

OECD Multi-level Governance Studies



The Future of Regional Development and Public Investment in Wales, United Kingdom



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Foreword

This report examines productivity and well-being performance in Wales, Welsh fiscal and public investment frameworks, and the Welsh Government's regional development and public investment governance practices. It identifies strengths and challenges in these areas and highlights immediate and longer-term actions that could help the Welsh Government meet its dual objective of growth plus inclusiveness.

Quality public investment, particularly for regional development, goes hand-in-hand with quality multi-level governance. How different levels of government interact in their pursuit of growth and well-being contributes to the effectiveness of the investment undertaken. A lack of clarity with respect to responsibilities, unaligned priorities, and limited or ineffective communication within or among levels of government can affect policy design and delivery, and the investments that support it. Effective institutions, clear policy objectives, appropriate regulatory and fiscal frameworks, adequate skills and expertise, and engaged stakeholders all contribute to better public investment outcomes. The quality of government has an incidence on economic performance, environmental sustainability, income inequality and poverty, education and health outcomes, as well as the subjective happiness of a population. Regions and local governments that enjoy higher quality governance are also more likely to effectively and efficiently use available public investment funds and attract additional ones.

In 2015, the Welsh Government introduced the Well-Being of Future Generations (Wales) Act in a significant step towards defining its path to balanced territorial growth. It is now considering new approaches to governance structures as well as regional development and public investment frameworks to further advance its objectives. For the Welsh Government's approach to flourish, ensuring that public investment funds are optimally used and supported by effective governance and financing structures becomes fundamental in a post-Brexit, post-COVID-19 era. This means appropriately prioritising public investment projects, co-ordinating investment across sectors, and understanding and meeting local needs. It also calls for a strong and effective implementation capacity at all levels of government. Moving forward, the Welsh Government, Welsh local authorities and their public, private and third sector partners will need to reinforce their ability to work together to achieve common objectives and priorities and channel investment in an appropriate and effective way – one that ensures well-being and quality of life for today's generations and those of the future.

The work with the Welsh Government was undertaken as part of the programme of work of the OECD's Regional Development Policy Committee (RDPC), a leading international forum in the fields of regional, urban, and rural development policy and multi-level governance, and served by the Centre for Entrepreneurship, SMEs, Regions and Cities (CFE). The RDPC has long advocated for multi-level governance and place-based approaches tailored to local and regional needs. In 2014, it endorsed the *OECD Recommendation on Effective Public Investment across Levels of Government* to support the governance of public investment. To further advance the RDPC's leadership in this area, the OECD created the *Multi-Level Governance Studies* series in 2016. As part of this series, this report contributes to the body of knowledge relating to the multi-level governance of public investment. The final report [CFE/RDPC(2020)9] was approved by the RDPC via written procedure on 24 July 2020.

Acknowledgements

This report was produced by the OECD Centre for Entrepreneurship, SMEs, Regions and Cities (CFE), led by Lamia Kamal-Chaoui, Director, as part of the programme of work of the Regional Development Policy Committee (RDPC). The OECD gratefully acknowledges the Welsh Government's generous financial support and substantive contributions, which made this work possible.

The report was led and co-ordinated by Maria Varinia Michalun. It was drafted by Marcos Díaz Ramírez (Chapter 3), Charlotte Lafitte (Chapter 4), Maria Varinia Michalun (Chapter 5), and Antti Moisio (Chapter 6), and supervised by Dorothée Allain-Dupré, Deputy-Head of the Economic Analysis, Statistics and Multi-Level Governance Section, led by Rüdiger Ahrend, Head of the Economic Analysis, Statistics and Multi-Level Governance Section. This report incorporates substantial contributions, insights and comments from Gerald Holtham (Cardiff Metropolitan University) and Kevin Morgan (Cardiff University). Their participation in this report has been invaluable. Comments from Rüdiger Ahrend, Isabelle Chatry, Joaquim Oliveira Martins and Paolo Veneri are highly appreciated, as are those from Sean Dougherty and Kass Forman of the OECD Fiscal Network.

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This report is based on a broad variety of sources including OECD, UK and Welsh Government databases, responses to an OECD questionnaire completed by the Welsh Government in February 2019, and extensive interviews conducted by the OECD in June and November 2019 with representatives from the Welsh Government, local authorities, the private and third sectors, academia and other stakeholders. It was copy-edited by Eleonore Morena. The publication process was managed by Pilar Philip and François Iglesias, with input from Charlotte Lafitte and Yingyin Wu.

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Abbreviations and acronyms

| | |
|-------------|---|
| AVI | Administrative Agencies (Finland) |
| BMWI | Federal Ministry for Economic Affairs and Energy |
| CCDP | Co-ordinating Committee for Development Policy (Poland) |
| CCR | Cardiff Capital Region |
| CJC | Corporate Joint Committee |
| COAG | Council of Australian Governments |
| CPER | <i>Contrats de Plan État-Région</i> (France) |
| CRO | Chief Regional Officer |
| DBW | Development Bank of Wales |
| ELY | Centres for Economic Development, Transport and the Environment (Finland) |
| ERDF | European Regional Development Fund |
| ESF | European Social Fund |
| ESIF | European Structural and Investment Funds |
| EU | European Union |
| EUR | Euro |
| FTC | Financial Transactions Capital |
| FUA | Functional urban area |
| GBP | Pound Sterling |
| GDP | Gross domestic product |
| GRW | Joint Task for the Improvement of Regional Economic Structures |
| GVA | Gross value added |
| IN | Intermediate |

| | |
|----------------|---|
| IPC | Indexed Per Capita |
| IT | Information Technology |
| IVL | International Visitor Conservation and Tourism Levy |
| KIBS | Knowledge-intensive business service |
| LDT | Landfill Disposals Tax |
| LTIP | Long Term Investment Plan |
| LTT | Land Transaction Tax |
| MIM | Mutual Investment Model |
| MIRT | Multi-Year Programme for Infrastructure, Spatial Planning and Transport (the Netherlands) |
| NDR | Non-domestic Rates |
| NICfW | National Infrastructure Commission for Wales |
| NSW | New South Wales |
| OECD | Organisation for Economic Co-operation and Development |
| OP | Operational Programme |
| OPP | Portugal Participatory Budget |
| PFI | Private Finance Initiative |
| PGF | Provincial Growth Fund |
| PIT | Personal Income Tax |
| PPP | Public-private partnership |
| PPP | Purchasing power parity |
| PR | Predominantly rural |
| PRC | Predominantly rural region close to a city |
| PRR | Predominantly rural remote region |
| PSB | Public Service Board |
| PU | Predominantly urban |
| R&D | Research and development |
| RAI | Regional Authority Index |
| RSES | Regional Spatial and Economic Strategy |

| | |
|-------------|--------------------------------------|
| RSG | Revenue Support Grant |
| SDG | Sustainable Development Goal |
| SDP | Strategic Development Plan |
| SFT | Scottish Futures Trust |
| SME | Small- and medium-sized enterprise |
| SSA | Standard Spending Assessment |
| TIF | Tax Increment Financing |
| UK | United Kingdom |
| UN | United Nation |
| US | United States |
| USD | US Dollar |
| WDA | Welsh Development Agency |
| WEFO | Welsh European Funding Office |
| WFGA | Well-being of Future Generations Act |
| WHO | World Health Organization |
| WIMD | Welsh Index of Multiple Deprivation |
| WLGA | Welsh Local Government Association |
| WRA | Welsh Revenue Authority |
| WRIT | Welsh Rates of Income Tax |

Executive summary

The Welsh Government and local authorities are aware of the territorial disparities they face and are committed to addressing them. Successfully achieving large-scale territorial objectives, such as minimising disparities or increasing well-being, is linked to the good governance of regional development and public investment policies. It leads to more effective use of public investment funds and creates growth possibilities. To support more effective public investment, the Welsh Government and local authorities could refine their approach and take stronger action in three areas: i) effective policy design and co-ordination, ii) sound and appropriate fiscal and investment frameworks, and iii) building capacity for policy implementation and learning by and at all levels of government.

The Welsh Government requested this OECD report as input into its policy actions for regional development and public investment. The report examines productivity and well-being performance across Wales, Welsh fiscal and public investment frameworks, and Welsh governance structures supporting regional development and investment decisions. The insights and recommendations in this report may be particularly timely in light of Brexit's potential impact on multi-level governance systems and regional investment financing in Wales, as well as the impact of the COVID-19 pandemic on the Welsh economy, service delivery capacity and fiscal health.

Key Findings

The territorial context

Persistent regional inequalities can increase mistrust in institutions, and generate discontent with the economic, social and political status quo, particularly in lagging regions. In 2018, the wealthiest top 10% of UK regions exhibited a gross domestic product (GDP) per capita close to five times higher than the bottom 10% of United Kingdom (UK) regions – 4 out of 12 of which are in Wales. Wales' two main urban areas cover less than a quarter of the Welsh territory, but are home to 70% of its residents and produce 75% of its GDP. In terms of well-being, Wales' performance across 11 OECD regional well-being dimensions is in the mid or top-range for OECD regions. However, when compared to other UK regions, Wales performs less well in income, health and education.

- Despite improving economic growth rates, Wales has difficulty catching up with UK average levels of economic prosperity and well-being.
- Productivity contributes to sustaining well-being. Unfortunately, labour productivity levels in Wales are among the lowest in the UK. Investing in high performing transport networks, research and development (R&D) and innovation, as well as in the skills of the Welsh workforce could boost productivity in Wales.
- Well-being is at the heart of the Welsh Government's policymaking, and ensuring it is balanced across all Welsh regions is essential for resilience and sustainable development. Addressing regional disparities in youth unemployment, income deprivation and access to high-speed Internet will be particularly important to spread well-being and economic growth more evenly across Wales.

The fiscal gap and public investment financing

Limited fiscal devolution, a low tax base, and low-levels of own-source revenue are creating a large fiscal gap for the Welsh Government and Welsh local authorities. This restricts their ability to pursue regional and local development objectives and to bridge an investment gap arising from several years of austerity. In the 2014-2021 EU programming period, Wales is the UK's largest recipient of EU funds per capita. Managing the investment financing uncertainty arising from Brexit depends on strengthening fiscal institutions and rules and improving the ability to attract public and private investment financing.

- Public investment frameworks or strategies help co-ordinate and target regional development financing. They will best support the Welsh Government's public investment aims when they: i) are supported by multi-annual funding frameworks; ii) integrate the priorities of diverse stakeholders; and iii) incorporate an outcome-based evaluation.
- Balanced fiscal decentralisation and stronger fiscal autonomy will contribute to effective regional and local development in Wales but must be coupled with sufficient financial and administrative capacity among local authorities and a well-designed fiscal equalisation scheme.
- Diversifying own-revenue sources at the Local Authority level, including through reconsidering user charges, and easing borrowing restrictions or making them more flexible, could help narrow the fiscal gap.

Reinforcing the governance of regional development and public investment

Treating regional development and investment as a policy package supports an innovative, stable, long-term development path. To accomplish this, a more coherent and co-ordinated approach to regional development policy design and delivery is called for in Wales. This includes introducing a stronger, more diversified mix of co-ordination mechanisms, generating agreement among government and non-government partners on policy and investment objectives and priorities, and better supporting local-level implementation capacity. Success also depends on the Welsh Government and local authorities adapting their roles in policy and service delivery, increasing their focus on results, and promoting learning at all levels of government.

- An integrated regional development policy could generate greater policy continuity, establish clearer guidelines for decision-making and action, align priorities and serve as a roadmap for sector policies and programming.
- An office at the centre of government responsible for strategic planning and public investment for regional development could strengthen policy co-ordination, oversee relevant public investment funding, and lead monitoring and evaluating policy initiatives based on the outcomes they yield.
- Actively assisting Welsh regional and local-level actors invest in and implement regional development programming would be valuable. Doing so can include integrated and regionally-designed development plans, formal agreements/contracts, a stronger learning-based approach, as well as an institutional structure, such as a regional development agency, to help identify public investment opportunities and grow local professional/productive activities.

Considering economic regions in Mid Wales and South West Wales

Using economic regions to support the devolution of regional economic development planning can lead to better-targeted regional development initiatives and investment. They can also delineate adequate scale for local authorities to deliver new tasks. Yet Welsh local authorities need sufficient economic, administrative and institutional capacity to meet these responsibilities.

- Regional-level co-operative bodies, as proposed by the Welsh Government, could build scale and local-level capacity. Success will depend on such bodies having the means to act effectively and to serve as intermediate-level partners that reflect local needs.
- Additional ways to help local authorities fulfil regional development responsibilities include reconsidering the grant structure, the equalisation mechanism and generators of own-source revenue. All local authorities should also be able to provide a standard/minimum level of service.
- Piloting four official economic Regions for development planning with clearly established and specific objectives, is a way to promote learning. They should be subject to an independent evaluation after a specified period of time, after which consideration can be given to whether four regions – or more, or fewer – makes sense.

****The Welsh-language version of this Executive Summary follows.***

Crynodeb Gweithredol

Mae Llywodraeth Cymru ac Awdurdodau Lleol yn ymwybodol o'r gwahaniaethau tiriogaethol sy'n eu hwynebu ac maent wedi ymrwymo i fynd i'r afael â'r rhain. Mae cyflawni amcanion tiriogaethol ar raddfa fawr yn llwyddiannus, fel lleihau'r gwahaniaethau neu gynyddu llesiant, yn gysylltiedig â llywodraethu polisïau datblygu rhanbarthol a buddsoddi cyhoeddus yn dda. Mae'n arwain at ddefnydd mwy effeithiol o gronfeydd buddsoddi cyhoeddus ac yn creu posibiliadau o ran twf. Er mwyn cefnogi buddsoddi cyhoeddus mwy effeithiol, gallai Llywodraeth Cymru ac Awdurdodau Lleol goethi eu dull a chymryd camau mwy cadarn yn y meysydd hyn: i) llunio a chydlynw polisi yn effeithiol, ii) fframweithiau cyllidol a buddsoddi cadarn a phriodol, a iii) meithrin gallu ar gyfer gweithredu polisi a dysgu ar bob lefel o lywodraeth.

Gofynnodd Llywodraeth Cymru am yr adroddiad hwn gan y Sefydliad ar gyfer Cydweithrediad a Datblygiad Economaidd (OECD) fel mewnbwn i'w chmau polisi ar gyfer datblygu rhanbarthol a buddsoddi cyhoeddus. Mae'r adroddiad yn archwilio cynhyrchiant a pherfformiad llesiant ledled Cymru, fframweithiau cyllidol a buddsoddi cyhoeddus Cymru a strwythurau llywodraethu Cymru sy'n cefnogi datblygiad rhanbarthol a phenderfyniadau buddsoddi. Gall y safbwyntiau a'r argymhellion a wneir yn yr adroddiad hwn fod yn amserol dros ben yng ngoleuni effaith bosibl Brexit ar systemau llywodraethu aml-lefel ac ar gyllido buddsoddi rhanbarthol yng Nghymru, ynghyd ag effaith pandemig Covid-19 ar economi Cymru, ar ei gallu o safbwynt darpariaeth gwasanaethau ac ar ei hiechyd cyllidol.

Canfyddiadau allweddol

Y cyd-destun tiriogaethol

Gall anghydraddoldebau rhanbarthol parhaus gynyddu'r diffyg ymddiriedaeth mewn sefydliadau, a chreu ymdeimlad o anffodlonrwydd gyda'r drefn economaidd, gymdeithasol a gwleidyddol, yn enwedig mewn rhanbarthau sydd ar ei hôl hi. Yn 2018, dangosodd 10% o ranbarthau cyfoethocaf y DU Gynnyrch Domestig Gross y pen a oedd yn agos i bum gwaith yn uwch na'r 10% isaf o ranbarthau'r DU - ac mae 4 o'r 12 yng Nghymru. Mae dwy brif ardal drefol Cymru yn cwmpasu llai na chwarter o diriogaeth Cymru, ond yn gartref i 70% o'i phreswylwyr ac yn cynhyrchu 75% o'i Chynnyrch Domestig Gros. O ran llesiant, mae perfformiad Cymru ar draws 11 dimensiwn llesiant rhanbarthol y Sefydliad ar gyfer Cydweithrediad a Datblygiad Economaidd yn yr amrediad canolig i uchel ar gyfer rhanbarthau'r Sefydliad. Fodd bynnag, o'i chymharu â rhanbarthau eraill yn y DU, nid yw Cymru yn perfformio cystal o ran incwm, iechyd ac addysg.

- Er gwella cyfraddau twf economaidd, mae Cymru yn cael trafferth dal i fyny gyda lefelau cyfartalog y DU o ran ffyniant economaidd a llesiant.
- Mae cynhyrchiant yn cyfrannu at gynnal llesiant. Yn anffodus, mae lefelau cynhyrchiant llafur Cymru ymysg yr isaf yn y DU. Gallai buddsoddi mewn rhwydweithiau trafnidiaeth sy'n perfformio'n dda, ymchwil a datblygu ac arloesi, ynghyd ag yn sgiliau gweithlu Cymru hybu cynhyrchiant yng Nghymru.
- Mae llesiant wrth wraidd gwaith llunio polisïau Llywodraeth Cymru, ac mae sicrhau ei fod yn gytbwys ar draws pob rhanbarth yng Nghymru yn hanfodol er mwyn sicrhau gwydnwch a datblygu cynaliadwy. Bydd mynd i'r afael â gwahaniaethau rhanbarthol o ran diweithdra ymysg pobl ifanc, amddifadedd incwm a mynediad at ryngrwyd cyflym yn arbennig o bwysig dros ben i ledauenu llesiant a thwf economaidd yn fwy cyfartal ledled Cymru.

Y bwllch cyllidol a chyllido buddsoddi cyhoeddus

Mae datganoli cyllidol cyfyngedig, sylfaen dreth isel a lefelau isel o refferiw o'i ffynonellau ei hun yn creu bwllch cyllidol mawr i Lywodraeth Cymru ac Awdurdodau Lleol Cymru. Mae hyn yn cyfyngu ar eu gallu i fynd i'r afael ag amcanion datblygu rhanbarthol a lleol a phontio'r bwllch buddsoddi sydd wedi ei achosi

gan flynyddoedd o gyni. Yng nghyfnod rhaglenni 2014-2021 yr UE, Cymru sydd wedi derbyn y lefel uchel o gronfeydd yr UE y pen yn y DU. Mae rheoli'r ansicrwydd ynghylch cyllido buddsoddi sy'n deillio o Brexit yn dibynnu ar gryfhau rheolau a sefydliadau cyllidol a gwella'r gallu i ddenu cyllid buddsoddi cyhoeddus a phreifat.

- Mae fframweithiau neu strategaethau buddsoddi cyhoeddus yn helpu i gydlyn a thargedu cyllid datblygu rhanbarthol. Byddant yn cefnogi nodau buddsoddi cyhoeddus Llywodraeth Cymru orau pan fyddant yn i) cael eu cefnogi gan fframweithiau cyllido aml-flynyddol, ii) integreiddio blaenoriaethau rhanddeiliaid amrywiol a iii) ymgorffori gwerthuso ar sail canlyniadau.
- Bydd datganoli cyllidol cytbwys ac ymreolaeth gyllidol gryfach yn cyfrannu ar ddatblygiad rhanbarthol a lleol effeithiol yng Nghymru, ond mae'n rhaid i hynny fynd law yn llaw â gallu ariannol a gweinyddol digonol ymysg Awdurdodau Lleol ynghyd â chynllun cydraddoldeb cyllidol sydd wedi'i gynllunio'n dda.
- Gallai arallgyfeirio ei ffynonellau refeniw ar lefel Awdurdod Lleol, gan gynnwys gwneud hynny drwy ailystyried taliadau defnyddwyr, a llacio cyfyngiadau benthyg neu eu gwneud yn fwy hyblyg, helpu i bontio'r bwlch cyllidol.

Atgyfnerthu llywodraethu datblygiad rhanbarthol a buddsoddi cyhoeddus

Mae ymdrin â datblygu a buddsoddi rhanbarthol fel pecyn polisi yn cefnogi llwybr datblygu hirdymor arloesol a sefydlog. Er mwyn cyflawni hyn, gelwir am ymagwedd fwy cydlynol a chydgyssylltiedig at lunio a darparu polisi datblygu yng Nghymru. Mae hyn yn cynnwys cyflwyno cymysgedd mwy cadarn ac amrywiol o fecanweithiau cydgyssylltu, gan sicrhau cytundeb ymysg partneriaid o'r llywodraeth a thu hwnt ar amcanion a blaenoriaethau buddsoddi a pholisi, a rhoi gwell cefnogaeth i allu i weithredu ar lefel leol. Mae llwyddiant hefyd yn dibynnu at Lywodraeth Cymru ac Awdurdodau Lleol yn addasu eu rolau ym maes polisi a darpariaeth gwasanaethau, gan gynyddu eu ffocws ar ganlyniadau, a hyrwyddo dysgu ar bob lefel o'r llywodraeth.

- Gallai polisi datblygu rhanbarthol integredig sicrhau gwell parhad o ran polisi, sefydlu canllawiau cliriach ar gyfer gwneud penderfyniadau a gweithredu, alinio blaenoriaethau a rhoi cyfeiriad i bolisiâu a rhaglenni'r sector.
- Gallai swyddfa yng Nghanol y Llywodraeth sy'n gyfrifol am gynllunio strategol a buddsoddi cyhoeddus ar gyfer datblygu rhanbarthol gryfhau cydgyssylltiad polisiâu, arolygu cyllid buddsoddi cyhoeddus perthnasol ac arwain y gwaith o fonitro a gwerthuso mentrau polisi ar sail y canlyniadau a ddaw yn eu sgil.
- Byddai mynd ati'n ddiwyd i gynorthwyo gweithredwyr rhanbarthol a lleol Cymru i fuddsoddi mewn rhaglen datblygu rhanbarthol a'i rhoi ar waith yn werthfawr. Gall gwneud hynny gynnwys cynlluniau datblygu integredig a rhai sydd wedi'u cynllunio'n rhanbarthol, cytundebau/contractau ffurfiol, dull seiliedig ar ddysgu cryfach, ynghyd â strwythur sefydliadol, fel asiantaeth datblygu rhanbarthol, helpu i nodi cyfleoedd buddsoddi cyhoeddus a chynyddu gweithgareddau proffesiynol/cynhyrchol lleol.

Ystyried Rhanbarthau Economaidd yn y Canolbarth a'r De-orllewin

Gall defnyddio Rhanbarthau Economaidd i gefnogi datganoli cynllunio datblygu economaidd rhanbarthol arwain at fentrau a buddsoddi rhanbarthol sydd wedi'u targedu'n well. Gallant hefyd gyfleu graddfa ddigonol i Awdurdodau Lleol fel y gallant gyflawni tasgau newydd. Ond mae angen gallu economaidd, gweinyddol a sefydliadol digonol ar Awdurdodau Lleol Cymru i fodloni'r cyfrifoldebau hyn.

- Gallai cyrff cydweithredol ar lefel ranbarthol, fel y cynigir gan Lywodraeth Cymru, feithrin gallu a chapasiti ar lefel leol. Bydd llwyddiant yn dibynnu ar gyrrff o'r fath â'r modd i weithredu'n effeithiol a gwasanaethu fel partneriaid lefel ganolradd sy'n adlewyrchu anghenion lleol.

- Mae ffyrdd ychwanegol o helpu Awdurdodau Lleol i fodloni cyfrifoldebau datblygu rhanbarthol yn cynnwys ailystyried y strwythur grantiau, y mecanwaith ar gyfer cydraddoli, a dulliau o gynhyrchu eu referiw o'u ffynonellau eu hunain. Dylai pob Awdurdod Lleol hefyd allu darparu lefel safonol/ofynnol o wasanaeth.
- Mae “treialu” pedwar Rhanbarth Economaidd swyddogol ar gyfer cynllunio datblygu gydag amcanion sefydledig a phenodol clir, yn ffordd o hyrwyddo dysgu. Dylent fod yn amodol ar werthusiad annibynnol ar ôl cyfnod penodol, ac yna gellid ystyried ai pedwar rhanbarth - neu fwy, neu lai – sy'n gwneud synnwyr.

1 Assessment and recommendations

Overview

The Welsh Government has set an ambitious and innovative path for regional development and public investment. It focuses on generating growth and increasing productivity, as well as on reducing territorial disparities and ensuring the well-being of citizens, now and in the future. At the same time, the Welsh Government and local authorities are working in a context of uncertainty. Uncertainty arising from Brexit, which can affect multi-level governance systems and regional investment financing. Uncertainty arising from the COVID-19 crisis, which will further strain the Welsh economy, service delivery capacity and its fiscal health.

With uncertainty and crisis also comes opportunity. The Welsh Government has the chance to meet its regional development and investment needs in a manner that is fully reflective of its territorial reality, requirements and priorities. This is also a moment when the Welsh Government can – and is – reconsidering its relationship with regional development stakeholders, including local authorities, the private sector, the third sector, civil society and academia, and how to strengthen these interactions.

Successfully navigating this period of change in a highly complex socio-economic environment will draw on the capacity of all Welsh regional development actors to adjust. The role of government at all levels is changing, and especially in decentralised or devolved contexts. National governments are increasingly called on to take a stronger strategic and policy co-ordination role, creating space for subnational authorities to implement policy and deliver service in a manner most suited to their local specificities. This means building capacity at and by all levels of government. These new roles put a spotlight on the quality of inter-governmental relationships, which in Wales is also evolving. They have been characterised by mistrust in the past – between the United Kingdom (UK) and the Welsh Government levels as well as between the Welsh Government and the local authority levels. This may be changing, but all parties will need to actively move toward building mutual trust and credibility. The aim is to build a win-win collaboration, including with citizens.

The purpose of this OECD report is to accompany the Welsh Government in building its regional governance and investment capacity. The report starts with an introduction establishing the frameworks for analysis used. Chapter 3 provides an overview of the Welsh context in terms of its territorial and socio-economic conditions, challenges and opportunities in addressing regional disparities in productivity and growth, and its well-being profile. Chapter 4 takes a careful look at Welsh fiscal and financial frameworks, highlighting some critical challenges and identifying opportunities for ensuring continuity in investment effectiveness, post-Brexit. Chapter 5 examines the Welsh regional development strategic and policy frameworks, and mechanisms to boost policy and investment implementation capacity. Finally, Chapter 6 is a case study focused on establishing economic regions in Mid and South West Wales. It brings together concepts explored in the report, including subnational spending and service delivery capacity as well as governance structures, and compares the opportunities and challenges that would confront a combined region versus two separate ones. Chapters 4, 5 and 6 conclude with recommendations for action. This report was researched and prepared prior to the European Union (EU)

Withdrawal Agreement Act 2020 receiving Royal Assent on 23 January 2020, and before the COVID-19 crisis.

The Welsh territorial context: Megatrends, productivity and well-being

Throughout the OECD, countries and regions are faced with managing global megatrends in demographics, technology and environmental change. Addressing this requires new, place-based regional development policy approaches and effective public investment, supported by institutional capacity at all levels of government. This is particularly important given the risk of megatrends exacerbating territorial inequalities. Furthermore, persistent regional inequalities can increase mistrust in institutions, and generate discontent with the economic, social and political status quo, particularly in lagging regions. In 2018, regional disparities in gross domestic product (GDP) per capita in the UK were among the largest among OECD countries – with the wealthiest top 10% of UK regions exhibiting a GDP per capita close to 5 times higher than the bottom 10% of UK regions. Of this latter group, 4 out of the 12 are in Wales. Wales is committed to ensuring the well-being of today and tomorrow's generations. This is evident in its adoption of the Well-being of Future Generations Act (WFGA) in 2015, which serves as a compass for Welsh policymakers when considering the economic, social and broader well-being implications of their decisions.

A territorial and socio-economic conditions snapshot of Wales

Wales is facing difficulty catching up with UK average levels of economic prosperity. For example, in 2000-18, Wales' GDP per capita remained the lowest among the 4 UK nations, representing 72% of the UK average. While there was some positive shift after 2009, GDP per capita remains sluggish, in Wales and the UK. Wales' economic activity is strongly concentrated in two urban clusters – one in the southeast and the other in the northeast. These two clusters produce 75% of Wales' GDP and are home to approximately 70% of its population – concentrated in 22% of the territory. This can result in unbalanced spatial development. In Wales, certain economic sectors and activities are highly spatially concentrated, partially explaining regional differences in GDP per capita. The sectoral composition of Welsh local economies reflects these differences as some economic sectors (e.g. high-tech) are associated with higher levels of value-added per input.

Managing a regional divide in labour productivity

Labour productivity levels in Wales remain among the lowest in the UK and are also below the average level among Northern and Western European-OECD regions. While overall labour productivity seems to be increasing, it is unequal across Welsh small regions. Its growth has been higher than 1% in the regions of Cardiff and Vale of Glamorgan, Swansea, Bridgend and Neath Port Talbot, Central and Gwent Valleys. In other regions, however, it has been decreasing over the past 16 years.

Ultimately, Wales is confronted with a choice in terms of productivity growth. It could pursue a distributed model, wherein productivity growth comes from converging regions, and the frontier region is not the main contributor to labour productivity growth. This model is evident in Austria, Germany and Poland, for example. Or, it could adopt a concentrated model, seen in France, the Netherlands and the UK. Here, most of the contributions to productivity growth come from frontier and keeping-pace regions (i.e. Greater London and Scotland respectively in the UK) while other regions contribute relatively little or even negatively. When considering these models, there is a trade-off. While the distributed model can help achieve regional convergence, it tends to generate lower aggregate growth. Another way to consider this: while a concentrated model can yield higher productivity gains, it does so at the cost of exacerbating regional disparities as frontier regions grow equally, or more, than regions already lagging behind. The choice between models will depend on overall objectives.

Enhancing productivity across all territories

In addressing its productivity challenges, Wales will need to consider several factors. First, is a need to better seize the benefits of agglomeration economies. This can mean investing in transport performance. High-performing transport networks, including green transport networks, improve accessibility within functional urban areas (FUAs), which contributes to well-being and productivity. In Wales, the metropolitan area of Cardiff demonstrates very low performance in both public transport efficiency and labour productivity, relative to other European metropolitan areas. Conversely, metropolitan areas with high public transport performance (e.g. Helsinki, London and Oslo) display among the highest levels of labour productivity. Inter-regional transport networks can also boost productivity in some rural remote areas by increasing proximity to the benefits of metropolitan areas. Additionally, high-performing transport infrastructure can facilitate integrating rural areas into regional or global value chains, helping unlock the potential of rural remote areas (e.g. Carmarthenshire or Powys) and contribute to better regional economic and social cohesion in Wales.

Second, population decline and ageing as productivity factors should be considered. Population growth within Wales is uneven. While the population of Cardiff is growing, that of Ceredigion, for example, is not. Beyond its implications for labour productivity, population decline in Wales can also negatively affect public service provision by reducing tax revenue. The Welsh Government's commitment to supporting its foundational economy may be difficult to accomplish in the context of a declining population and shrinking tax base.

Third, additional attention will need to be placed on increasing the skills of the Welsh workforce and to research and development (R&D) investment, in order to deliver a more productive, and greener, economy. Across the UK, regions with a high-skilled labour force exhibit higher levels of labour productivity. Only 38% of Wales' labour force has tertiary education. This translates into labour productivity of around USD 65 000 in Wales, compared to USD 77 000 in Scotland and USD 110 000 in Greater London (all in 2015 purchasing power parity [PPP]). Stronger investment in skills and R&D could help boost innovation and intensify competition among firms, which in turn may lead to greater productivity and improve employment and labour utilisation.

Using place-based regional development policy to ensure well-being today and for future generations

The well-being of its citizens is at the heart of the Welsh political and policy agenda. In general, well-being in Wales is above or equal to the OECD median value in 12 out of 13 indicators. Yet, it is below the UK average in most of these same dimensions. Addressing territorial inequalities can help improve well-being, smoothing out material (e.g. income, jobs, housing) and non-material (e.g. health, sense of community, education) well-being disparities.

The aim of place-based regional development policy is to help all types of regions thrive and offer their residents a high quality of life. While this is laudable, it can be difficult to achieve. Increasingly countries are re-evaluating their toolkit, identifying mechanisms that will help them promote high-levels of well-being by building on local assets and knowledge, undertaking strategic public investment and including a diverse stakeholder base in the process. Wales is considering all of these possibilities as it refines its governance and investment approaches to regional development, including through a green growth restart and recovery following the COVID-19 pandemic.

Reinforcing fiscal frameworks and public investment financing in Wales

The Welsh Government and local authorities operate in a fiscally and financially constrained environment. The fiscal framework is characterised by limited devolution, a low tax base and limited ability to generate

own-source revenue, contributing to a large fiscal gap. This affects the Welsh Government and local authority ability to finance many place-specific spending needs and to bridge an investment gap arising from several years of austerity. A stronger fiscal framework can help build a more resilient foundation to leverage external financing and enhance Welsh national and subnational capacity to invest in regional development. The limited access to sources of investment financing is an additional challenge for regional development in Wales. This is compounded by the uncertainty surrounding investment financing post-Brexit, including in terms of the exact value, and the terms and conditions for the disbursement of the intended replacement for European Union funding, including whether multi-annual funding will be maintained. Effectively managing the uncertainty will require strengthening fiscal institutions and rules and improving the capacity of all levels of government to attract public and private investment and support inclusive growth.

Fiscal devolution is an ongoing process with mixed results

Devolution, particularly fiscal devolution, is an ongoing process in Wales, with mixed results, thus far. In general, fiscal decentralisation in the UK is low compared to other OECD countries, and this is true as well in Wales when compared to EU and OECD Regions, and measured as regional government spending contributions as a percentage of total public expenditure. Approximately 60% of total public spending on services is financed by the Welsh Government and local authorities. The rest is financed by the UK government. In addition, fiscal devolution in Wales is unbalanced between spending responsibilities and revenue-generating capacity, creating a fiscal gap, which will likely be exacerbated by COVID-19. In such cases, there is a risk of compounding territorial inequalities, including in the accessibility, type, diversity and quality of services that local authorities can provide, as well as in their investment capacity.

