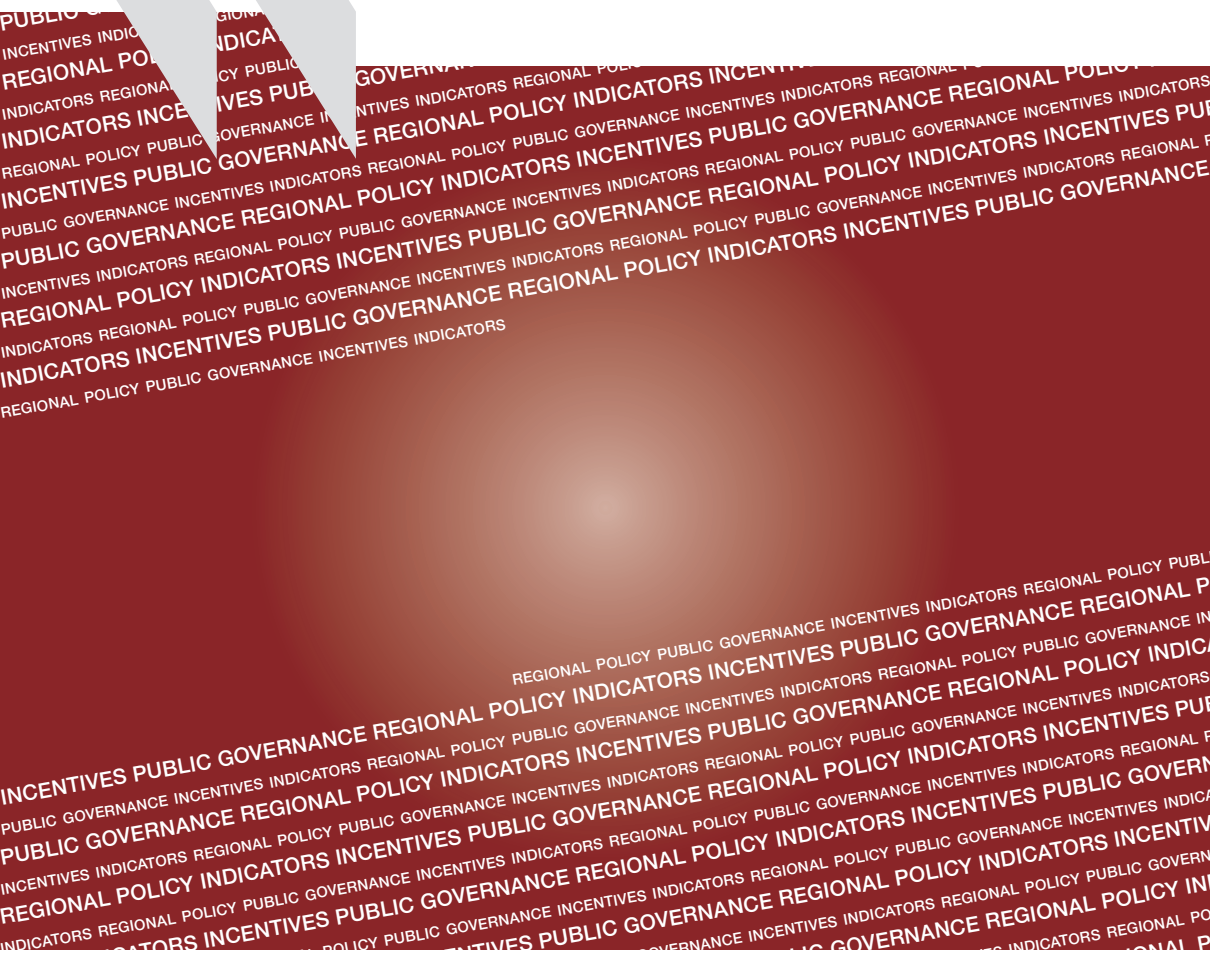
Governing Regional Development Policy

THE USE OF PERFORMANCE INDICATORS



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Governing Regional Development Policy

THE USE OF PERFORMANCE INDICATORS

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Foreword

In all OECD countries that have been the subject of investigation, regional development policy is a shared responsibility among levels of government and engages a variety of both public and private actors. As a result, the information needed to design and implement effective policies and programmes is unevenly scattered. In this context, promoting performance can be difficult. A tool is needed that can facilitate the information sharing, dialogue, and learning that are crucial for successful policy design and implementation. Well-designed indicator systems offer policy makers and practitioners just such a tool for generating and distributing information, encouraging collaboration between levels of government, and orienting stakeholders toward results.

This report synthesises findings about the use of indicator systems to monitor and manage regional policy. To do so it draws on multiple sources of information, including four in-depth case studies of the European Union, Italy, the United Kingdom (England), and the United States. These cases reveal both common themes and unique experiences when using performance indicator systems to monitor regional development policies and programmes. Importantly, the report examines both the benefits and "costs" of indicator systems. It aims to provide a comprehensive view that sheds light on both the value of indicator systems as well as challenges likely to be encountered when designing and using them.

This report contributes to the body of research on the governance of regional development policy elaborated by the OECD Territorial Development Policy Committee and the OECD Directorate of Public Governance and Territorial Development. Recent work on governance includes Linking Regions and Central Governments: Contracts for Regional Development and Building Competitive Regions: Strategies and Governance.

Acknowledgements

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The report was produced by Ms. Lee Mizell of the OECD Secretariat under the direction of Ms. Claire Charbit. It incorporates work drafted by Ms. Mizell and Ms. Julie Pellegrin, consultant (CSIL), with editing assistance provided by Ms. Linda Adamson, consultant. Valuable comments were offered by OECD staff members Mr. Roberto Villarreal, Ms. Monica Brezzi, and Ms. Zsuzsanna Lonti, as well as delegates of the Territorial Development Policy Committee. Ms. Erin Byrne helped prepare the document for publication.

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Acronyms

BERR	(UK) Department for Business, Enterprise, and Regulatory Reform
BSC	Balanced Scorecard
CAP	(EU) Common Agricultural Policy
CDBG	(US) Community Development Block Grant
CEDS	(US) Comprehensive Economic Development Strategy
CPD	(US) Office of Community Planning and Development
CSR	(UK) Comprehensive Spending Review
CSF	(EU) Community Support Framework
DIACT	(France) Inter-ministerial Directorate for Territorial Planning and Competitiveness
DPS	(Italy) Department for Development Policies
DTI	(UK) Department of Trade and Industry
EAGGF	(EU) European Agricultural Guidance and Guarantee Fund
ERDF	(EU) European Regional Development Fund
ESF	(EU) European Social Fund
FAS	(Italy) Fund for Underutilised Areas
FIFG	(EU) Financial Instrument for Fisheries Guidance
FTE	Full Time Equivalent
GDP	Gross Domestic Product
GPRA	(US) Government Performance and Results Act
GTF	(Canada) Gas Tax Fund
GVA	Gross Value Added
HUD	(US) Department of Housing and Urban Development
ICT	Information and Communication Technology
INFC	Infrastructure Canada
IT	Information Technology
LA	(UK) Local Authorities
LDA	London Development Agency
LPSA	(UK) Local Public Service Agreements
M&E	Monitoring and Evaluation
MTE	(EU) mid-term evaluation
NAICS	North American Industry Classification System
NAO	(UK) National Audit Office

ODPM	(UK) Office of the Deputy Prime Minister
OMB	(US) Office of Management and Budget
ONS	(UK) Office of National Statistics
OP	(EU) Operational Programme
OPCS	(US) Operational Planning and Control System
PAA	(Canada) Programme Activity Architecture
PAR	(US) Performance and Accountability Report
PART	(US) Program Assessment Rating Tool
PMF	(Canada) Performance Measurement Framework
PMS	(UK) Programme Management System
PSA	(UK) Public Service Agreement
PWEDA	(US) Public Works and Economic Development Act of 1965
RDA	Regional Development Agency
REP PSA	(UK) Regional Economic Performance Public Service Agreement
RES	(UK) Regional Economic Strategy
RTD	Research, Technology, and Development
SAV	(UK) Strategic Added Value
SME	Small and medium sized enterprises
SOA	(UK) Super Output Areas
SPD	(EU) Single Programming Document
TAAC	(US) Trade Adjustment Assistance Center
TBS	(Canada) Treasury Board Secretariat
UVAL	(Italy) Evaluation Unit (within DPS)
VAT	Value Added Tax
WTO	World Trade Organization

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Governing Regional Development Policy
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Executive Summary

Governing regional development policy is a complex task. The environment is characterised by vertical inter-dependencies between levels of government, horizontal relationships among stakeholders in multiple sectors, and a need for partnership between public and private actors. In this context, effective governance requires a flexible mechanism for meeting information needs and promoting performance. Indicator systems hold promise for doing just that. The goal of this report is to learn how indicator systems can be used as a governance tool in a regional policy context, with a particular focus on the role of monitoring. It addresses four research questions:

- What is the rationale for using indicator systems in a multi-level governance context?
- How are indicator systems designed and used to enhance the performance of regional development policy?
- What factors facilitate or hinder the implementation of these indicator systems?
- What lessons can be drawn about the overall use of indicators as a tool for enhancing governance?

Indicator systems offer regional policy stakeholders a tool for meeting two important challenges, both related to information. The first challenge has a strong vertical dimension. It involves reducing or eliminating information gaps between actors at different levels of government in order to achieve specific policy and programme objectives. Indicator systems contribute to meeting this challenge by complementing the contractual arrangements between levels of government. The second challenge has a more horizontal dimension. It involves capturing, creating, and distributing information throughout a network of actors to improve the formulation of objectives and enhance the effectiveness the strategies employed. Here indicator systems can bring together and distribute otherwise disparate information and create a common frame of reference for dialogue about regional policy.

The value of indicator systems for regional policy actors extends beyond generating and distributing information. These systems promote learning and orient stakeholders toward results. They provide information to enhance decision making throughout the policy cycle from resource allocation

decisions to policy or programme adjustments. When carefully coupled with specific incentive mechanisms and realistic targets, indicators can stimulate and focus actors' efforts in critical areas. In addition, engaging in the design and use of indicator systems, as well as in efforts to achieve targets can help promote capacity development and good management practices. Finally, effective use of indicator systems can improve transparency in the public sector and enhance accountability of stakeholders at all levels of government.

Reaping the benefits of indicator systems is not automatic, however. Careful consideration must be given to issues of system design, such as establishing clear objectives, selecting appropriate indicators, introducing incentive mechanisms, and planning for use of performance information. Challenges will emerge in both the process of design and use. The characteristics of regional policy, the capacities of stakeholders, availability of data, and the "costs" associated with indicator systems can complicate the task of effective monitoring. These challenges should not stand in the way of monitoring activities, but should temper expectations and be addressed on an ongoing basis. Mechanisms for addressing these challenges and maximising benefits include, but are not limited to, engaging stakeholders at all levels of government in the design and use of indicator systems; using pilot projects to test systems prior to nationwide implementation; using external consultants to fill gaps in technical expertise; streamlining procedures to minimise administrative burden; and anticipating and budgeting for training and capacity support.

These good practices are linked to a series of key findings which emerge from the report:

- **Indicator systems promote learning.** The process of developing and using indicator systems exposes stakeholders to information that they did not have at the outset – about programme performance, about actors' capabilities, and about the feasibility of a particular indicator system. The feedback provided by the use of indicator systems should be used for continuous improvement both in terms of policy but also in terms of the indicator system itself. For evolution to occur, the systems must be sufficiently flexible to accommodate user feedback, as well as policy and programming changes.
- **There is no "optimal" design for a performance indicator system.** The design and use of the system will depend heavily on the objectives established for the monitoring system and policy/programme objectives under consideration. As such, establishing clear objectives from the outset will greatly facilitate indicator selection, choices regarding incentives, and the proper use of information.
- **Incentives are inevitable with the use of indicator systems.** The strength of incentives depends on how information will be used and by whom. Attaching explicit rewards (or sanctions) to performance data can be a

powerful way to encourage effort and improvement; however an explicit monetary incentive is not a sufficient condition for success. The use of incentives can be challenging and important conditions must be met for such an approach to work effectively. As such, careful consideration should be given to the effects generated by the incentives in an indicator system.

- **Partnership between central and sub-central levels of government is crucial.** Vertical interactions between institutional levels, as well as horizontal co-operation and peer processes facilitate formulating precise objectives, identifying relevant indicators, setting realistic stretch targets, and devising appropriate incentive mechanisms. Moreover, rewards and sanctions are more likely to create the intended incentive effects if there is strong *ex ante* commitment from all levels of government to rigorous assessment of performance. In the absence of collaboration, a top-down approach to design and use of indicators by the central government can be perceived as an *ex post* substitute for *ex ante* control of regional economic development, producing resistance and jeopardising the long-term sustainability of the system.
- **Indicator systems should help inform short-term decisions, as well as long-term strategy.** Regional development policy produces outcomes that materialise over an extended period of time. Orienting an indicator system toward these outcomes can be beneficial, but excessive focus on outcomes can produce a deficit of information that is needed for strategic short- and medium-term decision making. Thus, even where policy makers are oriented toward outcomes, indicator systems should strive to produce information on inputs, processes, and outputs that is relevant for ongoing monitoring activities.

These findings emerge from analysis of the literature on performance indicator systems, discussions with experts, and the four case studies presented in this report. The case studies and their major findings are:

- **The European Union (EU) Structural Funds:** This case examines mechanisms for monitoring the performance of EU Structural Funds during the 2000-06 programming period, with a specific focus on the "performance reserve". The reserve was an inventive mechanism that aimed to provoke performance improvement by attaching explicit financial incentives to indicators and targets. It was implemented in a larger EU context of monitoring and evaluation activities that included a mid-term evaluation process and a de-commitment (N+2) rule. The reserve set aside 4% of a programme's total budget and distributed it only if some specific objectives were achieved. In consultation with the European Commission, member states selected their own indicators, chose their own approach to assessment, and used the mechanism differently. The case study reveals the political and technical challenges of implementing such a system, while also highlighting

the learning effects which took place. Although the mechanism is no longer compulsory, while it was in effect it helped to raise awareness of the importance of monitoring and evaluation, as well as the need to improve monitoring systems and capacity. It was a learning experience at both the EU and national levels in terms of designing systems, selecting indicators, achieving targets, and using explicit financial incentives.

- **The Italian national performance reserve:** Italy is a unique national example of the use of explicit incentives to improve the performance of regional development policy. During the 2000-06 programming period for the EU Structural Funds, Italy extended and reinforced the logic of the EU performance reserve by adopting a national performance reserve aimed at promoting modernisation of public administration. This reserve, which set aside 6% of a programme's budget, was developed collaboratively between the central government and regional actors. Specific arrangements were made to ensure transparency and enforcement of the approach. The extent to which the results of the national performance reserve translated into improved regional economic performance is unclear. However, Italy was sufficiently satisfied with the results that it has since developed a new incentive mechanism that moves beyond process and output targets, and focuses on rewarding achievement of outcomes.
- **The monitoring system for England's regional development agencies (RDAs):** The case of England highlights the dynamic nature of performance indicator systems. Since being established in 1998, the English RDAs have been subject to a number of different approaches to monitoring. With each change, the national government has aimed to enhance the quality of the monitoring process. Over time, the system has become increasingly flexible and accommodated feedback from the RDAs themselves. The most recent shift has been to allow RDAs to decide how best to measure their progress towards overall regional policy targets. Under this new approach, outputs are expected to demonstrate short term results and form the basis for impact information gained through evaluation.
- **The monitoring system for the US Economic Development Administration (EDA):** The case of the US EDA demonstrates the importance of using indicators to generate information that can be used for decision making on both a short- and a long-term basis. As a national agency, the EDA is subject to the US Government Performance and Results Act, which requires all federal agencies report to Congress regarding the achievement of specific goals. To do so, the EDA requires data collection from regional and local grantees. This can be somewhat costly and challenging, as the results of EDA investments often materialise over a number of years. One solution has been to project and report on indicators which track outcomes three, six, and nine years after programme investments have been made. However,

these and other data produced for GPRA are of limited use for short- to medium-term decision making. To meet their strategic information needs, the EDA couples reporting to Congress with the use of an internal Balanced Scorecard to monitor short-term progress.

Overall, this report suggests that indicator systems are an important tool in the larger toolkit of good governance practices. While implementation is not without challenges, indicator systems can bridge information gaps, generate a common point of reference for stakeholders, reveal where good practice occurs, and stimulate effort in particular areas. Most importantly they provide an opportunity for ongoing learning and adjustment, about policies, programmes, and good governance itself. This is especially critical for enhancing relationships between levels of government, a key ingredient for effective regional development policy.

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The Use of Performance Indicators

Introduction

With regions increasingly recognised as crucial contributors to overall national competitiveness, the performance of regional development policy has climbed to the top of the policy agenda. Since regional development policy in OECD countries is characterised by collaboration among levels of government, facilitating performance requires useful mechanisms for managing inter-governmental relations. The previous exploration of the contractual approach to multi-level governance arrangements revealed evaluation as a key dimension to be explored (OECD, 2007a). In response, this report investigates the use performance indicator systems as a mechanism for enhancing relations among levels of government and for promoting achievement of specific policy goals.

In this report, an "indicator system" refers to the systematic collection of information to measure and monitor the activities of government. Regular collection, use, and/or dissemination of information help to differentiate *ad hoc* use of indicators from indicator systems. In general, the aim of performance indicator systems is to provide information which can be used to enhance the effectiveness of decisions regarding policy priorities, strategies, and resource allocation. In recent years, indicator systems have been implemented both to monitor and to affect the performance of regional development policies in OECD countries. These indicator systems have many forms. Some aim to measure and monitor the performance of the regional economy. Others are used as governance tools to monitor and manage the performance of regional policy actors. This report focuses on the latter type of system.

Countries are at different stages with respect to their use of indicators for assessing sub-national performance. Some countries have well-developed systems, while others are in the process of discussing or adopting them. The goal of this report is to learn how indicator systems can be used to manage inter-governmental relations in a regional policy context. It seeks to address four research questions:

1. What is the rationale for using indicator systems in a multi-level governance context?
2. How are indicator systems designed and used to enhance the performance of regional development policy?

3. What factors facilitate or inhibit the implementation of these indicator systems?
4. What lessons can be drawn about the overall use of indicators as a tool for enhancing governance?

Methodology

The report builds on multiple sources of information to draw conclusions about the use of indicator systems for regional development policy. Certainly, it draws on relevant literature regarding performance assessment, indicator systems, and the management of regional development policy. However, relatively few studies exist on the specific use of indicator systems in the multi-level governance context of regional development policy where collaboration occurs across different levels of government. For this reason, a variety of activities were undertaken in order to enhance the knowledge base for this report.[1] First, four exploratory case studies have been prepared: the EU's system for monitoring regional policy implementation during 2000-06, the "national performance reserve" implemented by Italy during 2000-06, the performance framework for regional development agencies (RDAs) in England, and the approach employed by the United States Economic Development Administration (US EDA). Case studies were enhanced by interviews with stakeholders in Italy, the United States, and the United Kingdom. In addition, examples from other OECD countries are incorporated throughout the text.

Second, the OECD hosted two expert meetings on the use of indicator systems in a regional policy context in 2006 and 2007:

- "**The Use of Indicators for Regional Development Policies.**" This 2006 meeting was attended by delegates to the Territorial Development Policy Committee, the Working Party on Territorial Indicators, and the OECD Network on Fiscal Relations Across Levels of Government ("Fiscal Network"). It provided a comparative introduction to the use of indicators in six cases: the European Union, Italy, the United Kingdom, the United States, Sweden, and France. Presentations by country experts were complemented by a discussion paper which provided an analytic framework for examining the use of performance indicators in a regional policy context (OECD, 2006a).
- "**The Efficiency of Performance Indicator Systems in Regional Policy.**" This 2007 meeting brought together actors from the United States, France, Italy, Germany, the United Kingdom (England), and the EU to take an in-depth look at the "costs" associated with indicator systems and mechanisms for improving their cost effectiveness.

Finally, the report draws on research conducted by the OECD Fiscal Network on measuring and monitoring sub-national service delivery. The use of indicators for assessing the efficiency of sub-central spending was one of

two topics addressed at a full-day workshop co-organised by the Fiscal Network and the French Budget Directorate of the Ministry of Economy and Finance in May 2006. This workshop was followed by a comprehensive report on measuring and monitoring sub-national service delivery.[2] This Fiscal Network report incorporates information from questionnaires completed by 14 national governments and one regional government on a variety of policy areas.

Organisation of the report

This report is organised in two parts. Part I synthesises findings about the use of indicator systems in a regional policy context. Part II presents the four case studies referred to above.

Part I contains four chapters, each corresponding to the research questions which provide the framework for the report. Chapter 1 sets out the rationale for using indicator systems, placing particular emphasis on solving problems of information asymmetry. Chapter 2 examines important issues in system design; while Chapter 3 tackles the constraints under which such systems operate. Finally, Chapter 4 highlights benefits and lessons learned about indicator systems. The findings presented in Part I draw heavily on the four case studies presented in the second half of the report.

Part II is also divided into four chapters, each corresponding to a different case study. Chapter 5 presents the case of the European Union. It examines performance management mechanisms attached to the Structural Funds, with a particular emphasis on the mid-term evaluation, the de-commitment rule, and the performance reserve. The case of Italy follows in Chapter 6. This case focuses on the application of EU rules to national regional policy, with an in-depth examination of the national performance reserve created to reward performance. Chapter 7 presents the case of the United Kingdom and the evolution of performance assessment for the regional development agencies in England. Finally, Chapter 8 describes the case of the United States. It examines the implementation of the Government Performance and Results Act and the Balanced Scorecard at the Economic Development Administration.

Notes

1. Strengthening the knowledge base through case studies and expert meetings was made possible by support from the Korea Institute for Public Finance (KIPF).
2. The report for the Fiscal Network is Mizell, L. (2008), "Promoting Performance: Using Indicators to Enhance the Effectiveness of Sub-central Spending", Working Paper 5, OECD Network on Fiscal Relations Across Levels of Government. Various sections of the present report on indicator systems for regional policy are drawn from Mizell (2008). This endnote is provided in lieu of quotations and in-text citations.

PART I

System Design, Use and Good Practices

This report is divided into two parts. Part I synthesises findings about the use of indicator systems in a regional policy context. It is divided into four chapters. Chapter 1 elaborates a conceptual framework for understanding how indicator systems can contribute to improving the governance of regional development policy. Chapter 2 examines important issues in system design such as indicator selection, the use of incentives, target-setting, and the use of performance information. Chapter 3 examines the constraints under which such systems operate. It describes factors that can hinder the design and effectiveness of indicator systems, examines the "costs" of using indicator systems, and highlights the various mechanisms available for facilitating system effectiveness. Finally, Chapter 4 notes benefits and lessons learned about indicator systems.

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PART I

Chapter 1

The Value of Indicator Systems for Managing Regional Development Policy

Introduction

This chapter elaborates a conceptual framework for understanding how indicator systems can contribute to improving the governance of regional development policy. The first section provides a rationale for using indicator systems. It begins by describing the multi-level governance arrangements that characterise regional development policy. It explores how information gaps produce governance challenges that affect policy performance. The second section discusses the broad benefits of indicator systems. Finally, note is made of the difference between monitoring and evaluation.

Why indicator systems?

The rationale for using indicator systems to improve the performance of regional development policy is based on the information needs of regional policy actors. They operate in an environment characterised by a need for vertical and horizontal co-ordination among public and private actors at different levels of government, from the supra-national to the local. Multi-level governance arrangements emerge when responsibilities are shared between levels of government.[1] These vertical inter-dependencies occur where higher levels of government are concerned with outcomes at a lower level and where there is co-assignment of responsibilities. The information needs that arise in this context relate to these vertical and horizontal dimensions. Satisfying these information needs has direct implications for the performance of regional development policies.

Regional development policy often has two aims: to enhance the competitiveness of regions such that that they remain or become locations of economic development and to ensure equitable access to a basic set of public goods and services across regions (OECD, 2007c). In most OECD countries, responsibilities associated with achieving these goals are shared among levels of government. The European Union relies on countries and regions to deliver Structural and Cohesion Funds. The United Kingdom has delegated these responsibilities to regional development agencies and local governments. In the United States, regional economic development goals are pursued by multiple departments in collaboration with states, localities, and the private sector. The delegation and sharing of responsibility in regional development policy is predicated on the belief that regional and local actors are better positioned to design local solutions to local problems (McVittie and Swales, 2007a). Where

vertical delegation of authority occurs, it introduces a particular governance challenge, which can be understood in the context of a "principal-agent problem".[2]

In a simple version of the principal-agent framework, one individual or institution (a principal) engages another individual or institution work on his behalf (an agent). A ministry, for example, may delegate or decentralise responsibility for regional economic development to a lower level government or to an agency while retaining an important financing role. Contractual arrangements are established to frame the interaction of the different parties. They are designed to ensure "that the outcomes produced through the agent's efforts are the best the principal can achieve, given the choice to delegate in the first place" (Kiewiet and McCubbins, 1991). Problems arise when information gaps exist between the two parties. When responsibilities for regional development policy are delegated to actors at different levels of government, those who delegate may be unable to exactly observe the extent to which the capabilities, efforts, and results achieved by "agents" are fully aligned with the principal's goals.[3] A crucial governance challenge emerges: the principal must close the information gap and where a gap remains, encourage the agent to act in ways consistent with the principal's interest by incorporating adequate incentives into the contractual arrangement (OECD, 2006a; Whynes, 1993).

In multi-level governance arrangements, the role of indicators and incentives will vary with the characteristics of the contractual arrangement between the different parties (OECD, 2007a). Where the relationship is largely "transactional" (responsibilities and the rewards for the different parties are specified *ex ante*), the more an indicator system will be useful for solving asymmetries of information (and reducing risk for the principal in the delegation process). Where the contract is more "relational" (parties commit for co-operation *ex post*) the more indicators system will contribute to the co-operation building aim by sharing common references and objectives and above all contribute to a common learning process.

Concrete arrangements for governance of regional policy are, in fact, complex because they concern not only vertical arrangements because they incorporate a strong horizontal dimension as well. Ansell (2000) describes regional development actors as a "networked polity", where knowledge is often decentralised and distributed, where relationships are heterarchical as opposed to hierarchical,[4] where jurisdictions overlap, and where a premium is placed on co-operation. In this context, knowledge gaps exist throughout the system, in part because of its distributed nature and not least because there is no "optimal" strategy for regional economic development. The successes and failures of different strategies in different areas form a critical knowledge base from which all actors can draw. A second governance challenge emerges: knowledge about

"what works where" needs to be created or captured, contextualised, and distributed.

Thus, two crucial challenges emerge, both related to information:

- The first challenge can be viewed from a vertical perspective. It involves reducing or eliminating information gaps between the central government and sub-central actors, and stimulating adequate effort by different actors in charge of regional policy implementation. Indicator systems can contribute to meeting this challenge by complementing the contractual arrangements between levels of government.
- The second challenge can be viewed from a horizontal perspective. It involves capturing, creating, and distributing information throughout a network of actors to improve the formulation of objectives and enhance the effectiveness the strategies employed. The central government can play a crucial role as a "network node" by bringing together and distributing otherwise disparate information and by collaborating with sub-national actors to create a common frame of reference for dialogue about regional policy.

Meeting both challenges aims directly at the goal of improving the performance of regional development policy actors and strategies. For example, the national government may seek to know the efficiency with which a regional or local actor is using transfers to provide certain public services. Regional or local actors may also be interested in comparing their efficiency to other comparable entities at the same government level. Indicators on unit cost and volume of service may provide useful information in both cases, vertically (across levels of government) and horizontally (among different entities in the same level of government).

What benefits do they produce?

Indicator systems contribute to good governance by producing and presenting information that can improve decision making, enhance resource allocation, and increase accountability. By reducing information gaps these systems help to improve policy performance in a number of ways:

- *Selecting policy strategies, resource allocation, and actors*. Certain types of information, if available early in the policy cycle, could increase the likelihood that policy objectives are achieved. For example, information about the context in which strategies must be implemented can reveal the strengths and weaknesses of a regional economy, the complexity of the policy problem, the existing resources available for action, and the extent to which a desired outcome is under an agent's control. If associated with selection processes, information about the capabilities and goals of the agents could be used to select those whose interests best align with that of the principal. Where selection is not possible, *ex ante* knowledge can be used to determine how to

assign responsibilities, design contractual arrangements, and anticipate the need for technical training and support.[5]

- *Monitoring policy implementation*. Once policies are underway and programmes are being implemented, information can be gathered to monitor the choice of strategies, input utilisation, achievement of milestones, and the production of outputs.
- *Accounting for results*. Actors involved with regional development policy are accountable to other levels of government, their constituents, and partners for producing results. Information systems, if properly designed, can increase transparency and enhance accountability by providing information on what is (being) done, why, with what resources, and with what results.
- *Learning, adjusting, and improving*. Information tools can be used both to capture and create knowledge that can be shared vertically and horizontally. Actors at a higher level of government need information, not only to monitor performance but also to adjust and refine policy choices for the future. Adjustment can also be made by actors implementing regional policy strategies. Access to comparative performance data may encourage actors to increase their own efficiency and seek out alternative strategies. Experiences with different strategies can be pooled and compared for the purposes of identifying good practices. Indicator systems can produce information which feeds back into the policy cycle, improving the quality of decision making in a subsequent period.

Information, in and of itself, does not automatically produce benefits or improve policy performance. Mechanisms must exist to generate, validate, and distribute information, capacity must exist to use it in an effective and timely way, and specific incentives are frequently needed to encourage actors to pursue a particular course of action. As subsequent chapters show, certain conditions can facilitate the use of indicator systems and production of benefits, while other conditions give rise to costs and difficulties.

While indicator systems are not a perfect solution to the information problems faced by policy makers, they are one tool for reducing information gaps, facilitating the transfer of knowledge, and encouraging improvement of regional development policy performance.

Monitoring *versus* evaluation

This report focuses on the use of indicator systems for monitoring and managing regional development policy. In this context, monitoring activities must be distinguished from evaluation. Monitoring is an ongoing process of collecting and assessing qualitative and quantitative information on the inputs, processes, and outputs of programmes and policies, and the outcomes they aim to address. It may involve assessment against established targets,

benchmarks or relevant comparable phenomena and the integration of incentives for actors to achieve targets.

Monitoring can be distinguished from evaluation in part by its objectives. Whereas monitoring aims to track (and possibly promote) continuous progress, evaluation aims to assess if particular objectives have been achieved. Evaluation frequently makes a specific attempt to link cause and effect and to attribute changes in outcomes to programme activities. Thus, assessing the *impact* of regional development policies on regional economic outcomes, on reduction of regional disparities, and competitiveness generally falls under the domain of evaluation.

Because the purposes of monitoring and evaluation differ, the two activities tend to rely on different methodologies. However, indicator systems can be important sources of information for both activities. Monitoring and evaluation are often discussed together because they are complementary and a combination of both activities provides a comprehensive approach to enhancing policy performance.

Conclusions

In summary, the rationale for using indicator systems to improve the multi-level governance of regional development policy rests on the premise that they can close information gaps, and by doing so improve the quality of decision making by actors at different levels of government – thus improving the efficiency and effectiveness of policies and programmes. These information gaps emerge for a variety of reasons, at a minimum because information can be dispersed among many stakeholders at the central, regional, and local levels. Indicator systems hold promise for revealing and sharing important information to actors throughout the system, but most importantly for governance – to those responsible for designing and implementing measures to advance the competitiveness of regional economies.

The following chapters outline the major considerations in system design and implementation, and what has been learned in terms of the overall costs and benefits of using indicators to measure and monitor the performance of regional development policy.

Notes

1. The concept of multi-level governance of regional development policy was introduced in Marks, Gary (1993), "Structural Policy and Multilevel Governance in the EC", in Alan Cafruny and Glenda Rosenthal (eds.), *The State of the European Community*, Lynne Rienner, New York, pp. 391-410. It is an important aspect of the OECD approach to regional development policy.

2. The principal-agent framework has been used to describe regional development policy generally (OECD, 2007a) and at the country level (McVittie and Swales, 2007a; McVittie and Swales, 2007b; Learmonth and Swales, 2004).

3. Sub-national actors may have objectives which may legitimately diverge from those of a central government. For regional development policy, local knowledge and priorities are critically important. Taking advantage of these "comparative advantages" is precisely one of the benefits of delegation and decentralisation. Local knowledge may thus lead actors to value particular objectives. Moreover, elected regional or local governments, have downward accountability that may cause their objectives to diverge from a national government.

4. According to Ansell (2000), "What distinguishes a heterarchy from a hierarchy is the capacity of lower-level units to have relationships with multiple higher-level centers (violating vertical chains of command) as well as lateral links at the same organisational level" (p. 309).

5. In reality, principals in the public sector face limited choices in the selection of agents, especially for contractual arrangements between levels of government. Once the choice is made to delegate responsibilities to a lower level of government, a principal (such as a central government) may be unable to choose specific agents in the short-term, and may just face a single possible agent. Medium- to long-term solutions might involve upgrading capabilities, re-assignment of responsibilities, the creation of new agents *(e.g.,* regional development agencies or a regional level of government), or the choice of a private as opposed to a public agent.

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Governing Regional Development Policy
The Use of Performance Indicators

PART I

Chapter 2

Designing Indicator Systems that Work: Key Attributes

Introduction

Technical issues emerge when designing and using indicator systems to enhance the governance and performance of regional development policy. This chapter examines important issues in system design that should be considered when establishing indicator systems and when improving them over time. It begins with a look at what indicators should be included and the process of selection, before turning to the critical issue of incentives. Incentives that affect the behaviour of regional actors are inevitable when measuring and monitoring performance. The discussion in this chapter addresses how design considerations affect the type and degree of influence those incentives may have. Two additional design issues are also addressed: target setting and the use of performance information. Neither task is easy but must be considered if indicators are to be used to enhance performance.

Types of indicators

What is an indicator? An indicator is a measure that captures important information and provides insight that can be used in the context of decision making. They are generally divided into four categories:

- *Input measures* reveal what resources *(e.g.,* people, money, and time) are used in what amounts to produce and deliver goods and services.
- *Process measures* reveal the way in which activities are undertaken by a programme or project with the resources described.
- *Output measures* capture the goods and services activities produce *(e.g.,* number of SMEs served, kilometres of roads built).
- *Outcome measures* capture the dimension that is expected to change as a result of an intervention (policy, programme, or project) and the outputs produced.

In some cases, policy makers and practitioners seek to expand these categories. For example, the EU refers to "outcomes" in terms of "results" and "impacts" when monitoring and evaluating Structural and Cohesion Funds. Others have further differentiated categories of indicators.[1]

Two distinctions should be made with respect to the types of indicators. First, a distinction should be made between indicators that are substantially affected by factors exogenous to regional economic development programmes, strategies, and policies – and those that are more directly associated. "Context

indicators" fall in the first group. Context indicators provide information on the environment in which regional policies must operate.

A second important distinction should be made between indicators that summarise "gross" quantities and those that capture "net" quantities. This distinction is particularly important with respect to outcome indicators. For example, regional policies that aim to produce employment are likely to be concerned with jobs created or retained as a result of programme interventions. These jobs may be created directly *(e.g.,* by directly assisting firms) or indirectly *(e.g.,* through public works projects that make an area more attractive to firms). In contrast to "gross jobs created", which measures observed changes between two points in time, "net jobs created" accounts for what would have happened if the intervention had not occurred *(e.g.,* some jobs may have been created anyway, other jobs may not have relocated). Net totals are a better indicator of programme "impact", but require establishing a counterfactual and as such tend to correspond to evaluation. By contrast, gross totals can be a useful outcome indicator – but may not be fully attributable to the policy or programme.

Selection of indicators

Defining the types of indicators is relatively straightforward. Selecting the indicators to be monitored and for what purpose is more difficult. In determining what to measure, two factors are particularly important: the objectives of the monitoring system, and the policy and programme objectives to be achieved.

The objectives of the monitoring system

The design and use of indicator systems depend in large part on the objectives to be achieved: allocation of resources, control of resources, efficiency in the use of resources, transparency and communication with stakeholders, etc. A government could choose, for example, to induce competition to enhance cost effectiveness by comparing and ranking service delivery by different entities. Alternatively, the objective might be to transform the quality or availability of services by attaching targets to indicators, by monitoring and supporting local capacity to deliver services, or both. These and other objectives are not mutually exclusive.

Systems that aim largely to monitor and control financial flows will emphasise input indicators, with a focus on resources allocated for and committed by programmes. By contrast, monitoring systems that aim to track "what and how things get done" may focus on process measures that indicate if intended activities are undertaken, by whom, and at what pace. Output and outcome indicators will be the focus of systems that aim to hold policy makers

or programme staff accountable for "results". While "results" technically correspond to outcome measures, output indicators are often used to demonstrate "value for money" in terms of what is produced. In fact, monitoring activities rarely have a single aim. The combination of objectives means that a variety of indicators are followed.

The policy and programme objectives

Not only must the objectives of the monitoring system be taken into account, but the selection of indicators will be driven by the specific goals of the policies and programmes under consideration. The current paradigm that recommends focusing regional development policy on both regional inequalities and competitiveness affects not only the outputs and outcomes expected, but also the input mix and activities that are undertaken. Traditional indicators may be replaced by new measures that better correspond to these policy goals and programme choices.

Linking indicators, and policy and programme objectives is not always easy. These objectives are often numerous and can be difficult to measure. At the highest level are overarching development goals that aim to improve citizens' well-being. For example:

- UK regional policy aims to contribute to high and stable levels of growth and employment nationwide by ensuring that each region is achieving its full potential.
- In Poland, regional policy aims to support poles of growth (large cities) while simultaneously promoting development of lagging regions, particularly in eastern peripheral areas.
- Regional policy in Portugal aims increasingly at territorialising and integrating structural policy reforms while exploiting local endogenous assets.
- For the European Union, regional policy during the 2007-13 programming period sets forth objectives of cohesion, competitiveness and employment, and cross-border co-operation (EC 1083/2006).

These overarching or "global" objectives generally coincide with "impacts", or the long-term effects of programme interventions. Generally, assessment of impacts is done via evaluation, as opposed to pure monitoring of indicators.

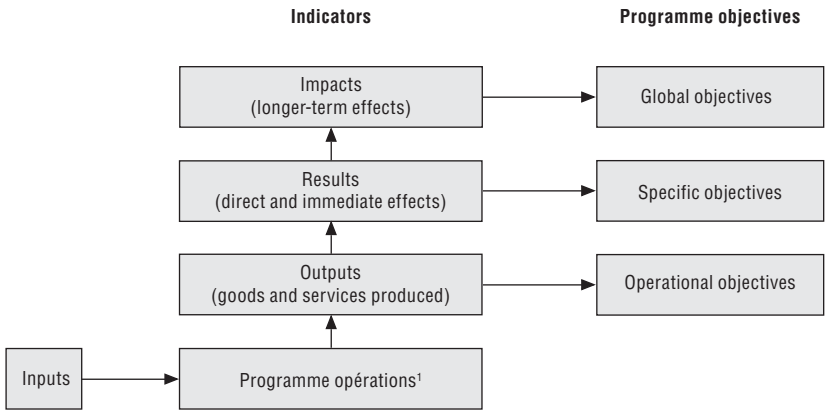
Global objectives are often complemented by additional "specific objectives" (to use EU terminology). For example, the EU Structural Funds regulations introduce more specific objectives, such as those related to innovation and environmental sustainability as a means of fostering competitiveness of regions. The United Kingdom has specific objectives in the areas of productivity, flexibility, and welfare – each requiring different types of indicators. The

productivity agenda demands indicators for investment, skills, innovation, competition, and enterprise. The flexibility agenda demands indicators of flexibility in the labour, product, and capital markets. Objectives associated with re-distribution demand indicators about public services and the distribution of public spending (Allsopp, 2003).

