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Competitive location policy

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Contents

The ongoing economic globalisation is resulting in new challenges for a competitive location policy. Recent research into competition processes between locations indicates a shift in the significance of individual location factors, which competitive location policy will have to take into account in promoting growth and employment both locally and regionally.

1 Definition and objectives of a competitive location policy

Local and regional competitive location policies generally comprise economic policy measures implemented by public and non-governmental stakeholders to promote the drivers of growth and employment in the business sector at city, municipality, and county level as well as at state and regional level (cf. Meyer-Stamer 1999). The objectives of a competitive location policy include attracting companies from outside the region and supporting, retaining, and expanding the existing local and regional companies. These objectives can be achieved by both concentrating on external development factors, such as the mobility of work and capital or the development of interregional infrastructure (mobility-oriented strategy), and by tapping the potential that lies within the region, taking into account the local and regional characteristics (endogenous strategy). Thus, a competitive location policy must navigate between corporate realities and various regulatory or quasi-regulatory frameworks: On the one hand, it must take into account the criteria on which companies base their ▹ *Choice of location*. There is a difference here between a competitive location policy from the perspective of spatial development and a company's own commercial location policy, which means the company's search for the optimal location for its business. On the other hand, a competitive location policy must be aligned with certain policies and guidelines, which it can influence only to a limited degree. These include the stipulations of ▹ *Spatial planning*, (▹ *Federal state spatial planning, federal state development*), and ▹ *Regional planning*, as well as the provisions of European state aid regulations to ensure fair competition between local and regional business centres.

Furthermore, a competitive location policy goes beyond the measures undertaken by the local authority to enhance the municipal economy (▹ *Promotion of economic development by local authorities)*, which are directly relevant to business investment and choice of location. As the comprehensive shaping and coordination of the spatial development of an entire area, a competitive location policy extends beyond the boundaries of an individual municipality. The coordination associated with this is not just vertical between cities, municipalities, regions, states, federal state, and EU to achieve the aforementioned objectives; a competitive location policy also involves the targeted horizontal coordination of measures between various departmental policies (promotion of economic development, technology and infrastructure policy, labour market, education, and research policy), which makes it an interdisciplinary task. A competitive location policy is also something more than pure industrial policy, which seeks to create jobs and prosperity. The main difference is that a competitive location policy is not limited solely to boosting industrial locations, but also seeks to promote the service sector. Moreover, in contrast to the traditional understanding of industrial policy, public stakeholders do not have a dominant role, but rather work increasingly with stakeholders from the business world and other parts of society (business associations, trade unions, representatives from the scientific community, etc.) within the framework of the competitive location policy.

2 Current challenges and types of competition between locations

In the course of the ongoing ▹ *Globalisation* of the economy, municipalities and regions are facing increased competition to host manufacturing enterprises and service providers. Furthermore, technological advancement means that economic development processes are increasingly tending towards a ▹ *Knowledge society*, which often requires a high level of mobility, qualifications, and flexibility on the part of the workforce and company management (cf. Stimson/Stough/Brian 2006; Läpple 2001). These fundamental changes also mean that municipalities and regions now more than ever have to increase their competitiveness in attracting companies and a (qualified) workforce as part of their competitive location policy.

This increasing intensity of competition between locations goes hand in hand with a growing level of companies moving location. This includes both business relocations and new companies being formed at home and abroad, as well as the expansion and ▹ *Shrinkage* of existing locations, the opening and closing of branches, and the decisions of companies to stay where they are. Likewise, in the future, an even more rapidly growing dynamic in business decisions relating to location is to be expected due to various changes in the economy, such as the introduction of new manufacturing strategies, the internationalisation of intermediate input relations, the shortening of product life cycles in the industrial and service sector (▹ *Industry/trade*; ▹ *Services*), or the growing importance of how companies manage their space.

What is also relevant to a competitive location policy is that, in view of these trends, the specific advantages and disadvantages of towns or cities, municipalities, counties, or regions are more pivotal than ever for company moves in most cases (cf. Blume 2012). Accordingly, firms will opt for locations with a high-performance environment that meets their requirements. With this in mind, from the perspective of a competitive location policy, there are three distinct types of competition between locations (cf. Meyer-Stamer 1999). Firstly, there is locational competition between those municipalities and regions which have failed to generate specific locational advantages. They can only offer general advantages, such as a sufficiently qualified workforce, adequate infrastructure, or uncontaminated industrial sites. These locations are primarily suitable for ‘old’ industries whose products and processes are well established and which thus do not require collective learning processes on the part of companies, customers, suppliers, banks, training and research institutes, and so on.

