the parties, but above all vis-à-vis other subnational governments and citizens. Stakeholders can play a role in the enforcement of a contract across levels of governments when they are provided with sufficient information. Even in this case, however there are the risks of capture, stakeholders’ fatigue, in addition to the fact that getting information might be costly.

Using enforcement mechanisms for more effective contracts across levels of government

Enforcement mechanisms are not exclusive to a specific type of contract and more than one mechanism can be used at the same time. In the absence of optimal contractual schemes and due to the evolution of their objectives over time, standard enforcement mechanisms need to be adapted to the level of aptitude and the target to be achieved. In order to improve the effectiveness of contracts across levels of government, some suggestions can be further explored:

To limit conflict of interest: internal enforcement often implies verification of results by the central government through the use of indicators. In this case, the credibility of a performance assessment might be questioned because of the lack of “evaluator neutrality”, the central government being a partner of the agreement itself. Moreover, assessing all parts of the contract or several of them, when signed with different regions, can be very costly in terms of human resources and also requires technical skills. Developing international peer experience to address the challenges and share the opportunities for subnational government that regional contracting entails, can be a powerful tool to limit the conflicts of interest that often characterise vertical contracts among levels of government.

To adopt a contractual period across different electoral mandates: the accountability and the commitment of the leadership are key for the contract to achieve targeted results. However, risks of opportunistic behaviour, self-interest motivations, and conflicts across political leaderships, can hinder continuity and/or negotiating efforts made by regional leaders in the previous period. One way to avoid these risks would be to adopt a contractual period operating across more than one electoral mandate. By setting out long-term commitments, beyond electoral mandates, contracts help stabilise relations across levels of government and bridge political discontinuity. This does not imply reducing the commitment and the responsibility of the leadership in place, but encouraging behaviours strongly motivated by the region's general interest and thus increasing the political “neutrality” of the contract in question. When dealing with
regional development, the complex issues to be covered by the contract require longer-term approaches. In this case, transparency is crucial to prevent opportunistic behaviour.

**To support “benchlearning”** in order to favour comparison among contractors (and regions). It is based on the fact that it is important to share information among peers to create more effective contracts and draw lessons from success stories and common challenges. In cases of empowerment contracts, it would be an incentive to learn from other similar experiences; in cases of policy-sharing contracts, it could be deployed for selecting good practices in the experimentation of complex policies. Successful outcomes can be communicated to both citizens and the media, thus contributing to enhance trust in government.

**To use rewards and not just sanction mechanisms** when developing contracts with subnational government. If not monetary, these rewards can be of a “quality” nature (e.g. obtaining a “label”). They would reinforce the capacity of subnational government to propose valuable projects by using relevant incentives and not just measuring if the budget has been spent in due time. It would also generate some competitive pressure to facilitate adoption of good practices across subnational governments. Another type of reward can consist of allowing greater autonomy to subnational governments in delivering public policies, thereby boosting motivations and capacities. Moreover, this can result in efficiency gains by reducing the bureaucratic burden of control procedures. Such rewards should be used for regions that in the previous contractual period have shown their aptitude and they should be progressive. Governments opting for it would have to agree with asymmetric decentralisation across regions, resulting in greater autonomy for some of them.

**To involve other partners**, by including other regional/local stakeholders in the project selection, design and implementation: from neighbouring subnational governments to levels lower than regional governments, to business associations, unions or NGOs. This would enhance a collective behaviour towards the achievement of agreed targets, favour information sharing and the transparency of processes. Stakeholders' supervision of results could help cope with opportunistic behaviour from parties. This would generate trust amongst partners for future agreements, increasing investment, and enhancing innovation and regions' attractiveness.

**To favour “repetition” in contractual agreements**: for this to happen, evaluation of results, as well as of behaviour of the parties, should be carried out in order to improve the terms of the next contract. New contractual phases between higher and lower levels of government usually start from scratch, being negotiated and signed without clear reference to past experiences and results. However, in a region's general interest, it is important to identify pitfalls and drawbacks, especially when they can create vicious cycles of inefficiency in public spending. Collective engagement can help avoid reproducing past mistakes, the latter possibly due to individual misbehaviour of the parties.

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20 See the KOSTRA Norwegian system. Also, the peer review of the Territorial Employment Pact (TEP) in Austria, was considered a success as it raised a number of issues (e.g. the issue of top-down versus bottom up, mainstreaming and devolution) and allowed an open discussion (http://www.pakte.at/teppub/2823).

21 European projects can reward regions by granting labels, underlining their outstanding performances. This is the case of the label “European Entrepreneurial Region” (EER), for regions participating to the EER project and demonstrating an innovative entrepreneurial policy strategy. This label has been set up in partnership with the European Commission and implementation measures are regularly monitored. More information at: http://cor.europa.eu/en/takepart/eer/Pages/eer.aspx (Accessed August 2016).
Conclusion

Contracts across levels of government represent a practical and flexible option for co-ordination across levels of government, which allow the establishing roles and responsibilities without changing the Constitution. Both parties can negotiate and organise the duties, according to needs, territorial circumstances and local specificities. Beyond their specific advantages and challenges, contractual arrangements across levels of government may be the only option for the central government to co-ordinate actions with regions and cities since adopting other multi-level governance devices would request significant institutional changes, which would take time and may lead to unforeseen/undesirable results.

This paper identified three main objectives for which a contract can be agreed upon. These objectives take into account the maturity of decentralisation in the country and the capacities of both national and subnational governments.

In cases of early decentralisation and thus low expertise of subnational government in dealing with regional development policy implementation, a contract can help empower the subnational government towards greater autonomy and capacity; in cases of mature decentralisation and expertise of the subnational government, a delegation contract would allow an efficient implementation of tasks at local level; finally, when allocation of competences overlaps, is unclear or does not yet exist because of new needs, a policy-sharing contract can favour mutual understanding and action.

Regardless of the purpose of the contract, enforcement and evaluation are two fundamental steps for the success of the agreement: the first helps influence the behaviour of the parties, the second helps assess the results of the contract itself (which in turn can be used to influence partners’ behaviour). Evaluation is an important step for learning from past successes and failures and adopting good practices in other contexts. Nowadays, evaluations of contracts are very rare and indicators are still far from being a perfect tool. However, they are always useful when publicly available. Evaluation should be carried out in a consistent time-frame, taking into account that regional development policies generate impacts over a long period of time. Enforcement pushes the parties to comply with their agreements, through internal and external mechanisms. Stakeholder expectations are a driver to make policy-makers more accountable and their behaviour more transparent. But in order to do so, it is important to set the conditions for the stakeholders to operate their “control”, through availability of information, consultation and other forms of engagement. Informal enforcement mechanisms may be requested and applied in those national cultures more oriented towards trust and mutual responsibility. The choice of the appropriate enforcement and evaluation processes, depending on the various objectives for which countries use contracts across levels of government, is crucial and merits further exploration.
REFERENCES


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