Finally, there are immediate "operational" objectives. Operational objectives are often associated with programmes and projects implemented regionally or locally. While they should correspond to the objectives set for regional policy at higher levels, they must also complement strategic objectives established at and by regional (and local) actors. These types of objectives are often simpler to define and more likely to be associated with attributable effects.

In its guidance on the use of indicator systems, the European Commission distinguishes between the three categories of objectives (global, specific, and operational) and matches each category to different types of indicators (outputs, results and impacts) (Figure 2.1).

Figure 2.1. **Linking indicators and programme objectives**



1. In the terminology of this report, programme operations are equivalent to processes.

Source: European Commission (1999), "Indicators for Monitoring and Evaluation: An Indicative Methodology", *The New Programming Period 2000-2006: Methodological Working Papers*, Working Paper 3, issued by Directorate-General XVI Regional Policy and Cohesion, Co-ordination and Evaluation of Operations, p. 6.

Going beyond the generic categories of output and outcome, what specific indicators should be monitored in the context of regional policy? There are two answers to this question. The first is: it depends. More accurately, it depends on the previously outlined objectives and the categories of intervention where government funds were spent. The case studies provided in Part II reveal differences and some similarities among the indicators that were monitored. The EU left the decision regarding indicator selection for the performance reserve to

member states, but insisted on monitoring input utilisation (through the de-commitment rule). Italy chose to emphasise process measures relating to effective public administration for its national performance reserve.[2] By contrast both the United States and the United Kingdom incorporate outcome measures into their performance monitoring systems by examining jobs created or retained, and private sector funding leveraged as a result of regional investments. Annex A provides suggestions for indicators suitable for regional (or local) economic development.

The second answer to the question is to measure what matters for regional economic development. Underlying this answer is an assumption that policy makers and regional stakeholders know and implement strategies "that work." However, regional economic development is complex and what works in one place may not be the appropriate prescription for another. One country's economic development goals may not mirror those of another country as assets and challenges vary across regions. In fact, like regional policy itself, indicator selection must be tailored to the goals and strategies undertaken for a specific region (or country). However, research can provide important guidance in researching the policies and investment "that work". For example, with respect to the effectiveness of the EU Structural Funds to achieve convergence among regions in Europe, Rodriguez-Posse (2004) highlights the importance of a diversified set of investments – not only in infrastructure and business support but also in educational and human capital development.

How many indicators?

Just as there is no "optimal" design of an indicator system, there is no "optimal" number of indicators. The set of indicators being monitored should meet the information needs of different stakeholders. Policy makers, senior staff, and the public tend to value information on inputs *(e.g.,* how much services cost) and outcomes (what is being achieved). By contrast, programme staff must manage day-to-day activities and therefore need information on processes and outputs (Horsch, 2006). A sufficient number of indicators should be selected to provide a comprehensive picture of performance, but not so many as to overburden programme staff and policy makers – either in terms of administrative burden or in terms of "too much" information. Where limited capacities exist, it can be useful to begin with a smaller, less complex set of indicators that can serve as the basis for learning and which can be adjusted or expanded in a subsequent phase. Experience, however, has often been the reverse. A few countries introduced over a thousand indicators for monitoring public service delivery at an early phase of system development. As these systems matured, the number of indicators tended to decline (Perrin, 2007).

Importantly, an indicator system can provide different information to different parties. A core set of indicators can be established for use by "principals" to measure and monitor the activities and achievements of "agents". At the same time, actors may choose to supplement the core set of indicators with other measures that meet their information needs. Ideally, the core set of indicators should lend itself to computing measures such as efficiency (output per input).

The number of indicators selected is also influenced by the degree of oversight that the central government wants to exert over local policy choices. If all actors must implement the same strategy, the central government may opt to monitor all steps of the process, from operational to global objectives. This approach was taken during the implementation of the national performance reserve in Italy (2000-06). Alternatively the central government can monitor just the global objective and let local actors determine how best to achieve it. Italy has adopted this second approach with respect to the 2007-13 incentive mechanism, taking into account the variability in the economic context in which the regional policy is implemented.

Who decides?

Regional development policy involves a multitude of actors at all levels of government. So who decides which indicators to monitor? When considering indicator systems that contribute to regional economic development nationwide, the central government is, *de facto*, a critical actor in any monitoring arrangement. However, the extent of central influence in the design and use of the system can vary with monitoring objectives, with the degree of decentralisation of a country, or the nature of policy arrangements between levels of government. Certain objectives, such as monitoring compliance with or achievement of national standards, determining budget allocations, or establishing financial control may be well accommodated by systems in which the central government plays the dominant role. By contrast, objectives that emphasise achieving regional goals, inter-governmental learning, capacity building, or identifying effective policy strategies may be achieved better through systems that engage sub-national actors in design, implementation, and use.

A purely top-down approach to indicator selection is likely to encounter two important challenges in the context of multi-level governance. First, the indicator system may fail to reflect regional specificities precisely because the central government does not possess perfect knowledge about regional actors or the context in which they operate. Second, seen purely as a requirement imposed from above, regional actors may comply with reporting requirements but fail to use the information produced by indicators for achieving real performance improvement. Orders from above may generate criticism that render the system less efficient at encouraging different entities and government

levels to converge in a collective and collaborative effort toward development in every region.

Inter-governmental collaboration can increase the relevance and usefulness of indicator systems. The various levels of government may be motivated to collaborate if they perceive it will lead to new or better information for enhancing service delivery, improve policy effectiveness, or if they can share the additional resources which result from efficiency gains. Central authorities are well positioned to add value by combining information from multiple sources and facilitating information sharing across the network of actors in ways that add to knowledge – both for the central and regional authorities. Both parties gain as information asymmetries are reduced across and between levels of government. Gains may come not just from new or better information, but because existing information is made available in a centralised, coherent, and uniform way that can be interpreted in a common manner over time. The experience of Infrastructure Canada provided in Chapter 3 (Box 3.1) reveals the importance of participatory efforts between the national and sub-national levels to identify common metrics, particularly where sub-national governments have developed their own set of indicators that respond to their electorate's information needs.

All of the case studies in Part II reveal some degree of participatory decision making. Italy relied on a strong partnership between central and regional governments to identify indicators and targets. Inter-governmental negotiations were a way to "reveal" the knowledge necessary to establish useful indicators (and their targets). This approach aims to address the fact that information is incomplete and scattered among different actors. In addition, a six-member independent technical group with representation from the Ministry of Economy, the Regional Evaluation Unit Network for Public Investment and experts appointed by the European Commission monitored the system. Participatory design and objective implementation are credited for the successful implementation of the system which incorporated indicators, targets, and financial incentives for performance (Mizell, 2008).

In the United States, the indicators monitored for the Government Performance and Results Act (GPRA) appear to have been selected by the EDA in a top-down fashion. The indicators are well-aligned with the agency's goals, and targets are consistent with research regarding the timing of effective outcomes. However, sub-national actors do encounter difficulties with data collection due to the time lag between project implementation and expected results. Sub-national actors have a greater role in deciding which indicators are used to provide baseline descriptive data regarding the regional economy in which they operate. Using broad guidance from the EDA, investment recipients select the indicators for the required Comprehensive Economic Development Strategy (CEDS), the framework document for regional

development projects. In contrast to GPRA indicators, the measures selected for the internal Balanced Scorecard appear to have been developed in a highly participatory fashion with regional office staff. Austria, which also intends to use a Balanced Scorecard to monitor regional development programmes, developed the indicators in a collaborative fashion between the national and regional levels (Box 2.1).

Box 2.1. **The use of the Balanced Scorecard in Austria**

Part II of this report includes a case study of the US Economic Development Administration, which uses the Balanced Scorecard (BSC) to monitor programme implementation. The United States is not the only country to use the BSC in the context of regional economic development. In Austria, the BSC will be used in the current EU programming period to monitor the performance of decentralised components of the National Rural Development programmes (regional programmes established under the LEADER priority axis). The main purpose of this monitoring is quality assurance by comparing and reflecting on the performance of individual programmes. The national level expects to gain insight into the implementation status of the programmes and to identify areas where additional external support would be appropriate. The BSC will not be used to rank the programmes, or to sanction or reward them according to their performance.

A set of 15 indicators was established by a working group composed of representatives from national and regional levels. These indicators are grouped in four dimensions according to the BSC model (modified for use in regional development): results and impacts, implementation process, learning and development, and resources. The LEADER Local Action Groups will assess their performance on an annual basis, normally by consulting a range of concerned actors in their region. The assessments of the individual programmes will then be transmitted to the national level where they will be aggregated and analysed. A comparative analysis will then be discussed by a national-level quality assurance working group.

Source: Federal Chancellery of Austria.

The case of the English RDAs demonstrates an evolution in the role of RDAs in the performance measurement framework. Whereas early arrangements were heavily influenced by the choices of the central government, over time the RDAs were given a larger role in updating the system. For example, the 2005 RDA Tasking Framework was designed in consultation with a Performance Management Group representing RDA views. Under a new approach taking effect in 2008, the central government will provide RDAs with greater leeway than in

the past to select indicators and targets that will enable them to track performance toward national regional policy goals. Two expected benefits of the new approach include less micro management by the central government and a better fit with the RDAs' strategic purpose[3] (Amison, 2007).

Finally, the case of the EU suggests both the benefits and the "costs" of participatory design in monitoring arrangements. On the one hand, the EU cannot move forward with governance arrangements, such as the performance reserve, that are not supported by member states. As a result, member states had influence over the design of the system from the outset. Countries insisted that plans for ambitious incentives (*i.e.*, a 10% budgetary set-aside to reward performance) be scaled down (*i.e.,* to 4%). Performance indicators, target values, and financial allocation mechanisms were also selected at the country-level, with broad guidance from the EU. The benefit of this approach may have been a more politically acceptable environment for implementation and more reasonable expectations than had the system design been established at the "centre". On the other hand, extensive "bottom-up" influence in the absence of strong national and regional monitoring and evaluation capacity may have weakened the incentive effects of the performance reserve, and made it more susceptible to political influence.

Use of incentives

When designing and using indicator systems, it is important to recognise that incentives are inevitable. From a design perspective, the choice regards the degree to which the system will incorporate implicit and explicit incentives.[4] Both are a function of system design and should be given careful consideration, particularly because incentives affect both the information revealed by regional policy actors and their behaviour in positive and negative ways.

Implicit incentives arise because reporting performance data is not neutral.[5] The strength of these implicit incentives will depend on how the information is used and by whom. For example, if information transfer is a primary objective, the central government may choose to do little more than to take advantage of its network position to collect, manipulate, and disseminate information for use by key actors. Norway's KOSTRA system which conveys data from municipalities to the central government, between municipalities, and to the public is an example of this approach.[6] The incentive effects in this system are relatively weak, and rely on the intrinsic motivation to take advantage of the information provided.

Alternatively, indicator systems can be designed to produce competition by presenting information on all regions, providers of services or entities in charge of programmes in order to facilitate relative comparisons by competent authorities or by the population at large. Invoked in this way, reputation

effects can be used to generate external pressure for accountability and reform. The case studies demonstrate that reputation effects are an important aspect of performance indicator systems. In the United Kingdom, reports summarising the performance of RDAs are submitted to the Parliament and made public twice a year. This constitutes a strong incentive for RDAs to achieve targets. In Italy too, the diffusion of the results was intended to encourage local policy makers to abide by their commitment to targets. For the United States, EDA performance against GPRA targets is reported annually to Congress and made publicly available online. The strength of reputation effects can encourage effort, but it can also encourage risk aversion when setting targets and reporting results – particularly if there are budgetary implications.

In contrast to implicit incentives, countries can attach explicit rewards and sanctions to indicators to stimulate effort by regional policy actors where specific performance objectives are to be met. These incentives are traditionally of two types: financial and administrative. Financial incentives refer to the availability of funds based on performance. Administrative incentives are changes to rules and regulations that affect regional policy actors, such as a relaxation (or tightening) of budgetary rules, decreased (or increased) oversight, etc.

The use of explicit incentives is challenging. The relationship between inputs, outputs, and outcomes must be known and measurable, the indicators associated with incentives must capture performance under the control of the actor, and they must be able to be affected in the time frame being measured. These conditions can be difficult to achieve in regional policy because outcomes can be difficult to measure, there is a substantial lag between policy implementation and results, and the causal relationship faces threats to internal validity. Under these conditions, the use of explicit incentives is not impossible, but rather requires careful selection of the indicators to which incentives will be attached. Italy aimed to address some of these challenges by distinguishing between "soft" and "hard" use of indicators (Box 2.2).

There is no optimum amount for an explicit monetary reward (or sanction). However, there may be a "critical level" in the sense that the award should represent a meaningful proportion of the programme or policy budget. Yet it is difficult to identify the amount that an agent would consider "critical". The United Kingdom's short-lived experience with a small performance fund representing 2.7% of the RDAs' budget may suggest that the financial award was too small to make a difference. On the face of it, the national performance reserve in Italy, which represented 6% of regional programmes funded by the EU Structural Funds yielded a broad effect and would tend to support the "critical level" argument. Yet, the overall amount of the reward may not fully explain the success of a financial incentive. Also important are the structure of the incentive and the context in which it is implemented.

Box 2.2. **Indicators and incentives – Regional development policy in Italy, 2000-06**

Due to the decentralisation of public services to local and regional levels in Italy, the knowledge needed to implement policies is distributed among several levels of government. Co-operation among different levels of government and the measurement of policy objectives has thus become increasingly important. A comprehensive system of indicators was designed for this purpose in the area of regional development policy for 2000-06.

Measuring the achievement of policy objectives can be challenging, especially when it is difficult to translate the final objectives into quantifiable and verifiable measures and difficult to establish a clear link between policy actions and changes in indicator values. In this situation, Italy chose to develop three categories of indicators ("context indicators" "monitoring, indicators", and "policy effort indicators") that could be used to improve the targeting of policy actions and broadly assess their effectiveness. This approach is described as "soft use". Context indicators are used to 1) identify regional strengths and weaknesses; 2) improve the clarity of regional policy objectives; and 3) increase the accountability of decision makers. Policy effort indicators are used to 1) establish reference values for assessing outputs and outcomes; 2) assess if policies are pursued correctly; 3) identify the types of expenditures that create synergies; and 4) assess the roles of different levels of government.

Italy also attached a series of indicators to rewards/sanctions for performance; an approach described as "hard use". This mechanism built on the 4% performance reserve for the EU Structural Funds by adding a 6% national performance reserve, effectively setting aside 10% of funds available for regional development policy. To access these funds, regions had to achieve targets in the areas of good management of funds, modernisation of public administration, and implementation of reforms. The overarching goal of this sanction/reward system was to promote institutional capacity building for regional development. It relied on a strong partnership process, transparent public information, objective monitoring by a technical group, and reliable, replicable, and complete information.

How successful were the "soft" and "hard" use of indicators? The impact of context indicators appears to be limited. The local partners have not used the results of the context indicators extensively to improve regional performance. By contrast, the system of rewards and sanctions did stimulate sub-central governments' efforts to improve their performance – a real need in lagging regions. More than 57% of targets associated with the incentive system were achieved.

For a complete description of Italy's approach to using performance indicators, see the case study in Part II.

Sources: Box originally appears in Mizell, L. (2008), "Promoting Performance: Using Indicators to Enhance the Effectiveness of Sub-central Spending", OECD Network on Fiscal Relations Across Levels of Government, Working Paper 5. It is modified from Box 1 in OECD (2006), "Workshop Proceedings: The Efficiency of Sub-central Spending", GOV/TDPC/RD(2006)12, and draws on Italy's response to "Efficiency of Sub-central Spending: Questionnaire on Performance Indicators", COM/CTPA/ECO/GOV(2007)2/REV1.

In general, use of explicit incentives comes with risk. Benefits associated with information sharing can be attenuated if rewards or sanctions create perverse incentives for misrepresentation of data, gaming, etc. As risks to actors increase, the incentive to reveal complete information declines and the incentive to alter behaviours to avoid risk (in perverse and legitimate ways) increases. In this environment, policy makers' decisions regarding resource allocation, policy priorities, and the like can be made on incomplete or inaccurate information. The more "high-powered" the incentives, the greater the risk of unintended consequences.

Target setting[7]

Targets enhance the incentive effects of indicator systems by helping to mobilise resources, to prioritise public expenditures, to introduce accountability, and to encourage effort. In order for targets to make a positive contribution to programme and policy performance, a variety of criteria should be met. Targets should:

- *Be ambitious yet realistic*: In order to maximise value-for-money and improve performance, targets should be set neither too low (and fail to provide an incentive for effort) nor too high (dampening motivation because they will be perceived as unattainable). Realistic also means establishing goals that are fiscally attainable and can be achieved within a reasonable time period.
- *Be of moderate number*: Aiming to achieve too many (or too few) targets can erode their usefulness in prioritising resource allocation. With a large number of targets, the significance of any single target in helping to prioritise expenditures is weakened.
- *Linked to a causal model*: Setting targets assumes some knowledge of the relationship between inputs, activities, outputs, and outcomes. Targets should not be established if actors do not understand how to manipulate inputs and activities to achieve output and outcome goals. In such a setting, targets are likely to be technically and financially unrealistic.
- *Be attributable to specific actors*: In order for targets to incite effort, their achievement must be attributable to specific actors and not highly affected by factors outside the control of these actors. This is not always easy for regional development policy, which relies on multiple actors to achieve objectives over an extended time period.
- *Be balanced*: The phrase "what gets measured gets done"[8] has become commonplace. In fact, actors will dedicate resources and prioritise activities that are attached to targets, particularly if targets are coupled with explicit incentives or have implications for reputation effects *(e.g.,* through public reporting). In order to ensure that sufficient attention is given to all aspects of service delivery, a comprehensive (but manageable) set of targets should

be selected. This also ensures that rewards (or sanctions) for performance are not contingent on achieving only a few targets. Performance is viewed in a more holistic manner.

- *Be enforceable*: Targets should not be too open-ended (and thus non-binding), too heavily specified (resulting in formalistic satisfaction of targets), or too easy to renegotiate (OECD, 2006b).

There are a variety of choices that need to be made regarding target-setting. A first choice has to do with the types of indicators that will be targeted. Targets attached to inputs and outputs are relatively short-term. They can ensure that programming activities stay on-track in terms of input mix, expenditures, and goods and services produced. Achieving these targets provides accountability for the efficiency and effectiveness of day-to-day functioning of programmes. By contrast, outcome targets emphasise the medium or longer term. They provide accountability for "results" both at the programme and policy levels, but they are often hard to establish and achieve because of the time lag which occurs between activities and results.

A comprehensive set of input, output, and outcome targets can be established. In this case, the targets should be internally consistent and each should be meet the criteria noted previously. For example:

- A (long-term) results target of increasing GDP per capita in a given region may, in turn, require
- A (medium-term) outcome target of creating high-value jobs in particular region, which may require
- A complementary (shorter-term) outcome target regarding the number of SMEs launched and sustained after two years, which is linked to
- A (short-term) output target regarding the number of entrepreneurs receiving seed money or small business loans, which must be complemented by
- An input target regarding the capital invested for SME support.

It is important to note in connection with the example in the preceding paragraph that both increasing GDP per capita and creating high-value jobs relates to more than just supporting SMEs. Achieving these targets would require complementary actions from a variety of actors and programmes. As such, care must be taken when determining which actors will be held accountable for the different targets and by what means. The involvement of a variety of actors and programmes also means that the number of shorter-term outcome and output targets could proliferate. According to Christiaensen *et al.* (2002, p. 135), "[t]he marginal benefits of yet another target in terms of increased incentives and accountability will have to be traded off against increasing marginal costs of implementing and monitoring this additional target". Priority could be given to the outcomes, outputs, and inputs that research suggests will

provide the largest pay-off for development goals. In order to enhance the knowledge base other indicators could be monitored without attaching targets – provided the overall number of indicators being monitored does not become excessive, thereby increasing the administrative burden of using an indicator system.

Another choice to be made when setting targets is whether to establish a range of target values (as is done in the United Kingdom by regional development agencies) or to set a single value target (as was done in the case of the Italian national performance reserve). Target ranges are perhaps most appropriate where the causal model that links inputs to outputs and outcomes is relatively uncertain, or where regional policy actors are expected to exert only partial influence over the indicator value. By contrast, where the production process is relatively clear and where actors exert substantial influence over the indicator value, single value (point) targets could be used. In fact, "hard" targets were established in Italy only in areas where regional actors had significant control: management of funds, modernisation of public administration, and implementation of reforms.

Finally, consideration should be given to the time frame set aside for achieving the target. Research, prior experience, or the experiences of other regions can provide insight regarding the time frame in which outputs, outcomes, and results can be expected to materialise. In the United States, the EDA commissioned a study precisely to determine when "pay-offs" from EDA investments materialise. The information provided by the study has been used for nearly a decade to establish three, six, and nine-year outcome targets for programme investments.

The issue of time frame touches on the question of "realistic" targets. How many SMEs can be served with a particular budget? How many jobs can be expected to be created by a business incubator programme? How great an impact will job creation or private sector investment have on regional GDP per capita? Realistic target-setting can be enhanced in a number of ways.

First, the actors that will be involved in delivering outputs and outcomes should be involved in selecting the indicators that will be monitored and the targets they will have to achieve. As noted in Chapter 1, a "principal" *(e.g.,* a central government, citizens) is often at an informational disadvantage relative to an "agent". This extends to knowledge about "what works", "how" and with what levels of technical efficiency. The challenge for a principal is to encourage an agent to reveal this information truthfully. Under some circumstances, however, it may be the "principal", in the form of a higher level of government or a contracting organisation, that possesses the better information in this regard. Clearly, then, both parties must engage in the indicator selection and target-setting process. It may be that no particular actor has "better" information, but

that partnership can produce consensus on what aspects of service delivery merit priority attention. Such a collaborative arrangement is not without difficulties or risks. Weak partnership and strategic behaviours can make effective target setting a challenge (see Box 2.3).

Second, the realistic nature of targets can be judged by using historical benchmarks. This involves comparing the change in the indicator implied by the target with the evolution of the indicator over time at the appropriate spatial level. Baseline data are critical for establishing the evolution of an indicator over time. If the target establishes a rate of change that substantially outpaces previous experience it may well be overambitious in the absence of clear justification *(e.g.,* the implementation of new technology, a corresponding increase in resources). Historical comparisons can be made within a particular region and between regions as well. However, a rate of improvement experienced by another region should not be adopted without giving consideration to the context, resources, and strategies used to achieve it.

Finally, targets can be tested by examining the assumptions which underlie their achievement. This involves sensitivity analysis with respect to a variety of considerations, ranging from the planned budgetary envelope, to the actors available to implement expected activities, to assumptions regarding the effectiveness of interventions in producing outcomes. The greater the uncertainty regarding such considerations, and the greater the sensitivity of targets to variations in those conditions, the less robust and possibly less "realistic" the targets.

Use of performance information

Indicator systems are of little value (and in fact represent a cost) if the information they produce is not used. The objectives of the system provide guidance not only about what to measure, but how to use the information. As such, policy makers and practitioners should anticipate and plan for the use of the information. If the goal is to facilitate regional comparisons and to reveal and share good practice *(e.g.,* through benchmarking), the government may choose to collect and distribute comprehensive information for actors to use – without attaching high-powered incentives. By contrast, if the goal is to transform the quality, cost, or availability of services, a "principal" may choose to link indicators, targets, and explicit incentives. Coherence between objectives and use increases the efficiency of the system (by minimising the collection of data that goes unused) and its effectiveness (by clarifying choices about incentives, and increasing the impact on public policies).

Box 2.3. **Indicators and incentives – Local Public Service Agreements in the United Kingdom**

In 2000, the United Kingdom introduced voluntary incentive-based performance agreements with the local governments as part of its effort to improve local public services. Called "Local Public Service Agreements" (LPSAs), these three-year agreements with upper-tier Local Authorities (LAs) established 12 outcome-based "stretch targets" in multiple service areas. Three categories of incentives were incorporated into the LPSAs. First, "pump-priming grants" were offered up front to enable local authorities to invest in capabilities to meet their targets. Second, if a local authority met at least 60% of the stretch target after three years, it could then receive a performance grant of up to 2.5% of its net annual budget. The amount received equalled the proportion(s) of the target(s) achieved up to 100%. Finally, they were offered capacity for additional borrowing and the possibility of relaxing administrative requirements.

On the positive side, LPSAs appear to have strengthened incentives for local public service delivery, due in part to the financial rewards and in part to the fact that local authorities participated in the establishment of the specific targets. They also strengthened local partnerships (as some targets could only be achieved collaboratively), and contributed to local capacity development and learning. Financial incentives were useful, particularly prime-pumping grants, for investing in capacity-building, encouraging partners to participate, and leveraging additional funds.

With respect to challenges, a few stand out: First, negotiating targets proved to be time-consuming for the central government and local authorities. The central government perceived some "gaming" in the sense that LAs attempted to negotiate in targets that they would find easy to achieve. Second, limited understanding of causal mechanisms and inadequate data may have hampered the LAs' ability to set realistic targets. Third, although LAs were involved in target selection, the process was centrally driven, often resulting in targets that did not necessarily reflect local priorities. Finally, administrative flexibility proved harder to deliver than anticipated.

Second generation LPSAs were launched at the end of 2003. A significant change was greater local involvement to increase the relevance of indicators and targets. In 2007, the LPSAs were integrated as an incentive mechanism into Local Area Agreements as part of an effort to streamline the number of agreements. The central government also plans to cap the number of indicators (198) to be monitored at the local level. From this set of 198, local authorities will select 35 against which targets will be established in negotiation with the central government.

Sources: Box originally appears in Mizell, L. (2008), "Promoting Performance: Using Indicators to Enhance the Effectiveness of Sub-central Spending", OECD Network on Fiscal Relations Across Levels of Government, Working Paper 5. It draws on Blake, J. (2007), "Local Public Service Agreements and Local Area Agreements: the UK Experience", unpublished presentation at the OECD TDPC Symposium: "Setting Standards for Local Public Goods Provision", 20 June 2007, Rome, Italy; DCLG (n.d.), "National Targets for Local PSAs"; ODPM (2005), "National Evaluation of Local Public Service Agreements: First Interim Report", August 2005; ODPM (2003), "Building on Success: A Guide to the Second Generation of Local Public Service Agreements", December 2003; DCLG (2007), "The New Performance Framework for Local Authorities and Local Authority Partnerships: Single Set of National Indicators".

Linking performance information and budgets

Choices about the use of information are not to be taken lightly. These choices fundamentally affect the incentives facing actors. Linking indicators to budget decisions, for example, introduces a very high powered set of incentives. It can represent the verdict by a "principal" on the performance of an "agent" and embodies the former's choice as to whether or not (or to what degree) the agent will continue to be engaged. So, to what degree should indicator values (performance) be linked to budgeting decisions?

Swiss (2005) highlights specific challenges to tightly coupling indicator values to budgets.[9] First, results should be measureable and materialise in the time frame associated with the incentive. This can be a tall order for regional development policy. Most important regional economic outcomes occur outside the time frame of an annual budget cycle. While some intermediate outcomes may emerge in a relatively short period of time *(e.g.,* road construction), in many cases policy makers may have to rely on input and output information when assessing performance. With short budgeting cycles, the result can be "goal displacement", where short-term goals *(e.g.,* producing outputs) inadvertently become more important than higher-level objectives *(e.g.,* improving welfare).

Second, the programme mechanism responsible for results should be understood. If results cannot be clearly explained, budgetary linkages should not be tightly coupled with performance measures. For example, it is a possible to imagine a programme or project that is successful at generating jobs in a particular region. Assessing only the gross number of jobs created may result in level or increased funding for the programme. However, without additional information regarding the types of jobs created, whether jobs are being relocated away from other areas, and whether the jobs are sustainable – the programme might be inappropriately rewarded. Similarly, budget officials must know what constitutes good (or efficient) performance. For new programmes, appropriate benchmarks may not exist.

Third, budgetary decisions must reward or sanction those responsible for actual performance, without causing unintended effects for other actors. Mechanisms which penalise regional actors by withholding funds or decreasing flexibility may inadvertently exacerbate the situation. For example, cutting funds for a small business loan programme that fails to meet performance targets without providing alternative arrangements may accurately penalise programme staff – but inadvertently leave small businesses without access to capital.

Finally, political considerations should take a back seat when evaluating results in the context of budgetary decisions. Unfortunately, budgetary decisions tend to be notably political and policy makers often prefer more, rather than less, discretion in decision making. Valid and reliable performance data may be

ignored and "fuzzy" results may be politicised. Indeed, the experience of the EU performance reserve reveals the perceived political risk associated with allocating funds among regions based on differential performance. If political considerations dominate the decision-making process, tight linkages between performance data and financial allocations are not recommended.

In summary, establishing tight linkages between performance data and budgetary decisions should be done with caution. Because of the incentive effects tight linkages can introduce, the challenges presented by rewards, sanctions, and target setting described previously should be carefully considered. This does not mean that indicator systems have no role in budgetary (or other policy) decisions. Rather, decision makers should consider the use of "performance informed budgeting" in which performance data are one source of information in budgetary decisions (OECD, 2007b).

Fortunately, indicator systems provide information that is useful not just for "high stakes" budgetary decisions, but also for adjusting policy priorities, retooling programme design, identifying potential "good practice", etc. Anticipating these uses in advance of data collection can enhance the utility of an indicator system and provide guidance regarding what types of information need to be collected, in which formats, at which spatial levels, how it will need to be summarised, etc. Importantly, if stakeholders are expected to use information produced by an indicator system to produce performance improvements, their capabilities to do so must be considered *ex ante* – a topic explored in the following chapter.

Public reporting of results

Clearly, linking performance data and resource allocation decisions introduces strong incentives for regional stakeholders. As noted earlier, incentives are also introduced by reputation effects which can be induced by public reporting of results. When reporting performance information to the public, data should be relevant for stakeholders, placed in context, and consumable by the average citizen. However, it is important to ensure that striving for clear and concise presentation does not result in an inadequate or incomplete picture of performance. For example, composite indicators can be easy for citizens to consume but present both pros and cons.[10]

Public dissemination of performance data plays an important role in three of the case studies: the United Kingdom, the United States, and Italy. In the United Kingdom, performance data for RDAs is made available on the website of the Department for Business Enterprise and Regulatory Reform. Two categories of information are made available: 1) RDA progress reports against core output targets; and 2) independent performance assessments of RDAs. Progress reports are also made available to Parliament twice a year and

are reported on RDA websites (BERR, 2008). The reputation effects of these reports are particularly important for the RDAs as they are statutory bodies that can be dissolved.

In the United States, GPRA performance data are included in regular reports to Congress which are made publicly available online. In addition, the results of the EDA's recently introduced performance awards for investment recipients are publicly reported. By contrast, results associated with the internal Balanced Scorecard (a managerial tool) are not made publicly available.

In comparison to the United States which publicly highlighted the final award decisions, Italy used ongoing public reporting of both the process and results associated the national performance reserve to ensure transparency and limit the renegotiation of targets. According to Barca *et al.* (2005, p. 69) "final evaluation was accepted since the process had always been very transparent and information was always available to the public. The document with indicators, targets, and rules of allocation was available on the web of the [Department for Development Policies, DPS]. Each region periodically wrote an assessment of its progress on the basis of which the Technical Group prepared a general Monitoring Report that was publicly accessible every six months. A general assessment of the process was included in the most official documents of the DPS and the Ministry of Economy and Finance. Within this framework, the possibilities for regions to put pressures on the evaluation were limited."

Even with this attention given to public reporting in Italy, there was a perception that the effect on accountability was inadequate. Without concurrent media coverage and commitment by policy makers to hold themselves accountable for results, it was possible that the impact of the system remained limited to the realm of good public management and failed to induce public accountability. This can be partially explained by the relevance of indicators for citizens. The indicators monitored in Italy (administrative reforms of public sector) were difficult to explain to citizens as there is no direct link between good public management and citizens' well-being. By contrast, a new system focuses on indicators that have more observable results for citizens: the capacity to solve the waste management problem, to offer sufficient child care and elderly care, to improve the level of education of young students, etc.

Conclusions

Design issues are fundamental to the effective functioning of indicator systems. Narrowing the vertical information gaps and sharing information across a network of actors requires *ex ante* consideration of what information is needed and for what purpose. Clarity of objectives is important in this regard. The objectives to be achieved through monitoring also provide guidance as to whether actors will be encouraged to achieve specific targets, and the type and strength

of incentives incorporated. Importantly, system design includes the "use of information". How information is used and by whom affects the incentives associated with an indicator system and has implications for achievement of performance goals.

While design issues must be addressed when planning or adjusting indicator systems, the path from intention to effective implementation is not necessarily a straight one. There are a variety of factors that can hinder or facilitate success. The following chapter examines these issues in depth.

Notes

1. See, for example, Basle, M. and P. Francke (1999) for a discussion on multiple categories used in the context of evaluation in France.
2. Other countries also monitor processes. In Austria, "Process Monitoring of Impacts" has been developed as a method to monitor core processes in Structural Fund Programmes. The method builds on the assumption that inputs and outputs must be used in order to produce desired effects. Thus, focus is placed on the actual use of inputs or outputs by partners, project owners, target groups, etc., which is considered decisive for the achievement of effects and can be influenced by the operators of a project/programme. The core task is to identify the likely connections between inputs, outputs, results and impacts and to check during implementation whether these links remain valid and actually take place.
3. Interestingly, aspects of this shift bear resemblance to the case of Switzerland which recently decentralised regional policy operations. From the 1970s to 2007, regional policy was managed down to the project level largely by the central government. In 2008, operational structures were aligned to the federalist funding of Swiss policy. Strategic objectives and milestones have been defined jointly by the central and sub-central actors; and whereas previous emphasis was placed on monitoring inputs and outputs, the new focus is on monitoring a decentralised results-oriented policy.
4. Burgess, Propper and Wilson (2002) present a slightly different presentation of implicit and explicit incentives.
5. Smith (1993, pp. 138-139) discusses why "performance data are not a neutral reporting device".
6. For more on the KOSTRA system, see Mizell, L. (2008) and OECD (2006b).
7. This section on target setting summarises much of Christiaensen, L., C. Scott, and Q. Wodon (2002). This endnote is provided in lieu of multiple in-text citations, as they would be numerous throughout the section.
8. According to Behn (2003), Peters and Waterman (1982, p. 268) attribute this quote to Mason Haire.
9. The subsequent discussion of challenges associated with linking budgets and indicators summarises arguments from Swiss (2005).
10. The pros and cons of composite indicators are discussed in Smith (2002) and R. Jacobs, M. Goddard and P. Smith (2007).

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The Use of Performance Indicators

PART I

Chapter 3

Factors that Hinder or Facilitate the Use of Indicator Systems

Introduction

Describing the technical aspects of monitoring systems is often easier than implementation. Policy makers and planners can and do encounter a variety of challenges in the planning, implementation, and revision of indicator systems. This chapter details the variety of factors that can hinder the design and effectiveness of indicator systems as a governance tool. It also notes the various mechanisms available for mediating these difficulties. It begins by outlining the specific characteristics of regional development policy that can pose a challenge for designing and using indicator systems. It then underscores the importance of stakeholder capacities with respect to effective implementation. A number of both direct and indirect "costs" are reviewed before turning to the mechanisms available for facilitating system effectiveness.

Factors that can hinder the development and use of indicator systems

Characteristics of regional policy

Indicator systems can be used in any policy area, at all levels of government. However, the conditions for implementation vary. Some of the attributes of regional development policy pose specific challenges for designing, implementing, and using indicator systems. Six characteristics should be considered:

- **Multi-sectoral.** The coherent engagement of actors across multiple sectors is a critical aspect of regional development policy. At the same time, the cross-sector emphasis can make monitoring (and evaluation) tasks more challenging. First, it can put upward pressure on the amount of information collected and encourage the proliferation of indicators. Second, it can make attribution of regional policy results difficult due to the influence of other sectoral actors. For example, while regional development agencies in England do have some influence over skills development in their regions, their overall impact may be dwarfed by other sectoral actors in the region – such as the Sector Skills Councils.
- **Multi-actor.** Regional development policy engages a multitude of actors at different levels of government, across sectors, in the public and private sectors. The result is an environment in which a premium is placed on partnership, and responsibility for outcomes does not lie with a single actor.

A tension emerges. On the one hand, where indicator systems are used to hold actors accountable, to promote performance, or to incentivise certain activities – performance (as defined by a change in indicator value) must be attributable to specific actors. On the other hand, indicator systems that emphasis performance of individual actors may create incentives that lead to the sub-optimal production of outputs and outcomes where joint action is required.

Engaging actors at different levels of government can also pose challenges for determining the extent to which indicators should be driven by top-down or bottom-up concerns. For example, the RDA performance framework developed during the UK devolution process illustrates a tension between the delegation of competences to regional actors and control from the centre in the form of performance assessment. Sub-national governments are also downwardly accountable to their own electorates and must demonstrate the results of their investments. In Canada, this led provinces to develop their own sets of indicators and reporting frameworks related to their policy objectives (see Box 3.1). Now, with the strategic involvement of the federal government in community infrastructure investments, the central government is doing the same thing. This raises issues of reconciling sometimes different regimes of indicators.

- **Variability in economic context.** According to the "new paradigm" for regional policy, development strategies should be tailored to individual regions unique needs and assets. This raises the issue of the extent to which indicators should account for local specificities. Indicator systems need to strike a balance between having diversified indicators adapted to regional specificities and having sufficient standardised indicators to make regional (or sub-regional) comparisons. One solution is having a core of comparable indicators supplemented by indicators tailored to local needs, an approach illustrated in the UK and EU cases.
- **Complexity.** Complexity is the norm for regional development policy because it is implemented as a shared responsibility with multiple actors engaged in multiple tasks using a variety of instruments to influence long-term outcomes over which actors do not have the sole influence. One reaction is to build a performance indicator system that tries to capture all of this complexity. The result is likely to be a plethora of indicators, for which good data may or may not be available, that tries to do too much. The resulting administrative burden can be high and may well require substantial capabilities in order to use the information produced by the system to make programming or policy adjustments or decisions. It would be a mistake to assume that indicators alone can capture the full complexity of regional policy.

Complexity can also come from the existence of multiple monitoring systems to which regional policy actors must respond. Other systems may relate to regional policies – or may be sector-based, such as in the fields of education, technology, or public works. Numerous incompatible indicator systems can result in a loss of synergy. In the EU if the Structural Funds performance framework is not well-aligned with other national systems, or when a national (or regional) system is imperfectly integrated with local performance measurement initiatives *(e.g.,* between regional and local systems) opportunities can be lost.