This is different to the competition between locations with specific advantages, whose competitiveness is based on the mobilisation of particular local and regional resources, which is orchestrated through a competitive location policy by local companies and collective activities, such as business associations and public stakeholders establishing training and consultancy facilities. Such locations are primarily relevant to ‘new’ industries, where companies must rely on collective learning processes and the support of external institutions owing to the high pressure to innovate (cf. Porter 1990). Finally, the third type of competition is characterised by the fact that the municipalities and regions concerned are faced with an exodus of previous (old) industries. The role of a competitive location policy here is not to leave the ensuing structural decline to the mercy of market forces but to proactively shape the necessary structural change. This centres on fundamentally reorienting the economic development of a region against the backdrop of preserving the interests of the 'old' industries.

Distinguishing between different types of competition between locations highlights why 'establishing new factories in the highest-bidding municipality, which some authors consider to be the prevailing model for (re)location decisions, a competitive location policy and the competition between locations, is just one of various others' (Meyer-Stamer 1999: 9). Rather, with regard to a competitive location policy, even when municipalities and regions start in an unfavourable economic position, stakeholders ready and willing to act, learn, and strategise can turn the globalisation process to their advantage.

3 Theoretical principles of a competitive location policy

When the processes underpinning the competition between locations have been analysed from the perspective of classic competitive location theories, the focus has primarily been on the differing cost effectiveness of the locations (cf. Hoover 1948; Beckmann 1968; Smith1971). Businesses chose to establish themselves in locations based on production and distribution costs which are influenced by spatial factors, as these in turn influenced the prices of their products and thus their competitiveness. For example, the difference in costs incurred by companies explained the difference between urban and rural locations, and between densely and sparsely populated areas. The main spatially-relevant factors impacting costs were procurement costs for raw materials, distribution costs, and manufacturing costs. While procurement and distribution costs were considered to be dependent on the distances involved, manufacturing costs were seen as being dependent on the density of companies in the same stage of production as well as upstream and downstream stages that were mutually beneficial to each other due to their concentration in a limited area (agglomeration advantages; ▹ *Agglomeration, agglomeration area*). The spatial distribution of economic activities can be subject to self-reinforcing effects because the advantages of agglomeration – especially in the form of growing sales and procurement markets that are associated with cost-reducing economies of scale – increase as the density of companies increases (cf. Krugman 1991; Schmutzler 1999).

When shaping a competitive location policy, the implicit message of classic location theories is that municipalities and regions can be successful if they offer companies locational advantages that reduce costs. Fast access to sales markets, low property prices, and an agglomeration of companies can contribute to this. These approaches thus focus on so-called hard location factors, such as the transport infrastructure, local taxes and duties, the sites and office space available, the conditions the location offers for production, or the amount of granted subsidies. Thus, in shaping a successful competitive location policy, municipalities and regions can assert or even improve their position in the competition between locations by attracting companies through low taxes and duties, by awarding subsidies or financial incentives, investing in the local transport infrastructure, or even offering office and commercial space at favourable costs.

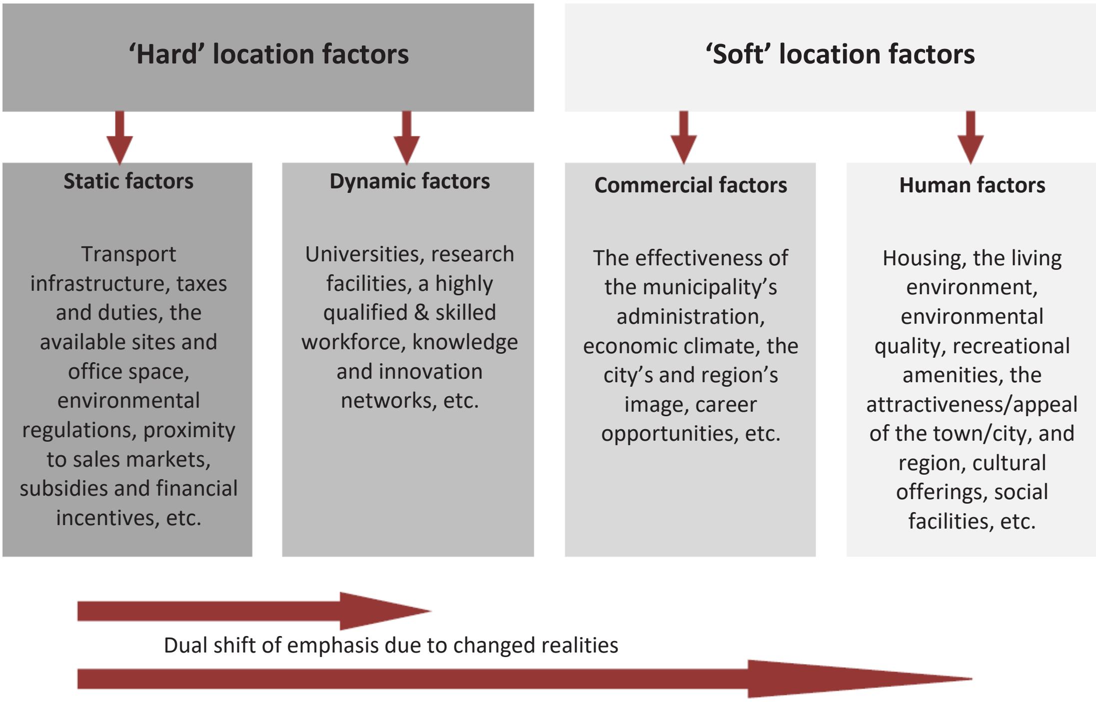
The approach of classic competitive location theories and the policy recommendations based on them have been increasingly challenged in recent years. Firstly, in contrast to the forecasts of classic competitive location theories, experience has shown that the concentration of companies in an area and the associated local and regional economic growth were greatest where the cost of living and cost of office space was high, space was at a premium, subsidies and financial incentives were (rarely) awarded, and the tax burden was relatively high. Attempts to explain this experience include the fact that modern economies are increasingly developing into service and knowledge societies in which previously relevant factors such as an orientation towards raw materials and sales markets are becoming less and less significant. Secondly, research in connection with the New Theory of Growth and ▷ *Regional economics* has resulted in a revised assessment of competition between locations and relevant location-based factors.

