

TECHNICAL BRIEF

PROMOTING INCLUSIVE GROWTH IN CITIES



September 2018

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The working paper is printed in this form to communicate the result of an analytical work with the objective of generating further discussions on the issue.

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## Executive summary

1. Cities are drivers of change in the three strategic areas of Council of Europe Development Bank (CEB) operations – sustainable and inclusive growth, climate action, and the integration of refugees, displaced persons and migrants. Notwithstanding their economic role, European cities face complex challenges due to growing spatial disparities and inequalities. The present economic recovery in Europe provides an opportunity to shift towards more inclusive growth – that is, economic growth that creates opportunities for all and distributes economic gains fairly.
2. This technical brief contributes to the discussion among practitioners on how European cities can grow more inclusively. It first provides a framework for assessing initiatives for inclusive growth in cities. It then outlines the main areas of government action and CEB support to its member countries and cities for advancing the inclusive growth agenda. The main highlights of this technical brief are the following:
  - ✓ The brief adopts a multi-dimensional framework for assessing inclusive growth, which focuses on the intersection of economic inclusion, liveability and social inclusion. To enable inclusive growth, cities need to prioritise policies and solutions that address all three of these dimensions.
  - ✓ City governments need to take centre stage in enabling inclusive growth. The challenges of making growth more inclusive in cities, and the capacity of city governments to address them, vary considerably due to differences between cities in terms of demography, economic performance and level of local autonomy. A territorial approach is thus required to respond to this diversity of local socio-economic dynamics.
  - ✓ Notwithstanding the differences among urban areas, this brief identifies a common roadmap of actions enabling inclusive growth in cities. Governments at all levels are formulating national urban policies, developing territorial strategies and plans, and promoting financial innovation based on the sound measurement of outcomes to enable inclusive growth in cities.
3. The CEB has made it a priority to support its member countries and cities in enhancing inclusive growth through financing, technical assistance and partnerships. The CEB provides a number of flexible financial instruments to support the implementation of multi-dimensional and multi-annual strategies and plans in cities, and to enable cities to mobilise additional resources from the private sector. Furthermore, the CEB has recently signed a Memorandum of Understanding with *100 Resilient Cities – Pioneered by The Rockefeller Foundation* to help cities enhance their capacity for developing and implementing inclusive resilience strategies. As a member of the Global Observatory on Sub-national Government Finance and Investment, a multi-stakeholder initiative led by the Organisation for Economic Cooperation and Development (OECD) and United Cities and Local Governments (UCLG), the CEB also contributes to promoting the development of robust data on sub-national finance – a pre-requisite for effective territorial planning.

## 1. Introduction

Cities are at the forefront of implementation of Europe 2020, the strategy adopted by the European Commission to promote smart, sustainable and inclusive growth in the European Union (EU)<sup>1</sup>. Cities are also leading the way in the three strategic areas of Council of Europe Development Bank (CEB) operations – sustainable and inclusive growth, climate action, and the integration of refugees, displaced persons and migrants (CEB, 2017). Notwithstanding their economic role, European cities are seeing inclusive growth put to the test by increasing inequality and, in many cities, job creation remains a challenge. Cities often have no choice but to channel their limited resources to reacting to the next crisis rather than proactively planning for a more sustainable future.

The CEB supports cities through a number of financing instruments, including direct lending to cities and municipal companies and loans to commercial banks and specialised municipal lending institutions for on-lending to cities. The CEB has provided a total of 28 direct loans to city governments and municipal companies for a total value of €2.1 billion since 2008, including €1.2 billion over the period 2016-18. Since 2008, the CEB has also provided a total of €1.4 billion in direct loans to sub-national (regional and provincial) governments and €2.4 billion in loans to commercial banks and financial institutions, all of which has contributed to inclusive growth in cities.

This technical brief aims to contribute to the ongoing discussion among urban practitioners about the challenges and solutions for making growth more inclusive in European cities by providing a framework for assessing initiatives for inclusive growth in cities, and describing the main areas of government action and CEB support in advancing the agenda. The brief is structured as follows: Section 2 presents a framework for assessing initiatives for inclusive growth in cities in line with the CEB's mandate, and describes common challenges that cities in Europe face with respect to inclusive growth. Section 3 outlines the critical role of city governments in making economic growth more inclusive. Finally, Section 4 provides an overview of the main actions that governments are undertaking to promote inclusive growth in cities, and discusses how the CEB supports its member countries and cities in advancing the agenda.

## 2. A framework for inclusive growth in cities

Widening socio-economic divides, growing spatial disparities, and persistent poverty have hampered social cohesion in Europe. The present economic recovery in Europe provides an opportunity to shift towards more inclusive growth, that is, economic growth that creates opportunities for all segments of the population and distributes the dividends of increased prosperity, both in monetary and non-monetary terms, fairly across society (OECD, 2015). The outcome of inclusive growth in cities is reflected in the level of people's well-being, which goes beyond income to include all aspects of quality of life. Making economic growth more inclusive in cities is thus a pre-condition for achieving Agenda 2030's Sustainable Development Goal number 11 which sets targets to make *cities and human settlements inclusive, safe, resilient and sustainable* (United Nations, 2015).

This brief outlines a framework for making economic growth more inclusive in cities, in line with the CEB's social mandate and strategic areas of operations, as defined in the 2017-2019 Development Plan (CEB, 2017). This framework is based on the following two principles, which are described in more detail below: (i) inclusive growth in cities spans several inter-related dimensions, and (ii) inclusive growth needs to be assessed from a spatial perspective<sup>2</sup>.

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<sup>1</sup> Europe 2020 is the ten-year strategy introduced by the European Commission in March 2010. Its stated aim is to promote smart, sustainable and inclusive growth in EU countries. Europe 2020 identifies eight headline targets to be attained by the end of 2020 in the five areas of employment, research and development, climate change and energy, education, and social inclusion and poverty reduction (European Commission, 2010).

<sup>2</sup> The framework for inclusive growth in cities presented in the brief draws on existing studies, including frameworks developed by the World Bank and the OECD (World Bank, 2015; OECD 2016a), and is in line with the vision set in the New Urban Agenda adopted at the Habitat III meeting in Quito, Ecuador on 20 October 2016 (United Nations, 2016).

