Issue 16 • Autumn 2012

iQnet bulletin

Improving the management of Structural Funds programmes

A challenging time for programme managers

Cohesion policy and financial engineering instruments

Shaping the future of State aid control

Innovation and 'Smart Specialisation' in Cohesion policy programmes

Welcome to the 16th issue of the IQ-Net Bulletin

As the start of the 2014-20 Structural Funds period approaches, programme managers are working hard on preparing the new generation of operational programmes. At this stage, there appears to be a great deal of continuity with the 2007-13 programmes, with a strong focus on competitiveness and innovation, and policy-makers can build on a wealth of evidence in developing the new programmes. However, the need to align the post-2013 programmes with the Europe 2020 objectives also involves new challenges. Many managing authorities welcome greater concentration, but there is also concern about an 'overly thematic focus' of the policy and the potential for a loss of focus on economic and social cohesion.

Two important elements of the next programme period have recently been studied and debated under IQ-Net, which are strongly promoted by the European Commission: the use of financial engineering instruments (see pp.3/4) and the focus on 'smart specialisation' (see pp.6/7). Both topics are set to move centre-stage in the new period, but they also introduce elements of uncertainty for programme managers.

Financial engineering instruments (FEIs) have become increasingly popular at EU level, particularly as they have the capacity to lever in additional private-sector resources in times of constrained budgets and (it is argued) can help to achieve EU policy goals more efficiently. As yet, however, managing authorities across the EU have very different degrees of experience working with financial engineering instruments, and the associated administrative complexities have been a source of major concern for some. Based on comparative research by EPRC on the use of FEIs in different countries and regions, IQ-Net partners had the opportunity to exchange experiences on the design and implementation of EU-co-funded FEIs at two IQ-Net meetings in Aachen (Germany) and Brussels. Looking ahead to 2014+ managing authorities feel under pressure to increase the proportion of their programmes spent on FEIs. However, they may not be suitable for all programmes and there are several important implementation difficulties still to be resolved.

Another important cornerstone of the future programmes, the ***'smart specialisation' agenda***, builds on the concept of regional innovation strategies, which have become mainstreamed in many European regions, at least to some extent. Drawing on EPRC research on how smart specialisation is perceived, IQ-Net partners debated the issue in Tampere (Finland). The views of managing authorities range from very positive to sceptical, a key issue being the need to adapt smart specialisation to the conditions, resources and potential of individual regions. Whilst in theory smart specialisation should be a strategy for all regions, the practical implications pose challenges for a number of regions and countries. As with FEIs, capacity-building is central to the success of this initiative. This is especially true for those regions with little experience of previous innovation strategy-building, or with a weak innovation support infrastructure.

This Bulletin provides a flavour of the research papers prepared for the IQ-Net meetings on both FEIs and smart specialisation, as well as the partner discussions. It also provides an outlook on latest developments in the field of ***State aid control***, a field which is relevant for managing authorities implementing both FEIs and smart specialisation strategies (see p.5).

Launched in 1996, the IQ-Net network is currently in its fifth phase, which will run until the end of 2013. It facilitates exchange of experience among national and regional managing authorities from 14 Member States, and over the past 17 years, IQ-Net has produced around 60 papers reviewing the progress of programmes and assessing many aspects of management and implementation. The network will continue to monitor closely the preparations for the next programme period and provide a pan-EU perspective on how managing authorities are addressing programming challenges.

Further details are available via the IQ-Net website. As ever, feedback on all the issues in this Bulletin is most welcome.

Professor John Bachtler
European Policies Research Centre

IQ-Net delegates visit the 'StreetScooter' innovation platform

At the Aachen IQ-Net meeting, delegates got a glimpse of the prototype of an affordable electric car for urban mobility developed by a consortium of industry partners around the Rhine-Westphalian Technical University (RWTH) Aachen. Promoted by the innovation platform 'StreetScooter' and part-funded by ERDF, this offers the opportunity to test innovative technologies, components, systems and modules in order to qualify for serial production.

