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**Research Report**

## Sharing prosperity? Options and issues for the UK Shared Prosperity Fund

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**Report**

Alex Davenport  
Samuel North  
David Phillips

# Sharing prosperity? Options and issues for the UK Shared Prosperity Fund

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## Preface

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## Executive summary

European Structural and Investment (ESI) funds help to pay for initiatives supporting business development, research and development, investment in digital and green infrastructure, as well skills and training interventions and support for job-seekers. But with the UK having formally departed the European Union, the country will stop receiving new ESI funding at the end of 2020. Thus, for 2021 and beyond, the UK government faces choices over what to replace ESI funding with. This is important as ESI funding forms a substantial component of spending on regional economic development in the UK, especially in the poorest regions. The government has announced the creation of the UK Shared Prosperity Fund (UKSPF) to this end, but has so far given few details around its scale, design and implementation.

Drawing on a review of the current ESI schemes, this report explores some of the key issues that the government and stakeholders need to consider for the new system. It also looks at how the funding allocations for different parts of England will depend on the indicators of funding ‘need’ used to calculate UKSPF funding allocations. This shows that a focus on areas with low productivity would see several rural areas receive the highest levels of funding per person, while a focus on low education and employment, and especially high deprivation, would channel the most funding to more urban parts of the Midlands and the North. The report concludes with a brief discussion of the issues posed by the COVID-19 crisis for the design and implementation of the UKSPF.

### Key findings

#### The current EU Structural Funding System

- **The UK is set to receive an average of €2.3 billion per year in ESI funding between 2014 and 2020, of which around two-thirds is for general economic development and one-third for agricultural innovation and rural development.** The €1.6 billion – or €26 per person – of annual funding for general economic development is tiny in the context of overall UK government spending, but fairly sizeable compared with other funding streams. For example, spending in England is around 60% of what the government spends on its Local Growth Deals – which also cover housing and transport, as well as economic development and skills – and almost twice what is set to be spent on the Towns Fund, aimed at regenerating deprived towns.
- **Within the UK, funding allocations are heavily skewed towards the two poorest regions, reflecting EU-mandated funding ‘cliff edges’.** Regions with economic output per person below 75% of the EU average are entitled to much more support than regions that are above this cut-off. As a result, Cornwall is due to receive an average of €144 per person per year between 2014 and 2020, compared to just €18 in South Yorkshire, which has only slightly higher output. These sharp differences are arbitrary, and a new UK system should avoid replicating them, while continuing a ‘progressive’ funding regime.
- **A new UK system should also be more transparent.** As long as it respects the EU-mandated cliff edges, the UK government already has significant discretion to determine funding allocations for specific areas. Information on how it does this – including the role of formal formulae and informal judgement – is lacking though. However, it appears that the UK government has in recent years used its discretion to prioritise the Midlands and North of England relative to the South: for a given level of economic output per person, subregions in the Midlands and North receive two to four times as much as those in the South (other than Cornwall).
- **Complex EU rules restrict the use of ESI funds, limiting local discretion.** Various minimum and maximum shares of funding need to go to projects satisfying certain ‘thematic objectives’, and projects must conform to centrally determined ‘investment priorities’ set out at the start of the EU’s seven-year funding period. This means that there is scope to make the new system less complex, more tailored to local priorities and more responsive to changing circumstances.

- **Research suggests ESI funding boosts economic growth in the areas receiving it.** However, the impacts are larger in areas with better educated workforces and stronger governance. There could therefore be a trade-off between maximising the impact of funding and targeting it at areas with the greatest need – which are likely to include places with less-educated workforces and potentially weaker governance. Some studies find impacts largely fade following the cessation of funding, which suggests that an increased focus on the long-term drivers of productivity could also be worthwhile.

### The design of the UK Shared Prosperity Fund

- **The government has highlighted boosting productivity and ‘tackling inequalities’ as two key objectives of the UKSPF – but detailed plans have yet to be published.** This includes: information on the specific objectives of the scheme; the overall amount of funding available; how funding will be allocated between different parts of the UK and between different projects; and the rules on what funding can be spent on.
- **A key issue is the role of ‘needs’ versus ‘outcomes’ in funding decisions, and the extent to which competitive bidding is used.** The current ESI funds use competitive bidding to select specific projects *within* regions, but funding for different regions is based on needs assessments. Extending the role of competition and outcomes assessment to regional allocations may be expected to channel more funding to the regions whose projects have the greatest potential or actual impacts, but the risk is that some poor regions miss out. However, evaluations of UK government programmes in the 1990s that used competitive bidding suggest that, on the one hand, the impact on project quality was limited, but that on the other hand the criteria used in assessing bids helped to ensure that poorer regions did not miss out on funding.
- **The geographic areas allocations are based on will be important.** The government has indicated that funding in England could be allocated to Local Economic Partnerships (LEPs). These cover relatively large areas, which is likely to be appropriate if the focus of the UKSPF and any needs assessment is productivity. However, smaller geographies (and within-area inequalities) will be more appropriate if the focus is on deprivation and poor social outcomes, which are often more localised. For example, the South East LEP contains affluent London commuter areas such as Epping Forrest and Sevenoaks but also areas with significant deprivation and low levels of earnings such as the more distant Hastings, Thanet and Tendring.
- **It will also be important to consider how the UKSPF fits into a complex patchwork of place-based policies.** These include city deals and local growth deals – which are funded via competitive bidding and do not have a specific focus on reducing geographic inequalities – and the Towns Fund – which combines a mix of needs-based funding and competitive bidding. If the rules and purposes of these different funds are not made clear and consistent, there is the potential for unnecessary complexity and inconsistent practice in different parts of the country.

### What might needs-based funding allocations look like?

- **Deprivation, lack of qualifications and low employment are concentrated in urban areas of the Midlands and the North, but low pay and productivity are big issues for some rural areas too.** The choice of indicators and the weights applied to them will therefore have significant impacts on how funding is distributed across the country.
- **Within England, for example, the (Welsh) Marches, Devon and Somerset, and Stoke and Staffordshire also have low productivity and pay, but perform better on other indicators.** These areas could therefore do well from the UKSPF if productivity and pay are weighted highly, but much less well if deprivation, employment and qualifications are weighted highly.
- **Cornwall has the lowest levels of productivity and pay in England, but even if these were weighted highly in the new formula, it may still lose significant funding compared to now.** This is because Cornwall’s very high allocation currently reflects the arbitrary cliff edges in the ESI system, which the new UKSPF should avoid replicating. Transitional arrangements should be considered to avoid

another type of cliff edge though: a sudden reduction in funding to levels that other comparable regions receive.

- **Most urban and former industrial parts of the Midlands and the North score poorly across a range of indicators and will receive above-average funding irrespective of the specific weights applied to them.** The Black Country stands out as an area that would be in the top three in terms of per person funding if either deprivation, education, employment, pay or productivity were used to allocate funding. The Tees Valley would be in the top four under the first four of these measures, but roughly mid-table if allocations were based on productivity alone.
- **The commitment in the Conservative manifesto to guarantee each UK nation at least as much funding as under existing EU schemes could mean similar areas in the different nations of the UK receiving very different amounts of funding.** For example, West Wales and the Valleys and East Wales could receive much more than comparable areas of England, given the large allocations of EU funding they currently receive – which, in the former case, reflects the EU mandated ‘cliff edge’ and, in the latter case, political decisions by the UK government to shift funding from England to the devolved nations for the 2014–20 EU budgetary period.

#### What are the implications of the COVID-19 crisis?

- **The government has confirmed its intention to exit the EU transition period – and hence the ESI schemes – at the end of 2020. This means new UK arrangements will need to be in place before the end of year.** If the pressing situation with the COVID-19 crisis means that it is impractical to finalise and consult on full details of the UKSPF, then the government could roll over existing allocations and rules for another year. This is the approach it has taken for local government funding in England, for example, where planned reforms to the funding regime from April 2021 have been postponed by at least one year.
- **The social and economic effects of the COVID-19 crisis could differ significantly between regions in ways not reflected in standard measures of regional and local economic disadvantage.** For example, the share of employees in the hospitality sector varies between 4.5% in Redditch district and 25% in Weymouth and Portland district. Jobs linked to air travel are concentrated in the areas surrounding major airports such as Heathrow, Gatwick and Manchester, and aerospace manufacturing is especially concentrated in North East Wales and South Gloucestershire. Reliance on public transport – reductions in the capacity of which could significantly reduce commuter, shopper and tourist flows – is much higher in London and, to a lesser extent, other major cities. Moreover, such patterns are not strongly correlated with measures of productivity, skills, incomes and deprivation, which seem likely to be the basis for the allocation of the UKSPF.
- **A key decision is therefore whether to adapt the UKSPF so that one of its objectives is to support parts of the country that are struggling to recover from the COVID-19 crisis, or that potentially have other more targeted programmes and funding for this task.** Integrating such support into the UKSPF could ensure that support for general economic development and recovery from the COVID-19 crisis is better integrated. However, it could complicate the operation and allocation of the UKSPF and it could mean that funding for recovery is not as well targeted as under a more bespoke scheme.



# 1. Introduction

For the period from 2014 to 2020, the UK will have received a total of €16.4 billion of European Structural and Investment (ESI) funding, with just over two-thirds of this funding aimed at improving economic performance and labour market outcomes, particularly in regions with weaker economies. The other third is used to support the economic development of rural areas and areas historically reliant on the fishing industry.

The UK is set to remain part of these schemes until the end of 2020, but faces a choice about what will replace these schemes in 2021 and beyond. The decisions taken will matter. While small in the context of overall UK government spending (around 0.3% of the total), ESI funding represents a sizeable chunk of the funding spent on economic development and active labour market policies, especially in those regions receiving the most funding. Moreover, these other funding streams either have fallen (e.g. local government spending on economic and community development is down over two-thirds since 2009–10), or are often allocated to different regions on a deal-based or competitive basis (such as City Deals and Local Growth Deals). This means ESI funds are the most important source of funding for economic development that is specifically focused at regions with weaker economies. For example, while across England government spending on Local Growth Deals – which provide funding for skills, economic development, transport and housing – equates to around 1.7 times the amount spent by the ESI funds, in Cornwall it is ESI funding that is most significant: over six times that provided by its Local Growth Deal. Moreover, across England as a whole, the ESI funds are around two-thirds larger than the Towns Fund, which is targeted specifically at more deprived towns.

We already know that the UK government will replace the ESI schemes. In 2017, it announced that it would be setting up what it calls the UK Shared Prosperity Fund (UKSPF), which, like the existing EU schemes, will aim at improving economic performance, especially in regions with weaker economies. The Conservative's 2017 manifesto said that the fund will be used to 'tackle inequalities between communities by raising productivity, especially in those parts of the country whose economies are furthest behind'.<sup>1</sup> Their 2019 manifesto highlighted 'tackling deprivation' as a key goal, and committed to ensuring each nation of the UK received as much funding as under existing ESI schemes, and to allocating £500 million annually to 'give disadvantaged people the skills they need to make a success of life'.<sup>2</sup>

However, the government has yet to publish detailed plans, and many questions about the design of the programme need to be addressed. For example, should funding be pre-allocated to regions or locales based on indicators of 'need' and, if so, which ones, and with what degree of progressivity? Or should allocations to regions depend to some extent on bids put forward about how that funding would be used? Different choices could lead to significant differences in how much funding is allocated to different policy areas and different parts of the country, as well as the outcomes that can be delivered.

The aim of this report is to highlight the key questions that need to be addressed, and assess the impact of different funding allocation rules on different regions. Any such assessment also requires an understanding of the position we start at, so we also review and assess the existing ESI schemes.

The report proceeds as follows. In Section 2, we provide an overview of the existing ESI funds, including their aims and main rules, and the resulting allocations to different regions of the UK. We also review the evidence on the effectiveness of these schemes in meeting their objectives of improving economic performance in disadvantaged regions. Then, in Section 3, we discuss the options and issues for the proposed UKSPF, including how funding could be allocated to different regions, how funding could be spent, and how the fund will fit in with existing funding schemes. In Section 4, we focus on the impact

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<sup>1</sup> Conservative Party, 2017.

<sup>2</sup> Conservative Party, 2019.

that different formulas for allocating funding could have on the amount allocated to different regions. In Section 5, we provide our concluding thoughts, including how the COVID-19 crisis may affect decisions over the introduction and design of the UKSPF.



## 2. EU Structural and Investment Funds

When designing any new policy, it is important to consider what lessons can be learned from other similar policies, including any it will replace. The UKSPF is no different.

Therefore, in this section, we provide an overview of the ESI funds, focusing on those targeted at improving economic and labour market performance. We discuss the funds' aims and main rules, the allocations received by different parts of the UK, and the evidence of their impact on growth and employment. In doing so, we highlight several issues for consideration and opportunities for greater transparency in the future UKSPF.

### 2.1 What are the ESI funds and what are their objectives?

Funds for regional economic development, targeted at areas with weaker economies, have been a feature of the EU's budget since the 1970s. Their importance has grown over time, increasing from around 33% of the EU's budget in 2000, to around 41% in 2018.<sup>3</sup>

There are actually five separate funds, each with different broad 'missions' as set out in the Treaty on the Functioning of the European Union<sup>4</sup> and the Common Provisions Regulation on the ESI funds:<sup>5</sup>

- The European Regional Development Fund (ERDF) aims to 'redress regional imbalances in the Union through the development of regions which are lagging behind'. Examples of recent projects in the UK that have received funding include the establishment of both the 'Advanced Manufacturing Innovation District' in Sheffield and the 'Cornwall and Isles of Scilly Investment Fund' to improve access to finance for small and medium-sized enterprises (SMEs).<sup>6</sup> The ERDF is available to all EU members, but funding is targeted at regions with weaker economies.
- The European Social Fund (ESF) aims to 'improve employment opportunities for workers in the internal market and to contribute thereby to raising the standard of living'. Examples of recipients of funding in the UK include the Lancashire 'Access to Employment' programme, which supports those out of work for six months with employer-specific training to help movement back into employment, and the 'Right Steps to Work' programme in Yorkshire, which helps participants build their CV writing and interview skills and puts them in contact with employers.<sup>7</sup>
- The Cohesion Fund (CF) is set up to 'provide a financial contribution to projects in the fields of environment and trans-European networks in the area of transport infrastructure'. Its funds can only be spent by EU members whose gross domestic product (GDP) is less than 90% of the EU average, which means it is not available to the UK and was only received by 15 member states in the 2014–20 allocations.
- The European Agricultural Fund for Rural Development (EAFRD), which is part of the Common Agricultural Policy, aims at supporting 'rural development strategies and projects'.<sup>8</sup> It can be used to fund investment in agricultural technology, improvements in animal welfare and moves towards low-carbon agriculture, and for economic and business development in rural areas.

<sup>3</sup> European Commission (2020a).

<sup>4</sup> See articles 162, 176 and 177 of the Official Journal of the European Union (2012).

<sup>5</sup> Official Journal of the European Union (2013).

<sup>6</sup> See Ministry of Housing, Communities and Local Government (2018a) for further case study examples of projects funded by the ERDF.

<sup>7</sup> See Department for Work and Pensions (2018) for further case study examples of projects funded by the ESF.

<sup>8</sup> European Commission, 2020b.

- The European Maritime Fund (EMF), which is part of the Common Fisheries Policy, ‘helps fishermen in the transition to sustainable fishing’ and ‘supports coastal communities’ in a variety of ways aimed at promoting growth and sustainability.<sup>9</sup>

In addition to the broad missions of these funds, the EU sets more specific ‘goals’ and ‘objectives’ for each fund, as part of its multi-year budget agreements. For example, for the 2014–20 multi-year budget, the EU set the overarching goal of promoting ‘sustainable, smart, inclusive growth’. This was mapped to 11 ‘thematic objectives’, with different funds contributing to these objectives to different extents.<sup>10</sup> These objectives include:

- strengthening research, technological development and innovation;
- supporting the shift towards a low-carbon economy in all sectors;
- promoting sustainable transport and removing bottlenecks in key network infrastructures.

