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Cooperation and Competition in Region-Building: The Role of Incentives

By: Sam Broadbent, MPA Candidate, School of Public Administration, University of Victoria

Abstract Economic performance for British Columbia involves complex interaction between regional networks and all levels of government. Accordingly, regional networks and local governments have an important effect on economic performance. The provincial government has a range of tools it can use to foster and guide regional networks and local governments. Chief among these tools are incentives, which can foster regional networks and capitalize on economic development opportunities. An incentive allows the provincial government to induce or motivate behaviour among local governments, regions, businesses and other relevant groups for the purposes of improving regional economic performance.

Local Government Institute
School of Public Administration
University of Victoria
P.O. Box 1700, STN CSC
Victoria, B.C. V8W 2Y2

Phone: (250) 721-8055
Fax: (250) 721-8849
E-mail: padm@uvic.ca

Web: http://publicadmin.uvic.ca/lgi/index.htm

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EXECUTIVE SUMMARY

Economic performance for British Columbia involves complex interaction between regional networks and all levels of government. There are a range of tools that can be used to enhance regional economic performance. Chief among these tools are incentives, which can be used to foster regional networks and capitalize on economic opportunities. An incentive allows the provincial government to induce or motivate behaviour among regions, local governments, private sector organizations and other relevant groups for the purposes of enhancing regional economic performance.

By working together regions can achieve many outcomes that would not have been possible working independently. Although it is difficult to measure the effects of increased cooperation, evidence shows that cooperation in regional economic development is beneficial. Among other benefits, regional cooperation can result in cost savings through the creation of economies of scale, increased regional governance and problem solving capacity, and leveraging of different resources and opportunities that may not have been possible without collective action. Effectively, cooperation can enhance the overall economic performance of British Columbia's regions.

Leveraging the opportunities brought forward by regional cooperation is facilitated by the use of incentives. Incentives assist in reinforcing regional economic strengths and comparative advantages inherent to a region. They can also be used to address areas of economic weakness. Ultimately, incentives can be used to foster cooperation between regions, local governments, the private sector and other relevant groups, thereby creating an environment conducive to increased economic performance.

At a general level, incentives can be levered in two major areas:

1. Functional economic regions (regions); and
2. Economic sectors (sectors).

There are certain natural factors that attract economic development and growth, including natural resource availability, transportation costs, economies of scale, population and

proximity/size of the market. As such, economic sectors within regions differ depending on the natural factors that contribute to economic development. However, increased performance in economic sectors can often create a benefit for the economic regions in which those sectors operate.

There are a number of incentives that can be used to foster cooperation and enhance regional and sectoral economic performance. When applying incentives it is important to ensure that there is a targeted outcome or output for the incentive to achieve. Equally important is ensuring that the incentive is chosen as a best fit to meet the targeted outcome or output. The following are some key incentives at the disposal of the provincial government in facilitating relationships that can drive the performance of the British Columbia economy over the coming years:

1. Tax Incentives
2. Infrastructure Incentives (Including Infrastructure Grants)
3. Sectoral Grants
4. Marketing and Communication
5. In-Kind Assistance
6. Revenue Sharing
7. Regulation and Deregulation
8. Permits, Licenses and Approvals
9. Trade Incentives
10. Trust Incentives

In conclusion, this paper provides a discussion of incentives and their impact on regional economic performance within British Columbia. Cooperation is introduced as a means of enabling regions to lever opportunities to enhance their economic performance. Ultimately, this paper finds that incentives can be used to create conditions that foster cooperative relationships between regions and ultimately enhance the overall economic performance for British Columbia.

1. INTRODUCTION

1.1 Levering Opportunities: Using Incentives to Address Cooperation

Economic performance for British Columbia involves complex interaction between regional networks and all levels of government. There are a range of tools that can be used to enhance regional economic performance. Chief among these tools are incentives, which can be used to foster regional networks and capitalize on economic opportunities. An incentive allows the provincial government to induce or motivate behaviour among regions, local governments, private sector organizations and other relevant groups for the purposes of improving regional economic performance. As there are numerous opportunities for enhancing economic performance across the regions of British Columbia, understanding the effects of the range of incentive tools is paramount.

This paper examines the extent to which regional cooperation can improve the overall level of economic performance in British Columbia. Closely linked is a discussion of how incentives can be used to foster regional cooperation for the purposes of enhancing economic performance. Ultimately, this paper will outline a range of incentives and identify how they can be levered to capitalize on economic opportunities, improve cooperation in regionalized economic networks and contribute to forward momentum for British Columbia.

1.2 The Two Levers of Incentives

An incentive is designed to induce or motivate behaviour that leads to desired outcomes. The impact of incentives can span from individual well-being to province-wide economic performance. Accordingly, incentives can have a range of purposes, from water conservation to increasing business investment. At a general level, incentives can be levered in two areas:

1. Functional economic regions (regional); and
2. Economic sectors (sectoral).

These categories are not necessarily exclusive, as an incentive can benefit a sector of the economy and in turn benefit the region where that economic sector is most prevalent.

1.3 Outline

Following this introductory section, which has provided the purpose and direction of the paper, a second section will outline some key aspects of regional economic performance within British Columbia. The third section looks at the advantages of cooperation for regional networks and local governments. The section will highlight where cooperation is most effective and identify some principles of cooperation. The fourth section will classify, define and analyze a range of incentive tools, showcasing their advantages and disadvantages. The fifth and final section will provide some lessons learned for levering incentives to increase regional cooperation in order to improve regional performance.

2. REGIONS IN THE BRITISH COLUMBIA ECONOMY

This section will set the context through which cooperation, competition and incentives are applied in British Columbia. It will be shown that regional economic performance is defined along two lines, economic production and economic well-being. There is a distinction between economic regions and economic sectors; although it will be shown that the two concepts are closely related, particularly when addressing regional economic development. It will be shown that the regional economies in British Columbia are distinguished by their natural endowments and are accordingly focused on specific sectors of the economy.

2.1 Defining Regional Economic Performance

Regional economic performance is a measure of the elements that contribute to the overall economic situation of a geographic region. Administrative regions, such as local governments, have an interest in enhancing their overall level of economic performance (TFOCO, 2006: iii). However, the benefits of increased economic performance extend beyond the borders of administrative regions and into functional regions. As such, Brunnen defines economic performance along two lines (Brunnen 2006):

1. The overall economic production in an area
    a. The value of goods and services produced in a geographic area (region)
2. The overall economic well-being in an area
    a. The overall economic welfare in a geographic area (region)

Incentives are tools that assist in creating conditions that maximize economic production and well-being. The focus of incentives in this context is not to differentiate between economic production and economic being. Rather, incentives can play an important role in establishing conditions where the two measures of economic performance can flourish.

