



Ministry of Housing,  
Communities &  
Local Government



**European Union**  
European Structural  
and Investment Funds

# ERDF 2007-2013 Analytical Programme Workstream Three

## **ERDF and meeting the priorities of localism**

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Ministry of Housing, Communities and Local Government

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**Note: While the Department for Communities and Local Government changed its official title to the Ministry of Housing, Communities and Local Government in 2018, this report refers to activity between 2007-2013 and so it is referenced by its former name throughout the document.**

# Executive Summary

## Introduction

- 1) DCLG<sup>1</sup>, as the Managing Authority, has a responsibility for evaluating the performance, impact, implementation and lessons for the 2007-13 programme, as well as to build on this in developing the new programme for 2014-20 with the European Commission. As part of this responsibility, DCLG commissioned Regeneris, Cambridge Econometrics and Professor Peter Tyler in November 2012 to progress a research and evaluation programme.
- 2) The primary purpose of the analytical programme was to deliver a package of evidence that informed the implementation and effective delivery of the next round of ERDF. Workstream 1 consisted of an assessment of the economic impacts of the current ERDF programme 2007-13. Workstream 2 assessed the economic effectiveness and lessons to be drawn from different types of interventions, across a range of relevant policy areas, in supporting local economic growth. Workstream 3 reviewed the role for and effectiveness of decentralised delivery and local incentives in local economic growth and the manner in which this can contribute to national economic growth.
- 3) A range of reports have been produced as part of the analytical programme. Draft final versions of the reports for Workstreams 2 and 3 were completed in November and August 2013 respectively. This report presents the final findings from Workstream 3.

## Purpose and Focus of Workstream 3

- 4) There has been a clear policy direction of travel since 2010 with the disbanding of the previous regional economic development architecture and its replacement by Local Enterprise Partnerships (LEPs). The LEPs have been given increased resources and responsibilities by government (with commitments to more). They are being tasked with a key role in the 2014-20 programme in England and the future investment of ERDF as part of this.
- 5) The form of local decentralisation, with the LEPs at its apex, is continually emerging. Strategic and coordination responsibilities are combined with commitments to some devolution of central government funding and incentives to generate 'own resources' through mechanisms including the New Homes Bonus or business rate retention. While the LEPs are not political or administrative institutions, they also have important partnership functions which bring accountability to local private and public sector partners.
- 6) A key factor in the LEPs' ability to shape local economic development will be the scale and nature of the funding resources they directly control or

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<sup>1</sup> DCLG was renamed the Ministry of Housing, Communities and Local Government in January 2018.

influence, including the EU Structural and Investment Funds. How this aspect of decentralisation develops will be critical, since it will bridge the link between the strategic economic development priorities LEP areas identify and the investment to realise them.

- 7) The challenge for government and local partners is to ensure that these arrangements enable the most effective and efficient use and management of ERDF as part of the wider push for economic growth.
- 8) This means investing in ways which will deliver the biggest impacts in terms of business competitiveness, job creation, innovation and the need to reduce or manage the effects of carbon emissions. It also means an approach to organising and delivering the funds which balances the need to use them creatively and flexibly with the complex requirements of the ERDF regulations.
- 9) This report is concerned with three main questions:
  - What are the advantages and drawbacks of decentralised approaches to economic development?
  - What does the evidence tell us works best in organising and delivering economic development interventions, and at what spatial levels (national, sub-national, local)?
  - What are the key messages for the design and development of the 2014-20 ERDF programme from this research?

## **Advantages and drawbacks of decentralisation**

- 10) In the current English context, decentralisation refers to the transfer of powers, decision making responsibility and funds from central government to local institutions. The decentralised delivery of economic development means the locally driven provision of some types of public good and/or action to address market failures.
- 11) Decentralisation research points to potentially significant benefits in deciding investment priorities and managing economic development interventions at a local level. Theory tells us these benefits centre on:
  - **Information advantages.** Local institutions and decision makers are better placed than central government to identify the assets, needs and opportunities that will help to drive local economic growth and improve performance. They understand how best to target resources, design and then deliver interventions benefiting businesses and residents in the local area.
  - **Coordination advantages.** Local actors can more effectively overcome the transaction costs involved in mobilising and organising the public and private sector investment and interventions which are central to economic development. This works best when they can

invest in and share the benefits or spillover effects of economic development within their area.

- 12) Together, these advantages are seen to result in the more efficient use of resources to pursue public policy objectives. Locally determined investment in technology, education, enterprise, skills and infrastructure can reinforce the key factors that drive productivity and competitiveness. It may enable an area to specialise where it has strengths, build critical mass in the form of agglomeration economies and offer businesses and residents choices about where to locate to their best advantage.
- 13) Decentralisation research also suggests it can lead to more innovative approaches to economic development. The argument is that local actors are better positioned than central government to tailor economic development activity to local circumstances and find new ways of promoting growth or tackling problems. Competition between areas helps to drive this innovation.
- 14) So theory suggests *why* there are advantages to decentralised economic development but it does not definitively tell us that locally based approaches work best across the full spectrum of economic development policies.
  - The quality of area-based information and the capacity to organise and coordinate economic development varies from place to place. Larger cities and city region bodies are often considered to be better positioned in this regard.
  - For some types of intervention, central government may be equally if not better placed to understand what investment is required and how to allocate resources to best effect, particularly where it also has a local presence. This may be the case for example where nationally significant infrastructure investment is involved.
  - Scale is important in the efficiency and effectiveness of some local economic development interventions. The costs and practicalities of developing and delivering interventions means that some investment is best organised and implemented on a larger scale, perhaps across several local areas or nationally. This also reduces the risk of financial resources being too widely dispersed to achieve critical mass.
  - While an element of competition between areas may be positive, there is also a risk that resources are used less than efficiently if one area is simply competing with another to capture the same markets (for example, local inward investment promotion or tourism marketing).
- 15) These advantages and drawbacks of decentralisation need to be carefully considered in developing the 2014-20 ERDF programme in England. They point to several potential benefits in enabling local areas to pursue economic growth. However, they also suggest that a local level is not necessarily the most effective and efficient at which to organise and deliver all interventions.

## Messages from the impact evidence

- 16) If the theory points to possible benefits from organising and delivering economic development locally, what is the evidence about its impacts on economic growth? In short, the relationship between economic growth and decentralisation is uncertain.
- There is some evidence that growth rates have been higher in areas with local fiscal powers (i.e. the power to raise and spend revenue locally). However other evidence shows this is linked to the wider performance of the economy, or to the underlying economic strengths of individual areas.
  - Studies have shown that urban areas with the greatest freedom to decide how to invest in education, infrastructure, innovation and enterprises have experienced higher rates of growth. Economic conditions at the time and the economic assets available to an area are also critical.
  - Other research shows that the quality and range of local political and administrative institutions in an area is linked to stronger economic performance. If local capacity is important, the evidence again suggests that the economic strength of an area and prevailing economic conditions are also important factors.
- 17) The overall message is that the way in which decentralising decision making, administrative and fiscal powers contribute to growth is still not well understood. In other words, we cannot be sure that more decentralisation necessarily leads to better economic performance.
- 18) In deciding how local economic development should be organised and how public investment including ERDF is best used, we also need to understand what the evidence tells us about the impacts of different types of intervention. This is a key question for the development of the 2014-20 ERDF programmes which provide a menu of interventions that could be supported with European funds.
- 19) Evaluation evidence shows that a wide range of locally based economic development interventions have generated positive economic benefits. These include new job and business creation, higher productivity, higher business turnover and additional private sector investment in an area. There are some common messages about what works in designing and delivering them:
- Evidence that the selective targeting of investment (for example at high performing small businesses) may generate better returns on investment than broader based approaches.
  - The advantages that local knowledge brings for some types of intervention. For instance, small businesses often point to the benefits of business advisors understanding local markets. This point equally

- applies to some local infrastructure investment such as large employment sites.
- The importance of coordination across different types of investment. The need for loan or venture capital finance to small businesses to be backed by advice about management and leadership is a good example.
  - The benefits of building on interventions with a track record of success, which also has advantages in terms of set up and management costs.
- 20) However, the evidence also highlights the key challenges in designing and delivering interventions:
- A need to ensure that services to businesses and individuals are not duplicated, particularly in smaller local areas. This may lead to the inefficient use of resources and can simply displace the benefits of investment from one area to another.
  - The need for clear and consistent branding and quality control for interventions such as business advisory services. Evaluation evidence points to a preference to work with recognised products and standards.
  - The importance of larger scale organisation and delivery for some types of intervention such as venture capital and loan funds both to spread management costs and secure critical mass in the size of funds.
  - The extent to which the “natural geography” of some activities determines the most appropriate geography to provide support. For example, the supply chain, networking and effective labour market for skills for some sectors (e.g. automotive) may be quite localised. For others the natural geography may be pan-LEP or even national.
- 21) The evidence we have reviewed underlines the positive economic impacts associated with decentralised approaches. It also underlines the point that the best level at which to design, organise and deliver interventions varies between the type of investment and between areas. These are important messages for the 2014-20 ERDF programmes. They point toward a need for pragmatism and flexibility, but also to a need for coordination and clarity of roles between central government and local actors, including the LEPs.

## **Key Messages for the 2014-20 ERDF Programme**

- 22) The principle of local responsibility in ERDF is well established and will be a core feature of the 2014-20 programmes. It has been reinforced by the EU's renewed emphasis on place-based economic development, in which local actors are expected to play a critical part.

Who is best placed to identify the need for ERDF interventions?

- 23) The government has decided to use LEPs in England to drive local growth. This makes sense as LEPs are in practice the new economic development architecture and there is evidence that they (or certainly some LEP areas) will be the most appropriate level at which to pursue many types of economic development intervention.
- 24) However, LEPs are very heterogeneous in their size, their degree of cohesion and their capacity. So it is dangerous to generalise about LEPs overall.
- 25) In developing ERDF investment strategies, a combination of evidence about an area's economic assets, opportunities with evidence about what has worked well in the past will be essential. The LEPs, alongside established local partnerships, are very well placed to marshal this evidence and it is entirely consistent with the responsibilities they have been given. Our research has found strong appetite among the LEPs to carry out this role, albeit with some concern in places where local capacity is relatively limited.
- 26) There is clearly a need to ensure economies of scale and efficiencies of impact are reflected in ERDF strategy design (potentially therefore needing ideally a supra-LEP co-ordinated approach), particularly in relation to:
  - Some business finance interventions such as venture capital and loan funds (but not necessarily micro-finance schemes) - the emerging proposal to develop England-level Financial Engineering Instruments
  - Sector support where a supra-LEP level platform may better suit the geography of these industries (such as automotive or aerospace) which are not necessarily and indeed unlikely to map onto a particular LEP geography
  - Some elements of R&D and innovation activity where nationally or internationally significant research is involved, or where the focus is primarily on enabling SMEs to work with knowledge assets that happen to lie within a LEP area.
- 27) Clarity about where responsibility for designing ERDF interventions is expected to lie between central government and LEP areas will therefore be essential. This applies both to the range of interventions to be encouraged and in some cases to delivery mechanisms. The government should also actively encourage pan-LEP cooperation at the investment planning stage.

What are the implications for the development and delivery of ERDF projects?

- 28) The opportunity for local areas to develop projects should encourage innovative solutions to delivering economic growth and will be essential in enabling LEPs to implement their wider growth strategies.
- 29) Crucially, this approach would be consistent with Lord Heseltine's proposals and the Spending Review 2013 commitment to a Single Growth Fund. In this sense, it offers the potential to link EU funds with other funding to promote



local economic development.