Overall budgets, as well as rules for the allocation of these to different member states and types of regions, are also agreed as part of the EU’s multi-year budget. This provides a greater degree of certainty and stability than if budgets and allocations were set annually, but it means total funding and funding allocations are less responsive to short- to medium-term changes in circumstances and needs.

Table 2.1 shows both the overall budget for each ESI fund, and the UK’s allocation and relative allocation per person, for the period 2014–20. In total, the UK is set to receive €16.4 billion of ESI funds during this period, equivalent to 3.5% of the total. This means the UK’s allocation per person (€267) is just 29% of the EU average (€923). This low allocation partly reflects the fact that the UK is ineligible for funding from the Cohesion Fund. But it also reflects relatively low allocations from the other funds too. Indeed, it is the third lowest allocation per person, roughly in line with the allocations of some of the other richer countries of Europe, such as Belgium and Denmark, but below that of others such as Germany and France.

**Table 2.1. ESI funding for the period 2014–20**

<i>EU policy area</i>	<i>ESI fund</i>	<i>Fund value (€bn)</i>	<i>UK allocation (€bn)</i>
Cohesion Policy	European Regional Development Fund	199.4	5.9
	European Social Fund	92.8	5.2
	The Cohesion Fund	63.3	0
Common Agricultural Policy	European Agricultural Fund for Rural Development	100.1	5.2
Common Fisheries Policy	European Maritime and Fisheries Fund	5.7	0.2
	<i>Total</i>	<i>461.8</i>	<i>16.4</i>

Note: The ESF values include €8.8 billion for the whole EU and €0.4 billion for the UK from the Youth Employment Initiative.

Source: Authors’ analysis of the European Commission’s ESI data via the Open Data Portal.

<sup>9</sup> European Commission, 2020c.

<sup>10</sup> A full list of the thematic objectives can be found in Article 9 of the Official Journal of the European Union (2013).

In the rest of this report, we focus on the first two funds: the ERDF and the ESF. These account for €11.1 billion or around two-thirds of overall ESI funding: around €1.6 billion in aggregate or €26 per person per year, on average. We focus on these because some information on allocation rules and outcomes is published, which is not true of the EAFRD or the EMF. However, while not explicitly confirmed, recent statements from the Department for Food and Rural Affairs suggest the EAFRD, at least, will be integrated with the UKSPF from next year.<sup>11</sup> Simply publishing the allocation rules and the resulting regional allocations (either ex ante or ex post) would therefore make the UKSPF more transparent than the EAFRD.

## 2.2 How are funding allocations to different regions determined?

ERDF and ESF allocations for different regions are determined in a two-stage process. First, the EU allocates funds to different member states and the regions within them, based on both the characteristics of the regions in each state, and the characteristics of the states as a whole. Second, governments of member states have some pre-defined flexibility to re-allocate funding between regions and can request additional flexibility from the EU, which is something the UK government has done.

### EU allocation rules

The EU decides how much funding to allocate to each member state based primarily on the characteristics of mid-sized regional divisions, termed NUTS level 2 geographies (or NUTS 2 regions, for convenience).<sup>12</sup> At the time the allocations were being set for the period 2014–20, the UK contained 37 NUTS 2 regions, with populations ranging from 469,000 (Highlands and Islands of Scotland) to 5.27 million (Outer London).<sup>13</sup>

The allocation rules are detailed in the EU regulations passed alongside each multi-year budget.<sup>14</sup> For the 2014–20 budget period, the process was as follows.

- The NUTS 2 regions were first categorised according to how the region's GDP per person in the period 2007–09 compared with the EU average GDP per person: (a) 'less developed' if it was less than 75%, (b) 'transition' if it was 75% to 90%, or (c) 'more developed' if it was above 90%. These cut-offs meant that the UK had 2 less-developed regions (Cornwall and the Isles of Scilly, and West Wales and the Valleys), 11 transition regions and 24 more-developed regions.
- 67% of the funding for ERDF and ESF was allocated to less-developed regions, 13% to transition regions, and 20% to more-developed regions of the EU.<sup>15</sup> These accounted for 24%, 14% and 62% of the population of the overall union in 2017.<sup>16</sup> This means that the average less-developed region is set to receive around 3.0 times as much per capita as the average transition region, and 8.7 times as much as the average more-developed region: a highly 'progressive' allocation, targeting most money at those regions with the lowest GDP per person. It also means small differences in GDP per person (e.g. 74.9% versus 75.1%) at the time of assessment can translate into very large differences in funding, which is difficult to justify. Such cliff edges in funding can, and should, be avoided in the design of the UKPF, while maintaining a highly progressive structure if so desired (see Section 4).

<sup>11</sup> Department for Environment, Food and Rural Affairs, 2019.

<sup>12</sup> NUTS 2 regions are a division of the Nomenclature of Territorial Units for Statistics (Eurostat, 2020).

<sup>13</sup> Population data are from ESTAT Population on 1 January 2017 by NUTS 2 region, downloaded on 13/02/20. Note that since the funding allocations were made, Inner and Outer London were split into several NUTS 2 regions, but these were aggregated back up for the purpose of this analysis.

<sup>14</sup> See Article 90 and Annex VII of the Official Journal of the European Union (2013).

<sup>15</sup> See Article 92 of the Official Journal of the European Union (2013).

<sup>16</sup> See note 15 for source.

- A set of formulas was then used to determine how funding was allocated between different regions in each category, with the precise formulas varying between categories.<sup>17</sup>
  - For less-developed and transition regions, regions with lower GDP per person, higher unemployment rates, and in member states with lower *national* gross national income (GNI), were allocated more funding.
  - For more-developed regions, regions with lower levels of educational attainment and lower population density were also allocated more funding by the formula.

Following the application of these formulas, a series of more ad-hoc adjustments were then made.

- Regions that in the previous assessment period had GDP per person below 75% of the EU average but which by 2007–09 had GDP per person above 75% of the EU average were then allocated a top-up to ensure they received at least 60% of their allocation in the previous period, adjusted for inflation.
- Greece, Italy, Portugal, Spain and parts of Ireland received top-ups to ‘address the effects of the economic crisis on member states within the euro area’.
- A series of further top-ups were made for parts of Belgium and Germany to reflect ‘long-standing effects of recent developments in their economy’.
- Finally, an additional €106.5 million was provided to the UK and €43.5 million to Ireland for ‘cross-border cooperation programmes involving Northern Ireland and Ireland’.

### Funding flexibilities exercised by the UK government

It is also important to note that member states had a high degree of flexibility in how they allocated funding between regions *within* the three categories. In agreement with the EU, they could also shift funding between regions in different categories of up to 3% of a category’s total allocation.<sup>18</sup>

The UK government made four important adjustments to the EU’s initial allocations for the 2014–20 period. First, to reduce the impact of reductions in the UK’s overall allocation on its poorest regions, the UK successfully requested an increase in the initial allocation to its two less-developed regions of over 10%. This was achieved by reducing allocations for more-developed and transition regions by 3% and 2.94%, respectively. Second, to mitigate significant reductions implied by the EU’s formula for regions in Northern Ireland, Scotland and Wales (a 27% reduction, on average), the UK government shifted funding from English regions in the same categories so as to achieve an equal percentage reduction in funding for each of the nations of the UK (5%).<sup>19</sup> Third, a decision was taken that, for England, regional needs had not changed significantly since the 2007–13 budgetary period. Therefore, the allocations for different regions remain based on the allocations for that period. These, in turn, were based on a basket of indicators including population, research and development spending, business start-up rates, academic qualification rates, employment rates and gross value added per capita.<sup>20</sup> Fourth, allocations were then mapped from NUTS 2 regions to LEP areas, using population to divide up funding between LEPs when boundaries did not align.

Decisions over allocations to regions within Scotland and Wales were devolved to the Scottish and Welsh governments, although in the latter case, EU rules effectively determined the allocations for the two regions in question (less-developed West Wales and the Valleys, and more-developed East Wales).

<sup>17</sup> Official Journal of the European Union, 2013.

<sup>18</sup> Official Journal of the European Union, 2013.

<sup>19</sup> Full details of the UK’s redistribution of funding from the European Commission’s initial allocations can be found on pages 101–105 of HM Government (2014).

<sup>20</sup> Department for Business, Innovation and Skills, 2013.

Scotland decided to treat its three more-developed regions as a single region for the purpose of deciding which specific projects to fund (see below).

### Discussion

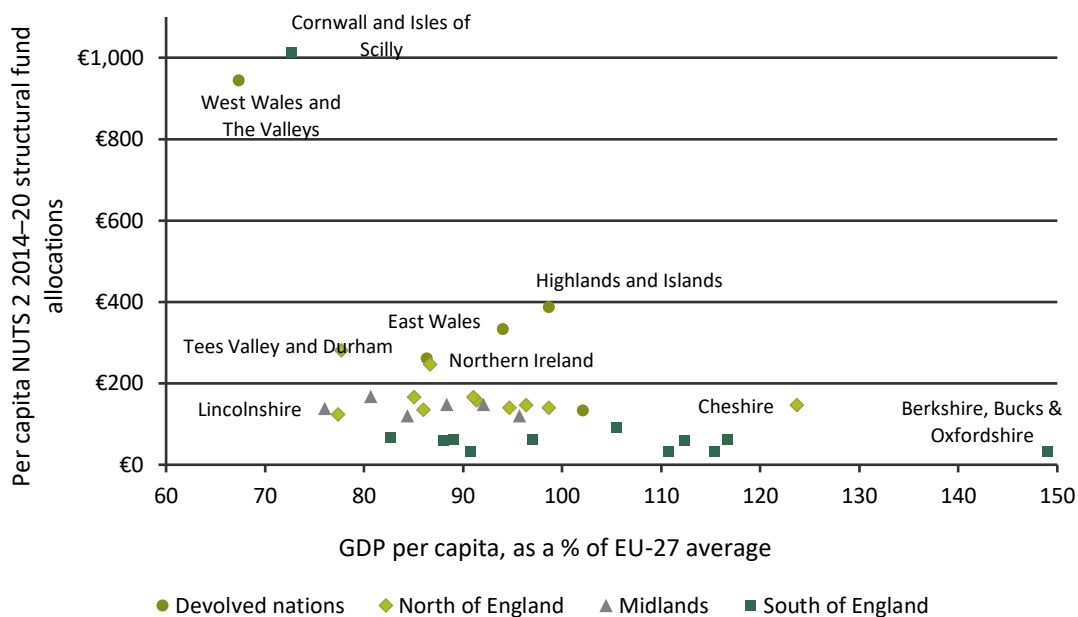
The combination of the decisions being taken at EU, UK and devolved government levels, the use of both indicator-based formulas and political negotiation and discretion, as well as a paucity of information, means that the allocation process lacks transparency. For example, the allocations implied by the EU formulas have not been published, meaning it is not possible to see how much the final allocations to NUTS 2 regions differ from these. However, while the EU has published the underlying formulas for allocating funding between regions, the UK government has not published full details of the formulas used to allocate funding between the NUTS 2 regions of England.

There is scope for significantly greater transparency in the calculation of allocations of the UKSPF. This would facilitate debate and scrutiny of the allocation decisions, including any transitional arrangements or formula-bypasses.

### 2.3 What are the resulting regional allocations?

Figures 2.1 and 2.2 show the allocations for each of the NUTS 2 regions of the UK: in Figure 2.1, these are plotted against their levels of GDP per person, and in Figure 2.2 geographically.<sup>21</sup>

**Figure 2.1. Comparison of UK regional GDP per capita and structural fund allocation**

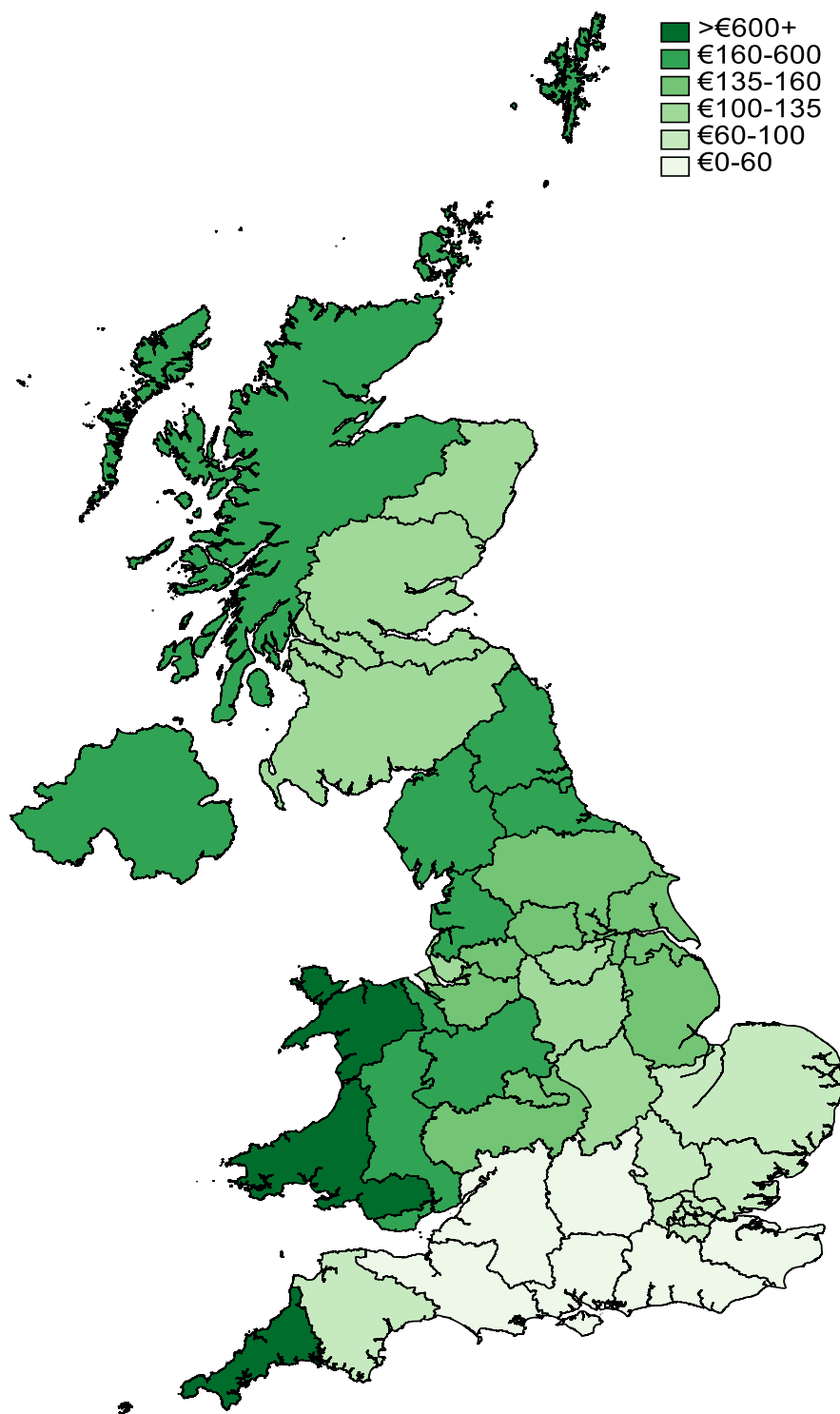


Note: Regional GDP statistics are now only available for the most recent 2016 NUTS classification boundaries. Therefore, we have been required to map 2016 regional GDP statistics back to their 2010 NUTS geographies to compare funding allocations, which may cause minor inaccuracies. Per capita funding has not been published for all of Scotland's NUTS 2010 regions: North Eastern Scotland, Eastern Scotland and South Western Scotland were grouped as 'rest of Scotland' and are therefore presented here as one with a weighted average GDP per capita. For clearer axes, Inner London has been removed from the graph.