The fiscal gap affects the capacity of the Welsh Government and local authorities to better target their spending and forces them to make budgetary choices between essential sectors. In terms of budget allocation, economic affairs accounted for 15% of Welsh Government spending in 2017, compared to 21%, on average, among regions in EU and OECD countries. At the local authority level, it represented 6% of their spending, compared to 12% on average for local governments across the EU. While this difference in spending is to be expected, it can signal limited development capacity in areas that promote growth, such as economic development, transport, communications, and energy and construction.

The Welsh Government and local authorities also face a gap in terms of revenue-generating capacity. Contributing to this is low revenue diversity. Up to 80% of Welsh Government revenue comes from a block grant from the UK government. Among regional governments in the EU and OECD, grant revenues generally account for 50% of total revenue, on average. This relatively high rate of revenue centralisation can affect Welsh Government fiscal autonomy, which in turn affects its capacity to borrow. Opportunities to address this issue are limited. First because the centralisation of tax revenue by the UK government is a constraining fact. Second, the Welsh tax base is low. Finally, own-source taxes are limited and new, and user fees and charges are an infrequently used tool. This situation is mirrored at the subnational level in Wales, as 61% of total local authority revenue in 2017 came from current grants.

Building fiscal and financial capacity and boosting territorial equalisation

Effective equalisation policies can help address disparities in revenue-generating capacity and public service delivery. The current equalisation system in Wales does not provide sufficient incentive for business development in an individual local authority. Nor does it offer sufficient support for local authorities in rural or sparsely populated areas. Given the territorial disparities in Wales, additional consideration should be given to equalisation arrangements, as these can help ensure that territorial inequalities are not accentuated by further decentralisation.

The Welsh Government recognises a need to shift towards a system that emphasises own-source revenue over grant-dependency. Updating the subnational fiscal framework is one way to achieve this, and the Welsh Government has taken steps to do so by launching a Tax Policy Framework as well as a comprehensive programme to reform subnational finance. Addressing the design of the Council Tax and Non-Domestic Rates, and optimising local tax capacity could be part of this effort. By improving subnational fiscal health, the borrowing capacity of the Welsh Government and local authorities could be strengthened.

Encouraging local authorities to work together as fiscal and financial actors, rather than autonomously could help address fiscal imbalances while also helping build their administrative and financial management capacity. Pooling resources to deliver services, sharing costly administrative functions and sharing the cost of experts can all reinforce fiscal capacity by freeing revenue for other expenses. There are several positive experiences in this type of activity in Wales, and more should be encouraged.

Introducing a coherent investment framework for regional development in Wales

Investment financing contributing to regional development in Wales is divided among financing from government departments, financing from EU funds and funds channelled through the City and Growth Deals. The challenge is to ensure that investment occurs strategically and coherently in order to maximise and optimise resource effectiveness – particularly as EU funds phase out and are replaced by funds from the UK government. To meet this challenge, the Welsh Government is rethinking its investment framework, the structures of investment co-ordination, and the need to further reinforce investment capacity. To this end, the government is developing a Framework for Regional Investment, which, if successfully implemented could support investment at the Welsh national and subnational levels. Such a framework is a fundamental co-ordination tool as it can help ensure that objectives and priorities align in a complementary fashion.

Day-to-day investment co-ordination is also critical. The Welsh European Funding Office (WEFO) and Welsh government departments have significant experience in managing multi-stakeholder, high-volume, complex investment projects and funding. This experience and institutional knowledge should be maintained and used to ensure that investment decisions are aligned with regional development objectives across government sectors and among different levels of government. The Welsh Government also appears to be aiming for a more integrated and flexible approach to public investment, one that can evolve with the changing structures and needs post-Brexit. One essential condition for investment planning, however, is a multi-annual approach to regional development funding. This provides the necessary stability and reassures investors, and is just as important in investment frameworks emanating from the Welsh Government as it is from those emanating from the UK government.

Reinforcing and building on current existing investment financing practices

The current moment presents a *tabula rasa* to the Welsh Government in terms of its investment framework. It has a unique opportunity to adjust investment conditions that are considered weak while maintaining those that have worked successfully. It is also a moment to ensure that public investment financing for regional development more strongly aligns with territorial characteristics than it was able to do when relying on EU Cohesion Policy, for example. There is also the opportunity to design or encourage cross-border investment, certainly between Welsh jurisdictions, but also with UK regions or cities. City and Growth Deals are powerful investment levers, and a good opportunity to advance green growth and circular economy priorities. It would be important to further integrate City and Growth Deals into Wales' broader regional development strategy and to make them more competitive with other UK City Deals. This may become particularly important if funds to replace EU financing are disbursed on a competitive basis and are channelled towards City and Growth Deals.

Limited efficiency in investment management is considered a barrier to mobilising capital funding for local investment in Wales. Thus, building expertise for public investment in Wales will be important in moving forward. The Development Bank of Wales and WEFO, for example, would be mobilised to support the Welsh Government and local authorities build their knowledge and skills base. Peer-exchange and pooling expertise among local authorities in areas related to public investment could also be further supported, for example through the Welsh Local Government Association (WLGA). Building this capacity will be fundamental given the need to expand the tools used to finance investment. Public-private partnerships (PPPs), innovative sources of public investment financing, such as land-value capture, climate finance and green bonds, as well as participatory budgeting, are all mechanisms that could be highly valuable to support regional development investment in Wales but require additional capacity-building support at the national and subnational levels.

Developing a coherent investment framework can be highly valuable in terms of maintaining a sustainable investment strategy for regional development. As Wales transitions to post-Brexit investment structures, opportunities to build on what works, and adjust what could work better present themselves.

Box 1.1. Recommendations for optimising fiscal and financial frameworks to support effective investment for regional development

1. Optimise the Welsh Government's capacity to reduce its fiscal gap and improve fiscal health

- Expand spending devolution to the extent possible, making sure shared responsibilities for economic development are clear among levels of government.
- Diversify Welsh own-revenue sources and make use of existing fiscal levers (e.g. tax rates, user fees, etc.) to fill the fiscal gap.
- Strengthen the fiscal management capacity of the Welsh Government and local authorities, including by monitoring revenue-raising capacity in order to produce long-term fiscal forecasts.
- Encourage local authorities to pool resources and work in partnership to build their administrative and financial capacity.

2. Further reform the subnational fiscal framework to increase own revenue

- Optimise and diversify local taxes and tax bases to increase own revenue among local authorities (e.g. vacant land tax, Non-Domestic Rates retention and tourist taxes).
- Review the fiscal equalisation system to reduce territorial disparities, support local authorities with a low tax base and encourage local economic development.
- Ease borrowing restrictions for the Welsh Government and local authorities, and make them more flexible in order to help address fiscal challenges in the short and medium term.

3. Address investment strategy fragmentation for better-co-ordinated investment post Brexit

- Adopt the proposed Framework for Regional Investment and use it to support investment initiatives across sectors and among levels of governments.
- Transition WEFO into an investment administration and management body for regional development, maintaining its location in the Office of the First Minister.
- Implement a multi-annual approach to financing investment projects for regional development, to the extent possible.
- Encourage cross-sector or cross-jurisdiction projects, including cross-border co-operation, including with specific incentives for local authorities.

4. Ensure all levels of government have sufficient capacity to support place-based investment

- Increase capacity and expertise of local authorities in the design, implementation and evaluation of investment projects through knowledge-transfer from WEFO and the Development Bank of Wales (among other agencies).
- Create an appropriately resourced PPP unit with sufficient resources and continue strengthening the use of the Mutual Investment Model (MIM).
- Ensure that *ex ante* analysis comes early in the investment cycle and that *ex post* evaluation includes outcomes.

5. Pursue additional sources of investment financing for regional development.

- Make City and Growth Deals more competitive with other UK City Deals by reinforcing their ability to leverage additional revenue and by improving their transparency and accountability.
- Promote the use of external financing mechanisms by local authorities (e.g. climate/green finance and land-value capture) on a case-by-case basis and subject to mutually agreed-upon pre-conditions.
- Encourage participatory budgeting and crowdfunding as complements to local authority financing for small-scale investment projects with high local visibility (e.g. community infrastructure, green and public space improvement, etc.).

Reinforcing Welsh strategic and implementation capacity for public investment in regional development

The factors supporting successful investment for regional development include using an integrated regional development strategy, engaging in place-based, cross-sector, regional development planning that is results-oriented and forward-looking, and ensuring that investment occurs at the proper territorial scale. Implicitly, this draws on the ability to bring together and guide diverse policy sectors and interests and take a learning-based approach to building national and subnational-level capacity. In its pursuit of balanced regional growth, inclusiveness and greater well-being, the Welsh Government may need to address fragmentation in its strategic and policy frameworks for regional development and investment, diversify the policy co-ordination mechanisms used and reinforce policy implementation mechanisms. Increasing policy effectiveness and generating trust-based partnerships will simultaneously depend on and nourish multi-level governance systems that support all levels of government in making successful investment decisions for regional development.

Creating an integrated strategic planning framework for regional development in Wales

Articulating a vision-based, long-range plan to achieve national, regional or local aims for growth and well-being is at the heart of a regional development strategy. It can anchor sector policy interventions for regional development and facilitate cross-government action to realise agreed-upon aims. It can also clarify what government means by and expects from regional development, its objectives and priorities. Some Welsh stakeholders have expressed frustration with the lack of strategic vision for regional development. A successful regional development strategy relies on societal agreement to promote policy coherence, optimise resources and realise desired outcomes.

The current strategic framework supporting Welsh regional development is structured around the WFGA and diverse strategy and policy documents, both active and proposed. While comprehensive, the framework is fragmented across policy sectors and government departments, which can affect policy

coherence and requires highly effective co-ordination mechanisms to ensure cohesive implementation. Funding streams are also fragmented. Such fragmentation is not unique to Wales. However, it represents a significant challenge and requires effective co-ordination. This is particularly important in light of the current uncertainty surrounding investment financing arising from Brexit, and the impact of COVID-19 on finances and investment needs.

As it advances with its regional development agenda, supporting a dedicated cross-sector policy for regional development and integrating the financing strands would be valuable. There are some distinct advantages to this approach: aligning priorities, building coherence and complementary across sectors, setting clear guidelines for decision-making and action, and building on cross-sector synergies. It can also serve as a roadmap for sector strategies and policies that contribute to the regional development agenda. Ensuring that diverse stakeholders are involved in its design can build a sense of ownership for the policy and its objectives, and can generate innovative solutions to specific challenges.

Strengthening regional development policy co-ordination in Wales

Responsibility and leadership for advancing the Welsh Government's regional development aims are spread throughout the government. Given the policy fragmentation, and a tendency for the Welsh Government to work in silos, there is a need for stronger horizontal and vertical co-ordination of regional development activity among actors and for a high degree of incentive to work together. Currently, there is an emphasis on consultation bodies. These are valuable for offering expert insight and advice, but they do not serve a co-ordination function. Turning to a high-level, inter-ministerial co-ordination body could help to identify cross-sector complementarities, harmonise expectations and rules, support investment pools, and establish a clear and transparent priority setting process that considers the territorial impact of policy and investment initiatives. Additionally, centres of government are playing stronger co-ordination roles across the OECD, and their emerging strategic importance goes hand-in-hand with a shift in the role of national-level governments. Today, national governments are being called on to take a more strategic role, focused on setting objectives, co-ordinating policy and monitoring performance, while subnational authorities concentrate on meeting their service responsibilities.

Not only do regional development and investment need political-level co-ordination but it also requires practical co-ordination. A technical-level entity with full cabinet (political) support and a formally-recognised mandate to co-ordinate regional development and investment would be important in Wales. This could be a dedicated office for regional development and investment within the office of the First Minister. Given the Welsh governance context, it is fundamental that such an office remain sector “neutral” and not politically or sectorally aligned with any specific government department or policy sector. Such an office could unite the strategic planning and investment planning dimensions of regional development into one entity, consolidating responsibility for strategy, policy co-ordination and investment management.

National regional development policy is important. Just as important is to complement it with place-specific development plans, designed and implemented at the relevant territorial scale (e.g. regions, metropolitan areas, local governments). A large amount of regional- and local-scale planning and service delivery already occurs in Wales. Ensuring that these are co-ordinated would be important. In the short term, it would be valuable to articulate clearly how the various regional- and local-level plans work together – including Regional Economic Frameworks, and City and Growth Deals. In the medium term, rationalising many of the existing plans into comprehensive, cross-sector, regionally designed development plans that align with a national regional development policy would be helpful. Such streamlining could also address questions of planning fatigue and limited resources.

Boosting policy and investment implementation capacity

Successful policy implementation is as essential as effective policy design. Policy implementation in Wales is reported to be challenging at the national and subnational levels. This can be due to policy instability, a disjointed policy delivery process, and limited capacity. As the Welsh Government moves to devolve additional responsibilities to local authorities, building capacity and strengthening relationships in order to work in tandem will be fundamental. Success moving forward will depend on accepting new roles and building capacity to fill them, including a more strategic approach for the Welsh Government, and a more empowered implementation role for local authorities. The Welsh Government is taking steps in this direction, for example with the introduction of chief regional officers (CROs) and their teams, and the proposed introduction of corporate joint committees (CJCs). However, additional steps are likely necessary. The devolution of responsibilities frequently calls for a “learning-by-doing” approach, that can be realised through a combination of trust-building mechanisms, including formal partnership agreements (e.g. contracts), and piloting the attribution of responsibilities. The weight of capacity building rests not only on the Welsh Government. Local authorities must also recognise their limitations and take the steps necessary to address these, including by working at a larger scale and being clear about what they can achieve in the short versus medium and long terms.

There is a rise in the use of regional development agencies among OECD countries. Reintroducing a regional development agency that is strategically oriented to support the implementation of regional development and investment policy could boost the potential of policy delivery and also build implementation capacity in the public and private sectors. It is critical that such a body be able to work across policy sectors and levels of government, have a national-level and subnational presence, be adequately resourced and have decision-making power within defined parameters. The Welsh Government’s experience with regional development agencies is mixed and it would be important to learn from the past while also capitalising on previous practical experience.

Governance tools to support stronger regional development and investment outcomes

Outcome-oriented performance measurement and a strategic approach to stakeholder engagement are tools that can contribute to policy and investment success. While Wales pursues both, it could reinforce its practices. A more robust approach to performance measurement in regional development would help Welsh public authorities to better understand the impact of their policies and programmes. A targeted, concise indicator system designed around specific regional development aims can help accomplish this. It could be used to highlight the effectiveness of programmes and investments that support growth, inclusiveness, service delivery, the foundational economy and well-being. Additionally, it can serve as a citizen accountability mechanism – especially when shared in easy to understand language, highlighting matters of citizen and stakeholder interest, and be available in an accessible format. Opening itself and its performance to public scrutiny would also permit the Welsh Government to lead by example and support efforts to increase outcome-based performance measurement at the subnational level as well.

Stakeholder engagement can help ensure successful public policy and investment outcomes. The Welsh Government relies on a variety of consultation mechanisms, from consultation bodies and working groups to reflection exercises and public consultation to support its policy process. There are limitations to this approach, however. Many of the key players and experts that participate in these bodies are the same. The advantage is trust and deep knowledge of the matters at hand, e.g. regional development policy and investment. The risk is a narrow approach that incorporates broader stakeholder consultation too late in the policy design process. For example, there is reportedly room to improve engagement practices with non-government stakeholders including the private sector, academia and the third sector. Active engagement with local authorities and other subnational actors could be strengthened, as well. In this case, there appears to be a disconnect between national and subnational government actors with respect to engagement definitions and expectations. While the Welsh Government stresses consultation, local

authorities expect more “active” or “hands-on” engagement in the design and delivery of policies and investments. This gap will need to be bridged. Establishing clear, agreed-upon definitions and aligning engagement expectations among all parties could improve engagement practices and contribute to building greater trust. Stakeholder engagement strategies are one mechanism to accomplish this.

Box 1.2. Recommendations for action to reinforce Welsh strategic and implementation capacity for regional development and public investment

1. Establish a vision-based, long-term regional development strategy for Wales

- Undertake an active, cross-sector, multi-stakeholder consultation process.
- Potentially use the WFGA as a basis for the strategy.
- Set clear, societally agreed-upon long-term objectives for the territory.

2. Introduce a single, integrated national regional development policy to realise strategic aims

- Take a cross-sector (whole-of-government), multi-stakeholder approach to policy design.
- Establish clear, measurable objectives that support the long-term development strategy.
- Ensure co-ordination between the regional development policy and sector policies with regional logic and goals.
- Create an outcome-based performance measurement system to evaluate regional development policy and investment implementation and success; adjust when necessary.

3. Strengthen and diversify co-ordination mechanisms for more effective policy and investment integration

- Reinforce the role of the centre of government as a guide and co-ordinator of regional development and investment policy.
- Establish a high-level inter-ministerial co-ordinating body for regional development chaired by the First Minister; complement with a technical/implementation subcommittee.
- Introduce/strengthen a multi-level, multi-stakeholder dialogue body and activate its innovation and knowledge-sharing potential via a strategic role in regional development and investment.

4. Establish an office for regional development and investment

- Link strategic regional development planning with regional development investment planning and management activities (currently in WEFO), by uniting them into one office.
- Ensure the office is “sector neutral” by placing it in the office of the First Minister.
- Give this office a mandate (ideally statutory) for leading regional development strategy and co-ordination efforts across government.
- Potentially move CRO teams into this office.

5. Reinforce subnational capacity to deliver on regional development planning and implementation responsibilities

- Better articulate complementarities between Regional Economic Frameworks and other City and Growth Deals, as well as other existing planning requirements and plans.
- In the medium term, introduce regional-level development plans, designed by subnational entities and aligned with a broader national regional development strategy, consolidating other relevant planning requirements into these.

- Establish formal agreements/contracts as a capacity-building mechanism.
- Adopt a learning-by-doing and asymmetric approach to devolving responsibilities.

6. Reintroduce a regional development agency to support regional development policy and investment implementation

- Orient this body toward strategic support for realising national and subnational regional development and investment aims at the regional and local levels, working with the public, private and third sectors.
- Ensure a sectorally independent head office, with accountability to the proposed office for regional development and investment.
- Establish regional-level “branch” offices (one per region). CRO teams may be effective support agents.
- Ensure adequate human and financial resources and decision-making power within its remit.
- If placed in an office to regional development and investment CRO teams may also effectively support such an agency at the subnational level.

7. Reinforce governance tools that support regional development and investment outcomes

- Strengthen an outcome-based dimension to performance measurement, using insights as a learning tool to evaluate and adjust regional development policy interventions and investment effectiveness and to build accountability to citizens.
- Support CJs and/or local authorities in the design, implementation and use of a monitoring and evaluation system for their regional development plans.
- Ensure system measures are easy to capture and to understand, are relevant to policymakers and citizens, and can support accountability to citizens.
- Adopt a stakeholder engagement strategy to establish clear engagement definitions and expectations for the Welsh Government and local authorities.
- Reinforce engagement practices with external regional development stakeholders (e.g. private and third sectors, academia, etc.).

Considering economic regions in Mid Wales and South West Wales

The Welsh Government is introducing economic regions as part of its approach to place-based regional development. Through these, it aims to build an adequate scale for devolving regional economic development planning and to build the capacity of local authorities in the planning and implementation process. For Wales to benefit from such regions, the economic, administrative and institutional capacities of local authorities will need to be strengthened. Establishing co-operative bodies among local authorities is one way to address problems of scale, and support more effective regional development policies. This, however, requires that the local authorities be in good fiscal health. Currently, Wales has introduced three economic regions: North Wales, South East Wales, and Mid and South West Wales. The question currently circulating among Welsh regional development actors is whether three economic regions should be maintained or if greater economic efficiency and regional equity could be gained by separating Mid and South West Wales into two distinct entities, creating four economic regions.

Welsh local authorities: The heart of proposed economic regions

Welsh local authorities are responsible for delivering over 700 services, making them important public service providers, particularly in education, social services, housing and security. Their per capita spending

on services is relatively similar across the territory, including those of Mid and South West Wales. Revenue comes primarily from Welsh Government grants (almost 70%). The share of own-revenue available to local authorities is small, which raises the question of adequacy with respect to revenue autonomy in Wales. Without a larger share of local authority spending financed by their own-revenue sources, some of the benefits of decentralisation are lost, despite the equalisation system. Another issue with respect to local authority financing is the role of earmarked transfers, which form between 25%-28% of total local authority revenue. In general, the extensive use of earmarked revenues is not advisable. It can draw subnational government attention away from local needs and preferences (or limit their ability to meet these), and weaken the transparency and accountability of local decision-making. Thus, it is often more desirable to opt for non-earmarked or block grants and use earmarked transfers only temporarily for special cases.

While transfers to Welsh local authorities have been cut, it has not been matched by a reform of the local government financing system. This can widen a fiscal gap, particularly as Council Tax revenues alone cannot make up the shortfall. It is also not possible to rely on the Non-Domestic Rates system since it does not encourage local authorities to develop business property tax bases, which otherwise could contribute to trimming the fiscal gap. If this gap persists, there could be a negative effect on local service quality and availability, posing a serious threat to the public service system in the medium and long run. To improve the fiscal health of Welsh local authorities and support their ability to undertake regional development planning and implementation tasks, there will need to be an adjustment to the tax framework.

A comparative look at Mid Wales and South West Wales

When considering Mid and South West Wales as one or two economic regions, a number of factors need to be accounted for. Population density is critical. Mid and South West Wales is home to about 29% of the population and 57% of the total territory, resulting in low population density. Furthermore, it exhibits the lowest population growth projection in Wales for the next 10 and 20 years. There are labour market factors to consider as well: more people commute out of the region to work than into the region, and the labour market links between communities in Mid Wales and South West Wales are not very strong. Mid Wales has a more rural profile when compared to South West Wales, though in both areas the public sector is the largest employer. Also, in both, the gross value added (GVA) per head is below that of Wales overall. Trends indicate a markedly different growth rate between South West Wales and Mid Wales, where GVA growth has slowed.

Ensuring governance capacity for a Mid (Wales) and South West Wales economic region

There is no “optimal” number of regions for any particular country and it is seldom the case that regions can be designed “from scratch” – without any pre-existing regional or local organisation. Regional reform, therefore, is often a path-dependent process affected by a variety of factors, ranging from administrative borders, economic and labour market characteristics, to historical, cultural and ethnic identity. The Welsh Government is proposing to build territorial scale and support devolution of regional economic development planning and implementation, with the introduction of inter-municipal co-operative bodies, corporate joint committees (CJCs) as “regional-level” entities. While the exact tasks of CJCs remain to be defined, they could help all levels of government consider the wider effects of local-level development needs and priorities, and help co-ordinate diverse plans. The ability of Welsh local authorities to carry out the tasks assigned through CJCs will depend on their fiscal, administrative and institutional capacities. Financial resources are scarce among local authorities, which means that, unless extra funding is made available, budget resources for CJCs risk being limited as well. Effective governance in such an arrangement can depend on fostering local-level ownership, strong accountability and empowerment to act in their region. Ensuring that CJC decision-making bodies are populated by local politicians (council members) is one way to achieve this.

The opportunities, challenges and trade-offs associated with three versus four economic regions

A Mid Wales economic region would likely result in a relatively homogenous entity in terms of service demand and needs. This would support the organisation of public services and help maintain better allocative efficiency – strong arguments from an economic perspective. At the same time, economic and administrative efficiency arguments, such as economies of scale and the capacity to provide services, do not strongly support a separate Mid Wales economic region. When considering benefits versus challenges, there are some clear opportunities. These include proximity to residents, potentially better-quality services and services that respond more directly to local needs. Furthermore, the two local authorities that would co-operate – Ceredigion and Powys – are highly motivated to work together and develop their area in tandem. There is also a danger that in a unified Mid and South West Wales economic region, the problems and potentials of Mid Wales would be overlooked, particularly if development focuses on urban and large-scale investments. In terms of challenges, the weaker financial, administrative and institutional capacities of Ceredigion and Powys need to be considered, particularly when compared to a larger unit of the six local authorities which form a Mid and South West Wales economic region.

Conversely, a single economic region for Mid and South West Wales could better offer a good base for policy effectiveness and enjoy lower administrative costs. This arrangement could also permit Swansea to be further strengthened as a motor for regional growth, innovation and productivity, benefitting the whole economic region. Furthermore, the critical mass to generate strong regional development is already present and could be additionally supported by building on synergies from the Swansea Bay City Deal and the proposed Mid Wales Growth Deal. The challenges such a region would face are linked to the heterogeneity of the area's local authorities. This means that a single CJC for the region may be unable to consider regional specificities to the same degree as in a two-region model and Mid Wales could suffer. Additionally, the distances and travel times within a larger region could be problematic for equity of access and service delivery, leading to less ability to meet service needs and demands. Finally, in a larger co-operative unit, there is a risk that each member aims to maximise their own benefit, which, in a worst-case scenario, would lead to excessive spending.

Adopting a pilot approach to support decision-making and supporting co-ordination

There are clear benefits and challenges in both a three- and four-region model, and trade-offs need to be considered. Given that CJsCs, as co-operative units, can be easily modified if necessary, it would be possible to adopt a pilot approach. In other words, first organise the economic regions around a four-region model with clear objectives and a clear timeframe for meeting these (e.g. five years). Once that time period is met, the model could be independently evaluated, for example by policy evaluation and academic experts, to determine if it should be kept or if Wales should move to a reduced number of regions.

Chief regional officers (CROs) and teams were introduced by the then Cabinet Secretary for Economy and Transport (now the Minister for Economy, Transport and North Wales) to support regional-level economic planning and co-ordination. CROs, as Welsh Government officials, together with CJsCs as regional-level entities, would play a key role in ensuring a strong partnership approach between levels of government. CROs could help maintain contact with diverse parts of the Welsh Government and support co-ordinating measures with other CJsCs. They could also help ensure equal treatment of the economic regions by the Welsh Government. However, care should be taken to ensure that the relationship is dialogue and not power-based. In other words, CROs should not be given decisive power over CJsCs, such as the power to accept or reject plans prepared by CJsCs. Yet, CJsCs could, and should, invite CROs to their meetings on an ad hoc basis to ensure relevant information is shared. As these regional structures take form, it will be important to ensure that the roles and responsibilities of all actors are clarified and strengthened.

Box 1.3. Recommendations for action to implement economic regions in Mid (Wales) and South West Wales

1. Strengthen the administrative and service provision capacity of local authorities

- Increase local authority fiscal autonomy by reducing the role of earmarked grants and increasing general grants.
- Concentrate the equalisation mechanism in the transfer system rather than in the Non-Domestic Rates.
- Increase the local authority own-source revenue (e.g. diversify local taxes; introduce a surcharge on personal income tax; reform the Council Tax; generate revenue from charges and fees).
- Adjust the equalisation system to ensure all local authorities can provide a standard/minimum level of service.
- Increase cross-jurisdiction co-operation (e.g. through CJs) to minimise territorial inequalities and build scale for key services, ensuring strong governance mechanisms, adequate resources and clear lines of accountability.

2. Take a strong evidence-based approach to establishing economic regions in Mid Wales and South West Wales

- Consider diverse territorial factors when establishing an economic region (e.g. population base, demographic trends, labour market conditions, commuting, deprivation, GVA, Internet connectivity, local government spending).
- Take a functional area approach when considering a Mid and South West Wales economic region(s), balancing between economic, administrative, social, cultural and identity dimensions and the trade-off between risks/challenges that are economically, socially and politically acceptable.

3. Ensure clear roles for CROs, CJs and local authorities in the economic region(s)

- Establish a close working partnership between CROs and their team(s) and CJs, where CROs play an enabling and consultative role but not a decision-making or authoritative role over CJs.
- Ensure a clear role and scope of authority for CJs and local authorities in regional development and foster local-level ownership, accountability and empowerment to act in their region(s).
- Secure strong CJC governance and accountability by ensuring that the decision-making bodies of CJs consist of local politicians (council members).
- Ensure that CROs and their offices have strong local-level knowledge.

4. Pilot a Mid Wales economic region to support a place-based approach to productivity, growth and regional well-being

- Establish a clear timeframe for the pilot (e.g. five years) then carefully evaluate the impact.
- Base the final decision of continuing with a four-region model or to merge Mid Wales with South West Wales on an independent evaluation of results achieved.
- Use the pilot to determine whether three or four CROs and teams is optimal.

2 Providing context: The importance of governance in Welsh public investment

This introduction features the framework of analysis used in this OECD report. It discusses the importance of effective multi-level governance for regional development and public investment, defines the investment cycle and presents a list of capacities necessary for productive public investment, based on the *OECD Recommendation on Effective Public Investment across Levels of Government*. Wales receives the highest amount of European Union (EU) Structural and Investment Funds, per capita, in the United Kingdom (UK), underscoring the need to ensure public investment is optimised in a post-Brexit era, and also post-COVID-19. The complexity of the Welsh multi-level governance system supporting regional development and public investment is described, as is the on-going devolution process, and the high-level governance issues that could limit the Welsh Government's ability to effectively realise its growth and well-being objectives.

The Welsh Government is dedicated to a regional development path that balances growth plus inclusiveness: maximising the potential for growth throughout the territory, reducing inter- and intra-territorial disparities, and enhancing well-being and quality of life for all residents. To realise its aims, the government seeks to ensure that its public investment and governance system for regional development is fit-for-purpose and able to meet the demands and pressures that might arise post-Brexit. This includes meeting the need for sustainable, robust public investment in a context of potentially fewer resources and/or possibly more constrained use. A great many factors contribute to achieving Welsh Government ambitions. They include an integrated, whole-of-government approach to investment and regional development policy design and implementation, with clear objectives and lines of accountability; the active participation of public and private sector stakeholders, including citizens; and sufficient financial, human and infrastructure resources at the most appropriate level of government. Underlying all of this is the ability to build a partnership among levels of government that is based on trust and mutual respect. While policies and governance structures can help or hinder development, depending on their efficacy and integrity, the quality of institutional and stakeholder relationships is fundamental (Morgan, 2019^[1]). Quality public investment, particularly for regional development, goes hand-in-hand with quality multi-level governance.

The focus of this report

This report focuses on the future of public investment for regional development in Wales and is undertaken at the request of the Welsh Government. The aim is to accompany the government in building its regional governance and investment capacity in order to advance policy actions dedicated to generating stronger growth and inclusiveness. In the short term, the analysis aims to inform the implementation of the Welsh Economic Action Plan, as part of the overarching Prosperity for All strategy and development agenda. In the medium to longer terms, it aims to assist the Welsh Government as it defines its regional development policy and support the government in realising its regional development objectives, including those identified in its policy paper “Regional investment in Wales after Brexit” (Welsh Government, 2018^[2]). The report’s overall analysis is based on desk research, published data, responses by the Welsh Government to an OECD questionnaire, and extensive interviews with representatives from all levels of government in Wales, as well as public, private and third sector regional development and public investment stakeholders in the UK and Wales.

The report begins by setting the scene, providing an overview of regional productivity, growth and well-being in Wales, particularly in the context of today’s megatrends associated with demographic, technological and environmental change. Chapter 4 takes an in-depth look at how Welsh fiscal and investment frameworks support public investment for regional development in a post-Brexit context and offers insight into making the most of available financial resources for regional development. Chapter 5 discusses the multi-level governance system, i.e. the frameworks, institutions and practices that support decision-making and implementation, surrounding Welsh public investment for regional development. It also examines options for reinforcing capacity to implement policy and investment decisions. Chapter 6 presents a case study on establishing economic regions, specifically in Mid and South West Wales. It sheds a practical light on various topics explored in the report’s previous chapters. Chapters 4-6 offer a series of recommendations for action.

The research and initial analysis for this report was undertaken prior to January 2020 when Brexit was formalised through a parliamentary vote and the EU Withdrawal Agreement Act 2020. At the time of writing, the data, concepts, examples and analysis remain valid despite the shift in the UK’s status with respect to the EU. Also at the time of writing, the UK government was clear in its aim to ensure that funds to replace those received from the EU would be equivalent in total value to those received from the EU. The intention is to align EU replacement funds with the UK’s strategies for territorial development (and further advance a place-based approach to regional investment). The structure, full value and allocation mechanisms for

EU replacement funding to support regional development and other public investment throughout the UK territory were still evolving when this report was presented to the Welsh Government (OECD, 2020^[3]).

The report was also researched and written prior to the COVID-19 pandemic. With its swift and unprecedented-in-peacetime impact on national and subnational economies and government budgets, its repercussions will continue to be felt in public finance, public investment and public services over the coming months, and – perhaps – years. The OECD estimates that for each month of strict containment measures, there will be a loss of two percentage points in annual gross domestic product (GDP). It also observes an asymmetric impact of the COVID-19 crisis within countries, across regions, in cities and among population groups, with some harder hit than others (OECD, 2020^[4]). In economic terms, the crisis will be felt differently across regions, depending on their exposure to tradeable sectors, global value chains and type of specialisation (e.g. tourism, services, etc.). Small- and medium-sized enterprises (SMEs), entrepreneurs and the self-employed are particularly affected, and unemployment figures and the number of aid seekers has risen dramatically, deepening the consequences of social and territorial inequalities (OECD, 2020^[4]). Subnational governments face multiple pressures arising from this pandemic. They are at the frontline for immediate crisis response given their responsibilities in healthcare, social services, education and essential public services. In the medium and longer term, subnational governments will need to juggle exit and recovery strategies, which can include managing the costs and revenue shortfalls associated with meeting the crisis head on, maintaining public investment, and ultimately applying the lessons learned and seizing the opportunities for renewal and change that a crisis can often bring (OECD, 2020^[4]; 2020^[5]).