For more information visit - **http://www.streetscooter.eu/**

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Aachen photographs (inc front cover): http://www.udo-geisler.de/

Cohesion policy and financial engineering instruments

What is the scope for making more use of financial engineering instruments (FIEs) in Cohesion policy programmes? The use of FEIs at EU level and their ability to increase the leverage of additional public and private sector resources is set to play an increasing role in the delivery of key EU policy objectives, notably Europe 2020. The EU Budget Review noted that innovative FEIs could provide an important new financing stream for strategic investments, leveraging investment from other public and private sector sources. The use of FEIs has risen in prominence over successive programme periods, rising from €570 million co-funded by the ERDF in 1994-99, to €1.3 billion in 2000-06. This trend has been described by European Commissioner Johannes Hahn as a "profound cultural shift".

Structural Funds managing authorities have been setting up and implementing complex co-funded FEIs in an uncertain economic climate. Although often building on experience during previous programme periods, many of them have been facing a steep learning curve. Data collected by the Commission in 2010 revealed significant differences between Member States in the use and operation of FEIs co-funded by the ERDF, including significant variations between countries in terms of the overall allocation of funding. Some FEIs are now fairly well established, while others have only just started their implementation phase. As the funds have been tailored to the individual needs of the regions and Member States, they have different priorities, funding allocations and implementation structures. As a CSES evaluation carried out in 2007 noted, "Different funds are appropriate for different regions… [and]… there is no 'ideal model'", but while there has been a great deal of feasibility and evaluation work carried out in setting up these funds, there has also been a significant element of 'trial and error', or 'learning by doing'.

The administrative complexities associated with EU co-financed FEIs have been - during the 2007-13 period in particular - a major concern for managing authorities. The establishment and operation of FEIs is complex, and requires detailed knowledge of Structural Funds regulations, State aid compliance requirements and market investment principles. Through the JEREMIE and JESSICA Networking Platforms launched in 2009, DG REGIO (in cooperation with the EIF and EIB) has supported the exchange of experience and best practice in implementation of these FEIs. Member States have also organised conferences and seminars to exchange information.

While these various initiatives have proved useful, uncertainties persist in many areas: concerns remain about how the recycling of funding will work on a practical level, about the mismatch between the Structural Funds regulations and FEIs in terms of timing, and about measuring impact. The draft regulatory proposals for the 2014-2020 period (during which period FEIs will be known in Commission documentation simply as Financial Instruments) build on previous COCOF guidance and are intended to provide managing authorities with more legal certainty. However, a number of these proposals also raise issues, especially regarding timely spending and increased reporting requirements.

The use of FEIs in Cohesion policy was the topic of the IQ-Net meeting held in Aachen, Nordrhein-Westfalen in December 2011, hosted by the Ministry for Economy, Energy, Construction, Housing and Transport of the Land Nordrhein-Westfalen. IQ-Net partner discussions on the issues surrounding the use of FEIs in Cohesion policy programmes continued in March 2012 in Brussels, where an Interim IQ-Net meeting was organised in cooperation with DG REGIO, and hosted by the Flanders Enterprise Agency.

Discussions on the topic will be taken forward to feed into the negotiations on the post-2013 period, as well as to contribute to EPRC's new research focus on entrepreneurial finance. IQ-Net partners can discuss their experiences and issues relating to FEIs via an interactive exchange forum on the partner pages of the IQ-Net website.

At the Aachen meeting, interventions were made by Rachel Lancry and Bjoern Gabriel of DG REGIO.

The full report on FEIs co-funded by Structural Funds, written by Rona Michie and Fiona Wishlade (December 2011), can be downloaded here: http://www.eprc.strath.ac.uk/iqnet/29-2.pdf

During a study tour following the Aachen meeting, IQ-Net partners learnt about several Structural Funds co-funded projects, including the NRW/EU.Mikrodarlehen micro loan instrument, a revolving fund supporting start-ups in Nordrhein-Westfalen; a zero-emission hybrid electric fuel cell bus; a fully transplantable artificial heart project developed by the Institute for Applied Medical Engineering located in the Helmholtz Institute, Aachen; and the StreetScooter electric vehicle prototype.

Cohesion policy and financial engineering instruments (Cont.)