Source: Regional GDP per data from Eurostat. NUTS level 2 regional allocation taken from Department for Business, Innovation and Skills (2014a).

<sup>21</sup> Recall that, in practice, allocations for England are then mapped over to LEPs. LEPs presently have overlapping boundaries so therefore we focus on the pre-mapping NUTS 2 allocations in these figures.

Figure 2.2. Comparison of UK regional per capita structural fund allocation



Note: Regional GDP statistics are now only available for the most recent 2016 NUTS classification boundaries. Therefore, we have been required to map 2016 NUTS regional GDP statistics back to their 2010 NUTS geographies to compare with funding allocations, which may cause minor inaccuracies. Per capita funding has not been published for all of Scotland's NUTS 2010 regions: North-Eastern Scotland, Eastern Scotland and South-Western Scotland were grouped as 'rest of Scotland' and are therefore presented here as one region with a weighted average GDP per capita. For clearer axes, Inner London has been removed from the graph.

Source: Regional GDP per capita data from Eurostat. NUTS 2 regional allocations taken from Department for Business, Innovation and Skills (2014a).

The figures show clearly that the two less-developed regions – Cornwall and the Isles of Scilly, and West Wales and the Valleys – have been allocated much greater funding than any other region: €1011 and €943 per person, respectively, for the period 2014–20 as a whole.<sup>22</sup> This contrasts with the allocations for Lincolnshire (€137) and South Yorkshire (€123), whose GDP per capita of 76% and 77% of the EU average, respectively, puts them just above the cut-off for being transition regions as opposed to less-developed regions. The sharp drop off in funding around the 75% threshold can be seen clearly in Figure 2.1. The drop off is much less apparent between the transition and more-developed regions around the 90% GDP cut-off. Indeed, with the exceptions of the Highlands and Islands and East Wales, no other regions are receiving more than 30% of the funding per person allocated to the less-developed regions.

Figure 2.1 also shows that among the categories of transition and more-developed regions, there is almost no correlation between funding allocations and GDP per person. For example, East Wales and the Highlands and Islands of Scotland, which have the highest allocations after the two less-developed regions, are roughly in the middle of the league when it comes to their GDP per person. However, there is a clear North–South divide in funding allocations, within England, with NUTS 2 regions in the North receiving more than those in the Midlands, which in turn are receiving more than those in the South, conditional upon GDP levels, as shown in Figure 2.2.

## 2.4 How is funding allocated to specific projects?

In order to access and spend the funding allocated to each region on specific projects, a further series of EU as well as UK government and devolved government rules and processes must be followed.

### Spending restrictions by objective

Member state governments have to agree an Operational Programme (OP) with the EU, setting out how they plan to spend and monitor their funding allocations, and how they will adhere to EU rules. While the agreement is between the UK government and EU, in practice the OPs for Scotland, Wales and Northern Ireland were developed by their devolved governments.

These OPs must identify ‘investment priorities’ that support the delivery of ‘priority axes’, which align with the ‘thematic objectives’ agreed for each funding period. Rules setting out the amounts to be spent on different ‘thematic objectives’, called ‘thematic concentrations’, are also agreed for each funding period.<sup>23</sup> The rules depend on both the specific ESI fund and the categories of region, and are most restrictive for more-developed regions, and least restrictive for less-developed regions. For the ERDF, the European Commission requires spending primarily on research and innovation, information and communication technologies, SMEs and the support of a low-carbon economy. For the ESF, most resources are required to be spent on up to five different investment priorities from a list of 19 possible priorities, and at least 20% spent on ‘promoting social inclusion, and combating poverty and any discrimination’.

The aim of these rules is to ensure that funding is spent on those areas deemed to be priorities by the EU and to help ensure that funding for different types of policies is sufficiently large that it can have a meaningful impact (rather than being too widely dispersed). However, they are also essentially arbitrary and, in some cases, could mean that funding cannot be spent on projects with the highest rates of return or deemed most suitable by national or local policymakers, especially in developed regions where the rules are most binding. More generally, the need to agree plans at the start of the multi-year budget period limits the scope for reallocating funds as priorities change.

<sup>22</sup> Structural Funds Equalities Impact Assessment, accessed on 21/02/20.

<sup>23</sup> The exact requirements on spending by ‘thematic objective’ for the ERDF can be found in Article 4 of Official Journal of the European Union (2013).

As discussed more in Section 3, one option for simplifying and increasing the flexibility of the UKSPF is to relax or abolish such rules.

### Co-financing requirements

Co-financing rules also mean that EU funds can only be used to fund a proportion of the cost of projects. These are agreed as part of each member state's OP, but are guided by a series of rules. The proportion of costs that can be covered by EU funds varies by regional category: generally, 80–85% for less-developed regions, 60% for transition regions and 50% for more-developed regions.<sup>24</sup> The remaining costs must be met by national or subnational governments, or by those bidding for funding.

The justification for these co-financing requirements is to ensure 'local ownership' of projects, given local funding is also invested in them. However, these could prevent certain beneficial projects being funded if those bidding for funding do not have access to sufficient co-funding, and/or if the government is unable or unwilling to co-fund projects from other revenue streams. Again, these issues are likely to be more of a concern for regions defined as more developed, given the higher co-financing requirements. One way to increase the flexibility of the UKSPF would be to abolish rules on co-financing and instead to incorporate the assessment of the co-financing arrangements proposed for different projects as part of the general appraisal process. Projects with low or even no co-financing could then be funded if their overall value-for-money was considered high enough to warrant funding.

### How are projects selected for investment?

Taking into account these rules on thematic concentrations and co-financing, the authorities managing ESI funds must select which specific projects to fund.

The process of soliciting and selecting projects differs across the nations of the UK. For Scotland, the Scottish government first allocates funds to different government departments, agencies and local authorities, which then distribute the funding between individual projects and organisations through either specific or rolling calls for proposals.<sup>25</sup> In Northern Ireland, two calls for proposals for projects seeking ESF funding are run, while those interested in applying for ERDF funding are asked to contact Invest NI.<sup>26</sup>

For England, the standard route to access funding is by responding to calls for applications for particular regions and particular investment priorities, which are issued by the government in partnership with LEPs.<sup>27</sup> In particular:

- the government engages with LEPs about local growth priorities, uses the outcome to draft calls for projects that address these priorities and posts these online;
- the government then assesses and appraises the applications received and, with input again from LEPs, selects which projects to fund;
- a funding agreement is drafted and signed, setting out the terms of the funding, including co-financing provided by applicants.

Selection of projects in Wales happens in two stages.<sup>28</sup> First, those applying for funding must contact the Welsh European Funding Office (WEFO) to discuss their proposal, starting the Pre-Planning Stage. This tests the suitability of a proposal for EU funding and requires applicants to set out how their proposal

<sup>24</sup> For full details on co-financing requirements, see Article 60 and Article 120 of Official Journal of the European Union (2013).

<sup>25</sup> Scottish Government, 2020.

<sup>26</sup> See Investment for Growth and Jobs Northern Ireland (2020) and Department for the Economy (NI) (2020).

<sup>27</sup> Access to EAFRD funding may not follow this exact procedure. Also, for some ESF activity, the route is through an application from a co-financing organisation which will then competitively select organisations. Full details of the process can be found in Department of Communities and Local Government (2015).

<sup>28</sup> Welsh Government, 2020.



would help meet the objectives set out in the OP for Wales and help the sectors or groups targeted. Projects that pass this stage must then submit a formal business case that is assessed by the WEFO, as part of the Business Planning Stage. Projects are rated according to the extent to which they demonstrate strategic fit with objectives set out in the OP, how they would ensure delivery, sustainability, value-for-money and financial compliance, with ratings of ‘minimal’, ‘low’, ‘medium’ and ‘high’.

Compared with the English approach, the Welsh approach involves less explicit competition between project proposals, which may make it harder to ensure that the best proposals aimed at particular issues are being selected. Involvement of regional or local bodies in decision-making is also less explicit. However, the avoidance of specific calls gives more discretion to project applicants in the types of projects and their geographical focus than in England. Also, applicants are provided with more support to navigate the system in Wales than England, with WEFO staff and regional advisors supporting applicants through the application process. As discussed further in Section 3, the role of competitive bidding and the extent to which processes and rules are allowed to vary across the UK are key issues for the UKSPF.

## 2.5 How effective are European regional development funds?

There is a wide literature on the design and effectiveness of ESI funding, which can inform decisions about the design of the future UKSPF.

Most higher-quality studies make use of the fact that the funding allocations for ESF and ERDF funding are based on sharp thresholds of relative GDP per person. In particular, funding per person is much higher if a region’s GDP per person is below 75% of the EU average (i.e. it is classified as ‘less developed’). A comparison of outcomes in regions just above and below this threshold, and in regions that move above or below this threshold over time, can yield insights into the effectiveness of such funds.<sup>29</sup> However, results from the literature must be taken with caution as the quality of methodology varies considerably.<sup>30</sup>

Insights from the literature can be divided into two main categories. The first category is estimates of the strength and duration of any impact of EU development funds. In the second category, the influence of programme design and implementation, and the characteristics of regions receiving funding are examined.

### How strong/long-lasting is the impact of EU regional development funds?

- Becker et al. (2018) find significant positive effects of the receipt of EU development funds on annual per capita income growth rates of 1–2%. However, there is significant variability within these estimates, and the effect seems to be much lower over the most recent funding cycles they examine (2000–13). There are no clear effects on employment growth, implying that increases in overall growth reflect increases in output per worker. Becker et al. (2010) find similar growth effects of 1.6%, and they find that the benefits of the funds outweigh the costs on a ratio of 1.2:1.
- Pellegrini et al. (2013) find a lower growth effect of 0.6–0.9% over the period 1995–2006. Over this period, most regions receiving significant funding were in Ireland, Spain, Greece, East Germany and Southern Italy, which may have experienced catch-up growth relative to the comparison group of more-developed areas.

<sup>29</sup> The specific research design used is usually regression discontinuity (RD) around the 75% threshold. Care must be taken to explore whether changes in funding occur sharply at this threshold. In addition, the presence of other factors or pre-existing trends relating to the threshold factor can mean results are not robust.

<sup>30</sup> In 2016, the What Works Centre for Local Economic Growth conducted a review of the literature and found only 18 studies that it assessed to be robust (after considering a short-list of 190). Often, this is because researchers do not successfully isolate the effect of the policy intervention as they fail to identify an appropriate counterfactual.

- Becker et al. (2018) also find that regions that lose access to ESI funding (either because the GDP threshold moves or because regional GDP moves above the threshold) see lower economic growth. This suggests that the positive growth effects seen from funding are not permanent and that funding either boosts growth via demand-side effects or has only temporary effects on the supply-side of the economy.
- There are two notable studies specific to the UK, although the research design means the results should be treated with caution. Evidence presented in Di Cataldo (2017) suggests an aggregate positive impact of structural funding on regional GDP per capita. However, Di Cataldo and Monastriotis (2020) suggest that this effect is only temporary and disappears when funding is withdrawn, as was seen with comparisons across the wider EU. This should be taken into account when designing the UKSPF, with a focus on the long-term drivers of productivity potentially worthwhile.

### **Which factors determine the effectiveness of EU regional development funds?**

- A number of studies find that the quality of both human capital and institutions in regions influences the 'absorptive capacity' of regions to use ESI funding effectively. Becker et al. (2013), in particular, find that positive effects on growth are only found in areas with above average human capital and institutional quality. This suggests that a skilled workforce and good-quality governance are needed to take full advantage of regional development funds. Further evidence from Pinho, Carum and Antunes (2015) suggests that 'innovative regions' see a bigger boost to growth from receipt of ESI funds.
- Bahr (2008) finds that increased subregional autonomy increases the impact of EU development funds. In particular, improved quality of governance on a local level, accompanied by increased 'autonomy' and discretion over spending priorities, leads to better outcomes. In the context of the UK, this may suggest providing greater discretion to local areas where strong and effective economic governance structures are in place, and working to boost effectiveness in other parts of the country.
- Focusing on the UK, Di Cataldo and Monastriotis (2020) find that alignment between funding efforts towards particular areas and regional needs improves outcomes on receipt of development funding, whereas misalignment has the opposite effect. This points to the possible importance of matching funding allocations to the requirements of specific areas, and suggests both that a 'one size fits all' approach to the design of the UKSPF may be inadvisable, and that local discretion is likely to be important.

### 3. Key issues for the design of the UK Shared Prosperity Fund

The UK government will need to take a range of decisions on the objectives, allocations and rules of the UKSPF, and how the fund should relate to other elements of regional and economic development policy. In taking these decisions, the UK government should seek to build on and learn lessons from the existing EU schemes discussed in the previous section. But a more fundamental assessment of the range of options and their potential pros and cons is also worthwhile. Therefore, in this section, we outline what the government has said so far about its plans for the UKSPF, and we discuss options and issues for areas where decisions still need to be taken. Finally, we seek to place the UKSPF in the context of other regional funding schemes.

#### 3.1 What has the government said about the UKSPF?

The UKSPF was announced as part of the Conservative Party's 2017 General Election Manifesto, and a commitment to it was restated in the 2019 manifesto.<sup>31</sup> However, apart from the information that can be gleaned from a handful of written statements and responses to parliamentary questions, we have learned little about the government's specific plans over the intervening three years.

The information the government has confirmed is the following.

- The high-level objective of the fund will be 'to tackle inequalities between communities by raising productivity, especially in those parts of the country whose economies are furthest behind'. The 2019 Conservative manifesto reiterated the focus on 'tackling inequality and deprivation' and pledged £500 million annually to skills development.
- There will be a very strong link with the government's Industrial Strategy, and the creation of Local Industrial Strategies, which aims to raise the UK's productivity by supporting what the government terms the five 'foundations' of productivity: ideas, people, infrastructure, business environment and places.<sup>32</sup>
- Emphasis will be placed on making the fund simpler and easier to access than the ESI funds.
- The operation of the UKSPF will, as far as the UK government is concerned, respect the Northern Irish, Scottish and Welsh devolution settlements. Moreover, each nation will receive at least as much funding as under existing EU schemes.

But this leaves many important questions still to be addressed, including the following.

- A more specific set of objectives or priorities for the funds.
- Rules on the allocation of funds between different regions or locales, including the geographical units over which allocations will be made.
- Rules on how funding can be spent.
- The relationship between the UKSPF and other regional and place-based funds focused on economic development.

<sup>31</sup> Conservative Party, 2017, 2019.

<sup>32</sup> HM Government, 2017.

- The overall level of funding allocated to the UKSPF – which will involve trade-offs with other areas of spending and levels of taxation and borrowing. These trade-offs may be more challenging now than initially anticipated, given the short-term and likely longer-term hit to the public finances as a result of the COVID-19 crisis.

### 3.2 What could the objectives of the UKSPF be?

While the government has stated the high-level objectives of the UKSPF, a set of more specific objectives and priorities are likely to be needed to allow for appropriate policy design, project appraisal and programme evaluation, as discussed in the government’s guide to policy design and appraisal (the ‘Green Book’).<sup>33</sup>

- **Will the ESI fund aim of convergence be carried over to the UKSPF?**  
A key feature of the ESI funds is the goal to reduce inequalities between regions across the EU. With the Johnson administration’s focus on ‘levelling up’ economic performance and living standards across the country, we may expect the UKSPF to have the same objective. However, it remains to be seen whether this will be an explicit aim against which the performance of the fund will be measured. This could have important implications for the indicators used to allocate funding across regions and to specific projects, and the measurement and evaluation of programme outcomes.
- **Which inequalities will the fund seek to address?**  
Precisely which inequalities will be targeted is also unclear. For example, a focus on regional differences in productivity may yield different policies and funding allocations to one focused on regional differences in employment and household incomes. ESI funds have social as well as economic objectives, and although manifesto commitments on the UKSPF talk of reducing inequalities, it is unclear whether these social objectives will be carried over.
- **What will the desire for a simple and easy-to-access fund mean in practice?**  
The government has also stated that the UKSPF will be simple and easy to access. Such implementation-focused objectives will likely generate a trade-off against the desire for detailed, outcome-focused objectives, as the latter would likely necessitate a greater number of rules surrounding the allocation, spending and monitoring of the fund.