2.2 Differentiating Regions and Economic Sectors

In the context of regional economic development, the economic profile of British Columbia involves interplay between two major factors:

- Regions; and
- Economic sectors.

Although Regions are the focus of this research, the two concepts are closely linked. Regions have natural endowments, such as resources or population. These natural endowments provide a region with a comparative advantage in one or more sectors of industry. Accordingly, certain regions are more appealing to certain economic sectors and vice-versa. For example, the rocky mountain foothills in the northeastern region of the province are attractive to energy industry due to the vast coal reserves in the region (BC Stats). However, this region would hold little interest to the fishery industry, for instance.

Economic Sectors

The BC Stats profile of the British Columbia economy outlines the following economic sectors as substantial drivers of the British Columbia economy (BC Stats):

1. Services
2. Natural Resources
    a. Forestry
    b. Mining
    c. Energy
3. Manufacturing
    a. Predominantly paper and wood
4. Agriculture
5. Fishing

6. Tourism
7. Other
    a. E.g. Construction, Film etc.

Economic Regions

There are certain natural factors that attract economic development and growth. Sridhar identifies these facts as natural resource availability, transportation costs, population and proximity/size of the market will all contribute to regional development (Sridhar 2005: 6-7). Sridhar's finding are consistent with the work of Hoover and Giarratani who identify natural resource endowment; transportation and communication costs; and potential to experience economies of scale as the driving factors for the location of economic activity (Hoover et al 1985: 1.2). As such, the economic activity differs by region depending on the level of each of the driving factors for development. Particularly, the economic activity of large urban regions will be distinct from the economic activity in smaller urban and rural regions. An economic region is tied to Brunnen's work on functional regions and governance networks.

Brunnen identified some of the distinctions between administrative and functional regions (Brunnen 2006: 9-10). Administrative regions are predominantly defined by their established geographic boundaries. These boundaries represent the service provision area of an administrative region. Functional regions are defined by their degree of internal integration, such as commodity, money and commuter flows (Brunnen 2006: 9). The inconsistencies between the boundaries of an administrative region and a functional regions present a challenge in developing strategies that enhance regional economic performance. The concept of administrative and functional regions is particularly important to the discussion of regional cooperation in Section 3.

Within British Columbia, approximately 80% of the more than 4 million population inhabits urban areas, predominantly in the lower mainland. Much of the population is concentrated in the lower mainland, as is much of the economic activity. However, it is forecast that economic growth will continue throughout the province over the coming years (Hirsch 2006). Although there are countless ways to breakdown of British Columbia's many economic regions, this paper will draw two major distinctions for the purposes of differentiating the types of economic activity within the province:

- Large urban regions
- Smaller urban regions and rural areas

Large Urban Regions

The large urban regions in British Columbia are the Greater Vancouver and surrounding area, Victoria and to a lesser extent, Kelowna, Nanaimo and Prince George. These areas are small in area, but vast in population. The economic focus in these regions is the service industry, manufacturing, trade, tourism and to a lesser extent, agriculture (BC Stats).

Smaller Urban Regions and Rural Regions

Much of the provincial geography falls into these regions, but less than half of the population. The focus in these areas is predominantly based on natural resources, including, mining, agriculture, forestry and energy (Hirsch 2006).

2.3 Section Summary

Regional economic performance is defined by the overall economic production and overall economic well-being in an area. In the context of regional economic development, the economic profile of British Columbia involves interplay between economic sectors and economic regions. As well, the contrast between a functional/economic region and an administrative region frames some of the discussion on regional cooperation. The regional economies within British Columbia are distinct based on the natural endowments of an area. A sharp contrast is drawn between large urban areas and smaller urban/rural areas.

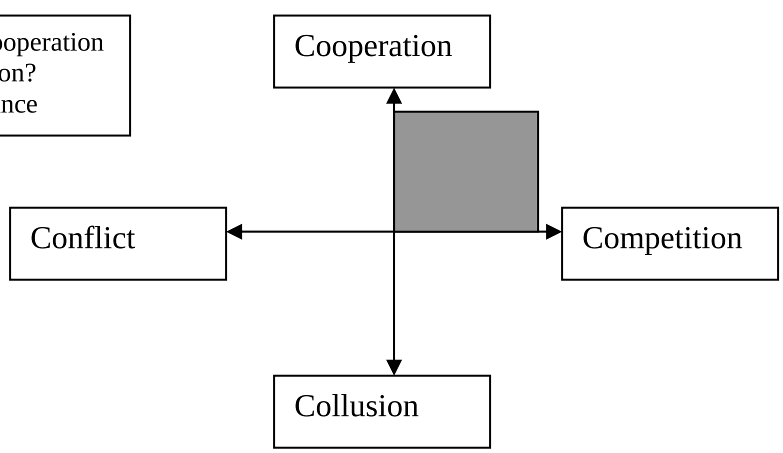
3. THE PRINCIPLES OF COOPERATION

This section will show that the economy in British Columbia is based upon competition. However, mitigating competition through regional cooperation is important in enhancing the overall economic performance and well-being of British Columbia and its regions. Following an outline of the benefits of cooperation, some lessons learned from the recent integration of the European Union identify some of the challenges for regional cooperation. The European experience also identifies some of the economic sectors where cooperation is most easily facilitated. Finally, this section provides an overview of the conditions under which cooperation is most likely.

3.1 The Relationship Between Cooperation and Competition

Cooperation and competition may be seen along the same line, with cooperation on one side and competition on the other. One tries to find a mid-point in the line between cooperation and competition that is most desirable for the given situation. Although this perspective is useful in showing the balance between cooperation and competition, it does not adequately frame cooperation and competition within a broader context. Another perspective, illustrated in Diagram A, may offer better insight into the interplay between cooperation and competition.

Figure A: Cooperation or Competition? Finding Balance



In figure A, the relationship between competition and cooperation is highlighted by the shaded square in the upper right quadrant. There is a dynamic relationship between cooperation and competition, as well as their negative counterparts, conflict and collusion (Patchell 1996: 484). This diagram indicates there should be elements of both cooperation and competition to find the best balance. Of key importance is that too little competition or cooperation can create collusion or conflict. Because the economy in BC is based on competition, it is important to ensure there is adequate cooperation to balance the regional effects of competition.