## 2.1 Dimensions of inclusive growth in cities

The first principle underpinning the framework is that inclusive growth in cities is multi-dimensional. The framework identifies three dimensions that make growth inclusive in cities: (i) economic inclusion, (ii) liveability, and (iii) social inclusion.

### ***Economic inclusion: Creating more and better economic opportunities for all***

Economic inclusion is about ensuring equitable access to economic opportunities for all groups of society, regardless of individual characteristics (such as gender, age or country of origin). As a condition for inclusive growth, economic inclusion promotes equality and innovation in society. Cities are uniquely positioned to promote economic inclusion because high-quality jobs are primarily located in urban areas, which attract newcomers in search of economic opportunities. Cities need multi-pronged initiatives to remove barriers to economic opportunities by enhancing access to jobs, providing quality education and skills training, and promoting equitable access to finance and entrepreneurship for all population groups.

European cities face pressing economic inclusion challenges as they strive to create more and better economic opportunities for all. The economic performances of cities are very uneven across countries. The fastest-growing metropolitan areas are located in Poland, the Czech Republic and the Slovak Republic, while many metropolitan areas in Italy, Portugal, Greece and the Netherlands registered zero or negative GDP growth over the period 2000-13. In addition, small and medium-sized cities, where the majority of the European urban population lives, struggle to keep up with the innovation and economic productivity of metropolitan areas (Giffinger et al., 2007). While on average cities enjoy higher employment rates than the rest of the country, job creation remains a challenge in urban areas. Cities with the highest unemployment rates are located in Southern Europe (Greece, Spain, Portugal and Italy) (EUROSTAT, 2016). Moreover, the benefits of economic growth and job creation have not been spread equally within cities. In 2014, 122 million people in the EU (that is almost one in four people) were at risk of poverty or social exclusion, and EU citizens in urban areas were only slightly less likely to live in poverty or be socially excluded than those living in rural areas (EUROSTAT, 2016)<sup>3</sup>. Furthermore, the financial crisis led to an increase in poverty in many countries. Cities in Belgium, Estonia, Greece, Portugal and Spain saw the largest increases in poverty (by 5% or more) between 2009 and 2014 (European Commission and UN-Habitat, 2016).

### ***Liveability: Addressing spatial segregation and the global challenge of climate change***

A liveable city provides a sustainable urban environment for all members of society. Liveability encompasses several inter-related dimensions, such as mobility, access to and quality of basic services, public spaces and amenities, preservation of cultural heritage, affordable access to housing, resilience to natural disasters (such as flood risk) and climate change.

Spatial segregation has become a growing challenge for liveability in European cities. Spatial segregation, where rich and poor residents live in separate neighbourhoods, creates stark differences in quality of life within a city, and significant challenges in the areas of affordable housing, mobility, and access to services and amenities. Access to affordable housing remains a priority policy area in most European cities. Problems of overcrowding and housing affordability are particularly acute in the largest cities. Moreover, European cities are not yet free from informal settlements. In Italy, more than 70,000 families live in informal housing (European Commission and UN-Habitat, 2016). Spatial segregation contributes to reducing mobility for the most vulnerable groups, who tend to live in isolated neighbourhoods in peri-urban areas which are not well connected to jobs, services or quality education. Because educational outcomes are strong predictors of future earnings, health and jobs, spatial segregation significantly affects the economic opportunities of the most vulnerable groups and of future generations.

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<sup>3</sup> The headline poverty indicator monitored by the EU as part of the 2020 strategy is “the number of people at risk of poverty or social exclusion”. The multi-dimensional aspects of poverty are captured by three sub-indicators that constitute the headline indicator: monetary poverty, severe material deprivation and persons living in households with a very low work intensity. In 2014, 24% of the EU population living in cities was at risk of poverty and social exclusion, compared to 25.5% of the population living in rural areas.

Climate change poses a global challenge for liveability and is now at the forefront of the agenda in most European cities. All EU countries have at least one city with a high risk of flooding, and there is increasing awareness of the need for cities to develop integrated solutions to build resilience to floods and other natural disasters (European Commission and UN-Habitat, 2016). Air pollution is a concern for human health and the environment in several European countries. For instance, target values for annual concentrations of Particulate Matter (PM) are exceeded all over Europe, especially in Bulgarian, Italian and Polish cities. The environmental and economic costs of motorisation are increasing throughout Europe. The economic costs of traffic congestion, for instance, are estimated at 1% of Europe's GDP, or €100 billion (European Commission and UN-Habitat, 2016).

### **Social inclusion: Managing urban diversity as a socio-economic asset**

As agglomerations of people, cities tend to have high levels of diversity – such as ethnic, demographic and socio-economic diversity – which may create barriers to social integration (Price and Chacko, 2012). Social inclusion is a dynamic process aimed at improving the ability, opportunity, and dignity of people disadvantaged on the basis of their identity to take part in society (World Bank, 2013). Enhancing the social inclusion of vulnerable groups benefits the entire community by contributing to create more socially dynamic and innovative societies. Hence, social inclusion is not only about removing barriers but also about leveraging diversity for the benefit of society as a whole.

European cities are faced with tremendous social inclusion challenges as a result of increased levels of inequality within cities. The surge in migrants and refugees in 2015 has also contributed to creating social divides within urban areas. Being among the most vulnerable populations, migrants and refugees are most at risk of social exclusion and marginalisation. "Arrival-city" neighbourhoods in capital cities tend to be culturally and socially isolated, thus preventing the development of a local sense of community and exacerbating the effect of spatial segregation<sup>4</sup>. Social exclusion limits the opportunities for people to receive high-quality education and to enter the labour market. For instance, employment rates are significantly lower for city residents born outside the EU (60%) compared to those born in the EU (70%) (European Commission and UN-Habitat, 2016). Overall, public safety tends to be a more pressing concern in cities than in rural areas – people in urban areas are three times more likely to feel unsafe compared to those in rural areas due to a higher incidence of crime (European Commission and UN-Habitat, 2016)<sup>5</sup>. To address the growing challenge of social inclusion in cities, several initiatives have recently been launched with the support of European institutions such as the Intercultural Cities Programme established by the Council of Europe (CoE) (see Box 1).