As of April 2020, the full implication of COVID-19 on Welsh fiscal, public investment and public service delivery capacity was unknown. Budget measures up to that time focused on buttressing businesses, the economy and public services delivery, with a Welsh Government support package amounting to GBP 2.4 billion. The total level of support, however, is expected to increase, accompanied by some unknowns: how to generate additional budget capacity, by how much and for how long. Some options have been identified, including drawing down on its reserves; reallocating spending from current budgets and EU projects; and receiving additional grants from the UK government, for example via a temporary reform to the Barnett formula. Adjustments to and/or greater flexibility in the Welsh Government's ability to manage its finances were also identified as valuable options, such as temporarily relaxed borrowing and “draw-down” restrictions, though these would depend on an agreement with the UK government (Wales Fiscal Analysis, 2020^[6]). At the moment, the path taken by the UK and Welsh Governments with respect to Wales' ability to meet and recover from the crisis in the medium and longer term, and what this recovery will look like, remain to be seen.

The investment cycle, investment capacity and a framework for analysis

It is important to define “public investment” and “capacity”, as they can be interpreted in a variety of ways. For the purpose of this report, “public investment” refers to expenditures to finance physical or “hard” infrastructure (e.g. roads, rail, ports, government or other public buildings, etc.) and “soft” infrastructure (e.g. human capital development, innovation, research and development, SMEs, etc.) whose productive life extends beyond the fiscal year (OECD, 2013^[7]; 2014^[8]). These tend to be capital expenditures. For this report, “capacity” means the ability to adhere to good practices in the design and implementation of public investment. It refers more specifically to good practices in terms of institutional arrangements, technical capabilities, financial resources and policy practices that can help subnational governments achieve important goals at different stages of the public investment cycle (Figure 2.1) leads policymakers and investors through a dynamic process of strategic reflection and planning, implementation and evaluation. Ideally, at the end of each investment cycle, policymakers and investors take stock of their experience, project outputs and results, in order to appropriately adjust their investment priorities and projects and more effectively launch a subsequent cycle.

Figure 2.1. The public investment cycle



Source: OECD (2018^[9]), *Rethinking Regional Development Policy-making*, <http://dx.doi.org/10.1787/9789264293014-en>; Mizell, L. and D. Allain-Dupré (2013^[10]), "Creating Conditions for Effective Public Investment: Sub-national Capacities in a Multi-level Governance Context", <https://dx.doi.org/10.1787/5k492c9v5mq-en>; Allain-Dupré, D., C. Hulbert and M. Vincent (2017^[11]), "Subnational Infrastructure Investment in OECD Countries: Trends and Key Governance Levers", <https://dx.doi.org/10.1787/e9077df7-en>; Rajaram, A. et al. (2010^[12]), *A diagnostic framework for assessing public investment management*, <http://documents.worldbank.org/curated/en/396891468330305148/pdf/WPS5397.pdf>; Dabla-Norris, E. et al. (2010^[13]), "Investing in public investment: An index of public investment efficiency", <https://www.imf.org/external/pubs/ft/wp/2011/wp1137.pdf>; Milio, S. (2007^[14]), "Can administrative capacity explain differences in regional performances? Evidence from structural funds implementation in Southern Italy", <http://dx.doi.org/10.1080/00343400601120213>.

Ensuring the effective management of the investment cycle includes building or reinforcing capacity for action and intervention by all levels of government. The OECD suggests a set of capacities that correspond to each stage of the investment cycle and a set of governance goals (Table 2.1). Several of these capacities are fundamental to the full investment cycle, such as monitoring and managing risks to integrity and accountability, engaging in better regulation, and ensuring sufficient expertise (Mizell and Allain-Dupré, 2013^[10]).

Table 2.1. Suggested capacities to develop for effective public investment

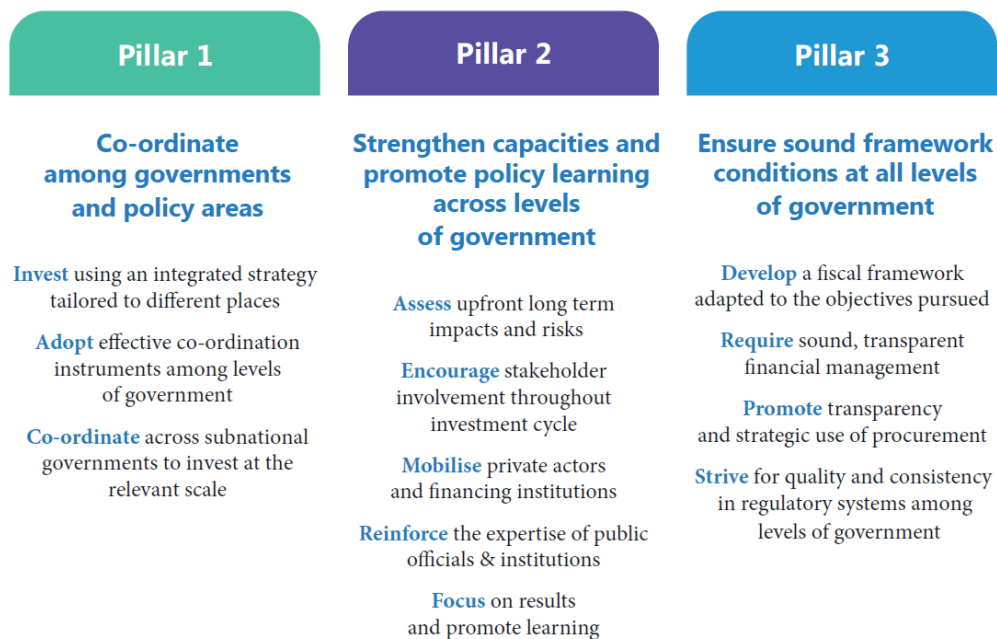
| Stage of the investment cycle | Governance goal | Suggested capacity to build or reinforce |
|-------------------------------|---|--|
| Strategic investment planning | To establish an investment portfolio that encourages regional development | Engaging in strategic planning that is tailored, results-oriented, realistic, forward-looking and coherent with national and/or other higher-level objectives. * |
| | | Ensuring the quality and availability of technical and managerial expertise necessary for planning and executing public investment, throughout the investment cycle. * |
| | | Co-ordinating across sectors and/or jurisdictions to achieve an integrated and place-based approach, ensure complementarities and achieve economies of scale. |
| | | Involving stakeholders in planning to enhance the quality and support for investment choices, while also preventing the risk of capture by specific interest groups. |
| | | Designing mechanisms to monitor and manage risks to integrity and accountability throughout the investment cycle. |
| Investment design | To ensure adequate resources | Conducting rigorous <i>ex ante</i> appraisal. * |
| | | Linking strategic plans to multi-annual budgets. |
| | | Tapping into traditional and innovative sources of financing. * |
| Investment implementation | To ensure accountability for public resources | Mobilising private sector financing without compromising long-term sustainability of public investment projects. |
| | | Designing and maintaining transparent, competitive, public procurement processes with appropriate internal control systems. * |
| | | Engaging in “better regulation” at all levels of government, and ensuring that regulations are coherent among them. |
| Monitoring and evaluation | To promote results and learning | Designing and applying monitoring indicators systems with realistic, performance-promoting targets. * |
| | | Conducting regular and rigorous <i>ex post</i> evaluation. |
| | | Using monitoring and evaluation information to enhance decision-making and identify necessary adjustments. |

Note: * indicates a critical action for all actors involved in public investment processes.

Source: OECD (2018^[9]), *Rethinking Regional Development Policy-making*, <http://dx.doi.org/10.1787/9789264293014-en>; Mizell, L. and D. Allain-Dupré (2013^[10]), “Creating Conditions for Effective Public Investment: Sub-national Capacities in a Multi-level Governance Context”, <https://dx.doi.org/10.1787/5k49j2civ5mq-en>; Allain-Dupré, D., C. Hulbert and M. Vincent (2017^[11]), “Subnational Infrastructure Investment in OECD Countries: Trends and Key Governance Levers”, <https://dx.doi.org/10.1787/e9077df7-en>; Rajaram, A. et al. (2010^[12]), *A diagnostic framework for assessing public investment management*, <http://documents.worldbank.org/curated/en/396891468330305148/pdf/WPS5397.pdf>; Dabla-Norris, E. et al. (2010^[13]), “Investing in public investment: An index of public investment efficiency”, <https://www.imf.org/external/pubs/ft/wp/2011/wp1137.pdf>; Milio, S. (2007^[14]), “Can administrative capacity explain differences in regional performances? Evidence from structural funds implementation in Southern Italy”, <http://dx.doi.org/10.1080/00343400601120213>.

A well-functioning public investment cycle can help achieve desired investment outcomes while making the most of scarce public resources. To support governments in this endeavour, the OECD identified a series of 12 principles, based on the public investment cycle and the identified necessary capacities. These principles are grouped into three pillars (Figure 2.2) to guide national and subnational governments as they consider their public investment capacity and the management of their investment cycle. They are the foundation of the *OECD Recommendation on Effective Public Investment across Levels of Government* (2014^[8]) and offer a framework for analysis, reflected in this report.

Figure 2.2. OECD Recommendation on Effective Public across Levels of Government: Principles for Action



Source: OECD (2019^[15]), *Effective Public Investment across Levels of Government: Implementing the OECD Principles*, <https://www.oecd.org/effective-public-investment-toolkit/>.

Why the multi-level governance of public investment is important

There are a number of reasons why ensuring the effective multi-level governance of public investment is important. First, in the context of declining public budgets, public investment is often cut in order to better meet current spending obligations (OECD, 2019^[16]). This affects the ability of governments at all levels to close a significant public investment gap (Box 2.1). It also aggravates a pressing need for investment in new infrastructure (including green infrastructure), in upgrading and modernising existing infrastructure, and in ensuring that all infrastructure is properly maintained, fully operational and, ideally, resilient. Ultimately, infrastructure deficiencies – be they in “hard” or “soft” infrastructure – hamper productivity, socio-economic opportunities and the resilience of countries and their regions. For example, until 2015, UK investments in the transport sector as a share of GDP were lower than the OECD average and that of most other advanced economies, affecting the quality of road and transport infrastructure, and hindering UK economic development. This was exacerbated by the fact that, as of 2015-16, 40% of investment in transport was concentrated in London and South East England (OECD, 2017^[17]). Investment in physical infrastructure alone is not enough to secure regional growth and development, however. It is only one of many contributing factors. Investment in human capital, innovation, research and development (R&D) and other forms of “soft” infrastructure are just as important to regional growth and development, and must be combined with “hard” infrastructure investment to maximise the potential for long-term growth (Garcilazo, E. and Oliveira Martins, J., 2013^[18]).

Second, countries with higher levels of *well-managed* public investment increase their productivity faster than countries with lower levels of public investment (Fournier, 2016^[19]; OECD, 2013^[7]). They may also generate substantial savings (OECD, 2013^[7]; IMF, 2015^[20]; McKinsey Global Institute, 2016^[21]; McKinsey Global Institute, 2013^[22]). Some estimates indicate that it is possible to generate savings of about 40% on infrastructure projects through more effective project selection and delivery, and by better managing

existing assets (McKinsey Global Institute, 2016^[21]; McKinsey Global Institute, 2013^[22]). Conversely, approximately 30% of the potential associated gains from public investment can be lost due to inefficiencies in the investment process (IMF, 2015^[20]). In the long-run, increasing the share of public investment in primary government spending by one percentage point could increase the long-term GDP level by about 5% (Fournier, 2016^[19]; OECD, 2013^[7]).

Box 2.1. The gap in public infrastructure investment

The OECD estimates that between 2016 and 2030, approximately USD 95 trillion in public and private investment in energy, transport, water and telecommunications infrastructure will be necessary to support growth and sustainable development, given the profound economic and demographic changes around the globe. This is equivalent to about USD 6.3 trillion per year in the next 15 years. To this should be added USD 300 billion annually if climate concerns are taken into consideration. In the EU, a further EUR 100-150 billion will be needed between 2018 and 2030 to bridge an investment gap in social infrastructure. The sticking point, however, is that current public investment is insufficient to address these needs: current investment in global infrastructure amounts to about USD 2.5 trillion per year and is declining.

Source: (OECD, 2017^[23]; McKinsey Global Institute, 2016^[21]; Brookings Institution et al, 2015^[24]; New Climate Economy, 2014^[25]; EIB, 2017^[26])

Third, positive investment outcomes can depend on the quality of national and subnational government¹ (Charron, Dijkstra and Lapuente, 2014^[27]) and governance. This includes effective institutions, appropriate regulatory and fiscal frameworks, clear policy objectives and engaged stakeholders. It is increasingly recognised that quality of government can result in better economic performance, higher environmental sustainability, lower income inequality and poverty, better education and health outcomes, and higher levels of subjective happiness (Charron, Dijkstra and Lapuente, 2014^[27]). Meanwhile, the low quality of government can lead to suboptimal use of investment funds. It is estimated that 10%-30% of the investment in a publicly-funded construction project may be lost through mismanagement and corruption (CoST, 2012^[28]).

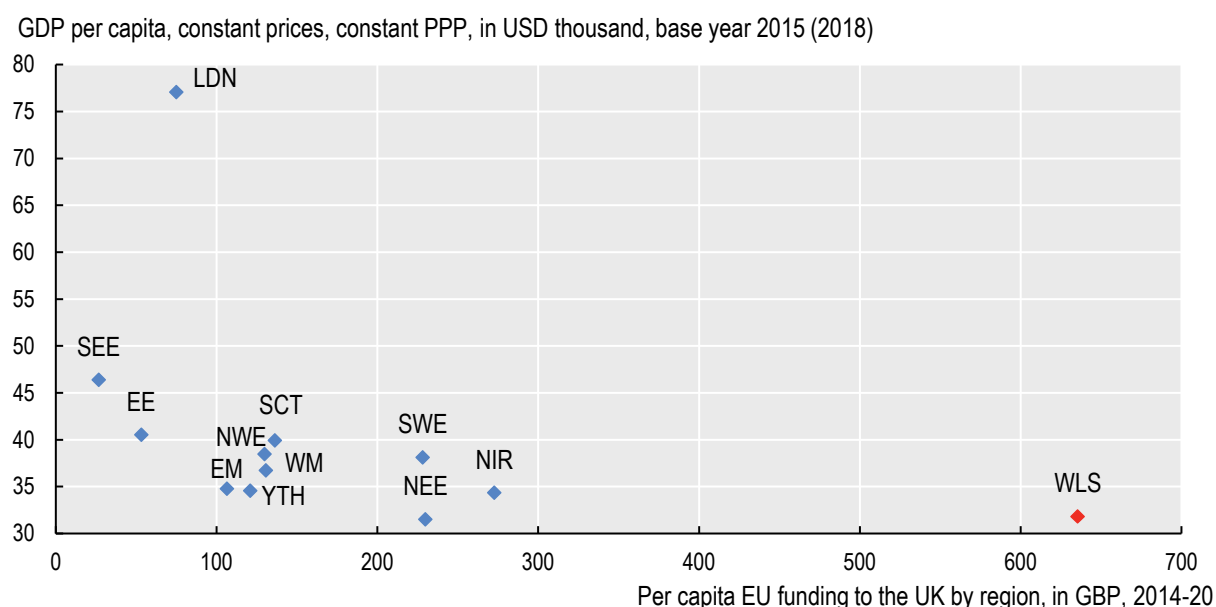
Finally, the quality of governance at the regional and local levels can determine the effectiveness of investment funds. In a study on the use of Cohesion Policy funds in 202 EU regions, those with a low quality of government were found to be less likely to make effective and efficient use of the funds (Charron, Dijkstra and Lapuente, 2014^[27]). This can result in low growth and highlights the importance of ensuring supportive governance conditions for investment. Furthermore, evidence suggests that institutional quality and governance processes affect the expected returns to public investment and have a positive influence on the capacity of public investment to leverage private investment, rather than to crowd it out (OECD, 2018^[9]). Thus, the quality of government and governance at all levels is a factor in whether investment translates into greater growth (OECD, 2013^[7]) and, ultimately, citizen well-being.

Taken together, these reasons link the effectiveness of public investment with the quality of government at the national and subnational levels. They also highlight the need for quality multi-level governance systems (i.e. the public institutions, frameworks and practices) that support the capacity of all levels of government to invest successfully in regional development.

Why does this matter for Wales? First, because subnational governments (i.e. regions, metropolitan areas, cities, local governments) are important investors in their territory's development. Among OECD member countries, almost 40% of total subnational public investment is dedicated to economic affairs (transport, communications, economic development, energy, construction, etc.) and 21% to education (OECD, 2018^[29]). Economic affairs² is the main capital spending area for the Welsh Government and local

authorities combined, accounting for 30% of their investment. However, in this area, most spending (73%) is the responsibility of the Welsh Government. Housing and community, and education are the primary capital spending areas for Welsh local authorities. Investment in these areas is one driver for productivity and growth in the short, medium and long terms. Second, most public investment responsibilities are shared among levels of government – for example, the central, intermediate and local levels. The Welsh Government, itself, is responsible for 33% of public investment in Wales, local authorities for 31% and the UK government for 36%. Thus, how these levels of government interact in their pursuit of achieving development aims contributes to the effectiveness of the investment undertaken. A lack of clarity with respect to responsibilities, unaligned priorities, and limited or ineffective communication within or among levels of government can affect policy delivery and the investments that support it. Furthermore, as the largest recipient of European Structural and Investment Funds (ESIF) in the UK on a per capita basis, Wales is highly exposed to their loss, post-Brexit. Among UK regions, Wales has one of the lowest GDP per capita (in constant PPP as of 2018) and receives correspondingly the highest amount of EU funding, per capita (Figure 2.3). For the 2014-20 programming period, Wales will receive a total of GBP 2 billion from EU funding and it is estimated they will have triggered a total investment value of GBP 3.8 billion over the period (Welsh European Funding Office, 2018^[30]). In addition, Wales tends to receive a lower share of EU competitive funding compared to the EU average (Bird and Phillips, n.d.^[31]). Ensuring that public investment funds are optimally used and supported by effective governance and financing structures becomes fundamental to Wales's investment capacity in a post-Brexit era. This means appropriately prioritising public investment projects, co-ordinating investment across sectors, and understanding and meeting local needs.

Figure 2.3. Allocation of European Structural and Investment Funds (ESIF) across UK regions (2014-20 programming period)



Note: Data on EU funding refer to the European Regional Development Fund (ERDF) and the European Social Fund (ESF) only. SEE: South East England; LDN: Greater London; SWE: South West England; NWE: North West England; NEE: North East England; EE: East of England; EM: East Midlands; WM: West Midlands; YTH: Yorkshire and The Humber; SCT: Scotland; NIR: Northern Ireland.

Source: OECD (2017^[17]), *OECD Economic Surveys: United Kingdom 2017*, http://dx.doi.org/doi.org/10.1787/eco_surveys-gbr-2017-en; SPERI (2016^[32]), *UK Regions and European Structural and Investment Funds*, <http://speri.dept.shef.ac.uk/wp-content/uploads/2018/11/Brief24-UK-regions-and-European-structural-and-investment-funds.pdf>.

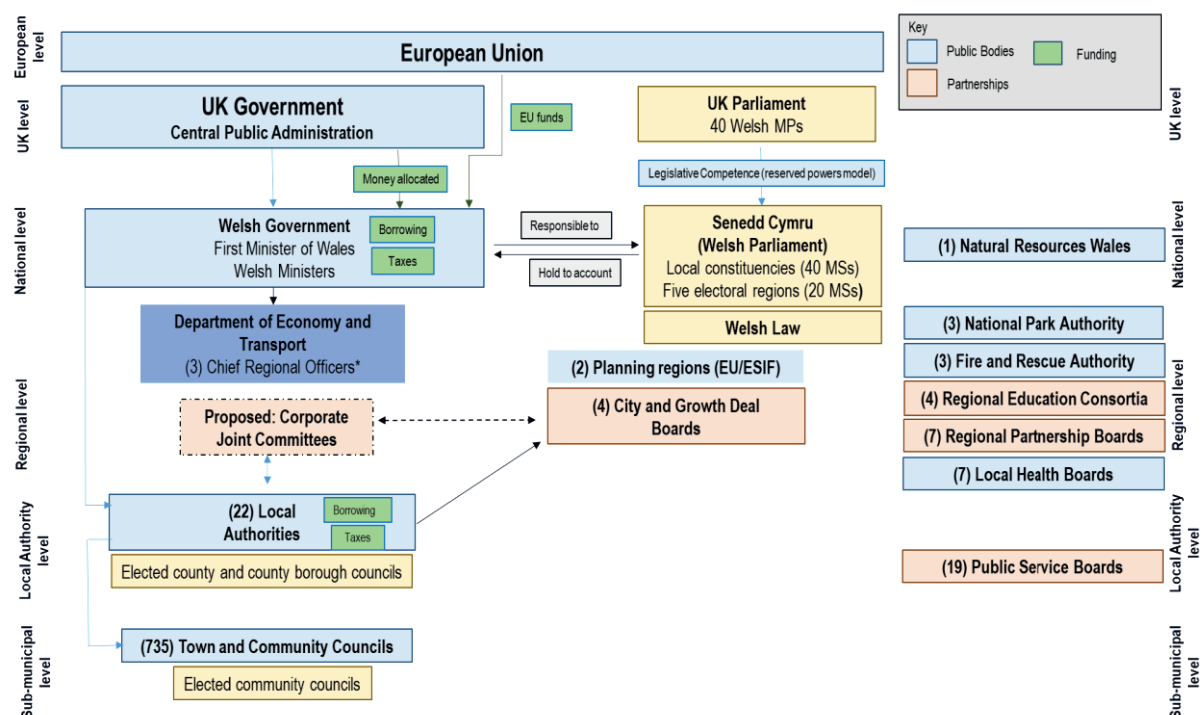
The complexity of multi-level governance in Wales

There is an inherent tension in the Welsh multi-level governance system. On the one hand, there appears to be a lack of trust among different levels of government, compounded by uncertainty – of the future, motives and possibilities. This is despite good intentions and the introduction of mechanisms that could lead to a new working ethos (OECD, 2019^[33]; 2019^[34]). It generates a degree of conflict in governance relationships and in the approach to implementing solutions to commonly acknowledged problems, including optimising governance structures for territorial development and investment. Often it appears that conflict surrounds the “how” – how to undertake policy and reform, for example in regional development or with respect to devolution within Wales. On the other hand, there is a clear capacity for consensus, evidenced by the alignment of high-level objectives between the Welsh Government and local authorities, a demonstrated ability to co-operate across jurisdictions with sufficient incentive, and a shared perspective that collaborative governance and partnership approach to policy design and implementation are desirable. This tension plays out, however, in day-to-day decision-making and policy implementation, including with respect to place-based regional development, decentralisation/devolution and stakeholder engagement.

The governance context in which public investment takes place matters. The Welsh Government is at the centre of a multi-level polity (Figure 2.4), where each level is intimately linked and interdependent in various ways, particularly in regulatory and financial terms. As the smallest and poorest of the three nations in Great Britain (England, Scotland and Wales), Wales is the most dependent on financial flows from the EU and the UK government. It received approximately GBP 5.2 billion in ESIF support over the past 3 programming periods. This makes its growth and investment planning particularly vulnerable to decisions taken at the supra-national level. In addition, disruptions at one level – between the EU and the UK, for example – can have a ripple effect on the balance of power among the rest. Of particular relevance is a constitutional inter-dependence among the supra and national levels. This originates in the constitutional basis for the devolution settlements in Northern Ireland, Scotland and Wales, which was furnished by the EU legal framework. Thus, while there is an implied bilateral relationship between the Devolved Administrations and the UK parliament, under the “reserved powers” devolution model the devolution settlements reflect the weight of EU law. In reality, the relationship is not one-to-one between the UK and the three devolved governments, but rather a trilateral relationship that includes the EU. The repatriation of these powers from the EU to the UK, post-Brexit, raises the issue of where they will be located – in Westminster or the Devolved Administrations (Morgan, 2019^[1]). This is of particular concern to the Welsh Government, and it is working to establish uniquely Welsh devolved governance structures and working practices as a counterweight, including for regional development and public investment.

Changes in inter-governmental arrangements, such as those that may be ushered in with Brexit, can also lead to new internal relationships between the UK and Wales, including the possibility of recentralising the governance of regional development policy, which the Welsh Government considers would destabilise its economy (Welsh Government, 2017^[35]). It also links national-level policy considerations – particularly that of regional development – to higher-level actions – notably Brexit – in two ways. First, with Brexit comes repatriation of powers from the EU to the UK, and some of these powers, with respect to regional policy, agri-food policy and environmental policy for example, could be transferred to the UK government despite their critical role in Welsh economic development policy, a devolved (i.e. Welsh) competency (Morgan, 2019^[1]). It is not yet clear if this, or some more nuanced form, will be the approach adopted by the UK government with respect to regional development and its financing (OECD, 2020^[3]). Second, the Brexit-related political conflicts arising between levels of government have affected inter-governmental trust, which can affect the level of co-operation necessary for successful (multi-scalar) regional development policy design and implementation (Morgan, 2019^[1]). There appears to be a shift in how this relationship is managed, which may begin to foster greater trust between levels of government and lead to a stronger partnership-based approach.

Figure 2.4. The Welsh multi-level governance system* supporting public investment



Note: As of January 2020, the UK exited the EU. However, the public investment frameworks, the regulations governing these and projects financed by European funds remain relevant until the financing is exhausted in 2023. Furthermore, the European level has influenced the devolution agreement between the UK government and the Welsh Government, and thus remains an actor, if a silent one, in the multi-level governance system at the time of writing this report.

* The chief regional officers (CROs) are attached to the Department of Economy of the Welsh government, with an aspirational role to act at the regional level.

Source: OECD elaboration based on Welsh Government (2019^[36]), *Responses to OECD Questionnaire*, unpublished.

Whatever the future holds, it seems clear that post-Brexit regional development policy will revolve around two critically important territorial relationships. The first is the inter-governmental relationship between the UK and Welsh Governments. Because of the current uncertainties regarding the Brexit agreement, as well as the scope of this project, this OECD report focuses on the second relationship – that which is internal-to-Wales, i.e. between the Welsh Government and Welsh local authorities, and which is also characterised by limited trust (Morgan, 2019^[11]). This has severely affected the partnership approach to governance valued by the Welsh national and subnational levels of government. Limited trust (as well as weak partnerships) can reinforce a siloed way of working, which inhibits integrated, cross-sector policymaking and investment at the national level. It can also colour national/subnational relations as reform by the national level or requests by the subnational may be met with mistrust or suspicion (OECD, 2019^[33]).

Welsh Government structures are continuing a transformative process that began in 1997 with a devolution referendum and the establishment of the Welsh Executive and National Assembly through the Government of Wales Act (1998) (National Assembly for Wales, 2019^[37]) and the Government of Wales Act (2006), which separated the executive and the legislature. These steps in political devolution were complemented by the first step toward fiscal devolution in 2014 with the Wales Act (2014) which devolved fiscal powers to the National Assembly for Wales (Welsh Government, 2019^[36]). More recent activity includes a degree of fiscal devolution through the Tax Collection and Management (Wales) Act (2016), the Land Transaction Tax and Anti-avoidance of Devolved Taxes (Wales) Act and the Landfill Disposals Tax (Wales) Act, both in 2017. As part of this process and in order to better meet its growth plus inclusiveness goals, the Welsh

Government is evaluating the Welsh multi-level governance system and its ability to support regional decision-making, policy delivery (including services) and investment processes for regional development. Many of the “hard” elements are in place, including statutory guidelines in the form of the Well-being for Future Generations Act, committed institutions and strong experience managing public investment. However, there are some gaps in the multi-level governance system to which attention should be paid, particularly in the “softer” dimensions such as vision setting for strategic policy planning, monitoring and evaluation practices and, perhaps most critically, building effective long-term partnerships for policy implementation.

The Welsh Government needs to consider at least three high-level governance issues as it moves forward in realising its regional development aims. The first is a tendency to work in operational or sectoral silos, with policy driven by individual ministers and their departments (OECD, 2019^[33]). The result is policy and programming fragmentation, compounding the “delivery gap”³ and limiting cross-sector policy coherence. In addition, it can dilute policy and investment effectiveness by generating an inefficient use of already limited resources. Ultimately, it makes it difficult to bring the various interests and objectives together to form an integrated, whole-of-government approach to designing and implementing government strategy. Ensuring policy coherence is critical for effective regional development, particularly when taking a place-based approach – it supports the ability to capture complementarities and synergies across policy disciplines and to maximise investment. Action in one area, such as innovation policy, will have incidence in others, for instance education and skills policy or energy policy. Ideally, these policy sectors should work together to identify how their objectives can be mutually reinforcing and where investment can be optimised by supporting the goals of more than one area.

The second is a need for policy continuity across election cycles. Since 1999, Wales has had strong party continuity in its leadership. One would expect, therefore, a strong capacity to ensure that policies requiring time to bear fruit stay in place long enough to have the opportunity to do so. The fact that this may not be the case may result from a culture of power consolidation at the individual level, rather than at the institutional level, as well as a siloed operational culture as mentioned above. For regional development policy to flourish, the capacity to sustain objectives beyond individual election cycles is important. This can depend on effective, multi-stakeholder vision setting and a strong centre of government. A lack of continuity may also contribute to a culture that places greater weight on policy design (the need for something new) rather than policy delivery (the need for giving what is in place a chance to yield results, monitoring, evaluating and adjusting when necessary) (Morgan, 2019^[11]).

The third is a need to streamline the layers of policy and service intervention in the territory. This appears to arise from a tendency to add layers to what exists – a new consultative body, board or authority, a new partnership catchment area, a new strategy, framework, policy or plan, etc. The result of this “variable geometry” is a geographic footprint that makes policy and service delivery, as well as their management, complex (Beecham, 2006^[38]) fragmented and potentially opaque. The Welsh Government and various partners have undertaken diverse mapping exercises with an eye on rationalising the system. A significant rationalisation may not be popular among all stakeholders but it would help better channel already strained human and financial resources, and introduce greater clarity in lines of responsibility, thereby boosting accountability. Furthermore, it may reduce “co-ordination fatigue”. Finally, it could contribute to identifying investment priorities and potential synergies across investment initiatives in order to more effectively target funds. Applying an integrated regional development policy across existing structures and plans requires strong co-ordination and high-levels of “buy-in” from local stakeholders. Without these, there is a risk of incoherence between the regional development policy and the various other structures and plans, resulting in an even more complex environment in which to design and deliver policy and services. It also renders policy evaluation and adjustment – a key component of the policy cycle – more complex. While the challenge of multiple plans and geographic footprints for development and service delivery is recognised by both national and subnational levels of government, there seems to be limited enthusiasm for seizing

opportunities to address the issue (OECD, 2019^[33]; 2019^[34]). This can beg the question of whether there is political will or capacity to do something about it.

For a place-based regional development policy to be effective, national and subnational objectives, development needs and investment priorities must align. This requires a solid co-operative framework and the capacity of all levels of government to engage in a manner that is coherent with their role in policy delivery. For the national governments, particularly in a decentralised (devolved) governance context, the policy delivery role is increasingly a strategic one. For subnational governments, it is increasingly focused on quality implementation, be it in terms of public or administrative policy or service delivery or “hard” and “soft” investment outcomes. There appears to be significant space for the Welsh Government to adopt a more learning-driven approach to the multi-level governance processes that support regional development. This means taking a fresh look at its regional development framework, the mechanisms for policy and service delivery, including devolution, and reconsidering the relationship and role with local authorities.

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Notes

¹ The quality of government refers to how government delivers policy – i.e. whether policies are delivered effectively, impartially and free of corruption, regardless of the policy's nature and degree or its provision (Charron, Dijkstra and Lapuente, 2014^[27]).

² Based on the Classification of the Functions of Government (COFOG), “economic affairs” include agriculture and fisheries, transport, commercial development and tourism.

³ The space between the policy as designed and the ability of actors (in terms of organisational culture, institutional capacity and managing process complexity) to deliver (i.e. implement) it (Beecham, 2006^[38]).

3

Understanding the Welsh territorial puzzle in the context of megatrends

Chapter 3 begins with a snapshot of Welsh territorial and socio-economic conditions. It then explores the regional divide in productivity and inclusive growth in Wales, highlighting disparities in labour productivity growth and putting this in the context of different productivity growth models. It identifies challenges and opportunities to enhance productivity across the full Welsh territory, with a focus on the role of cities, transport networks, demographics, skills, research and development (R&D) and business dynamics. The chapter also assesses well-being performance, noting that well-being outcomes in Wales are often higher than or equal to OECD standards but lower than United Kingdom (UK) averages. Youth unemployment and income deprivation are examined, as well as how inequalities can exacerbate a population's vulnerability to environmental and health risks, such as the COVID-19 pandemic. The chapter concludes with the importance of a place-based approach to regional development for addressing territorial inequalities in economic performance and for generating well-being throughout Wales.

Infographic 3.1. Key messages

Introduction

Wales, like several of its peer OECD regions, is currently facing global megatrends related to demographic (declining population and ageing), technological (digitalisation and automation) and environmental change (pollution, loss of biodiversity and climate change). Addressing these global shifts will require new policy approaches, as well as building stronger institutional capacity to manage public investment and ensure effective governance. These megatrends can also have important consequences at the local level, with the risk of exacerbating territorial inequalities. Such risk calls for action from all levels of government and for a place-based approach (OECD, 2019^[1]).

In addition to the uncertainty generated by megatrends, persistent regional inequalities have led to an increasing mistrust in institutions and discontent with the economic, social and political status quo, particularly in regions that are lagging behind (Rodríguez-Pose, 2018^[2]). There are many examples where sharp within-country inequalities reinforced the mistrust and discontent of the population in less developed regions, which struggle to catch up (OECD, 2019^[1]). In 2016, among OECD countries, the UK had one of the largest regional disparity in gross domestic product (GDP) per capita, with the richest top 10% of its regions showing a GDP per capita 4 times higher than the bottom 10% of regions (OECD, 2018^[3]). What is more, this ratio increased to 4.7 in 2018, with the bottom 10% of regions in the UK including 4 out of the 12 small regions of Wales (small regions refer to NUTS-3 or TL3 regions, see Box 3.1), namely the Isle of Anglesey, Central Valleys, Gwent Valleys and Powys.