- 30) However, local freedoms to develop ERDF projects need to be balanced with the cost efficiencies and scale advantages of national or larger area projects. This might involve, for example, the government developing a limited number of delivery mechanisms that can be used by LEPs (a pick and mix menu of delivery mechanisms). Innovation vouchers schemes or investments in R&D Centres of Excellence are good examples of this type of project.
- 31) There is a significant danger that a highly localised approach to project design and delivery could lead to inefficiencies, particularly for smaller LEP areas with fewer economies of scale. This has to be set against the opportunity for better targeting and awareness of the needs and opportunities at small geographies.
- 32) Our research has also highlighted concern amongst some LEPs about their ability to mobilise and coordinate project development activity once ERDF strategy is agreed. A commissioning approach may be part of the solution here. LEPs could look to invest their allocations to enhance existing provision (whether local or national) or join forces with other LEPs.
- 33) The clear implication is that many LEPs are likely to need considerable support in project development, and in the appraisal and approval processes which are central to ERDF. Further, careful consideration should be given to the role of the Growth and Delivery Teams and the way they are expected to work with the LEPs in this regard. This is essential both to developing a strong pipeline of ERDF projects and to ensuring progress in allocating ERDF funds in a way which minimises the risks of non-compliance with ERDF regulations.
- 34) Consideration also needs to be given to how expertise, experience and information are sensibly shared across LEPs to maximise the quality of new projects and the use of ERDF. The experience of sharing delivery/evaluation experience across regions let alone across more local areas under the current ERDF programmes has been very poor indeed. The experience of the RDAs was that it took nearly 10 years before an evaluation and shared learning culture started to become embedded. There is a clear danger that the process could take as long with LEPs. This really needs to be designed in and required from the off with the 2014-20 Programme.

How should incentivisation and performance management be approached?

- 35) The 2014-20 programme provides an opportunity for the incentivisation of local economic growth and performance management requirements to work in tandem. Indeed, the government's commitment to a Single Local Growth Fund and the potential for LEP areas to secure investment through Enterprise Zones, business rate retention and other mechanisms arguably offer a significant opportunity to align European, national and local funding to local growth strategies.
- 36) How this will work in practice is still being determined. The government has

indicated that the Single Local Growth Fund is to be allocated through a competitive process, while LEPs will be notionally allocated ERDF, ESF and elements of RDP.

- 37) The two approaches need not be seen as at odds either in process terms or in the range of interventions that might be funded through these mechanisms. There are a number of options to explore:
- If bidding competitively, LEPs could be required to show how Local Growth Fund resources would be used to complement European funded activity (for example devolved skills funding allied with European Social Fund resources).
  - Similarly, Local Growth Fund bids or ERDF applications might be assessed in part on the additional funds they will lever in alongside.
  - How an ERDF project is to strengthen other local investments and contribute to the delivery of local growth strategies could be used as criteria in assessing applications.
- 38) At the core of incentivisation will be the funding mechanisms that enable areas to maximise their draw down of ERDF and use it to pursue their growth objectives. Match funding remains a key requirement of ERDF, and the local partners who design and develop projects will need both some certainty or assurance about match funding sources but also the flexibility to approach match funding innovatively. This points towards:
- elements of future ERDF for local areas being pre-matched at source from central funds. For example, there is potential for TSB funds to be applied in this way, and it is a method that has worked well in previous programmes.
  - freedom for local areas to use devolved or delegated funds to lever in ERDF (and other investment).
  - clarity about what is and is not possible in using private sector contributions as a match funding source.
- 39) While some decentralisation will in its own right provide some incentive to use ERDF effectively, there is also a question of whether and how a reward element might be built in. Committing funding to projects which demonstrate the biggest contributions to programme targets might be designed into the approval process. The allocation of the performance reserve might include an element of allocations to areas which have best delivered against output and crucially results targets.
- 40) However incentivisation is approached, effective performance management will clearly be pivotal to it. The emphasis in the EU's draft regulations on performance against key outcomes (such as new job creation or R&D investment) is confirmed in the government's preliminary guidance to the LEPs. They will be required to show how their investment strategies will

contribute to the overall performance targets for the Structural and Investment Fund programme.

- 41) This presents two key challenges for the government and the LEPs:
- The eventual programme will need to be a mix of national top down priorities and targets and the bottom-up aspirations of the 39 LEPs<sup>2</sup>. National programme targets will rely on the robustness of the LEP-level forecasts of impact and this may under or overstate the reality of their position. The less well-developed are the LEP investment strategies, the less reliable will be any forecasts.
  - A clear position on how performance reward or sanction might be applied will be essential. Performance against spending and outcome targets is expected to be regularly reviewed as the 2014-20 programme is implemented. Some funds allocated to England will be held in reserve and only released by the EU in 2019 subject to performance milestones being met. So mechanisms to carefully monitor progress and potentially reallocate funds need to be designed into the national programme and local strategies.

### **What is required for sound governance, management and administration?**

- 42) Our research has found little appetite among the LEPs to take on the complex responsibilities for the management and administration of ERDF. There appears to be a broad consensus that arrangements based on DCLG as the managing authority for ERDF, with locally based DCLG teams, is likely to be the best approach to handling what is a complex process.
- 43) We have also found broad agreement about the need to simplify and streamline administrative arrangements for ERDF. This need to reduce delays and complexity has been recognised by the EU and the government, and will be important in ensuring that funding is committed and then spent effectively and efficiently to meet targets.
- 44) However, delivering more streamlined arrangements may be more difficult in practice given funding allocations to 39 areas, the challenge of identifying and securing new sources of match funding (including more private sector funds).

### **Recommendations**

- 45) We make a series of detailed recommendations in the final section of our report on future arrangements for handling ERDF. However, from this longer list there are a number of key practical recommendations for the government and its partners to consider if they are to ensure that a programme consisting of 39 sub-elements does offer overall value for money and that the best possible use is made of the resources:

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<sup>2</sup> There were 39 LEPs before the merger of Northamptonshire LEP and South East Midlands LEP in March 2017.

- i. *Recommendation 1:* Provide early clarification of which delivery mechanisms and match funding arrangements are to be nationally driven will be essential. Recently issued guidance to LEPs and the use of an opt in approach appears to be a good starting point in this respect.
- ii. *Recommendation 2:* The need to actively encourage or even if needed require pan-LEP co-operation in certain intervention areas. The government needs to specify in the programme the areas where this is strongly encouraged or expected. Business finance schemes or supply chain development initiatives are good examples.
- iii. *Recommendation 3:* Performance management requires a central intelligence function at the design stage of the programme, but also as project proposals are developed and approved. The LEPs will need to work with a common definition of outputs, results and impacts, using common methodologies and unit cost assumptions to assess targets. Overall, it needs to ensure LEP-level targets are realistic and consistent - so the sum of the LEP targets exceed comfortably national programme targets.
- iv. *Recommendation 4:* The related provision of a central function/service to provide on-going advice on what works, benchmarks and assessing value for money for the LEPs (and potentially supporting the Local Growth Teams in this regard).
- v. *Recommendation 5:* The need for targeted technical assistance support for LEPs, especially those with less well-developed capacity, and particularly in the project development and appraisal functions.
- vi. *Recommendation 6:* There is also case for a national technical assistance project to provide on-going evaluation advice, thematic reviews and support on value for money benchmarks that can help LEPs design projects and also assess value for money locally.
- vii. *Recommendation 7:* The need for a clearly understood and coherent approach to the managing authority function for ERDF, with preferences expressed for a managing authority for the Growth Programme with a local presence in the form of Managing Authority teams.

# 1. Introduction

## Background to the Analytical Programme

- 1.1 The European Regional Development Fund (ERDF) is a key funding instrument of EU Cohesion Policy which aims to promote economic, social and territorial cohesion across the whole territory of the European Union. ERDF is specifically focused upon investment to support economic growth and job creation in order to reduce intra and inter regional economic disparities within the EU. A further round is under development for 2014 to 2020.
- 1.2 The UK's priority is to restore the health of the national economy. This includes targeted interventions in support of local economic growth to strengthen the overall performance of the UK economy and support the rebalancing of the economy, in favour of a strengthened private sector. The objectives reflect the current and future priorities for the use of EU Structural and Cohesion Funds across England and the Devolved Administrations in the funding period 2014-2020.
- 1.3 In the current context of constrained public spending, the ERDF is an important potential source of public funding to support local economic growth. The Department for Communities and Local Government (DCLG) in its capacity as the Managing Authority for ERDF in England has strengthened local management arrangements and increased local influence over the direction of funds.
- 1.4 DCLG, as the Managing Authority, has a responsibility for evaluating the performance, impact, implementation and lessons for the 2007-13 programme, as well as to build on this in developing the new programme for 2014-20 with the European Commission. As part of this responsibility, DCLG commissioned Regeneris, Cambridge Econometrics and Professor Peter Tyler in November 2012 to progress a research and evaluation programme.
- 1.5 The primary purpose of the analytical programme was to deliver a package of evidence that informed the implementation and effective delivery of the next round of ERDF. It consisted of three workstreams:
- 1.6 **Workstream 1:** An assessment of the economic impacts of the current ERDF programme 2007-13. DCLG required an economic evaluation of the types of funding interventions that have worked and, linked to workstream 2, the factors which have been critical to success. The focus was on using counterfactual impact evaluation techniques, informed by the National Audit Office<sup>3</sup> report on evaluation to test the robustness of these approaches.
- 1.7 **Workstream 2:** An assessment of the economic effectiveness and lessons to be drawn from different types of interventions, across a range of relevant policy areas, in supporting local economic growth, as well as the factors which contribute to

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<sup>3</sup> Cross Government Report on Evaluation in Government, National Audit Office, December 2013

successful local economic development.

- 1.8 **Workstream 3:** A review of the role for and effectiveness of decentralised delivery and local incentives in local economic growth and the manner in which this can contribute to national economic growth.

## **Outputs from the Analytical Programme**

- 1.9 A range of reports have been produced as part of the analytical programme. Draft final versions of the reports for workstream 2 and 3 were completed in November and August 2013 respectively. The draft workstream 3 report informed DCLG's consideration of the approach to the delivery and management of ERDF through the LEPs in the new programme period. The draft workstream 2 report informed DCLG's consideration of the types of intervention could be effective in supporting local economic growth through the new ERDF programme and the lessons which should be considered. The report was also shared with the LEPs to inform them in the preparation of their European Structural and Investment Fund plans, which were initially submitted at the end of November and revised in January
- 1.10 The completion of workstream 1 has been completed over the course of 2013 and first part of 2014. Given the nature of the counterfactual approach adopted, it was necessary to focus the analysis on the beneficiaries of ERDF funded SME interventions. It has taken longer to complete the analysis, primarily due to delays in accessing and the matching of beneficiary data to the corresponding business records on the Business Structure Database (which is part of the Interdepartmental Business Register, held by the Office of National Statistics) and the selection of suitable control groups from the same source.

## **Purpose and Focus of Workstream 3**

- 1.11 The purpose of this workstream is to consider how the 2014-20 ERDF programme in England might best be approached in light of the priorities of localism and the need to incentivise local economic growth to assist the recovery from recession. It focuses particularly on the roles and responsibilities of the thirty nine Local Enterprise Partnerships which are set to take on key roles in the 2014-20 programme.
- 1.12 For England, total EU Structural Fund resources are expected to be around €5.2 billion over 2014-20 (subject to final EU budget negotiations). This presents the government and local partners with a major opportunity to use European funds to support local economic development. At the same time, there are significant challenges ahead if the potential benefits of the funds are to be fully realised.
- 1.13 The research has been carried out at a time when the European Commission, UK and local partners are developing investment priorities for the 2014-20 programmes. The ERDF element for England is being built around investment priorities including SME competitiveness, innovation/ research and development, ICT and low carbon.
- 1.14 The material for this report is based on a combination of a review of research literature and empirical evidence, with a series of consultations with representatives of government, the Growth Delivery Teams (GDT), Local Enterprise Partnerships

(LEPs), other local partners and wider stakeholders involved in EU funding programmes.