### 3.3 How will allocations be made across the UK?

Once the objectives of the UKSPF have been established, there are several factors that need to be considered relating to how the funds are allocated, including:

- whether funding should be pre-allocated to regions or subject to competitive bidding;
- the factors that need to be considered when designing a needs-based funding formula;
- and whether the rules for allocating funding to the devolved nations should differ from those used to allocate funding to the regions of England.

Within each of these factors, several questions need to be answered.

#### **Should funding be pre-allocated to regions or subject to competitive bidding?**

As discussed in Section 2, ESI funds are currently pre-allocated to regions based on needs-based formulas and political judgements. However, several UK place-based funding policies, such as the Single

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<sup>33</sup> HM Treasury, 2018.

Regeneration Budget in the 1990s and, more recently, Local Growth Deals, have been allocated on a competitive basis across regions (we discuss the latter scheme in more detail below).

To the extent that the appraisal process is able to identify high-quality bids, competitive bidding between regions could increase investment returns and maximise impacts on productivity and other targeted outcomes. However, competition could also lead to some regions missing out on funding, and regions with weaker governance and institutions – which might be in particular need of support – may be expected to particularly struggle to craft high-quality and competitive funding proposals.

Evidence on the impact of competitive bidding is fairly limited but a number of studies have examined the role it played in the implementation of the Single Regeneration Budget and other schemes in the UK in the 1990s.<sup>34</sup> These studies paint a decidedly mixed picture. On the one hand, competitive bidding led to improvements in bid quality over time, albeit fairly modest in scale and concentrated among the lower tail of rejected bids rather than those actually selected for funding. Failed bidders also highlighted how the competitive bidding process had encouraged them to work more closely with local partners to develop stronger bids. On the other hand, variables related to bid presentation (e.g. the inclusion of maps in bid documents) were found to be stronger predictors of success than the extent to which bids met the strategic objectives of the programme.<sup>35</sup> Evidence on the extent to which competition diverted funding from poorer regions is contested: the official evaluation commissioned by the government emphasises the relatively high share of funding received by local authorities serving more deprived communities;<sup>36</sup> but other work suggests that more deprived areas were only a little more likely to receive funding, conditional upon bidding, despite the programmes being targeted at addressing problems associated with deprivation.<sup>37</sup> This latter study also suggests that areas represented by the incumbent political party were, in some regions, more likely to have funding bids approved. However, formulas can also be tweaked to provide additional support for politically important areas, as has been shown for local government funding.<sup>38</sup>

Given this mixed picture, one option would be to allocate some funding to regions by formula and some by competitive bidding. This is the approach taken with the Stronger Towns Fund announced in March 2019, which allocated £1 billion of an initial £1.6 billion via a formula-based needs assessment, but reserved £600 million to be allocated via a competitive bidding process.<sup>39</sup>

### What factors need to be considered when designing a needs-based funding formula?

If at least some of the funding is pre-allocated to regions on the basis of assessed needs, key issues to consider include the following.

- **What characteristics should be used for assessing ‘need’ for regional funding?**

As already mentioned, allocations of ESI funding to regions are based on GDP per capita, as well as regional employment and unemployment rates, population size and density, educational attainment and geographical remoteness. An obvious question is therefore whether these are the right characteristics on which to base funding allocations, or whether there are other characteristics that should be used. This could include measures of deprivation – such as the Index of Multiple Deprivation (IMD) – or household incomes, inequality measures (such as inequalities in earnings, household incomes and/or between neighbourhoods *within* regions) and updated measures more

<sup>34</sup> See Taylor, Turok and Hastings (2001), John, Ward and Dowding (2004) and John and Ward (2005).

<sup>35</sup> These were: enhancing employment prospects and skills; encouraging sustainable economic growth; improving housing; benefiting ethnic minorities; tackling crime and safety; protecting and improving the environment; and enhancing the quality of life.

<sup>36</sup> Rhodes, Tyler and Brennan, 2007.

<sup>37</sup> John, Ward and Dowding, 2004.

<sup>38</sup> Hilber, Lyytikäinen and Vermeulen, 2011.

<sup>39</sup> HM Government, 2019a.

suitable for UK contexts (such as different measures of population sparseness or geographical remoteness).

- **At what geographical level should such assessments take place?**

The larger the geographical areas used, the greater the extent to which there could be significant inequalities *within* areas. If it is felt that economic disadvantage is determined by local characteristics, and that positive (and negative) spillovers between locales are fairly limited, then assessment and allocation of funding to smaller geographical areas may be beneficial. This could be the case if the fund places a greater emphasis on deprivation and poor social outcomes, which are often localised, with deprived communities found in regions that are relatively affluent overall, and vice versa.

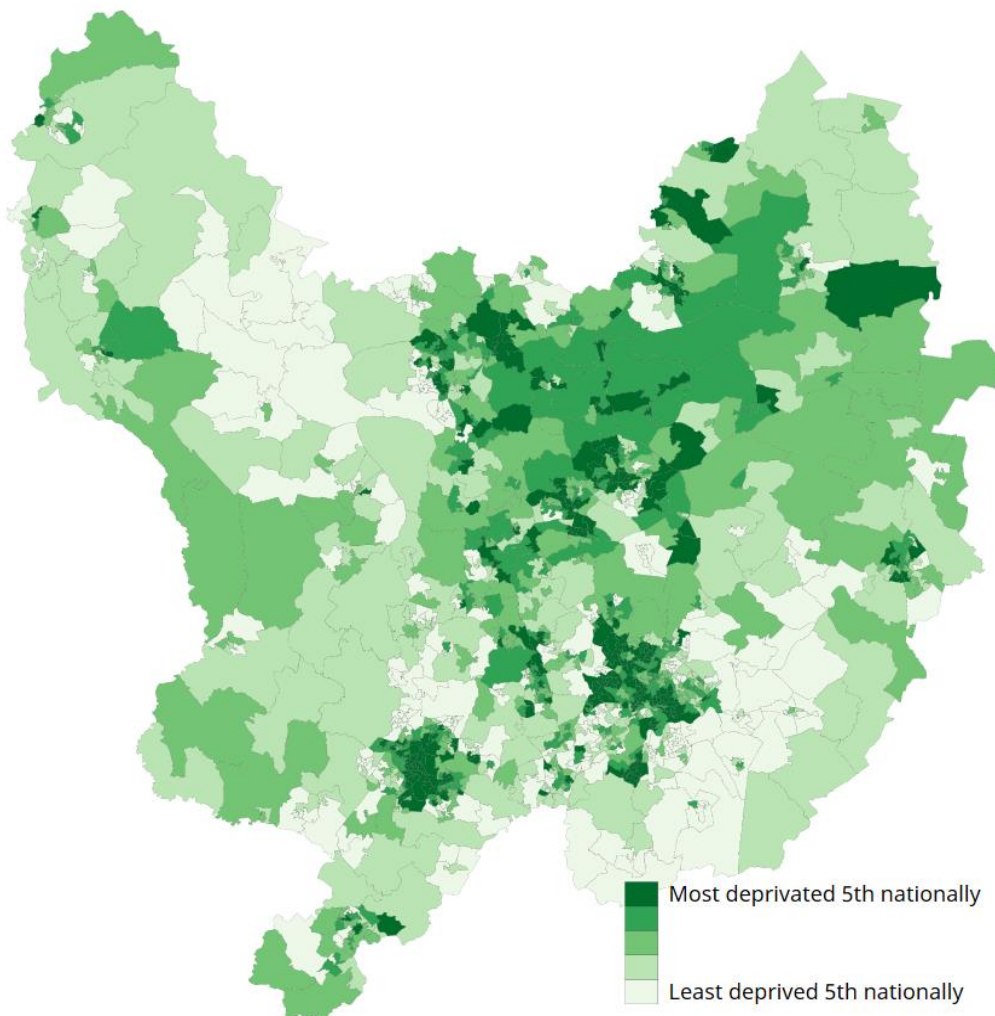
However, if it is felt that spillovers are greater, and there are benefits from choosing from the bigger pool of (and possibly bigger scale) projects that bigger areas can support, then there may be benefits from keeping relatively large geographical areas. However, existing NUTS 2 regions are unlikely to be the appropriate large areas given that their boundaries do not align with functional economic areas.

For England, it seems likely that the government will use LEPs as the unit of geography for assessment and allocation, given their role in developing and delivering local industrial strategies and the realignment of LEP boundaries to avoid overlaps.<sup>40</sup> LEPs are designed to cover functional economic areas – which is one of the reasons why NUTS 2 level allocations of ESI funding have been mapped over to LEPs since 2014. However, several LEP areas have very large populations and include sub-areas with very different levels of productivity, household income and deprivation. For example, the South East LEP includes affluent London commuter areas such as Epping Forest and Sevenoaks, and more peripheral areas with lower productivity and higher levels of deprivation such as Hastings, Thanet and Tendring. Further away from the capital, the Derbyshire and Nottinghamshire LEP, illustrated in Figure 3.1, contains large pockets of deprivation in the cities of Nottingham and Derby as well as some of the former industrial towns in the north of the LEP, but also large areas with very low levels of deprivation, especially in the city suburbs and in the more rural Rushcliffe and the Derbyshire Dales. In this context, it does seem worthwhile taking into account such within-LEP inequalities between neighbourhoods when deciding funding allocations and potentially the use of funding.

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<sup>40</sup> Ministry of Housing, Communities and Local Government, 2018c.

**Figure 3.1. Deprivation, as measured by the IMD by Lower Super Output Area in the Derbyshire and Nottinghamshire (D2N2) LEP**



Note: Using 2019 English Indices of Deprivation for Lower Super Output Areas by quintiles of ranks.

Source: Ministry of Housing, Communities and Local Government (2019b).

- **How redistributive/'targeted' should the funding be?**

As discussed in Section 2, allocations of ESI funding are highly progressive but rely on thresholds that create dramatic and arbitrary differences in funding allocations for regions that are very similar economically but fall either side of the thresholds. The government could maintain a similar overall degree of progressivity even without such thresholds (although those just below and just above the thresholds would likely lose and gain, somewhat, relative to the current system). Alternatively, it could seek to increase or decrease the progressiveness of the system. This choice should be guided by the objectives of the fund and, in particular, the importance of reducing geographical socio-economic inequalities relative to boosting productivity across the country – the more important the former relative to the latter, the more progressive the allocations should be.

- **Should transitional arrangements protect regions losing funding?**

As discussed in the previous section, those regions that lost eligibility for the highest levels of funding in the 2014–20 period are entitled to a funding top-up guaranteeing them at least 60% of their former funding levels. The UK government has already guaranteed that each nation of the UK will receive at least as much funding as under the existing EU schemes, but it may want to extend a degree of transitional protection to regions within England that would lose funding as a result of the



new formula used to allocate funding. However, this means either that those regions that would gain have to wait longer to see increases in their funding, or that additional funding has to be provided by the government.

- **How long should funding cycles last for?**

Currently, ESI funds are allocated for seven-year periods based on the characteristics of areas between five and seven years prior to the commencement of funding. Maintaining or increasing the length of funding cycles would provide greater stability and certainty to recipients, potentially enabling longer-term projects. It would also lessen the risk that local and regional governing bodies will avoid doing all they can to boost local economic performance for fear of losing funding in future. While it is unclear the extent to which such financial incentives will matter, similar considerations underlie reforms to increase the extent to which devolved and local government funding depends on local tax revenues.<sup>41</sup> However, long funding cycles reduce the speed with which funding allocations can reflect changes in the relative needs of different regions. Especially when funding is allocated to smaller geographical areas, such changes can be fairly rapid, such as the closing or opening of a large employer (or several medium-sized employers). And this issue is especially pertinent now given the uncertainty about the long-run economic impacts of the COVID-19 crisis – discussed in more detail in Section 5.

One option would be to undertake partial rather than full reassessments, so that changes in characteristics are only partially taken into account when updating funding allocations. Such an approach has been suggested for general funding for councils as part of the government’s Fair Funding Review.<sup>42</sup>

- **Is there a role for ‘outcomes’ as well as ‘characteristics’ in determining funding allocations?**

Concerns about the incentive effects of needs-based funding could also be addressed by basing some of the funding on ‘outcome’ measures. For instance, a fairly mechanical approach could be that as well as negatively depending on the *level* of GDP or productivity or educational attainment, reassessed allocations could depend positively on the *growth rate* of these variables. They could also depend upon evaluations of the projects funded by previous funding rounds and, more generally, of the economic and other policies of the areas in question: although the more subjective the assessments are, the greater the scope for disagreement, opaqueness and political manipulation.

### 3.4 What rules should apply to the use of UKSPF funding, and where should decision-making powers lie?

As discussed in Section 2, EU rules (e.g. on thematic concentrations) restrict the type of projects that can be funded presently, especially in more developed regions. Moreover, decisions over which projects to fund in England are formally taken by central government, albeit with input from LEPs at each stage of the process. Responsibility for designing and managing schemes in Northern Ireland, Scotland and Wales is delegated to the devolved governments of these nations though. In designing the UKSPF, a decision needs to be taken on whether to retain or reform these arrangements.

- **Should UKSPF funding be ring-fenced for particular types of projects?**

Given it has been stated that the UKSPF will support the government’s Industrial Strategy, one option would be to restrict funding to projects that align with one of the five pillars of that strategy. These include: supporting innovation (‘ideas’); generating jobs and greater earning power (‘people’); upgrading infrastructure; and facilitating and promoting business start-up and growth (‘business environment’).

<sup>41</sup> Department for Communities and Local Government, 2016.

<sup>42</sup> Ministry of Housing, Communities and Local Government, 2018b.



Ring-fencing funding for projects with a clear focus on socio-economic development may help to ensure that the UKSPF has a clear purpose relative to other funding streams, and may make monitoring and evaluation easier. However, allowing greater discretion would allow recipient regions to spend money on areas they deem to be local priorities. This could include investments or services not generally thought of as being related to economic development (such as health, social care or general education) but which nonetheless could have significant impacts on economic and more general well-being.

- **Where should decision-making power lie?**

The abolition of rules on ‘thematic concentrations’ may facilitate further devolution of decision-making powers to LEPs (or other regional or local governance bodies) in England. This is because central government would no longer have to ensure that particular shares of funding go to projects meeting particular objectives.<sup>43</sup> As discussed in Section 2, regions with stronger and more effective governance are likely to benefit most from further devolution. Therefore, one option would be to devolve additional decision-making powers to areas with stronger governance structures in place, such as the mayoral combined authorities. However, without plans to strengthen governance in other regions, this could lead to central control persisting in many parts of the country on an ongoing basis.

The powers of the Northern Irish, Scottish and Welsh governments, and in particular, the degree of autonomy they will have to allocate UKSPF funding between regions and projects, need to be clarified. A role for the UK government in allocating funding between locales and projects within these countries would represent a reduction in autonomy compared with the current EU schemes. At the other end of the spectrum, an option suggested by the Welsh Government and Welsh Assembly’s Finance Committee<sup>44</sup> is to add UKSPF allocations to the block grant funding provided to the devolved governments, allowing them to spend this funding as they see fit, as they can for other devolved responsibilities (such as health, education, transport, etc.). In doing this, it would be important that the allocations were still determined by the formulas (and any transitional protections) used specifically for the UKSPF rather than the Barnett formula: the latter formula has significant shortcomings, as discussed in Bird and Phillips (2018). And such an approach would only be practical for the formula-based element of funding; competitive bidding for funds by the regions and nations would necessarily involve centrally imposed restrictions on funding use (for the specific purposes set out in their bid proposal) and potentially on funding proposals (to aid comparability and evaluation).