The workshop discussions: feedback from the IQ-Net partners

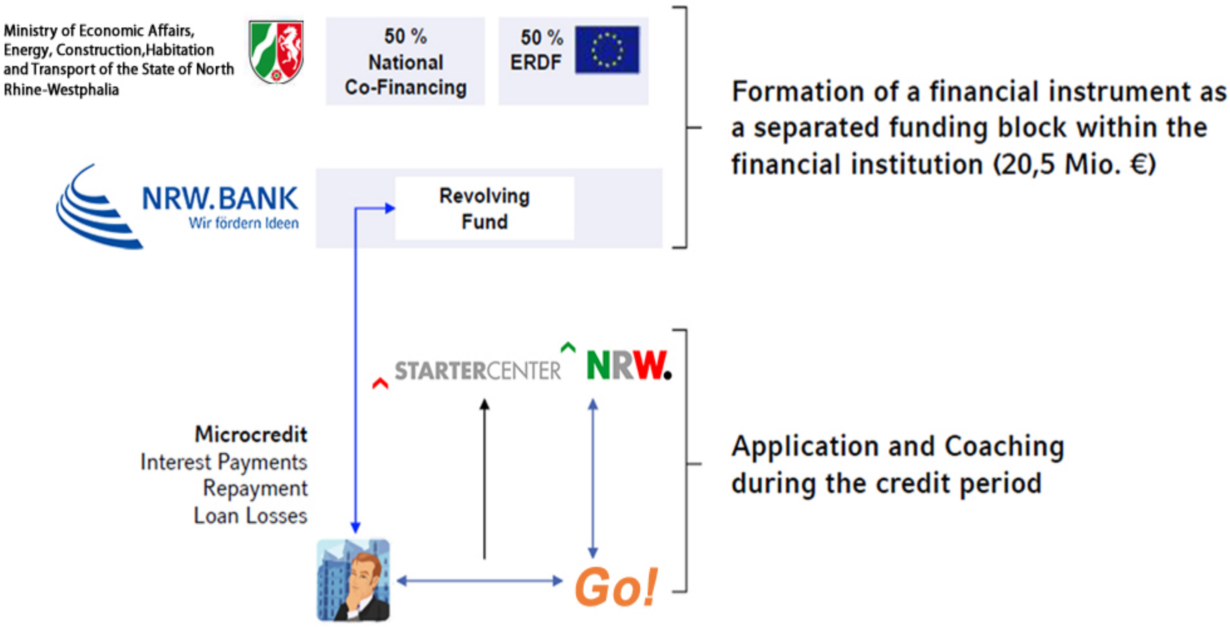
• **Lessons learned**: setting up FEIs takes a considerable amount of time (regardless of fund size), requires flexibility and involves a cultural shift away from a more traditional grant orientation towards 'mixed' modes of financing (grants, loans, equity etc.); it is essential to ensure that amounts put into FEIs are in line with absorption capacity; in terms of complying with State aid regulations, the use of *de minimis* involves delays but provides greater legal certainty than alternatives (although issues around monitoring usage of *de minimis* remain); the use of FEIs within Cohesion policy programmes requires new areas of expertise and capacity problems exist at the level of governments and applicants; use of FEIs may not be useful if the private sector is investing anyway or if private investor profitability is limited due to the seriousness of problems; there are different expectations of public and private actors regarding risks and returns, and this can be problematic.

• **Practical issues which were unresolved in FEI set-up and implementation**: the time-span over which FEIs run compared to the Structural Fund programme period; the use of interest payments and other yields; the need for risk assessment and risk management; IPR issues regarding support of very innovative firms; questions over efficiency/ cost effectiveness of FEIs as well as measurability and comparability of results and evaluation of softer outcomes.

• **Questions on the provisions in the new regulations**: the importance of clarity and flexibility were stressed; should the *ex ante* assessment be optional/ obligatory and should it be applied to all or only to new FEIs?; the proposed two-year rule (referring to investments) could be problematic during the start-up phase; authorities should be free to choose the proportion of funds allocated to FEIs; should Technical Assistance be made available and what kind of services would be needed?; thematic concentration may limit the use of FEIs; an increased administrative burden is foreseen; and improved communication and awareness-raising is needed.

IQ-Net partner case study: the NRW Revolving Loan Fund

A revolving loan fund was set up in October 2008 with the objective that "No sound start-up project should fail because of a lack of finance". Run by North Rhine-Westphalia's Development Bank (NRW Bank, see **www.nrwbank.de**), it involves funding of €20.5 million made up equally of ERDF and national co-financing (see graph). In the pilot phase, which ran until March 2011, instalment loans were provided over a five-year term (interest-only for one year, no securities required) for loans ranging between €5,000 and €25,000. It was exclusively targeted at start-ups and consolidations having existed three years at most.