1.15 This report is structured as follows:

- Section 1 considers the rationale for and benefits of decentralised approaches to the delivery of local economic development. It briefly sets out the principles of localism and the decentralised arrangements that are developing in England.
- Section 2 reviews the empirical evidence on decentralisation and economic development, including evidence on specific types of intervention.
- Section 3 addresses the question of how ERDF might be made to work most effectively to reflect the principles of localism and support the decentralisation of local economic development.
- Section 4 draws together the conclusions of the research and provides a set of key recommendations for the development of the 2014-20 programmes.

## 2. Advantages and Challenges of Decentralisation

- 2.1 The creation of the 39 English LEPs<sup>4</sup> is the key part of a process of decentralising elements of economic development policy in England. While this is still at a relatively early stage, the 2013 Spending Review and the Heseltine review have confirmed local powers to identify economic growth priorities, the availability of funding to pursue them (Single Growth Fund) and responsibilities for developing and managing local investments.
- 2.2 To assess the implications of this emerging decentralisation for the 2014-20 ERDF programme, our report first briefly considers the theoretical literature on decentralised approaches to economic development, their advantages and drawbacks.

### The Case for Decentralisation

- 2.3 In the broadest terms, free markets are regarded by some theorists as the purest form of decentralisation, with centrally planned systems the least decentralised. It is the failure of markets that provides the rationale for coordination and intervention by institutions including governments, and in turn for public policy.
- 2.4 The nature of these market failures is important in understanding why and how public policies are developed and implemented. Central to the rationale for policy intervention are the following types of market failure:
- Externalities and spillovers, where public policy intervention is justified either on the grounds of wider economic and social benefits that the market alone will not provide (e.g. diffusion of a new technology), or where there are costs from production and consumption (e.g. pollution) that arise outside the market.
  - Information failures, where there is insufficient information available in the market to enable rational choices to be made, or to ensure that resources are allocated efficiently.
  - Public goods, where it is not possible (or is exceptionally difficult) to charge for a public service, and where they will not be supplied by the private sector.
  - Coordination failures, where the high costs and widely shared benefits of collective action render it unlikely that the private sector will supply a service.
- 2.5 As an important strand of public policy in its own right, economic development policy addresses a number of these market failures. For example, investment in transport infrastructure, skills development, measures to attract inward investors and services to support business growth are activities whose benefits may be extensive and

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<sup>4</sup> There were 39 LEPs before the merger of Northamptonshire LEP and South East Midlands LEP in March 2017.



realised by many businesses and communities.

- 2.6 While the market failure grounds for economic development policy are reasonably clear cut, they do not tell us at what geographical level (e.g. national, LEP, city region, local authority) different aspects of policy should be organised and delivered. Research from the UK and elsewhere points to wide variation by country, policy type, the form of government, administrative arrangements and economic conditions. The underlying point is that understanding how economic development interventions are best approached is both complex and contested.
- 2.7 The theoretical case for decentralising to a local level centres on arguments about efficiency, effectiveness and accountability or legitimacy in providing these public goods. The thrust of the arguments are that:
- Local actors are better placed than central government to understand how best to target and tailor policies and resources to economic opportunities and needs in their area, and respond to local preferences (Rodríguez-Pose, 1999). These local information and knowledge advantages enable services to be targeted more effectively and provided more efficiently at a local level than centrally.
  - Local networks of public and private institutions and individuals are best able to mobilise and coordinate activity to support economic growth. Locally designed and delivered policy enables an area to capitalise on the networks and relationships that are central to the processes of learning, adaptation and specialisation that mark successful economies, what Streeck (1991) describes as 'social institutions'.
  - These goods should be provided at the lowest possible spatial level to maximise the choice available to businesses or residents of an area about where to locate to take benefit from competitive taxation regimes, investment incentives and different configurations of services (Dowding et al 1994). In turn, decentralised decision making and funding can encourage specialisation as areas compete for advantage.
- 2.8 By enabling local areas to decide how best to support economic development and invest the necessary resources, the literature suggests that decentralised approaches can strengthen economies. Targeted investment in innovation, technology, enterprise, education, skills and infrastructure may contribute to improving productivity, enhancing business competitiveness and reducing economic disparities. It can give local areas the opportunity to develop specialist strengths, investing where they have a competitive edge or the potential to develop one.
- 2.9 There are related arguments that the decentralisation of decision making and funding has positive spinoff benefits in the form of more innovative policies and interventions, although the extent of these benefits is contested (Strumpf 2000). However, this idea that local actors successfully experiment and learn has gained traction practically through the sharing of best practice, for example between local authorities in England through the Local Government Association.

- 2.10 Theory suggests that the strengths of decentralised decision making systems lie in the ability of decision makers to develop and pursue initiatives independently and without the higher level control characteristic of more hierarchical systems (Sah and Stiglitz, 1986). By contrast, while hierarchical systems or centralised systems are seen to limit the choice of decision makers down the hierarchy, the assertion is that they are better able to manage externalities.
- 2.11 Of course, much also depends on the capacity and resources of local public and private sector partners. The literature suggests that the more successful areas are those with stronger local institutions backed by funding (both local and central government) (see for example Pike et al 2006; Rodriguez-Pose, 2010). This constitutes both the formal structures and processes (e.g. political institutions, economic development agencies) and the informal networks, cultural characteristics, rules and norms that are characteristic of different areas.
- 2.12 Research also points to the benefits of decentralised approaches to economic development in terms of strengthening accountability and the legitimacy of policy. The argument is straightforward: decisions about investments that impact on a local economy should be taken as close as possible to the communities and individuals that experience and benefit from these impacts. In turn, this can help to reinforce political institutions and encourage popular engagement with those institutions.
- 2.13 For Seabright (1996), there is a trade-off between the stronger coordination that centralised public policy brings and the problem of 'diminished accountability'. Decentralised government, where regional or local elections determine who governs, who controls policy and the allocation of resources, may improve accountability even where the effects of public policies vary from area to area.
- 2.14 These advantages of decentralised approaches to economic development are now pretty well established in an extensive literature. While there are different views about why and how decentralisation might strengthen an economy, the widespread presence of locally based economic policy in many different countries underlines the currency it has gained. It is also central to the way that the European Union's Structural Funds are designed to work, and therefore important in designing and delivering the 2014-20 ERDF programme.

### **The challenges of decentralised approaches**

- 2.15 If the advantages of decentralised approaches have been extensively explored, the literature also points to a number of challenges. It is important that these are considered both in determining which level or area is the right focus for decentralisation and the types of intervention that should be pursued at different levels.
- 2.16 Foremost among these challenges is the complex issue of spillovers. The delivery of local public goods generates impacts which may extend to neighbouring areas and further afield (Cheshire, 2004). These spillover effects can be viewed in three ways:
- For a local area, spillover effects might be seen as positive, particularly where it has generated the funds to invest (e.g. through local taxation receipts or

business rates). For example, having invested in a programme to help create new businesses, it would look to ensure the benefits of this investment are retained in its area. This might give it a competitive edge over areas where no similar measures are in place.

- However, a local area might see its investment benefit neighbouring areas, perhaps as residents or businesses from other areas use a service or facilities. This is sometimes seen as a problem with locally based skills and training investment, if the result is that residents find it easier to secure work elsewhere (Joumard and Kongsrud, 2003).
- There is also a risk that they result in inefficiencies in the use of public resources. For example, this may arise where publicly funded services in one area are simply replicated in a neighbouring area, and where competition between areas simply displaces economic activity from one area to another.
- Studies of revenue sharing based forms of fiscal decentralisation have pointed to 'common pool' problems where local government may seek to minimise local taxation while drawing on central resources. However, the benefits of this expenditure are internalised to the local area, and may generate a 'pay off' to local government (e.g. improved electoral prospects) (De Mello Jr, 2000; Rodden, 2003).

2.17 In practice, it is very difficult to manage spillover impacts, particularly in small local areas. Many types of public intervention are not easily contained within administrative boundaries. In turn this raises questions about the right level or scale at which to develop and implement local economic development interventions. The literature offers a range of perspectives on this issue including:

- The need for services to be organised and funded across several areas to ensure the impacts of local public policy are 'internalised' and that governments take advantage of the cost efficiencies of larger scale provision (Fujita and Thisse, 2002; Marshall, 2005).
- The role of functional economic areas as the best scale at which to organise and deliver certain types of economic development policy (Bohme et al, 2011; Harrison 2010). The case appears strongest where interventions relate to the role of a major employment centre and its surrounding travel to work area.
- The related concept of city regions, particularly where some form of combined administrative arrangement and pooling of funding resources is present (Robson et al, 2006).

2.18 The key message here is that there is not a simple solution to decentralising economic development policy. The complexity of designing, funding and delivering interventions points towards the need for flexibility about which level or scale is most appropriate, who should determine priorities and how their funding and delivery should be managed.

## **Decentralisation and economic growth**

2.19 There has been recent renewed interest in decentralised approaches to economic development as a result of stagnant economic performance at a national level (Pike et al 2010:6). However, the lack of consensus about the advantages and drawbacks of decentralisation is mirrored in uncertainty about whether and how it might lead to improved economic performance. Some research has found a positive relationship:

- Cheshire and Magrini (2002) identify a link between the capacity of urban governments in several EU states to generate policies encouraging local growth, and the real GDP growth experienced by the functional urban areas in which they were located.
- Analysis by the OECD (2009a) identifies the mix of assets and policy levers (labour, physical/capital infrastructure, education and skills, innovation and business development) that are critical to a region's growth.<sup>5</sup> Areas best able to mobilise these assets and influence the key policies would be best placed to exploit growth opportunities (OECD 2009b).
- There is some evidence that fiscal decentralisation – specifically a high local share in overall government spending – is linked to GDP growth (Iimi, 2005: 459; Rodriguez-Pose and Krøijer, 2009).
- A number of studies suggest a link between administrative and political decentralisation and stronger economic performance (Stansel, 2005; Hammond and Tosun, 2011).

2.20 However, other research is more cautious about the benefits of decentralisation to growth. Thiessen (2003) concludes there were initial dividends from new fiscal decentralisation but that growth peaked and ultimately reversed over time. Bodman and Ford (2004) find that some fiscal decentralisation had positive impacts on capital investment and skills development, but did not lead to growth in output. Others find public services to be less efficiently provided when local authorities competed (Martinez-Vazquez and McNab, 2001).

## Conclusions

2.21 What emerges from this review of the literature is that no one form of decentralisation is seen as the most effective way to organise and deliver interventions to promote local economic growth or tackle disparities between areas. This reflects the difficulty of establishing which factors drive growth (Iimi, 2005: 451; Ashcroft et al, 2005: 6), and the continued weakness of the empirical evidence acknowledged by those carrying out research in this area.

2.22 There is also enormous variation in arrangements across and even within different countries. This applies in equal measure to institutional structures, funding, the range of interventions and mechanisms for incentivising growth. In one of the most comprehensive studies, the OECD (Clark and Mountford, 2007) points to local areas

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<sup>5</sup> Referred to in more detail in the Workstream 2 report.

having a stronger interest in fostering local growth when they directly benefit from returns in the form of the revenues it generates (for example, tax increment financing schemes, retained business rates). However, even in more centralised systems, innovative approaches are possible when local actors are given flexibility to use transferred funds to pursue local priorities or lever in other investment.