3.2 Competition at a Glance

Competition is a major foundation of the global and the British Columbia economy. The globalization of the economy means that many communities must compete on an international scale (TFOCO 2006: 3). Increased globalization has lead to an increase in the competition for BC regions. Despite the challenge that competition poses to regional economies, it has some positive aspects. According to basic economic theory, competition is in the best interests of society (Davies et al 2004: 1-2). An economy founded on competition creates many benefits, including reduced prices, increased innovation and better consumer service. Adam Smith supports competition when he states, "where competition is free, the rivalship of competitors obliges every man to endeavor to execute his work to a certain degree of exactness (Davies et al 2004: 1)."

Generally competition can be positive; however the British Columbia economy is founded on competition. Ensuring that the effects of competition do not overwhelm the benefits felt from cooperation is a worthwhile endeavor for the provincial government. Therefore, the negative effects of advanced competition between regions should be noted and avoided where possible. Competition between regions can occur in the provision of tax, infrastructure and sectoral specific incentives. If regions tax at different rates or provide differing levels of infrastructure, this may encourage businesses and other sources of capital investment to migrate to lower taxing and infrastructure intense regions. Regions will use incentives to attract economic investment, potentially at the detriment of both the region itself and the overall regional economy within British Columbia. Two examples follow that demonstrate some of the drawbacks of a business environment lacking in cooperation and founded primarily on competition.

The Race to the Bottom

The race to the bottom is a theoretical situation in which competing jurisdictions lower regulations and taxes in an attempt to attract investment (Chan 2003: 40-44). Through the continual competition for the lowest tax and regulatory burden, the competing jurisdictions receive lower tax revenues. As such, the ability of government to provide fundamental services and citizen protection is eroded. Despite being firmly grounded in theory, the evidence of a race to the bottom is mixed. However, the current evidence and the potential impact of a race to the bottom are substantial enough for policy makers to consider the potential repercussions of a race to the bottom when making policy choices (Brueckner 2000: 505).

Here the importance of non-benefit taxation should be mentioned. Non-benefit taxation refers to taxes that relate to a direct benefit that is received by the one incurring the tax (Oates 1999: 1125). For example, a tax for the receipt of a water service would be considered a benefit tax, because the payer of the tax receives water. On the other hand, a tax in order to provide a general income redistribution program, such as a welfare service would be a non-benefit tax, because those in receipt of the tax are not typically those receiving the benefit of welfare. It is important to draw the distinction between non-benefit and benefit taxation, because a tax that is offset by a benefit may be more agreeable for a business taxpayer. The importance of providing non-benefit taxes should not be lost in an attempt to provide benefit taxes in order to attract business, however. A situation where regions cooperate in order to provide broad and consistent levels of tax for business and other economic drivers is desirable from both a local government perspective, regional development perspective and a business planning perspective.

A Noteworthy Trend: Economic Zones (EZ)

Economic zones emerged from the United Kingdom and have since found significant roots in the United States. An economic zone is a tax haven where a region has been designated to provide an environment conducive to business, through lowered taxes, decreased regulation or other incentives. An economic zone is a regional means of attracting business. Effectively, an economic zone is a combination of a number of different incentives. Although economic zones may attract business, they do not necessarily benefit the regions in which they are located. In fact, a study of the 13 American states which had substantial enterprise zones prior to 1990 raised doubts about the benefit of those zones to the regions, businesses and workers which were involved (Fisher and Peter 2000).

3.3 Cooperation at a Glance

Cooperation is a voluntary agreement entered into for mutual benefit (Patchell 1996: 481). Cooperation is not a static relationship, as Ring and Van de Ven define cooperative relationships as "mechanisms for collective action, which are continually shaped and restructured by actions of the parties involved (Ashford et al. 1995: 10)." This implies that cooperation is consistently evolving and is very much a creature of interaction between individuals and groups. As cooperation is a fluid process, it is important to recognize that there is any number of different cooperative relationships. In a competitive environment, cooperation is the process of mediating competition, to create desirable effects for the parties involved.

By working together regions can achieve many outcomes that would not have been possible working independently. Although it is difficult to measure the effects of increased cooperation, there is evidence that regional economic development relationships are beneficial (Coe 2006: 9). Regional cooperation can result in cost savings through the creation of economies of scale, increased regional governance and problem solving capacity, and leveraging of different resources that may not have been possible without collective action. At the very root of this notion is that cooperation can enhance the overall economic performance of British Columbia's regions (Coe 2006: 9). As well, cooperation has long been seen as crucial to success for enterprise (Ashford et al. 1995: 7-9). Here a basic notion of trade economics should be introduced; rationale individuals or organizations will not enter into an agreement unless they determine that such an agreement is beneficial for them. As cooperation involves an agreement between two or more parties, it is reasonable to expect that all parties should perceive benefit.

The challenge of transcending administrative regions into functional regions is important for cooperation in British Columbia. The inconsistencies in boundaries between functional and administrative regions can blur the nature of cooperative relationships (Brunnen 2006: 9-10). It is important to foster regional interaction that is both functional and beneficial. Some of the boundary-based challenges for differentiating between functional and administrative regions are also relevant to economic sectors and economic regions.

Despite the linkages between economic sectors and economic regions, there are some distinctions in the prevalence for cooperation. Economic sectors may span multiple regions. As will be seen in Section 3.4, fostering cooperation between regions engaged in the same sectoral activities is one of the biggest challenges to enhancing regional performance. In this context, cooperation between regions is much more important than cooperation between sectors. If regions cooperate, it will enhance the overall desirability of British Columbia as a destination for firms engaged in economic activity and accordingly increase the collective welfare in British Columbia (TFOCO 2006: 5). Simply put, enhanced regional cooperation will distinguish British Columbia as a choice destination for specific economic sectors, particularly if regional cooperation creates an environment optimal for business activity.

3.4 Sectors Conducive to Cooperation: The European Experience

With the 1992 signing of the Maastricht Treaty the European Union moved towards a much higher level of integration. According to Wessels, the European Union is “to be shaped in the direction of a confederation designed to tackle a limited number of common problems by extending procedures of intergovernmental cooperation to all major policy areas (Wessels: 1994: 451).” Increasing the level of integration within Europe bridges the gap between administrative regions and functional regions. There are a number of important benefits that have been gained through cooperation among European regions (Uvalic 2002: 321). According to Uvalic, cooperative initiatives have facilitated dialogue, promoted the resolution of political and economic differences and allowed regions to develop trust and confidence with each other.