#### **Box 1: The Intercultural Cities Programme**

The Intercultural Cities Programme is a Council of Europe flagship initiative that supports cities in designing policies for intercultural integration based on the application of a diversity framework. The policy framework is based on the assumption that cities can turn cultural diversity into an advantage by tapping into migrants' resources for local economic, social and cultural development. Intercultural integration implies a shift in city governance and policies to encourage adequate multi-cultural representation and positive intercultural interaction based on shared values, and institutional capacity to ensure equal access to rights and opportunities for all. The Intercultural Cities Programme offers a comprehensive methodology for helping cities develop their diversity strategies, providing analytical and assessment tools, such as the Intercultural Cities Index, and access to a platform of experts to support systemic change in the economic integration of migrants. Pilot projects implemented under the Intercultural Cities Programme include Diversity Connectors for Start-ups (2016-17), to help cities reconfigure incubators to become diversity connectors, and Diversity in the Economy and Local Integration (DELI, 2014-15), to support migrant-owned small and medium-sized enterprises and migrant entrepreneurship as part of diversity and inclusion policies.

Source: CoE. "Intercultural Cities Programme". Accessed on September 10, 2018.  
<http://www.coe.int/en/web/interculturalcities/about>

<sup>4</sup> Author Doug Saunders (2010) coined the term arrival cities to refer to the neighbourhoods, slums or suburbs where migrants tend to settle in search of opportunities.

<sup>5</sup> The difference in public safety perceptions between urban and rural areas is particularly pronounced in Austria, Belgium, Germany, Italy, and Greece. However, there are important differences across countries, indicating that the national context matters more than the local context.

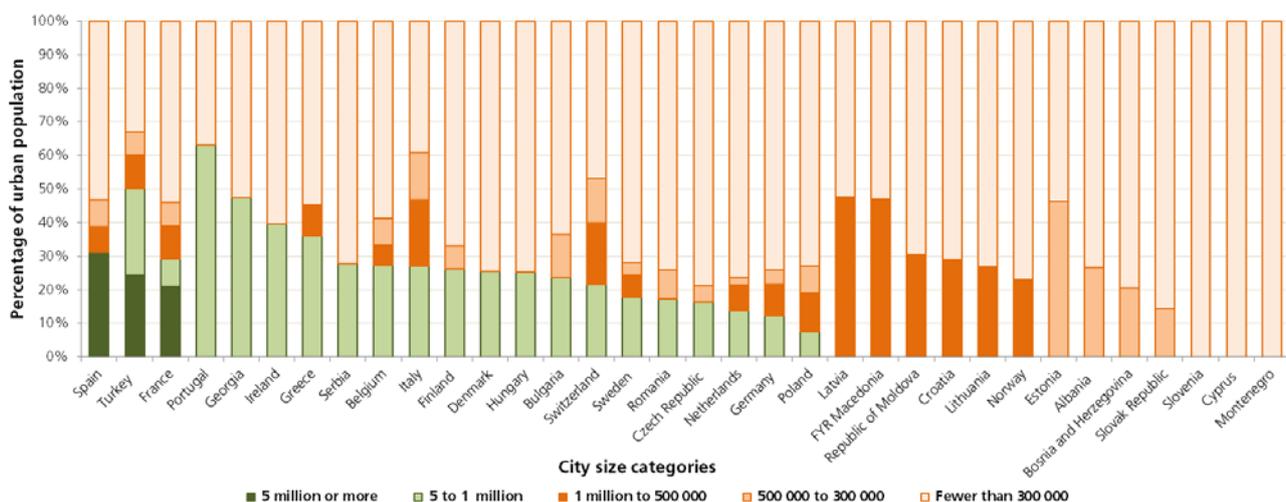
The CEB supports a broad range of initiatives to promote economic inclusion, liveability and social inclusion in cities in its member countries. The main areas of CEB operations are the following:

- ✓ Supporting economic inclusion in cities through the co-financing of city-led programmes for local economic development, with emphasis on distressed neighbourhoods; loans to financial intermediaries and microfinance providers to enhance financial inclusion and access to credit; and education infrastructure and skills training.
- ✓ Providing funding to improve living conditions in cities spanning a broad range of areas including investments in municipal services and amenities, health services, mobility and public transport, affordable housing, cultural heritage preservation, and resilience to natural disasters, with a focus on providing equitable access to services to the most vulnerable groups.
- ✓ Financing a broad range of initiatives to remove barriers to social inclusion and enhance diversity in cities, such as providing social care for people in need to enable them to become more self-reliant, promoting civic engagement and the participation of vulnerable groups in decision-making, and leveraging local culture and traditions to enhance awareness of cultural diversity based on shared values.

## 2.2 Inclusive growth in cities from a spatial perspective

The second principle underpinning the framework refers to the need for a spatial perspective when assessing inclusive growth in cities. In CEB member countries, the majority (65%) of the urban population live in small and medium-sized cities with populations below 500,000. There is however significant diversity in the distribution of the urban population across countries, as shown in Figure 1 below. On one side of the spectrum, Turkey, France and Spain have the largest concentrations of urban population in top-tier metropolitan cities with more than 5 million inhabitants. In Turkey, 7 fast-growing metropolitan cities (with populations between 1 and 5 million) have also significantly contributed to the country’s rapid urbanisation, accounting for 26% of the urban population in 2015. On the other side of the spectrum, most countries in the Western Balkans (“the former Yugoslav Republic of Macedonia”, Bosnia and Herzegovina, Albania and Montenegro), with the exception of Serbia, as well as small countries and islands (Cyprus and Malta) have the most dispersed distribution of urban population, with the largest share of their urban populations in small and medium-sized cities with fewer than 500,000 inhabitants. Italy has one of the most balanced urban systems among CEB member countries, with 27% of the urban population living in 4 metropolitan areas (with populations in the range of 1 to 5 million), 20% of the urban population living in 12 large cities with populations ranging between 1 million and 500,000, and 53% of the urban population living in small and medium-sized cities with populations below 500,000.