- **Uncertainty.** Regional policy often pursues strategies whose results cannot be known or forecast in advance. For example, in aiming to improve competitiveness or promote innovation, only general objectives can be clearly defined at the outset. By contrast, the appropriate approaches to achieving these goals will gradually emerge during implementation.[1] Under such conditions, viable performance criteria are difficult to establish *a priori* – and even more so the identification of suitable indicators to assess them.
- **Difficulty establishing causality.** Assessing the impact of policy actions on regional economic development is more an evaluation task than a monitoring one. However, understanding the causal linkages between policies, programmes, outputs, and results remains critical. Establishing causality in regional development policy is difficult, not least because of the challenge in establishing a counterfactual, the extended time frame within which benefits are expected to occur, and the influence of many variables on the policy objectives. The Canadian experience captured in Box 3.1 highlights the challenge associated with attributing outcomes to regional policy interventions, as well as other measurement and monitoring challenges.

  The result for indicator systems can be a tendency to focus on short-term outputs because causal linkages between activities and outputs are often relatively clear. However, excessive focus on the short-term can discourage strategic investments with long-term pay offs. In this case, the selection of a comprehensive set of output and intermediate outcome indicators may be best to ensure relevance for decision making. On the other hand, focusing on outcomes can make it difficult to incentivise short-term performance. There is also a risk of holding actors accountable for outcomes over which they have limited control. Overall, the case studies reveal a trend toward outcome-focused systems. The RDA case with its new framework for 2008-11 is one example.

Capacities of stakeholders

Weak local capabilities, such as insufficiently trained staff or an inadequate physical endowment might leave local administrations unprepared to face the

Box 3.1. **Measuring the performance of government programmes: The Canadian experience**

Overview

In Canada, like in other parts of the world, performance measurement has become an integral part of the management and operation of the public service. Introduced in 2000 by the government of Canada's Treasury Board Secretariat (TBS), performance measurement is not only intended to improve accountability and management practices (by supporting the decision-making process and by facilitating a better allocation of resources), but also to enhance reporting to the public and Parliament about the results of the various investments.

Performance measurement at the national level has two major components. A first component is developing a Programme Activity Architecture (PAA) that shows how departmental programmes are linked together and how the organisation intends to achieve its strategic outcome. A PAA provides a snapshot of the organisational structure of a department, and also serves as a basis for the development of a performance measurement framework (PMF). The PAA has four major components: 1) the Strategic Outcome; 2) Programme Activities; 3) Sub-Activities; and 4) Sub-Sub Activities. Within the PAA, these components are organised hierarchically in order to demonstrate the logical relationship between each programme activity and the strategic outcome each has been established to advance.

The second component is a performance measurement framework (PMF) that links each activity, sub-activity and sub-sub-activity within the PAA to benchmark indicators, quantitative targets and outcome measurements. The PMF allows the department to "tell its story" both to Parliament and to Canadians on how it has invested the taxpayer's resources to achieve its strategic policy objectives. Indeed, each programme activity is assigned a limited number of expected results, performance indicators and associated targets and data sources. The judicious choice of indicators and targets allows for an "uncluttered approach" to presenting the information.

Challenges in outcomes-based measurement

While Infrastructure Canada (INFC) is actively involved with and supportive of performance measurement, numerous challenges can be encountered. A key challenge is to understand the structure of the department's programmes and the links between them (the PAA) as this is necessary to develop a PMF. However, a PAA may not always be available or it may be poorly formulated. For example, when Infrastructure Canada started developing a PMF, a departmental PAA did not exist and needed to be established – a challenging exercise in itself.

Box 3.1. **Measuring the performance of government programmes: The Canadian experience** *(cont.)*

A second challenge relates to the availability and reliability of data. Reliable or accurate data are not always available, require dedicated resources which may not be available, or "the cost of obtaining more refined information outweighs the benefits such information can provide" (Treasury Board of Canada Secretariat, 2002). Moreover, analysis of both quantitative and qualitative indicators is required to understand the performance of a government department.

A third challenge of developing a PMF is to find consensus with other stakeholders about the best indicators to use for measuring performance. In a federal country like Canada, this challenge is compounded by the bilateral or trilateral character of government programmes. The Gas Tax Fund (GTF), for example, is administered with input on priority infrastructure investment categories from the three levels of government, and thus all three must agree on a common set of indicators. As provinces have adopted different approaches to performance measurement and reporting, it has been difficult to establish common indicators across provinces. This challenge has been addressed through intensive consultations with the Provinces and Territories, yet differences remain.

It is also difficult to connect the overarching PMF exercise and more focused evaluations. For example, the PMF for Infrastructure Canada, although broad in scope, is limited in indicators (as TBS guidelines allow for only three indicators for each of the department's programmes). At the same time, departmental programmes such as the Gas Tax Fund are subject to a Results-Based Management and Accountability Framework, which uses of a greater number of indicators than those allowed under the PMF. In other words, a single departmental programme is subject to two evaluation standards. Thus develops a need to link those two performance measurement processes in order to "tell the same story". However, differences in the number and type of indicators make such link challenging to establish.

Perhaps the greatest challenge is that of attribution. It is hard to definitively establish that a particular programme or programmes produced one or more desired outcomes. As noted by TBS, "other government programmes or actions, economic factors and societal trends often play a role in the achievement of actual outcomes" (Treasury Board of Canada Secretariat, 2002). In seeking to report to Treasury Board and to Parliament on the outcomes of GTF investments, INFC has faced this exact challenge: demonstrating that funds delivered to municipalities have achieved the desired outcomes of the GTF agreements, namely cleaner air, cleaner water, and reduction in GHG emissions.

Box 3.1. **Measuring the performance of government programmes: The Canadian experience** *(cont.)*

In order to overcome this attribution challenge *vis-à-vis* the GTF, Infrastructure Canada has been measuring programme performance using two types of indicators:

1. The number and value of projects achieved by investment categories (this is based on the assumption that the existence of the projects themselves is the basic requirement for achieving the programme's goals).
2. Pre/post measures of improvement *vis-à-vis* the desired project outcomes. For example, a water treatment project will result in X m^2 volume of cleaner water, a road project will result in X km of improved road surface, etc. While these sub-indicators are in fact outputs, they can be rolled up to demonstrate that the project has contributed to the desired national-level outcomes. This pre/post approach accounts for the other (non-programmatic) factors that play a role in achieving the outcomes.

Certainly, INFC is grappling with the challenges that underpin performance measurement. However, the fact that PMFs are developed for each department and programme in the government of Canada, despite the challenges associated with this process, is an indication that performance measurement is viewed as an essential tool for improved management and accountability – including areas related to spatial/regional economic development.

Sources: Infrastructure Canada; Mayne, J. (1999), "Addressing Attribution through Contribution Analysis: Using Performance Measures Sensibly", Office of the Auditor General of Canada, June 1999, Ottawa; Treasury Board of Canada (2000), "Results for Canadians: A Management Framework for the Government of Canada", Government of Canada, Ottawa; Treasury Board of Canada Secretariat (2002), "Performance Measurement Framework for Small Federal Agencies", Government of Canada, Ottawa.

tasks required by a performance measurement exercise. The result can be poor implementation, under-utilisation, and inefficient use of resources. Necessary competences include skills to design indicator systems, generate data, set accurate targets, and use the information produced by such systems. This includes developing a shared understanding with higher levels of government of the definitions of core indicators and the degree of data verification that is necessary. Broad knowledge of information management must also be coupled with an understanding of regional economic development and the workings of multiple sectors. Two main categories of capacities can be distinguished:

- **Technical capacity.** Organisations with existing measurement and monitoring capabilities are likely to have developed technical capabilities and are well positioned to launch new systems. This is due, in part, to the

ability to use existing IT systems, staff, and occasionally data. However, regional development programming often relies on (sometimes small) sub-national governments or non-government partners that may have little or no such infrastructure, training, and capacity to absorb new reporting requirements. There are examples from the United States of small counties relying on a third party, such as a community development agency, to assist with the management and reporting requirements associated with economic development funds. There can also be disparities in capacity between urban and rural areas. A 2001 study found that US rural counties were less likely to possess some categories of professional staff than metropolitan counties (Kraybill and Lobao, 2001).

Although a central government is more likely to have the resources and expertise available to develop and implement a system of indicators across or within sectors, the capacity to do so is not a foregone conclusion. Capacity challenges such as producing high-quality data (discussed below), defining robust performance indicators, or negotiating appropriate targets can occur at both the central and sub-central levels of government (ODPM, 2005).

- **Capacity to use information.** Importantly, reaping the benefits of knowledge transfer and producing performance gains can be limited by an actor's capacity to absorb and transform information into improvements.[2] Both central and regional actors must understand how to interpret performance data and adjust programmes or policies appropriately and in the correct timeframe. This includes identifying and reacting to "leading indicators" (which can provide signals about future developments) as well as "lagging indicators" (which provide information about what has occurred). It also includes knowing how to transform information about under-achievement into improvements, as well as how to maintain and capitalise on current gains.

Availability of data

A notable challenge for developing indicator systems and selecting targets for regional economic development is the availability of high-quality data at the right spatial level. There are two types of data that need to be collected: programme data and data about the regional economy. It is not correct to say that programme data are "easy" to collect, but perhaps easier than identifying and collecting valid and reliable measures of regional economic development that can be linked to programmes and projects. The financial arrangements that frequently underpin the "principal-agent" relationships in regional policy can facilitate collection of programme data. As financiers, principals often have at their disposal or can request data on programme inputs, processes, and outputs. Outcome data are harder to collect. The case of the EDA clearly demonstrates that challenges are associated with asking investment

recipients to gather and report on outcomes that occur three, six, and nine years after projects are launched.

Data on the regional economy are critical for assessing inter-regional gaps and intra-regional needs, for judging the relevance of proposed policies and programmes, establishing the context in which programmes must operate *(e.g.,* producing context indicators), setting baseline values against which performance can be evaluated, and ultimately providing final outcome data that can be used in the evaluation of regional policies. There are a variety of challenges that can be encountered when seeking this type of data. Challenges include, but are not limited to:[3]

- A lack of availability at an appropriate geographical level.
- Data availability that lags behind programming decisions.
- Insufficient detail with respect to beneficiary groups (individuals or firms).
- Insufficient accuracy at a regional level *(e.g.,* due to small [effective] sample sizes), and
- Inadequate capture of regional policy constructs of interest *(e.g.,* GDP as an indicator of regional income has been criticised [Wishlade *et al*., 1999]).

The issues associated with the collection and distribution of data for regional policy decision making are sufficiently challenging that the government of the United Kingdom commissioned two reports on the topic. The reports delivered in 2003 and 2004 addressed both challenges facing the Office of National Statistics and possible solutions (Allsopp, 2003; Allsopp, 2004). In Italy, a lack of detailed data at the sub-national level has been a constraint on the choice of indicators. Frequently, indicators that may have been useful for monitoring regional policy were not available or were constructed locally using different methodologies, undermining comparability. Implementing regional policy has thus meant that substantial efforts have been dedicated to improving the availability and quality of data at the regional level over the last 10 years.

Direct and indirect costs

Direct costs

Developing and using indicator systems is not without cost. There are both financial and nonfinancial "costs" to be considered. Direct financial costs are largely attributable to personnel, technology, data collection, and monetary incentives where they exist.

Personnel costs. Personnel costs include salaries and benefits for staff, hiring costs if new staff must be recruited, fees for external consultants, and training provided to new and existing staff. In the cases reviewed, direct personnel costs appear to be relatively contained. In fact, staff is rarely dedicated solely to running

the indicator system, making it difficult to isolate specific personnel costs. In Switzerland, for example, no resource is fully dedicated to the topic of indicators, either at the national or sub-national levels. Managing regional policy may be one of many tasks for an administrator. Isolating personnel costs can also be difficult as indicator systems are often based on existing monitoring systems and new monitoring tasks may overlap with traditional reporting functions. For example, in Italy the national performance reserve was part of wider monitoring activity for the EU Structural Funds. For the English RDAs, reporting on core output indicators is integrated into project monitoring, and reports on core outputs are prepared in conjunction with spending information. In the United States, EDA staff use a single database to capture and summarise performance information for both the Government Performance and Results Act, and the internal Balanced Scorecard.

External staff (consultant) costs could be significant if administrations do not have all the necessary (technical) skills in house. The Italian case shows the value of external experts for bringing specific knowledge in the context of limited local capabilities. The recourse to external consultants to help manage the monitoring requirements imposed by the EU Structural Funds was important in at least two regions (Sardinia and Lombardy). In both cases, they were financed through Technical Assistance Programmes provided in the context of the Structural Funds. Another example of leveraging external competence is illustrated in the US case by the study commissioned by Rutgers University to help estimate the size and timing of EDA investment impacts.

Technology costs. Technology costs cover both software and hardware. It is useful to distinguish between the technology costs related to establishing a performance indicators system and costs associated with maintaining it. However, development costs can be difficult to disentangle from wider IT costs if a pre-existing monitoring arrangement serves as a foundation for a performance indicator system.

- In the US case, a specific IT system called the Operational Planning and Control System (OPCS) has been used since 1999 to monitor investments from pre-application through close-out for EDA projects. The system is used for both the GPRA and the BSC reporting activities. Each year the EDA spends between USD 500 000 and USD 600 000 to maintain OPCS as well as another IT system for managing information for its loan programme.
- In Italy there was a close link between the monitoring systems used for the Structural Funds, and for the EU and national performance reserve mechanisms. Most regions relied on Monitweb, the software developed by the Ministry of Economy to fulfil the monitoring requirements imposed by the Structural Funds regulations. Sub-national adoption minimised regional development, maintenance, and adjustment IT costs. While this approach

was not tailored to regional needs, there was benefit in having an IT system readily available, particularly where there were limited local capabilities. In contrast to other regions, Lombardy developed its own IT system, MonitorWeb, which can communicate with Monitweb through common data protocols. The cost of having MonitorWeb developed by an external consultant was EUR 1.1 million plus a fee for hosting the database on an independent server (around EUR 284 000).

- In England, the regional development agencies collectively purchased the information technology system used for performance data management.

Data collection costs. Indicator systems are data driven and, as a result, data collection costs are important. Costs vary depending on the type of information collected, availability, and collection methods. Survey data, for example, tend to be expensive to collect, particularly where attempts must be made to achieve sufficient sample size for regional and sub-regional analysis. By contrast, administrative data and qualitative information can be less costly to obtain. The Italian national performance reserve for Objective 1 regions illustrates the relationship between the type of data collected and the resulting costs. The reserve required regions to report qualitative and process indicators *(e.g.,* was a regulatory provision adopted, yes or no). As these data were generally available or easy to gather, data collection costs were relatively minor.

Costs can also be contained if evidence can be gathered from existing data collected by national statistical offices. For example, the new version of the Italian national performance reserve will rely almost entirely on existing data from official statistical sources. However, all data are not presently available at the regional level for all indicators. The Ministry of Economy will compensate the National Statistics Office for the addition of two indicators on water and child care into official surveys.

Data validation also entails costs. Italy experienced few validation costs, as the collection and transmission process relied on data "self-certification" by the regions which were held responsible for the accuracy of the information forwarded. This was possible due to the qualitative nature of the indicators used *(e.g.,* yes/no; the adoption of normative disposition, approval of a law). In England, in order to ensure that grantees meet contractual obligations and that data are accurate, RDA staff monitor contracts and conduct risk assessments, site-visits, and project audits. In the EDA case, the reporting system used to comply with the GPRA requirements favours an *ex ante* assessment of eligibility criteria instead of an *ex post* data validation process. Although validation visits are expected to take place in the case of important investments, there are limited resources for this purpose.

Incentive costs. As noted earlier, indicator systems are not without incentives. These incentives can be associated with both indirect "costs" (unintended negative consequences) and direct financial costs. Financial costs are attributable to the monetary award(s) provided for the performance of regional actors.

Monetary awards were used by the EU and by Italy, but are not heavily emphasised in the US and the English cases. For the 2000-06 period, the Italian national performance reserve set aside 6% of the overall Structural Funds budget, or EUR 2.6 billion, to reward performance in Objective 1 regions. By contrast, the United Kingdom had a short-lived experience with a relatively small performance fund which set aside GBP 50 million for RDAs. This fund no longer exists. In the United States, the EDA recently introduced a performance award for investment recipients that meet or exceed specific criteria.

There are also examples of granting financial incentives to the personnel responsible for managing a policy or a programme. In the EDA, a link was established between the internal Balanced Scorecard and the remuneration of regional directors. For English RDAs, it was recently proposed that performance information be used for the recruitment and remuneration of board members and the Chief Executive as part of the performance assessment framework.

Indirect costs

In addition to direct financial costs, a performance indicator system can be associated with noteworthy indirect costs. These include opportunity costs, inefficient management of information, administrative burden, and unintended negative consequences. These costs are less quantifiable and more difficult to identify than direct financial costs.

Opportunity costs. The opportunity cost of a performance indicator system is the foregone benefit associated with an alternative use of the resources it consumes. These resources include personnel, money, and time. For example, how would the staff have used its time instead of establishing and running a performance indicator system? Has staff been diverted from other possibly more productive tasks? What is the opportunity cost of the money set aside for the incentive? Opportunity costs can materialise for actors at different levels of government. Ideally, a calculation of opportunity costs would make the monetary value of an alternative use of resources explicit. This is difficult to do for indicator systems, and as such, here opportunity costs are treated more generally.

Opportunity costs at the central level appear to be moderate. In Italy, the time spent developing and running the performance indicator system was considered to be part of the ordinary responsibilities of the unit charged with managing the monitoring arrangement related to Structural Funds. In England, at

least one English RDA would have tracked the outputs associated with their grant making activity, even if the central government had not required a specific system. The opportunity cost for the RDA comes from doing it differently. In the United States, the development phase of the Scorecard was lengthy and time-intensive. However, senior staff placed high priority on the development of the Balanced Scorecard (BSC) as opposed to other tasks. When compared to the alternative of "business as usual", the EDA's satisfaction with the BSC suggests that the opportunity cost of alternative use of staff time and resources is perceived to be low.

Opportunity costs can also arise if the information produced by or for the performance indicator system goes unused. For example, GPRA information produced by the EDA is useful for establishing accountability to the public, however it is not used systematically by Congress and appears to have limited strategic value for the EDA. Potential under-utilisation of the information points to an opportunity cost associated with the resources dedicated to producing it – both at the central and sub-central levels.

Actors at lower levels of implementation (agents) may also find the information they produce for policy makers/planners (the principal) to be of limited value. This is especially true if data collected have little local relevance, if local capabilities are too weak to take advantage of performance information, or if performance indicator systems are designed without paying sufficient attention to local expectations and needs. As the usefulness of the data declines, opportunity cost of agent resources spent collecting these data rises. For example in the RDA case, the approach initiated in 2002 (referred to as the "3-tier framework" in the case study) was criticised because targets were not particularly useful to account for regional priorities. They were also not well-suited for monitoring progress toward national Public Service Agreement targets. The resources spent collecting and monitoring these data thus represented an opportunity cost for both central and regional actors.

Administrative burden. A major indirect cost is the administrative burden that the management of a performance indicator system can represent. Complex indicator systems, time consuming data processing procedures, complicated data validation processes, and compliance with various requirements can quickly absorb substantial resources. For example, in 2005, the EDA estimated that GPRA requirements imposed a total of 19 768 hours of work on grantees and 16 422 hours of work for the EDA. The corresponding cost was estimated at USD 1.8 million. These figures may under-estimate the true burden of collection some GPRA requirements because collecting data years after project completion can be difficult and time consuming for grantees.

Issues associated with technology and local capacity can affect the overall administrative burden. For example, allowing direct data entry by

regional actors can minimise administrative burden by reducing the time and staff needed for data entry. However, none of the cases currently have a well-developed system for doing so. In Italy, despite the initial intention to decentralise data entry responsibilities to the local authorities, the task remained under the responsibility of the regional authority due to limited local capacity. Although in some cases experiments were made *(e.g.,* in Lombardy companies entered data in the system, and in Sardinia some provinces directly accessed the main database). In the United States, grantee reports are submitted in paper format and are subsequently manually entered into the EDA database by regional office staff. While there are plans to transition to an electronic reporting system, at present not all grantees have sufficient IT capacity to do so. In the UK case, most of the English RDAs use the same IT system, the "Programme Management System" to produce reports. The joint purchase of the system may have reduced costs/increased synergies but at present it is not connected to the central government system.

Producing data can also represent a substantial administrative burden, particularly for sub-national authorities which may have to produce information for multiple audiences at the central level. The administrative burden may be disproportionately high for small municipalities or for services where national funds represent a small proportion of sub-national resources. The burden of performance reporting for local governments in the United Kingdom prompted the creation the "Lifting the Burdens Task Force" to examine how it can be reduced.

Inefficiency

Indirect "costs" might be generated on the occasion of the ineffective functioning of a performance indicator system. This happens, for example, when targets are set at insufficiently challenging levels and the benefits expected to accrue from encouraging additional effort by agents do not materialise.

There are examples of many targets being met consistently. This can be interpreted in a number of ways. On the one hand, it could represent accurate target setting by regional policy actors. On the other hand, it may suggest some conservative target setting and possible perfunctory compliance. For example, English RDAs have until now reached most of their output targets. In addition to accurate target setting, two other reasons might be put forward for this achievement. First is a potential preference for low targets so as not to risk undermining the credibility of RDAs. Second, is a possible "cream skimming" effect resulting from an emphasis placed on short-term outputs. In this case there may be an incentive to select low-risk projects with a high likelihood of delivering outputs. Also, in Italy, all Objective 2 regions and almost all Objective 1 regions[4] subject to the EU performance reserve were awarded the expected premium. By contrast, performance with respect to the national

performance reserve was much more uneven, with clear winners and losers. This could mean that the national approach was better at identifying differences in performance and that the EU award was distributed in a way to minimise risks of a political nature, or that there were real differences in performance for the different types of indicators measured by the two reserves. Finally, achieving "stretch targets" can require additional resources. Actors may prefer to set conservative targets over the opportunity cost of diverting resources from other uses to achieve stretch targets.

Unintended negative consequences. Unintended negative consequences can also result from the application of a performance indicator system. These consequences can be highly problematic and are well-documented.[5] They include, but are not limited to, stifling innovation and responsiveness to new challenges (ossification), prioritisation (and possible diversion) of resources to what is measured at the expense of what is not, strategic behaviours (gaming), or misrepresentation of data.[6] The risks associated with these behaviours include decisions made on inaccurate information, outputs and outcome goals that are not achieved, and public service delivery that is sub-optimal. These risks are noteworthy, not least because Goddard, Mannion, and Smith (2000) demonstrate that these behaviours derive from the use of indicators in a principal-agent context which, as Chapter 1 established, can apply to regional development policy. These unintended consequences can lead to sub-optimal resource allocation and policy choices and as such represent social costs.

How might these unintended consequences emerge in the context of regional policy?

- A misallocation of resources or distorted policy decisions taken on the basis of unreliable or misleading information can potentially be very important. This can occur if the "wrong" indicators are used to measure performance. For example, if the indicator system overemphasises a specific type of output *(e.g.,* number of assisted businesses, kilometres of roads, etc.), it can induce some actors to implement sub-optimal interventions *(e.g.,* to excessively spread assistance or to extend an infrastructure network beyond what would be efficient).
- Where strong incentives are associated with an indicator system, gaming may occur. Actors aim to obtain the reward (monetary or reputation) without necessarily engaging in the changes that are expected. For example, a "ratchet effect" might materialise when performance at a point in time (t_2) depends on performance at a point in time (t_1). This might represent an incentive to minimise performance at the time (t_1) in order to have a bigger reward at (t_2.). There is a potential for the "ratchet effect" in the RDA case because efficiency targets are set as a function of prior performance possibly discouraging agencies from setting true stretch targets at the beginning of the performance period.

- The desire to perform well on indicators can also encourage "cream skimming". For example, in the "pre-application" process used by the EDA, data pertaining to a project (rate of co-financing, expected number of jobs created, etc.) are assessed in a preliminary phase to ensure that investments satisfy regulatory requirements and are in line with Investment Policy Guidelines. On the basis of this preliminary eligibility assessment, candidates are invited to submit a complete proposal. This is useful to help eliminate projects that are ineligible or poorly estimate future outputs. However, it may also encourage the selection of proposals that are most likely to succeed (and may have received private sector support), potentially at the expense of more problematic projects for which public support could be more decisive.
- Mechanisms implemented for positive reasons can also produce unintended effects. An example is the "de-commitment" rule used in the Structural Funds' monitoring framework. If funds allocated are not spent two years after they were committed, they are to be returned to the EU. One indicator incorporated into the EU performance reserve mirrored this rule, measuring the speed of the project selection process. The resulting acceleration of project selection may have reduced project quality.
- Another source of unintended consequences relates to the political risk of revealing performance results. In the application of the EU performance reserve, it was politically risky to discriminate between regions on the basis of their revealed performance. As a result, in a variety of cases all regions received shares of the reserve. This approach can undermine the incentive effect of a reward/sanction system attached to performance indicators.

Finally, while governments have an obligation to monitor programme implementation and progress, it is important that the indicators themselves are not misused as substitutes for stated objectives, as opposed to observation tools.

Mechanisms for facilitating system effectiveness

Clearly, the challenges involved in establishing effective indicator systems are numerous. Fortunately, they are not without possible remedies. Seven mechanisms are described below which can help limit costs and maximise benefits.

Participatory design

Participatory mechanisms are a powerful tool for attenuating many of the challenges associated with performance indicator systems. As noted in Chapter 2, they can balance top-down and bottom-up influences and can enhance the usefulness of an indicator system from the perspective of the various stakeholders party to the arrangement. A participatory approach also

helps to build ownership of the system and commitment to targets on the part of regional actors.

In the cases reviewed, some participatory mechanisms took the form of vertical co-ordination between higher and lower levels of government. For example, the EU performance reserve involved co-operation between central governments and the European Commission in the design and implementation of the reserve. It also had the effect of encouraging collaboration between central and regional actors – as in Italy where it inspired the implementation of a second, national performance reserve. In France, the EU performance reserve encouraged collaboration between the central government (DIACT) and regional authorities in order to improve the indicators selected. In England, the nine RDAs and the central government co-operated to define the output measures and built a sense of joint ownership. This made the performance assessment process less confrontational. Importantly, output definitions drew significantly from local expertise within the agencies, and thus did not require the use of expensive external consultants.

Participatory mechanisms can also foster horizontal co-ordination. In England, co-operation among the nine RDAs through the Performance Management Group helped to achieve design efficiencies, improve negotiations with the central government, and facilitate implementation (including collectively purchasing the information technology system). Sharing best practices also helped to reduce the costs of complying with the performance framework.

Finally, participatory mechanisms can also involve staff within the administration concerned. They are useful to obtain a common understanding about the performance indicator system's mechanisms and objectives. In the US case, it took approximately one year of collaboration at the EDA headquarters and with regional office staff to elaborate the Balanced Scorecard. In Italy, efforts were made to raise awareness and mobilise stakeholders at the central and regional levels in order to implement the performance reserve.

Pilot projects

Pilot projects can also be used to reduce risks and increase the benefits of a performance indicator system. The advantage is that they permit a preliminary assessment of system feasibility and cost in a lower risk environment than nationwide implementation. Moreover, they enable a learning process to take place and encourage innovative arrangements. There is a risk, however, that if not properly managed pilot projects can marginalise change (Perrin, 2007). Diffusing the results of pilot initiatives is thus an important aspect of encouraging change and promoting learning. There is also a risk that, because stakeholders know the pilot project is under scrutiny, they may act in ways that do not

accurately reflect what would occur in a full-scale implementation (the "Hawthorne effect"). As such, it is important to understand what factors contributed to success, failure, or particular difficulties in order to determine if such factors could be replicated or eliminated when "scaling up".

Pilot projects contrast to what is often termed a "big bang" approach in which comprehensive changes are made all at once. Advantages of this approach are that it can create strong pressure and momentum for reform; it communicates a vision of a desired change; and it takes less time to "roll out" than a sequential process of pilot initiatives. However, a big bang approach requires substantial resources and runs the risk of overwhelming staff, introducing confusion and complications if elements have not been sufficiently tested, and producing resistance. Moreover, such an approach generally requires high levels of political commitment to be sustainable (OECD, 2007b; Perrin, 2007). The case of the EU performance reserve demonstrates both the benefits and limits of a big bang approach.

Although smaller in scale, test phases should still be characterised by the good practices highlighted in this report. The reform of the Community Planning and Development Performance Measurement System of the US Department of Housing and Urban Development demonstrates how participatory mechanisms, a realistic approach to data collection, and test phases were combined to improve the quality of monitoring arrangements (see Box 3.2).

Use of external consultants

The use of external consultants is one way to strengthen capacities to design and implement indicator systems. External experts can lend technical expertise and compensate for limited organisational capacities. Italy, for example, tapped external consultants to assist with the design and implementation of the indicator system at a regional level. The regions of Lombardy and Sardinia brought external consultants "in house" to develop the information system. In this way, the needed specialised skills were combined with internal knowledge about the local specificities that characterised the policy implementation context. The United States took advantage of specialised expertise by commissioning research to understand how and when the impacts of EDA investments materialise. This research was then use to establish outcome targets and time frames.

A potential risk in hiring external consultants is they might be disconnected from the local context and use of local knowledge can be lost. There are examples of misplaced interventions by international consultants neglecting local specificities when assisting with monitoring and evaluation activities associated with EU Structural Funds (in particular in the new member states). This underscores the importance of prioritising engagement of regional and local actors even when external consultants are involved.

Box 3.2. **The HUD Community Planning and Development Outcome Performance Measurement System**

Each year the US Department of Housing and Urban Development (HUD) provides approximately USD 4 billion in formula-based grants to states and local governments through the Community Development Block Grant (CDBG), one of four formula grants administered by the Office of Community Planning and Development (CPD). Created as part of the Housing and Community Development Act of 1974, these grants target urban areas for the purpose of providing housing and services – such as neighbourhood revitalisation, economic development, and community facilities – for the benefit of low- and moderate-income individuals.

Like all federal programmes, CDBG has been subject to monitoring and review through the Government Performance and Results Act (GPRA) since 1997. However, it was not until 2005 that its performance was seriously called into question. Using PART, a performance-based budgeting tool introduced in fiscal year 2002, the US Office of Management and Budget (OMB) found the programme to be "ineffective". It recommended substantial cuts in funding for fiscal year 2006 and the consolidation of CDGB with other economic development programmes. Criticisms were based, in part, on the weaknesses of the performance measurement system. While OMB's recommended funding cuts and reorganisation did not gain congressional approval, the performance indicator system was nonetheless revised as a result of a reform process begun in 2003.

Because CDBG is a block grant, states and localities have flexibility in determining how CDGB funds will be spent in a particular area. As a result, HUD faced the challenge of collecting sub-national performance information on an array of programmes replete with differences in the structure, format, and timing of data collection which make national aggregation and reporting difficult. Revision of the performance indicator system was conducted through a joint working group with representatives of stakeholders from all levels of government. The approximately 25 working group members came from HUD, OMB and state and city associations, which in turn invited three to four interested grantees (local government officials) directly responsible for reporting. The group negotiated matters of indicator definition, data availability, data collection, and an outcome framework. Once a compromise had been reached, the resulting framework was submitted for public comment, followed by a pilot phase in which the new approach was tested in eight locations around the country. Regional fora were held in which stakeholders were able to provide feedback on the pilot phase. The full system was promulgated for all grantees in 2006.

Box 3.2. **The HUD Community Planning and Development Outcome Performance Measurement System** *(cont.)*

The new system enables HUD to collect information on the outcomes of the various activities funded through the block grant. It system requires grantees to align their activities with one of three national programme objectives (creating a suitable living environment, providing decent housing, or creating economic opportunities) and one of three related programme outcomes (improving availability or accessibility of housing or services, improving affordability of housing and other services; and improving sustainability by promoting viable communities). Grantees then report data on indicators associated with the type of activity undertaken. Data are entered into HUD's Integrated Disbursement and Information System and aggregated to demonstrate national results. Indicators include:

- Number of persons assisted; number of businesses assisted.
- Number of jobs created/retained in a given area (by type).
- Amount of money leveraged.
- Number of acres of remediated brownfields.
- Number of rental units constructed; number of homeownership units constructed (by type).

There was substantial need to provide training for grantees. In 2006, HUD conducted 15 training sessions to more than 3 100 individuals nationwide. Instructional materials, video, and background documentation are also available online.

HUD anticipates using the system to report results of the four CPD programmes, to track housing and community development trends, to develop goals for the Annual Performance Plan required under GPRA, and to compile results for the annual Performance and Accountability Report to Congress, and to respond to inquiries by members of Congress, elected officials, public interest associations, and citizens.

Sources: Drabenstott, M. (2005), "A Review of the Federal Role in Regional Economic Development", a special report, Center for the Study of Rural America, Federal Reserve Bank of Kansas City, May 2005; HUD (2005), "CPD Performance Measurement Outcome System Questions and Answers", updated 18 November 2005; HUD (2006), "CPD Performance Measurement Guidebook", 7 July 2006; HUD (n.d.), "Fiscal Year 2007 Annual Performance Plan"; Brown, D. (2007), "Efficiency of Performance Indicator Systems in Regional Development Policy: An Example from the US", unpublished presentation at the OECD expert meeting "Efficiency of Performance Indicator Systems in Regional Development Policy", 17 September 2007, Paris.

Streamlining procedures

Administrative burden is an important, albeit indirect, "cost" of indicator systems. Mechanisms for minimising administrative burden include co-ordinating data reporting requirements, guidelines, and submission

frequencies across sectors and programmes where possible, enhancing the capacity to submit information electronically, and maximising information sharing within and between levels of government to reduce redundant requests for information.[7] Importantly, administrative burden can be lessened by reducing the overall number of indicators to be monitored to those deemed essential for achieving (supra) national and regional priorities. As noted previously, this can consist of selecting a core set of indicators that can be augmented according to regional needs. Of the case studies presented in Part II, only the case of the EU performance reserve stands out as having an excessive number of indicators. Reducing their number was an important mid-course adjustment.

Training and capacity support

Because sufficient capacity is an important ingredient for the successful design, launch, and use of an indicator system, resources should be set aside to provide technical support and learning opportunities for stakeholders. Anticipating and budgeting for acquisition and adjustment of information technologies, stakeholder training, and facilitating learning networks can be useful in this regard. Stakeholders include personnel at central and sub-central levels of government, funded programme/project staff, and even the private sector. The 2003 Allsopp report recommends educating firms that provide data for business surveys about the surveys in order to increase response rates and data quality. While not necessarily formal training, this does represent one way to build the capacity of system stakeholders which could have a positive impact on the quality and utilisation of data.

Capacity development can take a variety of different forms: courses and seminars, use of outside consultants *(e.g.,* as in the case of Italy), use of government experts *(e.g.,* an advisory service), mentors and secondments of experienced staff, and learning networks *(e.g.,* the Performance Management Group established by English RDAs) (Perrin, 2007).

Linking indicators and actors' realm of influence

Another mechanism that can enhance the usefulness of an indicator system is to ensure that the indicators that form the basis of any accountability mechanism be within the actors' realm of influence. Building indicator systems that monitor interesting regional economic developments over which public actors have little influence is a costly exercise that can generate resistance and reduce moral. Linking indicators and actors' realm of influence requires an understanding of which programmes (and policies) produce which types of outputs and outcomes, under which circumstances, with what resources, and under what time frame. Complete information in this regard is rarely available and systems will have to be designed with varying levels of uncertainty. Drawing on policy research and programme evaluations can help. Importantly,

greater accountability can be established where more is known about the causal relationships between inputs, activities, outputs, and outcomes – and less accountability where information is less complete. Holding actors accountable for impacts can be particularly difficult – since the influence specific interventions (*i.e.,* programmes, policies) have on outcomes can decline over time as other factors gain influence.

Strong enforcement context

Finally, note should be made of the enforcement context for applying incentives. Proper enforcement mechanisms – such as accountability to citizens, peer enforcement, and recourse to a third authoritative party – can minimise renegotiation of targets, enhance the credibility of incentives, and strengthen the use of an indicator system. In the Italian case, a "technical group" played the role of third party authority, giving impartial recommendations and monitoring the performance assessment for the national performance reserve. In addition, "[a] widespread consensus was created which strongly reduced attempts to renegotiate [targets] and indeed allowed no renegotiation and prevented legal disputes after rewards and sanctions were decided" (Barca *et al.*, 2005). Enforcement mechanisms are less established in the other cases. Neither the US EDA nor the English RDAs are subject to strong explicit financial or administrative incentives. As a result, statutory obligations, public reporting of performance data, and resulting reputation effects form the basic elements of "enforcement".

Conclusions

This chapter has laid out important challenges actors are likely to face when designing and using indicator systems. These challenges should not be a deterrent. Rather, a variety of mechanisms have been presented that can help reduce "costs" and increase the likelihood that benefits will be achieved. Importantly, designing and using indicator systems is a dynamic process. Challenges should be anticipated and adjustments made over time.

Notes

1. See the concept of "openness" presented in Hummelbrunner, R., with W. Huber and R. Arbter (2005).
2. See, for example, a discussion of the limitations of schools to transform performance data into performance improvements in Visscher *et al.* (2000) or the importance of individual capacity to transform information into improvements in organisations in Swiss (2005).
3. The first three challenges listed are adapted from the European Commission (1999), "Indicators for Monitoring and Evaluation: An Indicative Methodology", *The New Programming Period 2000-2006: Methodological Working Papers, Working Paper 3*,

issued by Directorate-General XVI Regional Policy and Cohesion, Co-ordination and Evaluation of Operations.

4. Except Calabria and the National Operating Programme on Transport.

5. References to relevant literature and discussion on this topic can also be found in Van Thiel and Leeuw (2002), Goddard, Mannion, and Smith (2000), Burgess, Propper and Wilson (2002), and Goddard and Mannion (2004).

6. These categories of unintended consequences are frequently cited. They derive from a more comprehensive list of consequences attributable to Smith (1995) which are also summarised in Smith (1993).

7. See for example, Lifting the Burdens Task Force (2007) and US GAO (2006) for administrative burden issues and remedies.

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Governing Regional Development Policy
The Use of Performance Indicators

PART I

Chapter 4

Overall Benefits and Lessons Identified

Introduction

This report has laid out a rationale for the use of indicator systems in regional development policy as well as important technical considerations for designing and using them. But do indicator systems "pay off"? Are they a governance tool worth investing in? This chapter underscores that yes, indicator systems should feature in the toolkit of a regional policy maker or planner. It begins by examining whether or not the expected benefits of using indicator systems described in Chapter 1 materialise, particularly as demonstrated by the case studies in Part II. It then turns to "lessons learned" about these systems that should be considered. The chapter concludes with final comments and thoughts on areas for future research.

Benefits for regional development policy

Returning to the benefits outlined in Chapter 1, what evidence is there to suggest that governance of regional development policy has been enhanced by the use of indicator systems for monitoring programmes, policies and actors?

