



## Lowlands and Uplands Scotland ERDF and ESF Programmes 2007 - 2013 Programme Monitoring Committee

### OPTIONS ON FUTURE EUROPEAN STRUCTURAL FUND PROGRAMME PRIORITIES AND AMENDMENTS TO OPERATIONAL PROGRAMMES

#### 1. Purpose

- 1.1 This note follows up the independent review of the use of the 2007-13 European Structural Funds to date in the Lowlands and Uplands Scotland (LUPS) Programme area, undertaken by Fraser Associates, which was presented and discussed at the Programme Monitoring Committee (PMC) in March. PMC members requested that Scottish Government and Intermediate Administration Body officials reflect on the findings and produce a short options paper.

#### 2. Background

- 2.1 The context for the options presented here comprises 4 strands:

- 2.1.1 The contribution that European Structural Fund Programmes should make to alleviating the effects of the economic downturn through the Scottish Government's Economic Recovery Programme and the European Commission's Economic Recovery Plan.

The March PMC received a paper from the Scottish Government on the impact of the recession on output and the labour market in Scotland. Since then, the economic forecasts have tended to be revised downwards:

- the IMF projects that the world economy will contract by 1.5 per cent this year;
- the European Commission forecasts that the EU economy will shrink by 4 per cent in 2009 before resuming growth towards the end of 2010;
- the Chancellor of the Exchequer has forecast that output in the UK economy will decline by 3.5 per cent in 2009 before starting to recover next year;
- data published by the Scottish Government last month confirmed that Scottish GDP growth was negative in both the 3<sup>rd</sup> and 4<sup>th</sup> quarters of 2008.

- 2.1.2 The requirement for the Programmes to address structural issues in the economy with a medium/long term horizon. This will contribute to ensuring that Scotland has the building blocks in place – skills, investment, access to capital, etc – for a sustained recovery from recession. Each of the Operational Programmes currently has a range of Programme indicators and outcomes related to medium term impacts.

2.1.3 The need for synergy with other funding streams and systems in order to attain the greatest impact on Scotland's recovery and future economic growth from the reduced total funding available.

2.1.4 The allocations of European Structural Funds made to date - and the amounts of funding remaining - within each of the Priorities, following the second full Round within the LUPS Programme area.

### **3. Analysis**

**3.1** Our analysis of the Fraser Associates findings is presented for the European Social Fund (ESF) and European Regional Development Fund (ERDF) Programmes, respectively, in Annexes A and B below. The annexes include summary tables showing the Programmes' funding to date and the potential headroom within each Priority.

**3.2** The main conclusions are:

3.2.1 The European Structural Fund Programmes – ERDF and ESF - are aligned well with the Government's Economic Strategy. Both Programmes are contributing to the delivery of sustainable economic growth over the medium term, along with other public and private funding streams.

3.2.2 The ERDF Programme is also consistent with the set of Scottish Government counter-recessionary priorities. However, that part of the ESF Programme which focuses on the most disadvantaged and those furthest from the labour market is less well aligned with the immediate actions needed to assist those now becoming unemployed.

3.2.3 The front-loading of both ESF and ERDF has been useful, but more targeted use could now be made of the remaining funds. In particular, for ESF, more focus should be directed to those who are at danger of becoming inactive and dropping out of the workforce.

### **4. Recommendations**

**4.1** The Committee is invited to consider the following recommendations:

#### European Social Fund

4.1.1 Close Priority 3 and move the remaining funds into Priority 1, but retain the eligibility of Priority 3 activities within Priority 1 and 2, as appropriate.

4.1.2 Target the remaining Priority 1 allocation by:

- commissioning specific projects and working more closely with potential match funders such as the Big Lottery Fund and the Scottish Funding Council;
- enhancing the current Community Planning Partnership (CPP) Plans at the local area, where the CPPs can prove results and partnership in the use of ESF funding received to date.
- limiting the funding available for individual competitive bids;

- ensuring that, across all these options, there is a strong steer to use the expertise and delivery mechanisms of the Third Sector and the Further Education Sector.
- 4.1.3 Work with partners to commission more Priority 2 partnership projects addressing the current high levels of redundancies and/or sustaining Modern Apprenticeship training.
- 4.1.4 For areas that are eligible under ESF Priority 1 (and ERDF Priority 3), maintain that eligible status for the remainder of the Programme period, even if an area drops out of the most disadvantaged target group.