**Figure 1: Distribution of Urban Population across City Size Categories, CEB member countries, 2015**



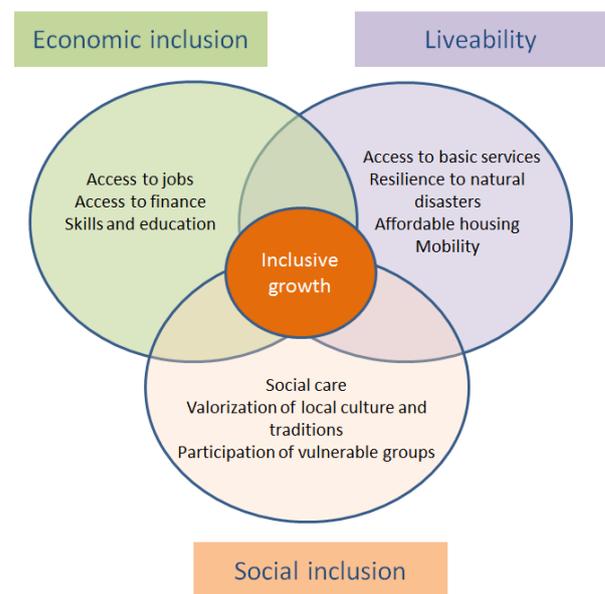
Note: Analysis based on World Urbanization Prospect’s standardised definition of urban areas (United Nations, 2018).  
 Source: Author’s elaborations from United Nations (2018).

Because of the diversity of urban areas within countries, successful inclusive growth policies require a spatial approach to leverage complementarities among urban areas – from small and medium-sized cities to top-tier metropolitan cities – in a country. In the largest cities, a spatial lens is also needed to capture economies of scale in the provision of services and spill over benefits, as the relevant scale of inclusive growth action may not coincide with the administrative boundaries of the city. For instance, key public services, such as transport, are best provided at metropolitan scale, to allow for economies of scale and offer a more equal level of service to all residents. When this is the case, coordination among all the local jurisdictions encompassing the metropolitan area needs to be pursued. Disparities can be staggeringly high between the core centre and the peri-urban areas of a city, or even between different neighbourhoods. When this is the case, inclusive growth policies and actions need to be spatially differentiated within a city to address such disparities.

### 2.3 An integrated approach for inclusive growth in cities

The three dimensions of inclusive growth in cities are strictly interlinked. As shown in Figure 2, enabling inclusive growth requires policies and spatial initiatives that mutually reinforce economic inclusion, liveability and social inclusion, thus forming an integrated approach. To enable inclusive growth, cities therefore need to prioritise policies and solutions that address all three dimensions. For instance, integrating migrants and refugees in a local community requires a multi-pronged approach to improve their well-being alongside that of the host community. Such an approach encompasses initiatives to provide migrants and refugees with equitable access to economic opportunities, affordable housing and basic services, and to facilitate their cultural integration. Promoting ethnic street fairs in public spaces is an example of an initiative that benefits several dimensions of inclusive growth, as it enhances cultural integration, generates economic opportunities while improving the quality of public spaces and the living environment for all members of the community.

**Figure 2: Dimensions of inclusive growth in cities and areas of interventions**



In order to integrate the multiple dimensions of inclusive growth, cities need to adopt a *territorial*, *programmatic* and *impact-oriented* approach. A territorial approach promotes place-based policies and initiatives for inclusive growth that are locally led to harness the collective power of local communities and institutions; a programmatic approach is a long-term, strategic approach that spans several years and multiple dimensions of inclusive growth; an impact-oriented approach defines the impact of a project upfront based on available evidence and local conditions to maximise impact. By focusing on impact and combining economic and social considerations into the project design, an integrated approach to inclusive growth is also more likely to be financially sustainable.

The CEB has developed a number of flexible financing instruments to enable cities to implement *territorial*, *programmatic* and *impact-oriented* approaches for inclusive growth. For instance, the CEB is supporting the city of Nicosia with a loan of €40 million for the revitalisation of the historic Walled City in the area close to the Buffer Zone controlled by the United Nations which divides the city into two sectors. This area faced tremendous economic and social challenges as most streets and buildings were abandoned following the establishment of the Buffer Zone. The aim of the project is to promote an integrated approach to urban regeneration by creating the conditions for economic inclusion through sustainable tourism and job creation, improving living conditions through the upgrading of infrastructure, and enhancing social inclusion through the preservation of local culture and heritage. The CEB is also co-funding an urban regeneration programme based on an integrated approach in the city of Vlore, Albania (see Box 2).

### Box 2: Urban Regeneration in Vlore Municipality, Albania

Vlore, a medium-sized city located in the southern coastal area of Albania, is undertaking a city-wide urban regeneration investment programme, in partnership with the Government of Albania and with support from development partners such as the CEB, the European Union, and the Albanian-American Development Foundation. The regeneration programme is expected to have a transformational impact on the entire southern region of Albania. The goal is to enhance inclusive economic growth through the development of sustainable tourism, while improving living conditions and social inclusion. To achieve these objectives, the municipality has embarked on a long-term investment programme to (i) improve the attractiveness of major tourist sites, including the *Lungo Mare* waterfront promenade; (ii) enhance accessibility by decongesting and diverting traffic out of the city centre and away from the main tourism attractions; (iii) enhance environmental sustainability by investing in public recreational spaces, and promoting walking and cycling as an alternative mode of transportation, with the construction of 11 km of dedicated bike lanes, and (iv) promote cultural identity through the active participation of communities in the restoration of the historic inner-city area and improved accessibility to the historic Kanine village. For instance, the planned reconstruction of the city's main boulevard is expected to significantly increase the attractiveness of the city of Vlore as a tourism destination, create the conditions for small-scale private investments in retail and commercial activities, and provide the local population and tourists with expanded public spaces and pedestrian access to the historic inner-city area.

