

## 1 INTRODUCTION

In January 2009, Fraser Associates was commissioned to undertake a Spot-check of Structural Funds Programmes operating in the Lowlands and Uplands of Scotland. The Spot Check has been carried out against the background of the rapid deterioration in economic circumstances since Summer 2008 and the gathering policy response on a national and European level. The work, which is at the Interim Report Stage, has encompassed:

- socio-economic analysis covering the period since the LUPS programmes were under development and which also provides a partial picture of developments since the onset of recession.
- review of policy developments in response to recession on a European, a UK and a Scottish level and which leads to a synthesis of counter-recessionary priority actions that potentially fall within the remit of the Structural Funds Programmes.
- analysis of the level of current and potential commitment in the LUPS Programmes and an assessment of the extent to which the PMC has room for manoeuvre in increasing the contribution that the Programmes may make to recovery strategy.
- an assessment of the extent to which the scope of the LUPS Programmes is already aligned with counter-recessionary priorities and the extent of alignment in the projects that have come forward under application Round 2.
- an exploration of the options that are available to the PMC.

## 2 FINDINGS FROM SOCIO-ECONOMIC REVIEW

Due to the lag in the production of socio-economic data, most of the analysis which has been possible provides illumination of the trends that were taking place between the period that the LUPS programmes were in development and the onset of economic downturn. Nevertheless, the findings highlight:

- Labour market conditions in the LUPS area improved between the start of the 2007-13 Structural Funds Programmes and mid-2008. The analysis to that point was consistent with a strategy of exploiting a buoyant labour market to tackle inactivity, and of addressing the skills needs of long term competitiveness.
- There was pressure on the employment level through 2008. Unemployment started to gather pace from the second quarter and has accelerated since the autumn. ILO Unemployment in the UK is now forecast to exceed 3m; this would be likely to be reflected in a further loss of 60-70,000 jobs in Scotland.
- There has been a disproportionate impact on women so far, more reflected in reduced activity rather than increased unemployment.
- The rate of GDP quarterly growth started to slow in Q3,2007 and became negative in Q3, 2008. In Scotland, contraction has been particularly severe in construction and related sectors. Recent announcements suggest that, since the start of 2009, decline is rapidly spreading into other sectors.
- Between 2003-07, the rate of business formation in LUPS increased significantly. VAT registrations increased by 24% compared with 7% in the UK over the same period. Nevertheless, in 2007, the business stock in LUPS remained only 80% the UK average.
- Employment across all sectors in LUPS grew by 81,000 between 2003 and 2007, but underlying this positive headline, the LUPS economy was undergoing significant restructuring. Some 22,000 jobs were lost in

manufacturing, while 40,000 jobs were lost as financial services and retailing consolidated. Among the growth areas were construction and real estate, both since severely affected by recession. However, there was positive progress in developing a knowledge-based economy with the addition of 40,000 jobs in ICTs, R&D and in business services. Less positive is the fact that two-thirds of the aggregate increase in employment was accounted for by growth in the public sector.

### 3 THE GATHERING POLICY RESPONSE TO RECESSION

Our review examined policy responses to recession being developed since Autumn 2008 by the European Commission, the UK Government and the Scottish Government.

We identify an aggregate set of counter-recessionary policy priorities that comprise:

- collective and national action to **restore stability to the banking system**.
- **fiscal stimulus** for the economy through a combination of tax reductions and increased public expenditure.
- **investing to meet long term structural challenges** and to enhance competitiveness, including in research and innovation, climate change adaptation and increased connectivity.
- **help for business**, with a particular emphasis on improving access to finance and investment in improved productivity and environmental performance.
- **help for people**, with particular emphasis upon the recently unemployed and those at risk from redundancy.

It is recognised that the Structural Funds have an important role to play in relation to the last three of these.

### 4 THE CONSISTENCY OF THE LUPS PROGRAMMES WITH COUNTER-RECESSIONARY POLICY PRIORITIES

#### Scope of the LUPS ERDF Programme

A benchmarking exercise was carried out to test the consistency between the scope of the LUPS ERDF Programme and the set of counter-recessionary policy priorities identified through the policy review described above.