2.23 In considering the complex and contested nature and impacts of decentralisation, several issues are relevant to the organisation and delivery of the 2014-20 ERDF programme:

- The theoretical literature does not provide a clear case for decentralising responsibilities for particular types of economic development initiative. Instead, theory suggests there are both market failure arguments and benefits (e.g. encouraging innovative use of resources) which support decentralised approaches across a range of public policies.
- Similarly, the theoretical literature (and indeed the empirical evidence) does not tell us that specific geographies are the most effective level at which to organise and deliver economic development policy, although it points to the importance of scale and capacity in terms of institutional strength, the ability to coordinate policy and potentially to raise resources. Larger urban areas are seen as having advantages in this regard.
- Much of the literature focuses on fiscal decentralisation and the related question of revenue transfers from central to local government. Benefits from the power to back local priority setting with funding are acknowledged in that it may offer local areas greater freedom to develop and implement economic development initiatives. But the literature also highlights risks including the inefficient use of public resources and competition or duplication between areas.
- The potential for decentralised economic development policy to strengthen accountability for the use of public resources, particularly where local decision makers have some degree of control over financial resources (either through revenue raising powers or revenue transfers).

2.24 Decentralisation is a core operating principle for ERDF in that it is explicitly designed to enable investment to strengthen areas with weaker economic performance, and to enable interventions to be designed and delivered sub-nationally. To this end, theoretical debate about the advantages and drawbacks of decentralisation are perhaps of limited value in planning for the organisation and future delivery of ERDF. What matters more is how to make best use of the resources it provides.

## 3. Review of Evidence

- 3.1 If there is little consensus about whether and how decentralisation impacts positively on local economic growth and the reduction of disparities, what evidence is there about the level at which particular types of economic development intervention are best organised and delivered?
- 3.2 These are key questions for the emerging LEP-based arrangements for local economic development, and for approaches to the 2014-20 ERDF programme specifically. This section considers a broad range of intervention types, but focuses particularly on those which are likely to be the main priorities in England's 2014-20 ERDF programme.

### Enterprise Development and Support

- 3.3 European funds have played an important role in business support services, with ERDF used alongside national, regional and local sources to fund new services, or to continue and expand established services. Measures to promote SME competitiveness have been central to the ERDF programmes, and will feature centrally in the 2014-20 programmes.

#### Research Evidence

- 3.4 Enterprise support has been extensively evaluated in England and elsewhere over a long period, and this provides a good source of evidence about the advantages and drawbacks of the provision of such services at different spatial levels. In some cases, these services are targeted at specific localities (e.g. enterprise in deprived areas); while in others they are local arrangements for the delivery or national (or subnational) initiatives (e.g. Business Links).
- 3.5 The key points from this evidence include:
- **Importance of local intelligence and local delivery:** The advantages of being able to tailor services to an area's business needs, with local expertise, together with the knowledge and ability to tap into local business networks seen as benefits of the locally provided services. This was highlighted by the national evaluation of the Local Enterprise Growth Initiative (LEGI) programmes (Amion, 2010: 60). Businesses see value in direct contact with advisers (SQW, 2010:2; Old Bell 3 and Cardiff University, 2012), with large scale beneficiary surveys frequently pointing to the perceived benefits by businesses of a local or sub-national presence rather than remote services.
  - **Need for consistent standards and branding:** Evaluations point to the importance of businesses being able to trust a support service before investing in it, and to the difficulties they face in selecting a service when a substantial range of public and private provision is available (CEEDR, 2011: 77; Aston Business School, 2007; Ekos, 2012: 17). This suggests standards and quality assurance measures being set at a higher spatial level than local

areas to reduce territorial variations in service quality. In turn, this may suggest service design and funding set at a national or at least across multiple local areas (Ecotec, 2010; Aston Business School, 2007; Bratton et al, 2003; Regeneris Consulting, 2008). This message is echoed in studies of business support in other EU member states, (Maltby & Needleman, 2012).

- **Related importance of scale and critical mass:** Higher volume services organised on a higher level scale are able to take advantage of economies of scale in terms of management costs and overheads (back office, marketing etc.). This implies greater efficiency through organising and managing services at this level. This needs to be balanced against the benefits of local interactions between businesses, and between beneficiaries and advisors (e.g. Ecotec 2010).
- **Risks of displacement:** Locally targeted and locally delivered services may bring higher risks of significant displacement effects where business activity simply shifts across an administrative boundary to take advantage of a service offered elsewhere. The national evaluation of the LEGI initiative found high levels of displacement. This was partly attributed to the type of businesses LEGI programmes worked with, which were primarily locally based and competing in a relatively small area (Amion 2010: 55). It is also the result of an intervention which targeted specific localities, creating a more favourable enterprise support environment in areas adjacent to others without similar funding mechanisms. Where supported businesses have fewer local competitors, displacement effects have been found to be lower (Ekosgen 2011). The message here appears to be that, in designing support services, the type of business (location of its markets, business sectors etc.) to be assisted should be carefully considered since this will strongly influence the project's additionality.
- **Need for integrated service provision:** Enterprise support measures appear to work best when they are delivered in tandem with other forms of capital and revenue support). Several evaluations have pointed to business finance (grants, loans, venture capital finance) as the key to delivering positive impacts on business performance, with advice and guidance to businesses assisting in maximising the benefit of financial support.

## **Business finance**

- 3.6 Action to improve the flow of finance to businesses is recognised as a priority by the EU's Common Strategic Framework for 2014-20 cohesion policy. The draft regulations for ERDF 2014-20 call for innovative approaches to financial engineering instruments (FEIs) together with an expansion in scope and the consolidation of existing instruments (Nunez Ferrer et al 2012). Considering how best to organise and deliver business finance will be a key issue in designing and delivering the future programme.

### **Research Evidence**

- 3.7 Research on the impacts of a wide range of business finance interventions points to

several key messages about what works best at different levels:

- **Importance of scale:** Much of the evidence highlights the need for scale and critical mass to ensure the viability and sustainability of venture capital and loan funds (European Investment Bank 2011). The need for large scale funds was one of the main recommendations of the influential 2009 Rowland Review of growth capital to SMEs. It concluded that scale was essential in reducing the fragmentation of provision and in generating economies of scale in terms of operating costs and the spread of risk to investors (BIS 2009). Other research has found drawbacks in operating multiple funds at the same time in an area, including the duplication of processes such as marketing or appraisal, organisational and administrative complexity and confusion amongst businesses (Regeneris 2008: 14; SQW 2010: 45).
- **Information advantages from a local presence and local expertise:** Some research recognises the benefits of local information and networking, for example in generating referrals from local intermediaries who are an essential connection to SMEs for funds (Bennett and Smith 2002: 11; Mason and Kwok 2010: 30). This needs to be balanced against the need to maintain consistent standards and coordinated service delivery. The Futurebuilders initiative, which provided funds to the voluntary and community sector, was found to be a good example of how to achieve this (Wells et al 2010: 19).
- **Challenges for small scale micro-finance schemes:** Small scale micro-finance schemes face particular problems in terms of achieving sustainability and generating legacy returns (GHK 2010: iv-v). Such schemes tend to have higher management costs as a proportion of their investment funds (European Commission 2000: 89).

3.8 The evidence points to the benefits of larger scale funds operating at a higher spatial level, but recognises that local networks and intelligence are essential in identifying new deals and achieving comprehensive coverage. In many respects, this is entirely consistent with the way that large private sector finance providers such as banks operate. Nationally and internationally organised operations provide the scale of resources required, but local delivery is essential in developing and maintaining a client base.

## **R&D and innovation**

3.9 Policies to support R&D and commercial innovation are central to the EU's Common Strategic Framework for the 2014-20 programmes and are a priority in UK economic policy. It is well established in sub-national policies, with many local economic strategies in England recognising the need for and benefits of increased R&D investment to a local economy, the need to develop and retain more higher value, innovative businesses and the associated benefits of a higher skilled and higher paid workforce.

### **Research Evidence**

3.10 There is an extensive literature on innovation policies, much of which considers how



effectively different types of delivery mechanism work. Key findings from this research include:

- **Benefits from national priority setting and coordination:** The literature points to the advantages of nationally driven approaches, particularly where large scale investment in publicly funded R&D programmes is involved (Wolleb and Ismeri 2010; Cunningham and Karakasidou 2009; Pelkonen et al 2008). This is about both the most efficient use of resources and the need to secure the benefits of scale for what are often high cost interventions which aim to establish national or internationally significant strengths.
- **Importance of scale in delivery:** Evaluation of demand stimulation initiatives such as Innovation Vouchers schemes have highlighted both the process efficiencies that this approach brings and their effectiveness in reaching large numbers of SME beneficiaries (Ecotec 2009). Small markets and fragmented governance arrangements have been highlighted as barriers to effective demand stimulation (Kincsö and Edler 2011:19).
- **Value of local information and locally tailored solutions:** There is a trade-off between the coordination of interventions at a higher level and the benefits of local delivery (Technopolis 2011). The national evaluation of the UK Technology Strategy Board's KTP initiative recommended greater delegation of KTP delivery to provide scope for more locally tailored arrangements and to offer greater flexibility for local innovation (Regeneris Consulting 2010: iv). The 2003 Lambert Review of university-business relationships in England explicitly called for an approach that better tailored provision to the needs of local businesses, and recognised the significant benefits that businesses could realise working with universities (HM Treasury 2003).
- **Growing recognition of the role of 'bottom up' approaches to innovation:** There is a growing literature highlighting how globalisation, technological change and social challenges are driving the need for creative local and regional innovation systems (OECD 2005; Servalli 2009). Arguments for city based innovation strategies in the UK have pointed to the changing characteristics of the knowledge economy and to the agglomeration benefits that cities offer in terms of the size and depth of networks of businesses, higher education institutions etc. that are essential to innovation (Athey et al 2007).
- **Uncertainty about the benefits of locally based cluster or sector development:** The idea that firms (and so local economies) may benefit from geographic proximity and agglomeration effects is central to clustering. The role of public intervention, including the use of ERDF, is seen as one of encouraging such concentrations to form and then supporting their expansion. However, the research raises question marks about whether public investment at a local level can have any significant effect on the development of clusters and the extent to which they can make an area's businesses better able to compete nationally and internationally (Uyarra and

Ramlogan 2011; Regeneris Consulting 2006; Brenner and Schlump 2012). Indeed, some studies have called into question the basic value of attempting to create clusters through public policy intervention at all (Muro and Katz, 2010: 18), and to whether clusters have any marked benefits for the prosperity of an area (Duranton 2011).

- 3.11 The direction of travel set out by the EU for the 2014-20 programme points to an approach based on strategies that promote fewer, larger scale investments, competitive specialisation in internationally significant research and commercial strengths and further concentration of resources. The effect of this approach is likely to be to require local strategies to be more clearly nested in national strategy, and for locally based interventions which demonstrate strong connections with EU and national action.

## **Transport, Land & Property and Other Physical Infrastructure**

- 3.12 Capital investment in infrastructure is firmly entrenched as part of the local economic development policy mix. As both an enabler of growth and a means to improve economic, social and environmental conditions in an area, influence and control of infrastructure investment is generally seen as a critical function in decentralised approaches. Transport infrastructure in particular has been regarded in policy as a mechanism to help reduce disparities between territories (e.g. by better connecting peripheral and marginalised areas to better performing areas).