The CEB is supporting the regeneration of Vlore under the Community Works IV Programme implemented through the Albanian Development Fund (ADF).

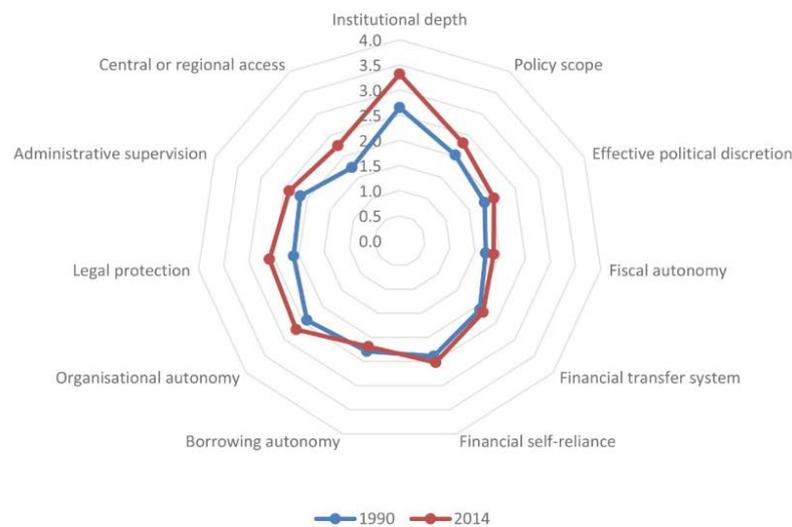
### 3. The role of city governments in making growth inclusive

Given their proximity to citizens, city governments have a crucial role to play in areas that matter for inclusive growth – such as education, health services and social care, and environmental protection. Local autonomy, meaning the capacity of local governments to regulate and manage public responsibilities under their jurisdictions, is an indicator of the capacity of cities to seize opportunities and address the challenges of making growth inclusive<sup>6</sup>. The European Commission has developed a *Local Autonomy Index* to provide a comparative assessment of local autonomy across European countries over the period 1990-2014<sup>7</sup>. The index shows that the overall degree of autonomy of local governments in European countries has increased slightly since the beginning of the 1990s. The level of local autonomy nevertheless varies considerably across countries. Countries with the highest levels of local autonomy are Germany, Poland, Switzerland and the Nordic countries (Finland, Iceland, Denmark, Sweden and Norway). The most significant advance in local autonomy is in the area of institutional depth, defined as the “extent to which a local government is formally autonomous and has a choice regarding which tasks to perform” (Ladner et al., 2016). It will be noted, however, that local borrowing autonomy decreased slightly over the period 1990-2014 (see Figure 3). Fiscal autonomy, a critical dimension of local autonomy that measures the ability of a local jurisdiction to provide services to their constituencies, also remains limited in a number of countries – overall, transfers from higher levels of government account for about half of the revenues of most local authorities in EU countries, with significant differences across countries (European Commission and UN-Habitat, 2016)<sup>8</sup>.

<sup>6</sup> This brief adopts a technical definition of local autonomy based on the European Charter of Local Self-Government adopted in 1985 by the member states of the Council of Europe (CoE, 1985). According to this charter, local self-government denotes “the effective capacity of local authorities, within the limits of the law, to regulate and manage a substantial share of public affairs under their own responsibility and in the interests of the local population” (Article 3). The adopted definition is therefore not linked to a specific funding and/or institutional framework and takes into account the broad diversity of legal systems across countries.

<sup>7</sup> This index comprises the following dimensions of local autonomy: institutional depth, policy scope, effective political discretion, fiscal autonomy, financial transfer system, financial self-reliance, borrowing autonomy, organisational autonomy, legal protection, administrative supervision, and central or regional access.

<sup>8</sup> Local authorities derive revenues from three principal sources: (i) transfers from higher government levels; (ii) local taxes; and (iii) fares and fees from services provided – with the latter two generally involving a higher degree of fiscal autonomy. For the EU as a whole, the 2013 distribution of municipal revenues was: 48% from transfers, 36% from local taxes, 13% from tariffs and fees and 3% from other sources (European Commission and UN-Habitat, 2016).

**Figure 3: Local Autonomy Index – European Cities, 1990-2014**

Note: The analysis covered 39 countries, including the 28 EU member states, as well as Albania, Georgia, Iceland, Liechtenstein, Republic of Moldova, Norway, Serbia, Switzerland, "the former Yugoslav Republic of Macedonia", Turkey and Ukraine. Source: Ladner et al., 2016.

The reduction in fiscal resources for municipal investments has not led to a diversification in the sources of local finance. Because of budgetary austerity, cities have faced increasing pressure from central governments to limit their deficits, and the scope for municipal borrowing remains limited. Overall, 39% of municipalities in Europe reported a decline in borrowing and only 12% have registered an increase since 2010. Overall, local debt accounted for only 6% of public debt in EU countries in 2014 (European Commission and UN-Habitat, 2016). In France, only 9% of the overall debt was held by local authorities. In Italy, the local debt of provinces and municipalities accounted for about 3.3% of GDP in 2014 (Ter-Minassian et al., 2017). The largest share of local government debt comes from bank loans (92% in 2014) – only France and Sweden saw a significant increase in the number of bonds issued by local governments (European Commission and UN-Habitat, 2016).

In spite of growing investment needs, municipal investments have been declining in European cities in the aftermath of the financial crisis of 2008. Local investments (as a share of GDP) fell from 1.6% in 2009 to 1.3% in 2014 – mostly as a result of the reduction in fiscal space (European Commission and UN-Habitat, 2016). Similarly, a recent comparative study of local finance in Germany, Italy and France found a significant decline in municipal infrastructure investments, in particular in Germany and Italy (Ter-Minassian et al., 2017). For example, in Italy, investments by local authorities fell by 34% between 2009 and 2014<sup>9</sup>. The decrease in local investments has also been significant in cities in Ireland, Portugal and Spain. On the other hand, local public investments have generally increased in cities in Central and Eastern European countries – notably Bulgaria and Romania (European Commission and UN-Habitat, 2016). Since 2016, the more positive economic outlook has created space for a recovery in investments at local level. A 2017 survey of municipalities carried out by the European Investment Bank (EIB) found that in all surveyed countries (except in the United Kingdom), the majority of municipalities are optimistic about the possibility of closing the investment gaps in the next five years (EIB, 2017).