- *Monitoring policy implementation.* All of the case studies demonstrate that indicator systems are used to monitor the implementation of policies and programmes. The EU case highlights the value of two key mechanisms for ensuring that programme implementation stays on-track: the de-commitment rule and the mid-term review process. The former worked to ensure that funds were spent on-time as committed, while the latter mechanism forced countries and programmes to take stock of progress and indeed led to some reprogramming. The case of the Italian national performance reserve shows that not only can indicators be used to monitor if outputs and outcomes are being produced, but also to monitor if the process of policy implementation is characterised by effective public administration. In the United States, an internal monitoring tool – the Balanced Scorecard – is used to ensure that short- and intermediate process objectives are achieved within the organisation in order to enhance the likelihood of positive programme performance. Finally, the UK case demonstrates continued efforts to monitor programme implementation *(e.g.,* through outputs) in a manner linked to national policy goals.
- *Assessing progress and accounting for results.* The cases also demonstrate how performance indicator systems contribute to making public policy more transparent and increasing accountability. For example, public annual

Performance and Accountability Reports summarise the performance of the EDA against specific targets; similarly publicly reported performance enhances the legitimacy of the English RDAs. The mid-term review provided EU officials with indicators regarding the progress across multiple countries, while simultaneously requiring awareness at the national level. Certainly, both the EU and Italian performance reserves aimed to hold regional actors accountable for results. The case of Italy, however, proved somewhat more successful in doing so.

- *Improving relations among levels of government*. The performance indicator systems reviewed also proved to be useful to improve relations between different levels of government and between stakeholders within the same level. For example, the two performance reserve mechanisms in place in Italy (EU and national systems) contributed to relations between the central government and the European Union, and to relations between the centre and the regions. The performance framework in England provided a basis for collaboration both across regional development agencies and with the central government departments. Interaction with sub-national actors is least intense in the United States. However, the Balanced Scorecard revision process provides ongoing opportunities for regional offices to interact with headquarters staff on strategic performance issues.
- *Selecting policy strategies and actors; determining resource allocation*. In principle, performance indicator systems can produce information for making relevant strategic decisions, re-orienting policies, and making budget decisions. An example emerges from the case of the US EDA. First there is link between context indicators and project implementation, albeit not a strong one. Context indicators are used in the formulation of the Comprehensive Economic Development Strategy (CEDS) by regional actors, a pre-requisite for receiving EDA funds. Projects implemented in the region should be consistent with the CEDS. Second, there is a moderate linkage between outcomes monitored and project selection. Specifically, some of information provided by prospective beneficiaries (*e.g.*, anticipated job creation) is linked to performance indicators monitored over time. Overall, the case studies suggest limited feedback on decision making. This is consistent within other OECD research on indicator systems (Mizell, 2008) and with the fact that multiple sources of information are generally used to make such decisions. Indicator systems tend to provide monitoring information, whereas evaluation data are often needed to make concrete decisions in these areas.
- *Learning, adjusting, and improving*. Finally, and importantly, performance indicator systems triggered learning processes improving policy governance and the way to deliver public services. While the EU performance reserve was introduced only as a voluntary tool in the 2007-13 programming period, during 2000-06 it did provoke learning within member countries. In France,

for example, new attention was given to the value of monitoring and evaluation instruments *per se*, and also for the relationship between central and sub-central levels of government. At the supra-national level, knowledge was gained about the use of incentives to promote performance, the need to reduce complexity in system design, and the capacities of different actors to set realistic targets. In Italy, the national performance reserve proved highly useful for revealing information about sub-national capacities, the value of central/sub-central partnership, and usefulness of indicators and incentives for promoting performance. The UK case clearly demonstrates that learning is an ongoing process. Multiple adjustments have been made to the performance framework for RDAs. The approach recently put in place will give new emphasis to the achievement of outcomes. In the United States, the EDA continues to invest resources to examine the relationship between inputs and outputs in order to produce lagged indicators, particularly for public works investments.

In general, the implementation of a performance indicator system is an iterative process, as it is part of a larger dynamic of testing new approaches for measuring and promoting effective public service delivery, evolving as information about its usefulness is revealed. This is illustrated in the fact that performance systems are being revised in the United Kingdom and in the EU, and by the fact that Italy has opted to introduce a new version of the performance reserve for 2007-13. Because Italy was able to achieve some administrative intermediate results between 2000-06 it is able to implement a new system that now targets final outcomes.

Lessons identified

Important lessons emerge from this study of indicator systems. First, these systems are valuable governance tools that can be used to inform and manage regional development policy. With carefully considered objectives and correspondingly thoughtful design, indicator systems can be used to 1) narrow information gaps among regional policy actors; and 2) contribute to accountability and effectiveness of sub-national governments.

Second, incentives are inevitable with the use of indicator systems. The incentives emerge because reporting performance data is not neutral. The strength of incentives depends on how information will be used and by whom. Attaching explicit rewards (or sanctions) to performance data can be a powerful way to encourage effort and improvement, however an explicit monetary incentive is not a sufficient condition for success. Important conditions must be met for such an approach to work effectively. These "high-powered" incentives come with risks that should be anticipated and managed wherever possible.

A third lesson is that partnership between central and sub-central levels of government is crucial if an indicator system is to be valuable for regional policy stakeholders. Partnership is not an absolute pre-requisite for developing certain types of indicator systems *(e.g.,* financial monitoring of transactional contracts). However, if the objective of monitoring is not just to control, but to build co-operation and promote learning, then stakeholders must be brought to the table. Vertical interactions between institutional levels, as well as horizontal co-operation and peer processes facilitate formulating precise objectives, identifying relevant indicators, setting realistic and stretch targets, and devising appropriate incentive mechanisms. In the absence of collaboration, a top-down approach by the central government to design and use indicators can be perceived as an *ex post* substitute for *ex ante* control of regional economic development, producing resistance and jeopardising the long-term sustainability of the system. Moreover, rewards and sanctions are more likely to create the intended incentive effects if there is strong *ex ante* commitment from all levels of government to rigorous assessment of performance.

Fourth, regional development policy produces outcomes that materialise over an extended period of time. The case studies presented in Part II reveal a move toward outcome measures (in Italy and in the English RDAs). However, orienting an indicator system solely toward these outcomes can produce a deficit of information that is needed for strategic short- and medium-term decision making. Thus, even where policy makers are oriented toward outcomes, indicator systems should strive to produce information on inputs, processes, and outputs that is relevant for ongoing activities. The US case demonstrates that results-oriented information systems can be coupled with other tools that allow decision makers to monitor "leading" indicators that enhance day-to-day management capacity.

Fifth, it is clear that tracking developments in regional development policy is difficult. The characteristics of regional policy, the capacities of stakeholders, issues of data availability, and the "costs" associated with developing and using indicator systems can complicate the task of effective monitoring. These challenges should not stand in the way of monitoring activities, but should temper expectations and be addressed on an ongoing basis through the various methods discussed here. This includes setting aside resources for developing and managing indicator systems, as well as technical assistance and training where needed.

Sixth, the cases reviewed indicate that the potential benefits of performance indicator systems are numerous. Performance indicator systems can be useful to strengthen transparency and accountability, to improve relations between different levels of government or different institutions, and to help to embed monitoring and evaluation activities into mainstream policy making. Moreover, they can enhance capacity building and

trigger learning processes. They must be seen in a dynamic context. The cases of the English RDAs and Italy clearly demonstrate that these systems evolve over time. The systems must be sufficiently flexible to accommodate user feedback, as well as policy and programming changes.

Finally, indicator systems promote learning. The process of developing and using indicator systems exposes stakeholders to information that they did not have at the outset – about programme performance, about actors' capabilities, and about the feasibility of a particular indicator system. The feedback provided by the use of indicator systems should be used for continuous improvement and progress.

Conclusions and areas for future research

There is no "optimal" design for performance indicator systems in regional development policy. While there are good practices to be followed and pitfalls to avoid, it becomes clear that each country's objectives – both in terms of policy and in terms of monitoring arrangements – shape the approach that should be taken. Even where overall goals may be similar, countries need to adapt the choice of indicators, the use of information, and the choice of incentives to regional and local specificities and stakeholder capabilities.

Ultimately, indicator systems should be seen as an important tool in the larger toolkit of good governance practices. Despite their limits, they are an effective way to bridge information gaps, generate a common point of reference for stakeholders, reveal where good practice occurs, and stimulate effort in particular areas. Most importantly they provide an opportunity for ongoing collective learning and adjustment, about policies, programmes, and good governance itself.

In what areas might further learning take place regarding the use of indicator systems? This report suggests at least two areas for future research. First, it notes the importance of stakeholder capacities, particularly for using information. Further research could investigate the extent to which different categories of actors use the information produced by performance indicator systems and how. Of particular interest would be the capacity of different sub-national actors to transform performance data into improvements. Second, the report has highlighted the importance of understanding causal linkages in regional development policy in order to design indicator systems, to set realistic targets, and to hold the right actors accountable for results. There is therefore an opportunity to extend the analysis presented here by examining how robust statistical information for monitoring the regional economy is best linked to policy and programme performance information.

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PART II

Case Studies: Indicator Systems in Context

Part II presents four case studies of the use of indicator systems for monitoring and managing regional development policy. Chapter 5 presents the case of the European Union. It examines performance management mechanisms attached to the Structural Funds, with a particular emphasis on the performance reserve. The case of Italy follows in Chapter 6. This case focuses on the application of EU rules to national regional policy, with an in-depth examination of the national performance reserve created to reward performance. Chapter 7 presents the case of the United Kingdom and the evolution of performance assessment for the Regional Development Agencies in England. Finally, Chapter 8 describes the case of the United States. It examines the implementation of the Government Performance and Results Act and the Balanced Scorecard at the Economic Development Administration.

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PART II

Chapter 5

The European Union Structural Funds

This chapter examines the European Union performance reserve during the 2000-06 programming period. It begins by placing the mechanism in the wider context of EU regional policy and the evolution of monitoring and evaluation at the EU level. It then details the design and implementation of the performance reserve, which attached monetary rewards to the achievement of targets. The case study reveals the political and technical challenges of implementing this mechanism, while also highlighting the learning effects which took place.

Introduction

EU regional policy delivered through the Structural Funds has been characterised by increasing attention to quality and performance. Throughout the 2000-06 programming period, much effort was expended to move beyond traditional expenditure-driven planning toward the development of a result-oriented logic. Substantial efforts were made to enhance efficiency and effectiveness by setting objectives and measuring achievement. Programmes were subject to rules regarding resource expenditures and accounting for results that were generally legally binding.

The "performance reserve" was one of the mechanisms used to improve spending effectiveness by holding a percentage of appropriations allocated to each EU member state in reserve until 2003, and then tying distribution to achieving a set of targets. This mechanism was introduced at the EU level for the 2000-06 programming period in the context of Structural Funds programming. It was developed as part of the overall monitoring and evaluation arrangement which was comprised of a few fundamental instruments with a solid institutional and legal basis. Although mandatory use of instrument was not renewed for the 2007-13 programming period, important lessons can be drawn from the 2000-06 experience.

This case study examines the performance reserve as an example of a high-powered incentive-based monitoring mechanism. It begins by placing the performance reserve in the wider context of EU regional policy and the evolution of monitoring and evaluation at EU level. Before entering into the details of the performance reserve mechanism, other mechanisms implemented during the 2000-06 programming period that make use of performance indicators (the mid-term evaluation and the so called "de-commitment rule") are briefly reviewed. The study concludes with an assessment of the performance reserve's costs and benefits, and different lessons learned.

Background: EU regional policies and performance measurement

The EU regional policy took its current shape 20 years ago, when the first regulation adopted in 1988 integrated existing financial instruments under what is now commonly called the EU "cohesion policy". Although the objective of reducing regional disparities was already present at the beginning of the European integration process in the late 1950s, by the end of the 1980s cohesion had become a fully-fledged and explicit objective to offset the burden of the

single market for less developed regions and countries. The objective of cohesion was officially enshrined in the Treaty of the European Union in 1993.

The EU cohesion policy, managed by the Directorate General for Regional Policy at the European Commission (DG Regio), is delivered through the Structural Funds which redistributes part of the member state budget contributions to the least prosperous regions of the EU, and through the Cohesion Fund direct it to the least prosperous member states. There are four main principles guiding the implementation of Structural and Cohesion Fund policies: concentration on specific objectives,[1] multi-annual programming, partnership between the European Commission and competent authorities in the member states, and additionality (to prevent substitution of national funds by EU resources). The EU cohesion policy mobilises traditional regional policy instruments: infrastructure construction, training and human resources interventions, and incentives for productive investments. Since 1988, three programming periods have occurred (1989-93, 1994-99, 2000-06) and a fourth is underway (2007-13).

Since the 1988 reform another principle has grown in importance: accountability. The 1988 reform introduced a comprehensive monitoring and evaluation (M&E) system which has evolved through both regulatory changes and learning processes at the EU and member state levels. As a result, both monitoring and evaluation have become increasingly valuable management tools (Taylor *et al*., 2001).

A principal component of the 1988 reform was the requirement to monitor the financial and physical progress of programmes financed by the Structural Funds. Evaluation was also officially enshrined in 1988 but it has been more effectively used since the mid-1990s. A second reform in 1999 introduced the major regulations that characterised the M&E system at work during the 2000-06 programming period. As far as monitoring is concerned, the 2000-06 programming period marked a significant step forward, with the effort by the Commission to ensure equal and uniform treatment of common issues and to encourage the implementation of comprehensive or integrated systems across the EU. The evaluation process was also formalised and structured to occur at distinct points during the programming process: an *ex ante* evaluation, a mid-term evaluation (MTE) and its update, and an *ex post* evaluation.

These underlying principles guiding the public management of Structural Funds have encouraged a shift from input-driven to result-oriented management. Three main motives account for this shift: the poor financial performance of some programmes together with management and implementation challenges; the trend towards more decentralised management of the Structural Funds programmes requiring top-down incentive (and control) systems (Aalbu and

Box 5.1. **Terms associated with EU Regional Policy**

Cohesion Fund: The Cohesion Fund was set up in 1993 to reduce disparities between EU member country economies by providing financial support for environment and transport infrastructure projects to the four poorest Community countries (Ireland, Greece, Spain and Portugal). From 1993 to 1999 the amount of financing available through the Fund each year ranged between EUR 1.5 billion and 2.6 billion, summing to a total of EUR 15.1 billion.

Community Support Framework (CSF): CSFs co-ordinate EU regional support. They are strategic documents that incorporate baseline data, strategies, action priorities, specific objectives, financial plan and implementing conditions.

Managing Authority: A public or private authority at the national, regional or local level designated by the member state to plan and manage each Structural Funds Programme in line with the EU regulations. It determines: 1) the funding allocations to the different eligible expenditure areas; 2) the funding instruments (grants, loans, etc.); 3) the criteria for making awards to individual projects; and 4) the process for managing and delivering the funds.

Measure/sub-measure: The basic unit of programme management, consisting of a set of similar projects and disposing of a precisely defined budget. Programmes are composed of priorities, which are themselves composed of measures (and possibly of sub-measures). Each measure has a particular management apparatus. Many measures are implemented through a process of Calls for Proposals and subsequent appraisals.

Mid-term evaluation (MTE): An opportunity to assess ongoing programme implementation, and reorient and influence fund reallocations if performance is found to deviate from *ex ante* forecasts.

Objectives and regions: For the 2000-06 programming period, there were three main categories of beneficiary regions, each corresponding to different objectives.

- *Objective 1 regions* (Ob. 1) where GDP per capita was less than 75% of the Community average. They received almost 70% of Structural Funds resources.
- *Objective 2 regions* (Ob. 2) are those with structural problems and whose socio-economic conversion needs to be supported. They comprise territories with traditional industries in decline, areas undergoing socio-economic change in service sectors, declining rural territories, depressed areas dependent on fisheries as well as cities whose difficulties are not caused by industrial crises. Ob. 2 regions received around 12% of Structural Funds.
- *Objective 3 regions* (Ob. 3) benefited from assistance in education training and employment policies, and active labour market policies.

Box 5.1. **Terms associated with EU Regional Policy** *(cont.)*

In the 2007-13 programming period, the new "Objectives" are: Convergence, Regional Competitiveness and Employment, and Territorial Co-operation.

Operational Programme (OP): Documents approved by the European Commission to implement a Community Support Framework (CSF), comprised of a set of priorities and multi-annual measures, using one or more funds.

Programme Complement: Documents that contain the operational details necessary to implement the strategies described in programmes, in particular the quantification of objectives and indicators.

Single Programming Document (SPD): For small amounts of assistance, the CSFs and OPs are combined into an SPD which is approved by the European Commission.

Structural Funds: Administered by the Commission to finance EU structural aid to regions. Until 2006 the funding instruments were: the European Regional Development Fund (ERDF) for economic development interventions, the European Social Fund (ESF) for training and human resource measures, the European Agricultural Guidance and Guarantee Fund (EAGGF) for rural development, and Financial Instrument for Fisheries Guidance (FIFG). For 2007-13, only three funds are mobilised: the ERDF, the ESF and the Cohesion Fund (see above). Financial support from the Structural Funds mainly goes to the poorer regions to strengthen the EU's economic and social cohesion. Final beneficiaries of support are generally government departments, local authorities, development agencies, non-governmental organisations, etc. In general, support is not provided directly to private firms.

Sources: Evalsed, *http://ec.europa.eu/regional_policy/sources/docgener/evaluation/evalsed/glossary/index_en.htm*; Inforegio, *http://ec.europa.eu/regional_policy/glossary/glossary_en.htm*; Department for Development and Cohesion Policies (DPS), "Italy's 2000-2006 Community Support Framework Ob. 1", *www.dps.tesoro.it/qcs-eng/qcs_italys2000-2006_csf.asp*.

Bachtler, 1998); and a general trend in public management toward more value-for-money considerations (CEC, 2004a).

The 2000-06 programming period introduced a number of innovations targeted at improving efficiency and effectiveness in the use of Structural Funds. Regulatory deadlines were created and access to (additional) financial allocations was linked to mid-term evaluation results. Also, two mechanisms were introduced that clearly linked performance to financial allocations: the "de-commitment" rule (N + 2 rule) and the performance reserve. The N + 2 rule allowed the European Commission to automatically "de-commitment" funds allocated to member states if they failed to spend the monies within two years. The performance reserve was an award mechanism that allocated additional funds to high performing programmes based on criteria established *ex ante*. The

N + 2 rule ensured that programmes advanced on schedule, and the performance reserve worked to ensure that resources were spent as effectively as possible.

The performance reserve in the context of the 2000-06 monitoring and evaluation arrangement

The performance reserve was related to the two other mechanisms that made use of performance indicators: the mid-term evaluation of the programmes co-financed by Structural Funds (which took place in 2003) and the de-commitment rule. In order to provide a comprehensive picture of monitoring (and evaluation) during the 2000-06 period, brief overviews of the MTE and de-commitment rule are provided.

The mid-term evaluation

The 2000-06 EU Structural Funds evaluation process was designed to assess a programme's overall impact on strengthening economic and social cohesion, and to analyse the effects on specific structural problems identified in each instance of assistance.[2] It consisted of three different exercises: an *ex ante* evaluation,[3] a mid-term evaluation[4] and an *ex post* evaluation.[5] The *ex ante* evaluation served to assess the adopted strategy and targets for consistency and relevance to local needs. This was designed to provide a baseline for specific targets. On this basis, the mid-term evaluation (MTE) was an opportunity to examine the initial results, their relevance and the extent to which the targets had been reached. *ex post* evaluation was more loosely connected to the programming process.

The European Commission stressed that the MTE was not an end in itself but a means to reorient and improve the quality and relevance of programming. It was a formal decision-making procedure for informing how to adapt the programme (CEC, 2000c). The MTE report was meant to analyse achievements to date, and to propose recommendations for changing the programme content or implementation system to maximise the long-term impact of programming. In addition to this over-arching goal, several specific objectives needed to be reached: to assess the quantification of objectives undertaken in the programming phase; to assess the adequacy of implementation and monitoring arrangements; and to measure performance against the agreed upon indicators for the performance reserve.[6]

The MTE was to assess performance along the following criteria:

- Effectiveness of operational and specific objectives: 1) analysis of progress towards operational objectives was based on output indicators compared to targets set in the Programme Complement; 2) analysis of progress towards specific objectives was based on result indicators (which related to the priorities set in the OP or SPD);

- Efficiency: comparing output and results indicators with input indicators (primarily resources deployed); and
- Impact related to global objectives: in particular on cohesion and the Commission's principal priorities.

The MTE report was executed by an independent evaluator under the responsibility of the Managing Authority, in co-operation with the Commission and the member state. The MTE report was submitted to the Monitoring Committee and then sent to the Commission by 31 December 2003. The Commission's review of the MTE submission had to be completed by 31 March 2004. Finally, an update of the MTE had to be done by the end of 2005 with a view to prepare for the subsequent programming period.

Overall, the MTE process progressed smoothly, a testament to the member states' growing evaluation capacity. As an illustration, two-thirds of the reports were considered to be of "good or excellent quality" at the end of a "quality assessment" exercise (CEC, 2004a; CEC, 2004b).

The principal use of the MTE was to "improve the quality and relevance of programming". It was linked with the performance reserve, but it did not primarily drive the allocations. Yet, the linkage between the two proved to be fruitful. The financial incentive to perform evaluations together with the fixed deadline created an incentive to complete evaluations well and on time. One drawback was that although the fixed deadline (and the link with the performance reserve) acted as an incentive to do the evaluation on time, it presented some difficulties for programmes with a slow start up.

In conformity with its *raison d'être*, the primary way in which the MTE reports were used was to inform the mid-term review. Changes in financial allocations were brought about, but they were often changes driven by absorption concerns. The link between the results of the MTE and strategic decisions on funding allocation was not very strong even if improvements were recorded compared to the previous programming period. MTE reports were mainly used by Managing Authorities, Monitoring Committees and implementing bodies, generating little public debate.

A shortcoming of the MTE exercise was the limited availability of quality data. The difficulty to develop and run efficient monitoring systems in member states and the inadequacy of the systems of indicators and targets made it difficult to use the indicators and organise the MTE on this basis. There were often too many indicators, they were not always measurable (and therefore not monitored), and not systematically relevant. As a result of the combination of poor monitoring systems and slow or late start up of programmes, MTE reports were found to generally lack a suitable analysis about results and impact (CEC, 2004b; Polverari *et al.*, 2004).

However, this weakness became an opportunity for learning and improving. In fact, in a majority of cases, the MTE process had a strong impact on implementation systems, leading to improvements in the system of indicators, the implementation of horizontal priorities, and project selection criteria. In 2002, faced with substantial evidence of implementation difficulty the European Commission issued a note to foster the simplification of Structural Funds implementation. Concerning indicators, the Commission acknowledged that there was a problem with quantification related to the existence of numerous indicators, applying at different programmes levels, and reflecting various objectives (CEC, 2004b).

Overall, the MTE process was a credible instrument to influence decision making in the context of reprogramming. It was generally seen as providing a useful stimulus for strategic decision making and partnership building. It was also considered to be an instrument for enhancing transparency and accountability. However, some perceived the rigid time-schedule to be problematic.[7]

The N + 2 rule

In contrast to the mid-term review process, the de-commitment rule is a case of a circumscribed mechanism with a single objective: to increase the speed of financial absorption. In the face of poor financial performance of some EU regional development programmes in the previous programming period, the de-commitment rule was designed to ensure that committed funds were followed by effective expenditures by automatically "de-committing" funds not spent within two years.[8]

The assessment of the N + 2 rule was straightforward as it consisted in comparing funds committed to funds effectively disbursed after two years. The Commission had to receive payment applications at the latest on 31 December of year N + 2. At the end of February N + 3, the Commission informed member states of all commitments of the year N which had not been fully covered by payments (or for which no exceptions had been accepted). Member states were given two months to introduce contestations, and then at the end of May N + 3 the Commission released its final de-commitment decisions.[9]

Member state and programme performance with respect to the N + 2 rule varied widely, paralleling the large variations in the levels of commitments and payments across member states and regions. The impetus for de-commitment was first to identify financial absorption difficulties, potentially explained by a too narrowly defined thematic focus, a small, fragmented eligible area, administrative difficulties, weaknesses in planning, etc.

The rigour with which the mechanism was applied required significant advance planning and ongoing monitoring by programme managers and other partners. There was evidence of specific difficulties due to the complexity of the claims management system, encountered even by those programmes characterised by strong levels of absorption. Also, there were occasionally problems with financial absorption below the level at which the N + 2 rule applied; *i.e.,* at the level of measures or sub-measures.

Member states and regions took various steps to ensure that they met the N + 2 rule, such as: communication plans, effective financial management and monitoring including risk analysis, and compressed payment claim cycles. Also, it was decided in some cases to increase domestic co-financing, increase staff resource in implementation, finalise fast spending projects, forward planning to facilitate project generation, and ensure project readiness before approval. The most efficient steps were to reduce delays in introducing payment claims, better project-level monitoring, and re-allocation at measure level (towards those which are better on financial indicators).

The pressure created by the N + 2 rule to increase spending has been a useful tool for enhancing programme implementation, and improving financial management, communication, and monitoring. However, there were possible negative impacts too, in particular on project quality and maintaining the strategic focus on innovative and complex programmes over traditional and simple programmes which at times was sacrificed. In some cases, the approach was said to have promoted a spending logic at the expense of project quality.

The performance reserve

In addition to the MTE and the N + 2 "de-commitment" rule, in 2000-06 the Commission introduced a system of financial rewards/sanctions associated with performance. Four stages characterised the implementation of the performance reserve mechanism: 1) performance indicator selection and quantification; 2) annual monitoring; 3) successful programme identification; and 4) performance reserve allocation. They are described in the sub-sections below.[10]

Performance indicator selection and quantification

The overall objective of the performance reserve was to facilitate better programme management and more effective Structural Funds spending. For this, the mechanism pursued a set of intermediate objectives deemed necessary to ensure the correct implementation of Structural Funds programmes. The different facets of programme implementation were measured along three sets of criteria: effectiveness, management quality, and financial implementation.[11]

The mechanism consisted of retaining a proportion (4%) of the total budgetary resources at the disposition of a programme (*i.e.*, of both the Community and the national co-financing share) and using it to reward the most successful programmes, assessed on the basis of performance indicators reflecting the above criteria. The specific indicators were to be defined by the member states "in close consultation" with the Commission – taking into account an indicative list (CEC, 2000b). The mechanism applied to all Operational Programmes (national and regional) and Single Programming Documents in Objective 1, 2 and 3 regions (see Annex 5).[12]

The European Commission recommended that indicators be quantifiable to the extent possible, to make them rigorous and justifiable, and to "avoid subjective judgement linked to qualitative assessment" (CEC, 2000b). It proposed a list of eight indicators reflecting the three categories of criteria above. Of these eight indicators, only one was a qualitative indicator (see Table 5.1).

Table 5.1. **Indicative list of indicators for the allocation of the EU performance reserve**

Criteria	Description
Effectiveness criteria	
1. Basket of outputs	Comparison of actual and planned results for some outputs (covering at least half of the value of the programme)
2. Basket of results	Comparison of actual and planned results for employment (temporary/permanent jobs created or maintained) or employability of target groups
Management criteria	
3. Quality of monitoring system	Percentage share of the programme measures (in terms of value) covered by annual financial and monitoring data compared with target
4. Quality of financial control	Percentage of expenditure covered by annual financial and management audits compared with target
5. Quality of project selection systems	Percentage of expenditure committed by projects selected using clearly identified selection criteria or appraised through cost-benefit analysis compared with target
6. Quality of evaluation system	Availability of independent intermediate evaluation of acceptable quality (predetermined quality standards)
Financial criteria	
7. Absorption of funds	Percentage of expenditure reimbursed or requested receivable in relation to annual commitment (standard: expenditure corresponding to 100% of commitments in the first two years)
8. Leverage effect	Percentage of private sector resources actually provided compared to planned target

Source: CEC (2000b), "The Implementation of the Performance Reserve", *The 2000-2006 Programming Period: Methodological Working Papers*, Working Paper 4, EC, Brussels.

Regarding effectiveness criteria, two types of indicators were proposed: output indicators (*i.e.*, what is actually achieved) and result indicators (*i.e.*, measuring the immediate benefits for direct beneficiaries). Their definition

and number were expected to vary depending on programmes. The Commission only recommended that they cover priorities or measures corresponding to a substantial part of the programme in budgetary terms (CEC, 2004a). All countries used both output and result indicators, except Greece, Italy Objective 2 and Denmark (which used only outputs) and Sweden (which used only results).

There was a significant variation in the number of indicators used for effectiveness, varying from two output indicators in Denmark to 28 indicators (14 output and 14 result) in the UK Eastern Scotland Objective 2. In 2002, part of the Commission's proposed simplification exercise was that performance reserve effectiveness indicators should be streamlined and simplified. The UK completed this exercise in 2002, while the exercise continued to 2003 in Greece, Portugal and Spain.

Regarding management criteria, four indicators were proposed. The first three dealt with project monitoring, financial control and selection. They were expected to be identically defined for every programme in the same objective of a member state. The fourth was qualitative and dealt with evaluation, both its process and its content. The variations ranged from Denmark with one management indicator – financial control of projects – to Portugal with six (the monitoring indicator was broken down into physical and financial monitoring and the financial control indicator broken down into an indicator for the financial control system and one for financial control of projects). Italy introduced even further refinement with its distinction between compulsory and optional indicators (most indicators were obligatory, while project selection was not).

Finally, the Commission proposed two financial implementation indicators: payments absorbed relative to commitments, and the degree of private sector mobilisation. The first compared commitments to payments made after three years of implementation. The second indicator varied to a great extent depending on the programme. Financial leverage was defined differently across member states *(e.g.,* private funding as a percentage of the total financing plan; or total private funding realised; or the percentage of planned private funding achieved). Leverage was not used as an indicator in Belgium, Germany (Transport), Finland, Spain or Sweden.

The definition of the management and financial indicators proved to be relatively straightforward (even too straightforward); they were chosen approximately in the same way in all member states. By contrast, effectiveness indicators were much more complex to select. For an illustration on how two member states, France and Italy, made different choices corresponding to their interpretations of the indicators proposed by the Commission, see Boxes 5.3 and 5.4.

Target setting and assessment

Once performance measurement indicators were selected, the Commission recommended comparing mid-term results with specific initial targets to determine a programme's success. According to the Commission, the performance reserve should "seek to check whether the objectives set by the initial programming for the programme in question have been achieved or the commitments made (…) have been fulfilled" (CEC, 2000b). This required that targets be quantified and results be compared to anticipated results. Both processes were to take place in partnership with the European Commission and be realised by the end of 2003. The Commission recommended that the percentage of target to be reached for a programme to be considered successful be clarified at the outset (and/or at the re-programming stage), and that the minimum threshold be fixed at 75% of the target. Under this approach the programme would be considered successful if the actual value of selected indicators reached 75% of the target set *ex ante*.[13] There were two cases in which minimum thresholds were not recommended to represent 75% of the target: 1) absorption of Community appropriation (for which it was suggested that the performance standard be that payments accounted for 100% of the commitment of the first two years); and 2) the unique indicator which was not quantified (evaluation) but for which some quantitative proxy was recommended (CEC, 2000b).

There were some variations amongst member states. For example, for the management monitoring indicator, Portugal set its target at 80%, while most other member states were at 100%. Variations were more pronounced for financial indicators making the percentage targets difficult to compare across countries. For the effectiveness indicators, most member states deemed that a target would be reached if 75% of the absolute figure for the mid-term target identified in the programme complement was achieved. One hundred per cent was to be achieved in Denmark, some German regions, Italy and the United Kingdom (England) while Spain proposed 80% and Portugal set its target at 60% (CEC, 2004a). Effectiveness indicator targets were often set unrealistically, either too low or too high.

Then in 2003, the member states, in close consultation with the Commission, conducted a final results assessment. Some member states established their method for identifying performance and allocating the reserve in their programming documents (Belgium, Denmark, Finland, Luxembourg and Sweden) or at the beginning of the programming process (Italy). In the other member states, decisions were taken through bilateral discussions with the Commission during 2002-03 (CEC, 2004a). In either case the time schedule was very tight as member states had to submit their list of "successful" programmes to the Commission by 31 December 2003. The Commission took no more than three months to review the member state proposals and ask for justification or

clarification where required, before giving final approval and proceeding with the performance reserve allocation (by 31 March 2004). The MTE reports served as supporting documentation during this process, providing an overview on programme performance and in some cases, reports on performance indicators.

The European Commission stressed that the assessment was not meant to evaluate a single point in time but rather to show results from a continuous and regular monitoring process (CEC, 2000b). Indeed, targets had to be verified and periodic checks were expected to be carried out, and if necessary, followed by corrective measures. For example, information contained in the Annual Implementation Reports would be used to assess the progress of financial and management indicators. (Annual) meetings of the Monitoring Committee (bringing together the Commission and Managing Authorities) were opportunities to validate targets, examine first results and if needed, review indicators and targets. The Commission encouraged the creation of an expert advisory group (with two national experts and two experts from the Commission) to support the creation of an objective and transparent selection process, and to ensure uniform interpretation across member states; however, only Italy followed this recommendation.

The assessment process took place in parallel with the realisation of the mid-term evaluations. Indeed, the two processes were inter-linked, as data necessary for the performance reserve allocation were collected as part of the MTE process. Overall, the methods for assessing the performance reserve used: 1) targets set in advance; and 2) findings from MTE, but also a series of data and information coming from the regular monitoring process. In addition, other "extra" elements were sometimes taken into account like the need for specific actions, consideration for absorption capacity, other national or regional policies, and changes in the socio-economic situation.

Performance reserve: form, level and allocation of incentives

The performance reserve was designed to function as an explicit financial reward to promote good performance. It set aside 4% of the Structural Funds budget to be allocated to successful performers within each member state. While assessment was the role of member states working in close co-operation with the Commission, the actual allocation of performance reserve funds was the responsibility of the European Commission, but carried out with the support of member states.

The reserve was to be entirely allocated to successful programmes (OPs, SPDs) within the same objective and in the same country. Alternatively, allocation could be made within the same programme, between priorities (but always at the country level).[14] The Commission insisted that this should be done in proportion to initial budgetary appropriations, and that those programmes considered unsuccessful should not be eligible for any additional allocation. Ultimately it

was a Community level decision to compare only programmes within a member state, and separately under each objective. However, in the very end, the details of the design of the reserve were left to member states.[15]

In October 2003, the Commission proposed guidelines for the distribution of the performance reserve. Two broad principles underlying the allocation process proposed by the European Commission were transparency and equity in treating programmes and Objectives. The goal was to ensure alignment between performance and the scale of the allocation, while minimising pro-rata allocation. Even with this in mind the performance reserve was distributed using very different methods across Europe. Amounts differed from country to country but also the distribution mechanisms varied largely depending on the degree of competition introduced.[16] Where all programmes clearly performed well, they all received a full allocation from the performance reserve. The Greek approach was to first eliminate non-performing programmes and then distribute the available resources to the highest performing programmes. In Spain the allocation was *pro rata* across all programmes, excluding only three. In Portugal, all but three programmes were divided into two groups, according to performance. In Austria, the reserve funds were redistributed between priorities of the same programme (see Box 5.2). Italy Objective 1, the UK-England and France proposed an allocation to all programmes with amounts less than 4% to those programmes which only partially achieved targets, with the highest allocations distributed to those which had the highest performance. The UK-England also introduced a cap of 5% because of absorption concerns. Weighting was used in some German regions *(e.g.,* Brandenburg) and in the UK-Scotland Objective 2. The Scottish proposal was a rigorous and transparent system in that it introduced weighting for effectiveness indicators and capped the actual performance ratio at 200% of the target (CEC, 2004a).

In total, around EUR 8 billion were allocated under the performance reserve mechanism in March 2004 (EUR 6 billion for Ob.1, EUR 1 billion for Ob. 2, and EUR 1 billion for Ob. 3). Nearly 80% of Objective 1 programmes (93 in total) received allocations from the reserve and all Objective 2 programmes received allocations[17] though the allocation range was greater for Objective 1 than for Objective 2. For programmes which received an allocation, the greatest range was in Greece (4% to 9.33% of total commitments) with 11 programmes not receiving any allocation.[18] *Pro rata* allocations were used in Finland and Sweden, where all programmes performed, and in Spain, where 20 programmes received an allocation and two did not. In Greece, Portugal, Spain and Ireland some programmes did not receive any performance allocation. For Objective 2, the allocations were more uniform with a less extensive range, partly due to a higher level of performance. There was a more extended range in allocations between priorities. In many cases, allocations were concentrated on a limited number of priorities (CEC, 2004a).

Box 5.2. **The application of the performance reserve in Austria**

The EU performance reserve in Austria was managed at the individual programme level, with some consultation and discussion at the national level. This was due to the small financial size of the programmes and their good financial performance. All programmes spent their funding according to plan and stayed within the margins allowed by the N + 2 rule. Under such conditions the redistribution of funds between programmes based on their individual performance was considered neither an incentive nor appropriate for improving performance. Instead, the funds allocated under the performance reserve were redistributed between priorities of the same programme, based on proposals by the respective programme authorities and indicators established *a priori*. Prior to the reallocation the performance of the individual programmes was discussed and compared at national level, and the reallocation proposals were discussed with the EU Commission in the context of the Monitoring Committee meetings. Some programmes (*e.g.,* Styria) opted to use their performance reserve not to reward past performance, but instead allocated their reserve funds in areas where new funding needs arose.

Austria has not opted to implement the performance reserve during the 2007-13 programming period, as its application was not perceived to have added value in comparison with the normal reallocation process foreseen by the Structural Fund Guidelines.

Source: Federal Chancellery of Austria.

Box 5.3. **The application of the EU performance reserve in France**

Categories of indicators and targets

The performance reserve in France was centrally managed by the DIACT, the Inter-ministerial Directorate for Territorial Planning and Competitiveness (formerly DATAR). Negotiations on the rules governing the French performance reserve were still going on in 2003, very close to the assessment deadline (31 December 2003). Throughout 2003, the DIACT worked with the Managing Authorities to revise certain indicators which turned out to be difficult to quantify. Regions were invited to substitute such indicators with data directly available from the monitoring system.

Following the European Commission's recommendations, France implemented the three proposed indicator categories, though introducing some significant changes. For the effectiveness criteria, France asked the regional Managing Authorities to select their own physical output and result indicators. Regarding the management quality indicators, France substituted the "quality of project selection" indicator with a "programming" indicator to measure the time required to process projects (to fulfil the indicator, projects need to be instructed within three months). The weighting reveals that the management quality category was given more importance than the two other arguably more strategy-relevant categories (for example, the mobilisation of private actors). The former accounted for 29.33 points, as opposed to 18 points for the financial criteria and 16 points for effectiveness.

Box 5.3. **The application of the EU performance reserve in France** *(cont.)*

The targets chosen were defined exclusively in absolute terms. For example for the "programming" indicator, the target was reached if the time for project application processing was verified in 80% of the cases.

The French performance reserve was EUR 273 million for Objective 2 regions and EUR 24 million for Objective 1 transitional support regions.

The French government chose performance reserve allocation mechanisms with the objective to not exclude any region from distribution, not even the less performing ones. In the face of disappointing programming performance in mid-2002, a series of simplification measures was adopted at the national level to avoid automatic de-commitment. However, it was clear that regions running the risk of de-commitment were also in danger of not fulfilling the performance reserve requirements. The allocation mechanism was composed of two steps to give a chance to all regions to receive at least a share of performance reserve. First an "absolute performance premium" was divided in three parts corresponding to each family of criteria. If a region reached targets for just one family of criteria, it received one-third of the "absolute performance premium". Second, a premium called "absorption of credit", using resources not distributed in the first step, was distributed equally to regions that had reached a satisfactory level of funds absorption. The performance reserve was therefore redistributed to a maximum number of regions, thus "diluting" the rewarding effects the Commission sought in its proposals.