Advisory support was provided by 'starter centres' for a period of three years. As a result, 366 agreements were concluded, amounting to €7.4 million and leading to 252 firm creations (168 by unemployed) and 114 cases of firm consolidation. Loan conditions were changed in April 2011 with an extension of the term to six years, but a reduction of the interest-only period to six months. Advisory support is available for two years and the instrument now targets expanding/ growing firms of up to five years. By end November 2011, 727 applications had been received, resulting in 429 agreements for an amount of €8.6 million and the creation of 534 direct jobs. Based on this experience, it has been concluded that this type of loan is generally the only possibility for start-ups to realise their project, but that "non bankables" need extensive advice and coaching. The new phasing of the product has proved of value and the new redemption scheme has improved the repayment of loans. The fact that this is an established product on the market is its unique selling point.

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Shaping the future of State aid control

Much of the focus of recent developments for IQ-Net partners has been on the new Cohesion policy programme period, the funds likely to be available in future and the reorientation of policy towards Europe 2020 objectives. In the meantime, but with rather less fanfare, the Commission is also seeking to reframe State aid control, a policy area with significant implications for managing authorities – as shown both in the recent IQ-Net paper on FIEs and an earlier paper specifically on State aid control.[1] The State aid modernisation initiative (SAM)[2] announced in May is essentially a successor to SAAP[3] which had provided a so-called 'road map' for reform over the 2005-09 period. SAAP was set in the context of the Lisbon agenda and the perception that the State aid rules did not facilitate support for innovation and aimed also to respond to criticism of the lack of economic analysis in State aid cases. At the same time, the implications of enlargement and a perceived need to reduce the bureaucracy associated with 'routine' aid schemes culminated in the adoption of the General Block Exemption Regulation (GBER) covering a range of policy areas, and much used for Structural Funds programmes.[4] While SAAP succeeded in putting some order into the State aid rules, there was limited progress in simplification, and disproportionate Commission resources are still spent scrutinising cases of limited practical significance – IQ-Net partners have consistently expressed frustration at the resources involved in securing State aid clearance of very modest measures.

SAM provides for a re-focusing of State aid control against the backdrop of Europe 2020. Accordingly, the substantive objective of SAM is "to foster sustainable, smart and inclusive growth in a competitive internal market." SAM also aims: to focus Commission *ex ante* scrutiny on cases with the biggest impact on the internal market while reinforcing Member State cooperation in enforcement; and to streamline the rules and provide for faster decision-making. As part of this, many of the rules that underpin the use of State aids in Cohesion policy programmes are up for review – these include the General Block Exemption Regulation, the *de minimis* rules, the Regional aid guidelines, the rules on State aid for risk capital and procedures for State aid clearance. Many of the rules and guidelines at stake expire at the end of 2013.

The outcomes of the various reviews underway and their implications for Cohesion policy implementation are hard to predict, but many will affect the design and value of measures in future programmes. For example: the review of the Regional Aid Guidelines will certainly alter the shape of the assisted area maps in most Member States and will likely reduce the rate of regional aid across the board; the assessment of the *de minimis* rule will consider whether the level at which support 'passes under the State aid radar' remains appropriate; and the revision of the GBER may well expand the categories of instrument exempted from notification. The exemption notification might also be extended to include aid granted to EU co-funded instruments such as JESSICA, a move likely to be welcomed by programme managers, though SAM is light on detail.

The question of what constitutes a State aid remains a perennial issue for domestic policymakers at national and subnational levels. SAM acknowledges the problems posed by the lack of 'sharp edges' to the definition of State aid and the Commission commits itself to clarifying the key concepts. However, its ambitions are 'limited to providing clarification as to how it understands and applies the provisions of the Treaty, as interpreted by the Court of Justice'. As such, it is unclear whether this will shed much light on definitional issues or, as important, give legal certainty to beneficiaries about the status of a given measure. Similarly, SAM stresses the importance of concepts and principles in assessing compatibility – this approach can be seen in the JESSICA North-West decision described in the recent IQ-Net paper,[5] where a 'precedent' decision offers a potential model for compatible support. However, there are questions about whether such decisions are sufficiently clear to be reapplied by domestic policymakers in different national and regional contexts – again there may be a 'trade off' between workload benefits for the Commission and legal certainty for policymakers and beneficiaries.