From a growth theory perspective, especially in industrialized countries it is not just having sufficient facilities or the availability of work and capital that is decisive for the successful development of locations. Rather, sustainable economic growth is attributed to knowledge as a factor of production and the associated drive to innovation (cf. Romer 1987; Lucas 1988). This insight is confirmed by a reinterpretation of the advantages of agglomeration in regional economics, whereby the concentration of companies in the area is primarily a factor increasing productivity. The direct advantages in terms of production and distribution costs play a less decisive role here compared to positive economies of scale, which are brought about by mutual learning and knowledge spillovers (cf. Döring/Schnellenbach 2006). Learning, innovation, and the ability of companies to develop new products and production processes on the basis of knowledge growth and knowledge exchange which takes place locally thus become critical success factors for regional economic development.

4 Relevance of different locational factors

The overview of the basic theoretical principles of a competitive location policy produces two different conclusions. Firstly, more recent perspectives in growth economics and regional economics no longer see the achievement of cost degression effects as the sole or decisive indicator for the relevant aspects of competition between locations. Instead, knowledge-based ▷ *Regional development* is needed, which relies on managing the ubiquitous structural change by enhancing companies' capacity to innovate. This goes hand in hand with a shift in the individual weight of hard location factors from the fairly static factors (transport infrastructure, local taxes, and duties, etc.) to factors regarded as dynamic (see Fig. 1). The latter include, for example, improving knowledge transfer between companies, universities, and research institutes, creating an environment where innovation and cooperative networks can flourish (▷ *Milieu*) (▷ *Networks, social and organisational*) as well as attracting a highly qualified, creative workforce (cf. Fritsch/Koschatzky/Schätzl 1998).

Figure 1: Shift in the relevance of location-based factors



Source: Döring/Aigner 2010

Secondly, an ever growing role is being ascribed to soft location factors, which are important for establishing innovation-oriented networks as well as for the performance and capability of companies with knowledge-based jobs. These are considered significant in assessing the quality of the location and are thus one of the factors determining where companies set up and where a qualified, creative workforce will gravitate. Soft location factors include commercial factors such as the effectiveness and efficiency of the local authority's administration, the image of the ▹ *City, town* and ▹ *Region*, as well as the local economic climate. But they also include human factors such as ▹ *Housing* and the living environment, the quality of the local environment, the recreational amenities and appeal of a city, as well as the quantity and quality of cultural programmes and social facilities. With regard to competition between locations, this creates new possibilities and new challenges: in relative terms, the classic instruments for promoting economic development are losing their effectiveness in terms of being successful in this competition in light of the shifts described above. At the same time, however, there are more options available to municipalities and regions to improve the attractiveness and competitiveness of their location thanks to the growing plurality of the relevant location-based factors.

5 Selected empirical findings

Empirical studies for the US and Europe on companies' (re)location decisions suggest that hard location factors (availability of sites and office space, transport infrastructure, taxes and duties, etc.) continue to be important (cf. Love/Crompton 1999; Kinkel/Dachs/Ebersberger 2007). It is only when these factors are present in the right quantity and quality that soft location factors then also come into play. However, a more nuanced picture emerges if one looks solely at companies with knowledge-intensive inputs and outputs. If knowledge-intensive services are relocated, as is often the case in the field of information technology or many business services, the significance of location-based factors diverges compared to industrial enterprises. Here, access to qualified staff is a significant driving factor for relocations (cf. Doh/Bunyaratavej/Hahn 2009; Lewin/Massini/Peeters 2009). Furthermore, higher-end services are often moved to countries with relatively high wage costs (cf. Bunyaratavej/Hahn/Doh 2007).