### **Research Evidence**

- 3.13 This theme spans a wide range of intervention types. Some, such as local property development schemes are highly localised while others such as investment in major road infrastructure are essentially public goods whose benefits are extensive. Key, relevant messages from the research are:
- **Local benefits to infrastructure investment, but less clarity about the appropriate level for investment decision making:** Research confirms the enabling benefits of local economic development of targeted transport infrastructure investments to improve the movement of goods, labour and services with examples reviewed including connections between road infrastructure and ports, and investments in rail infrastructure (Mott Macdonald 2012; Ecorys 2006; Steer Davis Gleave 2010). However, it is less clear what is the appropriate level for deciding where and how much to invest, particularly where central government funding is being used alongside local sources (or ERDF). Road, rail or ports infrastructure, for example, are public goods which point to a need for higher level coordination of investment. But in some cases the need for investment is driven by localised problems or growth aspirations, with the benefits of infrastructure most significant in the immediate area.
  - **The need for higher level coordination to manage spillover effects of land and property investments:** Displacement effects and the duplication of provision may contribute to reducing the net gain to a wider area, although the localised benefits (e.g. to a particular community or neighbourhood) may

be significant (e.g. new employment premises). Whilst much of this evidence does not address the question of the appropriate spatial levels for such policies, the mid-term reviews of the current ERDF programmes and project evaluations point to the need to coordinate local investments in such facilities to avoid the risks of duplication etc.

- **The related need for clarity about the potential benefits of investment in the decision making process:** Steer Davies and Gleave (2010) found that, for many projects funded by ERDF, the economic benefits of the investment are unclear. Its research recommended a more rigorous approach to the prioritisation of road schemes in future programmes, which makes clear how the project will remove bottlenecks or promote economic opportunities. This observation might be extended to other forms of infrastructure investment where choices are required about allocating resources to competing priorities.

3.14 It is important to note that the role of infrastructure in the 2014-20 CSF programmes will vary between areas, with less developed areas likely to see higher levels of investment than more developed areas and transitional areas.

## Digital Infrastructure

3.15 ICT has been earmarked as a core priority for the Structural and Investment Fund programmes by the EU. This reflects the rapid advances being made in technology, its application and demand from businesses and individual consumers. In contrast to infrastructure which is more clearly recognised as a public good, for digital infrastructure the overwhelming majority of providers are private and profit making entities, with end users charged for use of the infrastructure.

## Research Evidence

3.16 Major public investment, including ERDF, in digital infrastructure is still a comparatively recent development and there is a limited body of 'final evaluation' type evidence on which to draw for lessons about the best spatial levels for investment decision making and delivery. Relevant findings from the research include:

- **Intervention model should pass risk to the private operator:** Different intervention models for digital infrastructure investment entail different levels of risk to the public and private sector. Public ownership of a broadband network, while it may generate returns to the public sector, brings with it much higher levels of risk and costs. Interventions which are based on ownership and operation of the network by the private sector, but which use public investment to help overcome initial investment uncertainty, reduce the risk to the public sector but also the degree of control it exerts over coverage, expansion etc.
- **Demand stimulation measures are critically important:** Public investment in digital infrastructure, in whatever form it takes, must be accompanied by demand stimulation initiatives. The economic benefits of such investment are driven not by the infrastructure investment itself, but by the uptake of

services by businesses and individual end users.

- **Need for an integrated policy approach to ICT investment:** Research points to the need for careful coordination of policy on investment in this type of infrastructure. Evidence of differences in the economic impacts of broadband investment in different regions have underlined that this type of investment works as an enabling investment alongside other production factors (size and depth of labour force, size and quality of business base) (Eikelenboom 2011).
- **Practical benefits in a local delivery role in ICT infrastructure investment:** There is a good range of international evidence pointing to the positive economic impacts to local areas of investment in ICT (e.g. broadband) and other telecommunications infrastructure (Atif et al 2011; OECD 2009). Studies point to the practical necessity of organising and delivering 'hard' infrastructure investment on the ground, requiring local coordination and frequently locally based suppliers (OECD 2009).

## Low Carbon

- 3.17 Investment in the low carbon sector and in measures to reduce carbon emissions are a comparatively recent addition to mainstream local economic development policy. Nevertheless, driven by the urgent need to find ways to reduce carbon dioxide output, they have become a priority for the European Union and are expected to be a core feature of the 2014-20 ERDF programme.
- 3.18 Evidence about what works in supporting the low carbon economy is still at an early stage, but our research highlights several key messages to consider:
- **Benefit to nationally coordinated policy and investment:** The need for a coherent and coordinated approach to investment in R&D facilities has been recognised given the speed of change in the low carbon sector. The nature of the sector requires an inter-disciplinary and collaborative research effort between public institutions and the private sector spanning local, national and international activity (Natural Environment Research Council, 2008).
  - **Need to encourage innovation and experimentation:** Evaluation evidence points to the need to encourage experimentation and a degree of risk taking both in supporting the development of new low carbon technologies and in creating the mechanisms to promote its adoption (Department for Energy and Climate Change, 2011; Regeneris Consulting, 2010). This is a relatively novel field both for the public sector and for businesses (particularly small and medium sized enterprises) and there is a key role for the public sector to facilitate this. Research suggests that local areas in England are leading the development of some innovative approaches to stimulating R&D and encouraging the transfer of research to businesses and wider communities (Regeneris Consulting, 2010).
  - **Related importance of sustained public sector investment:** Uncertainty about the commercial risks and rewards associated with low carbon sector

development is seen as requiring substantial and sustained public sector investment (Scottish Government, 2010). Grants are likely to remain a key part of the policy mix in the short to medium term. This is critical to tackling the limited information available about where commercial returns are greatest, and therefore to the private sector's appetite to invest in this area. In broader terms, there is a substantial public good value to the reduction of carbon emissions, which reinforces the need for nationally driven interventions.

## **Conclusions**

- 3.19 This review of research about approaches to the organisation and delivery of different types of intervention points to several issues that should be considered in developing and designing the 2014-20 ERDF programme. It suggests that the roles of central government, Local Enterprise Partnerships and other local public and private sector actors should vary across different policy areas and by function (for example strategy setting, coordination, funding).
- 3.20 These findings are summarised in the table overleaf. It suggests what roles might be appropriate to each level, and gives examples of the specific functions that might be involved.

<b>Table 3-1: Appropriate Spatial Levels and Functions for Economic Development Interventions</b>				
<b>Broad Type</b>	<b>Examples of Specific Intervention Types</b>	<b>National or Supra-LEP Level Roles</b>	<b>LEP Area Level Roles</b>	<b>Role of Local Actors</b>
Enterprise Support	General support services	Coordination, programme development and standard setting	Setting investment priorities and targets; programme development decisions on provision of services and resource allocation	Project development and local delivery presence and intelligence gathering
	Sector development	Setting priorities for specialisation	Setting sector priorities for area and linking to national priorities; programme/project development	Support local businesses to plug into sector development initiatives
	Entrepreneurship support to individuals	Overall targets for economy and national programmes	Local area priority setting and development of local area programmes/projects	Project development, delivery to target areas/groups and intelligence gathering
	General SME start up support	Coordination, programme development and standard setting	Setting investment priorities and targets; programme development decisions on provision of services and resource allocation	Project development and local delivery presence and intelligence gathering
Access to Finance	Venture capital and loan schemes for SMEs	National priorities; development, coordination and funding of major schemes; supra-LEP organisation of schemes	Links to national schemes; awareness raising; intelligence gathering	Local delivery presence for funds
	Grant based schemes	National priorities; development of national scheme; supra-LEP development of schemes	Local investment priorities and development of schemes for area; coordination of delivery	Project development, delivery and intelligence functions
	Micro-finance schemes	National policy & some scope for supra-LEP organisation of provision	Local investment priorities; some allocation of funding resources	Local organisation and delivery essential
Innovation,	R&D infrastructure investment	Setting priorities for major investment and specialisation	Identifying how local R&D infrastructure connects to national priorities, and what investment required	Support local connection to key R&D facilities and enterprise support programmes
	Early stage commercialisation support	National priorities and programmes funded centrally; supra-LEP level to provide	Identifying local requirements and linkages to national or supra-LEP level programmes	Ensure local actors are aware of and engage with support activity

R&D		scale		
	Innovation support to SMEs	Some national programmes and funding mechanisms	Combination of local investment priorities and programme/project development; links to national programmes;	Local delivery presence essential; local intelligence function
	Development of broader innovation ecosystem	Limited number of national or supra-LEP level initiatives	Local priority setting; some coordination functions; project development	Local delivery presence essential, together with intelligence function; project development
Infrastructure	Transport	National or supra-LEP level priorities; allocation of resources; national or supra-LEP coordination of funding and delivery	Local investment priorities; coordination across LEP areas; project development some resource allocation	Role in delivery of investment on the ground; some project development
	ICT	National priorities and provision of funding	Links to national programmes; local investment priorities and coordination of investment	Investment delivered in specific localities
	Sites and Premises	National funding schemes	Set local investment priorities; bidding into national schemes; allocating funding for schemes	Delivery in local areas; project development
Low Carbon	Research and development	National priority setting, funding and coordination	Assess how area could work within national framework and coordinate local links to national initiatives	Provide local intelligence and awareness raising to ensure business & communities engage with facilities and services
	Sector development	National priority setting and funding	Area sector priority setting and coordination of local public and private sector funding to work alongside central funding	Local initiatives to ensure businesses engage with sector development activity
	Resource efficiency initiatives (businesses and communities)	National target setting and mix of central, devolved and delegated funding	Priority setting and potential to coordinate project development and funding	Delivery of locally targeted projects – some locally designed, others based on national initiatives

## 4. Messages for the 2014-20 ERDF Programme

- 4.1 This section brings together the evidence about what works in decentralised approaches to economic development with an assessment of the implications for the emerging model for the 2014-20 ERDF programme in England. It highlights the key messages for the government and its partners to consider in designing and delivering local growth programmes and the next ERDF programmes.

### Principles of the 2014-20 ERDF Programme

#### Common Strategic Framework

- 4.2 The CSF provides the EU's overarching framework for the 2014-20 Structural and Investment Funds programmes covering ERDF, ESF, EAFRD (Agriculture and Rural Development) and the EMFF (Fisheries) and the Cohesion Fund for the least developed EU states. The CSF approach is intended to improve the coordination of investment activity across the Structural Funds and is based on a number of principles:

- The concentration and targeting of resources on a common set of objectives defined by the EU 2020 strategy
- Simplification of both the process of developing strategy and delivering the funds
- Stronger emphasis on performance management and outcomes
- Harmonisation of eligibility rules and the extension of what are described as simplified cost options (European Commission, 2012a).

- 4.3 The CSF's investment priorities, including those proposed for ERDF, are driven by headline objectives and targets for the EU, principally those identified in the EU2020 initiative and the National Reform Programme. These are crucial in designing England's ERDF programme since they will shape the outcomes that it is expected to achieve by the EU.