### 3.5 How will the fund relate to other regional and place-based policies?

In designing the UKSPF, it will also be important to recognise that it will not sit in a policy vacuum. Other government spending and programmes also aim at supporting economic development and improving economic performance, some of which have a particular focus on areas with weaker economies. How the UKSPF interacts and relates to these other policies will matter, as a multiplicity of overlapping schemes with similar but somewhat differing rules and objectives risks complexity, inconsistent practice across the country, and sub-optimal outcomes.

Table 3.1 gives details of spending and some of the main features of schemes currently in place in England, as well as the existing ESI funds provided via the ERDF and ESF. It shows that the total annual budget for these ESI funds – approximately £1.37 billion per year for the UK as a whole and £0.88 billion a year for England – is fairly sizeable relative to these other schemes.<sup>45</sup> For example:

<sup>43</sup> The government could have formally devolved responsibility for decision-making and imposed these rules at the level of individual LEPs. However, while this would have meant more formal autonomy, it could have meant less autonomy in practice. This is because by retaining formal decision-making powers itself, the government can allow variations in spending across themes in individual LEPs, while ensuring that the EU’s rules are met for England as a whole.

<sup>44</sup> National Assembly for Wales Finance Committee, 2018.

<sup>45</sup> Using the GBP–EUR exchange rate on 30 June 2017, midway through the funding cycle, £1 = €1.1391.

- The £9.1 billion of ‘Growth Deals’ announced for England between 2014 and 2017 cover the period 2015–16 to 2020–21, making the annual funding approximately 1.7 times that provided by the ERDF and ESF.
- Net current expenditure on economic and community development by English local government in 2019–20 was budgeted to be £0.75 billion,<sup>46</sup> around 85% of that provided by the ERDF and ESF. Moreover, net expenditure on these services has declined from £1.7 billion in real terms in 2009–10.
- And the post-Brexit Towns Fund of £3.6 billion for English towns, covering the period 2019–26, amounts to around £0.45 billion a year, or just over half that provided by the ERDF and ESF.

This means that the UKSPF will likely be the largest source of funding for economic development focused specifically on reducing geographical economic inequalities. Growth Deals (and the similar ‘City Deals’, which are primarily vehicles for devolving existing powers and spending to city regions) are just that: deals with local government bodies, in this case LEPs, with the amount of funding awarded based on an implicit competition between LEP areas, with the policy paper stating that:

*‘LEPs with the strongest strategic plans that demonstrate their ability to deliver growth will gain the greatest share [of the funding available]’.*<sup>47</sup>

This focus on growth rather than regional convergence means that some LEPs covering relatively affluent areas have received high levels of funding per resident, including Hertfordshire, Oxfordshire and the West of England (which covers the Bristol city region) LEPs, while others have received relatively low levels of funding, such as the South East Midlands and Enterprise M3 (which covers north and central Hampshire and west Surrey) LEPs.<sup>48</sup> Similarly, while some LEPs covering relatively disadvantaged areas, such as the Lancashire, Liverpool City Region and Greater Manchester LEPs, have received high levels of funding, others including the Stoke and Staffordshire and Derbyshire and Nottinghamshire LEPs have received relatively little.

Figure 3.2 shows that this means there is only a very weak positive correlation between Growth Deal funding and ESI funding (which is targeted at poorer areas, especially in the Midlands and the North). Cornwall is omitted for reasons of presentation, but is an example of an area receiving very high ESI funding of over €150 annually per person, but relatively low Growth Deal funding of around £24 annually per person.

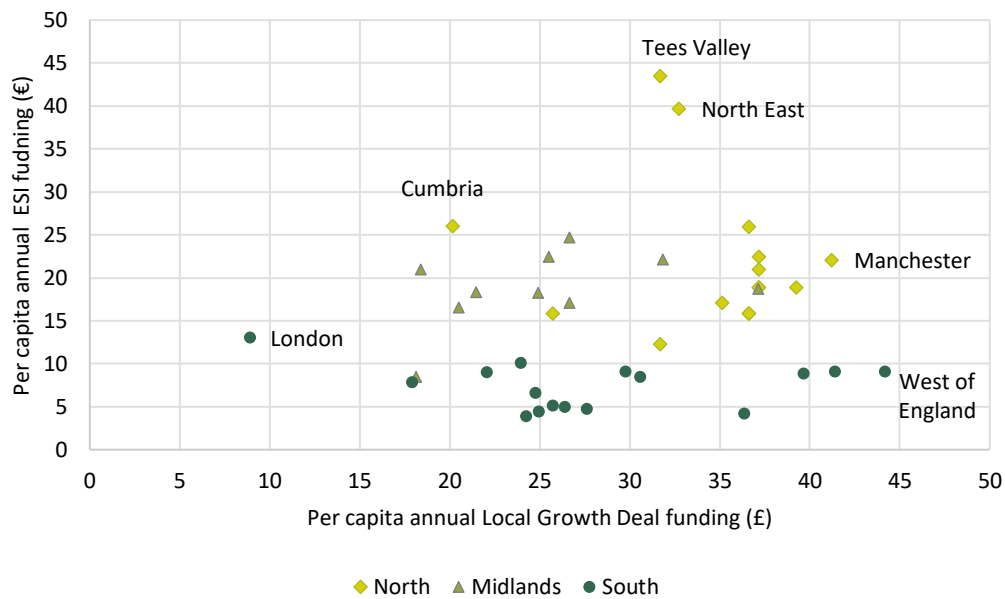
Money from the Growth Deals covers housing and transport, in addition to the skills, digital infrastructure and business development activities that are the mainstay of the ERDF and ESF. In order to avoid duplication and omission, LEPs were asked to develop strategic plans that encompassed both sets of funding. Similar coordination between the UKSPF and any further Growth Deal funding would likewise make sense.

How the UKSPF sits alongside the more recent Towns Fund – £1 billion of which has been allocated using a needs-based formula based on productivity, income and skills, and the rest of which is subject to competitive bidding – also needs to be considered. While the focus of this fund is on ‘left behind’ towns, rather than economically disadvantaged areas more generally, its aims have significant overlap with the UKSPF: business development, training for local people, digital and transport connections are all mentioned as potential uses of the fund, as are investments in property development and regeneration and cultural facilities. A smaller ‘Transforming Cities Fund’, allocated via competitive bidding, is focused on transport connections within and to cities.

<sup>46</sup> Authors’ calculations from Ministry of Housing, Communities and Local Government (2019a).

<sup>47</sup> HM Treasury, 2013.

<sup>48</sup> Ward, 2020.

**Figure 3.2. Comparison of ESI and Local Growth Deal funding by LEP**

Note: Cornwall and Isles of Scilly is omitted due to having far higher ESI funding than anywhere else. Local Growth Deal funding is the sum of the three rounds of growth deals announced in 2014, 2015 and 2017.

Source: Local Growth Deal funding from Ministry of Housing, Communities and Local Government (2017) and ESI funding from Department for Business, Innovation and Skills (2014b).

The UK's national and LEP-driven regional industrial strategies – and their aforementioned emphasis on ideas, people, infrastructure, business environment and place as drivers of productivity – are supposed to provide the broad framework in which the UKSPF and these other funds sit. But how this will work in practice and the emphasis placed on boosting growth versus 'levelling up' is unclear.

The risk of a plethora of schemes causing complexity, inconsistency and confusion could be avoided by rolling up one of more of these additional 'place-based funds' into the UKSPF, which would likely be simpler to access and spend. For example, integrating the UKSPF and Local Growth Deals could make sense, especially if the UKSPF has both needs-based and competition-based funding elements. However, a trade-off exists between this simplicity and the ability to target funding more closely at specific objectives (such as transport or housing) or particular types or sizes of places (such as specific towns or LEP areas), which the maintenance of separate schemes does allow.

**Table 3.1. Comparison of ESI funds with other economic development funding pots in England**

<i>Fund</i>	<i>Objective</i>	<i>Method of allocation of funding</i>	<i>Approximate annual spending</i>	<i>Period of scheme</i>
Current ERDF/ESF 2014–20 round	See Section 2 of this report.	Needs-based	£0.88 billion <sup>49</sup>	2014–20
Local Growth Fund	‘A single funding pot for local areas, without internal ring fences’ to ‘support growth’. Related closely to Strategic Economic plans.	Deal-based with implicit competitive bidding	£1.52 billion	2015–20
City Deals	To give ‘local areas specific powers and freedoms to help the region support economic growth, create jobs or invest in local projects’. <sup>50</sup>	Deal-based, with implicit competitive bidding	N/A	2012–ongoing
Towns Fund	‘Levelling up our towns’ and ‘Creating a sustainable future for towns’. <sup>51</sup>	Some needs based and some competitive bidding	£0.45 billion	2019–26
Transforming Cities Fund	‘Driving up productivity through improved public and sustainable transport investment’. <sup>52</sup>	Competitive bidding	£0.25 billion	2018–28
Local Government Economic and Community Development spendings <sup>53</sup>		Local budgetary decisions	£0.75 billion	Annual, ongoing

<sup>49</sup> Calculated by taking the total 2014–20 funding round figure for ERDF and ESF funding from Section 2, dividing by 7 to give an annual figure, and converting into GBP using the spot GBP–EUR exchange rate from 30 June 2017, midway through the funding period.

<sup>50</sup> City Deals landing page, accessed 13/02/20

<sup>51</sup> Towns Fund Prospectus (November 2019), <https://www.gov.uk/government/publications/towns-fund-prospectus>, accessed 13/02/20.

<sup>52</sup> Transforming Cities Fund, Supplementary Guidance for Shortlisted City Regions: Tranche 1 (November 2018), <https://www.gov.uk/government/publications/apply-for-the-transforming-cities-fund>, accessed 13/02/20.

<sup>53</sup> Based on total English local authority spending on planning and development in 2018–19 from table 2 of the Local Authority Revenue Expenditure and Financing: 2018–19 Final Outturn, England, accessed 22/02/20.

## 4. How could the choice of needs indicators affect funding allocations?

In this section, we examine how the choice of indicators in any formula used to allocate the UKSPF could affect the allocations provided to different parts of the country, focusing on England. To do this, we first show how five key variables – productivity, employment, earnings, education levels and deprivation – vary across English LEP areas, which highlights differences between the areas that have the lowest productivity and highest deprivation, for example. We then show how much the different LEP areas could receive relative to the average for England as a whole, using a simple linear formula that allocates different weights to each of these indicators.

It is important to note up front that we are not trying to forecast allocations or the gains or losses relative to existing ESI schemes: there are literally an infinite number of weights and degrees of progressivity that could be used in the formula, and the total budget is also as yet unknown. Our aim is instead to identify how the choice of indicators will affect the relative allocations of different areas, and to highlight areas that look set to receive relatively high or low allocations irrespective of the weights applied to different factors.

### 4.1 How does choice of ‘need’ indicator affect regional allocations?

In order to illustrate how the choice of indicators could affect funding allocations, we have selected five indicators that have been referenced by the government in its discussion of the UKSPF and/or were used in the allocation of the needs-based portion of the ‘Towns Fund’, aimed at supporting disadvantaged towns.<sup>54</sup>

- Productivity, as measured by gross value added (GVA) per hour worked.<sup>55</sup> This differs to the measure used in the allocation of ESI funding (GDP per person) in that it is not distorted directly by commuter flows between areas (which lead to low levels of GDP per person in outer London, for example, where many residents commute to central London for work).<sup>56</sup> However, it is possible for areas with high productivity to be economically disadvantaged if the employment and hours of work of residents are low, and for areas with low productivity to be relatively advantaged if employment and hours of work of residents are high.
- Employment, as measured by the employment rate of those aged 16–64, is therefore included as our second indicator.<sup>57</sup> Existing ESI funding is based on unemployment rates, but variation in employment rates also reflects other forms of economic inactivity, for example due to disability and home-making. These groups will include at least some discouraged workers, not officially counted as unemployed.
- Earnings, as measured by median gross weekly pay.<sup>58</sup> It is possible for areas to have relatively low wages even if productivity is relatively high – for example, due to the prevalence of economic activities with either high capital-to-labour ratios or high profit margins. Intra-regional earnings inequality could lead to productivity and mean wages for a region being relatively high, but median

<sup>54</sup> The formula is ‘based on a combination of productivity, skills, income, deprivation metrics and proportion of population living in towns’. See HM Government (2019b).

<sup>55</sup> Specifically we use the average for 2016, 2017 and 2018 of nominal smoothed GVA per hour worked. See Office for National Statistics (2020a).

<sup>56</sup> Ebell (2017) provides a good overview of the different regional productivity measures – in particular, the differences between per-resident and per-worker measures. Phillips (2020) explores the geographical patterns of output, productivity, earnings and household incomes in more detail.

<sup>57</sup> Averaged from the year to December, 2017, 2018 and 2019, using the employment rate among those aged 16–64 (Office for National Statistics, 2020b).

<sup>58</sup> Average of 2017, 2018 and 2019 median gross weekly pay for full-time earners resident in each LEP (Office for National Statistics, 2019).

wages and/or wages at, for example, the 25<sup>th</sup> percentile of the distribution (which are not affected by wage levels at the very top of the distribution, unlike the mean) being relatively low. Broader measures of household income, potentially adjusted for differences in housing costs, could also be included as an alternative.

- Low levels of education and skills, measured by the percentage of residents with no qualifications.<sup>59</sup> The government's Industrial Strategy highlights skills as one of the foundations of productivity, suggesting that areas where skills levels are relatively low may need additional support. However, evaluations of ESI funding have found more positive impacts in areas where education and skill levels are higher, suggesting a trade-off between the 'need' for funding and the potential effectiveness of that funding. Alternative definitions could include the share of the population with GCSE-level qualifications and below, or Degree-level qualifications and above (higher levels of which would be associated with *less* rather than more funding if 'need' was the driving factor).
- Deprivation, measured by the English IMD average score for an area. This measure summarises deprivation across several dimensions – including crime, earnings, education, employment, environment, health and housing – for small neighbourhoods within areas. Areas can perform relatively well on these indicators overall, but still have areas with severe deprivation. However, this measure is only available for England and has been excluded from the analysis, which extends to the devolved nations.<sup>60</sup> Use of deprivation as an indicator to allocate funding across the UK would require the development of a consistent index for the whole country.<sup>61</sup>

## 4.2 How different dimensions of 'need' vary across England

Figures 4.1–4.5 show how these different needs indicators vary across the LEP areas of England.<sup>62</sup> These show a degree of correlation between the different indicators, but also differences, especially between productivity and the other indicators.

Figure 4.1, for example, shows that productivity is lowest in a number of rural LEP areas, such as Cornwall and the Isles of Scilly (the lowest, at 75% of the English average), Devon and Somerset, Lincolnshire, the Marches and North Yorkshire, as well as some more urban areas of the North and the Midlands, such as the Sheffield City Region and the Black Country. Productivity is highest in the capital (132% of the English average) and in areas surrounding the capital, especially to its south and west, such as the Thames Valley Berkshire LEP area.

The geographical pattern for median pay is, perhaps unsurprisingly, most similar to that for productivity. Figure 4.2 shows that median pay is again lowest in some rural areas, such as Cornwall and the Isles of Scilly (the lowest, at 85% of the English average), Devon and Somerset, Lincolnshire and the Marches, as well as some more urban areas of the North, again including the Sheffield City Region and the Black Country. Median earnings are highest in the capital and the Enterprise M3 area covering western Surrey and northern and central Hampshire (118% of the English average), with other areas to the west of London also having relatively high earnings.

<sup>59</sup> Using Annual Population Survey % with no qualifications measure using average of year to December 2017, 2018 and 2019 (Office for National Statistics, 2020c).