European Regional Development Fund

- 4.1.5 For Priority 1, give a steer to the Advisory Group on the type of projects to be supported, focusing on research and innovation projects that address long term challenges such as climate change adjustment, clean transport and construction, and energy security.
- 4.1.6 For Priority 2, make greater use of commissioning projects that will allow a wider diversity of activity and outcomes.
- 4.1.7 For Priority 3, continue discussions with the Commission on: widening the eligibility criteria to offer support to larger capital projects; developing a JESSICA funding model; and implementing some technical changes relating to the treatment of match funding in the Operational Programme and financial tables.
- 4.1.8 For Priority 4, take forward the proposed changes to the Operational Programme (as discussed separately by the PMC) and explore whether an extension to the geographic coverage of the Priority would be supported by the statistical evidence.
- 4.1.9 Note that following the PMC discussion, Scottish Government officials will take matters forward with Ministers and the Commission, as appropriate.

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## EUROPEAN SOCIAL FUND

- A1. Table A1 shows the allocations made to date – and the amounts remaining – within each of the 3 ESF priorities. It can be seen that there has already been a very large commitment to Priority 1 in Rounds 1 and 2 at £81.3m (76%). In the other two Priorities, commitment and demand-to-date has been more modest, at around 20% in Priority 2 and 37% in Priority 3, following the 2<sup>nd</sup> Round decisions. Given the exchange rate assumption (£1 to 1.13 euros), there is some £120m remaining within the Programme for allocation in future Rounds.

**Table A1. ESF: funding to date and potential headroom**

	Financial Allocation (£m)	Round 1 Committed (£m)	Round 2 Committed (£m)	Potential Headroom Following Round 2 * (£m)
<u>Priority 1</u> To assist the co-ordinated progress of unemployed and inactive people of all ages towards sustainable employment	107.1	69.0	12.3	25.8
<u>Priority 2</u> To improve the skills of the workforce to enhance employability, productivity, adaptability, inclusion and entrepreneurial expertise; and to offer re-skilling to employees to enable them to remain in the workforce	88.0	12.6	4.8	70.6
<u>Priority 3</u> To widen access to post-school lifelong learning, particularly for key client groups	37.7	6.4	7.5	23.8
<b>Total</b>	<b>232.8</b>	<b>88.0</b>	<b>24.6</b>	<b>120.2</b>

Note: \* Assumes an exchange rate of £1 to 1.13 euros

- A2. The Fraser Associates report assessed the range of projects which had been approved across the 3 Programme objectives and the scope for more effective action in support of the Economic Recovery Programme. It noted that, with Priorities 1 and 3, there is limited consistency with counter-recessionary policy priorities. This is a reflection of the ESF Programme having been developed at a time when the newly unemployed were mostly finding work in a short period and the policy focus had been on assisting the hard-to-reach groups furthest from the labour market.
- A3. The Programme focus for Priority 1 was on offering skills and support to move the hard-to-reach, workless groups, those experiencing multiple challenges and those in the NEET group (not in education, employment or training) into employment and training. So far, the projects approved - including the CPP Plans – have concentrated on these most disadvantaged groups and specifically include a high proportion of young participants. At a time of low unemployment, high employment rates and high numbers of vacancies, this was

clearly in support of the Government Economic Strategy, and 45% of the ESF programme funding was allocated to this Priority.