It was found that as presently drafted, the LUPS ERDF Programme covers most of the set of counter-recessionary priorities. If the Programme were left unchanged, it is likely that the majority of expenditure would contribute to recovery. However, there is, in the judgement of the consultants, some scope to improve the alignment and relevance of activity supported.

#### Consistency in the ERDF Programme Project Pipeline

In order to develop a picture of the consistency of the ERDF project pipeline with current policy priorities, the consultants reviewed the project description for each Round 2 project at full application stage (in carrying out this work, the consultants were unaware of which projects were recommended for support by the Advisory Groups). On this basis, the projects were assigned to the best-fit counter-recessionary policy category, or to none at all, where appropriate.

Provisional analysis, in the process of being refined, found:

- In the case of Priority 1, all of the projects could be allocated to one of the categories. Prominent were investments in research infrastructure (£8m ERDF) and support for R&D and innovation (£24.9m).
- In Priority 2 the vast majority of projects and planned expenditure could be allocated to one of the categories. There was a very strong bias towards access to finance activities (£28.7m). The activity not allocated to one of the categories was mainly non-financial support for start-ups that was not explicitly targeted on the recently unemployed or at risk from redundancy.
- In Priorities 3 and 4 most of the proposed activity (P3 £10.2m and P4 £6.4m in ERDF) was aligned with one of the counter-recessionary policy categories. Projects which were non-compliant in this respect were mainly business premises of one sort or another.

### **Scope of the LUPS ESF Programme**

Benchmarking of the scope of the LUPS Programme found that the correlation between counter-recessionary policy priorities was strong in Priority 2, but relatively weak in Priority 1. Much of the scope of Priority 3, which is more concerned with a mode of intervention than particular target groups, could be interpreted as being potentially relevant to fighting recession.

### **Consistency in the ESF Programme Project Pipeline**

The same process of analysis was undertaken with Round 2 applications as for the ERDF Programme. The key findings from the analysis were:

- Priority 1, accounts for 57% of demand in Round 2 but only 16% of bids by value were considered to be aligned with counter-recessionary priorities. Of these, 66% by value are focused on enhanced education services – provision that will have clear benefits for social cohesion.
- in Priority 2, 100% of bids by value were assessed as being consistent with counter-recession priorities, with just over half relating to the upskilling of workers. This is entirely compatible with the Commission's concept of flexicurity.
- in Priority 3, 70% of bids by value were considered to be aligned with counter-recessionary priorities. The largest requests were for projects that will help develop systems for delivery to lower skilled workers and to matching skills development and skills gaps. These are both key areas in preparing a workforce that will be able to benefit, in due course, from an economic upturn.

## **5 THE RESOURCE POSITION IN THE LUPS PROGRAMMES**

Should the PMC wish to act to increase the contribution of the Programmes to fighting recession, its room for manoeuvre will be conditioned by commitment already made and its decisions on Round 2 applications.

Table 5.1 sets out the financial position in the LUPS Programmes based upon an exchange rate of £ = €1.131. The headroom figures for the ERDF Programme reflect the ring-fencing of resources for the South of Scotland Global Grants Scheme in addition to the value of Round 1 commitment and Round 2 recommendations.

<b>TABLE 5.1: LUPS PROGRAMMES, POTENTIAL HEADROOM FOLLOWING ROUND 2</b>					
	Financial Allocation (£m)	Round 1 Committed (£m)	Round 2 Recommendations	Potential Commitment Following Round 2	Potential Headroom Following Round 2
<b>LUPS ERDF Programme</b>					
Priority 1	81.4	43.8	24.3	68.1	13.3
Priority 2	108.1	36.0	34.5	70.5	37.6
Priority 3	89.8	11.8	1.6	13.4	76.4
Priority 4	45.2	3.0	6.4	9.4	16.8 <sup>1</sup>
Total	324.5	113.6	66.8	180.4	144.1
<b>LUPS ESF Programme</b>					
Priority 1	107.1	69.0	12.3	81.3	25.8
Priority 2	88.0	12.6	4.8	17.4	70.6
Priority 3	37.7	6.4	7.5	13.9	23.8
Total	232.8	88.0	24.6	112.6	120.2

### **LUPS ERDF Programme**

Overall, following Round 1, the LUPS ERDF Programme was 35% committed. Round 2 recommended bids would represent a further 21%. Discounting the ring-fenced allocation to Global Grants, this would leave some £144m for future Rounds, of which more than half is in Priority 3 and just over a quarter is in Priority 2.