<sup>60</sup> Using the 2019 English IMD for the Local Enterprise Partnerships IMD average score measure (Ministry of Housing, Communities and Local Government, 2019b).

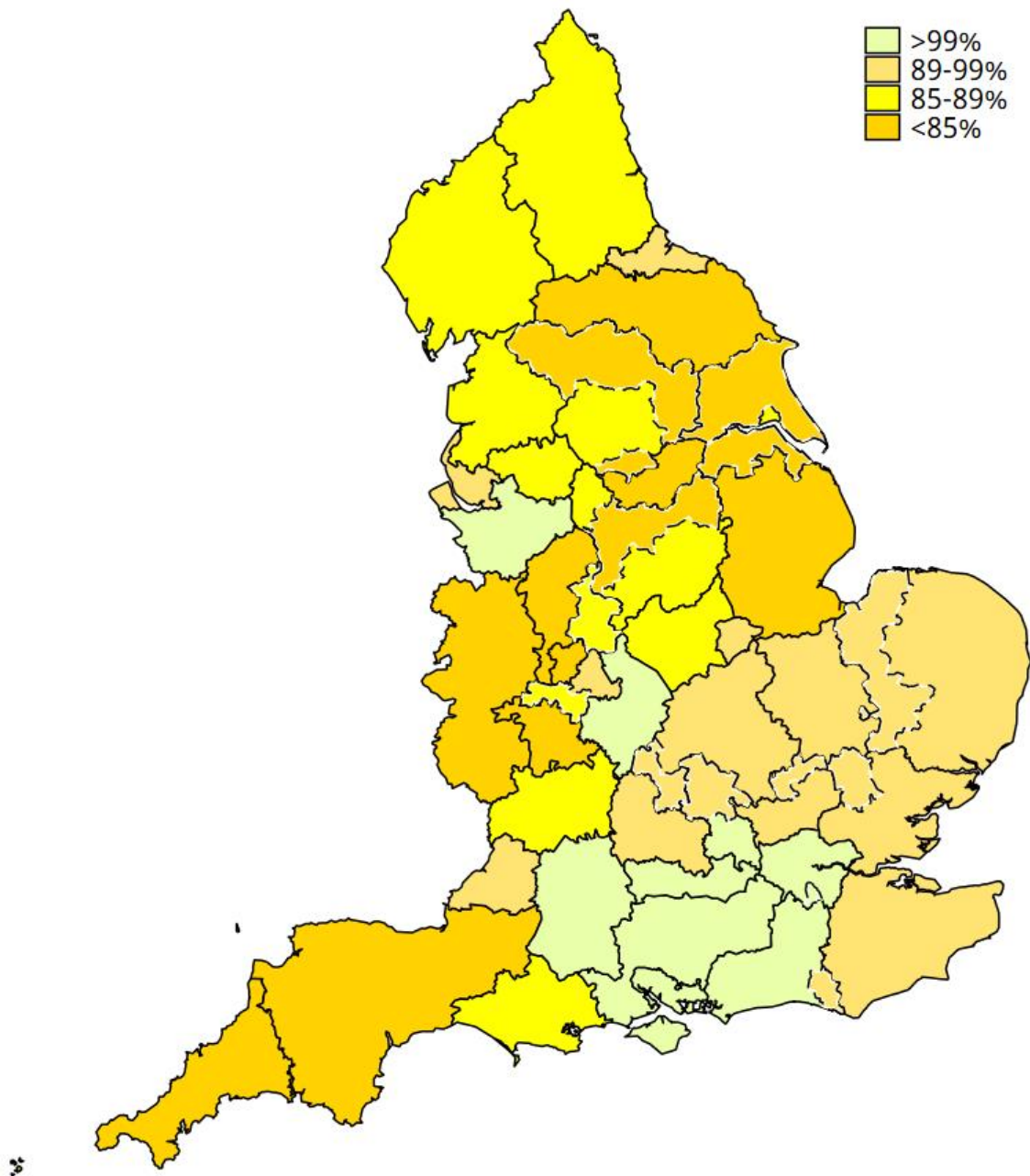
<sup>61</sup> Values of IMD are available for Northern Ireland, Scotland and Wales but these are not directly comparable with the English IMD.

<sup>62</sup> Many LEPs overlapped with one another when the most recent official boundaries were released in 2017. Areas that are overlaps of LEPs are marked by dashed border lines. Overlapping areas are assigned a value for each need measure that is a simple average of the two LEPs of which the overlap area is a constituent part. The government LEP review (Ministry of Housing, Communities and Local Government, 2018c) indicated that overlaps between Local Enterprise Partnerships should be removed. Although progress has been made in many areas on this, some issues remain unresolved so we do not know what the LEP boundaries will be in the future. We therefore use the most recently available boundaries from 2017.

However, the pattern for other indicators differs somewhat. Some of the areas with low productivity and earnings have relatively high employment and relatively low levels of people without qualifications. Figures 4.3 and 4.4 show that Devon and Somerset has above-average levels of employment and below-average levels of 'no qualifications', for example. Cornwall and the Isles of Scilly and the Marches also perform better on these indicators than they do for productivity and earnings.

Low employment and low skills are most concentrated in urban areas of the North and the Midlands. The lowest rates of employment are in the Tees Valley LEP (69%), closely followed by the Black Country. The Black Country also has the highest share of the population without qualifications (around 16%, more than double the rate nationally), with the Tees Valley, Liverpool and Humberside LEPs also having high shares. In contrast, employment rates are highest in areas of the South of England to the west of London, with the highest being Gloucestershire (GFirst) and Oxfordshire LEP areas at around 82%. The share of the population without qualifications is also lowest to the west and south of London, with the Buckinghamshire Thames Valley LEP area having the lowest share (around half the English average at 4%, meaning the likelihood of someone having no qualifications is just one-quarter of the rate in the Black Country).

Figure 4.1. Productivity measured by GVA per hour worked, % of England average

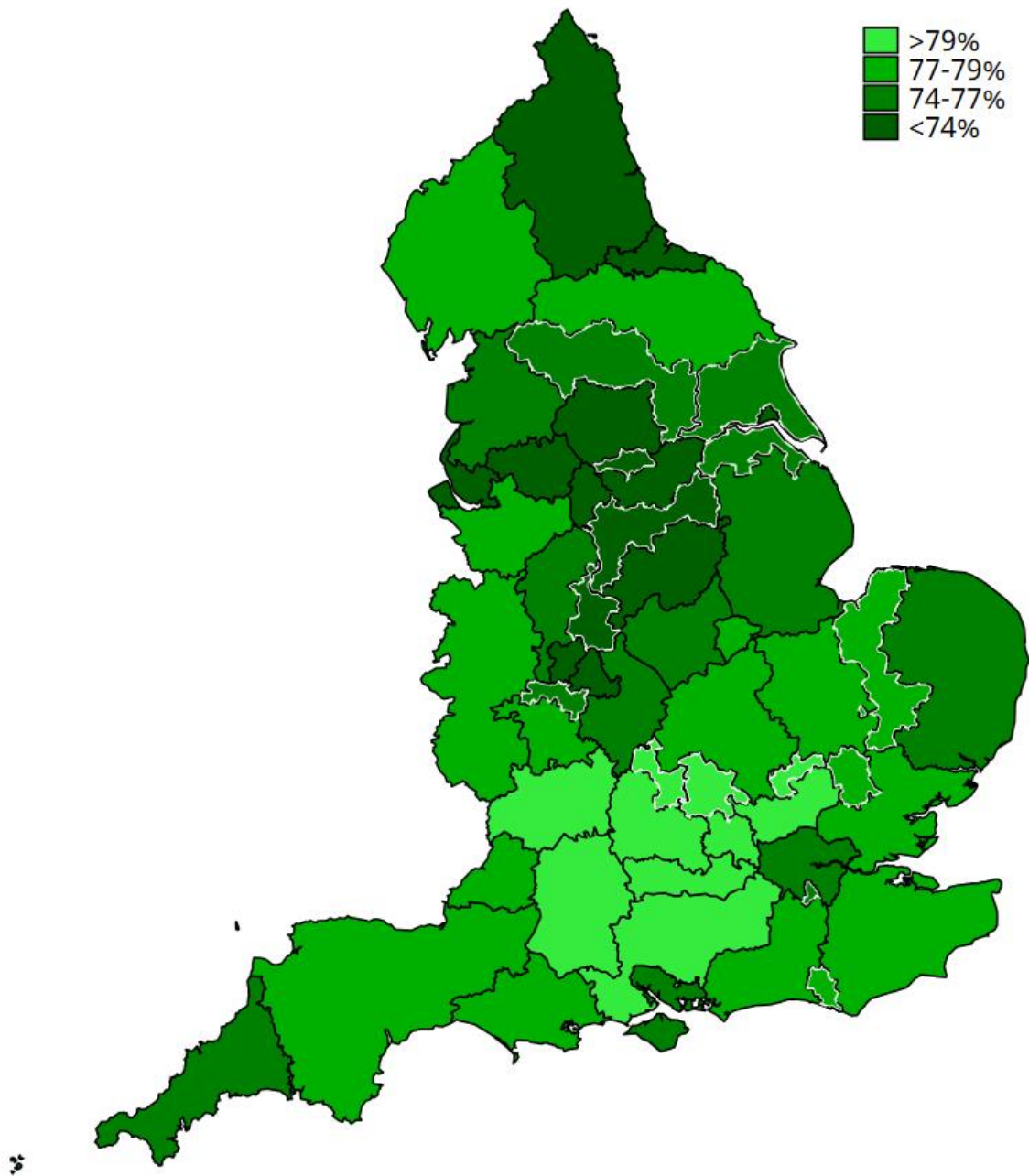


Note: Average of regional productivity from 2016, 2017 and 2018.

Source: Office for National Statistics (2020a).



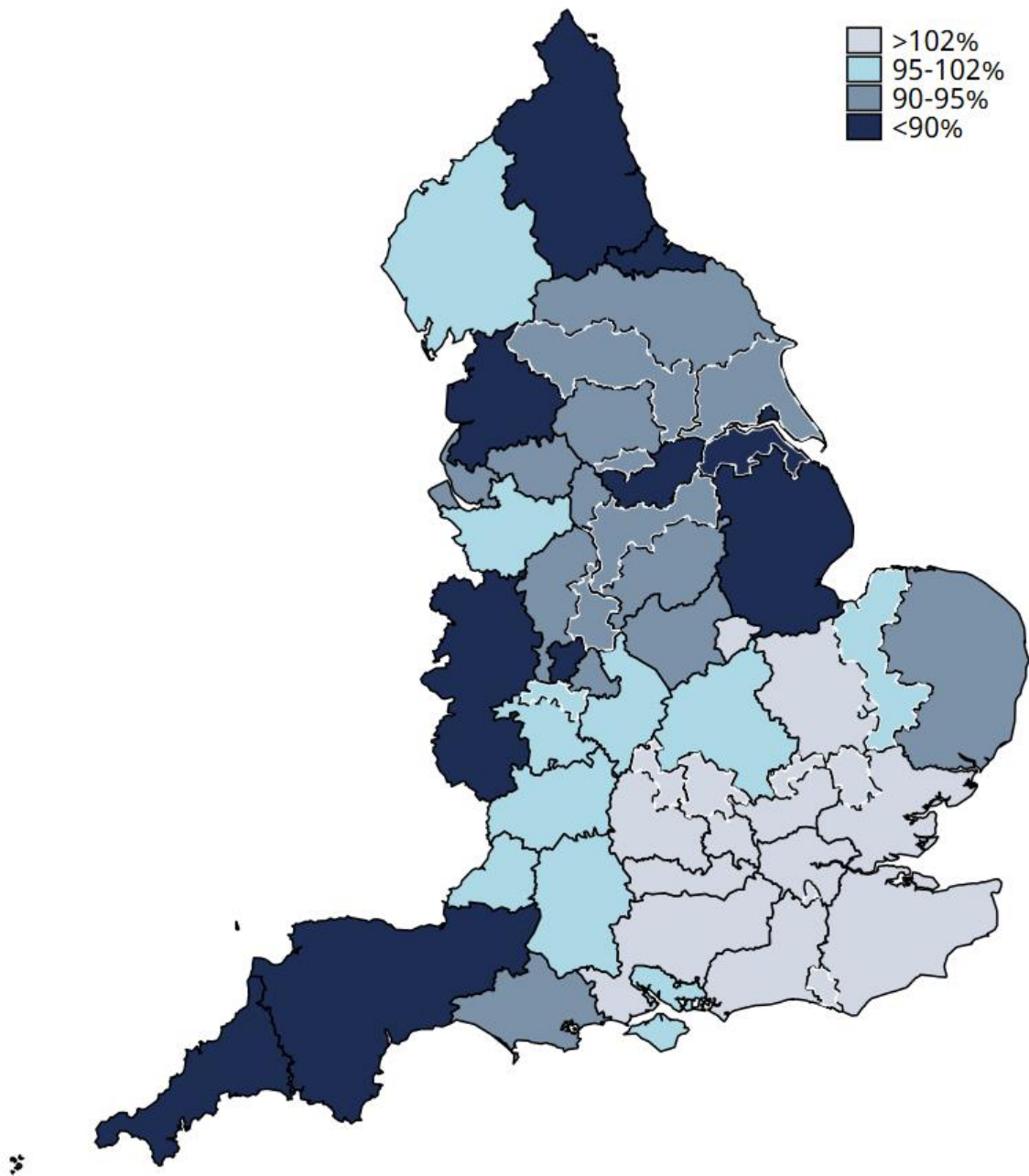
Figure 4.2. Employment rate for population aged 16–64



Note: Average from the year to December, 2017, 2018 and 2019, using the employment rate among those aged 16–64.

Source: Office for National Statistics (2020b).

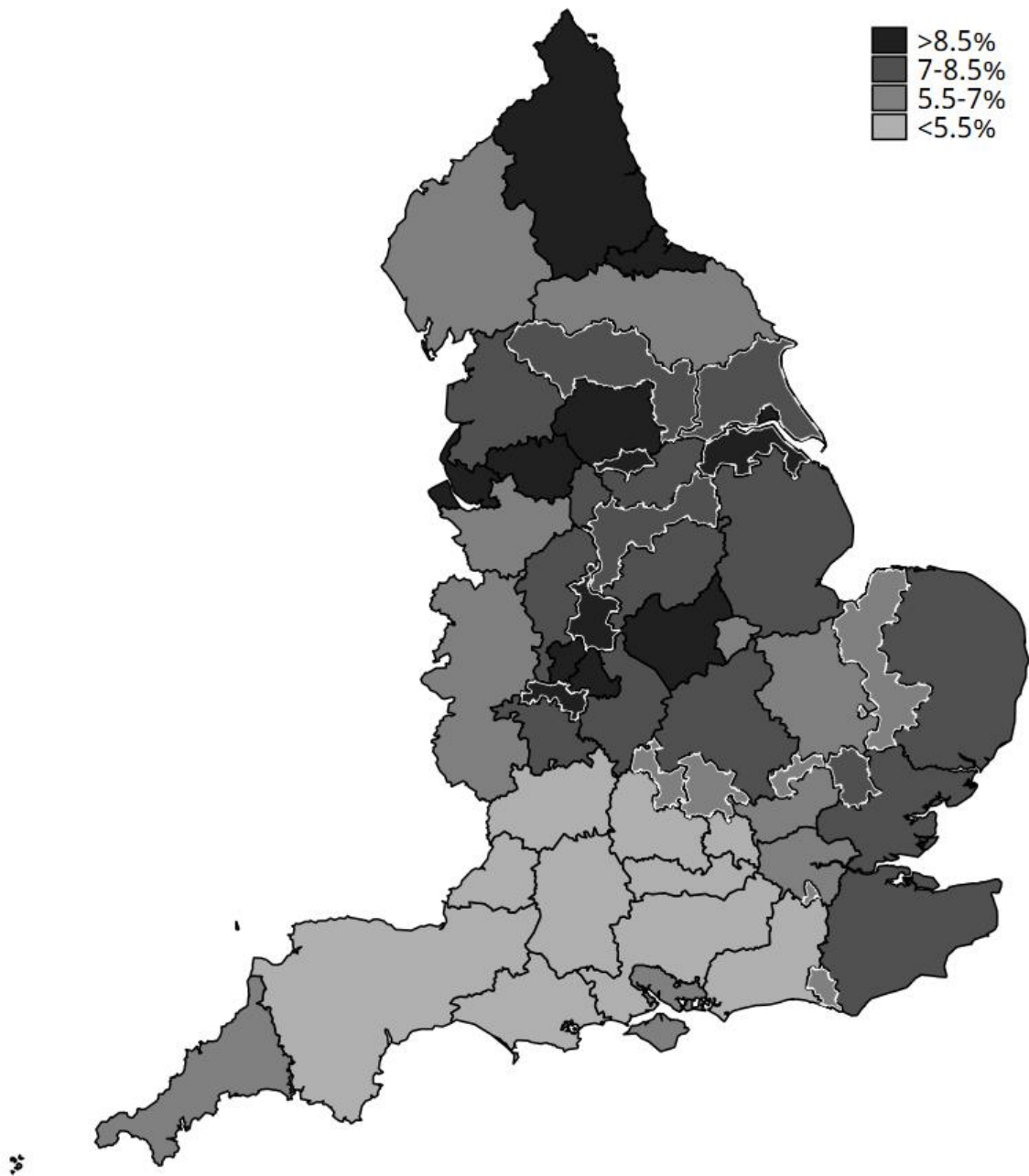
Figure 4.3. Median gross weekly pay for full-time earners



Note: Average of 2017, 2018 and 2019 median gross weekly pay for full-time earners resident in each LEP.