The UK's regional disparities in labour productivity are also among the starkest in the OECD. In 2018, Greater London presented levels of gross value added (GVA) per worker of around USD 110 000 (in 2015 purchasing power parity [PPP]), a level 70% higher than the labour productivity of Wales and Yorkshire and The Humber – the two UK large regions (NUTS-1 or TL2) with the lowest GVA per worker. Similarly, within Wales, the GVA per worker in the area of Cardiff and Vale of Glamorgan¹ was approximately 43% larger than that of Powys in the same year. Beyond productivity, well-being outcomes, such as having at least tertiary education or having a job, can also highlight important regional inequalities within Wales. For example, while Cardiff and Vale of Glamorgan display shares of the labour force with at least tertiary education above 45% and employment rates around 60%, Blaenau Gwent and Neath Port Talbot present shares of the labour force with at least tertiary education below 30% and employment rates around 52%.

In the context of the UK, the persistent within-country and within-nation inequalities might have contributed to radical political responses such as Brexit, where the most lagging regions tended to support leaving the European Union (EU) (Dijkstra, Poelman and Rodríguez-Pose, 2019^[4]). For example, Blaenau Gwent, the Welsh local authority with the highest support for Brexit during the EU referendum (Electoral Commission, 2020^[5]), is a region facing population decline over the last 17 years, with high shares of its population living in income deprivation and with one of the lowest educational levels for its workforce compared to other Welsh local authorities.

In light of the challenges posed by demographic, technological and environmental megatrends, as well as the uncertainty generated by the process of Brexit, the Welsh Government is adopting a place-based approach to regional policy that focuses on inclusive growth and well-being throughout its territory. This approach requires enhancing multi-level governance processes with national, local and UK authorities, as well as the participation of other stakeholders – including international co-operation (Welsh Government, 2020^[6]) and partnerships with European institutions.

After examining the geography of socio-economic conditions of Wales, this chapter provides an assessment of two major and interlinked policy areas that are at the core of the Welsh development agenda: i) productivity and inclusive growth; and ii) well-being today and for future generations. To provide insight into Wales' situation from an external perspective, every section provides international comparisons relative to other OECD regions (NUTS-2 or TL2 regions).² Subsequently, to understand the Welsh

territorial puzzle and to identify potential areas of improvement, each section further analyses outcomes and challenges across the Welsh local authorities or Welsh small regions (NUTS-3 or TL3 regions).

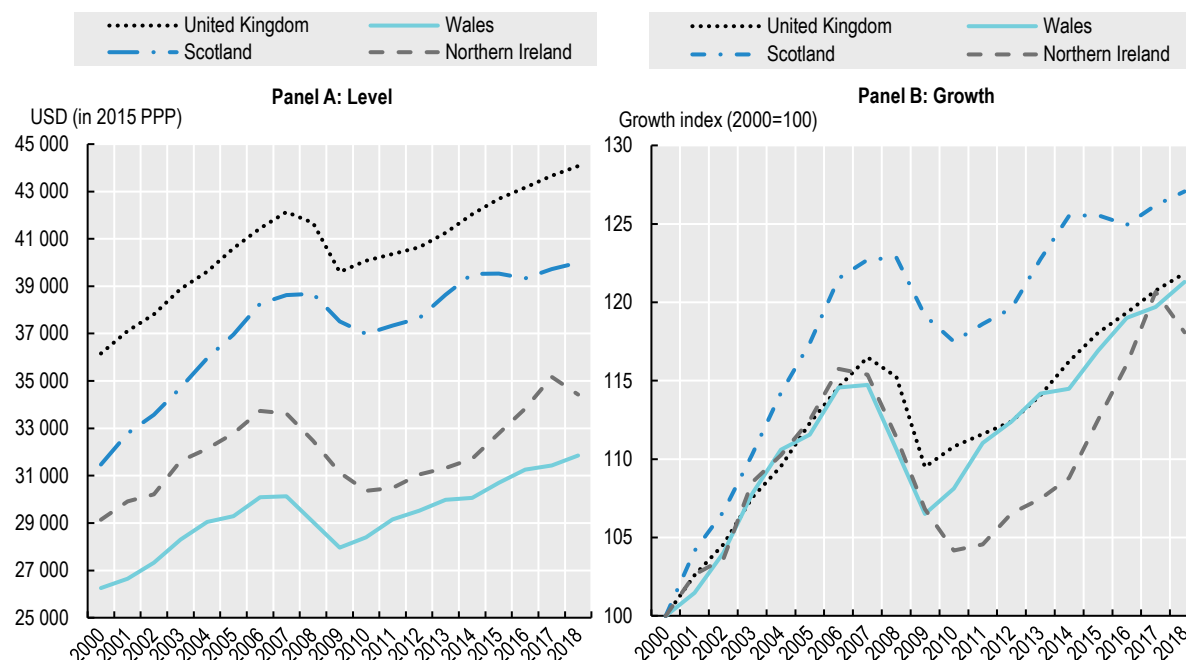
A snapshot of Welsh territorial and socio-economic conditions

Wales is one of the UK's four nations, together with England, Northern Ireland and Scotland. It has a population of around 3 million people and an area of approximately 20 000 km², which represents 5% of the total UK population and 9% of the total UK area. This makes Wales a very low-density region (151 people per km²) compared to the UK average (275 people per km²). This can be challenging for the delivery of public services, particularly in remote rural areas, and limits the potential of agglomeration economies. In 2018, Wales represented only 3.4% of the total GDP of the UK and 4% of its employment (a slightly lower portion than its share in terms of the UK population).

Wales has not been catching up with the UK average levels of economic prosperity but economic growth rates have been improving since the 2007-08 financial crisis

In the past 18 years, Wales has not been catching up with the UK average levels of GDP per capita. From 2000 to 2018, the GDP per capita in Wales remained the lowest of the 4 UK nations, representing only 72% of the UK average (Figure 3.1, panel A). Although long-term growth rates in GDP per capita have remained sluggish in both Wales and the UK (at an annual average of 1.1%), it is worth noting that growth rates in Wales slightly increased after the 2007-08 financial crisis – they shifted from 0.7% before the crisis (2000-09) to 1.5% for the post-crisis period (2009-18) (Figure 3.1, panel B).

Figure 3.1. Evolution of GDP per capita in Wales and the UK, 2000-18



Note: GDP per capita is expressed in USD PPP at constant prices of 2015.

Source: OECD (2020^[7]), *OECD Regional Statistics (database)*, <http://dx.doi.org/10.1787/region-data-en>.

Box 3.1. The OECD Regional and Metropolitan Classifications

Large (TL2) and small (TL3) regions

The OECD classifies its regions on two territorial levels reflecting the administrative organisation of countries. The 393 OECD large (TL2) regions represent the first administrative tier of subnational government, for example, the Ontario Province in Canada. The 2 256 OECD small (TL3) regions correspond to administrative regions, with the exception of Australia, Canada and the United States. These TL3 regions are contained in a TL2 region, with the exception of the United States for which the economic areas cross the states' borders. For New Zealand, TL2 and TL3 levels are equivalent and defined by regional councils. All regions are defined within national borders.

This classification – which, for European countries, is largely consistent with the Eurostat NUTS 2016 classification – facilitates greater comparability of geographic units at the same territorial level. These two levels, which are officially established and relatively stable in all member countries, are used as a framework for implementing regional policies in most countries.

Urban-rural typology

Traditionally the OECD has classified TL3 regions as predominantly urban (PU), intermediate (IN), or predominantly rural (PR) regions. This typology is mainly based on population density in each local unit, combined with the existence of urban centres where at least one-quarter of the regional population reside. An extended regional typology has been adopted to distinguish between rural regions that are located close to larger urban centres and those that are not. The result is a fourfold classification of TL3 regions: PU, IN, predominantly rural regions close to a city (PRC) and predominantly rural remote regions (PRR). The distance from urban centres is measured by the driving time necessary for a certain share of the regional population to reach an urban centre with at least 50 000 people (OECD, 2018^[3]).

Functional urban areas (FUAs)

The definition of FUAs was developed in collaboration with the EU. Using population density and travel-to-work flows as key information, an FUA consists of a densely inhabited city and of a surrounding area (commuting zone) whose labour market is highly integrated with the city. The ultimate aim of the EU-OECD approach to FUAs is to create a harmonised definition of cities and their areas of influence for international comparisons as well as for policy analysis on topics related to urban development.

Using FUAs allows designing policies at the right scale. For example, for mobility and accessibility to services. At the same time, FUAs provide a harmonised methodology to compare similar urban units in size and function. This is particularly relevant in the context of the Sustainable Development Goals (SDGs), a universal global agenda that requires comparability across the world in order to track progress towards sustainable development (OECD, 2020^[8]).

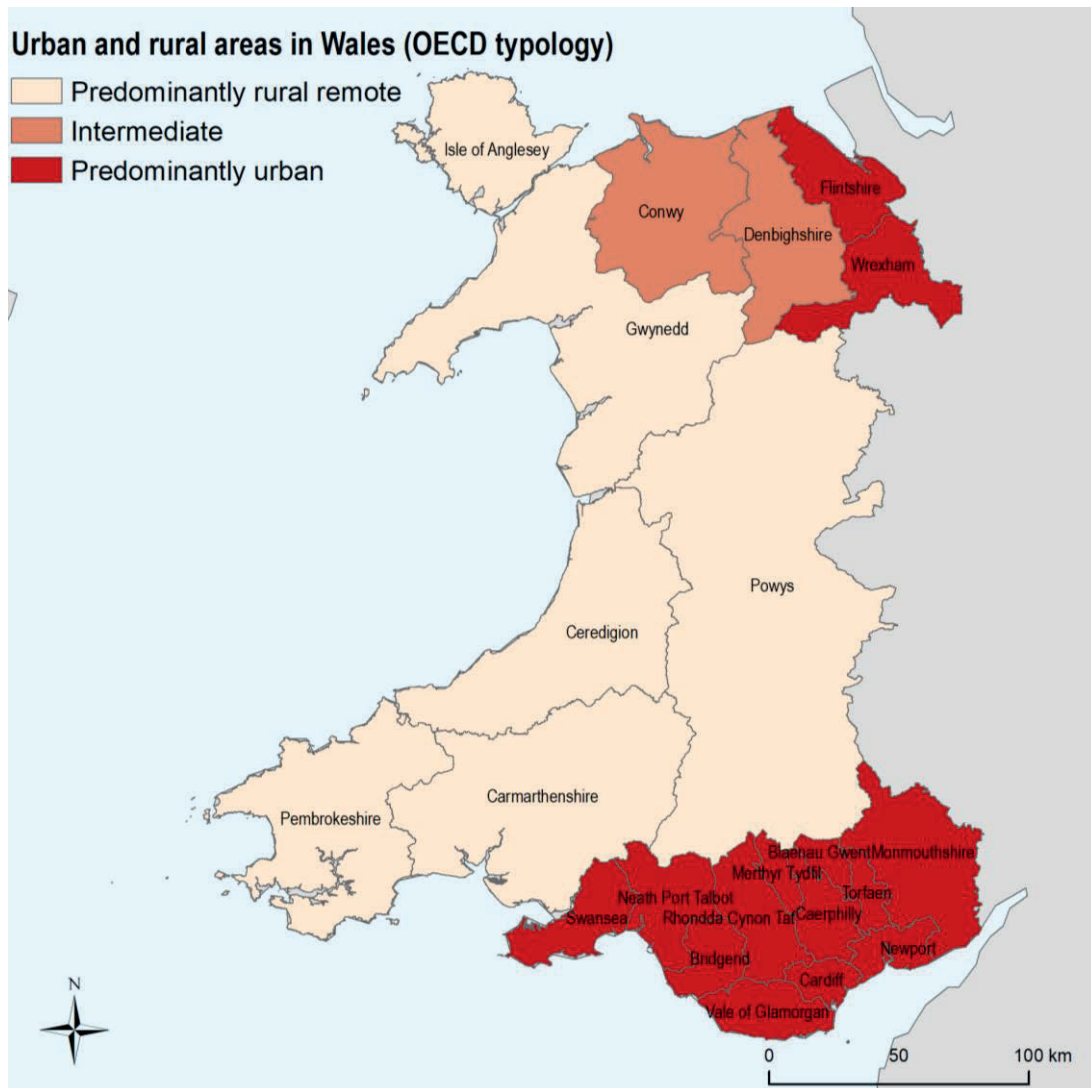
Source: OECD (2018^[3]), *OECD Regions and Cities at a Glance 2018*, https://doi.org/10.1787/reg_cit_glance-2018-en.

The largest cities in Wales close to England concentrate most of the economic activity, yielding an unbalanced spatial development

According to the OECD urban-rural typology (Box 3.1), Wales has 2 main urban clusters (the area encompassed by contiguous PU regions), 1 in the northeast and 1 in the southeast, separated by a distance of about 180 km (close to a 3-hour drive). The urban cluster in the southeast has its centre in Cardiff. It covers the area from Swansea to Newport and Monmouthshire and is bordered by Carmarthenshire and Powys to the north. The urban cluster in the northeast is composed of Wrexham and

Flintshire, bordered by Powys to the south and the intermediate areas of Conwy and Denbighshire to the west. These 2 urban clusters, which represent less than one-fourth of the Welsh territory, are home to 70% of the Welsh population and produce 75% of Wales' GDP. On the other hand, the rural remote areas of Wales, which account for more than two-thirds of the Welsh territory, host 23% of the population and produce 20% of the GDP (Figure 3.2).

Figure 3.2. Urban and rural areas in Wales



Note: For more details, see Box 3.1. This typology refers to a methodology based on small regions (NUTS-3 or TL3). For this reason, within small regions, differences in urbanisation patterns might not be reflected.

Source: OECD (2020^[7]), *OECD Regional Statistics (database)*, <http://dx.doi.org/10.1787/region-data-en>.

The main cities of Wales – concentrating a large part of the nation's economic activity and reaping the benefits of agglomeration economies – yield an unbalanced spatial development. This is characterised by a divide between the highly urbanised southeast and northeast areas on one side, and the rest of the nation, typified as predominantly rural remote regions (PRR). The main cities (high-density areas) in the southeast urban cluster are Cardiff, Newport and Swansea, while the densest areas in the northeast are the counties of Flintshire and Wrexham. Table 3.1 shows that the highest economic performance in Wales is concentrated in the regions that include the cities of Cardiff, Newport, Swansea, Flintshire and Wrexham

– with levels of GDP per capita that range from the USD 33 000 (in 2015 PPP) to USD 44 000. Nevertheless, Swansea is lagging in terms of GDP per capita relative to the southern Welsh regions that include Cardiff and Newport, which among other things, might be benefitting from their physical proximity to English markets.

Table 3.1. A statistical snapshot of the Welsh small regions, 2019 or most recent year available

| Region | Population, 2019 | Area, km ² , 2019 | Population density, 2019 | GDP per capita, 2018 | Share of total Welsh population (%), 2019 | Share of total Welsh area (%), 2019 | Share of total Welsh GDP (%), 2018 |
|-----------------------------------|---------------------|---------------------------------|--------------------------------|----------------------------|---|--|---|
| Wales | 3 136 383 | 20 738 | 151.2 | 31 805 | 5 (of the UK) | 9 (of the UK) | 3.4 (of the UK) |
| Isle of Anglesey | 70 073 | 711 | 98.6 | 22 936 | 2.2 | 3.4 | 1.6 |
| Gwynedd | 124 147 | 2 535 | 49.0 | 32 662 | 4.0 | 12.2 | 4.1 |
| Conwy and Denbighshire | 212 675 | 1 963 | 108.3 | 27 327 | 6.8 | 9.5 | 5.8 |
| South West Wales | 386 480 | 5 775 | 66.9 | 27 017 | 12.3 | 27.8 | 10.5 |
| Central Valleys | 299 239 | 536 | 558.3 | 23 750 | 9.5 | 2.6 | 7.1 |
| Gwent Valleys | 343 280 | 512 | 670.5 | 23 827 | 10.9 | 2.5 | 8.2 |
| Bridgend and Neath Port Talbot | 286 272 | 692 | 413.7 | 31 804 | 9.1 | 3.3 | 9.1 |
| Swansea | 246 217 | 380 | 647.9 | 33 619 | 7.9 | 1.8 | 8.3 |
| Monmouthshire and Newport | 244 891 | 1 040 | 235.5 | 38 756 | 7.8 | 5.0 | 9.5 |
| Cardiff and Vale of Glamorgan | 497 646 | 472 | 1 054.3 | 44 019 | 15.9 | 2.3 | 21.9 |
| Flintshire and Wrexham | 293 370 | 941 | 311.8 | 35 257 | 9.4 | 4.5 | 10.4 |
| Powys | 132 093 | 5 181 | 25.5 | 26 102 | 4.2 | 25.0 | 3.5 |

Note: GDP per capita is expressed in USD PPP at constant prices of 2015.

Source: OECD (2020^[7]), *OECD Regional Statistics (database)*, <http://dx.doi.org/10.1787/region-data-en>.

Box 3.2. The Welsh local authorities and the economic regions

The Welsh local authorities

There are currently 22 local authorities in Wales, which have statutory duties in sectors that influence and enhance regional development and the well-being of their population. The mandate of these municipalities covers a large range of public policy interventions. Their responsibilities encompass the education system (until 16 years old), the delivery of social care services (including for children and elderly people), housing, waste collection, road maintenance and public protection (including the population's environmental safety). To deliver these services, Welsh local authorities can partner with each other or with other entities, such as third-sector organisations. Local authorities are also legally required to promote equality of opportunities, including the eradication of discrimination, and to take into consideration the well-being of future generations in their policy choices. Table 3.2 lists the

22 Welsh local authorities and their correspondence to the 12 small statistical regions (NUTS-3 for Eurostat or TL3 for OECD). In this chapter, these 12 TL3 regions are also referred to as the Welsh small regions.

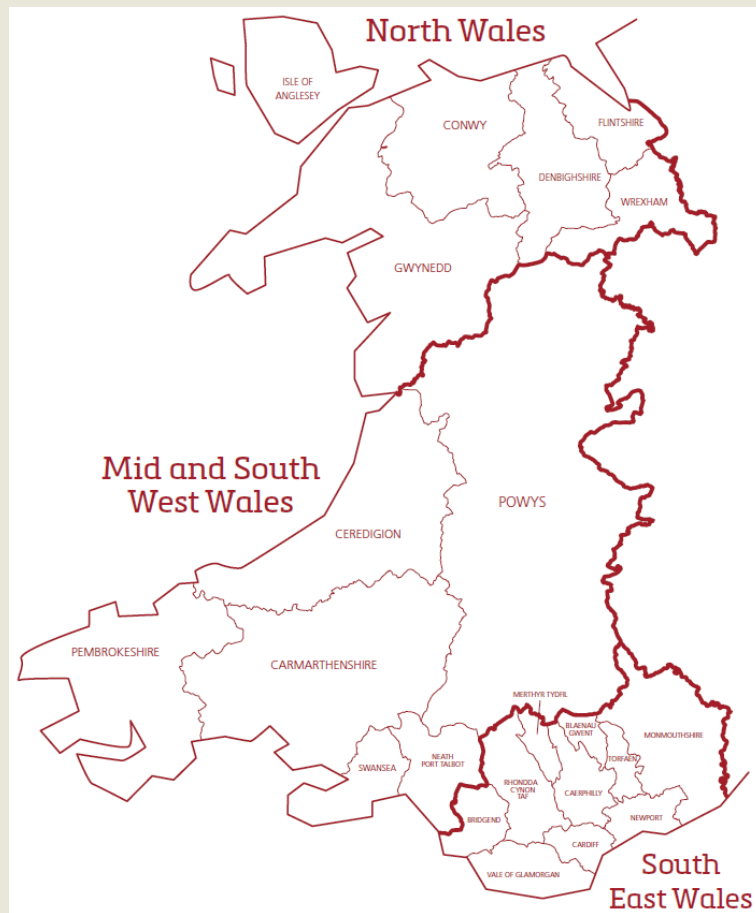
Table 3.2. Mapping of Welsh local authorities to selected geographical footprints

| Local authorities | Small regions (TL3 or NUTS-3) | Regional units for economic policy (4 regions) | Regional units for economic policy (3 regions) |
|-------------------|--------------------------------|--|--|
| Isle of Anglesey | Isle of Anglesey | North Wales | North Wales |
| Gwynedd | Gwynedd | North Wales | North Wales |
| Conwy | Conwy and Denbighshire | North Wales | North Wales |
| Denbighshire | Conwy and Denbighshire | North Wales | North Wales |
| Ceredigion | South West Wales | Mid Wales | Mid and South West Wales |
| Pembrokeshire | South West Wales | South West Wales | Mid and South West Wales |
| Cardiganshire | South West Wales | South West Wales | Mid and South West Wales |
| Rhondda Cynon Taf | Central Valleys | South East Wales | South East Wales |
| Merthyr Tydfil | Central Valleys | South East Wales | South East Wales |
| Caerphilly | Gwent Valleys | South East Wales | South East Wales |
| Blaenau Gwent | Gwent Valleys | South East Wales | South East Wales |
| Torfaen | Gwent Valleys | South East Wales | South East Wales |
| Neath Port Talbot | Bridgend and Neath Port Talbot | South West Wales | Mid and South West Wales |
| Bridgend | Bridgend and Neath Port Talbot | South East Wales | South East Wales |
| Swansea | Swansea | South West Wales | Mid and South West Wales |
| Monmouthshire | Monmouthshire and Newport | South East Wales | South East Wales |
| Newport | Monmouthshire and Newport | South East Wales | South East Wales |
| Vale of Glamorgan | Cardiff and Vale of Glamorgan | South East Wales | South East Wales |
| Cardiff | Cardiff and Vale of Glamorgan | South East Wales | South East Wales |
| Flintshire | Flintshire and Wrexham | North Wales | North Wales |
| Wrexham | Flintshire and Wrexham | North Wales | North Wales |
| Powys | Powys | Mid Wales | Mid and South West Wales |

Economic regions for economic policy

Following the Economic Action Plan (Welsh Government, 2017^[9]), the Welsh Government introduced three “economic regions” for which regional economic frameworks will be established and implemented in collaboration with local authorities and stakeholders. Figure 3.3 shows the three potential economic regions for Wales, namely North Wales, Mid and South West Wales, and South East Wales. One concern with this delineation of regions is the placement of Powys and Ceredigion into South West Wales due to sharp sectoral inequalities and low connectivity between regions, among others. For this reason, a second potential delineation of regional units proposes treating Powys and Ceredigion as another economic region denominated as Mid Wales (Table 3.2). Chapter 6 of this report examines this question more closely.

Figure 3.3. Potential economic regions for economic policy



Source: Map: Welsh Government (2017^[9]), *Prosperity for All: Economic Action Plan*, <https://gov.wales/sites/default/files/publications/2019-02/prosperity-for-all-economic-action-plan.pdf>.

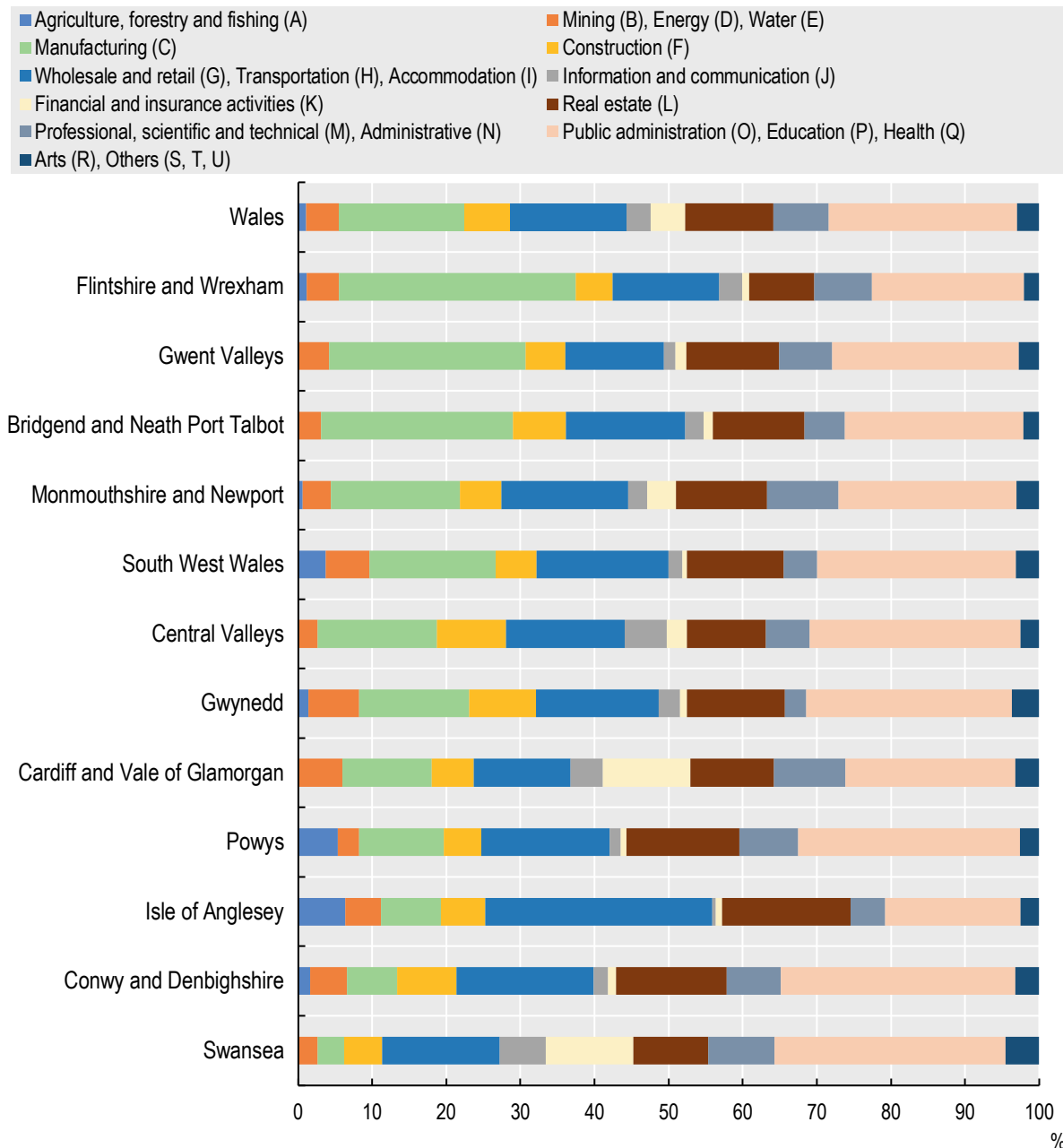
Source: Text: Welsh Government (2019^[10]), "Responses to OECD Questionnaire", Unpublished.

In Wales, certain economic sectors and types of workers are highly spatially concentrated, partially explaining current regional differences in GDP per capita levels. The sectoral composition of the local economy reflects those differences, as some economic sectors – notably high-tech and knowledge-intensive services – are associated with higher levels of value-added per input (OECD, 2020^[11]).

While the Cardiff area has developed a public sector- and service-based economy, the urban cluster in the northeast is highly specialised on manufacturing. Since the 1970s, the UK economy has gradually shifted from secondary to tertiary economic activities (OECD, 2020^[11]). This pattern is observed in the Cardiff area but not in Wrexham and Flintshire. While the urban cluster in the northeast relies on manufacturing (32% of total GVA), the urban cluster of the southeast such as Cardiff, Newport and Swansea are specialised in the public sector (administration, education and health) and services (wholesale and retail, transportation and accommodation) – which generates 35% or more of their total GVA. On the other hand, the economy of rural remote regions, such as the Isle of Anglesey, Gwynedd, Powys and South West Wales, relies to a significant extent on primary activities (agriculture, forestry, fishing, mining), energy and water – from 8% to 11% of their total GVA (Figure 3.4). Delineating strategic economic regions for a place-based approach requires considering the characteristics and distribution of industries and workers across the territory.

To implement its place-based approach to economic policy, the Welsh Government is delineating three “economic regions” (see Box 3.2). To ensure the success of this strategy, sectoral differences across local authorities should be considered. For instance, while in Flintshire and Wrexham manufacturing represents 32% of the total GVA, in Conwy and Denbighshire – areas that would integrate the new region of North Wales – it represents less than 7%. Although having different predominant industries does not imply incompatibility between regions, complementarities or relatedness between local economies can be relevant to drive the re-grouping of small regions (Figure 3.4).

Figure 3.4. Contribution of each Industry to GVA in Welsh small regions, 2018



Source: OECD (2020^[7]), *OECD Regional Statistics (database)*, <http://dx.doi.org/10.1787/region-data-en>.

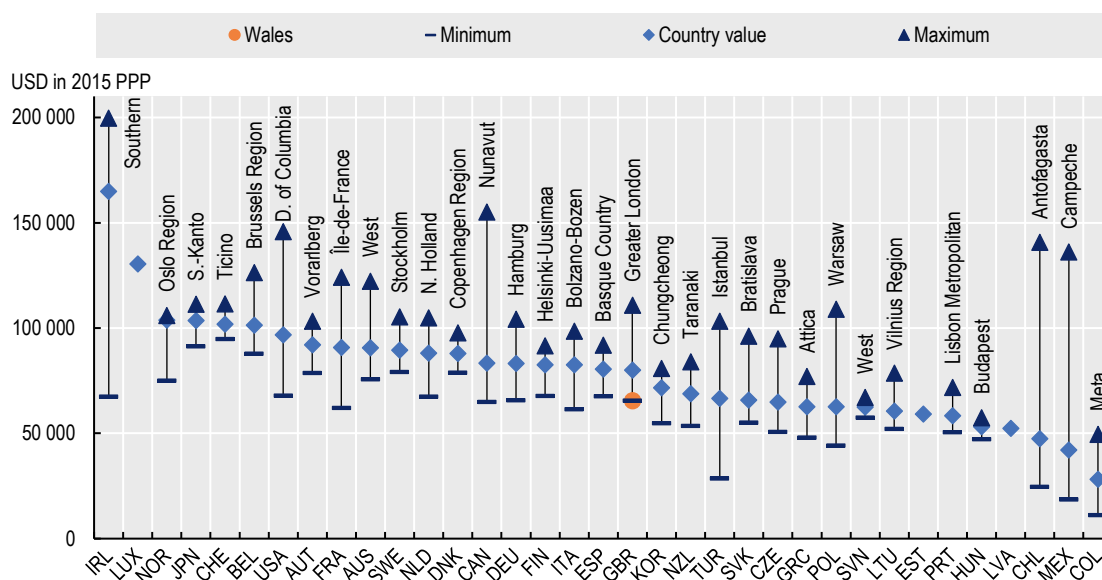
Delineating economic regions should also consider the location of workers, by sector and type of skills. In Powys, around 14% of the employed population works in agriculture, forestry and fishing, whereas in Swansea – which would be placed in the same region as Powys to form the new region of Mid and South West Wales – this is the case for less than 1% of the employed. Targeting policies to a scale that combines very different areas in terms of sectoral structures and settlement types (e.g. rural and urban) could make it harder to ensure an integrated approach with inclusive outcomes for all types of workers and population groups (Annex Figure 3.A.1). What is more, regional inequalities could be further accentuated if the mobility of the less-favoured workers across these regions is low³.

Productivity and inclusive growth: The regional divide

Productivity is crucial to ensure people's well-being today and for future generations. Although well-being is multi-dimensional and goes beyond material conditions (OECD, 2014^[12]), productivity – which reflects the efficiency in generating valuable output by better combining different inputs – is fundamental to sustain many well-being dimensions. Highly productive regions tend to have more resources and better means to ensure higher material conditions for workers (via high-quality jobs and wages), as well as better public services that enhance citizens' quality of life (Tsvektova et al., 2020^[13]). Although there are many types and ways to measure productivity, this chapter focuses on labour productivity, which is measured as the GVA per worker.

Labour productivity levels in Wales are still among the lowest in the UK and below the average level of Northern and Western European OECD regions. In 2018, labour productivity in Wales was approximately USD 65 000 (in 2015 PPP), very similar to Yorkshire and The Humber (Figure 3.5). This level of labour productivity is also low if compared to most Northern and Western European regions, where labour productivity in 2018 reached average levels of USD 90 000 (in constant 2015 PPP).

Figure 3.5. Labour productivity in large regions of OECD and partner countries, 2018



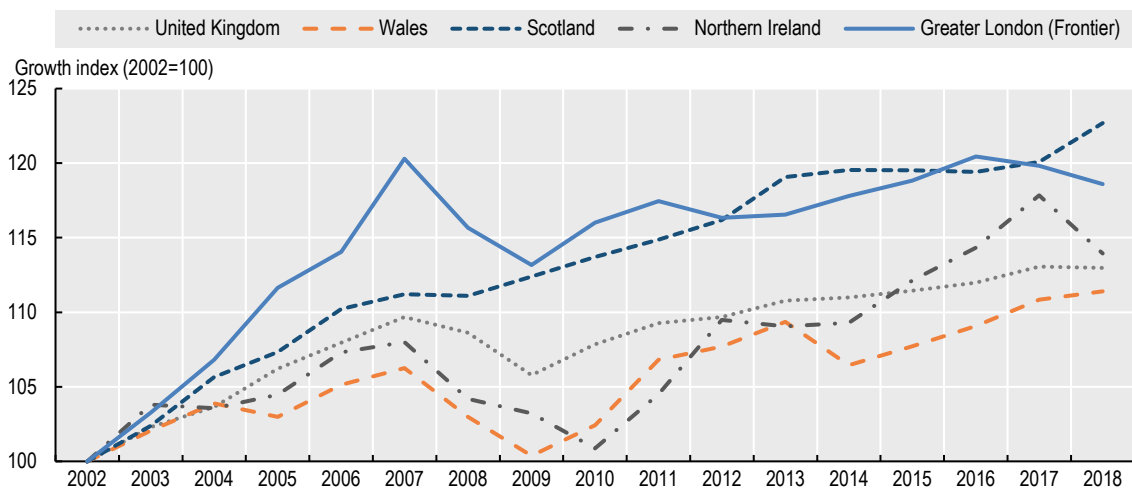
Note: Labour productivity is measured as GVA per worker and it is expressed in USD PPP at constant prices of 2015.