Because of the critical role of cities in making growth inclusive, building local capacity to enable city governments to perform their responsibilities is a priority. The CoE's Centre of Expertise for Local Government Reform provides capacity building in areas of critical importance to enable inclusive growth in cities – such as local finance, institutional capacity and quality of public services, territorial and cross-border cooperation, human resources and good governance. Box 3 provides an overview of the capacity building programmes developed by the Centre of Expertise for Local Government Reform.

<sup>9</sup> Local and regional governments in Italy have been subject to internal stability pacts, which set targets for budgetary imbalances and limit potential increases in expenditures at local level.

### Box 3: Building Local Capacity to Enable Inclusive Growth – The Centre of Expertise for Local Government Reform’s Programme

The Centre of Expertise for Local Government Reform of the Council of Europe (CoE) has developed a set of toolkits and capacity building programmes to assist local authorities in performing their functions, in line with the CoE’s 12 Principles of Good Governance at local level (CoE,2008). The Centre of Expertise provides technical assistance to central and local governments to adapt the toolkits to the local context, as well as implementation support and training. One of the toolkits developed by the Centre of Expertise for Local Government Reform is the Local Finance Benchmarking (LFB) tool aimed at helping local authorities make best use of their available resources by promoting financial management, accountability of financial decisions and budgetary flexibility at local level. The capacity building programme includes the development of a local finance database, implementation of a benchmarking survey, a training component and knowledge sharing events. The LFB, which was first piloted in Bulgaria and Ukraine, has also been applied in municipalities in Greece, Portugal and Spain. The toolkits on inter-municipal cooperation and territorial consolidation reforms provide local governments forming a metropolitan area with a step-by-step approach to strengthening institutional coordination. For instance, municipalities in the Adjara region in Georgia have applied the toolkit to find cooperation solutions for solid waste management.

Source: CoE. “Centre of Expertise for Local Government Reform”. Accessed on September 10, 2018.

<https://www.coe.int/en/web/good-governance/centre-of-expertise>

Note: the 12 Principles are enshrined in the Strategy on Innovation and Good Governance at local level, endorsed by a decision of the Committee of Ministers of the Council of Europe in 2008 (CoE, 2008).

## 4. Areas of action enabling inclusive growth in cities

City governments are best placed to drive the multi-dimensional agenda for inclusive growth. The Urban Agenda for the EU, established by the Pact of Amsterdam in 2016, underscores the critical role played by cities in addressing Europe’s most pressing socio-economic challenges<sup>10</sup>. Because of the multi-level governance of policies for inclusive growth in cities, coordinated actions across all tiers of government – at national, regional and local level – and new partnerships among public and private stakeholders are also needed. The Urban Agenda for the EU provides a platform for enhanced coordination on urban policies among cities, EU Member States, EU institutions and stakeholders (such as NGOs and research centres).

This section describes concerted actions that governments across all levels are undertaking to enhance inclusive growth in cities, and the challenges encountered. Despite the diversity of institutional arrangements among countries and the significant differences in levels of local autonomy and economic and demographic trends across European cities, the following three common areas of action are identified and together constitute a roadmap for enabling inclusive growth in cities:

- A. Formulating national urban policies for inclusive growth
- B. Developing and implementing territorial strategies and plans for inclusive growth
- C. Promoting financial innovation for inclusive growth in cities

The CEB has made it a priority to support its member countries and cities in these three areas of action through financing, technical assistance and partnerships. For each of the three areas, this section outlines priority actions that governments are identifying to chart a way forward, and discusses the CEB’s role in advancing the agenda.

<sup>10</sup> The Pact of Amsterdam has identified 12 priority thematic areas for urban development in line with the objectives of the EU 2020 strategy. Under the Urban Agenda for the EU, a multi-stakeholder partnership has been established for each thematic area to develop an action plan with concrete proposals for better regulation, better funding, and better knowledge related to the theme of the partnership (European Commission, 2017).

## A. Formulating national urban policies for inclusive growth

National governments can support inclusive growth in cities by formulating national urban policies that provide the enabling environment for cities to develop long-term programmes for inclusive growth<sup>11</sup>. Even in federal countries, the central government plays a coordination role in ensuring that regional policies are in line with national visions and objectives. An explicit national urban strategy needs to be accompanied by mechanisms for financing investments in priority areas for inclusive growth which are outside the purview of municipal governments, such as investments in connectivity. The New Urban Agenda adopted at the Habitat III conference in Quito, Ecuador on 20 October 2016 underlines the importance of effectively implementing national urban policies (United Nations, 2017). However, a recent survey carried out by the Organisation for Economic Cooperation and Development (OECD) in 35 countries found that significant efforts are still needed to make national urban strategies explicit, and to broaden their scope beyond economic development to include social and environmental dimensions. Among CEB member countries, France, Portugal, Spain and Turkey have a formalised national urban strategy (OECD, 2016b). The Urban Agenda for the EU has contributed to underline the importance of coordinated policy actions for urban development and, in some EU Member States, has triggered renewed interest in developing and strengthening their national urban policies (European Commission, 2017).

Main areas of government actions:

- ✓ Move toward explicit national urban policies for inclusive growth
- ✓ Ensure national urban policies incorporate multi-dimensional aspects of inclusive growth
- ✓ Establish national-level financing instruments to address priority areas for inclusive growth outside the purview of sub-national governments

**How does the CEB support national policies for inclusive growth in cities?** The CEB has long-standing experience in partnering with central governments to support the implementation of national strategies and policies for inclusive growth in cities. The CEB provides lines of credit to national and regional development banks and financial intermediaries to support the implementation of national strategies and objectives for inclusive growth. For instance, the CEB has established a long-term partnership with the Croatian Bank for Reconstruction and Development (HBOR) to finance priority investments for sustainable and balanced economic development in line with national strategic goals. The CEB is also supporting the Government of Albania with loans and technical assistance to implement strategic investments through the Albanian Development Fund (ADF) aimed at improving the accessibility and competitiveness of remote and lagging areas in line with the national territorial plan<sup>12</sup>.