Impact

The performance reserve was not used as an instrument to select and reward effective performance. The weight given to "management quality" criteria also demonstrated a preference toward criteria on which the most regions were likely to succeed. This was also reinforced by the room left to regional Managing Authorities to choose the "significant" measures to which effectiveness criteria should apply. The criteria selected tended to reflect compliance with objectives of a rather administrative and formalistic nature. The performance reserve thus rewarded (at best) management effectiveness and procedural performance. Eventually, the mechanism became a "politically oriented" instrument to enable the allocation of at least a share of Reserve to each region.

One merit of the approach was that it called attention to indicator quality, and realistic quantification. There is no evidence of other impact on the Structural Funds or territorial policy management systems. Moreover, after 2003 high performing regions continued to perform better, and the lower performing continued to under-perform, showing that the performance reserve had made little difference.

For the next programming period, the performance reserve is optional, and France has decided not to implement it. Reasons put forward have to do with the complexity of the mechanism, the fact that the exercise occurred too early in the programming process and that it was not considered to be an instrument representative of progress and efficiency.

Sources: OECD (2006), "Workshop on the Use of Indicators for Effective Regional Development Policies: Lessons from OECD Country Cases", working document, GOV/TDPC/RD(2006)10; Discussions at "The Use of Indicators for Effective Regional Development Policies: Lessons from OECD Country Cases", OECD experts meeting, 28 November 2006 and at "The Efficiency of Performance Indicator Systems in Regional Policy", OECD experts meeting, 17 September 2007.

Box 5.4. **The application of the EU performance reserve in Italy**

Categories of indicators and targets

In applying the EU performance reserve to Italy, the Department for Development Policies at the Ministry of the Economy (DPS) and the European Commission (EC) negotiated intensely about the definition of criteria and allocation mechanisms. Both indicators and the allocation mechanism were agreed upon in 2000, reflecting Italy's expectation that the mechanism would set strict conditions and ensure effective spending.

Italy introduced some modifications to the initial EC proposal in choosing its indicators. This was because the EC approach offered only limited comparability between programmes. In the effectiveness category, the only (compulsory) indicator dealt with physical realisation. Italy did not retain a results indicator as they were deemed too difficult to measure. For management quality, five indicators were proposed of which three were compulsory (quality of the monitoring system, quality of financial control, and quality of the evaluation system) and two were optional (quality of the project selection system and quality of the labour market analysis system – which was added at the Commission's suggestion). Concerning financial management, two indicators were optional (the de-commitment rule with a deadline anticipated by three months, and the realisation of "private public partnership" projects). In general, the indicators were defined in an ambitious manner. For example, the criteria proposed by the Commission for "quality of project selection systems" (under the quality of management category) was adapted and made more stringent in Italy with the introduction of a reference to environmental sustainability and equal opportunities. The need to clarify suggested indicators and the negotiation with the EC led to some indicators that were particularly ambitious and even introduced some rigidity into the system *(e.g.,* compulsory indicators and stringent project selection criteria).

A programme was deemed successful if performance reached a minimum acceptable threshold. Common targets were defined "exogenously" in partnership for all programmes. Below this target threshold, no access to the reserve was possible.

In June 2001, Italy established a technical experts group to monitor the criteria used to assess performance. The group produced annual progress reports, played an active role in improving indicators and targets, and identified difficulties as they emerged throughout the process. Performance assessment of performance was also a task of given to the Technical Group.

Form level and allocation of incentives

The performance reserve amounted to approximately EUR 2 billion. In principle, six out of the eight indicators and respective targets (of which five were compulsory) had to be reached for a programme to be eligible for the reserve (*i.e.,* administrations could chose at least one of the optional indicators for which not to be accountable). Regions that could not satisfy these conditions would not receive any share of the reserve. However, subsequently this rule was interpreted with some flexibility. The Technical Group proposed to proceed with a pro quota distribution of the reserve, in proportion with the results achieved. Unassigned resources were re-allocated to the performing administrations proportionally with the number of indicators fulfilled and the initial programme budget. Overall, the full reserve was allocated to the regions which reached six out of eight targets, and a partial allocation of the reserve was for two programmes: Calabria (60% of the reserve) and Transport (40%).

Box 5.4. **The application of the EU performance reserve in Italy** *(cont.)*

Impact

Due to the nature of the criteria adopted, the performance reserve had a limited impact on the management of the Structural Funds. However, it acted as an incentive for capacity building in good management practices. Some positive effects included the development of a monitoring system, a learning experience in how to select the appropriate indicators and targets, and awareness of the need to rationalise and strengthen human resources and to automate data processing. The mechanism induced regions to spend allocated funds, to carry out on-time evaluations, to establish financial control systems, and to improve the project selection process. Its transparency facilitated holding the different stakeholder parties accountable, and it contributed to strengthening the partnership between the European Commission and Italy as a member state. Overall, the mechanism was used as an opportunity to spur changes necessary for the successful achievement of the Structural Funds' strategy.

Transparency in the performance assessment process and the reserve allocation was seen as a strength. The identification of indicators also proved to be relatively successful, and their formulation was such that their quantification was generally not problematic. However, the combination of having some overly ambitious indicators and others that were difficult to measure, together with an initially rigid allocation mechanism, risked overloading the scheme. Among other weaknesses were insufficiently motivated and trained personnel in the local administrations charged with the implementation.

Sources: OECD (2006), "Workshop on the Use of Indicators for Effective Regional Development Policies: Lessons from OECD Country Cases", working document, GOV/TDPC/RD(2006)10; Discussions at "The Use of Indicators for Effective Regional Development Policies: Lessons from OECD Country Cases", OECD experts meeting, 28 November 2006 and at "The Efficiency of Performance Indicator Systems in Regional Policy", OECD experts meeting, 17 September 2007.

Assessment

Relations among levels of government

In principle, the rules contained in the Structural Funds regulations are defined and implemented in partnership between member states and the European Commission. In turn, the implementation of the Structural Funds at the country level should give rise to partnership between central governments and regional authorities (Managing Authorities).

In the case of the performance reserve, the partnership between the EU and member states took place with proposals made by the European Commission, debated at the national level and that lead to significant revisions of the initial Commission proposal. In this process, regions were not directly involved. At the regional level, the performance reserve was implemented once the choices had been made rather than negotiated in partnership with regional authorities.

The initial proposition by the Commission was bold. It proposed that the reserve be 10% of the total programme budget, and that those programmes performing best would receive an additional allocation (10-20%), those performing well, 10% and those under-performing would receive no extra funding. This proposal was criticised by different member states on the basis of several arguments: a general resistance to evaluation, the political risk represented by such a loss of funds, administrative and technical feasibility concerns, risk due to the uncertainty of the outcome, difficulties arising if comparisons were made at the European level, etc. (Aalbu and Bachtler, 1998).

Ultimately, the reserve was reduced with respect to the initial proposal. It involved less competitive pressure than originally planned and permitted countries to have significant room to accommodate the general principle underlying the scheme. Eventually, the performance reserve was set at 4% (with different levels possible due to the different allocation mechanisms that could be adopted by member states). It was decided that comparisons would take place within countries and within the same "objective" according to different modalities, but not at the European level as initially proposed.

Incentive structure

The performance reserve amounted to 4% of the total budget of programme (*i.e.,* covering the EU share and the national co-financing). The scale of resources available for distribution through the performance reserve fell into three categories (CEC, 2000e):

1. Approximately EUR 1 billion or more: Greece, Spain (Ob. 1), Portugal, Germany (Ob.1) and Italy (Ob. 1).
2. Approximately EUR 100 to 150 million: Spain (Ob. 2), Ireland, Germany (Ob. 2), Italy (Ob. 2), France (both Ob. 1 and 2) and the United Kingdom (both Ob. 1 and 2).
3. Less than EUR 50 million: Denmark, the Netherlands, Belgium, Austria, Finland, Sweden and Luxembourg.

The large variation is due to differences in the dimension of the programmes.

An important dimension of the distribution of the premium concerns the degree of competition in the distribution process. The allocation mechanisms of the performance reserve scheme introduced some competition as programmes were compared within countries and within the same objectives. However, as mentioned above, the European Commission's original plan was to foster a higher degree of competition between programmes by conducting pan-European comparisons. In practice, member states adopted a wide variety of allocation mechanisms with different degrees of competitive pressure placed on programmes to obtain the reserve (see Table 5.2). The result was that within the

Table 5.2. **Mechanisms used by EU member states to assess the EU performance reserve**

Austria	Competition limited to priorities inside each SPD (Ob. 1 and 2).
Belgium	Walloon Region: competition between measures for each SPD. Brussels Region: competition between measures. Flemish Region: competition between SPD.
Denmark	Competition between priorities within Ob. 2 SPD.
Finland	Competition between all SPDs inside each objective.
France	Competition between all Ob. 1 SPD and between the two phasing out regions. Competition between all Ob. 2 SPDs.
Germany	Competition limited to priorities inside each OP for Ob.1 and inside each SPD for Ob. 2.
Greece	Competition between all OPs.
Ireland	Competition between OPs for Ob.1 and between priorities for phasing out regions.
Italy	Competition between all OPs and SPD inside each objective.
Netherlands	Competition between measures for the only SPD for Ob. 1. Competition between SPD s for Ob. 2.
Portugal	Competition between all Ob. 1 programmes. Competition between priorities for Lisbon and Vale do Tejo phasing out regions.
Spain	Competition between all programmes for each objective.
Sweden	Competition between all programmes for each objective.
United Kingdom	England: competition between all programmes for each objective. Scotland and Wales: competition between priorities for SPD Ob. 1, and between OP for Ob. 2. Northern Ireland, Gibraltar: competition between priorities in the transitional OP.

Source: CEC (2000e), "Performance Reserve: Analysis of the Situation in the Member States: Objectives 1 and 2", Synthesis Report, DG Regio Evaluation Unit, December, Brussels.

adopted mechanisms the competitive pressure is often significantly less than what was initially envisioned.

Examination of the performance reserve and its application in the different member states reveals that the instrument was not always applied following the European Commission's intent when it introduced the mechanism. In particular, the reward effect based on a competitive performance assessment was in many cases diluted or eliminated. For example, in France, the instrument became centrally piloted so as to reward all regions.[19] *Pro rata* allocations took place in many countries, probably to avert the potential political risks of disclosing regional performance. Italy was one of the few countries that did aim to promote greater effort through competition and the prospect of an additional reward.

An important factor when establishing an incentive system is to ensure that the premium awarded is proportional to the effort expended to achieve the targets, and that it effectively rewards the "agent" responsible for the positive performance.[20] This requisite was made explicit by the European Commission that recommended there be alignment between the performance achieved and the scale of the allocated reserve (CEC, 2000b; CEC, 2003). As hinted above and further illustrated below, this principle was somewhat obfuscated by the tendency to accept perfunctory compliance with targets, which contributed to

disconnecting the reserve from effective performance. In this context, an additional incentive that might have resulted from a reputation element attached to the achievement of targets disappeared; Italy being an exception.[21]

Costs

The European Commission intended that the performance reserve implementation process be based on data available from existing monitoring systems, and would therefore not bring about additional costs (CEC, 2000b). Indeed most of the data came from monitoring systems established in connection with the Structural Funds programming. However, these monitoring systems were complex architectures that were expensive to run in terms of direct and indirect costs.

In fact, the performance reserve system turned out to be costly, as it entailed significant additional administrative costs in order to manage the scheme. In this respect, member states and regions frequently noted the additional administrative burden the performance reserve represented. Beside the costs of standard activities related to the formalisation of procedures, data analysis, reporting, etc., a series of features resulted in additional costs, mostly in terms of exchange of information. For example, the bargaining process that took place between the Commission and the member states during the performance assessment at the end of 2003 and at the beginning of 2004 may have been cumbersome for both the Commission and the member states.[22] Other sources of indirect costs are discussed below.

Overall, the Commission's expectation that the performance reserve would bring about no extra cost was probably optimistic. Apart from a few "enthusiastic implementers" like Italy (see Box 5.4), many member states perceived the performance reserve mechanism to be an additional burden.

Challenges encountered

Indicator selection

During the implementation of performance reserve, regions often encountered difficulty in defining clear and measurable indicators. At other times the utility of certain indicators was questioned. Financial indicators, in particular, were seen as duplicating the objective of the de-commitment rule. Management indicators were seen as unsophisticated and too easy to achieve. And effectiveness indicators, although useful in principle, were often difficult to assess because the process occurred too early in the programming process. There were also problems with targets being set at generally unchallenging levels.

Several initiatives were undertaken by member states to improve the indicators selection process. In France, the DIACT – the authority in charge of the management of Structural Funds at the central level – intervened to improve the

system of indicators adopted by regional programmes. In connection with the assessment of the 2003 performance reserve, the DIACT asked regional Managing Authorities to revise some of the indicators they had included in the Programme Complements and that they had selected as the indicators for the performance reserve. These were often not quantifiable or relevant *(e.g.,* GDP variation induced by investments in the programme) and had to be substituted. The DIACT also worked to harmonise indicator definitions and secure a common understanding. In other cases, attempts were made to secure a general agreement about indicators and targets in advance. Another solution involved reducing the number of indicators to a core set.

Lack of transparency and flexibility, and complexity of the mechanism

Member states indicated concern regarding the mechanism's lack of flexibility. In some countries, the performance reserve was considered to be an innovative instrument but which also brought about uncertainty as it fixed some rules which risked to being disconnected from local reality. The rules were also viewed as difficult to follow and complex to apply. Overall, the mechanism's complexity was seen as an important drawback.

The European Commission expressed concern about the diversity of methods used for assessing performance and making allocations. It considered that the variety of the methods for assessing performance and allocating the reserve resulted from insufficient clarity about the indicators, targets and assessment mechanisms that had been created by member states at the outset of the process. Indicators and mechanisms should have been agreed upon at an early stage in the programming process, and possibly in a more co-ordinated way across member states (CEC, 2004a).

The fact that the mechanism was implemented in many different ways by member states challenged the objective of transparency of the European Commission. At the EU level, this made it difficult to conduct an overall, comparative assessment of the member states' performance, contrary to what had been initially contemplated.

Perfunctory compliance

In a first approach, it is worth noting that targets set were generally achieved. At the European scale, nearly 80% of Objective 1 programmes (93 in total) received allocations from the reserve, and all Objective 2 programmes received allocations (CEC, 2004a). One could assert that this shows that targets were set realistically and that administrations (or a majority of them) managed to achieve the reserve's objectives; *i.e.,* creating the conditions to enable effective Structural Funds programming and spending. Alternatively, such good performance could be explained by targets set too low.

To strengthen target-setting, the European Commission proposed benchmarking against international experience. This approach could work if targets were set too low as a result of a lack of experience or expertise. However, where target setting was driven by political considerations, or to secure equal access to the premium for all regions and to avoid discrimination, such benchmarking would have limited benefits. This illustrates a significant drawback of the performance reserve: its susceptibility to being formalistically interpreted and applied. Compliance could be followed in purely administrative terms. Such nominal compliance with targets represents a potential source of opportunity costs.

Benefits

The performance reserve may have forwarded its objective to act as an incentive for capacity building in good management practices. It induced regions to ensure that money was spent, that evaluations were carried out (on time), and that monitoring as well as financial control systems were established. It also made the project selection process more transparent.

Another achievement was the mechanism's contribution to enhancing the partnership between the Commission and member states or at least to explore routes of dialogue. The European Commission indeed welcomed the member states' "positive attitude" to the new approach of linking financial allocation to performance (CEC, 2004a). Ultimately, however, the mechanism was not renewed in a compulsory form in the subsequent programming period. However, the member states did learn which areas deserve particular attention to make the implementation of regional development strategies more effective. Hence, even if the appropriate indicators and targets were not always selected, a learning process was triggered and issues were placed on the policy agenda. The realisation that indicators and target setting was often difficult propelled the European Commission to provide clearer guidelines and benchmarks. There is some evidence that this provoked national level spillover effects *(e.g.,* in France, awareness grew about the need to simplify and provide steadier guidance on indicators).

Overall, the most important result achieved by the performance reserve is best appreciated in terms of learning. Even in the case of the most reluctant implementers, the performance reserve raised awareness of factors that play an important role in efficient and effective policy programming like the proper functioning of monitoring systems, and the need for rational and manageable indicator systems with realistic and binding targets.

The way forward

In the 2007-13 programming period, significant changes characterise the way EU cohesion policy is implemented. Procedures were simplified and further decentralised. A new planning framework was proposed in which member states take more responsibility for programme design and management as well as financial control.[23]

This is also the case for monitoring and evaluation. The Commission has proposed a more flexible evaluation framework, aimed at achieving greater strategic use. Between planned *ex ante* and *ex post* evaluations, evaluations are to take place on an "on-going" basis. The links between evaluation and monitoring should be reinforced, as evaluations will be launched on the basis of monitoring information that reveals a departure from *ex ante* goals. This is expected to yield more strategic and needs-driven evaluation activities than the former MTE process constrained by its fixed time plan.

Other changes are notable. First, the new monitoring and evaluation arrangement has a weaker legal basis in the 2007-13 programming period than in 2000-06.[24] This is in response to the member states' observation that the past arrangement was too complex and constraining. While some would interpret this evolution as a loss of EU influence in the field, others would suggest that this paves the way for more open dialogue and partnership between the Commission and member states. Second, the N + 2 rule will be extended over the next programming period in a slightly more flexible approach. In particular, the reference period is extended to three years for member states with GDP below 85% of the EU average.[25] Finally, the performance reserve is not required in the 2007-13 programming period. It is now optional for member states and capped at 3% of initial budgetary resources.[26] Only Poland has considered applying such an approach in connection with Structural Funds programming. Italy has adopted a new performance reserve mechanism for regional policy, financed with national resources (resources (although it covers programmes co-financed with Structural Funds).

Conclusions

At first sight, it seems that the performance reserve brought about some benefits but also added some burden for member states. Although evidence is scattered and varies across member states, a general overview gives the impression that short-term costs may have outweighed benefits. This is suggested, not least, by the fact that a performance reserve mechanism was generally not adopted – even under a different form – in the current programming period. Different explanations can be put forward. First, enforcing such an approach over a constituency as deeply differentiated as the EU is extremely difficult in the absence of strong political backing. Second, member states'

reluctance to discriminate between regions based on their performance was probably under-estimated. Finally, a lack of familiarity with the technicalities of performance-based incentive mechanisms, and a persistent reluctance towards evaluation activities further hampered the performance reserve's implementation.

This assessment reflects a member state perspective, which tends to conceal the wider positive effects of the mechanism. While the performance reserve did not achieve a clear assessment of performance at the EU level, the mechanism's merit was that it triggered important learning effects which took place even in the countries where criticism was often the fiercest. The performance reserve contributed to raising awareness and building national and regional capacity for managing the Structural Funds in particular, and regional policy making in general. The importance of monitoring and evaluation, as well as the need for improving monitoring systems, are principles that are now largely shared and which the performance reserve exercise helped to consolidate. The performance reserve was a learning experience both in selecting indicators and targets, and in linking explicit incentives to indicators. Finally, it should be stressed that the performance reserve is best appreciated in the wider context of the monitoring and evaluation framework of the 2000-06 programming period. Together, the performance reserve and the MTE (and to a lesser extent the de-commitment rule) reinforced one another and contributed to overall learning.

Notes

1. The objectives are defined either geographically or functionally. For example over the 2000-06 programming period, Objective 1 regions are regions with a GDP/capita below 75% of the EU average while Objective 2 regions are regions with industries undergoing decline or in need of structural restructuring, and Objective 3 programmes are destined to combat structural unemployment.
2. See Chapter 3 of Council Regulation 1260/1999.
3. Article 41 of Council Regulation 1260/1999.
4. Article 42 of Council Regulation 1260/1999.
5. Article 43 of Council Regulation 1260/1999.
6. According to Working Paper 8, the MTE should also review the coverage of the effectiveness indicators.
7. For example, France argued that the MTE was carried out too early.
8. Article 31.2 Council Regulation 1260/1999 states that "the Commission shall automatically de-commit any part of a commitment which has not been settled by the payment on account or for which it has not received an acceptable payment application (…) by the end of the second year following the year of commitment (…)".
9. The N + 2 rule was applied at the programme or fund level, not at lower levels such as measures or sub-measures, which opened the possibility to fungibility.

10. Unless otherwise mentioned, much of the evidence used in these sub-sections comes from CEC (2004a), "A Report on the Performance Reserve and Mid-Term Evaluation in Objective 1 and 2 Regions", DG Regional Policy, 27 July, Brussels. Another source of information used is: Polverari, L., J. Bachtler and R. Michie (2003), "Taking Stock of Structural Fund Implementation: Current Challenges and Future Opportunities", IQ-Net Thematic Paper 12(1).
11. See Article 44 of the Council Regulation 1260/1999 established general provisions for the Structural Funds Official Journal L161, 26 June 1999.
12. The scheme did not apply to Community Initiatives or Innovation Actions (under the Structural Funds).
13. According to Working Paper 4, "the projected value attributed to each indicator can be considered to be the performance standard to be attained. If at midterm the value of the performance indicator is equal to this standard, then the level of performance is 100% for the indicator in question. Therefore a programme will be considered successful at mid-term if, for each of the three groups of criteria, the performance indicators attain an agreed value of around 75 % or more of their corresponding standard" (CEC, 2000b).
14. The initial idea about creating a reserve was to allocate it at the EU level, to create some implicit open competition among states and regions.
15. For example, Working Paper 4 insists that institutional specificities (like federal structure) should be taken into consideration when devising the performance reserve scheme at the country level (CEC, 2000b).
16. Two countries extended the EU scheme with a "national" reserve: Italy (proposing to set aside an additional amount of 6% and Portugal, 2.6%).
17. Except the technical assistance programme for France which was not included in the performance reserve exercise from the beginning.
18. Of which the Technical Assistance OP which was excluded in advance.
19. Interestingly, the region which was awarded the minor share of performance reserve was Alsace. Yet, it is a pilot experience in which it is the Regional Council (therefore not a "de-concentrated" service of the state as in the other regions) which is the Managing Authority in charge of Structural Funds distribution.
20. In fact, this is not so independent from the form of the incentive, since a quantitative reward makes it simpler to verify this principle of proportionality.
21. The reputation element resulting from the application of the EU performance reserve probably greatly benefited from the reputation element attached to the national scheme.
22. For example, some member states did not provide complete information to the Commission at the outset of the review period, and this necessitated additional co-ordination efforts.
23. For the 2007-13 programming period, see Council Regulation 1083/2006 of 11 July 2006, which lays out the general provisions for the European Regional Development Fund, the European Social Fund, and the Cohesion Fund, L.210, 31 July 2006.
24. See Articles 47, 48, 49 of Council Regulation 1083/2006.
25. See Section 7 of Council Regulation 1083/2006. This applies to the 12 most recent member states, as well as for Greece and Portugal until 2010.
26. See Article 50 of Council Regulation 1083/2006.

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ANNEX 5.A1

Table 5.A1.1. **Performance reserve indicators adopted by Italy and France**

Criteria and indicators	Description (recommended by EU)	As adopted by Italy	As adopted by France
Effectiveness criteria			
Basket of outputs	Comparison of actual and planned results for some outputs (covering at least half of the value of the programme).	Predefined target for comparing actual/planned outputs for measures covering at least 50% of the value of the programme. At least 80% of the planned outputs are achieved.	Managing Authorities select indicators. Eighty per cent of pre-defined targets reached for a set of output indicators corresponding to at least 50% of the total cost of the programme.
Basket of results	Comparison of actual and planned results for employment (temporary/permanent jobs created or maintained) or employability of target groups.	*Italy did not employ a result indicator. Results were considered too difficult to measure.*	Managing Authorities select indicators. Eighty per cent of pre-defined targets reached for a set of result indicators corresponding to at least 50% of the total cost of the programme.
Management criteria			
Quality of monitoring system	Percentage share of the programme measures (in terms of value) covered by annual financial and monitoring data compared with target.	Introduction of a system of indicators and of monitoring procedures responding to nationally agreed upon standards and guaranteeing the availability of financial, physical and procedural data from January 2001. Transmission of data at specified deadlines (quarterly).	At least 80% of indicators representing 80% of the programme's total budget are monitored.
Quality of financial control	Percentage of expenditure covered by annual financial and management audits compared with target.	Upgrading the control system to the model proposed in the CSF and in conformity with REG.438/99. Controls done on 5% of interventions realised by the end of 2003.	Controls done on 5% of expenditure by the end of 2003.
Quality of project selection systems	Percentage of expenditure committed by projects selected using clearly identified selection criteria or appraised through cost-benefit analysis compared with target.	(Optional) Application of selection procedures based on feasibility studies (60% of funds committed to projects above EUR 5 million), on criteria favouring environmental sustainability (50% in the most sensitive axes) and equal opportunities (30%).	"Quality of project selection" was substituted with a "programming" indicator that accounted for the time needed to process projects. Project applications need to be processed within three months (time respected in 80% of cases).

Table 5.A1.1. **Performance reserve indicators adopted by Italy and France** *(cont.)*

Criteria and indicators	Description (recommended by EU)	As adopted by Italy	As adopted by France
Quality of the evaluation system	Availability of independent intermediate evaluation of acceptable quality (pre-determined quality standards).	Appointment of the independent evaluator by 31 December 2001 and definition of "Terms of References" responding to national standards.	Presentation of a mid-term evaluation report.
		Additional (optional) indicator: Quality of the labour market analysis system Definition by 31 December 2001 of a system of analysis of the most significant aspects of the labour market and employment effects of interventions set up within the Managing Authority; diffusion of results.	
Financial criteria			
Financial absorption	Percentage of expenditure reimbursed or requested receivable in relation to annual commitment (standards: expenditure corresponding to 100% of commitments in first two years).	Attainment by September 2001 of declared expenditure in relation to commitments for 2000 and 2001.	Payment of 100% of commitment for 2000 and 2001.
Leverage effect	Percentage of private sector resources actually provided compared to planned target	*Public-private partnership* Implementation of at least four public-private partnership schemes for the financing of projects by 2002.	Eighty per cent of forecasted spending by private actors effectively realised.

Source: European Commission (n.d.), "Implementation of the Performance Reserve", *The New Programming Period 2000-2006: Methodological Working Papers*, Working Paper 4, issued by Directorate-General XVI Regional Policy and Cohesion, Co-ordination and Evaluation of Operations; DIACT (2006), Note relative à l'attribution de la réserve de performance – programmes Ob. 2 et Ob. 1 soutien transitoire France 2000/06 (Note regarding the allocation of performance reserve – programmes Ob. 2 and Ob. 1 France 2000/2006); Anselmo, I., M. Brezzi, L. Raimondo and F. Utili (2006), "Structural Funds Performance Reserve Mechanism in Italy in 2000-06", Ministry of Economy, Department of Development Policy.

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The Use of Performance Indicators

PART II

Chapter 6

The National Performance Reserve in Italy

Italy is a unique national example of the use of explicit incentives to improve the performance of regional development policy. During the 2000-06 programming period for the EU Structural Funds, Italy extended and reinforced the logic of the EU performance reserve by adopted a national performance reserve aimed at promoting modernisation of the public administration. This chapter takes a look at the implementation of this performance reserve, the associated indicators, and the system currently in place for 2007-13.

Introduction

Italy has been undergoing a profound overhaul of its traditional approach to regional development policy since the 1990s. Changes concern not only underlying principles, but also the policy delivery mechanisms. In particular, the trend towards decentralisation to lower levels of administration has required new ways of co-ordinating a growing number of actors in the field of regional development. In this context, Italy has embraced a result-oriented approach to planning and expenditures in order to improve efficiency and effectiveness. In particular the EU performance reserve mechanism devised for the 2000-06 Structural Funds programming period was viewed as a positive approach to improve the quality of spending. The mechanism involved setting aside 4% of the committed appropriation and distributing it to those programmes that met a series of targets. National policy makers expected a positive impact from the mechanism and therefore chose to complement the EU initiative with a separate national performance reserve. The national reserve set aside an additional 6% of 2000-06 Structural Funds for Objective 1 regions. In combination, the two initiatives were expected to enhance the quality of the programming process and the effectiveness of public investment.

This case study concentrates on the national component of the performance reserve. First, the mechanism is recast in the wider context of regional development policies in Italy. Following a description of the national performance reserve mechanism, an assessment in terms of costs and benefits is proposed. The case concludes with a look at how the performance indicator system will evolve in the current Structural Funds programming period.

Background: regional development policy in Italy

The implementation of the national performance reserve mechanism in Italy is best understood in the broader context of regional development policies. The 1990s saw progressive decentralisation of competence in favour of lower levels of government, seen as the best positioned to mobilise local actors (Viesti and Prota, 2004). Competition and partnership characterise the relations between the different levels of government involved, whose tasks are becoming increasingly differentiated (Brezzi *et al.*, 2008). Actors include:

- the EU, which sets overall objectives and general rules;

- the central government, which interprets and adapts EU objectives and rules to the national context, and monitors implementation and progress;
- regions, which receive most of the funds and are responsible for selecting and funding projects and for monitoring their implementation; and
- local administrations, which bring together local actors and mobilise them around projects.

During the 2000-06 programming period, the programming document provided guidelines for regional development policies in the less favoured southern Italian regions. The Community Support Framework (CSF) for Objective 1 regions funded by the EU Structural Funds (and its precursor the Development Programme for the "Mezzogiorno") was grounded in the hypothesis that development could be spurred by exploiting under-utilised local resources, and by inducing positive expectations and self-fulfilling realisations. The strategy was also based on the assumption that lower levels of government are best positioned to mobilise local actors who are seen as possessing the knowledge necessary for deciding and implementing policy initiatives. At the same time, such dispersion of knowledge necessitates a high degree of vertical and horizontal co-operation, involving both private and public actors.

The national performance reserve mechanism was developed against this backdrop. Inspired by the EU performance based incentive scheme introduced during the 2000-06 programming period, it was part of the wider system of monitoring and evaluation of Structural Funds.[1] The objective of the EU performance reserve mechanism was to ensure better programme management and effective spending. The Italian mechanism went a step further and reinforced and extended the EU performance reserve logic by promoting public administration modernisation, as well as completion of framework legislation at the regional level in various fields. In both cases, the mechanisms involved setting aside a reserve of a programme's budget and distributing it only if specific objectives were achieved. While the EU reserve amounted to 4% of a programme's budget, the national reserve was an additional 6% of a programme's budget. Also, whereas the EU performance reserve applied to all Structural Funds programmes (*i.e.,* under Objectives 1, 2 and 3), the national performance reserve applied only to Operational Programmes (OPs) under the CSF Objective 1 regions. Seven regions in the southern part of Italy were the recipients of EU Structural Funds for Objective 1 regions in 2000-06. This translated into seven regional OPs and seven national OPs.[2]

In general terms, the Structural Funds 2000-06 programming period made a significant contribution toward promoting performance measurement in Italy. Very little performance management had been experimented prior to the performance reserve introduction in 1999/2000. Then during the 2000-06 period, regulatory requirements contained in the Structural Funds regulation imposed

mechanisms such as the de-commitment rule, the EU performance reserve and the mid-term evaluation process, all aimed at assessing different aspects of programme performance.[3] In this context, Italy also chose to implement the national performance reserve (which extended the EU mechanism of an explicit financial reward for performance) and two other initiatives with "softer" use of performance indicators, referred to as "context indicators" and "breakthrough variables".[4] "Softer" use did not imply explicit financial rewards.

The Italian national performance reserve

The Italian national performance reserve was designed to bring about lasting effects on regional governance. Its specific objectives were to:

1. Foster institutional enhancement through the modernisation of public administration and the diffusion of institutional innovation necessary to accelerate and make effective Structural Funds spending decisions.
2. Promote and anticipate reforms in some of the sectors crucial for achieving the CSF development objectives.
3. Balance the constraints to rapid Structural Funds spending implicit in the de-commitment rule,[5] by creating incentives to select and organise more complex and higher quality projects.

The national performance reserve's objectives went beyond the strict implementation of Structural Funds. It aimed to improve the administration's capacity to enact reforms and simplification, implement administrative and organisational structures and processes (capacity building) necessary to increase project quality, and to improve administrative capacity to concentrate resources on a limited number of objectives. Key actors involved in the national performance reserve implementation included the Department for Development Policies (DPS) at the Ministry of the Economy, the Evaluation Unit within the DPS (UVAL), and regional Managing Authorities.

Categories of performance indicators

The national performance reserve monitored a total of 12 indicators grouped into three categories, corresponding to the reserve's three objectives. The indicators aimed to capture intermediate objectives associated with improved public administration effectiveness and better public spending quality. The three categories were: institutional enhancement, integration and concentration.

- **Institutional enhancement:** Ten indicators, divided into two categories, were applied at the regional level to evaluate the different aspects of institutional enhancement. One category included indicators to measure the ability to enact reform and simplify public administration, and support CSF strategy implementation. A second category was focused on implementing

administrative and organisational procedures expected to accelerate and improve spending efficiency. A final category was associated with implementing sector reforms. In the category of institutional enhancement, four indicators involving the central government were adopted (they correspond to the indicators A.1, A.2, A.3 and A.4 in Table 6.1).

- **Integration:** The integration category included just one indicator applied to regional administrations, which referred to territorial integration of projects. The indicator concerned the importance of "Integrated Territorial Projects". The central government had one indicator to account for in this category, reflecting the integration between national and regional strategies through the realisation of negotiated agreement between different levels of administration.
- **Concentration:** The last category also comprised only one indicator, corresponding to the concentration of financial resources. The selected indicator accounted for an Operational Programme's (OP) capacity to concentrate financial resources on a limited number of measures applied only at the regional level. The central government had no indicator applying in this category.

Overall, 12 indicators applied to regions (Table 6.1) and five to the central government. A system of weights was adopted to determine each indicator's relative importance in the measurement of the overall performance on which the financial reward depended. "Institutional enhancement" (ten indicators) represented 58% of the total, "integration" (one indicator) 25%, and "concentration" (one indicator) 17%.

The indicators were selected through negotiations between the central and regional Managing Authorities of the programmes subject to the national performance reserve. This was done to guarantee transparency and ensure a common understanding of the indicator definition. The selection process lasted from the second half of 1999 to April 2001 and involved different institutional actors, with the DPS being the principal co-ordinating party. Within the DPS, the evaluation unit (UVAL) drafted a proposal for indicators and allocation mechanisms. UVAL negotiated with the regions (their respective Managing Authorities), as well as with different ministries (whose knowledge of specific indicators was useful[6]).Various panels of discussions involved institutional partners, stakeholders and experts in an intense institutional and social partnership. Even the weighting scheme for the indicators was decided in collaboration with the interested administrations. In particular, regions advocated that the weight of institutional enhancement variables be increased from around 33% in the initial proposal by UVAL to slightly less than 60% testifying to the priority placed by regions on capacity building (UVAL, 2006). The EC was also kept informed throughout the process, but was only involved

Table 6.1. **Indicators and targets for regions under the Italian national performance reserve**

Criteria	Indicator	Target	Points
A. Institutional enhancement			35
Implementation of national legislation fostering the process of public administration reform	A.1. Delegation of managerial responsibilities to officials (legislative decree No. 29/93)	Adoption of the decree 29/93 and managers' evaluation for the year 2002	3.5
	A.2. Set up and implementation of an internal control management unit (legislative decree No. 286/99)	Set up and proof of activity of the internal control management unit	3.5
	A.3. Set up of regional and central administration evaluation units (L. 144/99)	Set up of the evaluation unit by April 2001, appointment of the director and experts by July 2001	3.5
Design and implementation of organisational and administrative innovation to accelerate and carry out effective Structural Funds spending	A.4. Development of the information society in the public administration	Transmission of data regarding at least 60% of total expenditure	3.5
	A.5. Implementation of one-stop shops	At least 80% of the regional population covered by the one-stop shops and at least 90% of papers processed on time	3.5
	A.6. Implementation of public employment services	At least 50% of the regional population covered by employment offices	3.5
Carrying out measures aimed at the implementation of sector reforms	A.7. Preparation and approval of territorial and landscape programming documents	Meet regional benchmarks of territorial landscape programming	3.5
	A.8. Concession or management by a private-public operator of integrated water services (L. 36/94)	Approval of the concession or management by a private-public operator of integrated water services	3.5
	A.9. Implementation for urban solid waste within optimal service areas	Choice of management mode and its implementation within optimal service areas	3.5
	A.10. Set up and operational performance of regional environmental agencies	Appointment of the director of the agency and approval of management rules, allocation of resources and personnel	3.5
B. Integration			15
Implementation of territorial integrated projects	B.1. Incidence of commitments of integrated territorial projects on the total amount of resources budgeted for integrated territorial projects in the operational programme	Incidence of commitments and disbursements of integrated territorial projects on the total amount of resources budgeted for integrated territorial projects in the operational programme higher than the average over all the regions	15
C. Concentration			10
Concentration of financial resources	C.3. Concentration of financial resources within a limited number of measures	Concentration of financial resources within a lower amount of measures than the average over all the regions	10
Total (A + B + C)	Number of indicators: 12		60

Sources: UVAL (2006), "Il sistema di premialità dei Fondi Strutturali 2000-06 – Riserva Comunitaria del 4%, riserva nazionale del 6%" (Structural Funds 4% and National 6% Performance Reserve), *Materiali UVAL*, No. 9; Brezzi, M., L. Raimondo and F. Utili (2008), "Using Performance Measurement and Competition to Make Administrations Accountable: The Italian Case", in P. de Lancer Julnes *et al.* (eds.) (2007), *International Handbook of Practice-based Performance Management*, Sage Publications, Inc.

when the Italian authorities submitted documentation with the indicators and rules, which were then approved as part of the Community Support Framework. The programme started officially in August 2000.

Target setting and assessment mechanisms

The targets associated with indicators in the "institutional enhancement" category consisted of standards set in advance, and were identical for all the regions. This was considered to be appropriate for indicators for which the path to reach the objectives was relatively clear, and the achievement criteria were uncontroversial and easily agreed upon by all regions, irrespective of a region's starting point. Besides being easier to measure, this had the advantage of enabling comparability.

For the two integration and concentration indicators the thresholds for achieving the targets were set at the end of the reference period by averaging the performance of the participating programmes. This introduced an element of competition between the programmes. The competitive pressure of comparative performance measurement on these two indicators represented 40% of the region's potential award. The use of this mechanism was in part due to the difficulty of agreeing *ex ante* about realistic targets, but also to introduce an element of competition to discourage collusion between regions. As noted below, competition was also introduced by the fact that reserve funds that were not allocated to under-performing regions were redistributed to better performers, who were thus able to gain more than their initial potential allocation.

A technical group of experts was set up to monitor the national performance reserve, comprised of two UVAL representatives, two regional evaluation unit representatives, and chaired by a UVAL delegate. A strong emphasis was placed on monitoring. Periodic reports were prepared by Managing Authorities, approved by Programme Monitoring Committees, and submitted to the Technical Group. The group delivered annual reports to the CSF Managing Authority and Monitoring Committee for each year. The Technical Group played an important role in ensuring that realistic indicators and targets were adopted, monitoring progress made, and difficulties that emerged were dealt with during the course of the reserve's implementation. It was also responsible for disseminating regional performance results to a wide audience of social partners and to the public at large. As such, the Technical Group contributed greatly to strengthening the mechanism's overall transparency.