Source: OECD (2020^[7]), *OECD Regional Statistics (database)*, <http://dx.doi.org/10.1787/region-data-en>.

Labour productivity in Wales is diverging with respect to the UK productivity frontier

Labour productivity in Wales is not catching up relative to the UK average level. What is more, in the last 16 years, labour productivity in Wales has been diverging relative to the UK frontier region of Greater London (see OECD labour productivity typology in Box 3.3). In 2018, Welsh labour productivity represented 82% of the UK average, 1.2 percentage points less than in 2002. In contrast, the nations of Northern Ireland and Scotland have closed their productivity gap with respect to the UK average by 0.8 and 7.7 percentage points respectively (Figure 3.6) – although only Scotland is keeping pace with respect to the frontier region of the UK (i.e. Greater London). Northern Ireland is also diverging. On the other hand, it is worth highlighting that productivity growth in Wales has increased in the last 8 years, reaching an annual rate of 1% for the period 2010-18, which is slightly above the average of OECD regions for the same period (Figure 3.7).

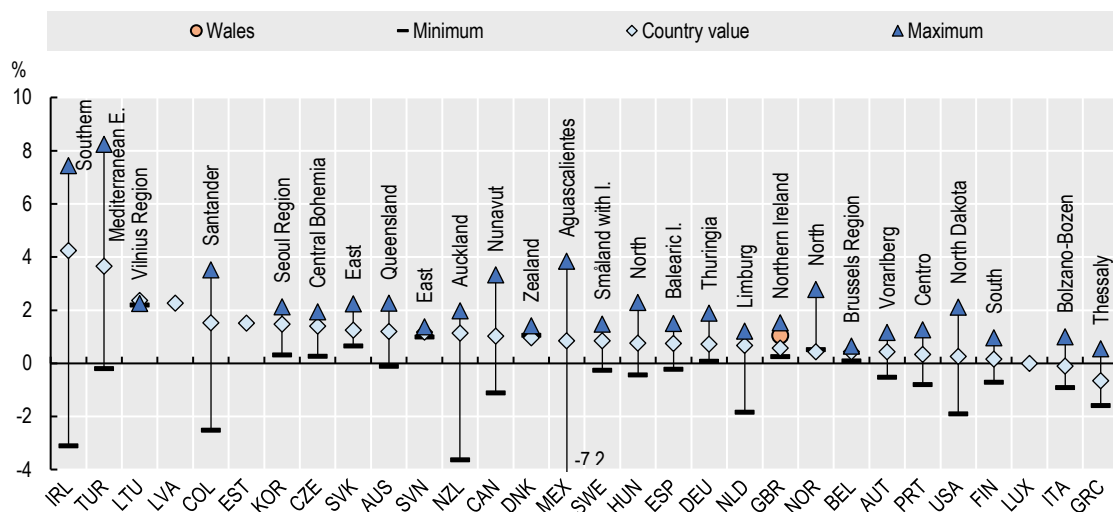
Figure 3.6. Evolution of labour productivity in Wales, 2002-18



Note: Labour productivity is measured as GVA per worker and it is expressed in USD PPP at constant prices of 2015.

Source: OECD (2020^[7]), *OECD Regional Statistics (database)*, <http://dx.doi.org/10.1787/region-data-en>.

Figure 3.7. Regional disparities in productivity growth in OECD large regions, average, 2010-18



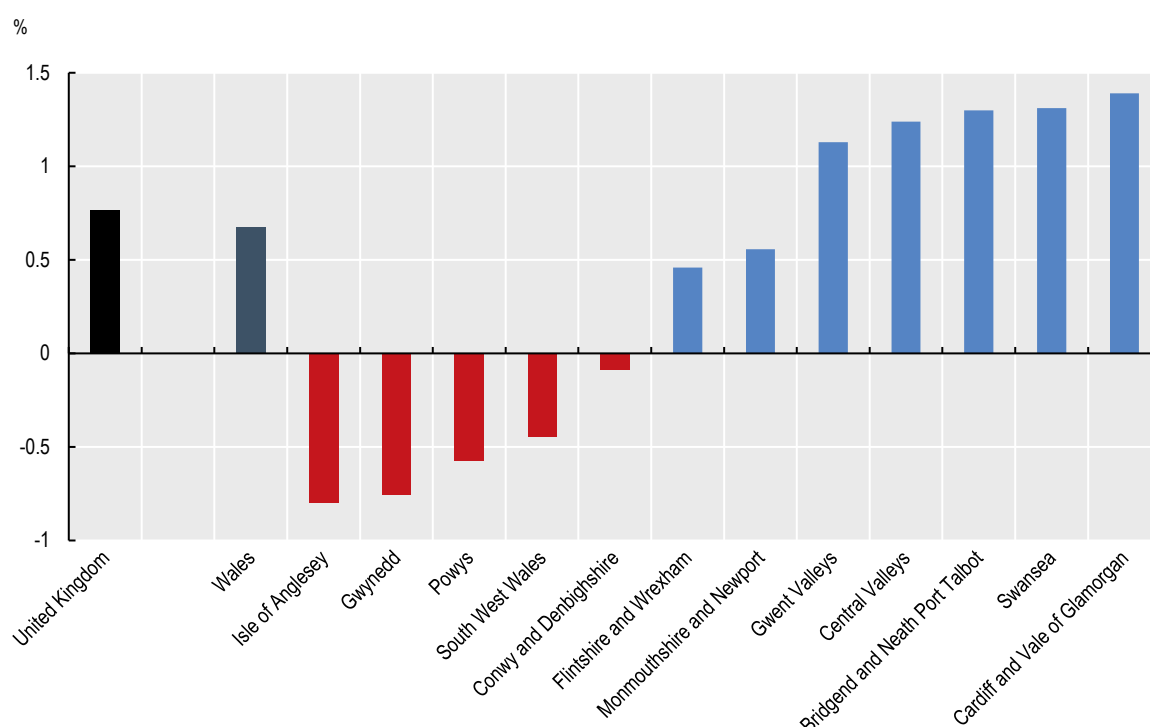
Note: Labour productivity is measured as GVA per worker and it is expressed in USD PPP at constant prices of 2015.

Source: OECD (2020^[7]), *OECD Regional Statistics (database)*, <http://dx.doi.org/10.1787/region-data-en>.

Productivity growth is not spread equally across Welsh regions, with around half of the regions experiencing low or negative growth rates in the last 16 years

Although average productivity growth in Wales has been positive in the past 16 years, this growth has not spread equally across Welsh small regions – with almost half of the regions actually experiencing close to zero or negative growth rates. From 2002 to 2018, labour productivity grew in Wales at an annual average growth rate of 0.7% – slightly lower than the UK’s average of 0.8%. However, the Welsh national average masks stark inequalities across Welsh small regions (TL3). Figures 3.8 and 3.9 show that labour productivity growth has been higher than 1% only in the regions of Cardiff and Vale of Glamorgan, Swansea, Bridgend and Neath Port Talbot, Central and Gwent Valleys; while in the Isle of Anglesey, Gwynedd, Powys, South West Wales and Conwy and Denbighshire productivity has been decreasing over the past 16 years.

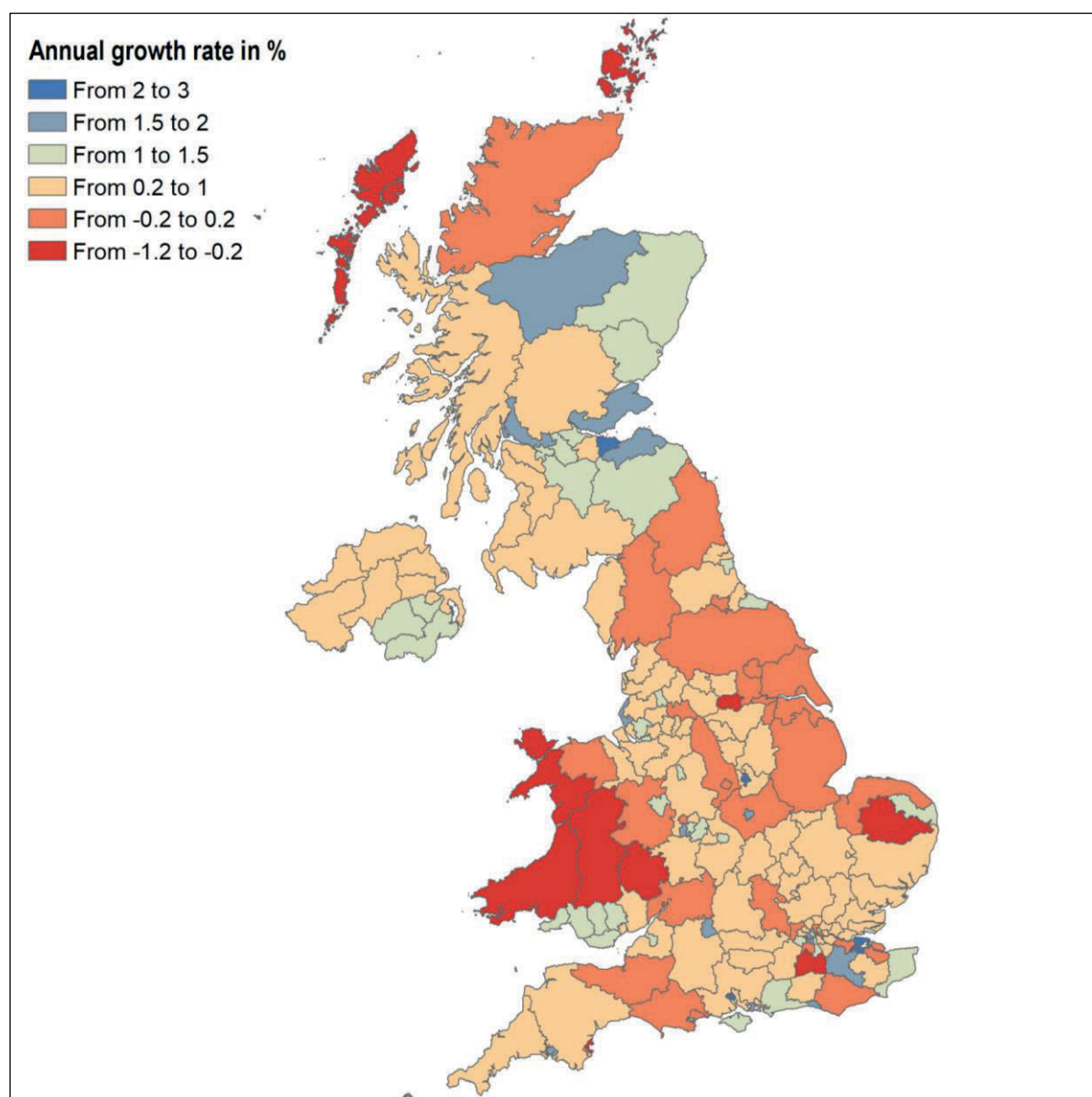
Figure 3.8. Labour productivity growth in the small regions of Wales, average, 2002-18



Notes: Labour productivity is measured as GVA per worker and is expressed in USD PPP at constant prices of 2015. GVA per worker estimates for small areas tend to neglect the economic interdependencies across close areas and are more likely to suffer from measurement biases. The Welsh Government also estimates labour productivity for small areas using GVA per filled jobs (instead of number of employees), which is closer to full-time equivalent jobs. Although using the latter definition of labour productivity generates some deviations with respect to the above figure, the overarching message related to an unbalanced distribution of productivity growth across Welsh regions is maintained (see Annex Figure 3.A.2).

Source: OECD (2020^[7]), *OECD Regional Statistics (database)*, <http://dx.doi.org/10.1787/region-data-en>.

Figure 3.9. Labour productivity growth in the small regions of the UK, average, 2002-18



Note: Labour productivity is measured as GVA per worker and is expressed in USD PPP at constant prices of 2015.

Source: OECD (2020^[77]), *OECD Regional Statistics (database)*, <http://dx.doi.org/10.1787/region-data-en>.

The main driver of GVA per capita growth in lagging Welsh regions is labour utilisation growth, which is compensating for sluggish labour productivity growth

GVA per capita growth (a close proxy of GDP per capita growth) can be decomposed into two main factors, namely labour productivity growth and labour utilisation growth. While labour productivity (measured as GVA per worker) denotes the average value-added associated with each worker, labour utilisation (measured as the number of workers relative to the total population) captures the level of participation of the population in the production process. According to Table 3.3, GVA per capita has been increasing in all Welsh regions in the last 16 years. Contrary to the predominant pattern observed in the UK, where the main driver is labour productivity growth, in Wales, the drivers of GVA per capita growth are more balanced. In 5 out of the 12 Welsh small regions, GVA per capita growth is mainly explained by positive labour

utilisation growth rates in the past 16 years, which have compensated for negative growth rates in labour productivity. Increasing labour utilisation is beneficial for economic performance and well-being, but in order to maximise GVA per capita, it should be accompanied by increases in labour productivity, in particular to sustain growth over time – as labour utilisation cannot grow indefinitely in the long term.

Table 3.3. Contribution of labour productivity and utilisation to GVA per capita, average, 2002-18

| Region | GVA per capita growth rate | Labour productivity growth rate | Labour utilisation growth rate |
|--------------------------------|----------------------------|---------------------------------|--------------------------------|
| United Kingdom | 1.00 | 0.76 | 0.23 |
| Wales | 1.00 | 0.68 | 0.32 |
| Powys | 0.45 | -0.57 | 1.03 |
| Gwynedd | 0.45 | -0.76 | 1.22 |
| Monmouthshire and Newport | 0.65 | 0.56 | 0.10 |
| Central Valleys | 0.77 | 1.24 | -0.46 |
| Isle of Anglesey | 0.80 | -0.80 | 1.61 |
| Flintshire and Wrexham | 0.90 | 0.46 | 0.44 |
| Gwent Valleys | 0.96 | 1.13 | -0.17 |
| South West Wales | 1.00 | -0.45 | 1.45 |
| Cardiff and Vale of Glamorgan | 1.10 | 1.39 | -0.29 |
| Bridgend and Neath Port Talbot | 1.16 | 1.30 | -0.14 |
| Conwy and Denbighshire | 1.25 | -0.09 | 1.34 |
| Swansea | 1.27 | 1.31 | -0.04 |

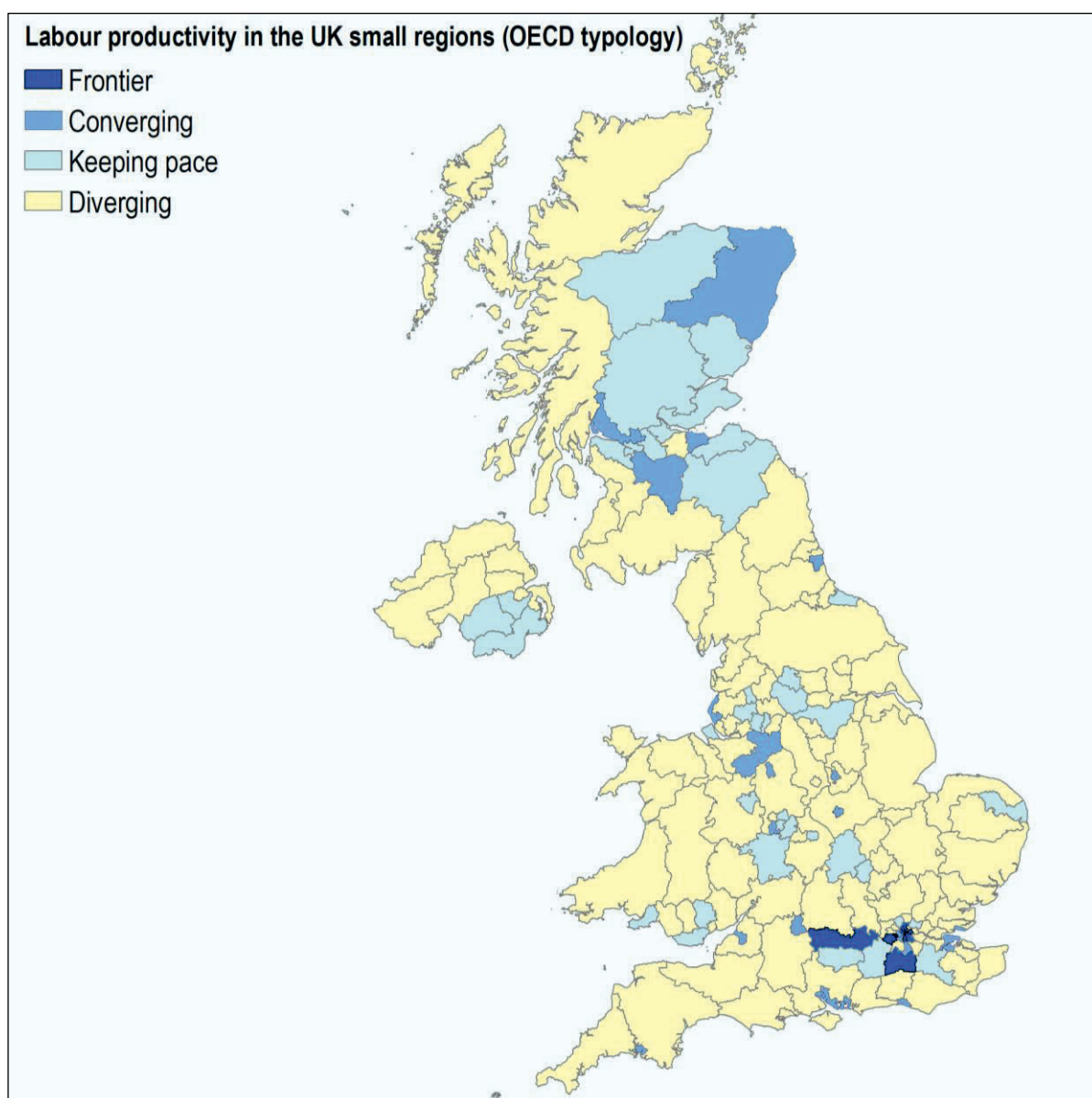
Source: OECD (2020^[7]), *OECD Regional Statistics (database)*, <http://dx.doi.org/10.1787/region-data-en>.

The area of Cardiff and Vale of Glamorgan, Gwent Valleys and Swansea are the only Welsh regions keeping pace with the UK productivity frontier, while the rest of the nation is diverging

Nine small (NUTS-3 or TL3) regions define the productivity frontier of the UK (seven are in Greater London and two in South East England). According to the OECD typology for labour productivity described in Box 3.3, only 23 small regions appear as converging towards the frontier. None of these converging small regions belong to Wales or Yorkshire and The Humber. The small regions of Cardiff and Vale of Glamorgan, Gwent Valleys and Swansea are the only Welsh areas keeping pace compared to the productivity growth of the UK frontier, while the rest of the Welsh regions are diverging. In the UK, out of the 179 small regions, only 9 define the frontier, 23 are converging, 39 are keeping pace and 108 are diverging (Figure 3.10).

It is also possible to classify small regions by their level or type of contribution to the average productivity growth of the country. Annex Figure 3.A.3 shows the UK small regions with a positive contribution to the country's aggregate productivity growth. Only 70 regions (3 of which are in Wales, namely Cardiff and Vale of Glamorgan, Gwent Valleys and Swansea) out of 179 contribute positively to labour productivity growth in the UK, of which 67 are either frontier, converging or keeping pace regions. On the other hand, 106 out of the 109 regions that have negative or no contribution to the country's productivity growth are diverging regions.

Figure 3.10. UK small regions by OECD labour productivity typology, 2000-18



Note: Based on the methodology of OECD (2016^[14]).

Source: OECD (2020^[7]), *OECD Regional Statistics (database)*, <http://dx.doi.org/10.1787/region-data-en>.

Box 3.3. The contribution of regions to aggregate productivity growth: What type of model?

Frontier, converging, keeping pace and diverging regions: The labour productivity typology

The OECD has developed a methodology to classify regions according to their labour productivity levels and dynamics over time. This typology first identifies frontier regions in terms of initial levels of labour productivity and employment size (i.e. most productive regions accounting for 10% of total employment in the country). Using frontier region growth rates as a benchmark, it analyses the growth rates of the non-frontier regions and classifies them as *catching up* (or converging, if growth rates are at least 5%

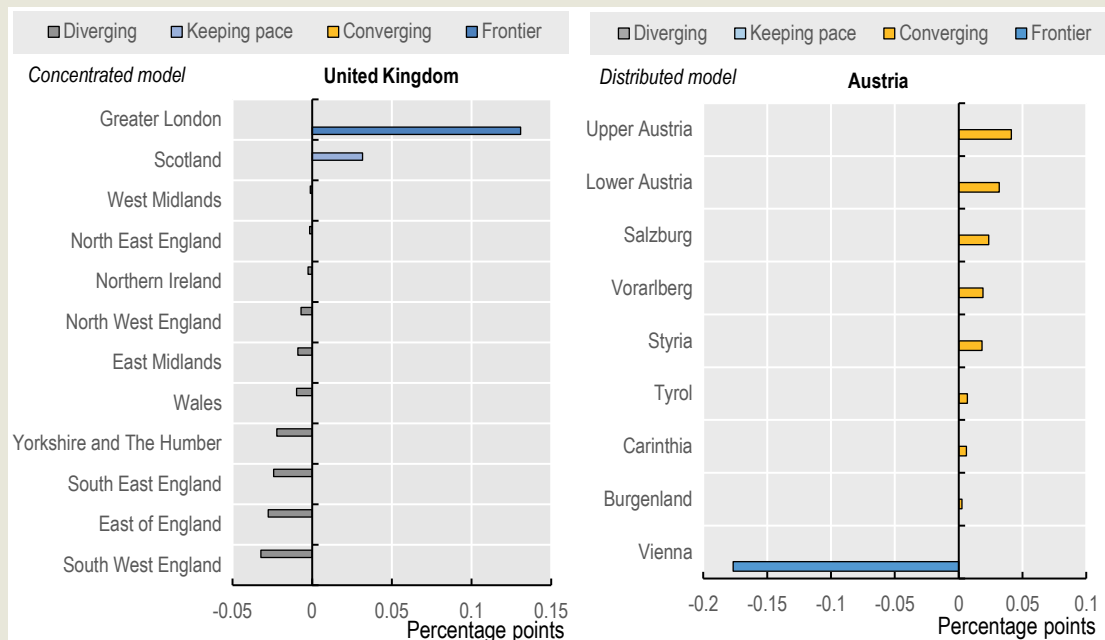
higher than in the frontier), *keeping pace* (if growth rates are neither 5% higher nor 5% lower than in the frontier) or *diverging* (if growth rates are at least 5% lower than in the frontier) (OECD, 2016^[14]).

For the UK large regions, only Scotland is keeping pace with the growth rates of Greater London – the frontier region – while the rest of the UK large regions (TL2 or NUTS-1), including Wales, are diverging. When applying this typology to the UK small regions (TL3 or NUTS-3) the results are not too different with respect to the frontier but some regional disparities in performance are observed for the rest. For instance, not all small regions in Wales are diverging. While nine Welsh small regions are diverging with respect to the UK frontier, Cardiff and Vale of Glamorgan, Gwent Valleys and Swansea are keeping pace.

The concentrated vs. the distributed model

The labour productivity typology allows studying the contribution of the different regions to the aggregate labour productivity growth of the country among other things. Using the cases of Austria and the UK, Figure 3.11 presents the contributions of large regions to the aggregate labour productivity growth of their respective country.

Figure 3.11. Regional contributions to labour productivity growth in Austria and the UK



Note: Period: 2000-18. The (pseudo) contribution of a region is defined as the difference between the national annual average labour productivity growth rate and the same rate excluding the indicated region (OECD, 2016^[14]).

Source: OECD (2020^[7]), *OECD Regional Statistics (database)*, <http://dx.doi.org/10.1787/region-data-en>.

In the UK, most of the contributions to the country's productivity growth come from the frontier and keeping-pace regions (Greater London and Scotland respectively), whereas the rest of the regions, including Wales, are contributing very little or even negatively to the aggregate growth. In contrast, the productivity growth of Austria is mainly coming from its eight converging regions, while the frontier region (Vienna) is not the main contributor to labour productivity growth. These countries depict two generalised models of regional contributions to aggregate productivity growth: the concentrated model (e.g. France, the Netherlands, Sweden and the UK) and the distributed model (e.g. Austria, Germany, Poland and Spain).

One challenging trade-off between these two models relates to reducing regional inequalities while maximising aggregate growth. While the distributed model is desirable to achieve regional convergence, it tends to generate lower aggregate growth rates than the concentrated model. To put it differently, while the concentrated model can yield higher productivity gains than the distributed model, it does it at the cost of exacerbating regional disparities, as frontier regions grow equally as or more than the regions already lagging behind (OECD, 2016^[14]).

Supporting the tradeable sector can contribute to narrowing the productivity gap

In recent years, the two main characteristics of regions that have managed to catch up with their country's productivity frontier are: i) having well-functioning links between cities and other regions; and ii) a strong and growing tradeable sector (i.e. sectors that produce goods or services that can be traded). In Europe, catching-up regions increased their share of GVA in the tradeable sector by 8% on average from 2000 to 2014. In contrast, for the same period, the tradeable sector of diverging regions remained without growth. While it is common to think that tradeable sectors expose workers more to the risks of global shocks, there is no robust evidence for this. For instance, OECD regions that experienced larger shifts of employment to the non-tradeable sector before the 2007-08 crisis suffered more job losses (OECD, 2018^[15]).

Source: OECD (2016^[14]), *OECD Regional Outlook 2016: Productive Regions for Inclusive Societies*, <https://doi.org/10.1787/9789264260245-en>; OECD (2020^[7]), *OECD Regional Statistics (database)*, <http://dx.doi.org/10.1787/region-data-en>.

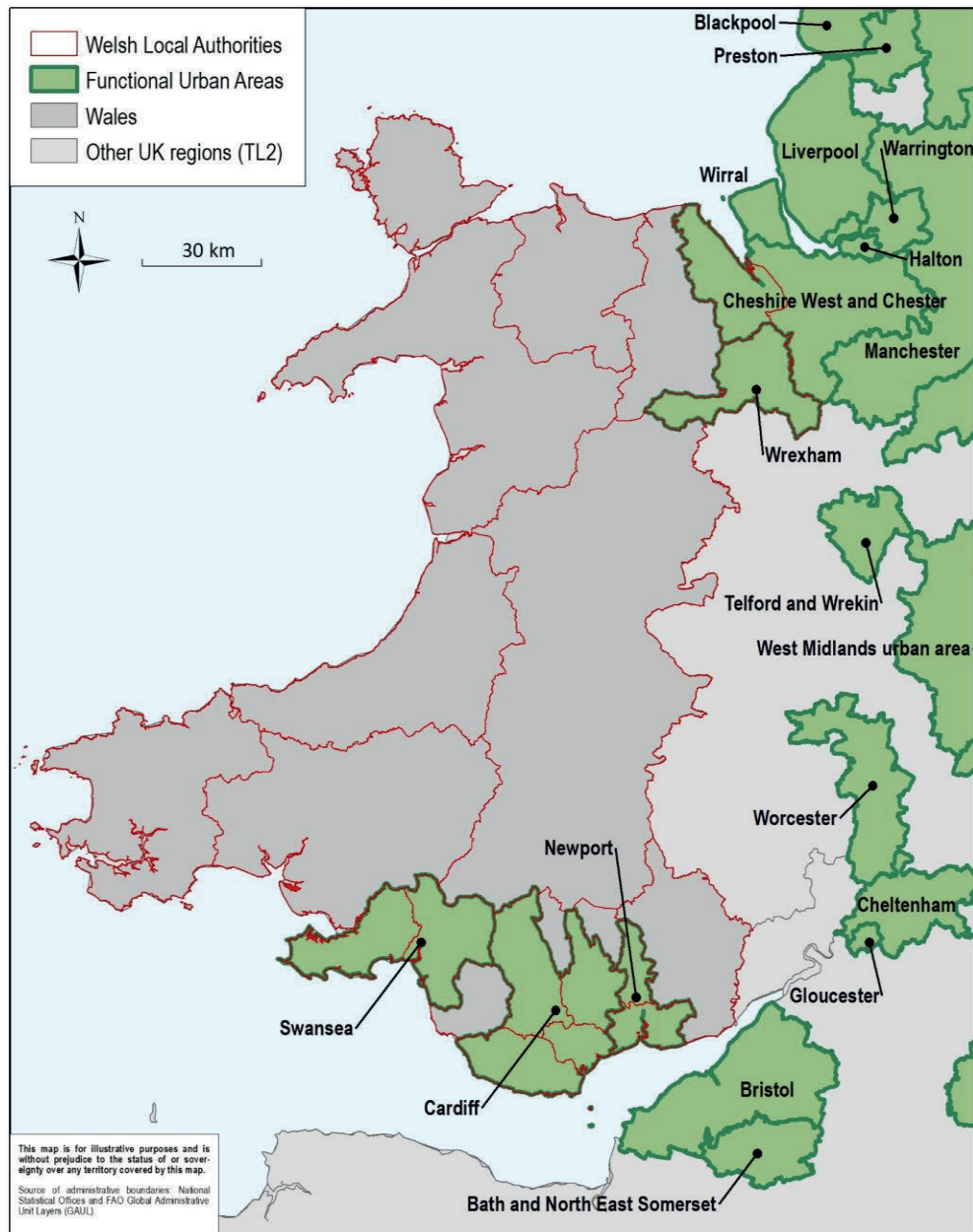
Enhancing productivity across all territories: Challenges and opportunities

To enhance productivity in urban areas, policies should promote the creation and the proper functioning of agglomeration economies. Agglomeration economies are the benefits that arise when people and firms co-locate (Glaeser, 2011^[16]). Technological spill-overs, innovation diffusion, labour pooling – in particular, of high-skilled workers – and intermediate input linkages are the main channels through which agglomeration economies enhance productivity. Along the same lines, cities that specialise in knowledge-intensive business services (KIBS) have higher average levels of productivity (OECD, 2020^[11]). Agglomeration economies can attract KIBS firms by supplying larger pools of high-skilled workers and better innovation diffusion channels.

Welsh cities can maximise the benefits of their agglomeration economies by boosting transport performance and by exploiting their proximity to English metropolitan areas

Wales has some opportunities to increase the benefits of its agglomeration economies, in particular by boosting transport performance within its functional urban areas (FUAs) and by exploiting the proximity of its urban centres to English metropolitan areas. Figure 3.12 displays the FUAs of Wales, namely Cardiff, Newport and Swansea in the south, and Flintshire and Wrexham in the northeast (although Flintshire belongs to the inter-regional FUA of Cheshire West and Chester). FUAs are densely populated places where people live, work and gather on a daily basis. For this reason, the identification of FUAs, which go beyond administrative boundaries (e.g. municipalities, regions and even countries), highlights the need for cross-border co-operation not only across local authorities but also across regions. The Welsh Government recognises the importance of functional areas and cross-border co-operation for regional economic development in its Economic Action Plan (Welsh Government, 2017^[9]).

Figure 3.12. FUAs in Wales and neighbouring regions

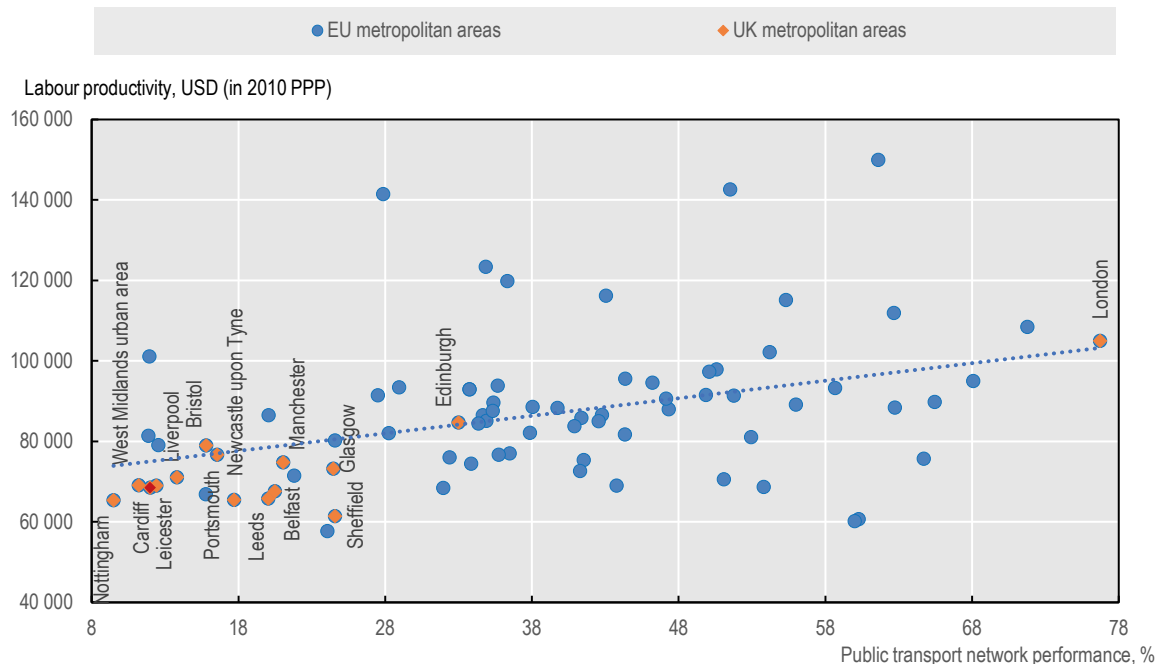


Note: Names are placed in the centroid of the FUA; they are not necessarily placed within the boundaries of the homonym municipality.
Source: OECD (2020^[17]), *Metropolitan Areas (dataset)*, <https://dx.doi.org/10.1787/data-00531-en> (accessed on 7 August 2020).