Source: Office for National Statistics (2019).

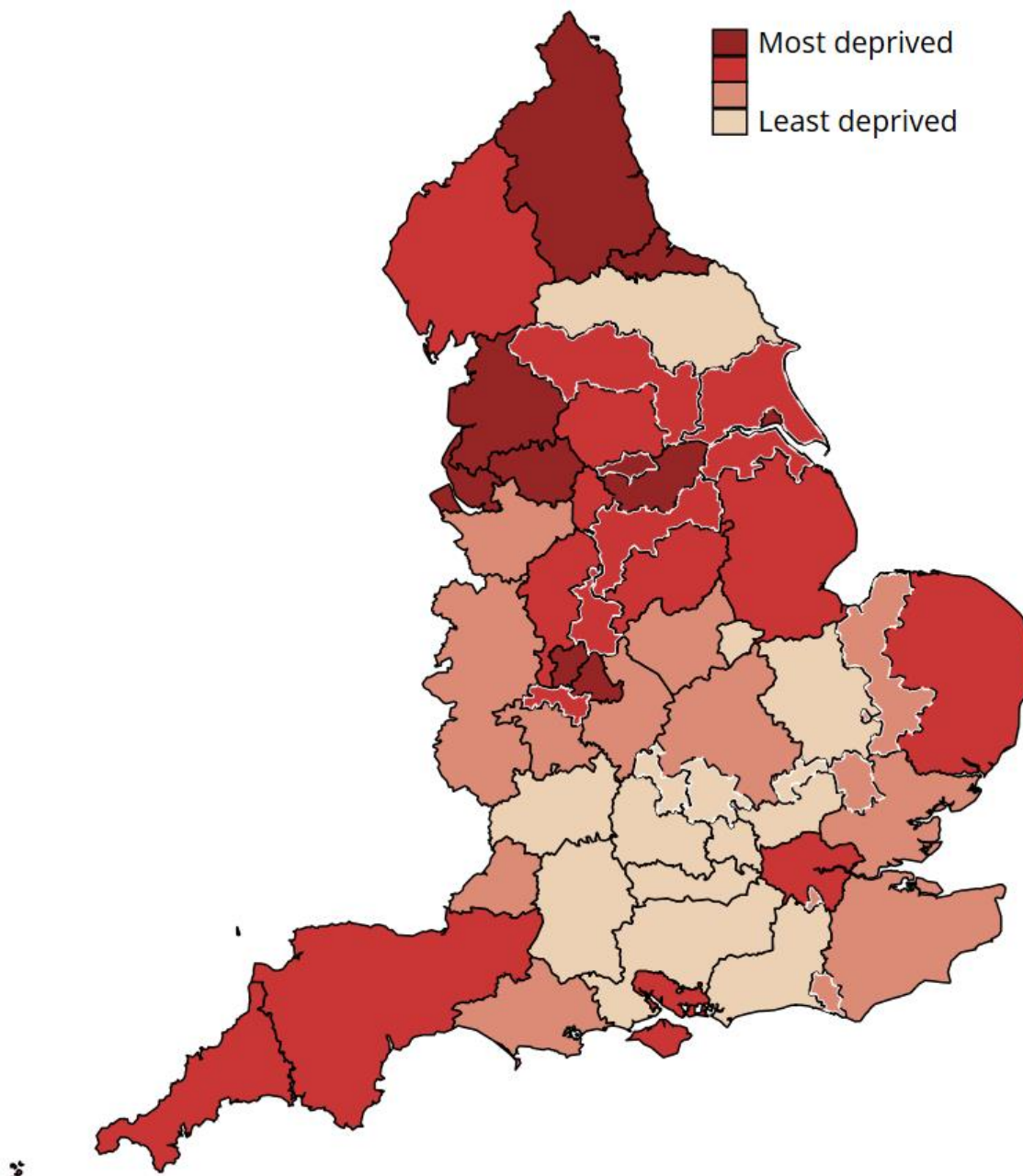
Figure 4.4. Proportion of workforce with no qualifications



Note: Using Annual Population Survey, measure of the percentage of workforce with no qualifications, using the average of year to December 2017, 2018 and 2019.

Source: Office for National Statistics (2020c).

Figure 4.5. Deprivation by IMD (quartiles)



Note: Using 2019 English IMD for the Local Enterprise Partnerships IMD average score measure.

Source: Ministry of Housing, Communities and Local Government (2019b).

Finally, Figure 4.5 shows that deprivation as measured by the IMD is concentrated in urban areas of the Midlands and the North, with Liverpool having the highest rate of deprivation. London also stands out as having much higher deprivation than the surrounding areas of the South East of England, reflecting the inequalities present within the capital: London has the highest share of the population at the top of the income distribution and the highest rates of poverty (using income measured after housing costs of any region of England, for example).<sup>63</sup> Deprivation is generally lower in rural and suburban areas, again

<sup>63</sup> Phillips, 2020.

especially to the west of London, with the Buckinghamshire Thames Valley LEP having the lowest rate of deprivation.

Taken together, these patterns imply that, based on the type of indicators utilised here, a number of mainly urban areas from the North and the Midlands are likely to receive relatively high allocations of funding irrespective of the weights applied to different indicators: they perform poorly across the board. Similarly, there are a number of LEP areas, mostly to the west of London, that do relatively well across the board and are therefore highly likely to be allocated relatively low levels of funding irrespective of the weights applied to different indicators. In contrast, a number of rural LEP areas, including Cornwall and the Isles of Scilly, Devon and Somerset, and the Marches, perform relatively well in terms of qualifications and employment, but much less well on pay and productivity. For these areas, the weights applied to different indicators would therefore make a bigger difference to funding allocations

### 4.3 Illustrating how the choice of indicators could affect funding allocation

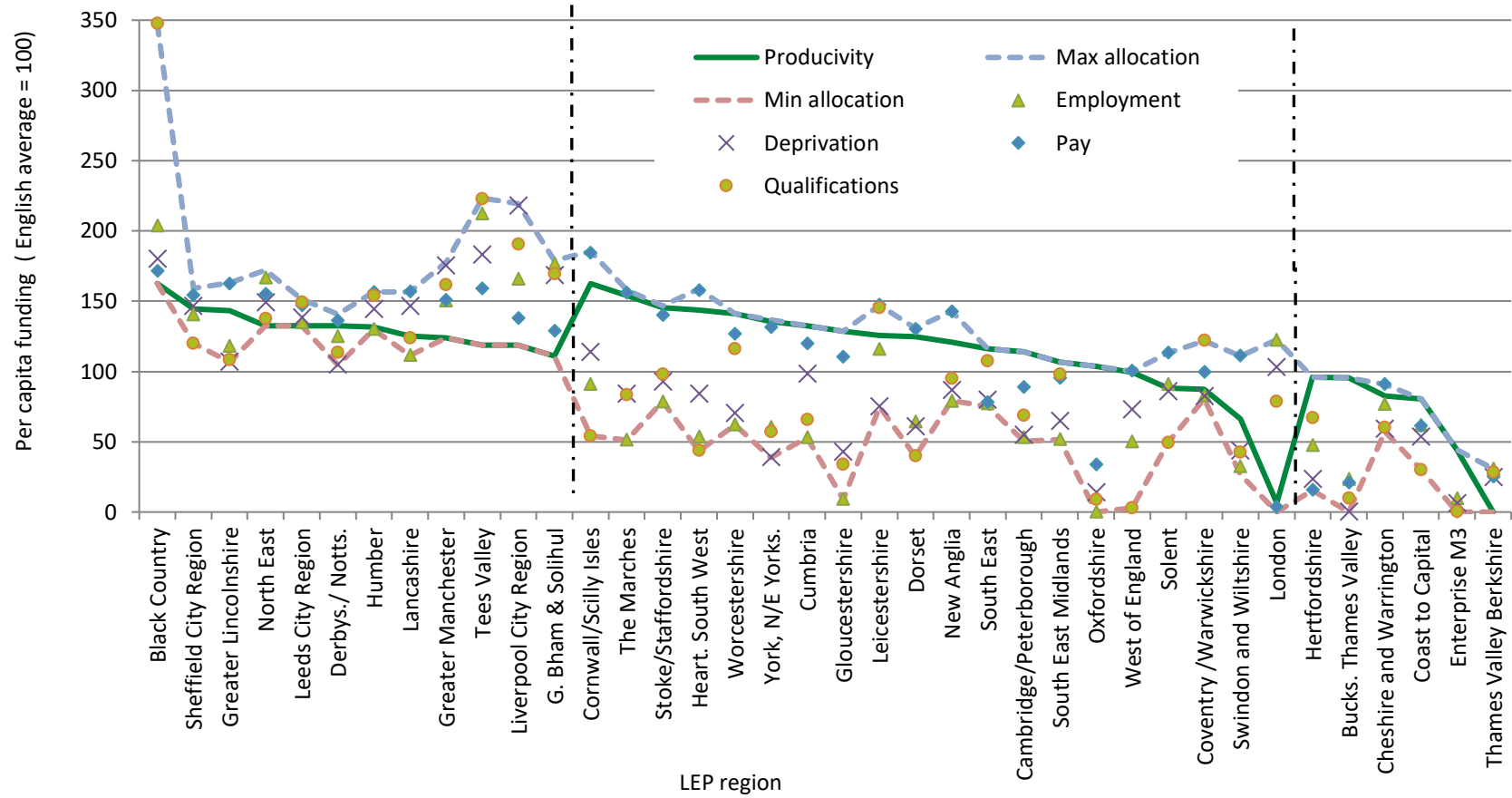
To illustrate this, we calculate how much each LEP area in England would receive per resident, measured relative to the English average, under different weights for each indicator and a simple linear formula. This formula allocates funding such that the area with the lowest weighted ‘need’ receives zero funding, an area with the same need as England as a whole receives 100% of the average per resident across LEPs, and all other areas (including the area with the highest need) receive per-resident funding on a linear sliding scale that interpolates and extrapolates from these two points.<sup>64</sup> It is important to note that this is not a prediction of how much each LEP will receive, or which LEPs will gain or lose relative to current allocations: these cannot currently be modelled, as they will depend on other unknown factors – such as the degree of progressivity of allocations and the overall quantum of funding provided. Instead, they illustrate how the choice and weighting of indicators matters.

The results of this exercise are shown in Figure 4.6. For each LEP, seven data points are plotted: the allocations given the combination and weightings giving the largest and smallest allocations of funding, and the allocation of funding received when only a single metric is used. All allocations are presented relative to the average across LEPs.

The LEPs on the graph are then organised into three groups: the 12 whose minimum possible allocation is above the English average, the 6 whose maximum possible allocation is below the English average, and the 20 whose maximum and minimum possible shares are above and below the UK average, respectively. Within these groups, the LEPs are then organised from left to right, in order of increasing productivity (and hence decreasing allocations if only productivity were included in the formula). Table 4.1 also highlights the five LEPs that would receive the most and least funding per capita if the funding formula were completely allocated according to one characteristic only.

<sup>64</sup> See the Appendix for details of the funding model.

Figure 4.6. Relative per capita funding allocations to English LEPs under formulas using different indicators



Source: Authors' calculations using Office for National Statistics (2019, 2020a, 2020b, 2020c) and Ministry of Communities, Housing and Local Government (2019b).

**Table 4.1. LEPs that would receive the highest and lowest funding if the allocation formula was based on a single indicator**

	Country/region	
	<i>Highest-funded LEPs</i>	<i>Lowest-funded LEPs</i>
Productivity	Cornwall and Isles of Scilly Black Country The Marches Stoke-on-Trent and Staffordshire Sheffield City Region	Thames Valley Berkshire London Enterprise M3 Swindon and Wiltshire Coast to Capital
Employment	Tees Valley Black Country Greater Birmingham and Solihull North East Liverpool City Region	Oxfordshire Gloucestershire Enterprise M3 Buckinghamshire Thames Valley Thames Valley Berkshire
Deprivation	Liverpool City Region Tees Valley Black Country Greater Manchester Greater Birmingham and Solihull	Buckinghamshire Thames Valley Enterprise M3 Oxfordshire Hertfordshire Thames Valley Berkshire
Pay	Cornwall and Isles of Scilly Black Country Greater Lincolnshire Tees Valley Heart of the South West	Enterprise M3 London Hertfordshire Buckinghamshire Thames Valley Thames Valley Berkshire
Qualifications	Black Country Tees Valley Liverpool City Region Greater Birmingham and Solihull Greater Manchester	Enterprise M3 West of England Oxfordshire Buckinghamshire Thames Valley Thames Valley Berkshire

Source: Authors' calculations using Office for National Statistics (2019, 2020a, 2020b, 2020c) and Ministry of Housing, Communities and Local Government (2019b).

Figure 4.6 and Table 4.1 show the following.

- The areas that would receive above-average allocations, irrespective of the weights applied to each of the five indicators, are largely urban or former industrial areas of the North and the Midlands (and none is in the south of England). This reflects the fact that these areas perform below average on all indicators, especially with respect to employment, rates of no qualifications, and deprivation. In Table 4.1, the Black Country and Tees Valley stand out as receiving high levels of funding whichever indicator is used.
- In contrast, with the exception of Cheshire and Warrington, all LEP areas that perform better than average on all indicators – and would therefore receive below-average funding irrespective of weightings – are in the south, forming an arc to the west of London. As Table 4.1 shows, Thames



Valley Berkshire, Buckinghamshire Thames Valley, Enterprise M3 and Oxfordshire stand out as receiving little funding no matter the indicators used.