## B. Developing and implementing territorial strategies and plans for inclusive growth

Metropolitan and city governments need coherent, integrated strategies and plans to address the multi-faceted dimensions of inclusive growth. Territorial strategies and plans provide the necessary flexibility for developing integrated solutions tailored to the specific challenges and needs of a territory. The importance of moving toward territorial planning has gained recognition in the EU through the introduction of Integrated Territorial Investments (ITI), a flexible tool for formulating integrated responses to territorial needs in the 2014-2020 Cohesion Policy programming period (European Commission, 2015).

<sup>11</sup> A National Urban Policy, as defined by UN Habitat (2014), is a “coherent set of decisions derived through a deliberate government-led process of coordinating and rallying various actors for a common vision and goal that will promote more transformative productive, inclusive and resilient urban development for the long-term”.

<sup>12</sup> The CEB provided a grant to the Government of Albania, through the Western Balkans Investment Framework (WBIF), in conjunction with a loan, for the preparation of an integrated strategy and territorial plan for the sustainable development of urban centres in the Albanian Alps, a remote and lagging region in the north of Albania.

While a number of cities in CEB member countries have taken steps towards developing integrated territorial plans, building the technical capacity to carry out integrated planning can be challenging for city governments, especially for smaller cities and less wealthy ones. Another constraint is that the relevant spatial area of action may encompass different administrative and political jurisdictions, requiring governance mechanisms and incentives for institutional coordination among local governments forming a metropolitan area, including adjacent rural areas. A recent assessment of metropolitan areas highlights the importance of developing strong collaborative arrangements for working across boundaries in metropolitan areas (European Committee on Democracy and Governance [CDDG], 2018)<sup>13</sup>. Cities also need to equip themselves with the appropriate tools and financial mechanisms with which to implement integrated plans in partnership with public and private actors. This requires, for instance, moving toward multi-year and multi-sector programming, which is often a challenge because of the rigidity of the budgetary process, the limited predictability of local financial resources in cities, and the lack of comparative and robust data on local finance. Finally, inclusive and participatory processes are critical to ensuring that territorial planning takes into consideration the needs of the poorest and most vulnerable into the planning process. Citizen participation is a particularly important factor for effective governance in metropolitan areas (CDDG, 2018). A thorough vulnerability risk assessment is an essential tool for making territorial strategies and plans inclusive and for assessing the impact of city programmes for inclusive growth. Box 4 discusses the methodology and challenges for integrating vulnerability risk assessments into the planning process in cities.

#### Box 4: Integrating Vulnerability Risk Assessments into City Planning

To make strategic planning inclusive, cities need to adopt a multi-dimensional definition of poverty and vulnerability as an input to the preparation of city plans. Assessing vulnerability risk in a city is a complex endeavour because it requires combining place-based factors of vulnerability with people-centred dimensions. Place-based factors include exposure to natural hazards, access to basic services and affordable housing. A people-centred approach to vulnerability would take into consideration individual demographic and socio-economic characteristics as well as factors influencing identity (i.e. age, gender, legal status, income level, ethnicity and disability) which increase vulnerability. Place-based and people-centred assessments of vulnerability often compound – for instance individual factors correlated with vulnerability, such as poverty and migrant or refugee status, are more likely to increase exposure to place-based stressors and hazards, such as flood risk. Cities often fail to integrate the place-based and people-centred dimensions of vulnerability because of a lack of adequate data. Even in the absence of quantitative data, it is possible to generate a broad picture of vulnerability. The qualitative dimensions of vulnerability can be identified from available contextual information and consultations with stakeholders, including NGOs and community-based organisations present in the territory, as well as from the available literature. For instance, a recent study found that the following socio-economic groups tend to be the most vulnerable and susceptible to natural disasters and shocks: children, people with disabilities, the elderly, people with chronic and acute mental illnesses, income poor, minorities, and people experiencing social isolation (Martin, 2015).

Source: Author's elaboration from S. Atyia Martin (2015).

<sup>13</sup> The assessment is based on the findings of the Seminar on Democratic Governance of Metropolitan Areas held on 17-18 October 2017 in Thessaloniki, Greece. The seminar was organised by the Council of Europe Centre of Expertise for Local Government Reform and European Committee on Democracy and Governance (CDDG).

**How does the CEB support cities with the development of territorial strategies and plans with a focus on inclusive growth?** The CEB contributes to inclusive growth in cities by providing finance and technical assistance for the preparation and implementation of urban strategies and territorial plans. The CEB has developed a number of financial instruments to support multi-dimensional and multi-annual municipal strategies and plans. For instance, the CEB provided a loan of €35 million to the city of Vilnius in Lithuania to support the city's strategic development objectives identified in the Vilnius City Integrated Territories Development Programme for 2014-2020, and co-financed an integrated urban renewal programme in the city of Łódź, Poland (see Box 5). In addition, the CEB has signed a Memorandum of Understanding with *100 Resilient Cities – Pioneered by The Rockefeller Foundation* to help cities develop resilience strategies and further enhance their capacity to design, implement and leverage resources for resilience projects. In line with the CEB's social mandate, the aim of the partnership is to help cities finance resilience-building initiatives that benefit the most marginalised and vulnerable population groups. The CEB has also joined the Global Observatory on Sub-national Government Finance and Investment, a multi-stakeholder initiative led by the OECD and United Cities and Local Governments (UCLG) and aimed at monitoring the financial capacity of local governments to perform the tasks that have been entrusted to them by law, and at developing robust, comparative data on sub-national government structures and finance – a pre-condition for effective coordination of investments and territorial planning.