Many aspects of the reforms are or will be the subject of public consultation and the Commission explicitly welcomes feedback from subnational authorities - so now is the time for IQ-Net partners to make their views known![6]

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[1] Wishlade F and Michie R (2009) Pandora's box and the Delphic oracle: EU Cohesion policy and State aid compliance, IQ-Net thematic paper, 24(2), European Policies Research Centre, University of Strathclyde, http://www.eprc.strath.ac.uk/iqnet/24-2.pdf.

[2] European Commission (2012) EU State aid modernisation – SAM, COM(2012) 209 final, 8 May.

[3] European Commission (2005) State aid action plan, COM(2005) 107 final, 7 June.

[4] Commission Regulation (EC) No 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market in application of Articles 87 and 88 of the Treaty [now Article 107 and 108], OJEU L214/3 of 9 August 2008.

[5] Michie R and Wishlade F (2011) Between Scylla and Charybdis: Navigating financial engineering instruments through Structural Funds and State aid requirements, IQ-Net thematic paper, 29(2), European Policies Research Centre, University of Strathclyde, http://www.eprc.strath.ac.uk/iqnet/29-2.pdf.

[6] See: http://ec.europa.eu/competition/consultations/open.html

Innovation and 'Smart Specialisation' in Cohesion policy programmes

What does smart specialisation mean in practice for managing authorities? Regional innovation policies have been promoted by the EU for almost two decades. Over time, the concept of regional innovation strategies has evolved and become somewhat mainstreamed in Europe's regions. It is being further developed at present through the extension to 'smart specialisation strategies for regional innovation' in response to the Europe 2020 strategy. This new (re)conceptualisation of regional innovation strategies is being actively promoted by DG REGIO as the basis for the 2013+ generation of Structural Funds programmes. Yet, it is often unclear what this means on the ground.

IQ-Net partner experiences with regional innovation policies and Structural Funds were discussed at the June 2012 IQ-Net meeting in Tampere, Finland hosted by the Council of Tampere Region, West Finland Alliance and the Ministry of Employment and the Economy. The development of innovation strategies at the regional level can be seen as a form of innovation 'journey', with strategies evolving on the basis of a policy cycle within which there are possibilities for failure, wrong turnings and difficult choices. Leadership is central to this process and is needed in various forms to develop a strategy, implement it and then make further adjustments depending on results. Capacity-building is crucial to the success of such an approach.

Research among IQ-Net partner countries and regions indicates varied approaches to strategy development, with examples of well-established strategies, strategies still under development and emerging strategies. Further, the presence or absence of a strategy is not conclusive: a number of regions implement advanced innovation policies without basing them on a single strategic document. Moreover, innovation strategies can be more or less formalised, they are not necessarily stand-alone documents and are more or less closely connected to the 2007-13 generation of Structural Funds programmes.

Based on experience of implementing innovation strategies by IQ-Net partners, several lessons can be drawn:

- **Collaborative leadership and commitment** based on strong regional consensus and/or close integration with domestic strategic programmes are crucial.
- **Partnership arrangements** should ensure collective 'ownership' of strategies; however, potential problems with decision-making as well as considerable costs need to be considered.
- **Sound prioritisation of resource allocation decisions** at strategic and operational levels is vital to avoid discrepancies between strategic commitments and their implementation.
- **Institutional capacity** is crucial for successfully ensuring leadership, partnership and prioritisation; the lack of capacity, especially when it is structural rather than temporary, is a significant constraint.
- **Regulatory complexity** presents a major constraint, especially when State aid is involved.

The views of managing authorities on 'smart specialisation' range from very positive to scepticism, as well as uncertainty and concern, and IQ-Net partners have stressed the importance of keeping the strategies flexible. Whilst in theory smart specialisation should be a strategy for all regions, the practical implications pose challenges for a number of regions and countries as to whether they can gain the benefits from the effort involved.

At the Tampere meeting, the Commission approach to RIS3 was presented by Dr Ruslan Rakhmatullin of the European Commission S3 Platform.

The full report, written by David Charles, Frederike Gross and John Bachtler (June 2012), can be downloaded here:
http://www.eprc.strath.ac.uk/iqnet/30-2.pdf

Partner feedback: the workshop discussions

• **Is it necessary to have a 'smart specialisation' strategy given the multitude of strategies and planning processes already in place?** Some partners see value in the RIS3 approach in helping improve regional strategy development in a complementary approach with the relevant stakeholders in a context of limited resources.