- A4. Within Priority 1, support is targeted on:
- the 10 LA areas accounting for the highest shares of population in the 15% most deprived data-zones, as measured by the Scottish Index of Multiple Deprivation;
  - the 7 LA areas showing the highest concentration of NEET individuals.
- A5. Approximately 75% of the funds in this Priority have now been allocated and this has contributed significantly to the desired front-loading of the programme spend. However, given the rapid deterioration in the numbers of registered unemployed, the fall in employment and the sharp decline in vacancy numbers, it might be judged that the concentration on projects to support those furthest from the labour market is now less appropriate as a response to the immediate needs of the economy, although the spatial targeting of the Priority remains valid. Accordingly, there are good arguments for targeting the funds in the next round on those needing help to avoid falling out of the labour market and into long term unemployment, inactivity, depression and ill health in the areas most affected by the economic downturn.
- A6. This targeting could be achieved in a number of ways, including the use of part of the remaining funds in a “smarter” way by working in partnership directly with major match funders such the Scottish Government and the Big Lottery Fund where their themes and outcomes complement ESF outcomes. It could also be done by giving additional funds to extend and enhance the current CPP Plans (using both ESF Priority 1 and ERDF Priority 3) to enable them to tackle these issues at their local area level in support of Single Outcome Agreements. Although this would mean a move away from another round of competitive bids for Priority 1, there would be a strong steer to use the expertise and delivery mechanisms of the Third Sector and the FE Sector in the development and implementation of these projects.
- A7. As only £26m remains within Priority 1, it would be desirable to seek the Commission’s agreement to vire into this Priority the £24m remaining in Priority 3 (Access to post school lifelong learning). We return to this below.
- A8. Finally, for Priority 1 ESF (and for Priority 3 ERDF, see below), it would seem appropriate to continue with the annual review of the eligible areas. However, in the event of an area dropping out of the most disadvantaged group, consideration should be given to maintaining its eligible status in order to assist with medium term planning and delivery.
- A9. Priority 2 covers the whole of the LUPS area and substantial funding remains available, even though the Operational Programme has been changed to include the assistance for those being made redundant. 37% of the Programme funds are allocated to this Priority.
- A10. Again, there are good arguments to commission more partnership projects to help with the current high levels of redundancies and to encourage employers to sustain Modern Apprenticeship training. This could be done through discussions between SG policy officials and Skills Development Scotland, the college sector and the Scottish Funding Council, though there could also be another round of competitive applications, albeit with a greater focus on the strategic fit with government priorities.
- A11. Priority 3 was given the smallest proportion (16%) of funding within the LUPS programme, and the Fraser Associates evaluation considered it to be something of a “luxury” in the

current economic climate. However, it has funded some important and innovative projects from the SQA, STUC, Colleges and Third Sector organisations offering new courses and/or new ways of accessing learning for individuals who cannot access the usual learning centres or mediums because of disability, previous bad experiences with learning, or the need to use distance learning while requiring substantial support.

- A12. An option here would be to seek Commission agreement to close this Priority to any further bids and vire the remaining funds into Priority 1. However, the eligible activity would be retained: either in Priority 1, where it would relate to those not in employment, or in Priority 2, where it would relate to those in employment.

## ANNEX B

## EUROPEAN REGIONAL DEVELOPMENT FUND

B1. Table B1 shows the allocations made to date – and the amounts remaining – within each of the 4 ERDF priorities. Following the first two rounds, the programme has committed just over one-half the available funds. Leaving to one side the ring-fenced allocation of £19m in Global Grants that will support the South of Scotland Competitiveness Strategy, this leaves some £144m for future Rounds, of which just over one-half is in Priority 3 and just over one-quarter is in Priority 2.

**Table B1. ERDF: funding to date and potential headroom**

	Financial Allocation (£m)	Round 1 Committed (£m)	Round 2 Committed	Potential Headroom Following Round 2 *
<u>Priority 1</u> To improve the competitiveness of the LUPS enterprise based through increased innovation and a fuller use of its RTD base	81.4	43.8	24.3	13.3
<u>Priority 2</u> To improve enterprise formation and growth rates by enhancing the enterprise support environment, particularly with regard to access to finance, entrepreneurship, e-commerce and resource efficiency	108.1	36.0	34.5	37.6
<u>Priority 3</u> To increase the contributions of the most disadvantaged urban communities to Lisbon goals by supporting their regeneration	89.8	11.8	1.6	76.4
<u>Priority 4</u> To maximise the contribution of rural areas to achieving Lisbon goals with a view to developing sustainable economic growth	45.2	3.0	6.4	** 16.8
<b>Total</b>	<b>324.5</b>	<b>113.6</b>	<b>66.8</b>	<b>144.1</b>

Notes: \* Assumes an exchange rate of £1 to 1.13 euros

\*\*Taking account of £19m ring-fenced for the South of Scotland Global Grants Scheme

B2. The Fraser Associates report found that the ERDF Programme is consistent with the set of Scottish Government counter-recessionary priorities, particularly in Priorities 1 and 2. If the Programme and selection criteria were left unchanged, it is likely that the majority of expenditure would contribute to economic recovery. However, the March PMC discussion and subsequent analysis suggests that there is some scope to further improve the relevance of activities. The review also allows us to address, albeit marginally, some of the difficulties that public sector co-funders will face in securing match funding in a tightening public sector spending environment.