- The remaining LEPs, which cover many rural areas, as well as more suburban parts of the Midlands and areas to the north and east of London, perform better than average on some indicators but worse than average on others. Nearly all have lower than average productivity, with the only exceptions being the Coventry & Warwickshire, London, Solent, Swindon & Wiltshire and West of England (Bristol) LEP areas. In particular, three largely rural LEPs – Cornwall and the Isles of Scilly, the Marches and Stoke and Staffordshire – have among the lowest productivity levels in the country, and would receive high levels of funding if productivity is highly weighted. However, they perform better than average in terms of employment rates and either deprivation (the Marches and Stoke and Staffordshire) and/or rates of no qualifications (Cornwall and the Isles of Scilly and the Marches) and would receive lower levels of funding the higher the weights placed on these indicators.
- High weightings on productivity and pay would see very different areas receive high funding to higher weights on skills, employment and deprivation. Table 4.1 shows that it is entirely urban areas in the North and the Midlands that would receive the highest funding based on skills, employment and deprivation. There is more of a mix using pay and productivity, with rural and southern areas present too.
- It is possible that some of the southern and south Midlands regions (such as the Cambridgeshire and Peterborough, South East Midlands, and South East LEP areas) on the right-hand side of the middle group will receive above-average funding levels given their below-average productivity. However, their stronger performance on the other metrics means this is unlikely if a range of factors are taken into account.
- High weights on pay and productivity would see London receive among the lowest levels of funding in England, but high weights on deprivation and employment would see London receive higher funding levels than the surrounding areas of the South East of England, and potentially the national average (if, for example, deprivation and employment were the only factors taken into account).

#### 4.4 Progressivity and the removal of cliff edges

As discussed in Section 3, as well as the choice of metrics used to determine need, the government will also have to decide how heavily to skew funding towards the areas with the worst performance on the chosen metrics. In other words, it will have to decide how targeted or ‘progressive’ the UKSPF is.

Funding could increase more or less steeply (and in a linear or non-linear way) than illustrated in Figure 4.6. The use of categories or bandings in any new system would similarly lead to arbitrary (and potentially large) differences in support for regions that have very similar characteristics but that are just either side of cut-off lines. As highlighted in Section 3, this should and could be avoided, while at the same time maintaining a highly ‘progressive’ system.

While it is not possible to say which regions will gain or lose under the UKSPF, it is highly likely that one area in England – Cornwall and the Isles of Scilly – would lose out if the arbitrary cliff edges are removed, unless overall funding for the UKSPF is significantly higher than under existing ESI schemes. This is because the removal of the cliff edge would almost certainly redistribute funding from this LEP area, just below the cliff edge, to other LEP areas. Precisely which LEP areas would gain would depend on the choice of indicators used in allocating the UKSPF, but areas with somewhat higher productivity but poor performance across a range of indicators seem likely. This includes many more urban parts of the North and the Midlands of England, such as the Black Country, Sheffield City Region, Liverpool City Region and the Humber LEP areas, which currently find themselves above the cut-off for significant support.



## 4.5 Allocations for the devolved nations

How the new regime for allocating funding will affect the different regions of Scotland, Wales and Northern Ireland will clearly depend on the discretion given to the devolved governments of these nations to allocate funding between regions. But it will also interact with the pledge to ensure that each nation will receive at least as much from the UKSPF as under existing ESI schemes. In particular, if the overall budget for the UKSPF is similar to that for the existing ESI schemes, this pledge will mean similar areas in different nations of the UK receiving very different amounts of funding.

To see this, consider the regions of West Wales and the Valleys and East Wales. Table 4.2 shows that, presently, the West Wales and the Valleys region receives a similar amount per person as the other ‘less-developed’ region of the UK that benefits from the cliff edge in ESI funding, Cornwall and the Isles of Scilly. East Wales, however, receives substantially more funding than parts of England with similar characteristics such as Greater Manchester.<sup>65</sup> As already highlighted, if the cliff edge in funding were removed and overall funding for the UKSPF was similar to existing ESI schemes, Cornwall and the Isles of Scilly would likely receive less funding than presently. However, the pledge to maintain Wales’ overall funding would either mean West Wales and the Valleys continuing to receive the high levels of funding it currently benefits from as a result of the cliff edge, or see a shift in funding to East Wales, which could potentially widen funding gaps between it and similar regions of England. Perpetuating such differences in funding levels – based as they are on the ill-advised cliff edges in EU funding – may be considered unfair, and it sits oddly with the aim of making the UKSPF more transparent and suited to British needs.

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<sup>65</sup> This partly reflects decisions by the UK government to cap reductions in overall reductions in Wales’ funding during the 2014–20 period at 5% (the same as each other nation of the UK), despite a reduction of 18% for West Wales and the Valleys (the same as Cornwall and the Isles of Scilly, the other less-developed region).

**Table 4.2. Funding levels and characteristics of the devolved nations and regions compared with England and the regions of England**

<i>Country/region</i>	<i>Funding per capita (£)</i>	<i>Share of total UK funding (%)</i>	<i>Per capita funding relative to UK average (=100)</i>	<i>GVA per hour worked (2018 £)<sup>66</sup></i>	<i>Employment rate (aged 16–64), 2019<sup>67</sup></i>	<i>Skills (% no qualifications), 2019</i>
<b>Whole UK (excl. Gibraltar)</b>	148	100	100	35	75.6	7.9
<b>England</b>	114	64.5	77	35.6	76.9	7.5
Cornwall and Isles of Scilly	955	5.5	645	26.5	77.4	5.9
Greater Manchester	135	3.9	91	31.2	72.7	9.4
<b>Wales</b>	695	22.5	470	29.2	74.4	8.5
West Wales and the Valleys	921	18.7	622	28.2	71.3	9.4
East Wales	318	3.8	215	30.4	76.2	7.0
<b>Scotland</b>	150	8.4	101	33.8	74.9	9.8
<b>Northern Ireland</b>	248	4.8	168	30.1	72.3	12.6

<sup>66</sup> See Office for National Statistics (2020a) for LEP level productivity within England, and Office for National Statistics (2020d) for country productivity and regions within Wales.

<sup>67</sup> Office for National Statistics (2020c) used for employment rate and rate of no qualifications.

## 5. Discussion and conclusion

This report has set out the big choices facing the government as it moves the UKSPF from manifesto pledge to implemented policy, and it has highlighted some of the lessons that can be learned from both the design and evaluation of existing EU schemes. Key issues that still need to be decided and/or communicated include:

- the precise objectives of the fund, including the balance between facilitating ‘levelling up’ versus boosting productivity and prosperity more generally;
- the role of competitive bidding, needs assessment and outcome evaluation in the allocation of funding;
- the stringency of any ring fencing of funding, and the degree of local discretion in the use of funds;
- the indicators used in any needs assessment, the frequency with which they and funding allocations are updated, and the ‘progressivity’ of the formula in which they are used;
- and, of course, the overall budget to be made available.

Fund objectives, rules and allocation procedures will need to be consistent. And the decisions taken will really matter, not least for the amount of funding different parts of the UK could receive, especially in the longer term as any transitional arrangements unwind. Within England, for example, a focus on productivity would allocate the most funding to rural areas, while a focus on low education, employment and deprivation, would allocate the most funding to urban and former industrial areas of the Midlands and the North.

These decisions would always be difficult. But they are now taking place in the context of the major public health and economic crisis caused by COVID-19. Responding to this crisis is a huge task for the government, and addressing the economic and fiscal fall out is likely to be a multi-year job. And this comes on top of the still significant work to do in relation to the UK’s exit from the EU, which is itself expected to have long-term negative economic impacts.

However, the government has confirmed its intention to still leave the EU – and hence the ESI schemes – at the end of 2020. This means, at least, that initial arrangements for the UKSPF will need to be decided and ready to implement in less than six months. If the pressing situation with the COVID-19 crisis means it is impractical to finalise and consult on full details of the UKSPF, then the government could roll over existing allocations and rules of the ESI for another year. This is the approach it has taken for local government funding in England, for example, where reforms to the funding regime planned for April 2021 have been postponed by at least a year.

A delay in making major changes to the way funding is allocated would give more time to understand the medium- to longer-term impacts of the COVID-19 crisis on the economic geography of the UK, and whether and how the design and allocation of the UKSPF should change as a result.

A range of analyses already suggest the social and economic effects of the COVID-19 crisis could differ significantly between regions in ways not reflected in existing measures of regional and local economic disadvantage. Take two industries that could be hit especially hard: the hospitality industry and the air travel and associated aircraft manufacturing industry.

The share of workers in the hospitality sector – including tourist accommodation, restaurants and nightlife – varies significantly across local areas, as illustrated in Figure 5.1. Areas with high reliance include a number of coastal and rural areas with low productivity – including parts of West Wales, the

South West of England, the Lake District, Yorkshire Dales and coastal Lincolnshire – but also parts of central London where productivity is by far the highest in the country.

Air travel and aircraft manufacture, while smaller industries, are even more concentrated: around the major airports serving London, most notably Heathrow and Gatwick, and in Flintshire and South Gloucestershire, where major aircraft manufacturing facilities are located. Moreover, these areas typically have relatively high productivity, wages and employment.

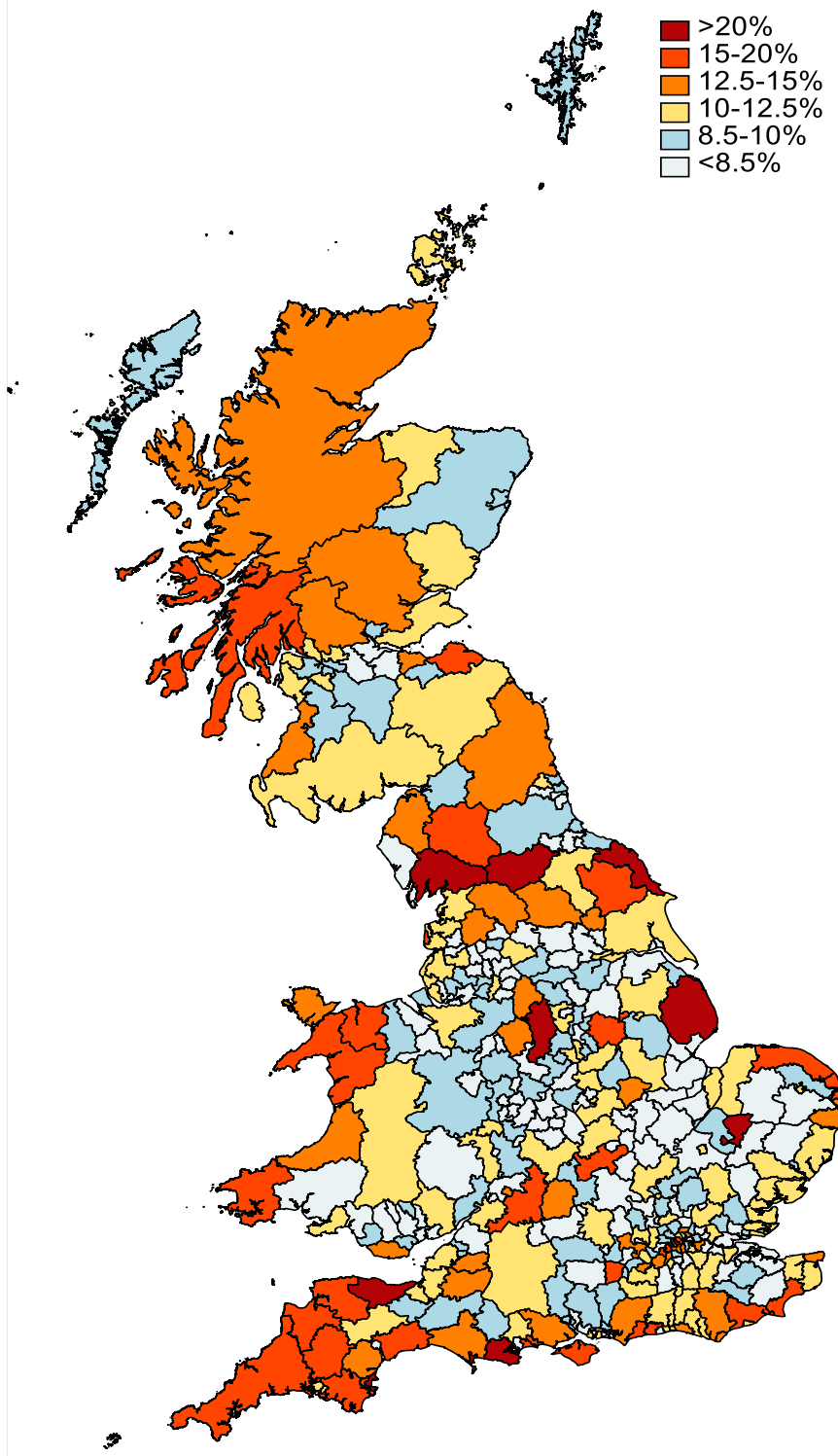
Reliance on public transport – reductions in the capacity of which could significantly reduce commuter, shopper and tourist flows – is much higher in London (and for residents of its commuter towns) and, to a lesser extent, other major cities than the rest of the country. For example, 67% of people working in inner London use public transport to travel to work, compared to 27–28% in Liverpool, Manchester and Newcastle and just 3–4% in local authorities that are mainly or largely rural.<sup>68</sup> London, in particular, has relatively high levels of productivity and education, although employment is often lower and deprivation higher in cities than less-urbanised areas.

This means that the negative economic impacts of the COVID-19 crisis may not align with existing patterns of productivity, education, employment, wages and deprivation. A key decision is therefore whether to adapt the UKSPF so that one of its objectives is to support parts of the country adversely affected and struggling to recover from the COVID-19 crisis, or potentially to have other more targeted programmes and funding for this task. Integrating such support into the UKSPF could ensure that support for general economic development and recovery from the COVID-19 crisis is better integrated. However, it could also complicate the operation and allocation of the UKSPF – necessitating the inclusion of additional indicators in needs assessment formulas, for example – and it could mean that funding for recovery is not as well targeted as under a more bespoke scheme. In other words, this is another tricky trade-off for the government to face as it tries to operationalise its vision of a simpler regional development funding policy post-Brexit.

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<sup>68</sup> See Office for National Statistics (2020f).

**Figure 5.1. Share of jobs in local areas that are in the hospitality and leisure sector**



Note: Calculated using 2018 employment in hospitality and leisure as a share of total employment in each Local Authority. Hospitality and leisure is defined as the following SIC codes; 551, 552, 553 and 558 (hotels and accommodation), 561–563 (restaurants, cafes, etc.), 791, 799 (travel agencies and reservation services), 900 (creative arts/entertainment activities), 910 (libraries and museums, etc.), 931 (sports activities) and 932 (amusement and recreation activities).

Source: Business Register and Employment Survey (Office for National Statistics, 2020e).

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## Appendix: Funding model details

The funding model generates relative per capita funding allocations for LEPs within England using a basket of indicators of need, which are given different weightings in the indicator.

The first stage is to take the raw data for each LEP for an indicator of need  $x$  and to generate a relative score for each LEP. This is done according to the formula,

$$score_{LEP}^x = 100(x_{LEP} - x_{min}) / (x_{max} - x_{min}),$$

where  $x_{LEP}$  is the level of that indicator for the particular LEP and  $x_{min}$  and  $x_{max}$  are the 'worst' and 'best' LEP scores, respectively. An analogous score for England as a whole is also calculated using the population-weighted average of the indicator for England as a whole,  $x_{England}$  in place of  $x_{LEP}$  to generate  $score_{England}^x$ .

These relative scores for a need are then taken to give a funding allocation according to the formula,

$$funding_{LEP}^x = \frac{100(score_{LEP}^x - score_{max}^x)}{score_{England}^x - score_{max}^x},$$

where  $funding_{LEP}^x$  is the relative per-capita funding based on need  $x$  for a LEP, and  $score_{max}^x$  is the highest relative score for any LEP.

It can be seen from this formula that the LEP with the highest relative score will receive no funding as the index will be 0 relative to the national average. Substituting in  $score_{England}^x$  for  $score_{LEP}^x$  in the numerator shows the funding collapsing to the 100 level of the national average. The formula thus allocates funding on a linear basis from the 'no-funding point', which equates to the need performance of the best-performing LEP for a particular indicator.

Where more than one need is used, the formula uses a weighted average of the relative funding levels under each need indicator, depending on the different weightings given to each need.