While studying the European Union and its enlargement, Milica Uvalic found that some sectors of the economy are more conducive to cooperation than others. There are some sectors in which cooperation works best (Uvalic 2002: 320-324) (Benyon 1994: 499):

- Transportation and Communication
- Infrastructure
- Energy
- The Environment
- Certain services, such as policing and water delivery

There are some sectors in which competition works best:

- Commercial Business attraction
- Inter-regional trade growth

Although certain sectors are more conducive to cooperation than others, the nature of this cooperative relationship may vary. Cooperation is less likely when the principles have a horizontal relationship, such as cooperation among local governments. Cooperation is more likely when the relationship is vertical, such as cooperation between the provincial and local governments (Ashford et al. 1995: 10). Because vertical cooperation is easier to achieve than horizontal cooperation, it is clear that the British Columbia provincial government can have a role in facilitating cooperation. The provincial government can provide incentives that facilitate both horizontal and vertical cooperation among local governments and the provincial government throughout British Columbia.

There is a good deal of research on the effects of regional integration, particularly across national boarders. A 1998 World Bank Conference on regional integration agreements concluded that there are two major benefits to regional integration for south-eastern European nations, both of which apply in the case of British Columbia (World Bank 2000). The World Bank found that increased cooperation and integration impacts regional economic growth and regional political credibility (World Bank 2000). Of import for British Columbia is that regional economies which are open tend to grow at a faster rate than those that are closed. Accordingly, integration and cooperation foster economic growth. This is further evidence of the import of the provincial government's role in providing incentives for cooperation, both horizontally and vertically.

The European integration experience provides some very pertinent lessons learned that can be applied to British Columbia. Beyond the information on sectors conducive to economic development and the distinctions between vertical and horizontal integration, the following three key questions emerged from the recent integration of the European Union and may impact the policy choices for regional integration in British Columbia (Uvalic 2002: 331-332)

- Is economic diversity a stimulus or barrier to regional cooperation? A certain degree of similarity is desirable to create shared interests, however if the regional economic profiles are too similar, there may be some drawbacks, particularly surrounding intra-regional trade.
- How are economic regions shaped? Uvalic hypothesizes that geography is the driving force behind economic regions, but acknowledges the possibility of many other factors (Uvalic 2002: 331).
- Are there economic motives at the base of regional cooperation, or is the process primarily politically motivated? This beckons back to Brunnen's analysis of administrative versus functional regions. Effectively, politically motivated cooperation indicates the importance of administrative regionalism, whereas economically motivated cooperation indicates the importance of functional regionalism. More than likely, there will be interplay between functional and administrative regionalism.

The European experience shows that regional cooperation is more likely when the focus is on transportation, communication, energy, the environment and service delivery. These are all sectors that cut across multiple regions, creating a multi-regional interest in sectoral economic outcomes and performance. The sectors that are most conducive to cooperation can inform the choices made by the British Columbia provincial government in targeting their incentives. Determining how best to foster sectoral cooperation can in turn guide the decisions and nature of the regional cooperation in British Columbia.

Above all, the European experience shows that cooperation is beneficial both economically and politically.

3.5 The Principles of Cooperation

Cooperation is not a prescribed process. Studies of organizational cooperation indicate that organizations do not merely cooperate, but cooperate for a reason (Schermerhorn Jr. 1975: 852). Applying this finding to local governments, it can be assumed that they consciously decide whether or not to enter into cooperative agreements. However, there are certain conditions under which cooperation is fostered. The general premise regarding cooperation is much the same as the adoption of incentives; organizations/governments will choose to cooperate when there is a net-benefit to cooperation.

The following principles create an environment conducive to net-benefits in cooperation (Schermerhorn Jr. 1975: 848-855):

1. Organizations have a shared goal, need or purpose
2. Sufficient interaction between actors, allowing for the communication of shared opportunities in the future
3. Cooperation is perceived as positive
4. A third party provides sufficient motivation to engage in cooperation
5. Costs to cooperation are minimal
    a. Relative loss of autonomy is acceptable
    b. Resources dedicated to coordination are not a significant deterrent
    c. The image of an organization is not negatively affected
6. Resource scarcity (organizational or otherwise) forces organizations into cooperative agreements
7. Physical realities, such as geographic proximity, are conducive to cooperation
8. The more permeable the boundaries of an organization, the more likely they are towards cooperation

Certain principles apply more aptly to regional economic development for British Columbia. Despite the ease and merits of vertical cooperation, the province can have a substantial impact in creating an environment conducive to horizontal cooperation between British Columbia local governments. According to the principles of cooperation, identifying and communicating the linkages between regions and the advantages of cooperation is important. Equally important is creating the necessary incentives to encourage regions to engage in cooperative behaviour. The importance of all eight principles should not be understated in fostering cooperation.

3.6 Section Summary

Despite the merits of competition and its prominence in the global and British Columbia economies, it has some key drawbacks towards regional economic development. Chiefly, competition can create a race to the bottom, where regions compete to provide incentives that attract business, thereby decreasing the regional well-being through an overabundance of business friendly incentives.

A sustained level of regional cooperation is important to balance the effects of competition. Cooperation between regions is a fluid relationship that creates mutual benefit. European integration has shown that the transportation, communication, infrastructure, energy and the environment sectors are most conducive to cooperation. The province can have a role in fostering regional cooperation, through identifying and providing opportunities for cooperation as well as providing the necessary incentives to induce cooperation between regions.

4. INCENTIVES: A TOOL FOR GROWTH AND COOPERATION

The focus of this section is on identifying, categorizing and describing a range of incentives. Incentives are vital in fostering cooperation among regions, both administrative and functional, and they can be applied to both economic sectors and geographic regions. Above all, incentives are most effective when they are properly targeted to the meet prescribed outcomes.

4.1 Defining Incentives

An incentive is designed to induce or motivate behaviour that leads to desired outcomes. In this context, incentives are a wide range of tools through which governments can foster regional cooperation and economic development. Effectively, the provincial government can use incentives to create conditions that are conducive for cooperation between administrative regions and increasing the functionality of economic networks.