In addition to studies on companies' (re)location decisions, the approaches of the New Theory of Growth have led to a range of research into the relationship between the spatial diffusion of knowledge, the innovative behaviour of companies, and the economic development of regions. These have shown that the differences in growth as well as labour productivity between locations can be explained by divergences in the availability of human capital (cf. Mankiw/Romer/Weil 1992; Martin 1999). Other studies have reached similar conclusions, which also include the relevance of technology and knowledge transfer between universities, non-university research institutes, and businesses in their analyses, in addition to the aforementioned factors (cf. Badinger/Tondl 2005).

Just as relevant to designing a competitive location policy is the finding that the commercial use of new knowledge is generally regional (cf. Anselin/Varga/Acs 1997; Funke/Niebuhr 2000). For municipalities and regions, this means that investing in developing a knowledge-based location seems worthwhile insofar as the possible returns of a competitive location policy thus oriented will benefit local stakeholders first and foremost. Direct evidence for the significance of cooperative networks highlighted in relation to knowledge as a factor of production can be found in those studies that ascribe a key role to the networking of local companies in relation to the success of industrial clusters (cf. Piore/Sabel 1984; Lazerson 1993; Gottardi 1996). In locations growing less quickly, the innovative success of existing local companies is also greatly determined by integration into the relevant cooperation networks.

The growing significance of soft location factors has barely been tested empirically – unlike considerations around knowledge as a factor of production. One exception is the studies on metropolitan regions (▷ *Metropolitan region*) in the US, which show that economic dynamism is found above all where highly qualified, creative people settle and where complementary companies also set up as a result (Stolarick 2005; Florida 2000). This means that the better the quality of life in individual locations, the higher the probability of coming across industries with a significant proportion of highly qualified employees. Locations with a high quality of life, expressed as high-quality housing and recreational amenities, a good social environment, a highly attractive city centre (▷ *Inner city*), an effective local administration, or even sufficient social and cultural facilities, can potentially be magnets. Studies on the attractiveness of German municipalities in the competition between locations also conclude that all towns, cities, and municipalities that have an efficient and flexible local administration, use modern management methods (e.g. New

Public Management, ▹ *Public Private Partnership*, urban and regional marketing), and have a regional network with business and trade associations, chambers, training institutes, etc. are at an advantage (Blume 2006).

6 Implications for a competitive location policy

The theoretical and empirical research suggests that the traditional components of a competitive location policy (real estate policy, advice for businesses, steering and tax policy, investment in local infrastructure relevant to businesses, etc.), which more or less take the same form everywhere, are no longer of much use in securing advantages in the competition between locations. Rather, competitive location policies need to be reoriented towards changing realities to stand a chance of success (cf. Blume 2012): with the growing importance of knowledge and human capital for business success, more value needs to be attached to these location-relevant factors with a view to the endogenous potential of a region, and a competitive local policy must reflect that. If, as a result, more weight is attached to providing subsidies and financial incentives for human capital and knowledge, the orientation of a competitive location policy will shift from the set-up of new companies to maintaining the existing ones.

It is also increasingly essential to implement measures to promote innovation and technology (business incubators, the intensification of knowledge transfer between companies and research facilities, establishing and strengthening networks), as well as to shift the focus from hard to soft infrastructure in order to encourage a highly qualified, skilled workforce to stay. This involves a reorientation of regional labour market policy and employment policy with the aim of creating more competitive jobs and increasing the level of the qualifications and skills of the local workforce. Furthermore, targeted financial support and other funding measures, aimed at the existing sectoral clusters (▹ *Cluster*), is required to boost the endogenous potential for a region's development in this way.

In addition, structural changes to competitive location policies appear necessary. In order to better align the economic and other policies of municipalities and regions with what existing and potential entrepreneurs are seeking, the various departmental policies (economic development policy, urban development policy, transport policy, culture policy, labour market policy, and ▹ *Environmental policy*) will need to be more closely linked under one common guiding principle of encouraging business, rather than simply coexisting side by side. Measures within a competitive location policy also need to be coordinated within relatively small areas, because as a rule it is only larger regions, which see themselves as a single entity with their varying availability of hard and soft location factors, which have sufficient potential to create innovative milieus and networks. Regional stakeholders (chambers, business and trade associations, municipalities, training and research facilities, etc.) all have a part to play here. Under this type of intensified cooperation between public and private stakeholders, external development funds or funding bodies (under private law), or even public-private partnerships are considered to be more successful than a competitive location policy which is structured on a purely public basis, as the former can respond more quickly and flexibly to companies' needs.

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