High-performing transport networks improve accessibility within FUAs, which is crucial for well-being and productivity. Good transport networks minimise the commuting time of workers to their place of work, improving well-being through better work-life balance and maximising the pool of workers accessible to firms. Transport infrastructure also contributes to the diffusion of knowledge and technology via increased mobility of people and goods, which are key elements for productivity (Andrews, Criscuolo and Gal, 2016^[18]). Figure 3.13 shows a positive correlation between labour productivity and the performance of the public transport network in metropolitan areas – where performance is measured as the ratio between the accessibility to certain amenities (including the number of people) by public transport (i.e. how many

amenities can be accessed by 30 minutes of public transport) and the proximity of these amenities (i.e. how many are located in a radius of 8 km) (ITF, 2019^[19]). Relative to other European metropolitan areas, the metropolitan areas of Cardiff and West Midlands present very low performance in both public transport efficiency and labour productivity. In contrast, metropolitan areas with high public transport performance such as Helsinki, London and Oslo display the highest levels of labour productivity (Figure 3.13).

Figure 3.13. Labour productivity vs. public transport performance in metropolitan areas, 2017



Notes: Public transport performance is the ratio between the population accessible within 30 minutes by public transport and the population in a radius of 8 km. Labour productivity is measured as GVA per worker. Correlation coefficient: 0.4, significantly different from 0 at the 95% confidence level. Metropolitan areas are defined as FUAs with more than 250 000 people. The graph includes 79 metropolitan areas of 23 European countries. This indicator does not take into account other factors, such as capacity and reliability, which are important for the performance of public transport networks.

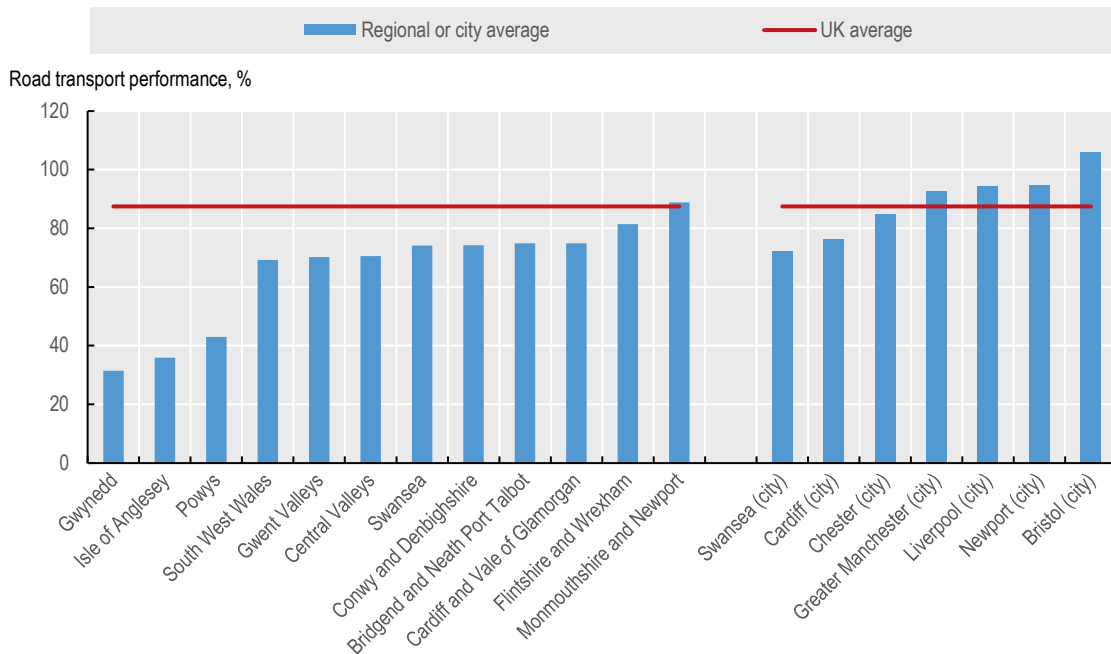
Source: OECD (2020^[17]), *Metropolitan Areas (dataset)*, <https://dx.doi.org/10.1787/data-00531-en> (accessed on 7 August 2020); ITF (2019^[19]), *Benchmarking Accessibility in Cities: Measuring the Impact of Proximity and Transport Performance*, <https://doi.org/10.1787/4b1f722b-en>.

The performance of the road transport network in most of the Welsh small regions is below the UK average level (Figure 3.14). Based on available data, when looking at the cores of functional urban areas (or cities), it is evident that neighbouring FUAs such as Bristol, Liverpool and Greater Manchester, have higher road transport performance than the Welsh FUA cores of Cardiff and Swansea. It is worth noting that, while this indicator integrates speeds on each of the road segments, it does not take into account congestion.

Beyond FUAs, inter-regional transport networks can also boost productivity in some rural remote areas by increasing proximity to the benefits of metropolitan areas and by facilitating the integration of these regions into the regional economy. Better access and reduced travel times to large metropolitan areas can be a significant driver of labour productivity and economic growth (Ahrend and Schumann, 2014^[20]). Apart from facilitating the transport of goods and people – which would result in better regional economic and social cohesion within Wales – high-performing transport infrastructure can facilitate the integration of rural areas into regional or global value chains (Cosar and Demir, 2016^[21]). This could be particularly helpful to unlock the potential of rural remote areas such as Carmarthenshire or Powys, which could, for instance, be better connected to Swansea and Cardiff or Wrexham and West Midlands (England) respectively. In the UK, road

transport performance is highly unequal across areas. While cities display an average performance of 93 (the ratio between accessibility and proximity), the performance in rural areas is below 76.

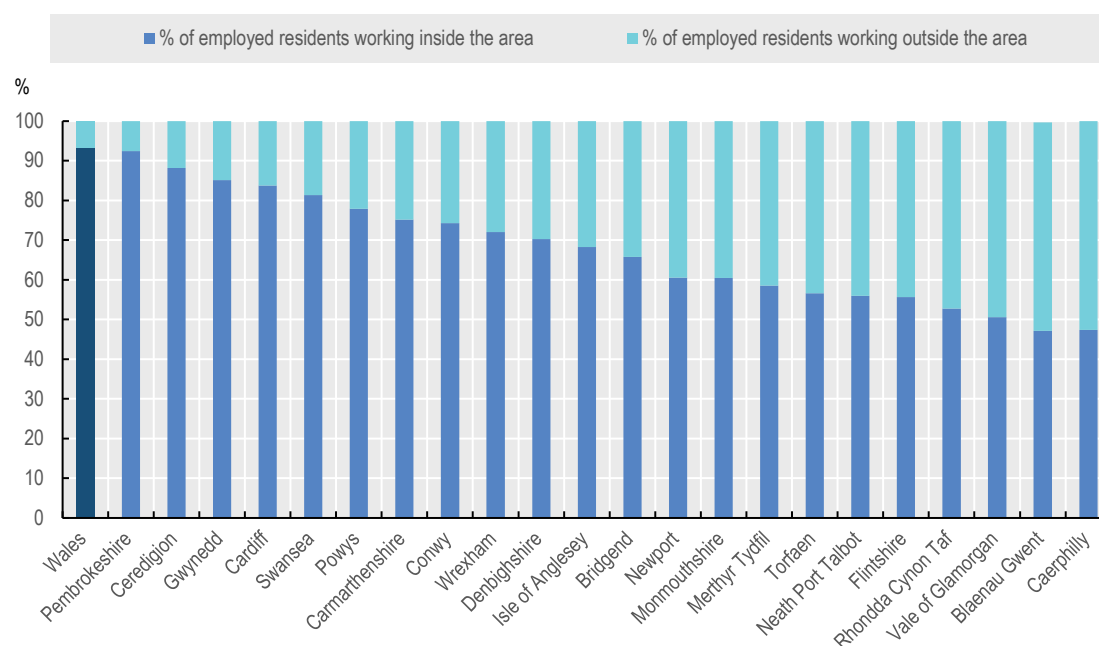
Figure 3.14. Road transport performance in the Welsh small regions and selected cities, 2016



Note: Road transport performance is the ratio between the population accessible within 1h30 by road and the population in a radius of 120 km. City stands for the core of an FUA. This indicator takes into account speeds on each of the road segments but it does not integrate congestion. While the road network data refers to 2016, the population grid used is from 2011.

Source: Dijkstra, L., H. Poelman and L. Ackermans (2019^[22]), "Road transport performance in Europe", <http://dx.doi.org/10.2776/046835>.

Developing transport networks requires assessing the existing and potential commuting flows of people and goods within and between regions and cities. While rural remote areas such as Ceredigion, Gwynedd and Pembrokeshire present commuting flows to other local authorities below 15%, the "Valleys" surrounding Cardiff (Blaenau Gwent, Caerphilly, Merthyr Tydfil, Rhondda Cynon Taf, Torfaen and Vale of Glamorgan) display commuting flows of 40% or more. In the north of Wales, only Flintshire presents commuting flows of this magnitude (Figure 3.15). Transport policies should also consider existing commuting flows and integration between Welsh and other UK regions and cities. Although economic integration within Wales is desirable, Welsh regions and cities should also seek to maximise the benefits of proximity to other UK regions and cities, in particular to English metropolitan areas. For example, in Flintshire and Wrexham, more than 60% of the residents that work outside of their local authority commute to a place outside of Wales (i.e. less than 40% travel to another Welsh region) – most commute to work in North West England (Table 3.4). On the other hand, 37% of the workers that live in but work outside of Powys commute to West Midlands (England). This is particularly relevant in the context of the Economic Action Plan (Welsh Government, 2017^[9]), with the economic region that places Powys with Swansea and South West Wales – areas to where Powys' commuting flows are marginal.

Figure 3.15. Commuting patterns of Welsh workers, 2018

Source: Welsh Government (2020^[23]), *Detailed Commuting Patterns by Welsh Local Authority, Annual Population Survey (database)*, <https://stats.wales.gov.wales/Catalogue/Business-Economy-and-Labour-Market/People-and-Work/Employment/Commuting/detailedcommutingpatterns/wales-by-welshlocalauthority>.

Table 3.4. Welsh workers commuting out Wales, by local authority, 2018

| Local authority | Employed residents commuting out of the local authority | Employed residents commuting out of Wales as a percentage of those who commute out of their local authority | Percentage to England (Total) | Percentage to North West, England | Percentage to West Midlands, England | Percentage to South West, England | Percentage to Scotland (Total) |
|-------------------|---|---|-------------------------------|-----------------------------------|--------------------------------------|-----------------------------------|--------------------------------|
| Isle of Anglesey | 10 200 | 9.8 | 7.8 | | | | |
| Gwynedd | 8 600 | 20.9 | 18.6 | | | | |
| Conwy | 12 800 | 21.1 | 18.8 | 10.2 | | | |
| Denbighshire | 12 800 | 30.5 | 30.5 | 21.1 | | | |
| Flintshire | 32 800 | 60.4 | 53.7 | 49.7 | | | 5.2 |
| Wrexham | 19 400 | 70.1 | 67.0 | 42.8 | 20.6 | | |
| Ceredigion | 4 100 | 22.0 | 19.5 | | | | |
| Powys | 13 800 | 47.8 | 45.7 | | 37.0 | | |
| Pembrokeshire | 4 100 | 26.8 | 24.4 | | | | |
| Carmarthenshire | 20 500 | 5.9 | | | | | |
| Swansea | 19 800 | 18.7 | 13.1 | | | 8.1 | |
| Neath Port Talbot | 27 600 | 2.9 | | | | | |
| Bridgend | 21 500 | 12.1 | 7.9 | | | | |

| Local authority | Employed residents commuting out of the local authority | Employed residents commuting out of Wales as a percentage of those who commute out of their local authority | Percentage to England (Total) | Percentage to North West, England | Percentage to West Midlands, England | Percentage to South West, England | Percentage to Scotland (Total) |
|-------------------|---|---|-------------------------------|-----------------------------------|--------------------------------------|-----------------------------------|--------------------------------|
| Vale of Glamorgan | 31 200 | 7.4 | 6.1 | | | 2.9 | |
| Cardiff | 30 500 | 15.1 | 13.4 | | | 8.2 | |
| Rhondda Cynon Taf | 50 900 | 9.8 | 7.9 | | | 3.9 | |
| Caerphilly | 42 700 | 7.7 | 7.0 | | | 4.2 | |
| Blaenau Gwent | 16 500 | 7.3 | 6.1 | | | | |
| Torfaen | 17 600 | 14.8 | 13.6 | | | 9.1 | |
| Monmouthshire | 17 300 | 48.6 | 48.0 | | 8.1 | 35.8 | |
| Newport | 28 000 | 25.0 | 24.3 | | | 20.4 | |
| Merthyr Tydfil | 11 200 | 11.6 | 11.6 | | | | |

Source: Welsh Government (2020^[23]), *Detailed Commuting Patterns by Welsh Local Authority, Annual Population Survey (database)*, <https://stats.wales.gov.wales/Catalogue/Business-Economy-and-Labour-Market/People-and-Work/Employment/Commuting/detailedcommutingpatterns/wales-by-welshlocalauthority>.

The megatrend of demographic change can affect the regional economy by changing the available pool of workers. Regions facing declining population are less capable of scaling up or even sustaining existing labour-intensive industries. Ageing can also affect labour productivity through two main channels: a negative one associated with the weakening of the physical abilities of workers and a positive one related to the accumulated experience of workers (Garibaldi, Oliveira Martins and van Ours, 2011^[24]).

Population decline and ageing in Wales can challenge productivity and the efficient provision of public services

In the period from 2000 to 2017, the population in OECD countries grew at the very low average annual rate of 0.64% (OECD, 2018^[3]). England has been driving most of the UK population increase, with an average annual growth rate of 0.72%, while nations like Scotland and Wales experienced growth rates of 0.4% – lower than the UK average of 0.67%. Such low population growth rates reveal the risk of population decline. In the OECD, 11% of the small (TL3) regions saw a population decrease between 2014 and 2017. For the UK, this number is currently lower than 3% but demographic projections suggest that the percentage of small regions with declining population could go up to 16.5% between 2014 and 2050 (OECD, 2019^[1]).

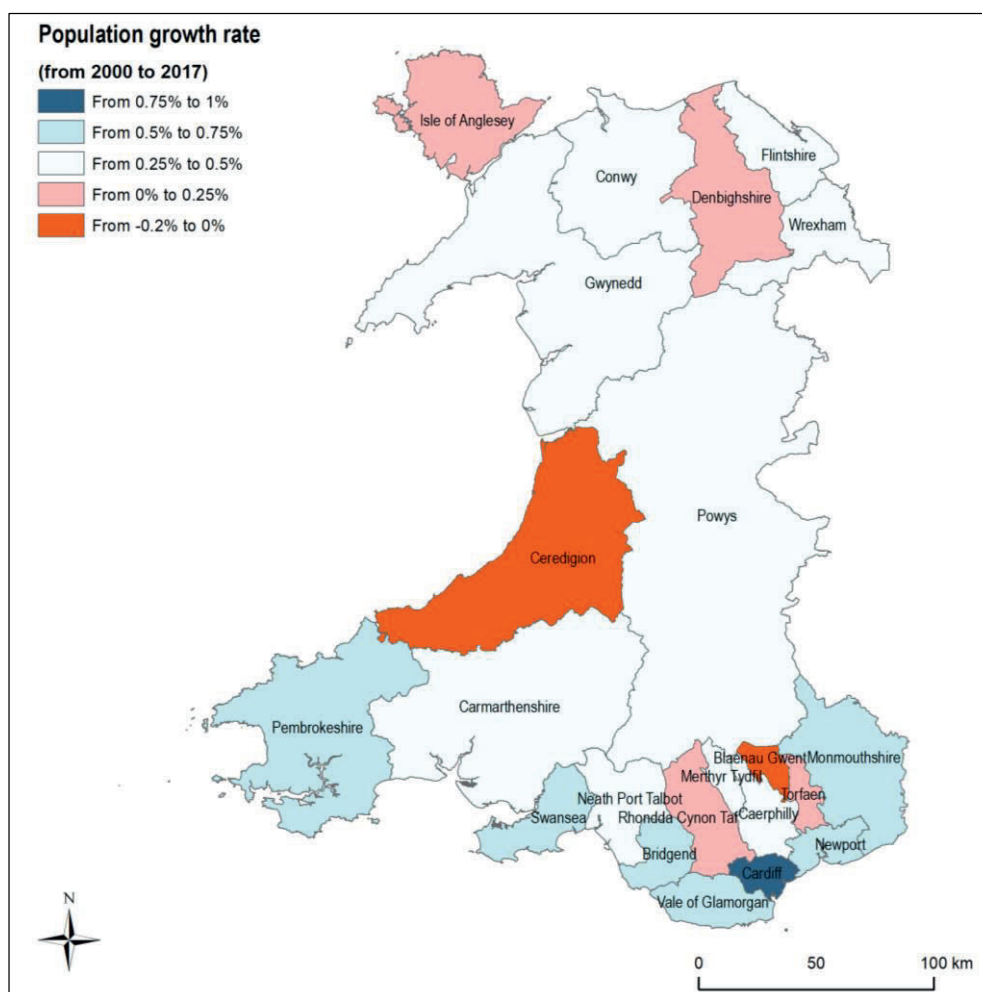
Population growth within Wales is also very uneven. While Cardiff is growing at an average annual rate of 1%, the populations of Blaenau Gwent and Ceredigion are declining (this decline is masked when looking at the Welsh NUTS-3 or TL3 regions). When examining population growth within Wales, it is possible to see that while Bridgend and Cardiff are growing at rates above OECD levels, the populations of Ceredigion and Blaenau Gwent are declining at an annual average rate of 0.15% and 0.08% respectively. At the same time, the population growth rates of Rhondda Cynon Taf and Torfaen in the south, and the Isle of Anglesey and Denbighshire in the north are very close to zero (Figure 3.16).

Beyond labour productivity, population decline in Wales can also hinder the efficient provision of public services. A declining population can pose new challenges for the delivery of public services that are financed through local taxes. Although in Wales, a large share of the local tax base is property based rather

than population-based, the demand and thus the value of collected taxes from real estate are directly affected by demographic trends. In this perspective, a declining population could represent a meaningful loss of tax revenue that is fundamental to finance health, social care, public education and transport. This is particularly relevant to the Welsh Government that is taking a strong position on the foundational economy, incorporating it as a pillar of its regional development framework. The foundational economy includes the goods and services that are the social and material infrastructure of civilised life because they provide the daily essentials for all households. They are classified as material (e.g. water, transport and energy) and providential (e.g. education, health and social care). In this framework, the main objective of public policy is to secure the provision of these foundational services (Morgan, 2019^[25]), which will be very difficult to accomplish in a context of a declining population and shrinking tax base.

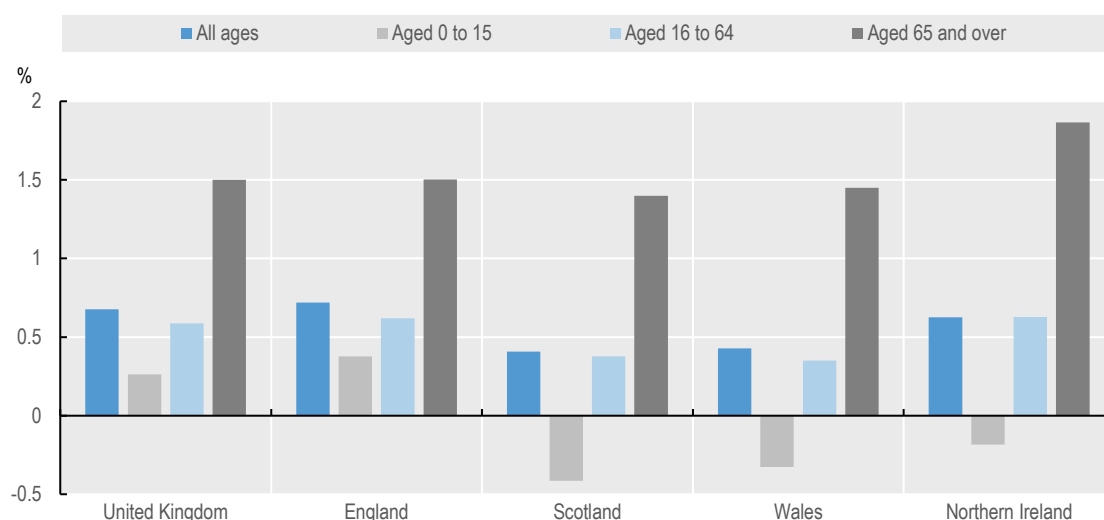
In 2017, the elderly population represented around 16.7% of the total population in OECD countries (OECD, 2018^[3]), while in the same year in Wales, the elderly population represented 20.6% of the total population. Similar to population decline, ageing can have a major impact on the labour market and the financing of public services and pension systems. More specifically, given the increasing demand of services from the elderly and the relatively decreasing tax base to finance them, ageing can strongly affect the implementation of certain pension systems, as well as on the expenditure for health services and care for the elderly.

Figure 3.16. Population growth in the Welsh local authorities, annual average, 2000-17



Source: Author's elaboration based on data from Welsh Government (2019^[10]), "Responses to OECD Questionnaire", Unpublished.

Figure 3.17. Population growth by age groups in the UK Nations, annual average, 2000-17



Source: Author's elaboration based on data from Welsh Government (2019^[10]), "Responses to OECD Questionnaire", Unpublished.

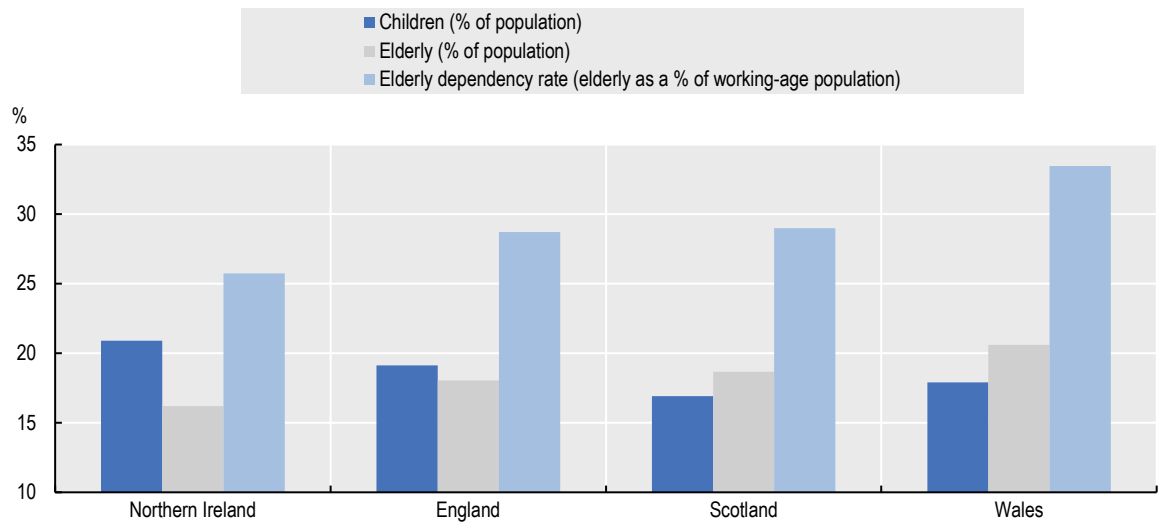
While the population growth rate for children is negative in Wales, the elderly population is growing at a faster rate than the working-age population. Figure 3.17 shows a population growth rate for the elderly of around 1.5%, almost 5 times the growth rate of the working-age population (aged 16-64). On the other hand, the child population in Wales (aged 0-15) is decreasing at a rate of 0.3% per year. Northern Ireland and Scotland exhibit very similar patterns, whereas in England, the population of children is growing over time.

The elderly dependency rate in Wales is the highest among the four UK nations, with an elderly population representing one-third of the total working-age population. The elderly dependency rate gives an indication of the pressure on the typically economically active population (aged 16-64 years old) from sustaining the typically retired population (aged 65 and over). In 2017, the elderly dependency ratio was around 33% in Wales, the largest across the 4 UK nations and 8 percentage points above the OECD average (Figure 3.18) (OECD, 2018^[3]).

The pressure of the elderly on the working-age population is very unequal across Welsh local authorities. While Cardiff displays elderly dependency rates lower than 25%, Conwy and Powys face elderly dependency rates above 45%. Elderly dependency rates are the lowest in the southern local authorities of Wales, going from Cardiff and Swansea to Newport and Torfaen (which may be partially explained by their student population), and in the northeast in Flintshire and Wrexham (below 35%); while in Conwy and Powys, those aged 65 and above represent almost half of the working-age population (Figure 3.18).

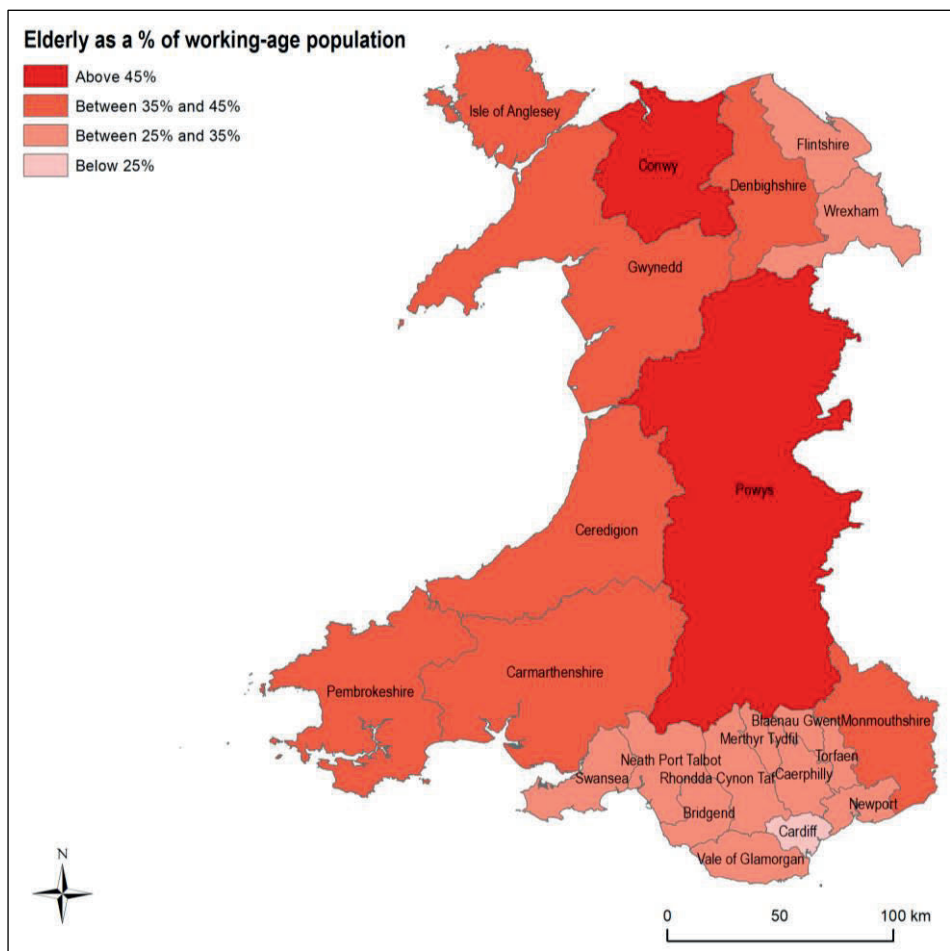
Population decline and ageing are posing new challenges for the present and future of the Welsh economy and well-being – in particular when focusing on spatial inequalities. Recent literature suggests that new labour-replacing technologies such as automation and artificial intelligence (AI) can help tackle the impact of demographic change (Acemoglu and Restrepo, 2017^[26]). Although new technologies can offer a response to declining productivity due to demographic change, the transition to automation, digitalisation and AI has to be strategically managed in order to minimise potential negative externalities, such as the risk of job losses due to automation.

Figure 3.18. Elderly dependency rate in the UK nations, 2017



Source: Author’s elaboration based on data from Welsh Government (2019_[10]), “Responses to OECD Questionnaire”, Unpublished.

Figure 3.19. Elderly dependency rates in the Welsh local authorities, 2017



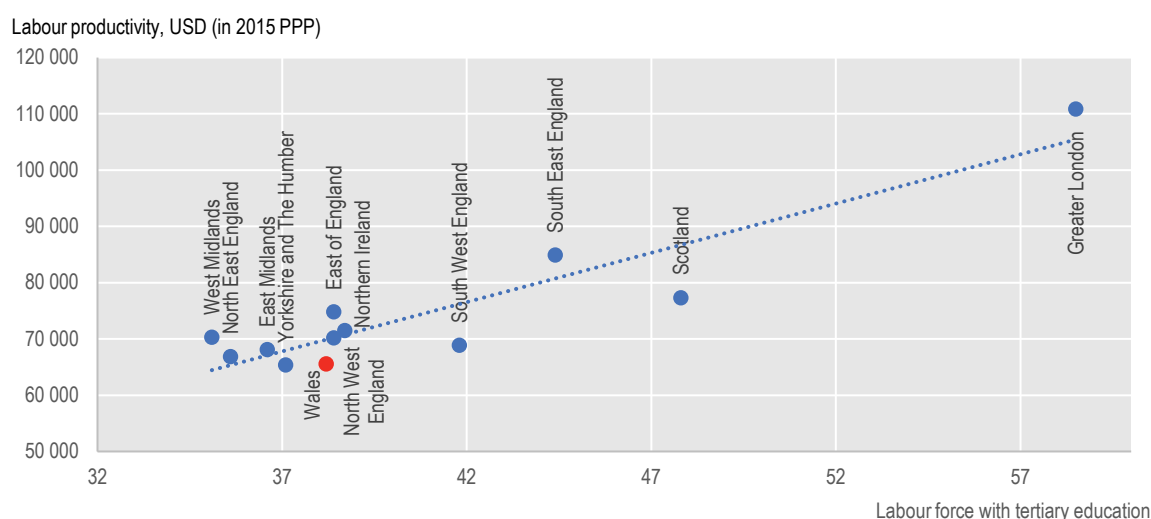
Source: Author’s elaboration based on data from Welsh Government (2019_[10]), “Responses to OECD Questionnaire”, Unpublished.

Technological change, together with globalisation and other megatrends, has been reshaping the drivers of productivity growth. Higher skills, innovation diffusion and technological progress have become the main determinants of productivity growth in the last decades (Berlingieri, Calligaris and Criscuolo, 2018^[27]). Workers' skills and education are among the most direct channels to affect labour productivity (Tsvetkova et al., 2020^[13]). What is more, enhancing skills and human capital at the local level is crucial to favouring the development of regional entrepreneurship, innovation (Charlot, Crescenzi and Musolesi, 2015^[28]) and of highly productive sectors, such as knowledge-intensive business services (KIBS).

Increasing the skills of the Welsh workforce can contribute to higher labour productivity

Across the UK, regions with a high-skilled labour force (measured as the share of the labour force with tertiary education) show higher levels of labour productivity. With only 38% of its labour force having tertiary education, Wales displays levels of productivity around USD 65 000 (in 2015 PPP). On the other hand, Scotland and Greater London, with 48% and 59% of their labour force having tertiary education, reach levels of labour productivity above USD 77 000 and USD 110 000 (in 2015 PPP) respectively (Figure 3.20).

Figure 3.20. Labour productivity vs. labour force with tertiary education, 2018

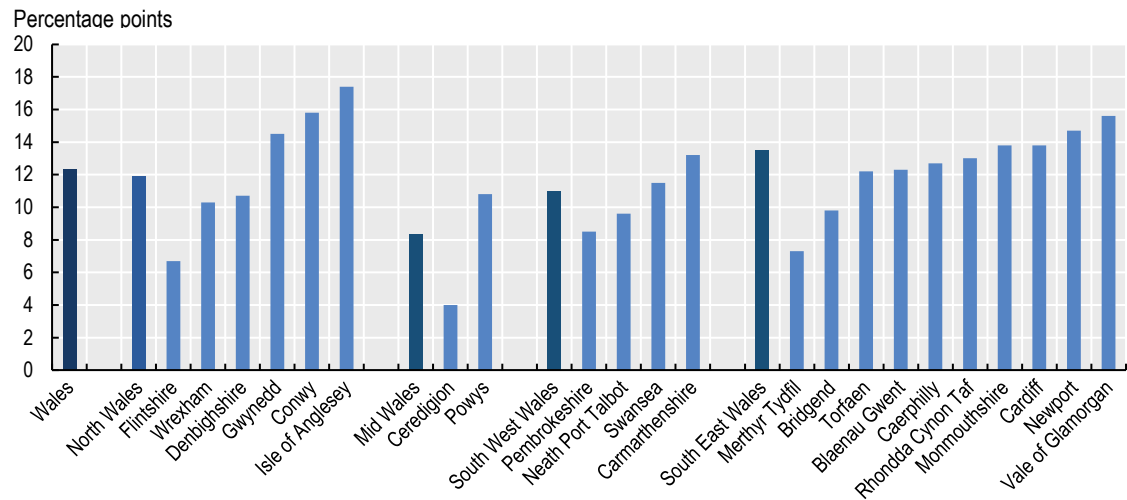


Note: Correlation coefficient: 0.9, significantly different from zero at the 95% confidence level. The correlation holds even when excluding Greater London.

Source: OECD (2020^[7]), *OECD Regional Statistics (database)*, <http://dx.doi.org/10.1787/region-data-en>.