4.2 Targeting Incentives to Outcomes and/or Outputs

A single incentive does not provide a catch-all means to improving regional productivity. In fact, incentives are a very specific tool that may have an impact over a specific geographic area, or a specific sector of the economy. In order for incentives to be effective, they must be targeted to achieve specific outcomes or outputs. The effects of an incentive do not need to be singular, as a single incentive can be used to target multiple outcomes. As well, incentives can be particularly effective when used in conjunction with one another. They can be used to reinforce regional economic strengths and the comparative advantages inherent to a region. This is particularly important in smaller regions, where economic activity is less diverse; further reinforcing the reliance on regional comparative advantages. Incentives can also be used to address areas of economic weakness within provincial regions. The importance of addressing economic weakness should not be understated, as Dissart identifies economic diversity as a key driver for enhanced economic performance (Dissart 2003: 425). Essentially, incentives can be used as a tool to foster the relative strengths within an area and/or buoy relative weaknesses. Incentives may apply differently, depending on the area of the province in which they are operating. However, the goal of the incentives in this context remains the same; to foster cooperation between regional networks in order to improve economic performance.

Effective use of incentives can have a positive impact on regional economic development and well-being (Sridhar 2005: 5-6). Tying incentives to target and achieve desired outcomes is a key aspect of effective incentive usage. The potential areas for enhancing regional economic performance are varied, thereby varying the application of incentives. The provincial government may target incentives to (TFOCO 2006: 16-17);

- Enable multi-sector alliances;
- provide direct economic benefits to regions that sustain increased economic production; and
- foster lasting alliances that target regional development initiatives.

Targeting incentives to any of these, or other outcomes, may require distinguishing regional and sectoral incentives.

Regional Vs. Sectoral Incentives

Incentives can foster regional economic performance; sectoral economic performance; or both regional *and* sectoral economic performance. Increased performance for economic sectors often impacts the economic performance of regions, as economic sectors are often located with a certain region. For example, if a sector specific incentive is introduced for the fishery industry, the majority of benefits will be felt in the western regions of the province, as this is where the fishing industry tends to be located (BC Stats). However, certain industries span multiple regions within the province. For example, the forestry is a multi-billion dollar annual industry that spans nearly the entire province, as forests land covers more than 50% of the area in British Columbia (BC Stats). As such, increased performance in the forestry industry is not tied to a specific region. The presence of multi-regional economic sectors presents an opportunity for inter-regional collaboration. Simply put, regional cooperation benefits both regional and sectoral economic performance.

4.3 Creating a Net-Benefit through Incentives

At the heart of an incentive based approach to regional economic development is the concept of net benefit. When making decisions about the extent to which an incentive should be used to target a specific outcome, it is vital to consider if the benefits created by the incentive will outweigh the costs of implementing and operationalizing it (Sridhar 2005: 170). The methodology for tabulating costs and benefits is at the discretion of the individual or organization making the decision to implement or provide the incentive. Of importance is facilitating a situation where the benefits from an incentive outweigh the costs, thereby creating a net benefit. The need for an incentive in this context can be ascertained by asking the following question:

- Will the gains in economic productivity and well-being be larger than the costs of the incentive(s)?

A Noted Exception: Achieving Results without Incentives

There may be cases where the desired goals can be achieved without using incentives, thus it is important to ask the questions: Would the workers/industry/investment come to area in the absence of an incentive? Creating incentives is a form of government intervention and may serve as a distortion on market activities (Clement 1992). The impact of government incentives may be minimal, as the largest impact may be from other factors, such as available markets, characteristics of the labour force and other factors that impact production (Feiock 1991: 643-655). Therefore, it may be possible to achieve targeted results without the use of incentive tools.

4.4 The Various Incentive Programs: Finding the Right Tool for the Job

Sridhar focuses on the distinctions between tax and infrastructure incentives and effectively categorizes incentives along these two lines (Sridhar 2005: 1-7). However, Sridhar acknowledges there is a range of other incentives, outside the scope of his analysis. Evidently, there are many different types of incentives, designed to accomplish many different functions and outcomes. This section highlights incentive tools that are particularly important for fostering regional economic performance and cooperation for

British Columbia. Ten incentives and some of their iterations will be examined in the pages that follow. For each type of incentive the following information will be outlined:

- Description of how the incentive functions
- Highlight the how the incentive might typically enhance economic well-being, productivity and regional cooperation

Prior to introducing the range of incentives available, a couple points should be made. First, incentives may be used to enhance regional and/or sectoral economic performance. They can foster cooperation and/or competition, both between functional and administrative regions. Second, each different incentive may create a variety of outcomes, some similar, some dissimilar. As such, incentives are not mutually exclusive and it may be most effective to use incentives in concert, thereby capturing the strengths inherent in each.

4.4.1 Tax Incentives

Tax incentives have been a staple of regional development policies, due to their ease of administration (Rowlands 1996: 341). A tax incentive typically takes the form of a tax credit, which reduces the total tax liability, or a tax deduction, which reduces the income level used to determine taxes owing. The third major tax incentive is a tax exemption, typically used to exclude certain items from sales tax. Tax incentives have been shown to substantially reduce the level of unemployment in an area, by attracting business to a region (Sridhar 2005: 169-170). A tax incentive usually has a well-defined useful life, as the benefits are optimized over a three to five year period after the introduction of the incentive (Sridhar 2005:170).

Tax Incentives and Employment

Generally, tax incentives are highly effective at increasing employment levels (Sridhar 2005: 169-170). Holding the level of infrastructure constant, a region with greater tax incentives will be more attractive to business activity and economic development. Using tax incentives to lower unemployment can have a substantial net-benefit on economic well-being, meaning the benefits from lower unemployment are greater than the costs of the tax incentives. This is particularly salient assuming three conditions are met (Sridhar 2005: 169-170):

1. The jobs are created in high unemployment areas
2. The jobs are skill based, thereby paying relatively well
3. Costs are minimized by targeting incentives towards labour intensive firms, without offering too large a tax incentive

Tax incentives are most effective when there is a substantial need to generate meaningful and well-paying job growth in a region and the net benefit from tax incentives is lowered when the costs of providing the incentive are high. Simply put, there reaches a point where the tax incentive is too great to generate meaningful net benefits.

Targeting Tax Incentives

A major issue surrounding tax incentives is their questionable ability to be targeted towards achieving certain outcomes. Local Governments in BC tax primarily on a property tax basis, which has limited flexibility in addressing sectoral development. Property taxes are also slow to respond economic growth, as the adjustment of property values lags behind economic growth (TFOCO 2006:1-3). On the other hand, the provincial government tends to tax on the basis of income and sales, which are more responsive to economic growth.