### **LUPS ESF Programme**

In the LUPS ESF Programme, there has already been a very large commitment to Priority 1 in Round 1. If met in full, recommended bids would push this to £81.3m (75%). In Priorities 2 and 3, commitment and demand-to-date has been more modest, some 14-17% in Round 1. If outstanding applications are approved in full, the commitment level would increase to around 20% in Priority 2 and 37% in Priority 3. Depending upon the exchange rate, there would be some £120m remaining for allocation in future Rounds if Round 2 recommendations are approved in full.

## **6 POSSIBLE OPTIONS OPEN TO THE PMC**

### **LUPS ERDF Programme**

From our benchmarking the ERDF project pipeline against counter-recessionary policy priorities, it is clear that there is a very high level of consistency, particularly in Priorities 1 and 2. Accordingly, we see no pressing need for the PMC to strengthen selection criteria to ensure that the Programme makes a substantial contribution to recovery strategy.

<sup>1</sup> Taking account of £19m ring-fenced for the South of Scotland Global Grants Scheme.

Option 1: The PMC might wish to give consideration to clarifications which may strengthen the consistency of activity at the margins, including by:

- giving particular priority to research and innovation projects that are designed to address long term challenges such as climate change adjustment such as clean transport and construction and projects addressing energy security.
- ensuring that scope for support of R&D and innovation in businesses includes financial incentives.
- ensuring that start-up support provision is actively targeted on the recently unemployed and those at threat from redundancy.
- extending access to finance provision in the short term to include grant funding, particularly to reduce the risk in investments by new and recently established businesses.

Option 2: A very large proportion of activity proposed in Priority 2 relates to access to finance. This follows a substantial commitment towards the co-investment fund and other access to finance provisions in Round 1. The PMC might wish to give consideration to whether the balance of effort is appropriate or whether further diversification of activity would be appropriate.

Option 3: While current applications under Priorities 3 and 4 are substantially consistent with counter-recessionary policy, these Priorities are seeing limited demand in terms of well developed projects. The PMC may wish to consider measures which will accelerate commitment and expenditure of these resources. There are a variety of measures that might be taken:

- commissioning activity in line with the existing scope of the Measures.
- expanding the scope of the Measures to allow additional projects in areas that there is scope to spend.
- developing a JESSICA scheme to de-risk investment in major regeneration projects.
- viring additional resources into Priorities 1 and 2.

Some of the steps highlighted under Option 3, e.g. JESSICA, may not result in activity that is well aligned with thematic policies for addressing recession, but would contribute to EU and Scottish Government policy of accelerating spending to provide a general stimulus to the economy.

### LUPS ESF Programme

Our analysis of both the scope of the ESF Programme and the pipeline of projects finds that, in Priority 1, there is limited consistency with counter-recessionary policy priorities while Priority 3 is perhaps rather horizontal in character. This is a reflection of the Programme having been developed at a time when the newly unemployed were mostly finding work in a short period.

The key factor in the short term is that the PMC is going to be asked to endorse recommendations on Round 2 applications. If it does so, the scope for responding to the recession in future rounds will be constrained in that available resources will diminish.

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Option 1: endorse recommendations where there is clear correlation with counter-recessionary priorities (c45% of current bid for ESF). Thereafter, agree criteria for future bids, derived from the identified counter-recessionary priorities.

Option 2: endorse all recommendations and prepare to vire funds to meet current and future demand – probably from P2 and/or P3 to P1. Again, agree criteria for future bids, derived from the identified counter-recessionary priorities.

Option 3: whether Option 1 or 2 is pursued, once criteria for future bids have been established, consideration should be given to launching a supplementary “counter-recessionary” bidding round.

Option 4: (Priority 3 only): after endorsement of Round 2 bids, close Priority 3 to further bidding and adjust the selection criteria so that greater weight is attached to the innovative nature of interventions in P1 and P2.

Option 5: defer endorsement of some or all applications and develop a strategic approach to bidding – in effect, commissioning. This would entail rapid identification and agreement by PMC of priorities and then launching a Bidding Round. Such an approach may not sit easily with Commission’s and the Scottish Government’s desire to accelerate expenditure.