- B3. Demand for funding in Priority 1 has been consistently high and it appears unlikely that the available resources (£13.3m) will support a third open bidding round. The PMC might wish to offer a specific steer to the Advisory Group to give priority to research and innovation projects that are designed to address long term challenges such as climate change adjustment, clean transport and construction, and projects addressing energy security .
- B4. Although the demand for funding in Priority 2 has been healthy, some caution is required in the interpretation of the data on financial commitments as 2 large awards (£20m and £27m) have been made to capitalise Scottish Enterprise's Co-investment Fund and Scottish Venture Fund. In addition, £6m has been offered to the West of Scotland Loan Fund (WoSLF) to offer debt finance to SMEs in the west of Scotland.
- B5. We have also engaged with COSLA inviting them to bring forward an access to finance project, modelled on the already established and successful West of Scotland Loan Fund, covering Local Authority areas currently excluded from the WoSLF. We recommend that a provisional allocation of £7m-£8m should be earmarked until the end of 2009 to fund that project. If no project is forthcoming by then, the funds would be released back to the competitive pot.
- B6. A large proportion of activity already approved or planned in Priority 2 thus relates to access to finance. Whilst it is accepted that this is a crucial factor in addressing the impact of the economic downturn, the PMC will wish to give consideration to whether the diversification of activity within this Priority would now be appropriate. In particular, it might wish to consider commissioning more tailored enterprise support and ensuring that start-up support provision is actively targeted on the recently unemployed and those at threat from redundancy.
- B7. Priority 3 is targeted on the same 13 Local Authority areas as ESF Priority 1. Demand thus far has been low, though the figures for realised commitment do not offer a complete picture of the potential activity.
- B8. We are in advanced negotiations with the European Commission to widen the scope of the eligible activity that will allow us to offer support to larger scale capital projects. Such agreement will stimulate an increase in demand in its own right.
- B9. In addition, we are actively exploring the scope for a JESSICA funding model. This would allow us to use part of the exiting ERDF allocation to replace traditional grant funding by offering equity investments or loans to support the delivery of integrated urban development plans. Given that returns to the JESSICA fund would continue to support urban regeneration after the end of the programming period – and that the current allocation is likely to be the last significant ERDF funding in the LUPS area - this type of legacy fund is an attractive proposition. To ensure longevity the fund would require a commitment of at least £25m ERDF to provide a fund of sufficient scale. The early findings of the scoping study commissioned to support the delivery of JESSICA in Scotland have suggested that there already exists a sizeable market of large scale regeneration projects that could benefit from a JESSICA investment. The upper value of a JESSICA intervention is probably only limited by the availability of match funding.
- B10. As noted above with regard to ESF Priority 1, it would be appropriate to maintain the eligible status of an area, even if it drops out of the most disadvantaged group because another area has been particularly severely hit. This would “lock in” those areas identified as eligible in 2009 for the remainder of the programme period, reflecting the complexity and longer lead times attached to the development of the integrated urban development plans required for a JESSICA initiative.

- B11. More generally, the tight public sector spending environment means that we need to revisit previous assumptions on match funding. It had been envisaged that public sector resources would be sufficient to provide the required match funding to fully utilise the ERDF. This meant that we excluded private sector contributions from the calculation of match funding. Although the Managing Authority accepts that the availability of private sector match is likely to be limited in the short term, we plan to put forward a change to the financial tables that will allow us to count private sector match on the same basis as public sector resources.
- B12. Within Priority 3, it is clear that the assumption that 60% of the eligible costs of a project would come from public sector resources is likely to become increasingly problematic for project sponsors. We therefore propose to approach the Commission with a suggestion to reduce the level of public sector co-finance required and increase the maximum intervention rate available to projects in Priority 3 from 40% to 50%.
- B13. Priority 4 is targeted on the Local Authorities in which rurality is particularly pronounced. Support is limited to LA areas with more than 25% of their population in “remote” or “accessible” rural areas as defined by the Scottish Government’s six-fold urban-rural classification:
- B14. Demand within Priority 4 has been low to date, although it should be noted that the work of the Global Grants Body (GGB) that will administer the development and delivery of projects in the South of Scotland was delayed and only started to operate at full capacity late last year. The arrangements are now in place to increase the pipeline of projects and improve spend in the GGB area.
- B15. Members of the PMC will be aware that, as with Priority 3, we are in negotiations with the European Commission to widen the scope of the eligible activity. We are also examining the statistical evidence to see if widening the geographic coverage of Priority 4 would be a reasonable option.
- B16. The virement of funds from Priority 4 to support additional activity in Priority 1 or Priority 2 remains an option. However, the Managing Authority takes the view that it is reasonable to allow one more round of funding - with a fully operating GGB in place, extended eligibility criteria, increased commissioning and possibly increased geographic coverage - before that option is examined further.