There are numerous examples of tax credits or tax deductions that are targeted to specific sectors of the British Columbia economy. These types of tax credits do not tend to directly foster functional regional networks, however may do so indirectly. Included among provincial and federal tax incentives in use in BC are (Invest British Columbia 2006):

- R & D tax credits and deductions
- Selected sales tax exemptions
- Mining exploration tax credit
- Film production tax credit
- International financial business tax refund

There are few regional tax incentives, as the provincial focus appears to be centred on sectoral tax benefits. Accordingly, local governments have few tax incentive options. However, Section 224 of the *Community Charter* grants the Municipal Council the authority to grant permissive tax exemptions under prescribed circumstance. These exemptions include the permissive property tax exemption for non-profit organizations and the heritage tax exemption (City of Victoria 2006). Because the authority to grant these exemptions is given by the *Community Charter*, it spans across British Columbia municipalities.

Tax incentives may be too blunt to target outcomes related to regional economic performance. It seems that tax incentives have historically been a tool that functions on a sectoral basis. As outlined in Section 3.3 and 3.4, sectoral incentives may address regional economic performance, but do not necessarily do so, particularly when an economic sector spans multiple regions. Should purely regional tax incentives be sought, there may be an opportunity to expand the authority of local governments to create tax incentives, particularly if local governments cooperate to do so. This would allow for regional flexibility in providing tax incentives. As well, increasing the tax room for local governments is a tax related strategy that has been identified as a potential tool for enhancing regional economic performance (TFOCO 2006: 1-3). As property tax is slow to respond to growth, providing local governments with another means of taxation may enhance the capacity and local interest in regional cooperation. However, a range of regionalized tax incentive programs may create a race to the bottom. This alone may provide rationale to continue a sectoral based approach to tax incentives.

4.4.2 Infrastructure Incentives: Grants and Loans

Infrastructure incentives involve the creation and maintenance of physical infrastructure. A strong infrastructure base benefits firms, taxpayers and local governments (Sridhar 2005: 170). The presence of infrastructure can attract business to a region, particularly if that infrastructure meets the needs of the business. For example, a forestry company is more likely to operate a mill in a region if there is relevant physical infrastructure in place, such as a transportation network or even an existing mill facility. The presence of business activity, which may have been absent without infrastructure incentives, will typically have a positive impact on regional productivity.

A key point in the creation of infrastructure is to recognize that industries tend to cluster across many local governments within a region (TFOCO 2006: 29). Coe outlines how the cluster effect tends to concentrate industry within certain geographic areas (Coe 2006). For example, the natural resource sector in British Columbia is predominantly concentrated outside of major urban areas (BC STATS). Infrastructure improvements in a region with a comparative advantage in an industrial sector will further attract that type of industry. The following section lists some incentives that address infrastructure, although they may not be exclusive to physical infrastructure.

Grant Programs

Grant programs are a tool through which the federal and provincial government can shape infrastructure development, by earmarking funds to certain projects. Accordingly, grant programs are highly targeted, as they can be tied to specific geographic area, economic sector or outcome. As well, grants can be a one-off occurrence and may not be a continuous or stable source of funding for a region. However, there are high administrative costs for grant programs, due to the need to carefully monitor government funds (Rowlands 1996:341).

Despite the administrative costs of grants, they can be an equitable form of incentive. Grants give local governments' access to provincial and federal streams of revenue, typically derived from income taxes. Income taxes are an equitable basis for taxation, as they are considered a progressive tax. On the other hand, property tax, the primary stream of revenue for local governments is often seen as regressive because it taxes on the basis of fixed assets rather than income. There are two major forms of grants:

Conditional Grants

- Conditional grants place restrictions on how grant money can be spent (Oates 1999: 1126). These types of grant programs allow upper levels of government to target specific outcomes at a local level and provide funding accordingly. They are particularly useful in addressing specific provincial interests at the local level.

Unconditional Grants

- Unconditional grants are lump-sum transfers from other levels of government that may be spent however the recipient desires (Oates 1999: 1126). The purpose of unconditional grants is typically equalization—the channeling of funds from an affluent region to a less-affluent region (Oates 1999: 1126).

In other regions of Canada, the focus for regional economic development has traditionally been on reducing unemployment by attracting new manufacturing investment, partially through infrastructure development (McNiven and Plumstead 1998). However, the British Columbia economy has its basis outside of manufacturing, thereby creating a need to target grants to other areas of the economy. This can be straightforward, as grants offer a great deal of flexibility in their application. Another key feature of grant incentives is their wide range of applicability. Grants can be given to any number of recipients for any number of purposes. More specifically, they can be used for any economic sector or region. As such, they do not fit exclusively in a discussion of physical infrastructure. A brief overview of grants has been provided, now the focus turns exclusively to grants for the basis of creating infrastructure.

Infrastructure Grants

Infrastructure grants are targeted towards upgrading local infrastructure. Infrastructure grants tend to directly benefit local governments, as they are geared towards physical upgrades. Access to infrastructure, particularly transportation, education, communication and energy related infrastructure are important in attracting skilled workers, investment and key industries to a region (TFOCO 2006: 29). Infrastructure has a direct impact on well-being and economic productivity as infrastructure often serves as an attraction for business (Sridhar 2005: 169-170).

Not only can infrastructure grants attract and retain business, they can also increase the tax base for local governments. This increases the capacity of local governments to address issues relating to the general well-being of citizens. As well, infrastructure grants can help enhance local capacity to deal with growth, both in terms of population and the regional economy. However, the focus of grant programs can be competitive, as regions issue competing proposals for grant dollars.

Subsidies

For all intents and purposes, subsidies provide the same incentive as a grant and are, for all intents and purposes, identical. They are monetary assistance by the government to a person or group. Like grants, subsidies are typically provided in accordance with the public interest.

Loan Incentives

Loans provide business and local governments with a funding source that helps address infrastructure needs. They provide valuable capital at the outset of a project, allowing for infrastructure to be created. Loans can impact economic prosperity, by allowing infrastructure to be created in order to attract business. This can also impact economic well-being, by enhancing the local government tax base. Although loans are typically granted to a single local government, there is the potential for creativity in loan structures that might increase regional linkages.

4.4.3 Non-Infrastructure Grants

Sectoral Grants

Administered in the same manner as infrastructure grants, non-infrastructure grants are geared towards a certain sector of the economy. Due to the diversity in available sectoral grants, they may target research and development, exporting, agriculture and any number of other sectors. So long as the benefits outweigh the costs, these grants will impact overall prosperity through fostering business development. Sectoral grants do not directly enhance cooperation between regions, as they are targeted to economic sectors, however they may do so indirectly.