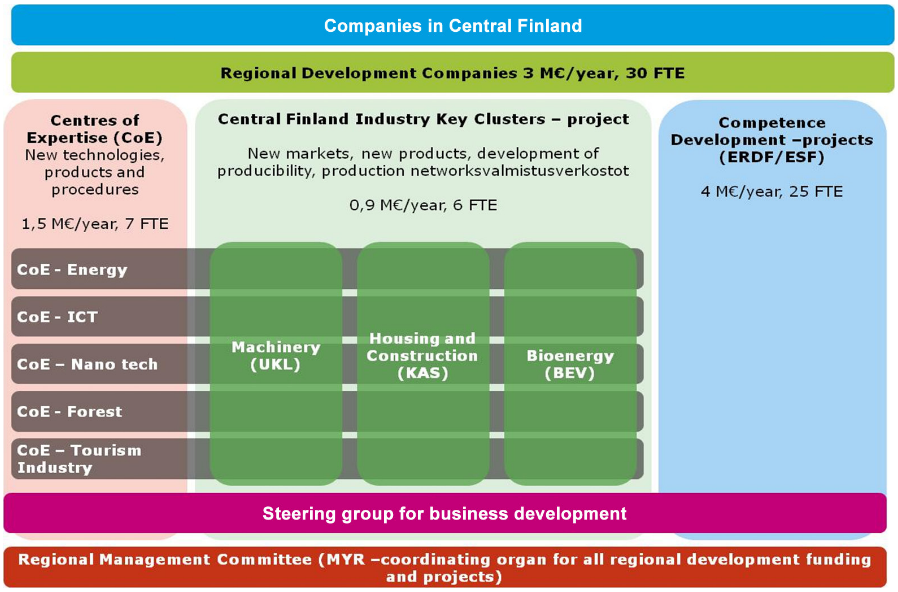
• **Strategic choices and prioritisation** – The selection of priorities is highly political, and there is a need for a more evidence-based approach as well as discussion/ benchmarking with other regions. Changes in government can lead to a shift in priorities, and some see the Structural Funds as a source of continuity. Regional differences mean that choices need to be tailor-made: the role of traditional sectors, common sectors or niches depends on the regional and wider EU context.

• **Smart specialisation and Structural Funds** – There are questions over the use of Structural Funds for implementing smart specialisation. Possibilities include capacity development in organisations applying for support under Horizon2020 and FP7. The link between ERDF and ESF can also be problematic, and the cross-financing option involves complicated audit requirements.

• **The entrepreneurial process** – It is often challenging to involve the private sector, i.e. making sure that lobbying groups are not getting too much influence at the same time as supporting newcomers with insufficient capacities.

IQ-Net partner case study: Cluster-based approach with Structural Funds in Western Finland

For the current 2007-13 period, the regional Growth Programme of the Western Finland region contains the main elements of an innovation strategy and is built around cluster-based specialisation. The cluster development model is at the core of local and regional development activity (see graph), which benefits from active intermediary organisations and a network of seven regional development agencies.



The region has also developed a partnership model based on the perception among regional actors of too many insufficiently co-ordinated activities in the field of innovation and business development. It involves private sector actors, public sector agencies and the main university at two levels:

• **Strategic level**: Decisions are discussed and agreed by the Regional Management Committee to ensure commitment and coordination.

• **Operational level**: Meetings of the regional business steering group are organised to provide targeted project support to companies and enhance the coordination of business development activities.

In 2010-12, ERDF funding of €800,000 has been allocated for partnership work in the framework of a 'coordination project', conceived as meta-coordination support for Structural Funds and domestic activities.

During the Tampere IQ-Net conference, partners viewed several projects which have benefited from European funding: the New Factory, an innovation and business incubation centre; a new learning environment organised by the Tampere University of Applied Sciences (TAMK) involving modern technologies from the fields of energy and environmental technology (OPI ENEMPI); and BioMediTech, a joint institute of the Tampere University of Technology (TUT) and the University of Tampere (UTA), bringing together multidisciplinary expertise in life sciences and medical technology.

What is IQ-Net?