#### Box 5: Urban Renewal through Culture in the City of Łódź Poland

With a loan of €50 million, the CEB co-financed a landmark urban renewal project in the city of Łódź, historically a leading manufacturing centre. Following the collapse of the textile industry, the city initiated an ambitious urban renewal programme to revitalise its inner core based on an integrated and participatory approach. The city's regeneration strategy was to upgrade public spaces and local infrastructure so as to improve living conditions in the historic district, and to leverage cultural heritage, including old industrial structures, as a driver for local job creation and social cohesion. The signature project was the adaptive re-use of a former power plant which was transformed into a cutting-edge cultural and education centre and tourist attraction, the EC1 Łódź City of Culture.

### C. Promoting financial innovation for inclusive growth in cities

A common challenge for European cities is mobilising finance for inclusive growth within the context of current fiscal constraints. Cities cannot address these challenges alone. More and more, city governments are striving to develop broad partnerships with the private sector and community-based organisations to leverage finance for inclusive growth. However, cities often lack mechanisms for mitigating the perceived risks of social projects, which often remain unfunded in spite of the social benefits that they can potentially deliver to local communities. In recent years, the focus of innovating finance for social impact has been on developing new models to align stakeholder interests and share risks while maximising the social impact of investments. Impact-based financing instruments, such as Social Impact Bonds, are intended to unlock private finance for social impact while providing incentives for efficiency gains by linking government payments to pre-determined outcomes. One of the main advantages of Social Impact Bonds is that they leverage private capital and at the same time decrease the risk for governments since investors are paid only if the pre-agreed outcomes are achieved. Social Impact Bonds also shift the focus to outcomes and provide incentives for multi-stakeholder collaboration. These financing instruments have been extensively used in the United States and the United Kingdom in the social welfare, education and criminal justice sectors, and have more recently been piloted in continental Europe (Gustafsson-Wright et al., 2015; Marty, 2016)<sup>14</sup>.

<sup>14</sup> Social Impact Bonds are also called Pay for Success in the United States. Development Impact Bond is the term used when outcome funders are development partners instead of governments.

The changing landscape for development finance and the increased focus on innovative risk-sharing mechanisms provide cities with new financing instruments to capitalise on local solutions for inclusive growth. For example, the Social Impact Bond launched by Actiris, the Brussels-Capital Region Employment Agency, the first Social Impact Bond in continental Europe, is aimed at reducing unemployment among young (18 to 30-year-old) migrants legally residing in the Brussels area – a priority area for inclusive growth in cities<sup>15</sup>. The social outcome metrics that determine the remuneration of the investors is the one-year re-employment rate<sup>16</sup>. If the improvement in re-employment rate (relative to a control group) is between 0 and 10%, the payment made gradually increases from 0% to 100% of the investment. If the improvement is beyond 10%, investors earn incrementally higher interest (Gustafsson-Wright et al., 2015; Denoël, 2014).

Promoting innovative financing mechanisms in cities nevertheless poses multiple challenges. The success of impact-based financing rests on the ability to define relevant measurable social outcomes, which is often a challenge in cities, as it requires a rigorous focus on performance management and a process in place to gather spatial data from multiple sources across sectors. Furthermore, small and medium-sized cities may not have the capacity to lead the process required to build alliances and negotiate complex partnerships with multiple stakeholders.

Main areas of government actions:

- ✓ Set up a monitoring team with responsibility for defining and measuring the relevant social outcomes of projects
- ✓ Pilot new impact-based financing models to maximise the social impact of investments
- ✓ Establish a coalition of stakeholders to build alliances to accelerate innovation for inclusive growth in cities

**How does the CEB support financial innovation for inclusive growth in cities?** The CEB offers flexible financing instruments that enable cities to leverage additional resources from the private sector for projects with a social impact. The main instruments for direct lending to cities include the Programme Loan, the Cross-Sectoral Loan (CSL), the EU Co-financing Facility (ECF) and the Public Sector Financing Facility (PFF). The CEB also provides technical support to cities in the preparation and implementation phases of their projects, to measure the social outcomes of their investments and to build their monitoring capacity – a pre-condition for mobilising finance for social impact. The CEB has also a track record of partnering with governments to develop impact-based financing instruments with the potential to have a transformational social impact. For instance, the CEB has recently co-financed the social impact investment fund Hémisphère, an innovative financing solution for the provision of emergency accommodation and social welfare services in cities – a challenge that many cities in CEB member countries currently face – where the remuneration of institutional investors is partially tied to the achievement of social outcomes (see Box 6).

<sup>15</sup> The government contractor is Actiris, the Brussels-Capital Region Employment Agency. The service provider is DUO for a Job, a not-for-profit organisation which matches young job seekers of immigrant background with local retirees. The lead social investor is Koïs Invest. DUO for a Job, as the service provider, entered into a direct agreement with Actiris and had responsibility for raising finance.

<sup>16</sup> The one-year re-employment rate is defined as having accumulated more than 90 days of employment or obtained a permanent employment contract in the year following the programme.

### Box 6: Innovative Finance for Emergency Accommodation – the Hémisphère Fund

The social impact investment fund Hémisphère SCI was set up in 2017 to address the increased need for emergency accommodation following the growing influx of foreign-born asylum-seekers in France.

The fund, with a total investment capacity of €200 million, is financed by six institutional investors for a total amount of €100 million, and a loan of €100 million from the CEB, and is managed by AMPERE Gestion, a subsidiary of CDC Habitat. The fund plans to acquire around 100 low-cost hotels, refurbish and convert them into 10,000 units of emergency accommodation. The units are let to ADOMA, the leading provider of emergency and supported housing in France, which is responsible for managing the units and providing emergency accommodation and social assistance services to migrants and refugees. The scheme is expected to deliver significant efficiency savings equivalent to more than 40% of the cost of providing emergency accommodation via the public sector. What is more, investors are remunerated based on progress made in achieving predefined social outcomes. In addition to the fixed rent from ADOMA, institutional investors receive a variable return based on the progress made toward the achievement of four social outcomes, namely (i) the percentage of migrant and refugee children (in the 6-16 age range) attending school; (ii) the number of programme participants placed in permanent accommodation; (iii) the percentage of eligible participants who signed contracts to receive emergency accommodation and social support services; and (iv) the percentage of eligible participants with access to social security benefits. The outcomes are independently verified by annual social audits.

Source: CDC Habitat (2018).

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