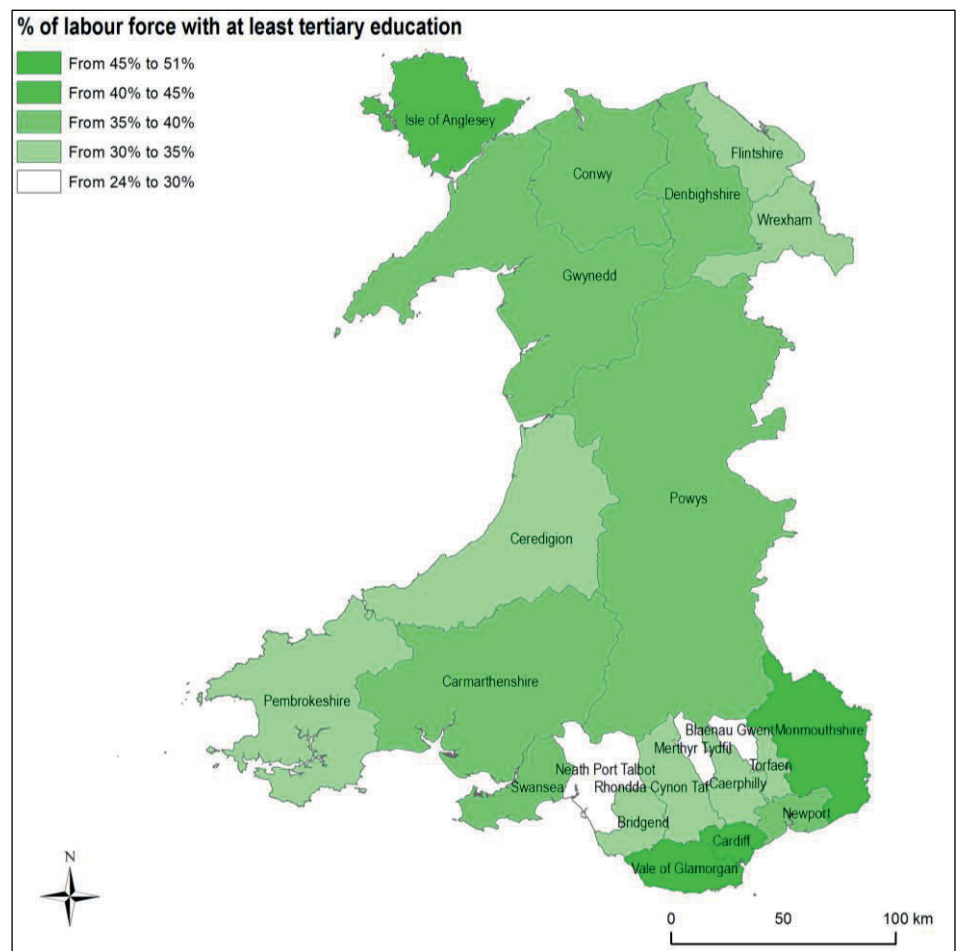
Wales presents important disparities in the labour force with tertiary education across its local authorities. Although the educational attainment of the labour force increased everywhere in Wales from 2004 to 2017, more efforts are required in some local authorities such as Ceredigion and Merthyr Tydfil, where the proportion of the labour force with at least tertiary education has increased only by 4 and 7 percentage points in the past 13 years respectively (Figure 3.21). In addition, in 2017, substantial regional disparities in the education of the workforce remained across Welsh local authorities. For example, while Blaenau Gwent and Neath Port Talbot present shares of the labour force with at least tertiary education below the 30% (worst outcomes), Cardiff and Vale of Glamorgan display shares of the labour force with at least tertiary education above 45% (best outcomes) (Figure 3.22).

Figure 3.21. Change in the labour force with at least tertiary education, 2004-17



Source: Author’s elaboration based on data from Welsh Government (2019_[10]), “Responses to OECD Questionnaire”, Unpublished.

Figure 3.22. Labour force with at least tertiary education in the Welsh local authorities, 2018



Source: Author’s elaboration based on data from Welsh Government (2019_[10]), “Responses to OECD Questionnaire”, Unpublished.

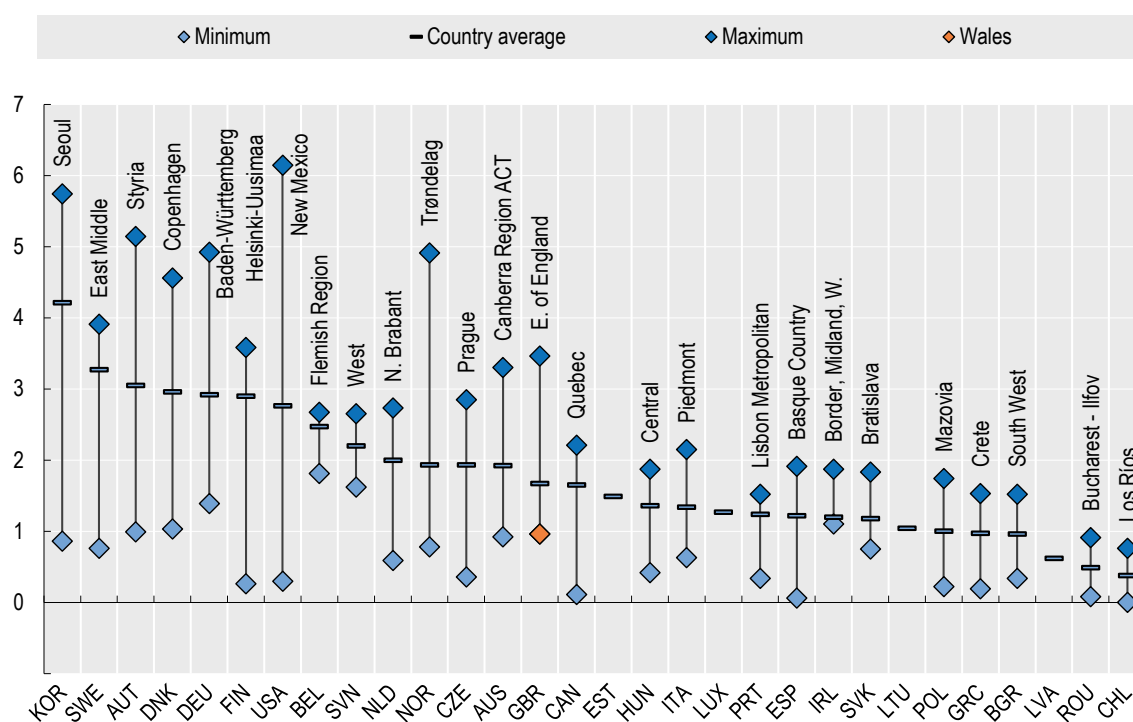
Innovation is the main driver of long-term productivity growth. It allows combining the production factors, including labour, in a more efficient way to maximise economic output. In this sense, investing in R&D is one of the best ways to stimulate innovation and thus productivity growth (OECD, 2020^[11]). It is worth highlighting that R&D expenditure alone might not quickly translate into significant increases in patenting, in particular with low levels of investment – as the relationship between R&D expenditure and patents is not linear. Besides, academic research suggests that R&D expenditure can be more effective in increasing patenting when accompanied by high levels of human capital (Charlot, Crescenzi and Musolesi, 2015^[28]).

Wales could invest more in R&D with respect to both the UK and OECD standards

In terms of expenditure in R&D as a percentage of GDP, Wales invests the least in innovation within the UK. Figure 3.23 shows that expenditure in R&D in Wales represented only 0.96% of its GDP in 2015, almost 1 percentage point below the UK average. This is particularly concerning when considering that UK expenditure in R&D (1.7%) is also low compared to the OECD average (2.4%). Within-country disparities are large in the UK, as R&D expenditure in East England, the best-performing region, is three and a half times higher than in Wales. A similar gap in R&D expenditure appears in other OECD countries such as Germany, where the region of Baden-Württemberg also spends three and a half times more on R&D than the region of Saxony-Anhalt (OECD, 2018^[3]).

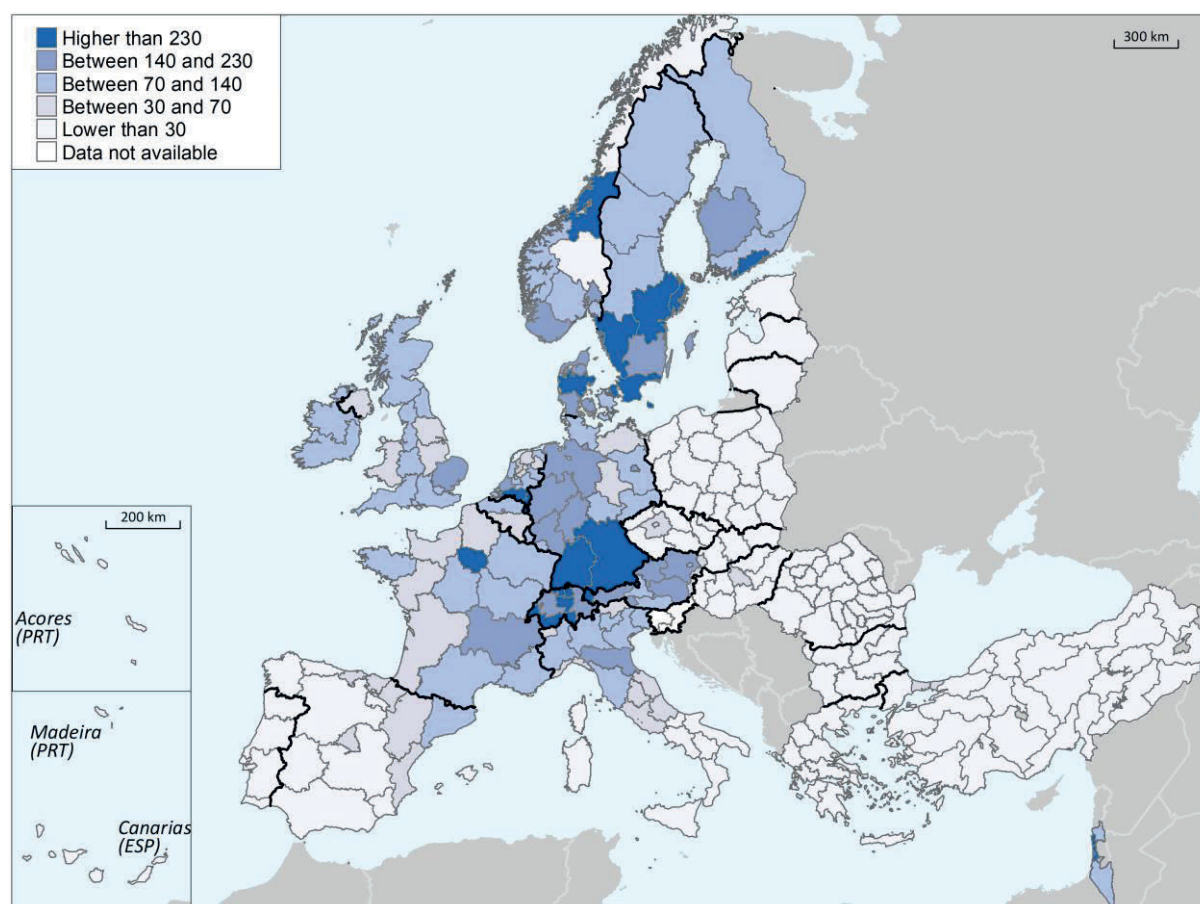
With the lowest number of patent applications per million inhabitants, Northern Ireland and Wales appear to be the least innovative regions of the UK. In 2015, Northern Ireland and Wales respectively produced 37 and 39 patents per million inhabitants, significantly behind the other large UK regions. Inter-regional inequalities in patent applications are large in the UK as the most innovative region (East of England) applied for 130 more patents per million inhabitants than Wales did in the same year. From an OECD perspective, the level of patent applications in Wales is similar to that of the Central Bohemian region in the Czech Republic, the province of Bolzano-Bozen in Italy and the region of Valencia in Spain (Figure 3.24).

Figure 3.23. Expenditure in R&D in OECD large regions, 2015



Source: OECD (2018^[3]), *OECD Regions and Cities at a Glance 2018*, https://doi.org/10.1787/reg_cit_glance-2018-en.

Figure 3.24. Patents per million inhabitants in EU-OECD large regions, 2015



Source: OECD (2018^[3]), *OECD Regions and Cities at a Glance 2018*, https://doi.org/10.1787/reg_cit_glance-2018-en.

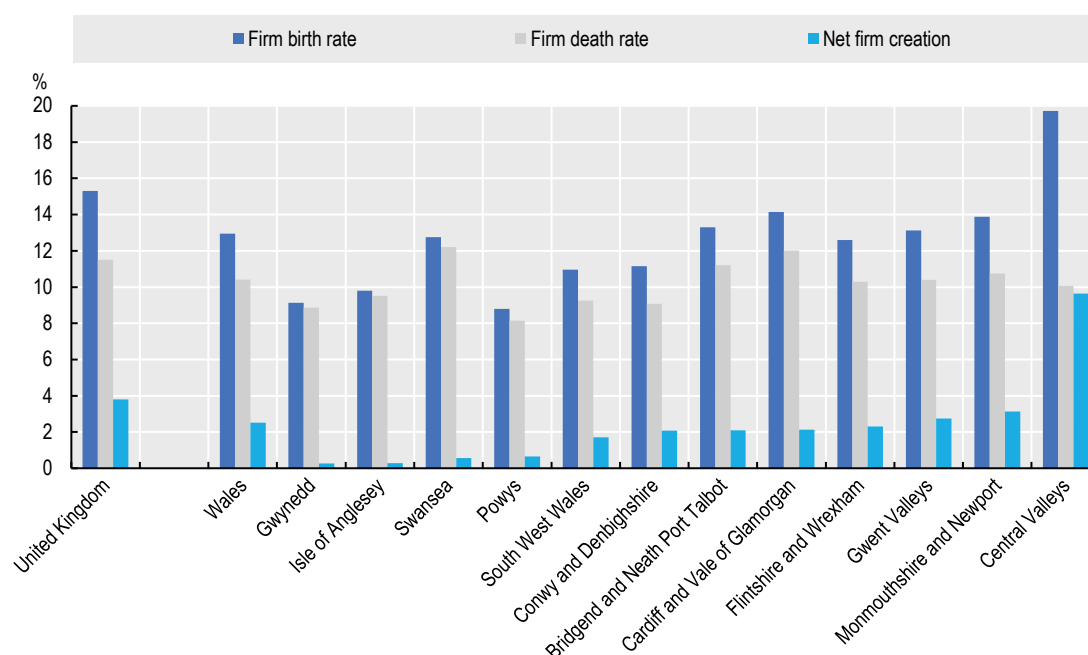
Innovation also intensifies competition among firms. When a firm innovates – and becomes more productive – it forces existing firms to become more efficient or to exit the market. This creation and destruction of firms (churning) and jobs – which also stimulates a better reallocation of resources – generates higher levels of regional labour productivity. Additionally, if the competition associated with new innovative firms entering the market leads to more productivity through the adaptation of incumbent firms (without firm destruction), employment and labour utilisation are also improved (Diaz Ramirez, Klein and Veneri, forthcoming^[29]).

The business churn and net business creation rates in Wales are lower than the UK averages but Welsh areas surrounding Cardiff are reaching or surpassing UK levels

The business churn rate in Wales, measured as firm creation and deaths over total active firms, was 3 percentage points lower than the UK average (of 27%) in 2016. Nevertheless, the regions of Bridgend and Neath Port Talbot, Monmouthshire and Newport, Swansea and the Central Valleys, which might be benefitting from their proximity to Cardiff, present similar or higher levels of firm dynamics compared to the UK average for the same year. Although business churn is good for productivity, it does not always translate into a significantly larger number of firms and employment. Among the aforementioned regions, only the Central Valleys, Monmouthshire and Newport display both large business dynamics and net firm creation.

Firm creation rates in Wales are very similar to the UK average but vary considerably across Welsh small regions. In 2016, on average, the number of newly created firms (including employer and non-employer firms) in Wales represented almost 13% of all already-existing firms, a share close to the average birth rate of firms observed in the UK (15%) (Figure 3.25). Similar to the UK, which is among the most unequal countries of the OECD in terms of firm creation (OECD, 2018^[3]), Wales also presents large within-nation inequalities in firm birth rates. The largest gap prevails between Central Valleys (20%) and Gwynedd (9%).

Figure 3.25. Business dynamics in Welsh small regions, 2016



Note: As a percentage of active firms. This figure refers to all type of firms (both employer and non-employer) and from most economic sectors, excluding agriculture and insurance activities of holding companies.

Source: OECD (2020^[7]), *OECD Regional Statistics (database)*, <http://dx.doi.org/10.1787/region-data-en>.

While firm birth and death rates are very similar to each other in most Welsh small regions, firm creation is substantially larger than firm destruction in Central Valleys – generating a significant net creation of new businesses. In all of Wales' small regions, except the region of Central Valleys, the birth rate of businesses and the death rate of firms display very similar levels, leading to a low net firm creation rate (average of 2.5%), which is below the UK average by 1.3 percentage points (Figure 3.25). Within Wales, only the regions of Gwent Valleys, Monmouthshire and Newport, and Central Valleys display both strong dynamics for business creation and a relatively low death rate of firms, resulting in a net birth rate of businesses superior to the Welsh average of 2.5%. One possible explanation is that the Valleys (Gwent and Central), and the area of Monmouthshire and Newport are capturing the benefits of proximity to Cardiff (without the high congestion costs), which makes these regions more attractive to new firms.

Well-being today and for future generations

Through the Well-being of Future Generations (Wales) Act 2015, Welsh institutions have made it clear that people's well-being is at the core of Welsh political values and therefore one of the main pillars of the Welsh development agenda.

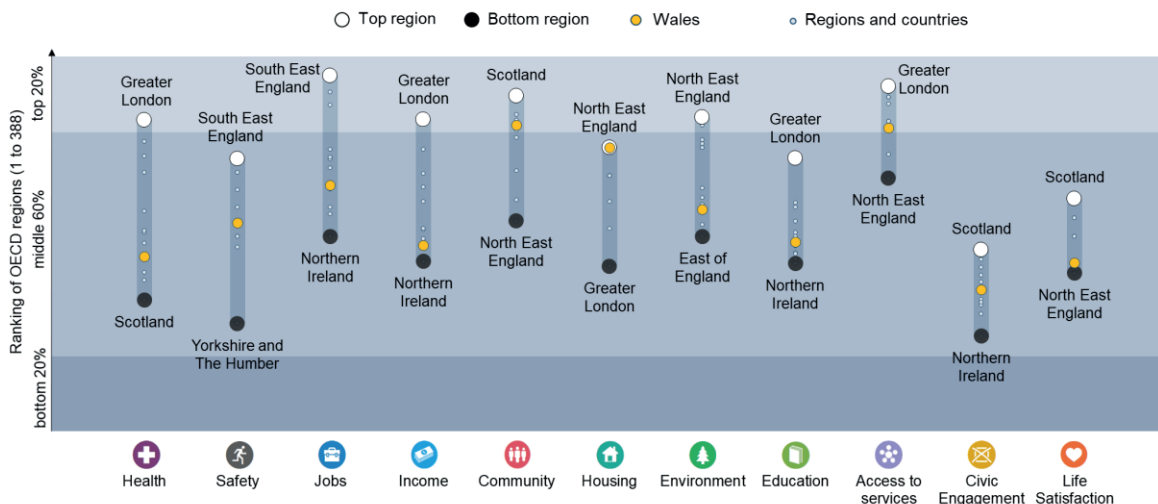
This section provides a general overview of well-being in Wales applying the OECD regional well-being framework (OECD, 2014^[12]; 2019^[30]). Using 13 OECD headline indicators,⁴ this section benchmarks well-being outcomes in Wales against around 400 OECD large (TL2) regions and provides comparisons to the UK's average values. Finally, using a set of well-being indicators available at a more granular level, inequalities in well-being across Welsh local authorities are also documented.

Well-being in Wales is higher than or equal to OECD standards in most dimensions but lower than the UK average

Well-being in Wales is above or equal to the OECD median value in 12 out of 13 indicators but below the UK average in most well-being dimensions. Only in the indicator of voter turnout is the Welsh outcome below the OECD median region – by five percentage points. On the other hand, when comparing exclusively to the UK, Wales fares slightly better only on the indicators of the homicide rate, social support network, rooms per inhabitant and exposure to air pollution (PM2.5) (Figures 3.26 and 3.27). With 90% of its households having access to broadband and 95% of the adult population having a strong social support network, Wales is among the top 20% best-performing OECD regions in the dimension of Access to Services and the dimension of Community. In the dimension of Housing (rooms per inhabitant), Wales is in the top quartile of best-performing OECD regions. Together with North East England, Wales is the best-ranked region in the UK in terms of this indicator. In the dimensions of Income, Safety (homicides rate) and Jobs (employment and unemployment rates), Wales is among the middle 60% of OECD regions, but slightly better than the OECD median. Although Wales is in the middle 60% of OECD regions in the dimensions of Environment and Civic Engagement, the exposure of the Welsh population to PM2.5 is just slightly below the suggested levels by the World Health Organization (WHO) (of 10 micrograms per cubic metre), while voter turnout is 5 percentage points below the OECD average.












Figure 3.26. Applying the OECD well-being framework in Wales: Rankings

Score from 0 to 100, where 100 is the best possible outcome



Source: OECD (2020^[7]), *OECD Regional Statistics (database)*, <http://dx.doi.org/10.1787/region-data-en>.

Figure 3.27. Applying the OECD well-being framework in Wales: Indicators

| | UK Average | Wales | OECD median region | British regions | |
|---|---------------|--------|-----------------------|-----------------|------------|
| | | | | Top 20% | Bottom 20% |
|  Health | | | | | |
| Life Expectancy at birth (years), 2016 | 81.2 | 80.4 | 80.4 | 82.7 | 79.7 |
| Age adjusted mortality rate (per 1 000 people), 2016 | 7.7 | 8.2 | 8.1 | 6.9 | 8.6 |
|  Safety | | | | | |
| Homicide Rate (per 100 000 people), 2016 | 1.2 | 1.1 | 1.4 | 0.7 | 2.0 |
|  Jobs | | | | | |
| Employment rate 15 to 64 years old (%), 2017 | 72.8 | 70.8 | 67.7 | 76.4 | 69.8 |
| Unemployment rate 15 to 64 years old (%), 2017 | 4.5 | 4.7 | 5.5 | 3.5 | 5.5 |
|  Income | | | | | |
| Disposable income per capita (in USD PPP), 2016 | 20 610 | 17 733 | 17 695 | 25 589 | 17 656 |
|  Community | | | | | |
| Perceived social network support (%), 2013 | 94.8 | 95.0 | 91.4 | 95.9 | 92.8 |
|  Housing | | | | | |
| Rooms per person, 2016 | 1.9 | 2.2 | 1.8 | 2.1 | 1.8 |
|  Environment | | | | | |
| Level of air pollution in PM2.5 (µg/m³), 2015 | 10.4 | 9.4 | 12.4 | 7.2 | 11.7 |
|  Education | | | | | |
| Labour force with at least upper secondary education (%), 2017 | 83.3 | 81.6 | 81.7 | 87.5 | 79.7 |
|  Access to services | | | | | |
| Households with broadband access (%), 2017 | 93.0 | 90.0 | 78.0 | 96.0 | 88.8 |
|  Civic engagement | | | | | |
| Voters in last national election (%), 2017 or latest year | 66.1 | 65.7 | 70.9 | 70.0 | 62.1 |
|  Life Satisfaction | | | | | |
| Life satisfaction (scale from 0 to 10), 2013 | 6.9 | 6.8 | 6.8 | 7.1 | 6.8 |

Source: OECD (2020^[7]), *OECD Regional Statistics (database)*, <http://dx.doi.org/10.1787/region-data-en>.

Inequalities across Welsh local authorities are stark in certain well-being indicators, such as youth unemployment and income deprivation

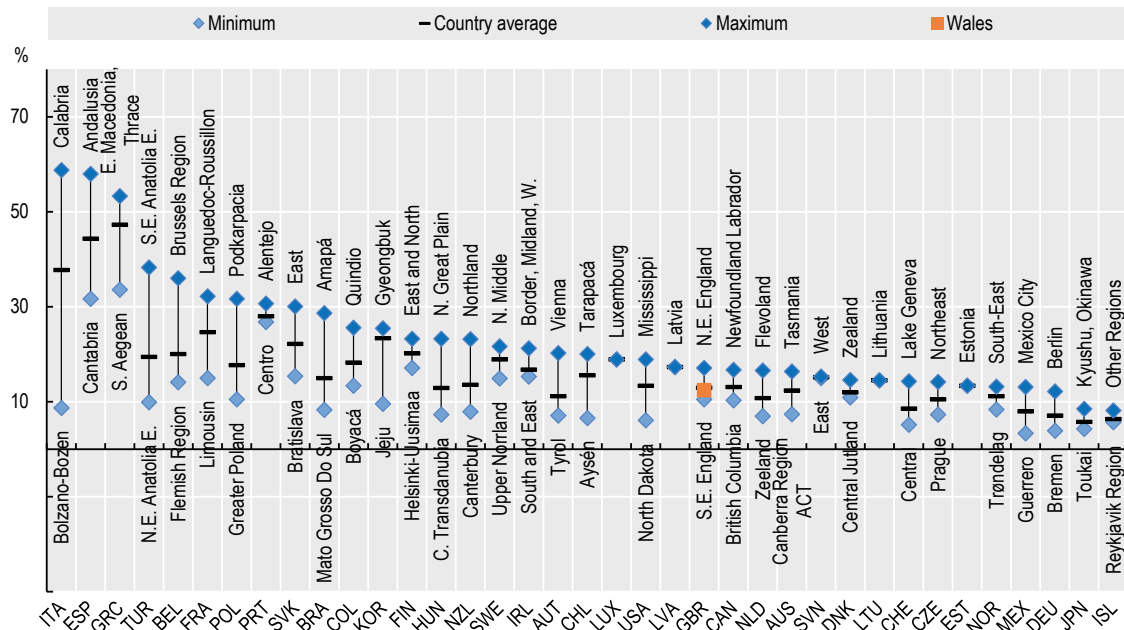
Regional disparities in well-being dimensions such as youth unemployment and access to high-speed Internet are sharp across Welsh local authorities, where the worst outcomes in two or more dimensions tend to concentrate in the same regions. For example, Blaenau Gwent and Caerphilly face levels of youth unemployment above 16% and only 4% of their premises have access to high-speed Internet (i.e. ultra fibre, >300Mbit/s).

The youth unemployment rate in Wales is lower than the OECD regional average by around five percentage points. Nevertheless, special attention should be paid in South West Wales, where the local authorities of Neath Port Talbot and Swansea display youth unemployment rates above 20%, which implies that out of every 5 youngsters (aged 16-24) that are looking for a job, one of them cannot integrate into the labour market (Figure 3.28).

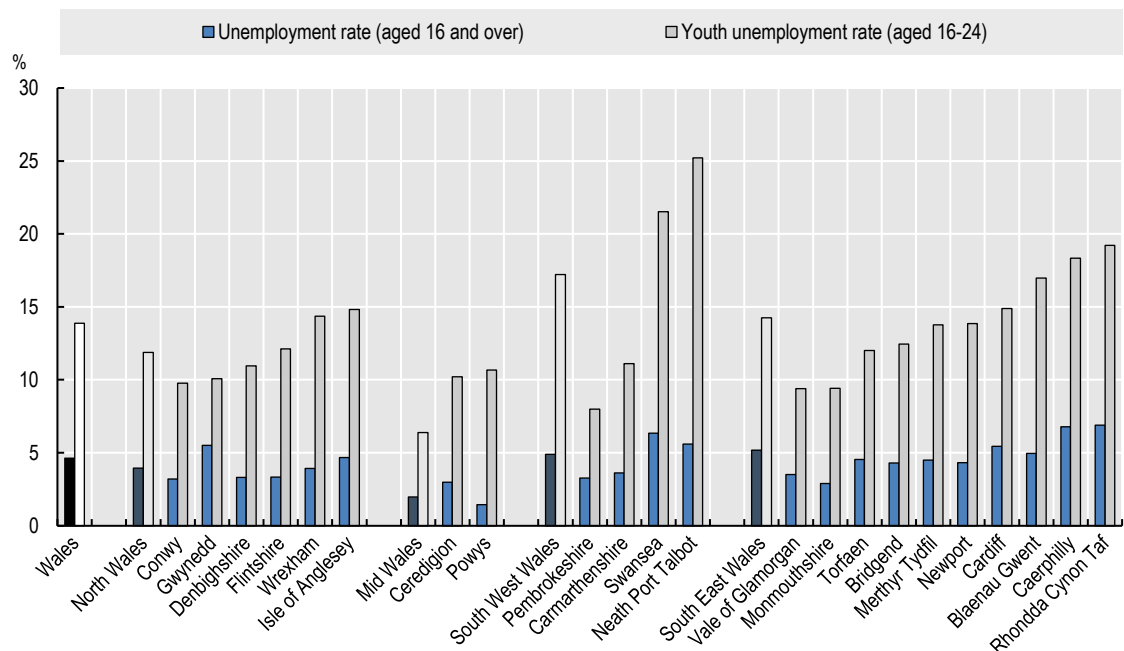
In 2018, the unemployment rate in Wales was 4.6%, 9.3 percentage points lower than its youth unemployment rate. While most of the variation in unemployment rates comes from comparing local authorities from the different economic regions suggested by the Economic Action Plan (Welsh Government, 2019^[10]), the largest disparity in the youth unemployment rate is found within the same economic region. The widest gap in the unemployment rate is found between Powys in Mid and South West Wales (1.4%) and Rhondda Cynon Taf in South East Wales (6.9%). On the other hand, the largest inequality in the youth unemployment rate is observed in Mid and South West Wales, between Pembrokeshire (8%) and Neath Port Talbot (25.2%) (Figure 3.29).

Figure 3.28. Youth unemployment rates in OECD TL2 regions, circa 2016

Unemployed people aged 15 to 24 as a percentage of the labour force of the same age



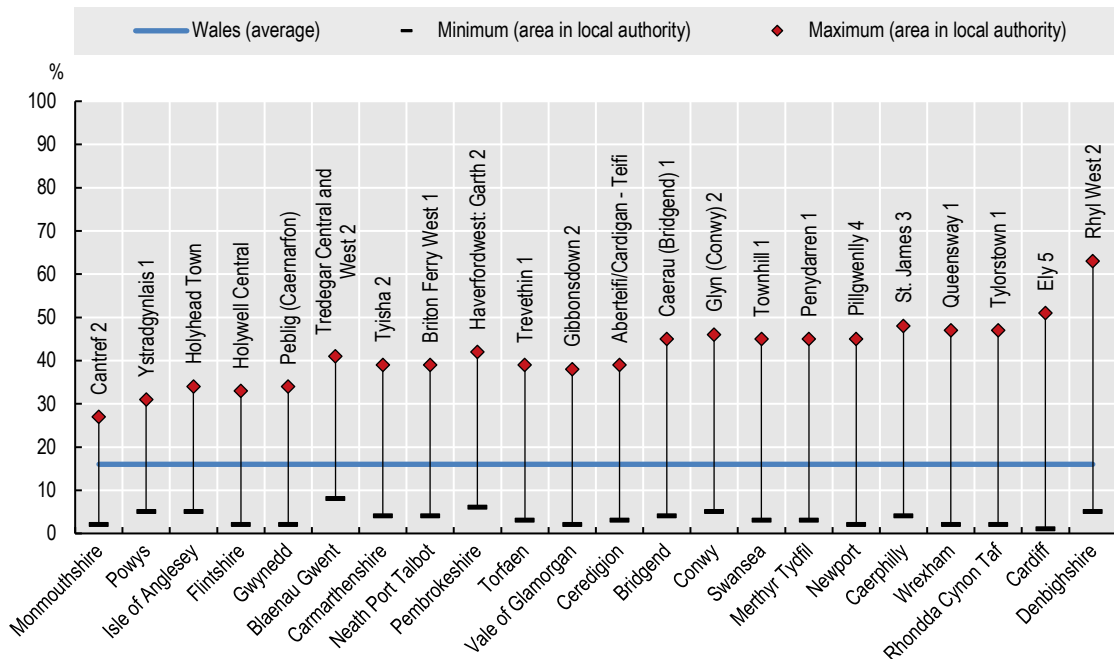
Source: OECD (2020^[7]), *OECD Regional Statistics (database)*, <http://dx.doi.org/10.1787/region-data-en>.

Figure 3.29. Unemployment rates in the Welsh local authorities, 2018

Source: Author's elaboration based on data from Welsh Government (2019^[10]), "Responses to OECD Questionnaire", Unpublished.

Stark spatial inequalities in well-being are also present within local authorities. For example, the average gap in income deprivation between the most and least deprived area within a local authority is 38 percentage points (Figure 3.30). With the exception of Blaenau Gwent, most of the Welsh local authorities have at least one area with an income deprivation below 5%. The granularity of this indicator is very useful to identify areas with concerning income deprivation levels. For example, while the average income deprivation in Wales was 16% in 2017, the worst outcome within a local authority can range from 27% (Cantref 2, Monmouthshire) to 68% (Rhyl West 2, Denbighshire).

Figure 3.30. Disparities in income deprivation within local authorities, 2017



Note: The geographical units in this figure correspond to Lower Super Output Area (LSOA).

Source: Author's elaboration based on data from Welsh Government (2019^[10]), "Responses to OECD Questionnaire", Unpublished.