IQ-Net is a network which brings together regional and national partners from Structural Funds programmes across the European Union. Its aim is to improve the quality of Structural Funds programme management through exchange of experience. The network involves a structured programme of applied research and debate, centred on bi-annual conferences.

IQ-Net was launched in 1996 and is managed by the European Policies Research Centre (EPRC) in the School of Government and Public Policy at the University of Strathclyde in Glasgow. The partner organisations are mainly regional or national managing authorities or programme secretariats.

Conferences are hosted by the partners on a rotation basis. Previous IQ-Net Conferences have been hosted in Leoben, Semmering & Schloss Seggau (Austria), Antwerp, Brussels & Grobbendonk (Belgium), Prague (Czech Republic), Aalborg (Denmark), Oulu & Tampere (Finland), Bordeaux & Strasbourg (France), Aachen, Dortmund, Gelsenkirchen, Magdeburg & Saarbrücken (Germany), Athens (Greece), Como & Artimino (Italy), Katowice (Poland), Algarve (Portugal), Åre, Fyrstad & Luleå (Sweden) and Cardiff, Glasgow, New Lanark, Newcastle upon Tyne & Swansea (UK).

IQ-Net members currently comprise:

Austria: Niederösterreich - Lower Austrian Land Government
Steiermark - Styrian Land Government

Belgium: Vlaanderen - Enterprise Flanders Agency

Czech Republic: Ministry for Regional Development

Denmark: Danish Business Authority

Finland: Western Finland Alliance (Länsi-Suomi), in association with the Ministry of Employment & the Economy

France: DATAR (Inter-ministerial Delegation for Territorial Development and Regional Attractiveness)

Germany: Nordrhein-Westfalen - Ministry for Economy, Energy, Construction, Housing and Transport
Sachsen-Anhalt - Ministry of Finance

Greece: Management Organisation Unit of Development Programmes S.A.

Italy: Ministry of Economic Development & Promuovi Italia SpA

Poland: Śląskie Województwo - Marshal's Office of Silesia

Portugal: Financial Institute for Regional Development

Slovenia: Government Office for Local Self-Government and Regional Policy

Spain: País Vasco - Provincial Council of Bizkaia

UK: Department for Communities and Local Government (CLG)
Welsh European Funding Office
The Scottish Government

DG Regio of the European Commission

DG Emploi of the European Commission

IQ-Net welcomes expressions of interest from potential new members (regional or national programme authorities) from any EU-27 Member State. Further information about the network can be obtained from:

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This publication has been co-financed by the European Regional Development Fund, through the contribution of IQ-Net partners. This support is gratefully acknowledged. This newsletter does not represent the official view of the European Commission or of IQ-Net partners.

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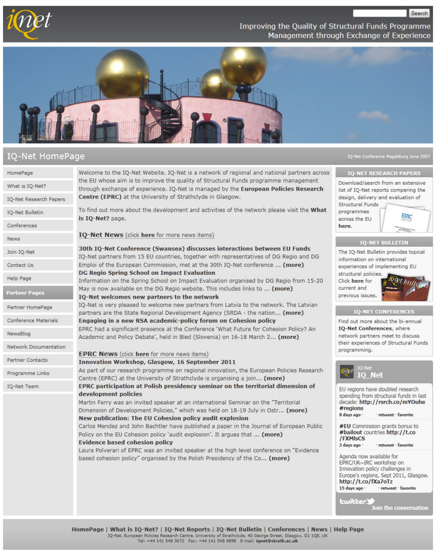

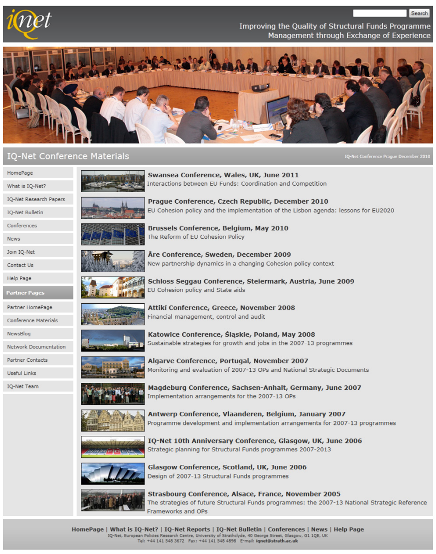

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News: regular news on network developments, publications and conferences.

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