#### European Union Key Targets

- 75 per cent employment rate for 20 to 64-year-olds to be employed
- 3 per cent of EU GDP invested in R&D
- Access for all to broadband speeds of 30 megabytes per second (MBPS) or more by 2020, and 50 per cent at 100 MBPS
- Reduction of school drop out rates to below 10 per cent and an increase in the proportion of graduate level educated 30-34 year olds to 40 per cent
- Greenhouse gas emissions to be 20 per cent lower than in 1990, with the EU producing 20 per cent of energy from renewable sources and the achievement of a 20 per cent increase in energy efficiency
- A cut of at least 20 million people in or at risk of poverty and social exclusion



4.4 For ERDF, there is an even stronger emphasis than in previous programmes on the low carbon economy, SME competitiveness, commercial innovation, research and development. Together, these investment themes are expected to account for 80 per cent of programme investments in more developed and transitional areas, and 50 per cent in the lower performing areas. These will strongly influence the scope of England's programme and the types of activity that local areas might look to develop and deliver:

- **Innovation** – The need for research excellence, internationally competitive R&D activity and the targeting of resources are reflected in the requirement for ERDF programmes to include 'smart specialisation strategies'. Driving up commercial innovation is a key priority alongside this. There is also strong emphasis on innovation to tackle social challenges (e.g. ageing population, impacts of global warming).
- **SME Competitiveness** – The emphasis is on SMEs' role in economic growth and job creation, with the key actions identified by the Commission including support for innovation, SME finance and internationalisation (European Commission 2012c: 9). The latter reflects the recognition that more SMEs need to become export oriented.
- **Low Carbon** – Low carbon covers the most comprehensive set of actions under three individual themes. The Structural Funds are expected to support the development of the EU's environmental technologies sectors, the drive to reduce CO2 emissions (both industrial and domestic) and adaptation to climate change.

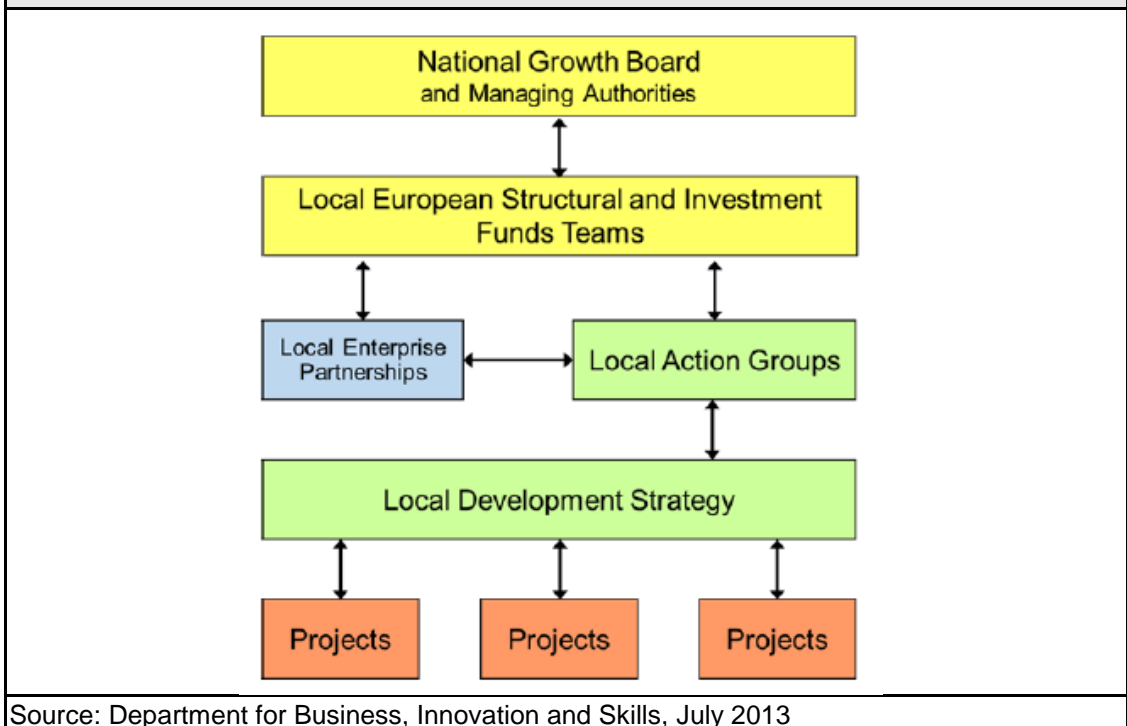
4.5 Among the other EU investment priorities ICT is also set to be a key feature of England's ERDF 2014-20 programme. The EU's focus is on high speed internet access, digital communications technologies and ICT uptake by businesses

### **The Emerging ERDF Model in England**

4.6 LEPs will be central to the 2014-20 programmes. The 2013 Spending Review and the government's response to the Heseltine Review confirmed that LEPs would be asked to develop EU funding investment plans to work as part of an integrated package with wider local area growth plans. England's ERDF programme would be a result of both these investment priorities and those of the LEP.

4.7 The government's guidance to Local Enterprise Partnerships sets out its emerging view of priorities and possible interventions, together with broad governance arrangements. This framework is shown in the diagram below.

**Figure 4-1: Emerging Model for England**



4.8 The key features of the emerging model in the context of localism and decentralised local economic development include the following:

- A Structural and Investment Fund programme for England will set out the objectives for ERDF and the other EU funds. Innovation/R&D, SME competitiveness, low carbon and ICT are the main areas for ERDF investment.
- Each of the 39 LEPs<sup>6</sup> is asked to develop an investment strategy for its area, identifying investment needs and opportunities, how it would like to invest funds and the outcomes it expects to achieve. These are expected to be linked to LEP growth plans and to the Single Local Growth Fund outlined in the 2013 Spending Review.
- Each LEP area has a notional funding allocation, which it is expected to target towards its investment objectives and the measures it wishes to support.
- Government departments (DCLG, DWP, DEFRA) will be the Managing Authorities for the Structural and Investment Fund programmes, with Local European Structural and Investment Fund teams providing a locally based presence to manage and administer ERDF.
- Wider local partnerships will continue to be the cornerstone of arrangements for local decision making about EU investment, with the overall programme overseen by a National Growth Board.

<sup>6</sup> There were 39 LEPs before the merger of Northamptonshire LEP and South East Midlands LEP in March 2017.

- 4.9 The recently agreed EU budget for 2014-20 committed €325 billion to cohesion policy, with estimates for the UK suggesting an ERDF allocation that will be similar in nominal terms to the current 2007-13 programmes. Subnational areas within the EU will fall into three categories for the allocation of the Structural Funds.

Category	Eligibility	Probable NUTS2 Areas in England
Less developed areas	GDP per capita less than 75% of average for 27 EU states	Cornwall
Transitional areas	GDP per capita between 75% and 90% of average for EU states	Cumbria, Devon, Lincolnshire, Tees Valley and Durham, Shropshire; Staffordshire, South Yorkshire, and Merseyside.
More developed areas	GDP per capita in excess of 90% of average for EU states	All other NUTS 2 areas

## **ERDF Performance Management and incentivisation**

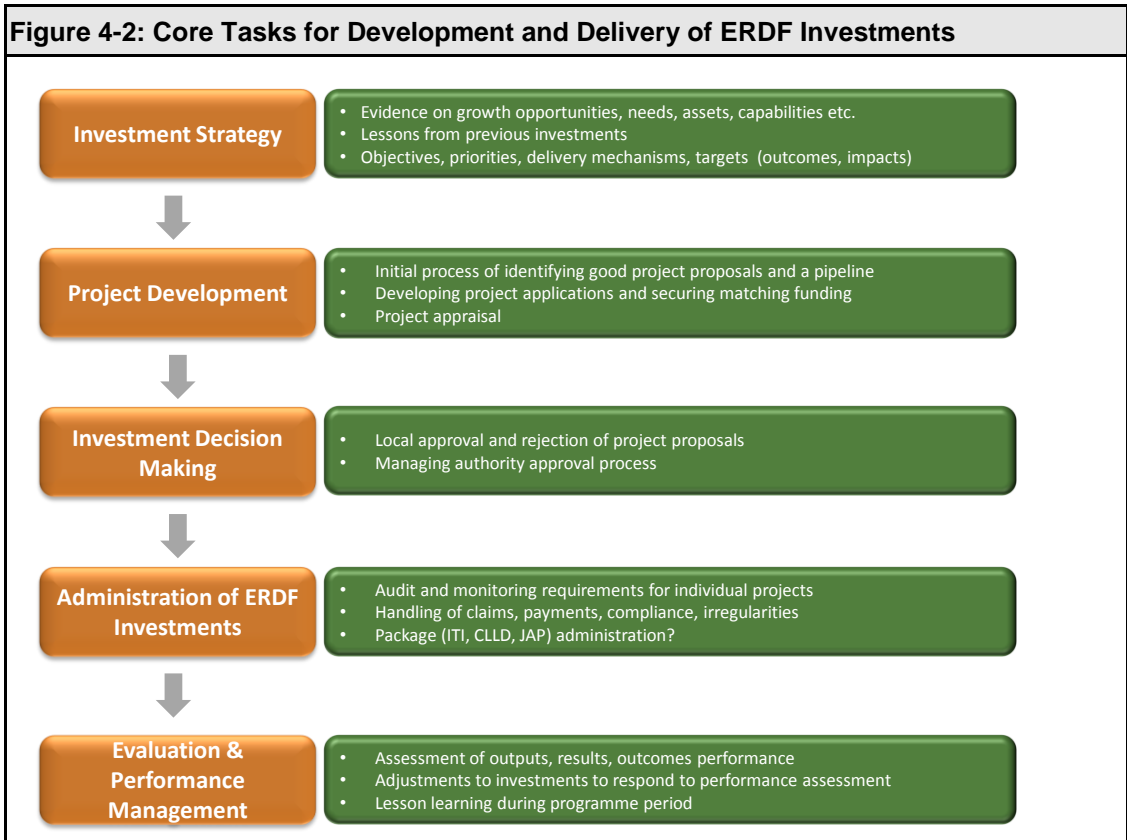
- 4.10 The EU's draft regulations for the Structural Funds signal a shift to a stronger performance management framework (European Commission 2012b). This is based on the following:

- 7 per cent of a programme's allocation will be set aside in a performance reserve to be released to those EU states that meet spend, output and results milestones at review in 2018.
- The government would then agree with the European Commission how this reserve would be allocated in support of the national ERDF programme.
- The regulation also indicates that failure to deliver against targets could lead to a suspension of funds or, in case of what is described as 'serious underachievement', the cancellation of funds.

- 4.11 This development has important implications for the local investment of ERDF in England. Local strategies will have to be clear about the targets they seek to achieve and how the proposed investments deliver them. It should also be seen as part of the broader question of how best to incentivise local areas to invest EU funding effectively in support of key economic development objectives.

## **Key Messages for the ERDF programme**

- 4.12 The relationship between local areas (LEPs and local governance partnerships) and the Managing Authority will be critical to the way ERDF 2014-20 works in practice, in terms of developing investment priorities and in the delivery and management of future investments. This is a complex challenge with commitments to flexibility and simplification needing to be balanced against the need to meet the requirements of the EU's regulations.
- 4.13 There are several core elements to the arrangements for the development and delivery of the 2014-20 ERDF programmes in England. These are summarised below.



4.14 In assessing how the 2014-20 programmes might best be approached in light of the principles of localism, this section considers each of the main tasks in turn.

## Setting ERDF Priorities

4.15 The delegation of ERDF strategy setting responsibilities to LEPs has several implications:

- 1) In effect it devolves the responsibility for developing investment strategies to a smaller geographic scale than was the case when partnerships in NUTS 1 areas (regions) with some NUTS 2 areas (Objective 1, Convergence, Transitional areas) carried the responsibility.
- 2) It potentially greatly increases the number of ERDF, ESF and RDP investment strategies that will be in place across England, and the individual investment priorities that areas will identify.
- 3) It requires a strong fit between local LEPs and national priorities and targets. National spend, output and results targets for ERDF (and thus performance against milestones) will be determined in large part by the effectiveness of sub-national and local investment activity.
- 4) With representatives of large employers and SMEs prominent on the boards of LEPs, private sector involvement in setting priorities for ERDF funds is set to be stepped up.
- 5) Business focused LEPs will need to recognise that wider partnership

arrangements for decision making on local ERDF strategies and on projects to be funded will be required in line with the EU's regulations (Article 9, draft regulation). This includes other public authorities, economic and social partners, NGOs, the voluntary and community sector, environmental bodies and representatives of equality and diversity organisations.