The assessment was made on the basis of performance results achieved by September 2002. Administrations had therefore approximately two years to reach their targets.

Form, level and allocation of incentives

The national performance reserve amounted to 6% of the Structural Funds programme budget (*i.e.,* the EU and the national shares ["co-financing"] taken together). For Objective 1 regions, this represented EUR 2.6 billion. Allocation was flexible, in that a programme's performance reserve allocation would be a function of the number of targets achieved by September 2002. This provided a strong incentive for the lower performing administrations to reach at least some targets in order to obtain a part of the reserve. At this stage, some of the reserve was not allocated because administrations had not achieved certain targets. Fifty per cent of the unallocated portion was redistributed to better performing administrations.

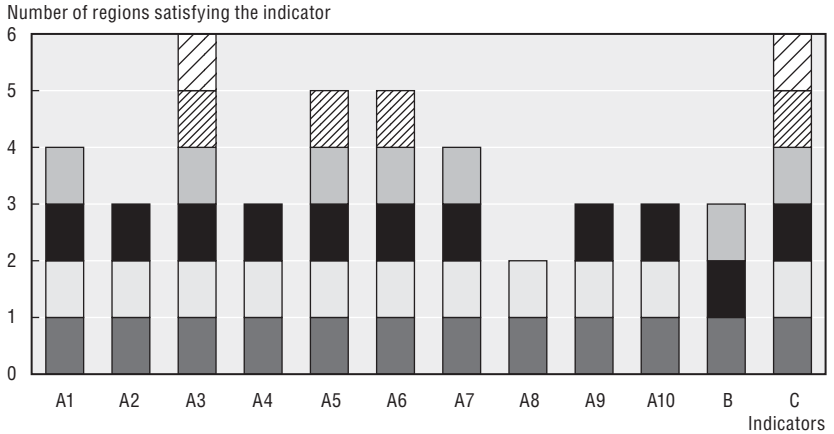
A second distribution of allocations was permitted by the Monitoring Committee. The period for assessing performance was extended to September 2003 using a limited number of indicators and 25% of the amount not allocated during the first phase was subsequently distributed. The objective was to reward the administrations that had made considerable efforts, even though in many cases they had not reached their targets. Hence, on the occasion of the distribution of this second round, indirect competition was (again) introduced between administrations. The remaining 25% of the unallocated portion was allocated in 2004 and linked to the results associated with the EU performance reserve.

Overall, the total resources allocated in the two rounds was EUR 911 million, of which only EUR 8 million were not allocated due to unachieved targets (UVAL, 2006).[7]

Results

Together, administrations involved in the national performance reserve achieved around 60% of total targets by the first deadline in September 2002. This general figure concealed quite differentiated regional performance as illustrated in Figure 6.1. Overall, one region, Basilicata, received almost 140% of its initial endowment, three regions (Campania, Sicilia and Puglia) got between 79-98% of the reserve while two regions (Sardinia and Calabria) earned around 40%. It is interesting to see that all regions satisfied at least one indicator.

Figure 6.1. **National performance reserve indicators achieved by regions as of September 2002**



Source: Barca, F., M. Brezzi, F. Terribile and F. Utili (2004), "Measuring for Decision-making: Soft and Hard Use of Indicators in Regional Development Policies", *Materiali UVAL*, No. 2, November-December.

Table 6.2. **Distribution of the national performance reserve**

Operational Programme	EU co-financing	Per cent resource total CSF (%)	Maximum 6% performance reserve (EUR million)	Actual performance reserve distributed (EUR million)
Basilicata	742 778	3.46	45 480	69 887
Calabria	1 994 246	9.29	122 106	79 357
Campania	3 824 933	17.83	234 198	272 523
Puglia	2 639 488	12.30	161 614	174 924
Sardegna	1 946 229	9.07	119 166	79 884
Sicilia	3 857 946	17.98	236 219	234 234
Research	1 191 485	5.55	72 718	60 592
School	472 558	2.20	28 841	30 426
Security	573 108	2.67	34 978	29 076
Local development	1 978 939	9.22	120 778	170 350
Transport	1 801 313	8.39	109 937	61 949
Fishing	122 000	0.57	7 446	4 814
Technical assistance	312 428	1.46	19 068	44 533
Total CSF	21 457 451	100.00	1 312 549	1 312 549

Source: Formez (2007), Mappatura Esperienze premiali 4%-6% – FAS Regioni Mezzogiorno (Mapping 4% and 6% Performance Reserve Experiences – Southern Italian Regions).

Assessment

Relations between levels of government

The implementation of the national performance reserve in Italy gave rise to intense vertical co-ordination between levels of government, involving regions and the central government. This close co-operation developed mostly around defining indicators and targets, and to a lesser degree around defining the assessment and allocation mechanisms of the premium.

The involvement of stakeholders in participatory mechanisms is one way to obtain the information necessary to define indicators closely associated with objectives and reflecting imputable phenomena as well as to set targets at appropriate levels. This is because information is incomplete, scattered among different levels of government and stakeholders, and tends to be revealed during policy implementation. Negotiations between the central government and the regions were a way to "reveal" the knowledge necessary to establish a useful system of indicators and targets (Barca *et al.*, 2004). The issue at stake was to identify common indicators and targets that could suit all the regions, not a simple task as the Objective 1 area is fairly differentiated, and some regions were more advantaged at the outset.

There is much evidence illustrating the co-operation between the central government and regions. For example, negotiation of the list of indicators and associated weights proposed by UVAL eventually yielded an increase in the weight of the institutional enhancement indicators, a priority for the regions who saw how this work had specific strategic importance. Also, for some specific indicators, negotiations regarding data collection and target selection were particularly intense (Brezzi *et al.*, 2008).

Once indicators and targets were selected, vertical co-ordination with regions continued during the implementation phase. One element that helped sustain momentum of the partnership was the bi-annual publication of monitoring reports prepared by the regions and submitted to the Technical Group. The Technical Group's reports were a platform for dialogue and helped to ensure a common understanding and avoid misinterpretations of the trends recorded.

Much co-ordination also took place within the administrations concerned. At the central level, the Head of the Department for Development Policies took the initiative to spread information and raise awareness of the performance reserve, helping to create consensus around the endeavour. However, horizontal co-ordination with other institutional partners proved more difficult than vertical co-ordination. Invoking the importance of the role of the EU and the possibility of a sanction were used to facilitate co-ordination efforts. At the regional level, the implementation of the national performance reserve

(concomitant with that of the EU performance reserve) often triggered mobilisation of stakeholders within the regional administrations.

Overall, decision making was consensual. The indicator selection and target setting proved to be ambitious but realistic, mainly thanks to the partnership at work during the definition phase. The allocation mechanisms also proved to be one of the factors that accounted for the successful implementation of the reserve.

Incentive structure

The national performance reserve is one example of a performance indicator system associated with a clear and explicit monetary reward and as such can be considered a "high powered incentive scheme". However, one should not neglect the important (if not decisive) reputation component of the reward that usefully complemented the monetary incentive.

The central government followed an explicit strategy to increase the visibility of the performance reserve. Besides contributing to transparency and accountability, the publication and diffusion of the results were meant to trigger a "reputation" effect. The Technical Group diffused the results to a large audience made of stakeholders and social partners, and beyond, to the public at large. Results were presented in standardised format, allowing for straightforward comparisons across regions. Thus, the monitoring and assessment activity of the Technical Group had a media and political impact which reinforced the "naming and shaming" exercise that the group was performing initially only internally. In a context where regional policy makers are directly elected, the media impact was meant to hold the political sphere accountable and reinforce the overall incentive logic of the mechanism. Both elected policy makers, and administrative personnel were placed under public scrutiny, and held responsible if, for example their home region was performing badly compared to neighbouring regions. Yet, Barca *et al.* (2005) concluded that communication to the public and the mass media coverage was insufficient and therefore, the impact on accountability was "inadequate".

Interestingly, the reputation component of the incentive mechanism seems to be closely related to its pecuniary aspect. Perhaps without the financial incentive, or with a lower financial incentive, media attention would not have been so high. The fact that one region was badly performing and that this could have translated into a loss of revenue were two reinforcing factors that increased the pressure on politicians and bureaucrats. Overall, the incentive's reputation component had an intrinsic competitive pressure that triggered peer review and benchmarking between regions on the basis of which learning could take place.

Also of interest is the "spill over" dimension of the reputation effect: the objective of not being among the failing regions, in turn, gave officials at the regional level considerable leverage on regional staff to perform better.

Costs

Costs incurred when setting up a performance indicator system cover both direct and indirect costs. While the former are in principle easy to quantify, the latter can be identified but not directly quantified.

Direct costs

Staff cost. Disentangling the specific direct costs related to running the national performance reserve from the costs associated with the implementation of the EU performance reserve is difficult, in particular at the regional level. This is especially true of staff costs. Staff costs remained limited at the regional level (generally involving one to two dedicated civil servants mobilised occasionally when reports had to be sent to the Technical Group around twice a year). At the central level, human resources were also limited, but staff dedicated to establishing and running the national performance reserve was more clearly identifiable. Between 2000 and 2003, there were approximately five people working full time on the national performance reserve scheme. This compares with 25-30 UVAL employees. The follow-up mechanisms put in place after 2003, the so called "monitoring consolidation system", required one part-time person. In addition, the Technical Group mobilised four people (two UVAL representatives, and two regional evaluation unit representatives) over three years.

Data collection costs. The national performance reserve did not incur many data collection costs as it was mostly based on qualitative and procedural indicators *(e.g.,* was a regulatory provision adopted, yes/no), which did not require expensive specific technical solutions. In addition, the institutional enhancement indicators of the national performance reserve, for example, were transmitted by the regions to UVAL electronically.

One aspect of data collection costs is data entry. Monitoring of Structural Funds required data entry into a common database, which was then linked to monitoring for the performance reserve. In principle, it is possible to distribute responsibility for data entry among different participants at different levels of government. In most regions, data entry for the EU Structural Funds was mostly conducted by the "Responsibles of Measures" in charge of the management of one specific measure within the Operational Programme. Although it was initially contemplated that the weight of monitoring would shift towards final beneficiaries, "Responsibles of Measures" continued to be responsible for

Structural Fund data entry. Italian performance reserve data were not collected locally.

Another cost related to data collection had to do with data validation. Here again, direct costs incurred were negligible. Regional authorities were responsible for data validation. The process relied on a "self certification" process whereby regions were held responsible for the validity of the data provided. This was linked to the qualitative nature of the indicators used.

At the central level the performance reserve mechanisms did not entail any specific data collection costs. However, the central level was responsible for data assessment. Because automatic decisions were not taken on the basis of perfectly objective data, applying the national performance reserve required careful interpretation of the information received from regions done on a case-by-case basis. For example, it was necessary to determine if the different approaches taken by different regions to reach an objective could be considered equivalent and thus accepted. On some occasions this required specific competences and thus represented a cost in terms of expert staff time.

Indirect costs. Indirect costs associated with establishing and running a national performance reserve mechanism are administrative burden, co-ordination costs, opportunity costs, inefficient information management, and unintended negative consequences.

There appeared to be little additional burden associated with running the national performance reserve, perhaps due to the simplicity of the data collection and reporting processes at regional level. At the central level, the time spent on developing and running the performance indicator system was considered part of the ordinary activity of UVAL.

Another possible drawback of mechanisms such as the national performance reserve is that they can yield perfunctory compliance; *i.e.,* targets are reached but without representing real improvements in the organisation. This can occur if targets are set too conservatively or as a result of the objective (*i.e.,* intermediate process indicators). For example, it is clear that reaching the objectives such as establishing Regional Environmental Agencies or Regional Evaluation Units, as the national performance reserve contributed to achieve, is not equivalent to having such entities operating effectively (even though precautions were taken to include conditions of operability in the assessment criteria). The fact that the regional allocations (see above) of the reserve followed uneven patterns in identifying clear winners and losers suggests that targets have been to some extent "stretching", and that they did correspond to effective performance.

There is little evidence of distorted effects resulting from the implementation of the national performance reserve such as a misallocation of

resources or inappropriate policy decisions taken on the basis of misleading information. However, there is some scattered evidence regarding concealment of under-performance (*e.g.*, one region admitted it failed to reach one target, whereas other regions stretched the interpretation of the admissibility criteria and purported to have met the condition).[8]

Challenges encountered

The national performance reserve had "weaknesses" that risked endangering its eventual success. One was insufficient preparation of regional and sub-regional personnel, and insufficient administrative capabilities at the regional level. In some regions insufficient initial assessment of a region's ability to reach the targets (set in co-operation with the central government and other regions) was due to a missing link between technical and political competence, making the collection of relevant data and especially the achievement of the targets difficult or impossible. Other potential risks included potential polarisation of human resources and resistance of the sub-regional level to innovative organisational models (Formez, 2007).

The mechanism required regulatory changes that involved political decision making, rather than simple administrative management. Successful performance thus depended on political actions that were not always under the control of the authority in charge (*e.g.*, adoption of laws by the Regional Assembly). Although this could have spurred co-operation between political and administrative competence, it might have penalised local administrations in terms of speed of adaptation.

More generally, the correct implementation of the national performance reserve might have suffered from the difficulties establishing the causal chain of imputable effects. It is indeed important that indicators – and their evolution – can be attributed to the initiatives of decision makers in charge so that they can be held accountable. Although the national performance reserve did better in this field than other performance indicator systems at work in Italy at the time,[9] some indicators were less clearly linked to the implementation of the programme than others. For example institutional enhancement indicators such as delegation of managerial responsibilities and establishing managerial control units were only loosely related to policy implementation.

Also, the system of indicators has been said to contain too many and differing indicators in the institutional enhancement category. In addition, some quantitative indicators were considered to be difficult to use in order to account for essentially qualitative elements (*e.g.*, integration).

Mechanisms to reduce risks and costs

Several factors contributed to minimise the potential risks in implementing the national performance reserve. At least three features that are part of the original design of the mechanism reinforced the incentive effect of the scheme and its credibility. Each of them responds to one specific possible drawback but it is their combination which increased the mechanism's overall effectiveness.

Setting targets

The way in which targets were set contributed to identifying values that were both realistic and binding. Targets can in principle be set either in absolute or relative terms. As explained previously, the Italian national performance reserve opted for a mix of these two options. While targets for the administrative enhancement indicators were set in absolute terms, the two last indicators were subject to targets defined on the basis of the average level reached.

The decision to adopt absolute targets for the administrative enhancement indicators was discussed on the grounds that it could possibly disadvantage regions starting from lower levels. However, minimum service thresholds were relatively uncontroversial (such as with the Public Employment Service example). Also, absolute targets served the more political objective of securing a share of the reserve for the largest number of regions possible (see below). Defining the targets for the two integration and concentration indicators in relative terms introduced an element of competition between regions. This competitive pressure was useful to secure the commitment of the actors party to the contract, to promote peer review, and to avoid collusion. In addition, the use of relative performance was used as a way to "filter uncertainty" (see Brezzi *et al.*, 2008).

Allocation design

The allocation process was also designed in a way which helped to keep some of the risks associated with the mechanism under control and enabled its successful enforcement. In particular, the allocation process contributed to mitigating the political risk of revealing regional performance. This was done mostly thanks to the degree of flexibility in the allocation mechanism, allowing a region to earn a share of the reserve allocation based on the number of indicator targets met. This principle of proportionality acted as an incentive for the less performing regions to be engaged so they could gain access to at least part of the reserve. In addition, a second distribution was introduced to distribute the sums that were unassigned after the first round, and reward those regions which appeared to have deployed particularly intense effort and made significant progress. The decision to add a second round of distributions was agreed upon by participants during the first year of

implementation after determining that the time frame had been too short for some indicators to be achieved.

While the national performance reserve gave all regions a chance to access their reserve or part of it, it also introduced real competition between regions, directly by setting some targets in relative terms, and indirectly, on the occasion of the distribution of the second round of the reserve. This competitive pressure coupled with the incentive aspect of the mechanism and under the supervision of third authoritative party, enhanced peer review and avoided collusion between regions that could have agreed together not to "play the game". Hence, despite the high degree of differentiation between regional performance, and the quasi-competition introduced between them, there was actually no rejection of the mechanisms adopted or indicators chosen. Nor was there collusion between the participating regions in advocating for lower targets, or attempts by the regions to "corrupt" the central government (Brezzi *et al.*, 2008). Competition and peer control among participants proved an important aspect of system effectiveness.

Technical Group

Setting up a Technical Group was decisive in securing the overall credibility of the mechanism. The Technical Group played an important role in ensuring that realistic indicators and targets were adopted and that this was done in a transparent way. The role of the Technical Group also proved to be decisive in dealing with problems connected to the definition and interpretation of indicators and targets. Fundamentally, the Technical Group enabled an uncontroversial performance assessment. Its character as a third and impartial party made the final decision about reserve allocations definitive and accepted by regions without renegotiation or rejection. Overall, with this transparency there was trust in the decisions of the Technical Group, such that sanctions and rewards were accepted – one of the mechanism's major strengths (Barca *et al.*, 2004).

Benefits

The national performance reserve contributed to the attainment of many specific objectives.[10] It facilitated the establishment of bodies that improved regional governance *(e.g.,* environment agencies or one-stop-shops). It mobilised local administrations' objectives, reforms or strategies already on the regional agenda, moving them beyond the stage of being partially formulated, to implemented and fulfilled (for example the objective of instituting evaluation units, or enacting environmental strategies). It also mobilised local administrations on objectives, reforms or strategies particularly pertinent to Structural Funds implementation.

The question remains as to whether these results are to be attributed *only* to the initial stimulus given by the national performance reserve mechanism. Some would argue that objectives endorsed by the performance reserve *had* to be reached to enable further policy implementation (for example the Regional Environment Agency had to be created in order to receive funding). But even so, it is difficult to deny the performance reserve its role as a catalyst.

Beyond these first order effects, wider impacts can be attributed to the reserve. First, it produced a heightened awareness of the need for certain skills and competences among the administrative staff. Second, it contributed to improve transparency and accountability, which are now explicit regional policy-making objectives. Third, it fostered relations among levels of governments, defining and consolidating channels of dialogue between the central government and regions. Finally, the national performance reserve also had positive impacts on monitoring.[11] The Department for Development Policies has implemented a monitoring system ("Information system on the strengthening of results from performance reserves") to follow progress made by the administrations after the official closure of the national performance reserve mechanism. The same indicators are monitored,[12] but a closer examination is also given to additional qualitative elements *(e.g.,* how operationally effective is a development agency). Three years later, it appeared that these Administrations generally continued their effort towards the objectives set through the national performance reserve indicators (Formez, 2007).

In addition, regions appear to have endorsed the objective of implementing incentive mechanisms. For example, all regions benefiting from the national FAS (Fund for Underutilised Areas) availed themselves of the FAS reserve to implement a sub-regional indicator-based incentive mechanisms discussed and designed in partnership with UVAL and local entities.[13] All regions adopted indicators reflecting the objective of promoting capacity building, and proposed related incentive mechanisms. Five of them also included indicators dealing with project quality. Thus, six regions which had experience with the national performance reserve formally introduced sub-regional incentive mechanisms (Ministero dell'Economia e delle Finanze, 2004a; Ministero dello Sviluppo Economico, 2007a).

Overall, the hypothesis is that the mechanism has contributed to shifting some planning capability to regions. As a consequence, managing and implementing functions could be further devolved to lower administrative levels.

2007-13: A new indicator system

With the end of the 2000-06 programming period, the performance reserve mechanisms (both the national and the EU approaches) came to an end. The

decision to prolong the experience under the new programming period in 2007-13 was left to the Italian authorities as the Commission suspended the compulsory requirement at the EU level. Italy decided to adopt a scheme under the new programming period, but one largely different from its predecessor. Once the gains of the previous mechanism had been secured, it is as though there was no more need to replicate an experience that yielded the expected benefits.

Following the end of the EU performance reserve experience, the Italian authorities adopted a new performance reserve system for 2007-13 with distinctively new contours. The new approach draws on lessons from the previous experience, such as focusing on a more limited number of objectives to obtain greater visibility and adopting final objectives that are easily understandable by the public to avoid formal compliance and strengthen the accountability of local administrations. The major difference between the former and the current systems lies in the transition from a performance assessment of process and output indicators to one based on outcome and equity indicators. Rather than integrating incremental changes into the previous system, the new system represents a step change (Ministero dell'Economia e delle Finanze, 2005).

The mechanism is enclosed within the National Strategic Framework, the document that provides the basis for implementing Italian regional policies (both national and European Structural Funds) for the period 2007-13. The system of indicators focuses on a set of objectives considered to be strategic for regional development. Four "essential" collective services have been identified, which are decisive in determining a citizens' quality of life and business' propensity to invest. These services, with their associated strategic goal are listed in Table 6.3.

Eleven quantifiable indicators are associated with the four strategic goals. They are all outcome or equity indicators except one that is an output indicator (concerning child care). Targets have been set for the eight regions of the Mezzogiorno and the Ministry of Public Education. The minimum achievement levels are the same for the eight regions as they are considered to be the minimum acceptable service standards. The total amount of the reserve is around EUR 3 billion. Two deadlines exist, one in 2009 to compare progress with the baseline and the other in 2013 to assess if the minimal thresholds have been reached. As in the past, the objectives, indicators and targets have been selected on the basis of in-depth consultations between the central government and the regions and the involvement of a technical group (Ministero dello Sviluppo Economico, 2007c).

The main difference between the past and present mechanism is that objectives are no longer intermediate ones *(e.g.,* to monitor the institutional set up) but rather correspond to final outcomes (delivery of final services). The

Table 6.3. **Objectives, indicators, and targets in the new performance reserve for 2007-13**

Objective	Indicator	Baseline (%)	Target in 2013 (%)
Education: Improve students' competence, reduce drop-outs and broaden population's learning opportunities.	% of early school leavers	26	10
	% of students with poor competencies in reading	35	20
	% of students with poor competencies in math	48	21
Child and elderly care: Increase the availability of child and elderly care to favour women's participation in the labour market.	% of municipalities with child care services	21	35
	%. of children (age 0-3) in child care	4	12
	% of elderly people beneficiary of home assistance	1.66	33.5
Urban waste management: Protect and improve the quality of the environment, in relation to urban waste management.	Amount of urban waste disposed in refuse tip	395 kg per capita	230 kg per capita
	% of recycled urban waste	9	40
	% of composted waste	3	20
Water service: Protect and improve the quality of the environment, in relation to integrated water service.	% of water distributed	63	75
	% of population served by waste water treatment plants	56	64

Source: Ministero dello Sviluppo Economico, Dipartimento per le Politiche di Sviluppo (Ministry for Economic Development, Department for Development Policies) (n.d.), "Measurable Objectives for Essential Services", accessed October 2008, *www.dps.tesoro.it/obiettivi_servizio/eng/ml.asp*.

explicit consideration of final objectives is considered to be an improvement with respect to the previous performance reserve. This is expected to focus attention on results in public services provision and quality essential for development. In addition, the achievement of these objectives is subject to good interactions taking place between several institutional actors. The attempt is therefore being made to explicitly and more thoroughly involve the different stakeholders concerned and assess collective performance. Regions are left free to choose how best to reach the targets. They must adopt an action plan detailing their adopted strategy.

Data collection costs will change under the new system. The number of indicators is approximately the same as under the previous mechanism. While the intention is that data will come from official sources, all the indicator data are not currently available at the regional level. Two indicators will require *ad hoc* data collection arrangements. An agreement with the National Statistical Office has been established to produce statistical information at the regional level for the indicators on water and child care. In order to obtain regional data more quickly, the Ministry of Economy will compensate the National Statistics Office for these changes, but the figure has not yet been determined. In addition, regions participating in the incentive mechanism are asked to contribute financially in

order to produce information at the regional level for the OECD – PISA survey on the competencies of students.

Conclusions

Direct costs related to establishing and running the national performance reserve were limited at both the regional and central levels. Vertical and horizontal "co-ordination costs" were the most important non-monetary costs. Some unintended negative consequences emerged but some devices were built into the design of the mechanism such as a careful balance between competition and incentive, which offset the inherent political risk inherent to distributing premiums to regions.

Beyond the technicalities of the mechanism, what appears to have been decisive is whether local authorities effectively appropriated or *owned* the approach. Monetary incentives alone were probably not sufficient to foster this sense of ownership. The reputation effect of ranking and comparing regions seemed to have been a decisive complement in mobilising stakeholders. Participatory mechanisms helped to secure ownership by local authorities. These mechanisms were important not only in their external dimension (vertical interactions between different levels of government or horizontal co-operation with other institutional partners) but also internally, as a means to overcome resistance, foster a collaborative approach and trigger learning within the local administrations.

In examining benefits, the analysis suggests that the national performance reserve generally achieved the objective it set to improve regional administrative capacity. This is apparent through the series of specific objectives it reached (setting up institutions and adopting legal dispositions decisive for the quality of governance at the regional level). These are intermediate objectives that do not guarantee that once a reform is enacted or a law is passed, an effective change will take place that will outlast the incentive effect of the mechanism. Nor is it clear that the achievement of these intermediate objectives has led to an improvement in regional economic development. However, there is evidence that the reserve brought about wider indirect and favourable impacts on policy learning and policy governance. The protracted effort of regional administrations to reach targets which were not initially met by the official deadline as well as the adoption of incentive-based performance indicator systems are examples. Also the capacity of the reserve to involve different administrative levels, and the peer review and benchmarking triggered by the mechanism on the basis of which learning could take place are further evidence of the possibly long-term effects of the national performance reserve.

Notes

1. The evaluation arrangement comprises the Mid-Term Evaluation and its update (to re-assess the relevance of the strategy decided at the beginning of the period, to raise awareness on the need of evaluation activities, and invest efforts in the rationalisation of the indicator system), as well as other devices like the de-commitment rule (N + 2 rule) when funds are de-committed after two years if they have not been spent.
2. Programmes in Objective 1 regions received more than 70% of the total Structural Funds.
3. See Footnote 1 and the case study on the EU in this report.
4. The context indicators were set of approximately 56 indicators used to describe southern Italy's socio-economic situation. The breakthrough variables were 13 closely monitored indicators identified as variables capable of both directing strategic policy choice and registering the effects of the programmes (Ministero dell'Economia e delle Finanze, 2003; Barca *et al.*, 2004).
5. See Footnote 1.
6. In particular, the Ministry of Labour, Department for Public Administration, and the Ministry for Cultural Heritage respectively participated in the selection of targets, and the monitoring for progress of the following indicators: one-stop-shop employment services and territorial programming.
7. This sum was reallocated in favour of Lisbon and Göteborg objectives to the National OPs.
8. For example, Sardinia admitted that it did not achieve the A4 indicator target on the basis of a strict interpretation of the indicator (hard copy of e-mail exchanges had not been kept); however, other regions were reported to have concealed the fact and were considered successful on the basis of e-mail exchange only.
9. According to Barca *et al*. (2004), despite a few difficulties with some of the national performance reserve indicators, the latter system performed better than other indicator systems *(e.g.,* the "context indicators").
10. While results varied from region to region, some indicators showed a dramatic change. An example has to do with water distribution for which all southern regions have the adequate normative regulation, and not the northern ones.
11. It is connected to the monitoring system through indicator A4: "Development of information society in public administration".
12. One indicator of the EU performance reserve is added (effects on employment).
13. Del. CIPE 20/2004 and its reserve of EUR 76.5 million.

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Governing Regional Development Policy
The Use of Performance Indicators

PART II

Chapter 7

The English Regional Development Agencies

This chapter examines the evolution of performance assessment for the Regional Development Agencies (RDAs) in England. Since being established in 1998, the English RDAs have been subject to a number of different approaches to monitoring. After providing a brief overview of the history of the RDAs and the environment in which they operate, the chapter examines four generations of indicator systems to monitor RDA performance.

Introduction

The goal of UK regional policy is to contribute to high and stable levels of growth and employment nationwide by ensuring that each region is achieving its full potential. Historically policies affecting regions have been centrally determined and diffused regionally. Since 1997, the central government's policy has emphasised a "devolved approach, building the capability of regional and local institutions to deliver the government's objectives" (Fothergill, 2005). Responsibilities have been decentralised to the Parliament and Executive in Scotland and in Northern Ireland, an Assembly in Wales, and devolved to regional development agencies (RDAs) in England, which operate alongside the central government office in the regions[1] (Department for Constitutional Affairs, n.d.). This case study examines the use of performance indicators to monitor and shape regional policy in this newly devolved context, with a specific focus on the mechanisms applied to England's RDAs.

England's regional development agencies

As part of the United Kingdom's trend toward devolution and decentralisation, beginning in 1998 RDAs were created in each of eight regions, identified by the government, outside London. The London Development Agency (LDA) was created in 2000. This case study focuses on the RDAs outside London because of the LDA's unique governance arrangements and distinct operating context from its counterparts. The RDAs outside of London are non-departmental government bodies classified as part of the central government for accounting purposes, but which operate at arms' length from ministers.[2] They are business-led organisations with boards of directors composed of business leaders and regional stakeholders, such as representatives of trade unions, local government and the education sector. The statutory purposes of an RDA are to:

1. Further economic development and regeneration in its region;
2. Promote business efficiency, investment and competitiveness in its region;
3. Promote employment in its region;
4. Enhance development and application of skills relevant to employment in its region; and
5. Contribute to sustainable development in its region (BERR (n.d.[b]).

They meet these objectives by leading development of a Regional Economic Strategy (RES) in co-operation with regional partners, and by funding programmes and projects in their regions. Since 2002, six central government departments have funded the RDAs[3] with previously disparate funding streams now pooled under the Single Programme administered by the Department for Business, Enterprise and Regulatory Reform (BERR, formerly the Department of Trade and Industry, DTI). Funding available through the Single Programme totals GBP 2.3 billion for 2007-08. RDAs have substantial flexibility with regard to expenditures, but must contribute to national goals for public service delivery. These goals, generally referred to as targets, are captured in a contractual performance monitoring mechanism called a Public Service Agreement (PSA), discussed later in this case study.

Indicator systems for measuring and monitoring RDA performance

With devolution of responsibilities to regional and sub-regional levels came the need to develop a corresponding performance measurement system for managing the new multi-level governance arrangements. Since their launch in 1999, the RDAs have been subject to four different approaches to performance measurement. This section briefly describes each of these approaches and relates them to the system of PSAs. The systems described apply specifically to the eight English RDAs. Due to a different governance arrangement, the London Development Agency uses a different – but largely comparable – approach.

Background: Public Service Agreements

Public Service Agreements (PSAs) were introduced in the 1998 Comprehensive Spending Review as part of the national government's approach to reforming public service delivery. National objectives and outcome targets for public services were captured in a series of three-year agreements (PSAs) established between HM Treasury and government departments. Although set nationally, the PSAs have sub-national implications. They have been revised with each spending review, which examines and sets government expenditure for the subsequent three years. Between the 1998 and 2004 spending reviews, the number of PSA targets declined from over 600 to approximately 126 (Gay, 2005).

While multiple PSAs have implications for regional development policy, the Regional Economic Performance PSA (REP PSA) stands out. First introduced in 2002 as a joint target of the Office of the Deputy Prime Minister (ODPM), HM Treasury, and DTI, it set as a goal to "make sustainable improvements in the performance of all English regions by 2008, and over the long term narrow the gap

in growth rates between the regions, demonstrating progress by 2006" (BERR, 2005). The government's aim with respect to this target is twofold:

- Achieve higher average annual Gross Value Added (GVA) growth rates in all the English regions between 2003-08 than occurred between 1990-2002; and
- Reduce the gap in average trend GVA growth rates between the top three performing regions and the six lesser performing regions over the period 2003-12 as compared to 1990-2002.[4]

Regional development agencies were identified as the primary delivery vehicle for achieving this PSA target.

System 1: An interim approach

Until 2005, the performance indicator system for monitoring RDA performance was not explicitly linked to national PSAs. In fact, when RDAs were established, the REP PSA did not exist. In 1999, the Departments and RDAs discussed an interim approach to monitoring based on a range of indicators from the multiple funding streams that originally funded the RDAs. It established two categories of performance indicators: 1) "state of the region" indicators that reflected the regional economic context in which the RDAs operated and which they were expected to affect; and 2) "activity indicators" that reflected the outputs of RDA activities with targets set by the central government. Both sets of indicators mapped to the purposes of the RDAs. This first system, established as an interim approach, was replaced in 2002 with the introduction of the single budget also referred to as the "Single Pot" (Allen, 2002). This unified funding stream freed RDAs from the constraints of legacy programmes and multiple funding streams, each with its own reporting and evaluation requirements (PA Consulting and SQW, Ltd., 2006).

System 2: A three-tier approach

In 2002, DTI established a three-tier performance monitoring system that increased the RDAs accountability for delivering results in exchange for the flexibilities introduced with the Single Pot. Under this system, tier one captured objectives representing the RDAs' statutory purposes (described previously). Tier one objectives were the same for all RDAs. Tier two established long-term regional outcome goals in 11 areas loosely linked to PSA targets that the RDAs were expected to achieve collectively. Tier two indicators were prescribed at the national level but each RDA set the level or target for each indicator as part of its Corporate Planning process. The Corporate Plan is a three-year strategic planning document which sets out how the RDA will invest its resources to achieve the objectives of the RES. Tier three set out five short-term output targets for RDAs to achieve individually and was supplemented with targets tailored to the economic situation of each region

(see Table 7.1). The Government Office in the regions monitored RDA performance, annually for tier two targets and quarterly for tier three targets (Allen, 2002; LDA, 2004; ONE, 2003; NAO, 2003).

Target setting was a negotiated process with the central government and addressed differently by different RDAs. For example, the East Midlands Development Agency initially established tier two targets on the basis of DTI Technical Guidance and revised them following the 2002 review of the RES – a consultation process involving regional stakeholders. One Northeast (the RDA covering North East England) used economic modelling to quantify its tier two targets. The South East England Development Agency set its tier three targets after consultations with regional partners including business support organisations and local authorities. It was also common for RDAs to set tier three targets in consultation with the Government Office in the region and the Regional Assembly. An inter-agency Performance Management Group helped to ensure consistency in terms of definitions and approaches to measurement across RDAs and liaised with the central government (House of Commons, Trade and Industry Committee, 2004).

Ultimately, the three-tier approach was criticised on a number of fronts (NAO, 2003):

- Tier two targets, defined nationally and quantified regionally, did not align properly with the long-term economic goals embodied in the RES set through a regional consultation process. Regional stakeholders reported greater ownership of the RES than the national targets.
- Because the tier two targets were only loosely linked to PSAs, it was difficult for central government departments to see how the RDAs' work contributed to national priorities.
- Effective monitoring of tier two targets required timely and relevant data that was not readily available. This hampered planning and monitoring efforts, and lead to requests for additional information by the central government which increased the RDAs' administrative burden.
- Emphasis placed on monitoring and public reporting of tier three targets provided an incentive to favour activities that resulted in short-term outputs that did not necessarily contribute to strategic longer-term results.
- Quarterly reporting of tier three targets resulted in an excessive administrative burden.

There was also a suggestion that Departments felt limited ownership of regional targets, particularly with respect to the REP PSA (HM Treasury, ODPM, and DTI, 2004).

System 3: The RDA Tasking Framework

In 2005 a new RDA Tasking Framework was created, partially in response to criticisms of the three-tier approach, to provide a way to better link the PSAs and the activity of the regional development agencies. The new approach was designed in consultation with the RDAs through the Performance Management Group. Under this system RDAs were responsible for achieving cross-cutting output targets that contributed to multiple PSAs.[5] Specifically, each RDA was required to demonstrate in its 2005-08 Corporate Plan how it would address the priorities outlined in its RES and contribute directly to three key PSA targets: regional economic performance, sustainable development, and productivity/rural productivity, and indirectly to the nine other PSA targets (Table 7.1). These PSA targets essentially replaced the tier two regional outcome targets.

An RDA's contribution to the PSA targets was monitored in two ways. One way was by linking an RDA's activities to specific PSAs in the Corporate Plan. RDAs chose their own activities, which corresponded to the commitments and priorities in the RES. The second way was by tracking performance on ten core output targets, which replaced the tier three targets. Table 7.2 shows the correspondence between the two sets of output indicators, which are not dramatically different. Under both the three-tier and the RDA Tasking Frameworks, agencies established target ranges for their outputs in their Corporate Plans. RDAs were able to add additional measures of performance and set associated targets if they felt their activities were not sufficiently captured by the required output measures. Under the Tasking Framework, progress was reported twice a year by RDAs to BERR, which in turn provided the information to Parliament and to the public on its web site. Regular performance reports were also provided to each RDA's executive team and to its board.

Core outputs needed to be attributable to RDA-funded projects. Output data were therefore collected from grantees, which were contractually obligated to report on progress. A common set of definitions and minimum evidence was used to collect and verify core output data consistently across RDAs (OffPAT, 2006a). In order to ensure that grantees were meeting contractual obligations and that data were accurate, staff monitored contracts, conducted risk assessments, conducted site-visits, and audited a portion of projects.

The core output targets were intermediate indicators of RDA contributions to regional economic growth, an outcome defined by the REP PSA. Although RDAs were the primary vehicles for achieving the REP PSA, direct monitoring of this target was not conducted via the Tasking Framework or the Corporate Plan. Rather, RDAs monitored indicators such as regional gross value added (GVA) in annual monitoring reports for the RES and in "State of the Region" reports. The central government assessed nationwide progress in 2006[6] and published 12 related indicators in the "Regional Competitiveness and State of the Regions"

Table 7.1. **Twelve PSA targets to which the RDAs contributed**

Primary PSA targets to which the RDAs contributed:	
Regional economic performance	• Making sustainable improvements in the performance of all English regions by 2008, and over the long term narrowing the gap in growth rates between the regions, demonstrating progress by 2006.
Sustainable development	• Promoting sustainable development across government and in the United Kingdom and internationally (specific measures provided).
Productivity/rural productivity	• Demonstrating further progress by 2008 on the government's long-term objective of raising the rate of UK productivity growth over the economic cycle, and narrowing the gap with major industrial competitors. • Improving the productivity of the tourism, creative and leisure industries by 2008. • Reducing the gap in productivity between the least well performing quartile of rural areas and the English median by 2008, demonstrating progress by 2006, and improving the accessibility of services for rural people.
Other PSA targets to which the RDAs contributed:	
Employment	• Over the three years to spring 2008, and taking account of the economic cycle: – Demonstrating progress on increasing the employment rate. – Increasing the employment rates of disadvantaged groups (definition provided in text). – Significantly reducing the difference between the employment rates of the disadvantaged groups and the overall rate.
Enterprise	• Building an enterprise society in which small firms of all kinds thrived and achieved their potential with an increase in the number of people considering going into business; an improvement in the overall productivity of small firms; and more enterprise in disadvantaged communities.
International trade and FDI	• By 2008, delivering a measurable improvement in the business performance of UK Trade and Investment's international trade customers, with an emphasis on new to export firms; and maintaining the United Kingdom as the prime location in the EU for foreign direct investment.
Neighbourhood renewal	• Tackling social exclusion and delivering neighbourhood renewal, working with departments to help them meet their PSA floor targets, in particular narrowing the gap in health, education, crime, worklessness, housing and liveability outcomes between the most deprived areas and the rest of England, with measurable improvement by 2010.
Science and innovation	• Improving the relative international performance of the UK research base and increasing the overall innovation performance of the UK economy, making continued progress to 2008, including through effective knowledge transfer amongst universities, research institutions and business.
Skills	• Attaining greater labour market capacity and higher productivity and business performance, and ensuring individuals have the skills they need for employment, progression and personal development. • Increasing the number of adults with the skills required for employability and progression to higher levels of training through: improving the basic skill levels of 2.25 million adults between the launch of Skills for Life in 2001 until 2010, with a milestone of 1.5 million in 2007; and reducing by at least 40% the number of adults in the workforce who lack NVQ2 or equivalent qualifications by 2010. Working towards this, one million adults in the workforce to achieve level 2 between 2003 and 2006.
Sustainable communities	• Achieving a better balance between housing availability and the demand for housing, including improving affordability, in all English regions while protecting valuable countryside around our towns, cities and in the green belt and the sustainability of towns and cities.
Sustainable farming and food	• Delivering more customer focused, competitive and sustainable farming and food industries and securing further progress via CAP and WTO negotiations in reducing CAP trade-distorting support.
Voluntary and community sector	• Increasing voluntary and community sector engagement, especially amongst those at risk of social exclusion.