Venture Capital/Small Business Grants

Grant programs that target small business and innovative thinking fall into this category. In this regard, grants are allocated to businesses that meet certain criteria, not necessarily relating to business location. This type of grant has the largest impact in areas where there are a number of small businesses. The size of the market in large urban areas is most conducive to small business development, thereby attracting small business towards this area of the province.

Labour, Training and Apprenticeship Grants

Typically delivered through a grant program, labour and training programs help address the needs for increased employee capacity. When geared towards students or recent graduates, the incentive typically takes the form of an apprenticeship program. These incentives are a means of upgrading the quality of labour within British Columbia and can be targeted towards any region or sector. Typically labour pools tend to reside in urban areas, therefore labour and training programs may inadvertently target these regions. Sufficient levels of human capital is important to facilitate knowledge transfer, foster innovation and stimulate economic development (Brunnen 2006: 20-22).

Business Development Planning Grants

Over the past 10 years there has been a shift away from direct grants to industry, towards pro-entrepreneurial activities (Rowlands 1996:341). According to Rowlands, subsidies continue to play an important role in regional economic development, however the importance of business planning and marketing are increasingly recognized as important undertakings (Rowlands 1996: 341). Funding for business planning can assist not only businesses, but local governments as well. Business planning support can aid the provincial government in fostering bottom-up development of economic networks.

4.4.4 Marketing/Communication Opportunities

Not only does regional development involve creating an environment conducive to economic performance, it must also ensure that the desirable economic conditions of a region are made aware to potential investment, business and skilled workers.

Communication and marketing highlights the inherent benefits of a region to a certain economic sector. The importance of accessing marketing opportunities is significant for both urban and rural areas. This type of incentive is an area where the possiblity for cooperation is very high. The potential exists for a number of local governments, comprising a larger region could work together to develop a business marketing strategy that would benefit on a region-wide basis. The key point surrounding marketing activities is that this area blurs the line between sectoral and regional activities. Regions are able to market and communicate their value for a specific industry. Marketing and communication allows regions to work together to convey both the comparative advantages and the incentives (infrastructure, tax or otherwise) inherent to locating in their region.

4.4.5 In-Kind Incentives

In this context, an in-kind incentive involves non-financial provincial support in addressing regional issues. Effectively, it is the provision of provincial staff time towards meeting regional needs and supporting regional development. In-kind incentives are highly targeted as they are allocated to a specific region or to a specific issue. Regional staffing resources may lack a particularly skill, making it difficult to pursue certain economic opportunities and as such regions may be unable to undertake activities beneficial to regional economic development. However provincial staff may have the expertise lacking regionally, providing valuable support. It is possible for support to extend beyond the province and emerge from regional development bodies or the private sector. A regional development body could be created to provide staffing support and advisory services for the purposes of fostering regional networks and collaboration. Access to such staffing and expertise would serve as an incentive to cooperative regional relationships.

4.4.6 Revenue Sharing

Traditionally, revenue sharing involves a government apportioning a part of its tax revenue to other levels of government (Encyclopedia Britannica Online 2006). Despite the similarities between revenue sharing and grant funding, the two stand in contrast. Whereas grant funding levels are often a one-off occurrence, revenue sharing amounts are set in legislation or regulation and often span multiple years (Encyclopedia Britannica Online 2006). The major advantage for local governments is that revenue sharing agreements provide legislative certainty that a certain funding level will be maintained over a period of time (Indian and Northern Affairs 2003). In most cases, revenues are shared vertically between levels of government but there are instances when revenues are shared horizontally across local governments. Tax sharing agreements between local governments can be contentious and complicated. Accordingly, revenue sharing can be a bargained process between governments (Indian and Northern Affairs 2003).

Revenue sharing is particularly effective at targeting regional productivity as it can be based on regional economic indicators. Effectively, it may be desirable to implement a system where the more successful a region, administrative or functional, is at meeting provincial targets, the more benefit the region will receive from shared revenues. Provincial targets may centre on cooperation, increased economic performance or any number of other outcomes or outputs.

4.4.7 Regulation and Deregulation

The Economic Council of Canada defines regulations as “the imposition of constraints, backed by government authority that are intended specifically to modify the economic behaviour of individuals in the private sector (Premier’s Summit 1995: 166).” Effectively, regulation and legislation set the conditions within which much of the BC economy operates. During the 1994 Premier’s forum on investment, the regulatory working group found that the regulatory environment is equally as important as the tax environment in determining business investment (Premier’s Summit 1995: 166). Not only can regulation can be used to foster outcomes in the economy, it can target results in the environment, worker health and safety and the overall quality of life in British Columbia. Thus the potential impact of regulation is much more expansive that the economy. Without digging deeper into the power of the regulatory role of government, it is suffice to say that the importance of effective regulation cannot be understated.

It is difficult to create regulations that mandate cooperation. Cooperation is not a prescribed process, as seen in Section 3.3: The Principles of Cooperation. However, through the process of deregulation, the provincial government can downsize the prescriptive aspects of local government legislation, thereby increasing the autonomy of local governments. Through regulation or deregulation, the capacity for multi-regional agreements can be enhanced and a framework for regional cooperation can be sought. Greater autonomy and decreased provincial involvement creates a situation for greater interdependence between local governments. A regulatory framework may provide local governments with the necessary incentives to foster horizontal relationships between each other, thereby enhancing functional networks between them.

4.4.8 Permits, Licenses and Approvals

Municipalities have broad authority to regulate permits, licenses and certain approvals within their jurisdiction (TFOCO 2006: 33). These requirements can impose administrative costs associate with compliance. In some cases, the duplication of these costs occurs between neighbouring jurisdictions, as licenses, permits and approvals may differ between local governments. Coordinating an approach to licensing can serve as an incentive in increasing regional economic performance. There is already a substantial commitment to coordinating business licensing in British Columbia, as seen by (TFOCO 2006: 33-36):

- The BC-Alberta Trade, Investment and Labour Mobility Agreement
- Front-Counter BC
- The Capital Regional District inter-municipal business licensing scheme

4.4.9 Trade Incentives

Although trade incentives, such as tariffs and preferential trade agreements are classic examples of government incentives, they fall outside the control of British Columbia's regions. Accordingly, trade incentives tend to apply to international trade. There is sufficient prescriptive federal and provincial policy surrounding international and intra-national trade (Small Business BC). Coe provides a profile of the Cascadia region, which spans from Vancouver, British Columbia to Portland, Oregon and showcases some aspects of international trade (Coe 2006: 19-23). There are numerous participants in international trade, including federal governments, provinces and states, local governments, businesses and non-governmental organizations (Coe 2006: 19). Canadian international trade is controlled in part by Foreign Affairs and International Trade Canada as they oversee the *Export and Imports Permit Act* where some key trade conditions can be found (Foreign Affairs 2006). Provincial influence over international tariffs and trade agreements involves complex interactions between countless stakeholders. As such, the provision of trade incentives may be outside the scope of the provincial government in providing sufficient incentive for regional cooperation.