- 4.16 In effect, strategy setting responsibility is delegated to LEPs. This approach is consistent with the wider range of functions that LEPs are being tasked with by the government, and particularly with the roles they are taken on in driving wider local economic growth strategies.

### **Possible Challenges**

- 4.17 Nevertheless, there are challenges for both local partners and central government in this aspect of the emerging model.

- **Funding needs to follow priorities:** A combination of priority setting responsibility and influence or control over the resources allocated to those priorities will be essential in securing the commitment of local partners to work with ERDF. This will provide part of the incentive to set ambitious investment strategies and stretching targets.
- **Balancing scale and coordination with local flexibility:** Evidence of what works in ERDF points to the need for larger scale interventions such as Knowledge Transfer Partnerships, Innovation Vouchers Schemes or resource efficiency advisory schemes to operate across multiple areas. The national programme and LEP investment strategies will need to strike a balance between higher level coordination and funding, and arrangements which reflect local intelligence, assets and priorities. This points to a mix of ERDF investments which combine national and locally driven priorities.
- **Minimising the risk of duplication and inefficiencies:** The creation of 39 investment strategies with funding allocations behind them potentially increases the risk of duplication of ERDF supported activity in adjacent areas (e.g. identical business support services operating in two neighbouring LEP areas).
- **Recognising the wide variation in capacity between LEPs:** Some LEPs, particularly those which are based on more established local institutional structures and partnerships, are likely to be better equipped to identify, set and then deliver investment priorities than those with fewer resources.

- 4.18 In setting investment priorities, the key task will be to reconcile the national programme with 39 individual investment strategies. This will be an important test of relationships between central government responsible departments and the LEPs.

### **Lessons from the 2007-13 Programmes**

- 4.19 The research has pointed to a number of useful lessons from the 2007-13 programmes in approaching the setting of investment strategies in the 2014-20

programmes:

- Mid-term ERDF programme evaluations suggest benefits from a smaller number of core priorities and specific action areas in terms of clarity for project applicants and partner organisations, the development of an investment pipeline and efforts to reduce the risks of duplication or overlap between investments (e.g. Regeneris Consulting, 2010a; Regeneris Consulting 2010b).
- There are benefits in developing specific delivery vehicles for particular types of intervention at an early stage. For example, Innovation Connectors in the North East ERDF programme have helped to create efficiencies in the management and administration of such projects.
- The related benefits of drawing on established national investments and delivery mechanisms as part of an investment strategy, with initiatives such as the Knowledge Transfer Partnerships, Innovation Vouchers Schemes and Manufacturing Advisory Services regarded as effective mechanisms for delivering large scale support using widely recognised services and schemes.
- The need for investment strategies to be responsive to changes in economic conditions, national and sub-national policy priorities, match funding provision and institutional arrangements. This includes being able to adjust investment pipelines, pursue new or alternative project activity and adapt target frameworks.

## **Recommendations**

4.20 Our review points to a number of recommendations relating to the development of ERDF investment strategies:

- 1) Provide early clarification of which delivery mechanisms and match funding arrangements are to be nationally driven will be essential. This guidance is a starting point in this respect.
- 2) The government should set out a clear position on what is expected in terms of collaboration between LEPs (which investment themes, what types of interventions) and how such collaboration might be incentivised.
- 3) Explain how the government will work with local areas to ensure coherence between local growth programmes and 39 local area investment strategies. In effect, some form of 'clearing' arrangement will be necessary and local partners will need an early understanding about how this will work.
- 4) Disseminate evaluation findings and research about lessons learned from previous programmes, evidence about what works in local economic development and best practice examples from across the EU.

## **Project Development**

4.21 Translating investment strategies into a strong pipeline of ERDF projects will be

critical to the programme's success. This will require a mix of locally driven project development activity with nationally led projects and delivery mechanisms. There are several issues to consider in creating an effective project development process:

- 1) **Potential value of a commissioning role for LEPs:** While a mix of approaches could be adopted (e.g. open calls for projects under a particular investment priority, closed calls, commissioning of specific providers), a key task will be to ensure that project development activity is fully geared to the LEP's strategy. To this end, a commissioning approach is likely to better enable the coordination of project development than more flexible approaches such as open calls.
- 2) **A need to reach out to potential delivery organisations:** Past experience points to the value of a wide range of applicants from the public, private and third sectors in local areas with the capacity to generate good quality projects. This means LEPs being well connected to local networks of such organisations.
- 3) **A need for expertise and resource capacity to assist in project development:** Applying for ERDF can be a complex process with requirements such as state aid compliance and eligibility demand specialist knowledge.
- 4) **The importance of robust project appraisal processes:** This is critical given both the formal requirements for compliant projects and the need to secure projects that will deliver against spend, output and results targets.

### **Possible Challenges**

4.22 The research suggests that this is perceived to be one of the more challenging aspects of the delivery of the 2014-20 programmes. Changes in the institutional arrangements for the coordination of ERDF and resource savings by public and third sector organisations have created uncertainty about how the development of future ERDF projects at a local level might best be supported. The following are highlighted:

- Clear recognition of the need to be innovative in assembling funding packages including ERDF to support local investment priorities.
- The importance attached to securing higher levels of private sector match funding than has been the case in previous programmes. Engaging private sector partners in what is a complex funding regime is challenging in its own right, but past experience (for example with private sector capital investment or SME contributions to business support) has highlighted the practical difficulties involved.
- A lack of previous experience of working with ERDF amongst potential applicants and constraints on resources. The extent to which this is a problem is likely to vary from LEP to LEP depending on the strength of their local partnership arrangements and the resources available to support project development activity.

- A key challenge will be to ensure effective working relationships between LEPs/wider local CSF partnerships, the Managing Authority and those responsible for assisting project development and appraisal. How the Managing Authority teams are configured and how they work with the LEPs and local partners will be crucial to this process.

### **Lessons from the 2007-13 Programmes**

4.23 Key lessons from the evaluation evidence include:

- 1) The benefits of securing a mix of project applicants which includes organisations experienced in delivering ERDF. This provided a way of securing early and often large scale investments by the new programmes.
- 2) The merits of commissioning-based approaches to developing a project pipeline for programmes, particularly in their early stages. In other words, start early in identifying projects and delivery mechanisms.
- 3) The value of a being able to draw on a 'call for projects' approach to projects both in securing innovative projects and in maintaining spending commitments.
- 4) The importance of the personnel and expertise to support the development of good quality ERDF, ESF and RDP projects stands out as a critical factor in the effective investment of the funds, with the current PDTs and ERDF experienced local partners having been central to providing this function.

### **Recommendations**

4.24 The research suggests two main recommendations to consider:

- 1) The government should identify and develop at an early stage nationally led interventions and delivery mechanisms with an element of pre-matched funding for ERDF. LEPs could 'buy in' to these using their notional allocations to provide local match funding where necessary. The decision to offer an opt-in approach covering a number of national programmes (e.g. Manufacturing Advisory Service, Growth Accelerator) suggests this is the likely to be an important feature of the 2014-20 programme.
- 2) Some TA funds to support the development and delivery of LEP EU strategies may be earmarked. With investment unlikely to commence until mid-late 2014, there are strong grounds for investing resources now to ensure that local areas are well positioned to make early investments.

### **Incentivisation and performance management**

4.25 Detail is still emerging of the ways in which incentivisation and performance managing might work in the 2014-20 ERDF programme. The European Commission has signalled a stronger emphasis on performance management for the new programmes. For each programme, a 7 per cent performance reserve will be held, to be released in 2019 following what is effectively a mid-term review of the programme's performance against spend, output and results targets.



## **Key challenges**

- 4.26 Securing match funding will be challenging at a time when the downturn in economic context has affected the investment resources available to the public and private sector. Nevertheless, it is a key question for the design and development of the 2014-20 programmes. Project developers (and the LEP areas) will require some certainty about match funding sources to back their investment priorities, and this should be seen as an incentive to invest ERDF effectively in its own right.
- 4.27 However, this need for certainty must be balanced against the flexibility for areas to assemble match funding from their 'own resources' and approach it creatively. The creation of the local growth fund and the availability of locally controlled resources, through for example repayments from Growing Places Funds and retained business rates from Enterprise Zones, are among the mechanisms that LEP areas are already considering as part of a possible match funding pot for ERDF.
- 4.28 In terms of the performance management requirements, the following issues need to be considered:
- How to develop an approach to target setting that enables potentially 39 sets of LEP targets from investment strategies to be reflected at national and programme level.
  - Conversely, how to ensure that the targets to which LEPs commit add up to (or better still exceed) the targets agreed between the government and the European Commission for the national programme.
  - The development of a target framework which can be applied consistently across all LEP areas both in terms of the performance measures themselves (e.g. job creation, private R&D investment) and measurement methods. This will be essential if the return on investment and potential impacts of an ERDF project are to be compared against another.
  - How the government and local partners will approach the allocation of the performance reserve, subject to the LEPs achieving their performance targets at the 2019 review.
  - Where responsibilities for performance monitoring and (if necessary) remedial action will lie. How LEP areas might be held to account for their performance against the targets set in their investment strategies is not yet entirely clear.

## **Lessons from the 2007-13 Programmes**

- 4.29 Evaluation evidence points to a number of relevant lessons including:
- The value of matching ERDF (and other EU funds) at source, which brings an element of certainty for project developers.
  - The complexity of private sector match funding, which has resulted in some programme areas deciding against using it and others having successfully

matched ERDF with contributions from for example SMEs, large companies or property developers.

- The need for a consistent and centrally determined approach to defining outputs and results targets and approaches to measuring them. Comparing programme performance has been challenging in the face of an extensive set of indicators.
- The related value of metrics which enable investment decision makers to weigh up the potential benefits of different types of intervention. Differences of approach to calculating the value for money of investments have led to some uncertainty for those responsible for approving projects.

## Recommendations

4.30 Our research suggests the government and its partners should consider:

- 1) The need to provide detail about how the performance reserve might be implemented, particularly the criteria which might be used to allocate funding to LEP areas in 2019.
- 2) The creation of a central intelligence function at the design stage of the programme, and also for project development and approval. The government and the LEPs will need to use common definitions of outputs, results and impacts; single methodologies and unit cost assumptions assess targets. This will be essential if LEP-level targets are to be realistic and consistent so the sum of the LEP targets comfortably exceeds national programme targets.
- 3) Further clarification on the 'freedoms and flexibilities' available to LEPs relating to the way ERDF and other public funding can be used. These should be seen as an incentive to make the most effective use of ERDF in its own right.

## Governance and investment decision making

4.31 The LEPs and their local partners will expect to take responsibility for overseeing the delivery of their investment strategies and for decisions about which investments to support. Such responsibility, coupled with delegated or decentralised funding through notional allocations, should be counted among the incentives that will encourage local areas to work with ERDF to support growth.

4.32 This research has highlighted three main issues for the government and LEPs to consider:

- 1) **Balancing local decision making responsibility with the need for compliant investment:** How the priority attached by LEPs and their partners to specific investments will be balanced against the formal requirements for ERDF project approval (appraisal, conditions attached to investment etc.).
- 2) **Meeting EU requirements for partnership decision making:** Broad based local partnerships must be centrally involved in the implementation of

programmes i.e. in strategic investment decisions and programme oversight, and this should be an early priority as the LEPs prepare their strategies.

- 3) **Reconciling local decision making power with a national programme:** The content of the national programme and expenditure, output and results targets will be agreed between the government and the European Commission. The government and LEPs will need to ensure that approved investments are geared towards meeting these targets.