Source: Excerpted from BERR, "England's Regional Development Agencies RDA Corporate Plans For 2005-08 Tasking Framework", accessed July 2007, *www.berr.gov.uk/files/file26126.pdf*.

Table 7.2. **Output targets for RDAs under the three-tier system and the 2005 Tasking Framework**

Three-tier system		2005 RDA Tasking Framework	
Tier 3 output area	Tier 3 output indicator	Core output area	Core output indicator
1. Employment opportunities	• Number of employment opportunities directly attributable to RDA activity – sum of new and safeguarded jobs.	1. Employment creation	• Number of jobs created or safeguarded.
2. Business performance	• Number of new businesses added to the regional economy as a direct result of RDA activities.	2. Employment support	• Number of people assisted to get a job.
3. Brownfield land	• Number of hectares of land remediated to an acceptable condition or recycled into effective use as a direct result of RDA inputs and activities.	3. Business creation	• Number of new businesses created and demonstrating growth after 12 months, and businesses attracted to the region.
4. Education and skills	• Number of learning opportunities, or support provided or influenced as a direct result of RDA support.	4. Business support	• Number of businesses assisted to improve their performance. • Number of businesses within the region assisted to engage in new collaborations with the UK knowledge base.
5. Private investment in deprived areas	• The amount of private sector investment benefiting residents of the most deprived wards as a result of RDA funding and activity.	5. Regeneration	• Public and private regeneration infrastructure investment leveraged. • Hectares of brownfield land reclaimed or redeveloped.
		6. Skills	• Number of people assisted in their skills development as a result of RDA programmes. • Number of adults gaining basic skills as part of the Skills for Life Strategy that count towards the Skills PSA Target. • Number of adults in the workforce lacking a full level 2 or equivalent qualification who are supported in achieving at least a full Level 2 equivalent or qualification.

Note: Outputs must be disaggregatable and reported for urban, rural and disadvantaged areas (OffPAT, 2006b).
Sources: BERR (2005), "England Regional Development Agencies: RDA Corporate Plans for 2005-08 Tasking Framework" and BERR (n.d.[b]), "Regional Development Agencies' Reported Midyear Outputs for 2003/04".

series.[7] The next section describes the possibility of greater monitoring of RDAs' contributions to the REP PSA target as a result of the 2007 CSR.

In addition to achieving core output targets, the RDAs were also required to measure and achieve annual efficiency gains of at least 2.5% with respect to outputs. How such gains were achieved was up to the RDA, which had to establish targets and a strategy for achieving them in their Corporate Plan. Gains could come, for example, by reducing administrative costs to make funds available for achieving additional outputs (BERR, 2005).

System 4: Outcome-oriented measurement

As a result of the 2007 CSR, the approach to measuring and monitoring RDA performance has evolved again. The 2005-08 Tasking Framework has now been replaced. The new sponsorship framework was started with the current Corporate Planning round (2008-11). The new system simplifies RDA targeting and allows them to focus more clearly on delivering their commitments under the Regional Economic Strategies. The previous approach was hampered by confusion regarding the RDAs' specific focus, the complexity of the performance framework, and the administrative burden of performance reporting. The new system will most likely allow for "a simplified outcome and growth-focused framework defined by a single over-arching growth objective… aimed at increasing regional GVA per head" (HM Treasury, BERR and DCLG, 2007). The single objective will be supported by five outcome indicators that correspond to drivers of productivity and employment, and to indicators being developed for the Regional Economic Performance PSA (Table 7.3). This new framework is accompanied by a move toward a more strategic role for RDAs, with less focus on direct involvement in project funding.

Table 7.3. **Regional outcome indicators**

Regional growth objective: To be established at the regional level	
Driver	Indicator
Productivity	• GVA per hour worked
Employment	• Employment rate, showing proportion of the working age population employed
Skills	• Basic, intermediate and higher level skills attainment
Innovation	• Research and development expenditure as a proportion of GVA
Enterprise	• Business start-up rates

Source: H.M. Treasury, BERR and DCLG (2007), "Review of Sub-national Economic Development and Regeneration", July 2007.

The indicators selected relate to the central government's position that regional disparities in GDP per capita are related to a combination of four factors: productivity (driven by skills, investment, innovation, enterprise, and competition), unemployment, workforce participation, and the working-age population share (HM Treasury and DTI, 2001). After consultation with regional stakeholders, RDAs have set their own outcome targets for delivery against objectives. Progress against these targets is reviewed at six-monthly senior level strategic review meetings. Each RDA issues an annual report on its performance.

To date, RDAs generally contributed to PSA targets in two different ways: 1) leadership in developing and contributing to the RES; and 2) programme grants for regional projects. However, the core output targets only monitor the

results of grant activity. Output targets do not fully capture the RDA's contributions to the RES in areas like strategic leadership because they are difficult to measure. Qualitative Strategic Added Value (SAV) measures were incorporated into the Tasking Framework, but were dropped because they were difficult to measure and subjective. Following the 2007 spending review, RDAs will continue to lead development of the regional economic strategy and make grants for regional projects. However, the RES will be replaced by a new single regional strategy that also integrates what was known as the Regional Spatial Strategy. In addition, they will manage European Regional Development Funds in their regions. However, their contributions to the PSA targets will no longer be monitored in terms of outputs associated with these activities. Instead, focus will be on monitoring indicators of regional economic growth. Attention will be placed on identifying the logic chain connecting inputs and activities to impact on regional GVA. Mandatory outputs will no longer be prescribed by government. RDAs will decide themselves how best to measure their progress towards the PSA target. Under this new approach, outputs are expected to demonstrate short-term results and form the basis for impactful information gained through evaluation. However, outputs may no longer be fully comparable across RDAs. The drawbacks associated with devolved decisions on how to measure delivery may be offset by the increased flexibility RDAs will have for strategic planning and investment. However, government and RDAs are working together to evaluate RDA programmes and RDAs will still need good quality information on performance in order to assess what works.

Proposals for the new outcome-oriented performance framework also include greater flexibility for RDA decision making, clear and regular public reporting requirements, independent assessment of RDA performance, evaluation of the RDAs' economic value added, and enhanced use of performance information for the recruitment and remuneration of RDA Board members and the Chief Executive (HM Treasury, BERR and DCLG, 2007).

Performance measurement context

It is important to point out that the performance indicator system is not the only tool used to measure and monitor the performance of RDAs. Indicators are part of a larger performance framework that includes: annual auditing of financial accounts by the National Audit Office, assessment via independent appraisals, corporate plan reviews and financial monitoring; and evaluation of how well RDAs attain strategic objectives (DCLG and BERR, 2008).

The performance measurement system for RDAs is only one of the systems operating at the regional level that affect regional development policy in the United Kingdom. It operates alongside an extensive performance management system for the EU Structural Funds. The monitoring and evaluation

instruments of the EU may have had some positive effects on the capabilities of regional actors in the United Kingdom (ECOTEC, 2003). Rarely, however, are the two systems discussed or analysed together.

Performance of other government actors in the region is also measured in different ways and systems designed for measuring regional performance do not necessarily interact with or take into account the multiple performance systems implemented locally. Regional and local actors face a myriad of measures and targets set by different government departments above and beyond the PSA targets set at the national level. This complicates collaboration among regional stakeholders and between regional and local actors (HM Treasury and Cabinet Office, 2004). The outcome-based performance framework recommended in the *Review of Sub-national Economic Development and Regeneration* aims to simplify and enhance the co-ordination among systems.

Assessment

Relations among levels of government

As noted earlier, regional development agencies were created as part of the process of devolving responsibility for public service delivery in the United Kingdom. The result was an increase in shared responsibility for regional development activities at a time when emphasis was also placed on greater assessment of public service delivery. The result is a tension between devolution and maintenance of central control through performance measurement.

On the one hand RDAs are pulled toward national priorities. Although they operate at "arm's length" from ministers, the minister of the sponsoring department remains accountable for their performance. As a result, there is a strong incentive to ensure that RDA and central government priorities are aligned. This incentive is strengthened by charging RDAs with helping to reduce economic disparities across regions – a predominately national concern. The performance measurement system is one mechanism for monitoring and rewarding alignment of central and sub-central objectives.

On the other hand RDAs are pulled toward sub-national priorities. While DTI/BERR emphasise RDAs' role in reducing regional disparities, the agencies are focused on improving the performance of their own region's economy. To do so they collaborate with multiple actors in their region to develop the RES, to finance programmes and projects that support the strategy, and encourage other related activities. In this regard, there is a strong incentive to ensure that the priorities of an RDA align with those of its partners in the region. The performance of an RDA can thus be judged both by the central government and by its sub-national partners (whose priorities are articulated in the RES). For example, RDA activities have traditionally been scrutinised by their Regional Assemblies – although this will change as a result of the 2007 sub-

national review. Unfortunately for RDAs, the objectives of both "constituencies" are unlikely to be a perfect match.

The tension between retention of central influence and the demands of devolution is apparent in the implementation of the performance indicators. This was highlighted in the criticism that the nationally established tier two targets did not align properly with the long-term economic goals embodied in regionally designed Regional Economic Strategies. Regional stakeholders must still buy in to the priorities of the central government (PSA targets and core output targets) to reconcile the performance framework and the RES. The move away from a single set of output targets prescribed by government and toward an outcome-based framework may enable individual RDAs to develop performance frameworks customised to the salient issues for their region (and the RES), that are also oriented toward the long-term national objectives.

Incentive structures

Incentive mechanisms in indicator systems are intended to better align the motivations and actions of the agents with those of the principal. Incentives can be monetary *(e.g.,* increase or loss of budget, supplemental funds) or non-monetary *(e.g.,* reputation effects, administrative flexibilities). There have been few monetary incentives to encourage RDAs to achieve output targets, or to penalise missed targets. RDAs report to BERR every six months and must explain under-achievement on core output targets. However, allocations to agency budgets are not affected as they are formula-driven and reflect the economic situation of the region (BERR, 2007b).

Explicit financial rewards for performance were offered for only a short period. A GBP 50 million Performance Fund was established and allocated on the basis of Government Office assessments as part of the three-tier framework (Medawar, 2004). Each RDA received a one-time performance-based bonus award in addition to its budget allocation for 2004-05 (DTI,West Midlands, 2004). There are three potential explanations for why the bonus structure did not last. First, the reward amount was small relative to RDAs' total allocation (2.7% of GBP 1 847 million). Second, it was paid from a fund carved out of the RDAs' 2003-04 budget allocation – making it seem less like a reward and more like an allocation of funds due. Third, financial rewards proved to be less important than reputation effects of performance for RDAs. The strongest performance incentive for RDAs is reputation. Reputation is critical to an RDA's existence because as a statutory body it can be dissolved. Performance reports are provided to Parliament and made publicly available through BERR. This creates a reputation-based incentive for RDAs to achieve targets.

To date, RDAs have consistently met the majority of their output targets. In 2005-06, 93% of all RDA targets were met (EEF, 2007). This may reflect a

combination of three factors. The first is risk aversion. RDAs' legal and political status could encourage conservative target setting because they can be abolished if they are not seen to be effective. In addition, the achievement of outputs is affected by factors outside the control of RDAs, further encouraging conservative target setting. In fact, all of the six targets missed in 2005-06 were in the area of skills building, an area in which the RDAs' influence is likely to be less than other actors in the region (EEF, 2007). Second is a possible "cream skimming" of investments. The emphasis on short-term outputs as a primary measure of performance can lead agencies to invest in "sure bets". For example, targeting private investment leveraged can encourage financing of projects that may have occurred without RDA support. The third is the "ratchet effect". RDA efficiency targets are set as a function of prior performance thereby encouraging conservative target setting at the outset of a planning period.

A move toward an outcome-based performance measurement system will create new incentives for RDAs. They will be encouraged to clarify the process their programmes and projects use to achieve outcomes for the regional economy. This is challenging because the path from inputs to outcomes in regional development policy is a complex, lengthy one affected by factors outside the purview of RDAs. Tracking growth objectives and demonstrating achievement should be somewhat easier than in the past as a result of efforts to improve the quality and availability of sub-national economic data.[8] However, a solid understanding of "what works" to enhance regional economic performance is still needed.

"Costs"

The costs associated with performance indicator systems can be both direct financial costs and indirect costs that come in different forms. Financial costs come from the information technology, staffing and training associated with establishing and using the system, along with the monetary awards for performance. In general, calculating direct financial costs for a performance indicators system is difficult as compiling and monitoring indicators is often spread across job functions. For example, although the number of PSA targets declined substantially between 1998 and 2004, no corresponding decline in staffing was reported by the central government. The same is true for RDAs. In at least one RDA (but likely in all), reporting core outputs is integrated into project monitoring and reports on core outputs are produced in conjunction with spending information.

It is also difficult to quantify non-financial costs. Such "costs" include the opportunity costs of the time and finances associated with the system, transaction costs, the costs of unintended negative consequences, and costs associated with transitioning from one system to the next.

The **opportunity costs** associated with performance indicator systems are the foregone benefits that could have been gained by engaging in an alternative activity, such as service delivery. In this case there is some perception that if the central government was not imposing performance requirements, similar activities would be undertaken by RDAs to assess the value of their investments; any additional "cost" comes from doing it differently. This cost can be low if the output targets are relevant for the regions. It is when the targets are divorced from regional needs that the costs rise. In fact one criticism of the three-tier framework was that the targets were neither useful for aligning RDA activities with regional priorities (an opportunity cost for regions) nor for monitoring progress toward PSA targets (an opportunity cost for the central government). *Success in the Regions* highlighted the case of one RDA that spent GBP 500 000[9] to prepare its Corporate Plan and associated (three-tier) targets, only to find it so divorced from agency needs that it prepared another business plan for its own purposes. Thus opportunity costs rise as the relevance of information declines. At present, RDAs are able to supplement the core targets to keep the indicators relevant for the region without adding a substantial burden.

One source of **transaction costs** for performance indicator systems is information exchange. At present most RDAs use the same information technology system to report on the core targets. This computerised Programme Management System (PMS) is in some cases directly linked to the finance system to produce reports, although it does not "talk" electronically to London. For the 2007-13 programming period, the RDAs will assume responsibility for managing the EU Structural Funds. In order to meet reporting requirements, the EU would prefer that the RDAs use an EU IT package, but this has produced some resistance among the RDAs as PMS can be used to produce reports for the EU. This second system would be incompatible with existing information technology and thus raise the overall cost of information exchange.

Transitioning costs are incurred in moving from one system to the next, even if the new system is expected to be an improvement over the previous one. These costs range from direct financial costs associated with new information technologies or staff training, to opportunity costs while new systems are established or while learning takes place, to transaction costs for grantees that must change administrative systems to comply with new reporting requirements. There is also potential for loss in comparability of data as reporting definitions change over time. The 2005 Tasking Framework highlighted that:

> The differences between the Core Outputs and the Targets embodied in the [three-tier] target framework are likely to result in a data collection time-lag while the new arrangements bed in with the RDAs and external partners, for example the terms of new funding contracts will have to be amended to cover the collection of outputs under the new definitions. There are also transitional issues in relation to programme management information

systems, the treatment of existing, pipeline and new project contracts, changes in project application and appraisal, delivery/monitoring and evaluation guidance and associated forms/checklists, etc., and training and guidance for RDA and partner staff (BERR, 2005).

Several core output targets in the 2005 Tasking Framework were new for RDAs and new data had to be collected. In addition, output definitions changed, making it difficult to map tier three outputs to core output targets and to set accurate target ranges for the coming year(s) (EEDA, 2005). The importance of mapping tier three outputs to core output targets was particularly significant as some projects in place at the time the new Tasking Framework was introduced had been selected with tier three targets in mind. Moreover, projects commissioned under the new framework beginning in April 2005 would be unlikely to produce results that could be reported against the new targets until 2006 or 2007 (SWRDA, 2005).

Other transitional activities that were mentioned by RDAs in their 2005-08 Corporate Plans included modifying the information system to capture new output data, revising the project appraisal guidance to be consistent with the new framework, training of staff, and changing existing contracts to capture the new outputs (Northwest Regional Development Agency). Each of these activities is associated with direct and indirect "costs".

The costs of transitioning from the three-tier system to the Tasking Framework were minimised in a number of ways. First, the new system was designed to be largely compatible with the three-tier framework. Mapping from the old to the new system was possible. Second, forward planning permitted RDAs to prepare for the change. Third, transitional agreements were put in place between the central government and the RDAs to facilitate the conversion process. Finally, implementation was phased in, with the new approach only applied to new projects. In contrast, the timeframe for transitioning to the proposed new system will be relatively limited. Whereas the previous transition took approximately 1.5 years, less time has been spent designing and transitioning to the new approach (Amison, 2007).

Finally, there is a great deal of literature on the **unintended consequences** (also known as dysfunctional effects) of using and publishing performance indicators. Goddard, Mannion, and Smith (2000) demonstrate how tunnel vision, sub-optimisation, myopia, misrepresentation, and gaming result from the principal-agent relationship. This context characterises the operating environment for RDAs. Of these effects, myopia appears to have been the greatest risk for RDAs, with some risks of tunnel vision and gaming.

Myopia occurs when performance indicators encourage prioritisation of short-term gains over long-term ones. In reviewing the three-tier target framework, the NAO found that "DTI's monitoring of the Agencies' performance

has focused on short-term targets for direct activity" and that emphasis on short-term targets "gives the Agencies incentives to pursue immediate goals in preference to more strategic objectives. Because short-term targets are not designed to support long-term targets, achieving them is no guarantee of sustained success" (NAO, 2003). The focus on core output targets under the 2005-08 Tasking Framework did not alter the short-term orientation of performance monitoring. Fortunately, this short-term focus is somewhat offset by the long-term orientation of the regional economic strategy. The proposal to transition to an outcome-oriented framework will reduce the incentives for myopia, but will still require monitoring of intermediate indicators (outputs and outcomes).

Tunnel vision refers to emphasising those activities which produce measurable results to the exclusion of those whose results are not measured (or measurable). In its consideration of the three-tier framework, the House of Commons concluded that "[i]n focussing on the achievement of quantifiable indicators in the short term, the targets do not necessarily capture all of value that the RDAs provide to business in their regions. Anything that has a long lead time or that is designed to achieve less readily quantifiable goals will be excluded" (House of Commons, Trade and Industry Committee, 2004). This is a clear example of tunnel vision. Even with the current system, core output targets do not capture the RDA's contributions via the RES. "Strategic leadership", for example, goes unmeasured because it is difficult to capture. Qualitative assessment of strategic added value was initially incorporated in the performance framework and reported by RDAs, but this was eventually dropped because it was hard to measure and subjective. However, agencies still aim to define, assess and report strategic added value to their stakeholders.[10]

Gaming refers to strategic behaviours intended to ensure positive performance results. There is little documented evidence regarding persistent or distortionary gaming by RDAs. However, the possibilities of cream skimming and the ratchet effect discussed previously could be considered strategic behaviours. Gaming may have been limited by the relatively rapid transition from one system to the next and the explicit guidance and data definitions for the different systems provided in the technical notes.

Benefits

With so many costs, why measure and monitor performance? The underlying assumption of performance measurement systems is that tracking and responding to performance indicators brings benefits in excess of these costs. Benefits include:

- increased efforts and better targeting of efforts by sub-national actors;
- improved accountability and legitimacy;

- larning;
- improved efficiency;
- opportunities for evidence-based reform;
- enhanced decision making and resource allocation; and
- increased likelihood of achieving policy outcomes (results).

While it is likely that the performance measurement system for RDAs produced some benefits in each of these areas, two types of benefits stand out: improved accountability and legitimacy, and learning.

The legitimacy and accountability of RDAs has been scrutinised and discussed since their creation. As noted previously, the longevity of RDAs depends a great deal on their performance. In this regard, RDAs may have received some "boost" in legitimacy from the public reporting of and attention given to their performance. Parliament, ministers, RDA board members, executive staff, and the Regional Assembly receive regular reports. Regional partners and the public are able to monitor performance through public dissemination of performance data.

Learning has occurred in both inter-governmental relations and regional development policy. Taken together, the four performance measurement systems represent an evolution in system quality, and inter-governmental relations and learning. There is a transition toward a less prescribed performance framework, as the central government learns about and gains confidence in RDAs as increasingly mature organisations. Each system represents a stage of learning for both the central government and the RDAs in terms of:

- generating regional economic growth in a newly devolved context;
- acquiring the knowledge and capabilities needed and available at a regional level;
- fuelling the level of outputs (effort) that can be achieved by RDAs; and
- creating the indicators and accountability framework that encourage and measure performance.

The process has been characterised by increasing central government knowledge about sub-national capabilities and enhanced consultation with RDAs. It is consistent with a move "away from the old-style approach that tended towards short-term micro management, to one that is increasingly longer term and strategic" (HM Treasury, ODPM, and DTI, 2004). The system of performance indicators has potentially contributed to the "earned autonomy" of RDAs. In its 2004 examination of devolved decision making, the central government noted that controls would decrease and flexibility would increase for high performing organisations (presumably including RDAs) (HM Treasury and Cabinet Office, 2004). An expected benefit of the new proposed performance

framework includes not only less micro management by the central government but also a better fit with the RDAs' strategic purpose (Amison, 2007).

A substantial amount of learning appears to have taken place from assessing the performance measurement system itself. Reports such as *Success in the Regions* and *Devolving Decision Making* along with the spending reviews have revealed the challenges of promoting performance in a devolved context. Whether or not the information produced by the performance indicator system itself has been equally useful for supporting, adapting and changing policy and programming practices is unclear. If it has not, this could represent a substantial opportunity cost.

Moving toward outcome-based performance indicators will require new learning, as noted earlier. Regional development agencies will have to clarify the process by which their activities and investments contribute to regional economic outcomes. This will also apply to policy strategies, as the new performance framework will be accompanied by an emphasis on strategy-focused roles for RDAs (as opposed to funding projects). The shift toward outcome measures may enhance an RDA's ability to customise its "core" outputs, which are currently common across agencies, and to showcase the results of their strategies.

Conclusions

The indicator system for measuring and monitoring for the performance of RDAs in England has undergone numerous transformations. Each transformation has aimed to increase the cost-effectiveness of performance management by increasing the system's usefulness and thereby lowering its opportunity costs. The direct costs of using indicator systems are difficult to quantify, but are most likely contained for the central government and RDAs which can couple performance monitoring with other administrative and strategic planning tasks. It is not clear if this is true for grantees, which provide regular reports to RDAs. There are indirect costs associated with measuring and monitoring performance – particularly in terms of emphasis on short-term outputs potentially at the expense of long-term strategic outcomes. Transitioning from system to system has also produced some costs, although the benefits of the learning represented by these changes most likely outweigh any transitional costs. Collaborative efforts among RDAs and between RDAs and the central government may have made a positive contribution in this regard. What remains to be seen is if the learning that has taken place, represented by the new performance framework, will translate into more effective policy choices for regional economic development.

Notes

1. Regional Assemblies are non-elected bodies of elected representatives from local authorities and appointed representatives from different stakeholder groups that also operate at the regional level. Among their tasks was to help ensure RDA accountability for regional concerns. However, as a result of the outcome from a recent review by government of sub-national economic development and regeneration they are likely to have disappear by 2010.

2. Non-departmental government bodies are neither a central government department nor a part of one, but a separate legal entity with a government department as its sponsor. They have greater independence in decision making and staffing than do government departments (and are often described as existing at arms length) though they do rely on transfers from the central government to fund their activities. The minister of the sponsoring department remains accountable for their performance (Agencies and Public Bodies Team, Cabinet Office, 2006).

3. Department for Business, Enterprise and Regulatory Reform (BERR), Department of Communities and Local Government (DCLG), Department for Innovation, Universities and Skills (DIUS), Department for Environment, Food and Rural Affairs (DEFRA), Department for Culture Media and Sport (DCMS), and UK Trade and Investment (UKTI) (BERR, 2007d).

4. The top three performing regions are those with above average GVA per capita (London, South East, and East of England). The six lesser performing regions are those with lower than average GVA per capita (North East, North West, Yorkshire and the Humber, West Midlands, East Midlands, and the South West).

5. In preparation for the 2004 Spending Review, RDAs contributed to "Regional Emphasis Documents" which provided a perspective on regional priorities for use by departments when preparing their 2005-08 spending plans. RDAs provided inputs on the PSA targets to which they felt they could contribute (HM Treasury, 2004).

6. See HM Treasury, DTI and DCLG (2006), *Regional Economic Performance: Progress to Date*.

7. SQW Ltd and Oxford Economic Forecasting recommended 11 core indicators for RDA Evaluation and Performance Monitoring, nine of which are included in "Regional Competitiveness and State of the Regions". They are: Gross Value Added (GVA) (on a workplace basis) per head of population, Manufacturing GVA per head, Business formations per 10 000 adults, Unemployment rate, Percentage of adults with [National Vocational Qualifications] level 4 skills/equivalent, Percentage of adults with no qualifications, Percentage of residents within families dependent on income support benefits, Road congestion, and Stock of derelict land. Many of these indicators overlap with the 12 indicators monitored by the publication in relation to the REP PSA (DTI, 2007).

8. Efforts have been made to improve the quality and availability of sub-national economic data following the 2004 Allsopp review. This includes enhancing statistics for the regional level as well as providing neighbourhood statistics. In addition, the Office of National Statistics (ONS) placed two staff in each of the regions in March 2007 to support regional statistical needs, provide a regional point of contact with ONS, enable access to key administrative datasets, advise on local data collection to enhance data comparability, and convey knowledge about the regional economy back to ONS. This staff, located at the RDA or at the regional observatory, is funded by the regional development agencies.

9. This included the costs of public consultations, economic analysis and special events (House of Commons, Trade and Industry Committee, 2004).

10. See, for example, the review of strategic added value measurement in GHK Consulting Ltd. (2006), *Evaluation of the West Midlands Regional Economic Strategy – Final Report*.

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Governing Regional Development Policy
The Use of Performance Indicators

PART II

Chapter 8

US Economic Development Administration

This chapter explores the implementation of the Government Performance and Results Act and the Balanced Scorecard at the US Economic Development Administration (EDA). It begins by providing an overview of the history and programmes of the EDA before turning to the indicator systems used to monitor performance. The case study demonstrates the importance of using indicators to generate information that can be used for decision making on both a short- and a long-term basis.

Introduction

Regional economic development in the United States is carried out through a constellation of approximately 180 programmes undertaken by nine federal departments and five independent agencies. Their actions are complemented by ongoing activities by states, localities, and the private sector. These federal programmes address a diverse set of needs ranging from rural development to small business support to workforce adjustment. The US Economic Development Administration (EDA), housed in the Department of Commerce, is one of the few federal agencies that focus on the economic development of specific regions (Drabenstott, 2005). In FY 2001, the EDA made performance measures the second pillar of a three-pronged strategy for transforming the agency's results-orientation (US Department of Commerce, n.d.[b]). This case study examines how the EDA uses indicators to measure and monitor the performance of its regional investments. It aims specifically at identifying the costs and benefits of the current approach.

The Economic Development Administration

The EDA was created in 1965 by the Public Works and Economic Development Act for the purpose of enhancing economic activity in distressed communities, primarily by financing of public works projects (Glasmeier and Wood, 2005). It was the successor to the 1961 Area Redevelopment Act designed to stimulate job creation in depressed areas through infrastructure investment and business loans (Drabenstott, 2005). Although it has survived longer than its predecessor, the EDA experienced a fitful start. Initially authorised through 1971, it continued to operate by means of one, two, or three-year extensions from 1971 to 1982. The EDA operated without official authorisation from 1982 until 1998, when the Clinton Administration identified the EDA as a means for assisting regions with economic adjustment needs resulting from defence cuts, base closings, and natural disasters[1] (Drabenstott, 2005). It has since operated under full congressional authorisation. The FY 2006 budget of the EDA was approximately USD 280 million, of which USD 250 million was allocated to economic development assistance programmes (US Department of Commerce, 2007).

The stated mission of the EDA is "to lead the federal economic development agenda by promoting innovation and competitiveness, preparing American regions for growth and success in the worldwide economy" (US Department of

Commerce, n.d.[a]). According to its reauthorising legislation, the EDA contributes to federal efforts to promote economic development by:

- creating an environment that promotes economic activity by improving and expanding public infrastructure;
- promoting job creation through increased innovation, productivity, and entrepreneurship; and
- empowering local and regional communities experiencing chronic high unemployment and low per capita income to develop private sector business and attract increased private-sector capital investment (PWEDA, as amended 2004).

Of these three goals, a priority is placed on creating jobs by promoting a business environment that attracts private investment (US Department of Commerce, n.d.[a]). The EDA targets assistance to lagging rural and urban communities through six categories of programmes which provide grants to sub-national and non-profit entities:

1. **Public works and economic development investments.** This is the largest EDA programme, absorbing 63% of the programme budget in FY 2006.[2] Grants can be used to "support the construction or rehabilitation of essential public infrastructure and facilities necessary to generate or retain private sector jobs and investments, attract private sector capital, and promote regional competitiveness, including investments that expand and upgrade infrastructure to attract new industry, support technology-led development, redevelop brownfield sites, provide eco-industrial development, and support heritage preservation development investments…". The average size of a Public Works investment in FY 2006 was USD 1.223 million (EDA, 2007b). The vast majority of the EDA's budget finances construction-related projects (GAO, 2006).
2. **Economic adjustment.** The second largest programme (18% of programme funds) targets two types of assistance to areas which have experienced or may experience structural damage to the underlying economic base: 1) implementation of one or more Comprehensive Economic Development Strategy (CEDS)[3] initiatives; and 2) loans to local businesses that cannot access commercial credit (US Department of Commerce, n.d.[a]).
3. **Economic development planning.** This programme (11% of programme funds) supports "partnerships with District Organisations,[4] Indian Tribes, community development corporations, non-profit regional planning organisations, and other eligible recipients" to conduct, implement, revise, and replace regional economic development CEDS planning documents (13 C.F.R. 303.1).

4. **Trade adjustment.** Through a network of eleven Trade Adjustment Assistance Centers, this programme (5% of programme funds) helps "trade-injured" manufacturers and producers affected by increased imports to prepare and implement strategies for economic recovery (US Department of Commerce, n.d.[a]; Drabenstott, 2005). This programme is administered by EDA but is authorised under a different statute than PWEDA. It is quite different from the rest of the EDA's programmes.
5. **Local technical assistance.** The EDA provides support for local planning and feasibility studies (3% of programme funds) through the Local Technical Assistance Program, and the technical assistance/outreach for economic development via the University Center Technical Assistance Program (US Department of Commerce, n.d.[a]).
6. **Research.** Finally, the EDA invests a small sum each year in research studies, evaluations, and information dissemination on the topics relevant to its mission (US Department of Commerce, n.d.[a]). Recent activities funded included assessing economic development opportunities from a regional perspective, and tools to assist practitioners in identifying growing and emerging business clusters. In FY 2006, this programme received 0.2% of total programme funds.

Programmes are administered through six regional offices to sub-national entities.

While EDA assistance has traditionally been viewed as a grant award, in recent years the EDA shifted away from a view of its role as a provider of grants toward that of an investor in regional development projects. As a result, awards are expected to produce a return-on-investment in the form of local economic impact – measured in terms of jobs created or retained and private sector funding leveraged.

Not all communities are eligible to receive EDA support. Its predecessor, the Area Redevelopment Administration, targeted areas beset by high levels of unemployment, high percentages of low-income families, and farming regions with low production. These eligibility criteria were carried over to the newly authorised EDA, and as a result, regions eligible for assistance tended to be rural. Over time, however, eligibility was extended to urban areas and later to regions experiencing economic adjustment difficulties (Glasmeier and Wood, 2005). Today, the EDA targets both rural and urban communities with high unemployment (a 24-month unemployment rate that is at least one point higher than the national average), low per capita income (80% or less than the national average), or economic dislocations due to:

- Industrial restructuring or relocation.
- Military base closures or defence-related job loss.

- Natural disasters or emergencies.
- Extraordinary depletion of natural resources.
- Substantial out-migration or population loss.
- Adverse consequences of foreign trade on industries and firms (US Department of Commerce, n.d.[b]).

Like many federal agencies, the EDA relies on third parties for programme implementation. Recipients of EDA funding can be states, cities, or other political subdivisions; special purpose units of government; Indian tribes; non-profit organisations working with a local government; institutions of higher education; and co-operative partners administering assistance for "trade-injured manufacturers and producers" (US Department of Commerce, n.d.[a]). The EDA is currently encouraging multi-jurisdictional collaboration and co-operation across local political boundaries to promote regional development.

In order to receive awards, grant recipients must provide a 20% to 50% funding match. However, in cases where the EDA determines an eligible grantee has exhausted its taxing and/or borrowing capacity, the EDA can provide a grant of up to 100% of the total project cost.

Indicator systems for measuring and monitoring EDA performance

The context in which the EDA operates is characterised by a chain of stakeholders extending from the national to the local level. At one end are Congress and taxpayers, the stakeholders to which EDA is ultimately accountable. The EDA implements the mandate set forth by Congress in its authorising legislation in line with priorities established by the White House. In turn, EDA Headquarters relies on six regional offices to implement its programmes in partnership with grant recipients at a sub-national level. The performance indicator system currently used by the EDA fits this tiered "principal-agent" context through two major components: an external reporting requirement to Congress (The Government Performance and Results Act, GPRA) and an internal monitoring system (the Balanced Scorecard).

The Government Performance and Results Act (GPRA)

The Government Performance and Results Act (GPRA), passed in 1993 and put into force in 1997, aims to improve congressional decision making, promote good programme management, and increase accountability to taxpayers (McNab and Melese, 2003). It stipulates that each year, every federal agency must submit to Congress both a performance plan for the upcoming year and a performance report for the previous year, for each programme activity in the President's budget request for that agency. Moreover, these plans and reports

must be linked to a five-year strategic plan. This means that each year, the Department of Commerce submits a forward-looking plan and a retrospective report to Congress which includes information for the EDA.

The EDA's GPRA report summarises achievement on two strategic goals, eight performance measures, and 12 associated targets which are selected by the EDA (Table 8.1). The two strategic goals are linked to one of the Department of Commerce's three overarching goals. The measures of performance associated with goal one ("promote private enterprise and job creation in economically distressed communities") emphasise outcomes: private sector dollars leveraged and jobs created or retained. Based on a study by Rutgers University (Burchell *et al.*, 1997) which suggested that the benefits of EDA public works investments accrue multiple years after project completion, the indicators for goal one are associated with targets set for three, six, and nine years after the start of the funded project (which runs approximately three years). The nine-year projections are derived from the study findings, and the three- and six-year targets are estimated percentages of the nine-year targets to be achieved by those benchmark dates (Department of Commerce, 2007). Because job creation is influenced by a variety of factors in a region, the EDA discounts the projected number of jobs to be created or retained by 25%.

In contrast to the measures for goal one, the indicators for goal two ("improve community capacity to achieve and sustain economic growth") are broader and tend to be process-oriented. This results, in part, from the difficulties measuring the outputs/outcomes of technical assistance and planning support.

EDA's performance measures are generated on the basis of in-depth evaluations of its investment programmes, often conducted by universities (Department of Commerce, FY 2003 PAR). Looking forward, the EDA is investing nearly USD 1 million to update and extend the Rutgers study. New targets, a more rigorous methodology, and a move away from the three, six, and nine-year targets are envisaged for the near future.

Once a grantee has received an EDA award it must agree to provide performance data, as requested by the EDA, in order to comply with the Government Performance and Results Act. For Public Works projects, this means reporting on jobs created/retained and private sector investment leveraged multiple years after the project has ended. Universities Centers and Trade Adjustment Assistance Centers must report on performance two years after receiving a grant. District Organisations and Indian tribes report on performance during the previous fiscal year. It is the responsibility of the regional offices to collect and report this information to headquarters via the Operational Planning and Control System (OPCS) database, where it is aggregated and used to produce GRPA reports.

Table 8.1. **EDA GPRA performance goals, measures, and targets, FY 2006**

Department of Commerce Goal: Provide the information and tools to maximise US competitiveness and enable economic growth for American industries, workers, and consumers.

EDA goals	Performance measures	FY 2006 targets[1]	Actual performance
1. Promote private enterprise and job creation in economically distressed communities FY 2006 – USD 208.3 million	1a. Private sector dollars invested in distressed communities as a result of EDA investments	USD 320 million for FY03 awards USD 1 020 million for FY00 awards USD 1 162 million for FY97 awards	USD 1 669 million for FY03 awards USD 1 058 million for FY00 awards USD 2 210 million for FY97 awards
	1b. Jobs created or retained in distressed communities as a result of EDA investments	9 170 for FY03 awards 28 200 for FY00 awards	11 702 for FY03 awards 42 958 for FY00 awards 50 546 for FY97 awards
2. Improve community capacity to achieve and sustain economic growth FY 2006 – USD 72.1 million	2a. Percentage of economic development districts and Indian tribes implementing economic development projects from the comprehensive economic development strategy process that lead to private investments and jobs	95%	96.5%
	2b. Percentage of sub-state jurisdiction members actively participating in the Economic Development District Program	89-93%	89.5%
	2c. Percentage of University Center clients taking action as a result of the assistance facilitated by the University Center	75%	76.0%
	2d. Percentage of those actions taken by University Center clients that achieved the expected results	80%	82.3%
	2e. Percentage of Trade Adjustment Assistance Center (TACC) clients taking action as a result of the assistance facilitated by TACC	90%	90.0%
	2f. Percentage of those actions taken by TACC clients that achieved the expected results	95%	95.8%

1. EDA investments are expected to achieve their targets by the end of a nine-year period, with benchmark targets achieved in three-year intervals. Thus, the targets to be achieved in FY 2006 are related to investments made three, six, and nine years before.

Sources: United States Department of Commerce (2007), "Economic Development Administration", in US Department of Commerce, *FY 2008 Budget in Brief*, p. 44.

For the purpose of public accountability, the EDA reports performance data each year through the Department of Commerce Performance and Accountability Report (PAR) to the Office of Management and Budget, the

Government Accountability Office, and Congress. The data are also used to assess the Administration's annual budget request (EDA Annual Report, 2004).