4.4.10 Trust Funds

Trusts are separate budget accounts established to pre-commit resources for specific programs, activities and regions (Patashnik 1997: 432). Trusts are designed to give funding and ability to pursue new opportunities for sustained growth, often to a specific region (MED 2006). The initial funding for trusts is often established through a grant, which is earmarked for a specific purpose (MED 2006). Although the monetary impact of a trust is similar to a grant, its impact on a community can be very different. Trust funding implies a greater level of financial stability than grant funding. When funding is committed through a trust fund, there is often a community belief that the benefits stemming from trust funding commitments are earned rights and should be protected outside of normal budgetary pressures (Patashnik 1997: 432).

If the budget is a contract of how taxpayer money is to be spent, then it is a loose contract, particularly for an operating budget (Wildavsky 1964: 2) (Patashnik 1997: 437). Through the creation of a trust fund, the government is enhancing its budgetary commitment and providing a funding incentive for the activities earmarked by the trust. Accordingly, trust fund allocations in the United States accounted for nearly 40% of US federal receipts in 1997 (Patashnik 1997: 432). Of these more than 150 American federal trusts, the largest dozen account for 90% of trust income and spending (Patashnik 1997: 438). American trusts of this time included Social Security, Hospital Insurance and Federal Retirement Trusts.

The two aspects guiding the prevalence of trusts as a government incentive tool are; the current distribution of political support for government activities, which shifts in accordance with public opinion and the political climate; and the overall ground rules for government budgeting (Patashnik 1997: 449). Trusts can indicate a stable financial commitment to a region and assist in developing regional economic strategies. Effectively, trust funds can be levered to enhance regional cooperation with the hopes of fostering increased regional economic performance. Currently, there are some major funding commitments to trusts in British Columbia, including:

- The Northern Development Initiative Trust ($185 million in committed funding)
- The Southern Interior Development Initiative Trust ($50 million in committed funding)
- The North Island-Coast Development Initiative Trust ($50 million in committed funding)

These three trusts have been established by enabling legislation. They are guided by their legislation and this dramatically reduces the level of provincial involvement in the trusts. Each trust is managed by an independent Board of Directors, tasked with sectoral development over a specific regional area (MED 2006).

4.5 Section Summary

There are a great number of incentives that facilitate regional and sectoral development. Incentives can be used in conjunction with one another and can provide sufficient motivation to induce or motivate certain behaviour. Ten incentives were presented that can be used to enhance cooperation as well as regional economic performance. The key aspect of applying incentives is ensuring that:

1. There is a targeted outcome or output
2. The choice of incentive is best suited to achieve the targeted outcome or output

Incentives should also create a net-benefit for an area. The bottom line is that the costs of developing and implementing an incentive should not outweigh the benefits.

5. INCENTIVES AND COOPERATION: LESSONS LEARNED

This section outlines some of lessons learned for applying incentives to foster economic performance.

5.1 Lessons Learned

Incentives can be levered to capitalize on economic opportunities, particularly through enhancing cooperation in fostering regional economic networks within British Columbia. In order to effectively lever incentives for this purpose, some key concepts were discussed throughout the paper. .

The British Columbia Economy Comprises Economic Regions and Economic Sectors

Economic sectors and economic regions both contribute to regional economic performance. An economic sector is an industrial component of the economy, such as the mining industry. An economic region is a geographic area whose boundaries can be defined by any number of measures. Because economic sectors tend to be based in specific regions, sectoral development can help strengthen regional economies. Linkages between regional and sectoral economic performance have been demonstrated, as an enhancement in one aspect of economic performance will likely enhance the other. However, incentives targeted to a specific economic sector do not necessarily foster regional development, particularly if the economic sector spans multiple regions.

Regional Cooperation Fosters Regional Economic Performance

Despite the merits of competition and its prominence within the global economy, regional cooperation is important in fostering an environment conducive to enhanced economic performance. The clear benefits of regional cooperation include the creation of economies of scales; increased regional problem solving capacity; and a wider range of available resources. Although cooperation may be desirable, it is a challenge ensuring cooperative relationships between regions, as cooperation is not a prescribed process. As well, cooperation can occur between both economic regions and administrative regions Above all, cooperation can enhance the overall economic performance of British Columbia’s regions.

Certain Economic Sectors are Most Viable for Cooperative Initiatives

As shown by the European integration experience, certain economic sectors are more conducive to cooperation. The transportation, communication, infrastructure, energy, environment and service delivery sectors are particularly suited to regional cooperative initiatives. According to the principles of cooperation, cooperation is further facilitated when the advantages to cooperative relationships are identified and communicated to stakeholders and necessary incentives are provided for engaging in cooperative behaviour.

Incentives Can Enhance Cooperative Behaviour and Improve Regional Economic Performance; Particularly when Targeted to Desired Outcomes and/or Outputs

There are a range of incentives that can induce or motivate certain behaviour. This paper identified, described and discussed ten different types of incentive, and their various iterations. In this context, incentives are a wide range of tools through which governments can foster regional cooperation and economic development. Effectively, incentives can be used to create a net-benefit through levering opportunities for enhancing regional economic performance.

Targeting incentives to achieve desired outcomes or outputs is a key aspect of effectively using incentives. Different incentives are more aptly suited to achieving certain outcomes and therefore should be levered accordingly. As the characteristics of incentives differ, some are narrowly focused, whereas others function much more broadly. Not only are the characteristics of each incentive tool distinct, the use of incentives may also differ by economic sector, economic region or even the current political climate. Combining incentives may lever the strengths inherent in each incentive. Understanding the differences in the incentive tools will enable the best fit to be found.

5.2 Summary

This paper provided a discussion of incentives and their impact on regional economic performance within British Columbia. Cooperation was introduced as a means of enabling regions to lever opportunities to enhance their economic performance. Incentives were presented as a tool for enhancing cooperation between regions and as a means of developing regional and sectoral economic growth. Above all, it was found that incentives can be used to foster cooperative relationships between regions and ultimately enhance the overall economic performance for British Columbia.

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