### **Possible Challenges**

4.33 Our review suggests several challenges that the government and LEPs will need to address in designing governance arrangements for the 2014-20 programmes:

- Too little direct responsibility for local areas in investment decision making is likely to serve as a disincentive to engage with the funds, so a careful balance will need to be struck between central government and local roles in investment approval.
- The sheer volume of decisions is likely to prove challenging. With potentially 39 areas developing projects, clearly delegated and streamlined decision making arrangements, perhaps underpinned by approval limits in terms of the value of projects, will be essential.
- There remains potential for different forms of delegated and devolved delivery arrangements to be agreed with local areas (Integrated Territorial Investments, Community Led Local Development). How such arrangements work in the context of a national programme will need to be specified prior to the approval of such mechanisms.

### **Lessons from the 2007-13 Programmes**

4.34 The current programmes suggest several lessons to be considered for the 2014-20 programmes:

- The importance of an intelligence led process, with mechanisms which enable the strategic fit, costs, activities, and potential benefits etc. of projects to be assessed and fully understood by decision-makers. The current programmes have achieved this through a combination of good quality information to investment decision making committees, and through advisory and decision making structures in which expert input (e.g. West Midlands Priority Working Groups, South West Endorsement Advisory and Commissioning Delivery Group).
- Constructive and well-informed local partnerships are valuable in good investment decision making and programme oversight. The mid-term evaluation evidence suggests that the most effective partnerships are those in which members are thoroughly engaged with the programme strategy and are provided with timely and high quality management information about implementation and performance.

- The importance of processes which allow investment strategies and project development arrangements to be quickly and flexibly adjusted. For example, the use of open call or commissioning processes to address gaps in investment portfolios has been a notable feature of current programmes.

## **Recommendations**

4.35 Four recommendations emerge from the research:

- 1) Early detailed clarification of the respective decision making roles and responsibilities of the LEPs, local partnerships, government and the Managing Authority will help ensure a smooth transition from the current to the future programmes.
- 2) Develop basic unit cost information to help understand and assess value for money in proposed investments. Stronger emphasis on performance milestones and the 2018 review will certainly need to be reflected in investment decisions.
- 3) Where this is not already taking place, the LEPs will need to work with local partners, possibly through existing Local Management Committees, to develop the governance partnerships required by the EU regulations.
- 4) Early agreement of any delegated limits for local investment decision making and project value thresholds if appropriate. This will play a part in shaping investment strategies and project pipelines.

## **Management and Administration**

4.36 There are some core principles which will be essential to the sound management and administration of the 2014-20 ERDF programmes:

- 1) Compliance of CSF investments with EU and national law (e.g. state aid law).
- 2) Eligibility rules, which are especially significant in determining whether expenditure by programmes and individual projects meets the EU's regulations.
- 3) Effective management and control systems to monitor and verify expenditure, with audit remaining a core process in the administration of CSF investments.

4.37 The role of the Managing Authority is extensive and critical here, spanning the contracting process with individual projects, the full spectrum of systems and verification requirements, the processing of claims and payments, performance monitoring and reporting to the European Commission. For ERDF, DCLG will maintain managing authority responsibility, giving it a central role in compliance to minimise the risks associated with under-performance and irregularities, including the clawback of funding.

## **Possible Challenges**

4.38 The key challenges for the government and LEPs to consider include:

- The cost and complexity of managing and administering ERDF. While larger local bodies with more substantial capacity and funding might be better placed to exercise such functions, generally speaking they are probably beyond the capacity of many institutions at the local level and are better delivered by national or higher level sub-national bodies.
- The additional challenge of working with organisations, including the LEPs and delivery organisations, which may be new to ERDF.

### **Lessons from the 2007-13 Programmes**

4.39 The evaluation evidence from the 2007-13 programmes suggests several issues to be considered in developing new management and administrative arrangements:

- 1) The need to reduce delays in the process of moving from approval to contract with projects, partly a result of the detailed systems and process checks required for compliance.
- 2) The desire on the part of applicants to simplify aspects of the audit and verification requirements, with problems such as the eligibility of overheads for universities and delays in paying claims until project engagement visits are carried out. This can be a deterrent to project applicants engaging with ERDF.
- 3) The importance of clear guidelines and advice to applicants produced by the Managing Authority. For example, uncertainty about aspects of eligibility rules features in a number of programme and project evaluations.
- 4) The value to projects and programmes of the expert advice provided by representatives of the Managing Authority, particularly with regard to the application of the more complex aspects of the regulations (e.g. state aid, Article 55 revenue generation).

### **Recommendations**

4.40 There are two main recommendations from our research:

- 1) While a small number of LEP areas and their local partners might take on aspects of Managing Authority responsibilities, the best solution would appear to be a single Managing Authority for the ERDF element with the possible exception of London.
- 2) There is clear backing for the government's commitments to streamline and simplify ERDF management and administration processes where this is possible. The government should look to the experiences of the current GDTs, local partners, projects and the evaluation evidence in devising these processes.

### **Monitoring, Evaluation and Performance Management**

4.41 Effective monitoring, evaluation and performance management procedures will be crucial to the sound management of ERDF and to implementing any incentive based

approach across the LEPs. The main requirements are:

- 1) **Focus on EU 2020 targets:** In developing performance frameworks and indicators, setting individual targets and devising strategies for ERDF, the government, LEPs and local partners will need to focus in particular on results and impacts including increased R&D expenditure, the creation of employment, reductions in carbon dioxide emissions and improved broadband speeds.
- 2) **Produce good quality and timely management information:** With 39 strategies in delivery and a national programme, effective processes for monitoring and sharing information about the performance of investments will be critical. There needs to be a clear picture at any given point in time.
- 3) **Effective accountability mechanisms:** With stronger emphasis on measuring progress and the milestones review in 2019, there will be a requirement for accountability mechanisms which flag under-performance and enable the government and LEPs to respond to it.

### **Possible Challenges**

4.42 There are several challenges in agreeing and delivering an effective performance management framework between the government and LEPs:

- How the government and LEPs will ensure that investments meet (or exceed) the targets set by the Structural and Investment Funds programme when responsibility is relatively dispersed.
- How to hold LEPs to account for the performance of investments relating to their strategy. While there are mechanisms for dealing with performance problems with individual projects, the formal status of the LEPs varies from area to area and it is likely to be difficult to develop a coherent accountability mechanism.
- The extent to which the EU2020 targets might limit and constrain the objectives and investments that the government and individual LEPs areas seek to pursue.

### **Lessons from the 2007-13 Programmes**

4.43 Evidence from the current programmes highlights several messages to consider in developing performance monitoring and management arrangements for the 2014-20 programmes.

- 1) The difficulty of designing targets early in the programme development process when the nature of actual investments is unclear. The government and LEPs need to be smart in setting targets (for instance, not setting economic growth targets if the activity is essentially about reducing carbon dioxide emissions).
- 2) The sequencing of investments over an extended period and the time lag

involved in seeing the impacts of investments (e.g. net increases in employment, net additional gross value added) make it difficult to build an accurate and comprehensive picture of results performance during the delivery of the programme.

- 3) Investments in innovation infrastructure and in measures to support commercial innovation appear to face particular challenges in demonstrating impact. This is attributed in several evaluations to the long lead in times for early stage investments in R&D, the development of intellectual property and the development and testing of new products to generate commercial benefits.
- 4) The large number of projects and the costs and complexity of monitoring the effects of project activity on beneficiaries has also presented difficulties in capturing the impacts of ERDF investments. There has been a lack of consistency in the way this is approached in different programme areas.

## **Recommendations**

4.44 Three recommendations arise from the research:

- 1) The need to assess the results and impacts of ERDF investments will require a renewed focus on the evaluation of programmes and projects. Standard performance monitoring processes will continue to capture the outputs and aspects of the results delivered by projects (e.g. reported number of jobs created by business beneficiaries). However, impact assessment will require more robust and sophisticated evaluation of the net effects of investments.
- 2) The related need to shift the emphasis from expenditure, outputs and process to emerging results and impacts in mid-term and interim programmes and project evaluations.
- 3) The limited evidence available from programme and project evaluations for the 2007-13 programmes points to specific types of ERDF investment that appear to have generated the biggest impacts in terms of employment and improved business performance. In designing the 2014-20 programmes, this evidence should be considered both in identifying specific investment priorities (by type of investment) and in setting programme targets.

## **Conclusions**

4.45 The design, development and delivery of the 2014-20 programme for England are challenging tasks for the government and its local partners. Commitment to the principles of localism, including the key functions that the LEPs have been tasked with, requires a balance to be struck between local responsibility for determining how (and how much) ERDF should be invested, and the need to ensure the sound management and administration of CSF funds at national level. Finding the right balance will be important to incentivising local areas to work with ERDF to deliver local economic growth.

4.46 The analysis presented in this section points to a number of conclusions and

recommendations about the emerging model for the 2014-20 CSF funds and the responsibilities of the government, LEPs and local partners. These are summarised in Table 4-2 below.

<b>Table 4-2: Conclusions on emerging arrangements for handling 2014-20 ERDF Programmes</b>		
	Key Requirements	Responsibilities <sup>7</sup>
Investment Strategy	Evidence base Local EU strategy development Fit with local growth programmes	LEPs coordinate with local partners LEPs lead with local partners & LEPs
Project Development	Project pipeline development Project development Project appraisal	LEPs & local partners lead Applicants with local partner and government support Some flexibility – government and local areas
Investment Decision Making	Approval of projects	Local partnership committees and Managing Authority
Administration of Funds	Contracting with projects Audit, monitoring and claims Guidance and advice to projects	Managing Authority Managing Authority Growth Teams, Managing Authority
Evaluation and Performance Management	Evaluation of programmes and projects Overall performance management	Government to coordinate Managing Authority leads, but coordinated with LEPs & local partners

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<sup>7</sup> For delegated delivery arrangements such as ITIs or CLLDs, the configuration of roles and responsibilities is likely to differ depending on the nature of the agreement with government and the European Commission. While core functions including that of the Managing Authority will be clearly defined, the local arrangements for investment strategies, project development and approval will form part of the agreements on the individual packages.



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## Appendix A Organisations Consulted

Consultees for Workstream 3	
Central Government	
Carole Swetenham	DCLG
Sue Baxter	BIS
Angus Gray	DWP
Helen Diplock	DEFRA
Carole Swetenham	DCLG
Sue Baxter	BIS
Programme Delivery Teams	
Anna Vinsen/Mark Foley	West Midlands /East Midlands
Theo Leijser	Cornwall
Andrew Morgan/David Malpass	National Network
Alex Conway	London
Eifion Jones	South West
Iain Derrick & Lesley Calder	North East
David Morrall	East of England & South East
David Read	North West
Local Enterprise Partnerships	
Chris Pomfret, Glenn Caplin, Jo Banks	Cornwall LEP
Mike Palin	Liverpool LEP
Susan Priest	South East LEP
Ben Still and Martin Cantor	Sheffield LEP
Rob Norreys	Leeds LEP
Simon Nokes	Greater Manchester LEP
Edward Twiddy & James Davies	North East LEP
Jason Middleton	New Anglia LEP
James Trowdale	Humber LEP
Lloyd Broad	Birmingham and Solihull LEP
Lorna Gibbons	LEP Network
Other Organisations	
Nick Porter	Local Government Association
Greg Wade and Lisa Bungeoth	Universities UK
Ingrid Gardner	NCVO
Professor Andy Pike	CURDS
Professor Richard Evans	Liverpool John Moores University
Professor Fiona Wishlade	European Policies Research Centre