The Balanced Scorecard

While the 1997 implementation of GPRA introduced a focus on results across all of government, it does not produce sufficient information for strategic decision making. Thus, when the EDA leadership decided to transform the organisation from delivering grants to delivering results in 2001, it sought an additional performance management tool. The Balanced Scorecard was put in place with the intention of enhancing management processes, improving investments and the way they are monitored, and strengthening the EDA's credibility after functioning 16 years without formal authorisation (Balanced Scorecard Collaborative, 2005). The Balanced Scorecard (BSC) is a strategic management tool developed in the early 1990s that enables managers to monitor indicators in multiple areas that affect the organisation's performance.

Approximately one year was spent on intensive preparation and consultation within the organisation before launching the BSC in fiscal year 2003. The result was six individual regional strategy maps (which embody objectives) and scorecards (which contain the corresponding measures and targets). These are summarised in an overall regional office strategy map and scorecard (Table 8.2). Efforts are underway to update the regional level and also to produce a headquarters scorecard. The two will then be combined to generate an enterprise-level scorecard.

While the BSC is an internal management tool that focuses largely on the process of delivering EDA services, three measures are tied to the outcomes that the organisation hopes to achieve: 1) estimated number of jobs created or retained; 2) the amount of private sector dollars invested; and 3) the private sector dollars invested per EDA dollar. These BSC measures are tied to the GPRA targets and overall levels are distributed across the regional offices as a function of their funding allocation. Quarterly targets are then set for each regional office. Other measures are less directly linked to outcomes but important nonetheless. For example, since numerous measures on the BSC reflect interactions between regional offices and sub-national partners, achieving BSC targets can affect the pace at which projects are implemented, particularly by inciting regional office staff to encourage investment recipients to start projects on time. BSC reports are submitted by regional offices on a quarterly basis. Scorecards are reviewed by regional office directors as well as headquarters staff.

Looking forward, an updated BSC will be launched that incorporates a variety of changes. Attention is being given to the categorisation of investments to ensure that measures are accurate and valid. In addition, a shift will be made

Table 8.2. **EDA Balanced Scorecard**

Strategic objective	Measures
Stakeholder perspective: Congress, the White House, OMB, the Department of Commerce, the American taxpayer	
Maximise EDA impact on distressed areas	*Estimated number of jobs created or retained*[1]
Knowledgeable and prompt economic development advisors	% of investments invited that are approved[3] % of proposals with decisions within established target timeframe
Show visible results	Number of positive media hits about investments Number of signs up and accurate at project sites
Make investments that are engines from growth	% of investments that support regional competitiveness
Advance Department of Commerce/EDA policy	% of dollars invested that support EDA funding priorities
Customer perspective: distressed communities, investment partners, the private sector	
	No active measure
Financial perspective	
Maximise administrative efficiency/effectiveness	% of funds recommended by Regional Director for reservation
Maximise private sector leverage	*Private sector dollars invested per EDA dollar*[1] *Total private sector dollars invested*[1]
Internal perspective	
Emphasise funding priorities	% of dollars allocated that meet minimum threshold for funding priorities
Implement investment policy guidelines	% of investment summaries that clear quality control
Expand deal flow	% of deals with new partners (within five years)[3]
Enhance due diligence	% (and number) of projects started on time[3] % (and number) of projects completed on time[3]
Enhance post-approval monitoring	% of active projects visited/called once per year[3]
Enhance records management	% of OPCS records without critical data omissions[2]
Align resource with strategic priorities	% of strategic objectives at or above targets
Learning and growth	
Enhance communication	% of employees with full access to all communication tools Number of monthly all-hands staff meetings
Attract top talent	% of new employees endorsed by Office of Assistant Secretary
Develop technology proficiency	Number of IT courses per employee
Establish performance culture	% of employees with performance goals tied to the BSC

1. Indicators linked to the GPRA measures.
2. Indicators linked to the data quality.
3. Indicators that reflect interactions between regional offices and sub-national partners. Only objectives with active measures are listed.

Source: EDA.

away from largely operational measures to indicators of more complex concepts such as entrepreneurship and regional impact. When the BSC was first implemented, the EDA was not in a good position to assess such concepts; learning and education both internally and with investment recipients had to take place. The intention is to transition to a system that will allow the EDA to draw inferences about the relationship between types of investments and outcomes, such as jobs created.

Assessment

What is measured

Determining what to measure with respect to regional economic development is no small task. Linkages between policy or programming actions and regional economic performance are difficult to establish because the causal relationship between inputs, outputs, and outcomes are often fuzzy for regional development policy, because there is a significant lag between when time investments are made and results are achieved, and because the central government must rely on other parties to produce high-quality outputs (such as nonprofits, firms, or sub-national governments in the case of the EDA).

The EDA selected outcome measures of job creation and private sector investment leveraged as headline indicators. These measures do not correspond directly to the desired policy goal: "to raise the standard of living for all citizens and increase the wealth and overall rate of growth of the economy by encouraging communities to develop a more competitive and diversified economic base…" Instead, the assumption is that jobs created and private sector funds leveraged are highly correlated with this policy objective. In this case, the types of jobs created, whether they are new or relocated, who they employ, where and how all matter. These dimensions are not tracked via GPRA or the BSC. The EDA recently re-oriented its investments to prioritise creation of higher-skill, higher-wage jobs, but this dimension is also not reflected in the GPRA measures. However, there are plans to better measure the types of jobs created. In the new BSC, EDA will aim to measure the quality of jobs by using NAICS codes to identify the primary beneficiary of projects. The quality of the jobs will be imputed based on the type of industry.

The headline indicators selected by the EDA are not necessarily easy to measure. Complexity emerges because the causal link between job creation, private investment, and EDA project funding is likely to be more difficult to observe over time – especially nine years after project start-up. This is especially true as a public works grant tends to be small relative to the size of the local or regional economy (Haughwout, 1999).

Other measures of the impact of EDA investments on the local economy, such as changes in the local tax base, are captured during GPRA validation site visits by examining the increase in the local real or business property tax base (OMB, 2004). During validation site visits, EDA also requests other information that may be available, such as unemployment tax paid as a measure of employment and business taxes paid as a measure of business activity. However, assessing these metrics can be difficult and validation site visits are infrequent. Six such visits are conducted each year.

Relations among levels of government

Performance indicator systems can be used to reduce information asymmetries across the different levels of government. In this case, regional economic development involves national, state, and sub-state actors. Both the GPRA and BSC data provide information about sub-national activity to the national government, and in doing so reduces information gaps regarding outputs and outcomes being produced. However, for communicating with sub-national grantees, the EDA's investment policy guidelines appear to have been useful for conveying the priorities associated with outcome targets. The investment policy guidelines are criteria for evaluating funding applications. They are integrated into the (re)authorising legislation and made publicly available online. They explicitly link funding criteria to indicators of performance, stating that an investment should "… capitalize on a region's competitive strengths and will positively move a regional economic indicator measured on EDA's Balanced Scorecard, such as: an increased number of higher-skill, higher-wage jobs; increased tax revenue; or increased private-sector investment". EDA priorities and economic development information is also communicated to investment recipients via magazines, webcasts, performance awards, and the like.

Incentives structures

The purpose of incentive mechanisms in indicator systems is to better align the motivations and actions of the agents with those of the principal in the presence of asymmetrical information. Incentives can be monetary *(e.g.,* increase or loss of budget, supplemental funds) or non-monetary *(e.g.,* reputation effects, administrative flexibilities). In fact, GPRA has no explicit rewards or sanctions for performance. However, there is an intention to link federal budgeting and performance. Officially, performance information is used by the Department of Commerce, the OMB, and Congress when evaluating the EDA's budget request. The link is sufficiently strong to have prompted the EDA to merged performance evaluation and budgeting functions into a single division (EDA Annual Report, 2004). However, the specific use of information by Congress is not entirely clear. There is a perception that under-performance relative to proposed targets could be sanctioned by Congress by reducing an agency's funding. By contrast, satisfactory performance can be "rewarded" if the budget is left untouched or increased. But the link between performance and budget is not explicit or consistently applied. In fact, congressional use of GPRA information does not appear systematic, and could make agencies risk-averse when setting performance targets.[5] Some agencies, such as the National Highway Transportation Safety Administration, have been chastised by Congress for failing to meet challenging targets that rely on high levels of performance by states (Metzenbaum, 2003). Thus federal agencies may have limited incentive to

establish "stretch targets" to increase spending efficiency, particularly where sub-national partners are heavily involved in achieving outputs and outcomes.

In 2007, the EDA introduced a reward for investment recipients whose performance met or beat established targets. Funds previously used as a bonus for grantees who participated in an Economic Development District[6] are now used to reward investment recipients if they complete projects on time and meet targets set in their grant award for job creation and private sector funds leveraged (Section 215(b)(2) of PWEDA [42 USC. 3154a]). These indicators are monitored for all investment recipients through the regional Balanced Scorecard. As it is currently designed, the "bonus" is not provided for achieving stretch targets or superior performance, but rather for meeting (or exceeding) contractual obligations. However, additional performance criteria can (and may) be established. Investment recipients receive the awards after projects are completed and the amounts awarded cannot exceed 10% of the project's award (Federal Register, 2006).

In addition to awards, grantees face performance incentives in other forms. For example, the funding formula for the Trade Adjustment Assistance Centers incorporates performance information. The Administration also introduced a pilot project to award grants to University Centers on a competitive basis and has terminated awards due to insufficient performance (OMB, 2004). GPRA measures provided a basis for the competitive awards.

Because the Balanced Scorecard is an internal management tool, the incentives are attached to its implementation are attached to staff assessment. Within government regulations which place limits on performance-based pay, the EDA was able to link BSC scores with the performance assessment and remuneration of regional directors (Balanced Scorecard Collaborative, 2005).

"Costs"

The implementation of GPRA has both direct and indirect costs for both the EDA and its investment recipients. **Direct costs**, such as dedicated staff and information technology systems, are difficult to measure in part because both staff and IT systems are rarely dedicated solely to GPRA compliance. One estimate is that approximately one 0.75 full-time equivalent staff person is dedicated to managing the information system requirements for GPRA, the Balanced Scorecard, and related systems at EDA headquarters. Each regional office also has approximately one full-time equivalent staff person working on these indicator systems and the associated reporting requirements. Formal training, another direct cost of indicator systems, is not provided for GPRA. The EDA spends between USD 500 000 and USD 600 000 each year to maintain OPCS as well as another IT system for managing information for its loan programme.[7]

There is also an opportunity cost related to staff time. Opportunity costs are the foregone benefits associated with an alternative use of resources, in this case a diversion of staff from other productive tasks. In fact, substantial staff time was spent producing the Balanced Scorecard. The original BSC was put in place after nearly a year of intensive work at headquarters and subsequent collaboration with regional offices. The process began in November 2001 with a series of two-day, off-site training sessions with external consultants for EDA's top leadership and senior managers, both from headquarters and the regional offices. Two senior staff were placed in charge of the implementation effort and their other functions were made lesser priorities (Sampson remarks, 2003; Balanced Scorecard Collaborative, 2005). They were supported by two teams: a Leadership Team (five executive headquarters staff, plus two Regional Directors) and a Core Team (eight staff from throughout organisation). Although the BSC was rolled out in late 2002, it was subsequently reviewed and updated in 2006. This update involved 10 weeks of participation by the leadership team (five meetings of approximately 5-6 hours each) and the core team (two 4-hour meetings per week). In all, approximately 815 person hours were spent on updating and revising the headquarters BSC, excluding travel time for regional office participants. Additional time will have to be spent revising and updating the regional scorecard. Providing accurate and timely data for the BSC also requires staff time.

The opportunity cost of performance indicator systems declines as its usefulness increases. How useful is GPRA information for Congress? For the EDA? According to the legislation, one use of GPRA information is to improve congressional funding decisions. However, the difficulties associated with measuring the performance of public policies make a tight linkage between GPRA information and budget decisions difficult (CBO, 2001). Moreover, congressional use of GPRA information does not appear to be predictable or systematic, with a loss of funding being a potentially unwelcome outcome. In this context, achieving targets is not seen as a matter of degree, but rather as "pass or fail" and can discourage the establishment of stretch targets.[8] There is, however, periodic oversight regarding the achievement of GPRA targets by the Government Accountability Office at the request of Congress.[9] In these instances, attention has been given to the achievement of GPRA targets by the EDA.

For the EDA, GPRA information appears to have limited strategic value. This is not dissimilar to the use of GPRA information in other federal agencies (GAO, 2004b). At the EDA, this may be attributable to a number of factors. First, the EDA often reports on indicators that lag years behind current budgetary and management decisions, and possibly behind the regional economic climate that could affect the success of investments. A variety of exogenous factors can intervene during the nine-year window that can positively or negatively affect achievement of outcomes (jobs, investment) and policy goals

(economic growth). This highlights the importance of having reliable short-, medium-, and long-term indicators of performance. For the EDA, short-term indicators are associated with their Balanced Scorecard, making it the primary tool for regular strategic decision making. Second, like many federal agencies, the EDA is not a direct provider of public services. As such, the performance indicators being monitored reflect the effect of interventions over which they have only partial control. In this regard the performance data are used when considering subsequent award requests by grantees.

Another indirect cost of performance indicator systems is the **administrative burden** that it places on participants. Often this administrative burden is difficult to quantify. Some information in this regard comes from compliance data for the Paperwork Reduction Act of 1995.[10]

The EDA collects GRPA information from its investment recipients via four short forms, one for each type of grantee. In 2005, the EDA estimated the cost of the administrative burden that these requirements placed on both its investment recipients and on the EDA itself. In all, it estimated that the GPRA reporting requirements would impose a total of 19 768 hours of work for investment recipients and 16 422 hours of work for the EDA (Table 8.3). The total cost of this burden was estimated to be approximately USD 1.8 million (0.63% of the EDA budget), with the bulk of the cost accruing to investment recipients. At present, all grantee reports are submitted in paper format and are subsequently entered into the EDA database by regional office staff – thereby substantially increasing the administrative burden. Because the federal government requires electronic transmission of data from investment recipients, the EDA is developing an electronic processing and data collection system to facilitate data collection and aggregation. However, some actors in distressed communities do not have access to sufficient information technology.

For organisations with high levels of administrative capacity, the equivalent time-on-task can represent a far lower burden than an organisation with limited administrative resources. In particular, investment recipients in rural areas are more likely to face capacity constraints than urban ones. A 2001 study from The National Association of Counties found that only 28% of US rural counties have a grant writer on staff, compared to 51% of metropolitan counties. They are also less likely to have an economic development professional (31% *vs.* 61%) or even a web site (37% *vs.* 85%)[11] (Kraybill and Lobao, 2001).

The burden imposed by the collection of GPRA data extends beyond the costs captured in Table 8.3. The greatest challenge relates to the lagged indicators. Although investment recipients are aware of future reporting requirements when they receive an award, they may not fully anticipate the long-term data collection requirements. The lags associated with reporting results of

Table 8.3. **Administrative burden of EDA's GPRA reporting requirements**

GPRA Grantee	Responses (hours per response)	Labour cost per hour[1] (USD)	Non-labour cost per response[2] (USD)	Total burden (hours)	Total burden (cost in USD)
Public Works and Economic Adjustment Infrastructure and Revolving Loan Funds	1 100 (8)	42.00	68.25	8 800	444 675
Economic Development District and Indian Tribe	365 (6)	42.00	68.25	2 190	116 891
University Centre	1 146 (7)	42.00	68.25	8 022	415 139
Trade Adjustment Assistance	126 (6)	42.00	68.25	756	40 352
Annual burden to respondents	2 737 (–)			19 768	1 017 056
Annual burden to the EDA	2 737 (6)	45.00		16 422	738 990
Total administrative burden	*4 374 (–)*			*36 190*	*1 756 046*
Total EDA budget FY 2006					*280 432 000*
As % of overall budget					*0.63%*

1. Professional and support staff.
2. Equipment, printing, postage, and overhead.

Source: EDA, "OMB Data Collection Clearance 2005".

investments mean that investment recipients must collect and report data three, six, and nine years after the initial award. This involves contacting beneficiaries of investments (*e.g.*, locating businesses in a particular region) to request company employment data. As these beneficiaries may not have been party to the original award and unaware of the investments that lured them to a region, convincing private companies to release such information can be a challenge. In other cases, staff turnover among grantees can result in a loss of institutional memory regarding the EDA funded project. In some cases staff of the District Organisation may intervene to assist investment recipients in their region to locate and produce the needed documentation. These challenges increase the **transaction costs** associated with the performance framework. In other cases, collecting lagged data is less problematic – such as the case of University Centers, which tend to have well-developed information systems and which report data with only a two-year lag.

Implementing the Balanced Scorecard has relied on better use of existing information and did not result in increased data collection from investment recipients. In fact, until its recent update and revision, the BSC contained metrics that were not fully operational because compliance with the Paperwork Reduction Act would have required approval to collect the additional data from grantees. The updated version of the BSC has removed these measures.

Another indirect cost of indicator systems comes from the **unintended consequences** that can emerge. Such consequences include, but are not limited to, cheating or gaming on the part of agents, cream skimming, shifts in work organisation and orientation, and misallocation of resources or compromised

policy decisions resulting from inappropriate or poorly measured indicators. While such consequences are not entirely avoidable, developing robust mechanisms for detecting and managing these effects adds credibility to the system. For example, while lagged measures may better capture the outcomes associated with EDA investments, ensuring the validity of data can be challenging when it is collected nearly a decade after the project launched. The primary mechanisms observed at the EDA for managing such consequences include data verification and auditing, and changing the culture of the regional offices and grantees to see the value of accurate information.

With respect to data verification, data are first reviewed when proposals are made. The lagged nature of GPRA indicators means that data are often collected a number of years after projects have been funded. However, projected values are taken into consideration at the time a project is proposed. When a prospective applicant submits a pre-application form, it must identify private sector employers who will benefit from the project, enumerate the number of jobs that will be "saved" or "created", and the amount of private sector capital that will contribute to the project. This information, along with other data provided in the pre-application, is used by the EDA regional offices to determine preliminary eligibility, and evaluate the competitiveness of a proposed project (EDA, "Pre-Application For Investment Assistance"). If proposals are determined to be satisfactory, the prospective grantee is invited to submit a complete proposal. On the one hand, by using expert assessment this approach can weed out applicants that have inflated their anticipated achievements in an attempt to "score well" as compared to other applicants. On the other hand, it can also lead to "cream skimming" in which proposals that are most likely to succeed are selected, but which may not adequately address the needs of difficult-to-employ populations or provide investment for projects that would not otherwise occur.

In addition to a review of proposed outcomes in the pre-application phase, GPRA site validation visits are also conducted for a sample of EDA investments over USD 500 000 reporting jobs created/retained and private sector investment leveraged *(e.g.,* one investment per regional office). A variety of data are requested from the grantee, including the number of jobs created/retained, changes in the average annual wage before and after the EDA investment (if available), and the amount of private investment associated with the project (EDA, FY 2007 Congressional Budget Request Draft). Overall, however, capacity for post-award auditing is quite limited. Confidence is placed in the grantee and emphasis is placed on *ex ante* evaluation of their forecasts in proposals.

Finally, the EDA requires that investment recipients maintain accurate and verifiable data that can be substantiated by an independent source in order to minimise bias. Introducing this requirement provoked concern from grantees regarding the burden this imposes. However, in promulgating its

rules, the EDA noted "that locating independent sources has time and cost implications [but believes] it is very important that the data used by a Recipient is verified when possible by a reliable source independent of the Recipient" (Federal Register, 2006).

Shifts in work organisation and orientation that result from the introduction of performance measures can be both positive and negative. The information produced through indicator systems should be used precisely for evaluating whether or not work organisation is effective and priorities are being met. On the other hand, there is a potential risk that overemphasis on certain measures can shift resources away from important, productive activities. For example, the emphasis on job creation could potentially lead to a (re)orientation to programming that could result in a great number of jobs (*e.g.,* planning activities) as opposed to alternative investments (*e.g.,* public works). This type of shift could be detected by examining budgetary allocations over time.

Benefits

Performance monitoring through GPRA and BSC appears to have delivered three categories of benefits: improved public accountability, improved strategic management decisions, and overall learning.

GPRA appears to have delivered some benefits in terms of public accountability for results. It is credited for shifting the focus of the national government away from measuring inputs and process toward outputs and results. The continual focus on monitoring performance and the public dissemination of results enhances public accountability (albeit at costs outlined earlier). It also appears to have stimulated learning. The EDA invested and continues to invest resources to examine the relationship between inputs, outputs, and outcomes in order to produce lagged indicators, particularly for public works investments.

The Balanced Scorecard has contributed to strategic management to a greater degree than GPRA. It has proved useful for the EDA in a number of ways. Specifically, it has helped to:

- Identify which regional offices are performing well (or poorly) on specific objectives, encourage action by regional offices to meet targets on a quarterly basis, communicate progress to staff, and monitor forecasted job creation and investment.
- Enhance the working relationship with the Office of Management and Budget by promoting the EDA as a high-performing organisation. The BSC is referenced in OMB's 2004 PART review of the EDA.
- Focus the EDA on promoting "high value" projects for distressed communities.

- Promote a cultural shift in the organisation and move the debate from what is "good" for distressed communities to what is "best" by setting targets for specific categories of investments.
- Better communicate with investment recipients regarding EDA priorities.
- Conceptualise goals for staff.

BSC also had a positive effect on the quality and usefulness of information about investments. For example, since 1999 the EDA has used an Operations Planning and Control System (OPCS) to monitor investments from pre-application through close-out. OPCS provides much of the data used for both the Balanced Scorecard and GPRA. Prior to the introduction of the BSC, however, data were often entered in an untimely, inaccurate, or incomplete fashion – lessening the usefulness of data. With the introduction of OPCS related targets in the BSC, the percentage of complete and accurate records increased from 89% in FY 2003 to 98% in FY 2004 (Balanced Scorecard Collaborative, 2005). OPCS proves useful not only for complying with formal reporting requirements (such as GPRA), but also to provide data on-demand to congressmen interested in the number of projects, jobs created, investment, etc., occurring in their districts.

Kelman (2006) distinguishes between *performance measurement* systems, where actors choose measures and report against them, and *performance management*, where actors go beyond measurement and use data to improve performance. GPRA might be considered "performance measurement" because there appears to be little evidence of a strong feedback effect on policy choices, programming decisions, etc. As such, the benefits accrue largely in the area of accountability. By contrast, because the Balanced Scorecard is used for organisational performance, it might be considered under the rubric of performance management. Benefits relate largely to enhanced internal strategic decision making, with spillovers for sub-national grantees coming from the link between the BSC and investment guidelines.

One benefit attributable to both systems has to do with learning. The ongoing attention given to refining measures for both GRPA reports and the BSC highlights the evolving nature of indicator systems and the need for continual learning. Both approaches will be updated to include enhanced measures and to reflect learning that has occurred both within the organisation and with investment recipients.

Conclusions

This case study underscores the fact that although performance indicator systems can be beneficial, they are not without costs and risks. Moreover, regional policy poses unique challenges regarding what to measure and how to incite performance when short-term outputs are part of a complex, long-term process where causal relationships are often uncertain. GPRA emphasises

the accountability of federal programmes to Congress (and taxpayers). It requires federal agencies, such as the EDA, to plan for and track programme performance. In aiming to demonstrate "results" to Congress, the EDA chose lagged measures (intermediate indicators) of performance. This approach has multiple costs and benefits, as noted here. One "cost" is the limited usefulness of this information for strategic decision making. The EDA has addressed this problem by implementing an internal performance management tool, which monitors both processes and short-term outputs. In doing so, it bridges performance measurement and performance management. Ultimately, however, the challenge of linking inputs, outputs, and regional economy outcomes remains. There are ongoing efforts at the EDA to move the performance indicator system in this difficult but worthwhile direction.

Notes

1. "Authorizing legislation establishes federal agencies and programmes and outlines their roles and responsibilities for a specific period of time. When that period expires, Congress must pass legislation renewing the authorizing legislation. Appropriations committees determine the annual budget of agencies within the constraints of ceilings that are established by the authorizing process and overall budget limits established through the budget committees" (Eisenberg, 2000). The EDA operated without explicit authorisation for many years, but it received implicit authorisation through the annual appropriations process.
2. The distribution of programme funds uses FY 2006 budget data reported in the EDA's FY 2008 EDA Congressional Budget Submission, available as part of the Commerce's FY 2008 Congressional Budget Justification online at: *www.osec.doc.gov/bmi/budget/08CJB/eda.pdf*.
3. CEDS are regional economic plans. They outline the opportunities and constraints affecting the regional economy, the availability of resources for economic development, regional development goals, priority programmes and projects for implementation, and a process for evaluation. In most cases, a CEDS must be in place to receive EDA funds (EDA, "Planning for Economic Development").
4. A district organisation is an entity that conducts regional economic development activities in an Economic Development District. Specific definitions can be found in 13 C.F.R. 304.1 and 304.2.
5. "… Congress has not paid much attention to the information in agency reports, though it requires them to be produced. When Congress does begin to use the information contained in agency reports, it will have the effect of motivating agencies to produce better results, better measures, and better data." Testimony of Eileen Norcross, Research Fellow for the Government Accountability Project, The Mercatus Center at George Mason University before the Subcommittee on Federal Financial Management, Government Information and International Security of the Senate Subcommittee on Homeland Security and Governmental Affairs, 14 June 2005.
6. In the past, investment recipients that were also participants in an Economic Development District received an additional 10% of federal funds. For example, a USD 1 million public works grant would be increased by 10% of the grantee working in an EDD framework.

7. See IT Investment Details worksheets (companions to Chapter 9 of "Analytical Perspectives, Budget of the United States Government" for Fiscal Years 2007 and 2008), accessed December 2007, *www.gpoaccess.gov/usbudget/fy07/sheets/itspending.xls*; and *www.whitehouse.gov/omb/budget/fy2008/sheets/itspending.xls*.
8. However, it is important to note that not all agencies in the Department of Commerce meet all their GPRA targets.
9. See "Observations on the Department of Commerce's Fiscal Year 1999 Annual Program Performance Report and Fiscal Year 2001 Annual Performance Plan" (GAO/GGD-00-152R), and "Department of Commerce: Status of Achieving Key Outcomes and Addressing Major Management Challenges" (GAO-01-793).
10. The Paperwork Reduction Act established a process for reviewing and approving the collection of information from 10 or more persons by federal agencies. Before collecting or amending collections of information from the public, agencies must gain prior approval from the Office of Management and Budget.
11. While these resources may not relate directly to managing EDA grants, the limited technical staff points to the general capacity constraint facing rural areas when considering application for and management of an award.

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Governing Regional Development Policy
The Use of Performance Indicators

ANNEX A

Key Terms

- **Activities:** Actions taken or work performed through which inputs are mobilised to produce specific outputs.
- **Effectiveness:** The extent to which [an] intervention's objectives were achieved, or are expected to be achieved, taking into account their relative importance. Also used as an aggregate measure of (or judgment about) the merit or worth of an activity, *i.e.,* the extent to which an intervention has attained, or is expected to attain, its major relevant objectives efficiently in a sustainable fashion and with a positive institutional development impact.
- **Efficiency:** A measure of how economically resources/inputs (funds, expertise, time, etc.) are converted to results. Can be measured as cost per unit of output.[1]
- **Evaluation:** The systematic and objective assessment of an on-going or completed project, programme or policy, its design, implementation and results. The aim is to determine the relevance and fulfillment of objectives (effectiveness), the ways in which activities were performed for the transformation of inputs into outputs (efficiency), and the ultimate effects observed on the field to which programmes or policies were addressed (impact and sustainability). An evaluation should provide analysis of context, information that is credible and useful, and interpretation or explanation regarding what is observed, thus enabling the incorporation of lessons learned into the decision-making process.
- **Impacts:** Positive and negative, primary and secondary long-term effects produced by [an] intervention, directly or indirectly, intended or unintended. EU Structural Funds programming differentiates between "specific impacts" which occur after a certain lapse of time but which are directly linked to the action taken, and "global impacts" which are longer-term effects affecting a wider population.[2]
- **Indicator:** Quantitative or qualitative measure that provides a simple and reliable means to assess achievement, to reflect the changes connected to an intervention, or to help assess the performance of [an] actor.

- **Inputs:** The financial, human, and material resources used for an intervention.
- **Monitoring:** A continual process that uses systematic collection of data on specified indicators to provide management and the main stakeholders of an ongoing intervention with indications of the extent of progress and achievement of objectives and progress in the use of allocated funds over time.
- **Outcomes:** The likely or achieved effects of an intervention's outputs. EU Structural Funds programming differentiates between "results" which are direct and immediate effects of outputs and are linked to "specific objectives", and "impacts" which are longer-term effects associated with "global objectives".[2]
- **Outputs:** The concrete and immediate results (products, capital goods and services, etc.) which are obtained from [an] intervention; may also include changes resulting from the intervention which are relevant to the achievement of outcomes. EU Structural Funds programming associated outputs with "operational objectives".[2]
- **Performance:** The degree to which an intervention or a partner operates according to specific criteria/standards/guidelines or achieves results in accordance with stated goals or plans.
- **Performance indicator:**[3] Measures of project impacts, outcomes, outputs, and inputs, or ratios of outputs to inputs, that are monitored during programme or policy implementation to assess progress toward objectives; also used later to evaluate a programme or policy's success.
- **Results chain:** The causal sequence for an intervention that stipulates the necessary sequence to achieve desired objectives beginning with inputs, moving through activities and outputs, and culminating in outcomes, impacts, and feedback.

Note: Most definitions come from OECD (2002), *OECD Glossaries: Evaluation and Aid Effectiveness* No. 6 – Glossary of Key Terms in Evaluation and Results Based Management, OECD Publishing, Paris. They have been modified to make them more broadly applicable, in this case for regional development policy. Where additional source material has been used to produce or complement a definition, it is noted by a superscript and the corresponding sources are listed at the end of the text.

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ANNEX B

Indicators for Regional and Local Economic Development

Recommendations from selected sources

Table B.1. **Indicators for local economic development**
Source: The UK Audit Commission

Theme	Construct of interest	Suggested indicators
Employment	Employment	• Proportion of people of working age in employment
	Unemployment	• Proportion of the working age population who are claiming Job Seekers Allowance (JSA) • Proportion of 1) all unemployed people; 2) males; and 3) females claiming JSA who have been out of work for more than one year
	Local jobs	• The percentage of local jobs by sector • The percentage of these jobs that are full time • Annual change in number of local jobs
Earning and skills	Earnings	• Median annual earnings for all in full-time employment • Median annual earnings for full-time males • Median annual earnings for full-time females
	Workforce skills	• Percentage of population of working age failing to meet NVQ Level 1 standard or equivalent • Percentage of population of working age qualified to NVQ level 2 • Percentage of population of working age qualified to NVQ level 3 • Percentage of population of working age qualified to NVQ level 4 and 5
Economic vitality	Economic vitality	• Gross Value Added (GVA) per head of local population • Growth in GVA per head of local population • Percentage of the local working age population who are economically inactive
	Business growth	• Number of VAT 1) registrations; and 2) deregistrations in the area per 10 000 economically active population • Percentage change in number of VAT registered business in the area over the year
	House prices and affordability	• Median property price • Median property price/median earnings of full time employees
	Business confidence	• Previously developed land that is unused or may be available for redevelopment; and 2) derelict land as a percentage of the local authority land area • Satisfaction with the local area as a business location

Table B.1. **Indicators for local economic development** *(cont.)*
Source: The UK Audit Commission

Theme	Construct of interest	Suggested indicators
Demography and deprivation	Population	• Total number of people living in the local authority area categorised by: 1) gender; 2) age bands; 3) ethnicity • Population density • Percentage change in total population by age bands
	Household poverty	• Children under 16 living in low-income households • Percentage of population of working age who are claiming key benefits
	Deprivation	• Proportion of Super Output Areas (SOAs) in the local authority area that rank within the most deprived 20% of SOAs in the country
Town centres and tourism	Town centre revitalisation – usage	• Visits (measured by pedestrian footfall) to the town centre (survey) • Satisfaction with the town centre (survey)
	Town centre revitalisation – activity	• Number of retail ground floor units not being used as a proportion of the total number of ground floor businesses and 2) percentage change since previous year • Number of charity shops as a percentage of the total number of ground floor businesses • Prime retail rent per square metre • Shopping centre yield
	Tourism	• Day visitors per annum • Bed nights per annum and 2) room occupancy (ratio of total occupied rooms to total available rooms) • Average spend per visitor (day and overnight combined)
Workforce development and employability	Workforce development	• Proportion of employees and self employees that have received job related training in the last 13 weeks
Investment	Business investment	• Total number of 1) inward investment enquiries; and 2) re-investment per 10 000 economically active population • Total number of 1) new investments; and 2) re-investments made in the area that have occurred as a result of the promotion and support activities of the authority • Jobs created and/or safeguarded to which the authority's promotional and support activity has made a significant contribution • Cost per job created and/or safeguarded to which the authority's inward investment promotional and support activity has made a significant contribution • Percentage of business customers using the inward investment services (including aftercare) expressing satisfaction with the services and support provided • The extent to which the local authority's investment in the development of land and premises for economic development has been instrumental in levering funds from other sources, including grant aid
	Land and premises brought forward for development	• Brownfield land reclaimed as a percentage of all land made available for industrial, commercial and leisure purposes
Business and social enterprise support	Business support – start-ups	• Number of new business start-ups supported in the local area per 1 000 VAT registered businesses • Percentage of these start-ups which are located in wards that contain a Super Output Area (SOA) in the 20% most deprived SOAs in the country • Average cost of local authority business support per new business start up supported • User satisfaction with business start-up support

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Table B.1. **Indicators for local economic development** *(cont.)*
Source: The UK Audit Commission

Theme	Construct of interest	Suggested indicators
	Business support – units and managed workspace	• Number of persons employed by businesses occupying managed workspace provided by (or funded by) the local authority • Survival rates of businesses in managed workspace (*i.e.,* after two years) • Annual cost of providing the business units in relation to 1) FTE jobs employed in the managed workspace (*i.e.,* cost per job supported) and 2) total floor space of the units (square metres) (*i.e.,* subsidy provided) • Satisfaction of tenants of managed workspaces
	Business support – other	• Number of business enquiries for advice and information received in the financial year per 10 000 economically active population • Cost per business enquiry for advice and information dealt with • Number of jobs created or safeguarded in which the business support provided has made a substantial contribution (normally financial) • Number of businesses assisted through business support initiatives and services during the financial year • Satisfaction of customers receiving business support services
	Social and community enterprise	• Jobs (FTE) created in the last financial year by social enterprises that have received substantive support from the local authority • Total income generated by all of the supported social enterprise

Note: The 2005 Audit Commission report contains only the themes and suggested indicators; the "construct of interest" was listed as an indicator title in the 2003 report. Correspondence between the two documents was created to produce this table.

Sources: Audit Commission (2005), "Economic Regeneration Performance Indicators", March, London, United Kingdom, *www.local-pi-library.gov.uk/documents/EconomicRegenerationPIs.pdf*; and Audit Commission (2003), "Economic Regeneration Performance Indicators", Local Government Feedback Paper, March, London, United Kingdom, *www.local-pi-library.gov.uk/pdfs/ER_report_Low_res.pdf*.

Table B.2. **Core indicators for regional development policy**
Source: The European Commission

EU objective	Thematic field	Indicator
Convergence; Competitiveness and Employment		1. Jobs created (gross direct jobs created, full time equivalents) 2. Jobs created for men (gross direct jobs created, full time equivalents) 3. Jobs created for women (gross direct jobs created, full time equivalents)
	Research and technological development (RTD)	4. Number of RTD projects 5. Number of co-operation projects enterprises – research institutions 6. Research jobs created (preferably five years after project start)
	Direct investment aid to SMEs	7. Number of projects 8. – Of which, number of start-ups supported (first two years after start-up) 9. Jobs created (gross, full time equivalent) 10. Investment induced (million EUR)
	Information society	11. Number of projects 12. Number of additional population covered by broadband access
	Transport	13. Number of projects 14. Km of new roads 15. – Of which TEN 16. Km of reconstructed roads 17. Km of new railroads 18. – Of which TEN 19. Km of reconstructed railroads 20. Value for time savings in EUR/year stemming from new and reconstructed roads for passengers and freight 21. Value for time savings in EUR/year stemming from new and reconstructed railroads for passengers and freight 22. Additional population served with improved urban transport
	Renewable energy	23. Number of projects 24. Additional capacity of renewable energy production (MW)
	Environment	25. Additional population served by water projects 26. Additional population served by waste water projects 27. Number of waste projects 28. Number of projects on improvement of air quality 29. Area rehabilitated (km^2)
	Climate change	30. Reduction greenhouse emissions (CO_2 and equivalents, kt)
	Prevention of risks	31. Number of projects 32. Number of people benefiting from flood protection measures 33. Number of people benefiting from forest fire protection and other protection measures
	Tourism	34. Number of projects 35. Number of jobs created
	Education	36. Number of projects 37. Number of benefiting students
	Health	38. Number of projects
	Urban issues – physical and environmental regeneration	39. Number of projects ensuring sustainability and improving the attractiveness of towns and cities
	Urban issues – competitiveness	40. Number of projects seeking to promote businesses, entrepreneurship, new technology

Table B.2. **Core indicators for regional development policy** *(cont.)*
Source: The European Commission

EU objective	Thematic field	Indicator
	Urban issues – social inclusion	41. Number of projects offering services to promote equal opportunities and social inclusion for minorities and young people
Co-operation Cross-border co-operation and transnational co-operation	Degree of co-operation	42. Number of projects respecting two of the following criteria: joint development, joint implementation, joint staffing, joint financing 43. Number of projects respecting three of the following criteria: joint development, joint implementation, joint staffing, joint financing 44. Number of projects respecting all four of the following criteria: joint development, joint implementation, joint staffing, joint financing
	Cross-border co-operation	45. Number of projects encouraging the development of cross-border trade 46. Number of projects developing joint use of infrastructure 47. Number of projects developing collaboration in the field of public services 48. Number of projects reducing isolation through improved access to transport, ICT networks and services 49. Number of projects encouraging and improving the joint protection and management of the environment 50. Number of people participating in joint education or training activities 51. Number of people getting employment on the other side of the border as a result of CBC project
	Transnational co-operation	52. Number of projects on water management 53. Number of projects improving accessibility 54. Number of projects on risk prevention 55. Number of projects developing RTD and innovation networks
	Inter-regional co-operation	56. Number of projects

Source: European Commission (2006), "The New Programming Period 2007-2013: Indicative Guidelines on Evaluation Methods: Monitoring and Evaluation Indicators", Working Document No. 2.

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Governing Regional Development Policy

THE USE OF PERFORMANCE INDICATORS

The governance of regional development policy is distinctive. It engages multiple actors, across many sectors and at different levels of government – each with varying levels of information and capabilities. Effective governance requires a flexible mechanism for meeting information needs and promoting performance.

This report looks at one tool for doing so – the use of indicator systems. It examines both the challenges and the opportunities associated with designing and using indicator systems in the context of multi-level governance. It draws on the experiences of a number of OECD countries and provides an in-depth look at the cases of Italy, the United Kingdom (England), the United States and the European Union. It builds on previous OECD work on the governance of regional development policy by extending lessons about contractual relations among levels of government to performance indicator systems.

This report should be of interest to stakeholders – from ministers to mayors – seeking to enhance the efficiency and effectiveness of public spending and to strengthen mechanisms for effective multi-level governance.

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