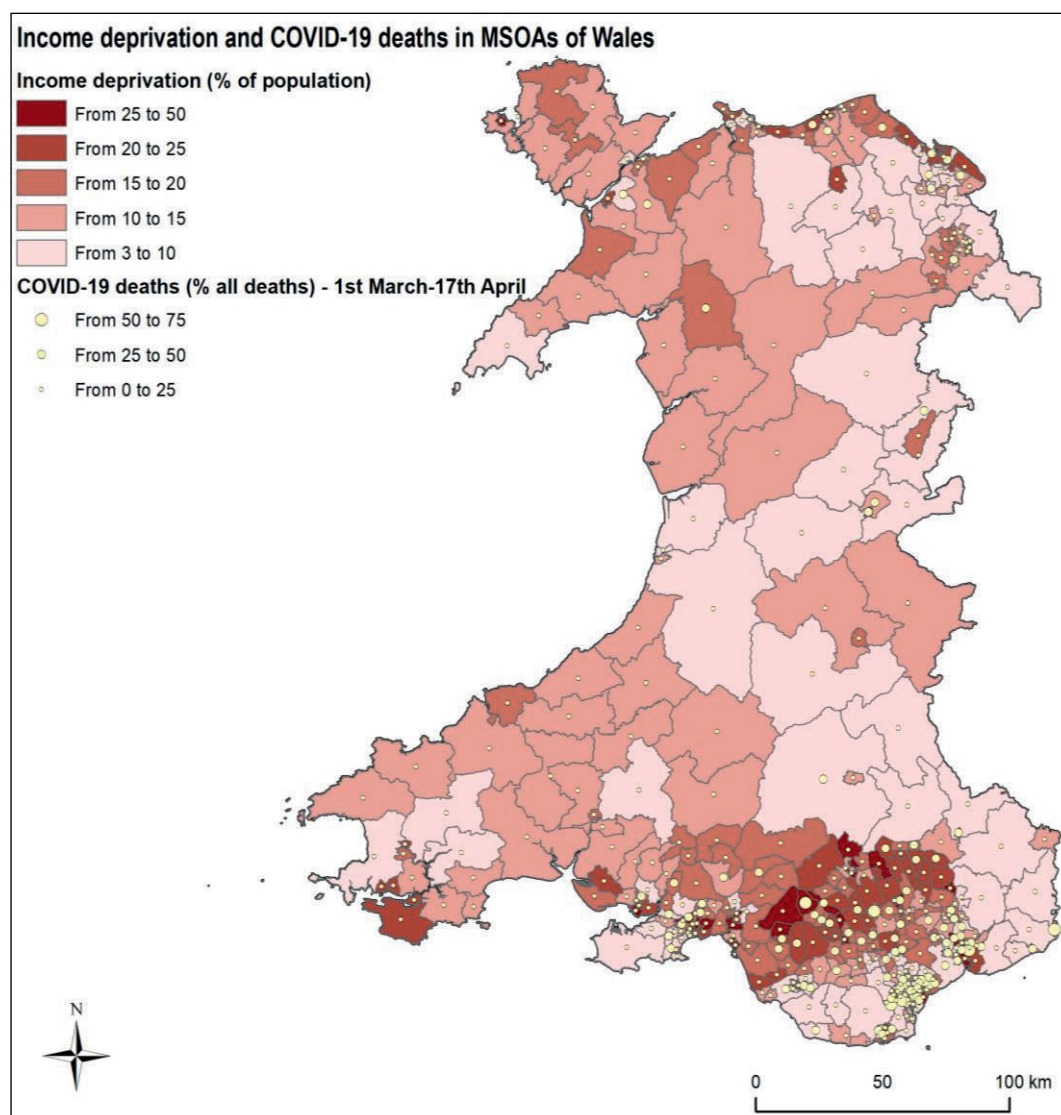
While people are at the centre of well-being policies, ensuring a balanced distribution of well-being in places (where people live) is essential for resilience and sustainable development. For example, large inequalities in income tend to lead to more spatial segregation. In practice, segregation of poor households tends to be problematic when disadvantages in other well-being dimensions concentrate in space and reinforce each other (e.g. education, health and safety), leading to negative lifelong outcomes for residents (OECD, 2018^[31]).

Large inequalities across and within regions make some communities and groups of people more vulnerable than others to the adverse effects of environmental or other crises, such as the current COVID-19 pandemic. For example, there is evidence that more deprived areas in England and Wales are experiencing a disproportionate rate of deaths due to COVID-19 compared to less deprived places (Iacobucci, 2020^[32]).

From 1 March to 17 April 2020, the most disadvantaged areas in Wales registered around 45 COVID-19 deaths per 100 000 people, while areas with less deprivations experienced close to 23 COVID-19 deaths per 100 000 inhabitants (Iacobucci, 2020^[32]) – a similar pattern is also registered for England. Figure 3.31 shows that, for the same period, the most income-deprived areas of Wales were also the most affected by COVID-19. In particular, there is a high spatial concentration of both income deprivation and COVID-19

fatalities in the neighbourhoods of Cardiff, Newport and the Valleys. While density can be an important determinant for the spread of the virus (impacting faster in urban areas), fatality rates are also determined by health system capacity, as well as pre-existing health conditions of people (e.g. high blood pressure, obesity and diabetes), which tend to be correlated to income and education. It is worth noting that the COVID-19 crisis is still an evolving issue. Therefore, statistical evidence at the time of writing – even if suggestive about the particular vulnerability of deprived areas – should not be seen as consolidated.

Figure 3.31. Income deprivation and COVID-19 deaths in MSOAs of Wales (1 March-17 April, 2020)



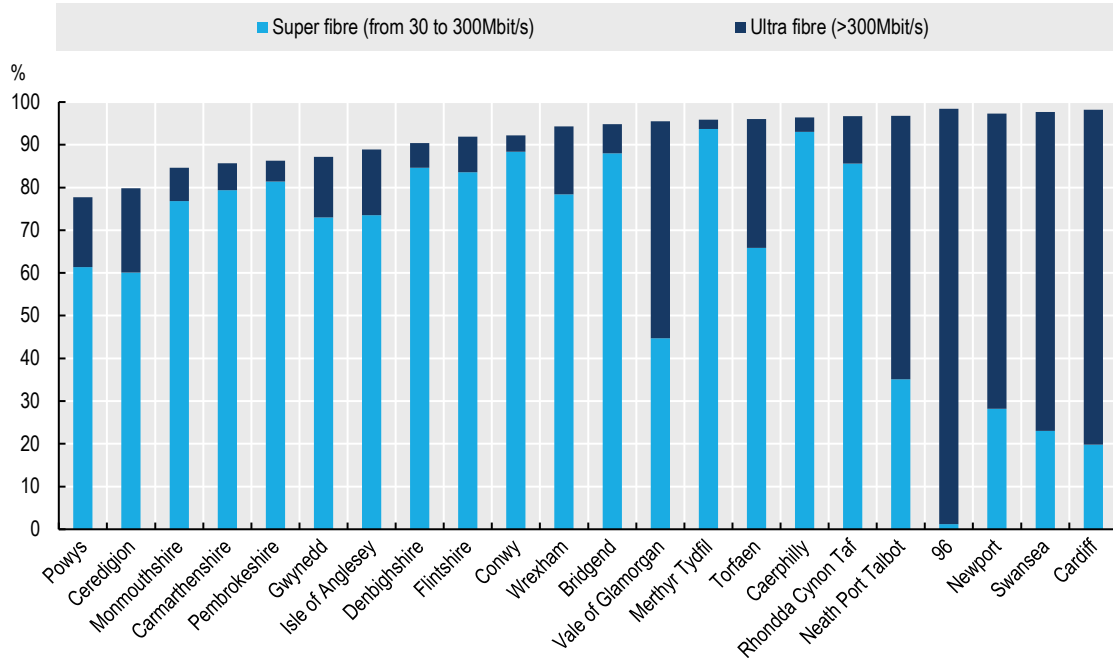
Note: The geographical units in this figure correspond to Middle Super Output Area (MSOA).

Source: Author's elaboration based on data from Welsh Government (2019^[10]), "Responses to OECD Questionnaire", Unpublished and Office for National Statistics (2020^[33]), *Deaths Involving COVID-19 by Local Area and Deprivation (dataset)*, <https://www.ons.gov.uk/peoplepopulationandcommunity/birthsdeathsandmarriages/deaths/datasets/deathsinvolvingcovid19bylocalareasanddeprivation>.

In the era of digitalisation, having access to Internet is a key determinant of access to opportunities, such as education and jobs. In 2017, broadband access in Wales was 12 percentage points higher than the regional median OECD value of 78%. Additionally, in Wales, inequalities in Internet access are mainly due

to high-performing regions such as Cardiff, Newport and Swansea with broadband access levels above 97%, while Ceredigion and Powys present levels slightly below 80% – similar to the OECD median value.

Figure 3.32. Accessibility to fibre in the Welsh local authorities, 2018



Source: Author's elaboration based on data from Welsh Government (2019^[10]), "Responses to OECD Questionnaire", Unpublished.

In the context of COVID-19 and measures of social distancing, access to high-speed Internet is proving to be a source of social and economic resilience. Digital tools have become fundamental for the continuity of educational programmes and lifelong learning (OECD, 2020^[34]), as well as health consultations among others. On top of that, economies founded in sectors and businesses that can re-adapt their productive processes to teleworking systems are more likely to survive the lockdowns and recover faster from the ongoing global recession.

Some Welsh local authorities are leading in the transition to high-speed Internet (ultra fibre, >300Mbit/s). For example, in Cardiff, Neath Port Talbot, Newport and Swansea, the percentage of premises with ultra fibre is above 60%. While the general Internet coverage is good across Welsh local authorities, some areas could improve the quality of their fibre. This is particularly the case in Blaenau Gwent, Caerphilly, Conwy, Merthyr Tydfil and Pembrokeshire, where the ultra fibre coverage is below 5% (Figure 3.32). By working to ensure well-being today and in the future, Wales is building local resilience and contributing to the achievement of the global SDGs

The 2030 Agenda for Sustainable Development, with its 17 SDGs and its 169 targets, recognises that ending all kinds of social deprivations must go hand in hand with economic prosperity and the planet's protection (OECD, 2020^[8]). This aligns with Welsh strategic and policy documents such as the Economic Action Plan and the statutory guidance on the Well-being of Future Generations (Wales) Act 2015 (Welsh Government, 2017^[9]; 2016^[35]).

To achieve the SDGs, governments need to know where they stand today with respect to the 2030 Agenda. To help policymakers to measure the distance of their country, region or city towards the SDGs, the OECD has developed a visualisation tool. Among other things, the tool aims to foster peer-learning and policy

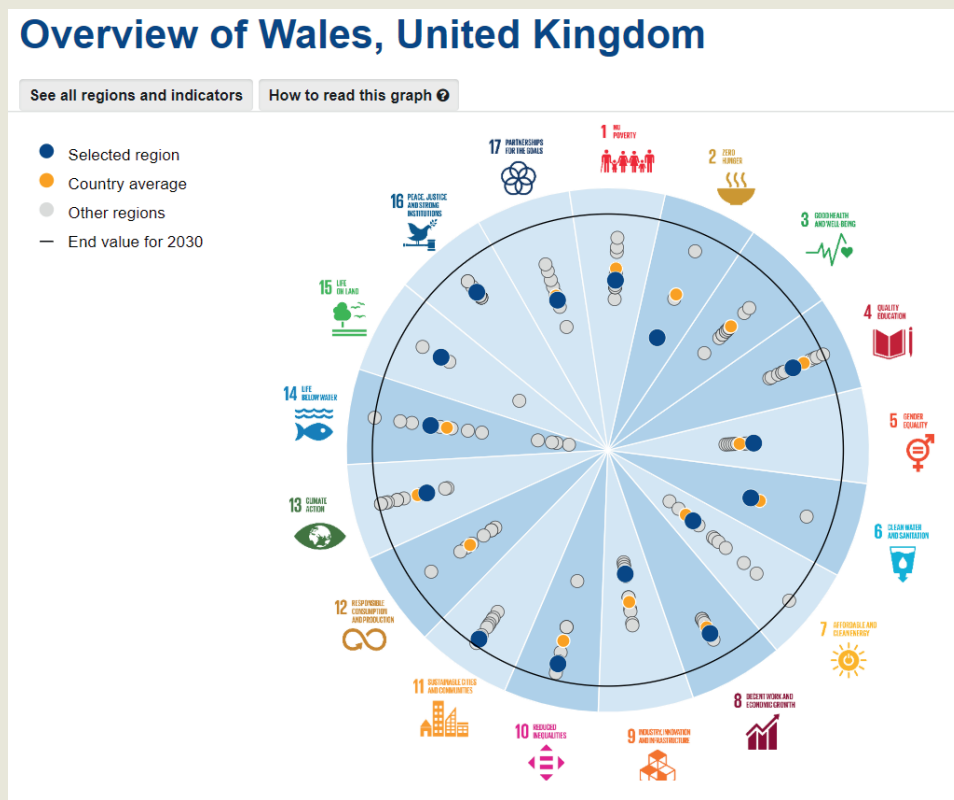
dialogues across similar regions and cities, increase accountability of governments with regards to the SDGs and raise SDG awareness across society at large (Box 3.4).

Box 3.4. Measuring the distance to achieving SDGs in regions and cities: An OECD visualisation tool

Under the Territorial Approach to the SDGs programme, the OECD has developed a visualisation tool to help policymakers measure the distance of regions and cities towards reaching the SDGs (see <http://www.oecd-local-sdgs.org>). The tool covers around 600 regions and 600 cities from OECD and partner countries and includes more than 100 indicators to monitor progress across the 17 SDGs. These indicators can be visualised individually or as a composite index (OECD, 2020^[8]).

The web tool allows each region and city to visualise its distance to an end value for 2030, compare it to its country peer regions and the country average. With the objective of enhancing partnerships and the sharing of best practices for the SDGs among regions and cities, the tool also suggests two profiles of similar regions or cities from different countries. The similarity between regions is determined in terms of relevant characteristics (e.g. population size or GDP per capita). However, only the regions or cities that overall are performing better on their path towards achieving the SDGs are considered. The tool also allows visualising the distance of a region or city towards an end value with respect to all OECD regions or cities. This visualisation can be done either by goal index or individual indicator.

Figure 3.33. Measuring the distance of Wales towards the SDGs



Source: OECD (2020^[36]), *Measuring the Distance to the SDGs in Regions and Cities* (webtool), <http://www.oecd-local-sdgs.org>.

Compared to OECD regions and United Nations (UN) standards, Wales (blue point in Figure 3.33) is performing well in the SDGs related to education (SDG 4), decent work (SDG 8), reduced inequalities (SDG 10), sustainable cities (SDG 11), and peace and institutions (SDG 16). It is worth highlighting that there are still important data gaps (described in the tool) that have to be considered when interpreting indexes. While SDG indexes are useful for communication and visualisation, they are only an entry point to further analyse the whole set of indicators underlying each goal.

Source: OECD (2020^[8]), *A Territorial Approach to the Sustainable Development Goals: Synthesis report*, <https://doi.org/10.1787/e86fa715-en>.

Conclusion

Diverging productivity across Welsh regions is a driver of low economic performance in the nation and persistent well-being inequalities across local authorities

Wales, similarly to the UK, depicts a regional model of productivity that concentrates most of the economic performance in a few urban clusters, while the rest of the regions are struggling to catch up. For concentrated models such as this one (see Box 3.3), one traditional policy approach is to compensate the lagging regions through financial support and subsidies while promoting labour mobility and public employment opportunities. However, this model can create dependence and, under distressing conditions such as during economic downturns, trigger the “geography of discontent” (McCann, 2019^[37]), polarising political responses. What is more, the traditional compensating system tends to be characterised by a top-down approach implemented through large-scale investments in socio-economically weak areas (Rodríguez-Pose, 2018^[2]) – with typically low institutional capacity to manage these investments. This can result in inefficient use of financial resources rather than creating long-term development opportunities.








A thriving Welsh economy that generates well-being today and for future generations can be achieved through a place-based approach to regional policy

Over the past two decades, many OECD countries have been refocusing regional development policy to a more integrated, place-based approach to solve productivity growth and well-being issues. Promoting growth and well-being throughout the territory, rather than focusing on high- or low-performing regions, is likely to yield economies that are less vulnerable to external shocks (OECD, 2012^[38]). In addition, ensuring that investment reaches all regions, including the less performing ones, is beneficial for sustainable growth. Regions that under-perform can be costly to national budgets as missed growth opportunities go hand in hand with lower tax revenues and lower quality public service delivery. Shifting from an approach that only focuses on transfers and subsidies as generators of growth to one that focuses on identifying and building the productive potential of each region (Figure 3.34) can maximise both regional well-being and national growth (OECD, 2012^[38]).

Ensuring the success of a place-based approach requires developing effective multi-level governance systems and public investment capacity

The goal of regional development policy is to ensure that all types of regions are able to thrive and offer their residents a high quality of life (OECD, 2016^[14]). However, this framework is just a general guide for implementation. In practice, the success or failure of a place-based approach will be determined, among other things, by the effectiveness of the multi-level governance mechanisms in place and the investment capacity of the managing authorities. Adopting a place-based approach is clearly more demanding in terms of governance because it requires tailored regional strategies and high levels of co-ordination across levels of government and sectors of society, but it leads to more effective investment and sustainable development results.

Figure 3.34. The OECD regional policy paradigm

| | TRADITIONAL APPROACH | MODERN REGIONAL DEVELOPMENT POLICY |
|--|---|--|
|  OBJECTIVE | Transfers to poorest regions | High levels of well-being in all regions |
|  KEY INSTRUMENTS | Long-term public subsidies | Strategic public investment |
|  FOCUS | External interventions not linked to local strategy | Building on local assets and knowledge |
|  TARGETED REGIONS | Administrative jurisdictions only | Functional areas also considered |
|  ACTORS | National government only | All levels of government and other public / private stakeholders |
|  POLICY FIELDS | Place-based policies only | Place-based and place-proofed policies |
|  IMPLEMENTATION | Collection of individual, one-off programmes | Co-ordinated policy packages |

Source: Oliveira Martins, J. (2019^[39]), "The challenges of regional and local development: The OECD perspective", Presentation at the OECD Seminar "The Future of Regional Development and Investment in Wales", 27 November, Cardiff, Wales.

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Notes

¹ Robust measures of GVA per worker are not available at the Welsh local authority level. For this reason, Cardiff and Vale of Glamorgan cannot be split for the analysis.

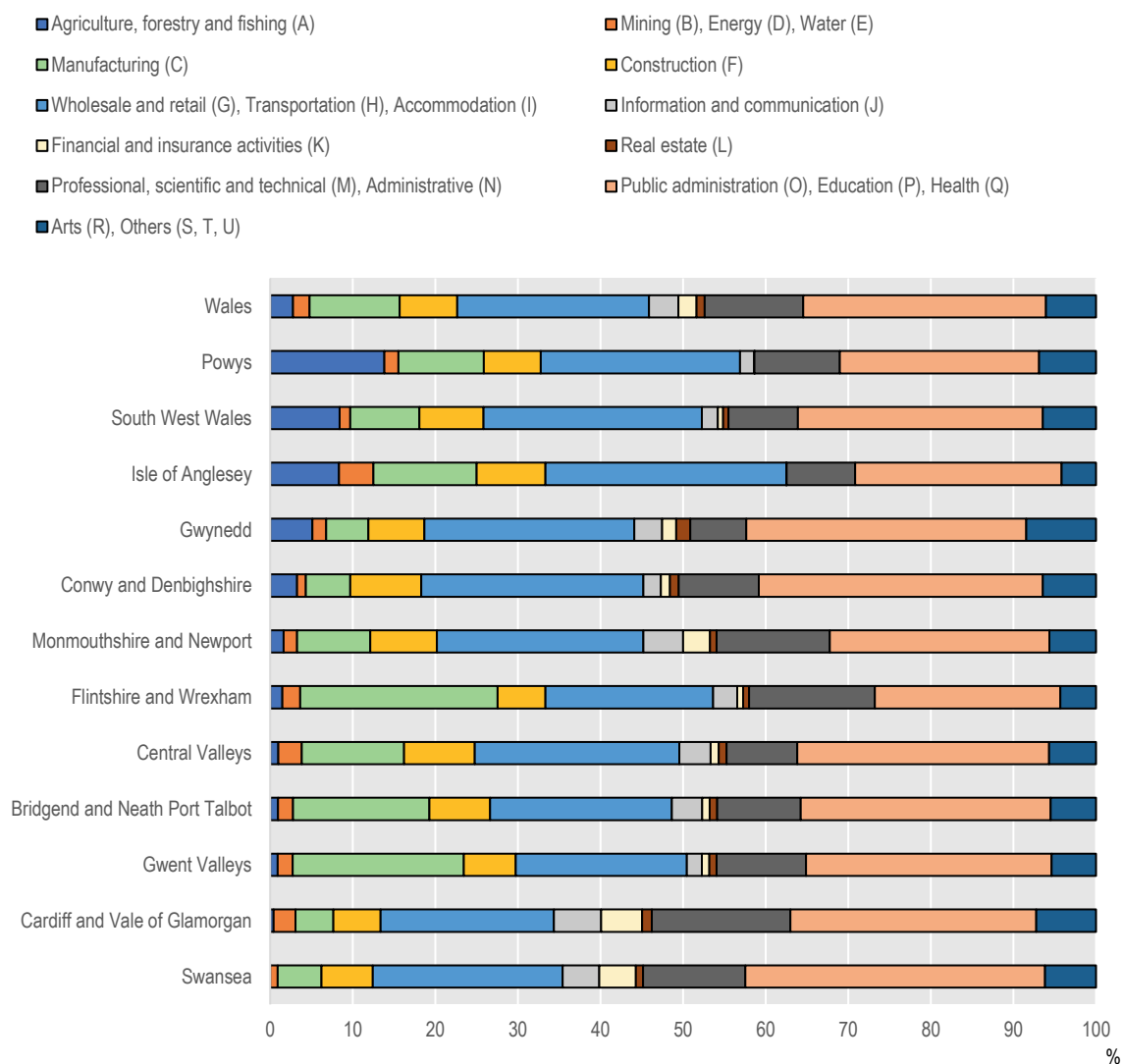
² At the OECD, TL2 regions correspond to the first administrative tier of subnational government. For Europe, OECD TL2 regions are, in most cases, equivalent to NUTS-2 regions. One exception is the UK, where TL2 regions correspond to the NUTS-1 regions, which include Northern Ireland, Scotland and Wales and nine statistical regions for England.

³ For an in-depth discussion on the challenges and opportunities of the economic planning regions, see Chapter 6: “Case study: Considerations for economic regions for Mid Wales and South West Wales”.

⁴ Headline indicators in the OECD regional well-being framework provide an overview of each well-being dimension using one or two statistics. These headline indicators should be interpreted just as an entry point to compare well-being across regions. The main reason for using no more than two indicators per well-being dimension relates to data availability across all OECD regions.

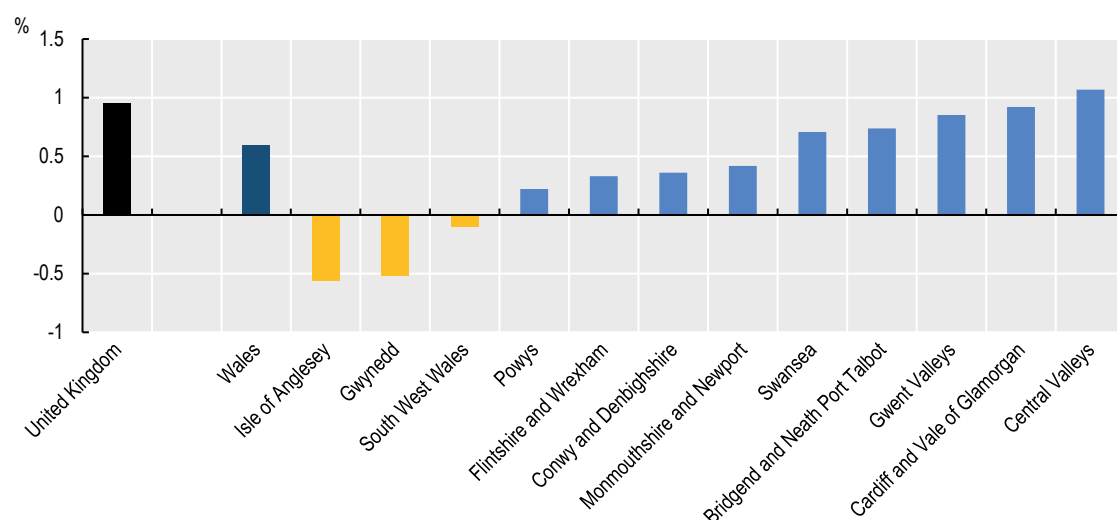
Annex 3.A. Complementary figures

Annex Figure 3.A.1. Distribution of employment by industry in Welsh small regions, 2018



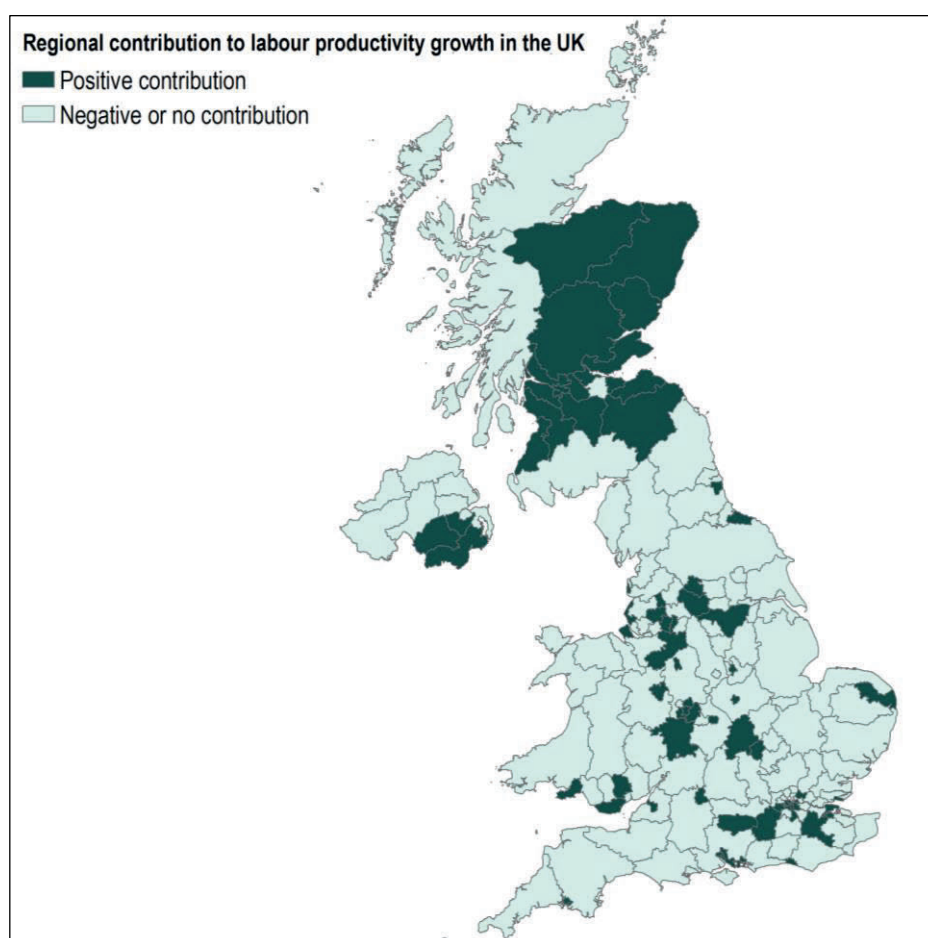
Source: OECD (2020^[7]), *OECD Regional Statistics (database)*, <http://dx.doi.org/10.1787/region-data-en>.

Annex Figure 3.A.2. Labour productivity growth in the small regions of Wales, average, 2002-18



Source: Author's elaboration based on data from Welsh Government (2019^[10]), "Responses to OECD Questionnaire", Unpublished.

Annex Figure 3.A.3. The contribution of small regions to the UK aggregate productivity growth



Note: Period: 2000-18. Based on the methodology of OECD (2016^[14]).

Source: OECD (2020^[7]), *OECD Regional Statistics (database)*, <http://dx.doi.org/10.1787/region-data-en>.

4 Fiscal frameworks and public investment financing in Wales

This chapter, divided into two parts, explores the challenges surrounding fiscal frameworks and public investment financing in Wales. Part 1 features the constraints that the Welsh Government and Welsh local authorities face in their fiscal frameworks, and how these affect the ability of governments to fulfil their responsibilities, including in public investment for development and growth. Part 2 makes a case for introducing a coherent public investment framework for regional development in Wales, particularly given a need to optimise limited resources. It explores ensuring co-ordinated public investment in light of Brexit, discusses existing and new investment financing practices, and calls for making the most out of City and Growth Deals. It also offers insight into building capacity for stronger place-based public investment and highlights some innovative sources of public investment financing, including land value capture, green procurement and participatory budgeting.

Infographic 4.1. Key messages

Introduction

Welsh capacity to invest in its regional development agenda – one that promotes growth plus inclusiveness – faces two significant challenges. The first is a constrained fiscal framework, characterised by limited devolution (including with respect to expenditures), and limited revenue-generating capacity, which contributes to a large fiscal gap. Combined, this affects the ability of the Welsh Government and Welsh local authorities to generate sufficient revenue to self-finance the majority of their investment needs and to bridge the investment gap created by several years of austerity measures. The second challenge is limited sources for financing regional development investment. Wales relies on two sources. The first source of investment financing comes from the Welsh Government department budgets, used to meet national and subnational sector policy aims. The second source, specifically targeting regional development, is the European Union (EU) Structural and Investment Funds (ESIF) as well as EU competitive funding. For the 2014-20 programming period, it received approximately GBP 700 million annually from EU financing sources (of which approximately GBP 300 million were directed to regional development through the European Regional Development Fund [ERDF] and European Social Fund [ESF]) (Welsh Government, 2020^[1]). Post-Brexit, the United Kingdom (UK) government has promised a level of investment financing equivalent to that received from the EU (House of Lords, 2020^[2]). The exact value, and the terms and conditions for the disbursement of the intended replacement for European funding (e.g. block grant transfer, competitive funding or a combination of both), however, remain unknown at the time of writing this report. To manage this uncertainty, Wales will need to enhance and ensure the sustainability of its finances. Doing so means strengthening the coherence of its fiscal institutions and rules in order to improve its capacity to attract public and private investment, and support inclusive growth. It also means ensuring that public investment funds are maximised and used as effectively as possible.

The Welsh Government aims to build its investment capacity for regional development, making the most of limited resources and identifying ways to attract additional ones. Over the past years, it has engaged in several consultations and studies to explore new revenue sources, including external resources and private finance (National Assembly for Wales, 2019^[3]; Auditor General for Wales, 2018^[4]). This chapter is presented in two parts. Part 1 focuses on Welsh fiscal frameworks at the national and subnational levels and their role in supporting or impeding investment for regional development. It explores the degree of fiscal devolution in Wales and examines the sources of its fiscal gap. It also offers insight into mechanisms to help reinforce these fiscal frameworks, such as territorial equalisation, optimising revenue sources and increasing local financial capacity. Part 2 examines the investment frameworks that support regional development. It analyses the main components of a proposed national investment framework and how it can add value by aligning objectives and priorities across sectors and levels of government. It also examines how to support more place-based investment. Finally, this section explores the potential for Wales to use a series of innovative financing mechanisms to help fill its investment gaps.

Part 1: The role of fiscal frameworks in Welsh public investment capacity

For Wales to realise its regional development agenda, one that values growth, inclusiveness and emphasises a place-based approach, reinforcing the existing fiscal and financial arrangements will be necessary. The Welsh Government is aware of the constraints on its ability to implement this agenda, including a weak tax base, an enduring fiscal deficit and a strong reliance on intergovernmental transfers from the UK government.

Fiscal frameworks – all arrangements, procedures, rules and institutions that underlie the conduct of government budgetary policies – are the foundation for government capacity to finance investment in the short, medium and long terms, and to ensure inclusive growth (Kim and Dougherty, 2018^[5]). At the national level, they set the budgetary parameters and spending vision for the whole country; at the regional and local levels, they shape fiscal outcomes and directly affect investment, business productivity and growth.

Across the OECD, subnational governments are responsible for approximately 41% of total public expenditure, and they collect, on average, 32% of tax revenue (OECD, 2020^[6]). This provides subnational governments with considerable scope to affect their country's fiscal and economic outcomes through policies that contribute to determining how private stakeholders and citizens spend, pay taxes and invest (Kim and Dougherty, 2018^[5]).

To a large extent, Welsh fiscal prospects depend on the UK government's fiscal position, as this determines the size of the budget grant transferred to the Welsh Government. It also depends on the revenues raised from devolved taxes. Predictions vary regarding the impact of Brexit on the UK and, as an extension, Welsh fiscal health. Recent reports estimate that a no-deal Brexit could lead to a decrease of 2% of UK gross domestic product (GDP) per year (Nabarro and Schulz, 2019^[7]) and this decline could be further affected by the COVID-19 crisis. This means that fiscal settlements in Wales will most certainly need to be reviewed in accordance with political decisions to ensure a stable future for Wales.

In recent years, the Welsh fiscal framework¹ has improved. This is linked to an increasing share of own-source revenue and greater borrowing powers attributed to the Welsh Government and local authorities. Yet, there is still room for further improvement. This is particularly true if fiscal frameworks and budget capacity are to meet the challenge of increased pressure arising from greater public service demands and the need for climate change action, as acknowledged by the Welsh Government in its draft budget for 2020-21 (Welsh Government, 2020^[1]) and unforeseen expenditures arising from COVID-19.

As an investment-support mechanism, the Welsh fiscal framework faces three significant constraints:

1. Limited fiscal devolution, which affects the ability of all levels of government to set and finance investment priorities.
2. A fiscal gap between spending and revenues.
3. Limited revenue-generating capacity, which compounds the fiscal gap at the Welsh government and local authority levels.

This section explores these challenges and the mechanisms available to the Welsh Government to address them, including territorial equalisation to reinforcing local tax revenue, borrowing powers and increasing financial and administrative capacities of local authorities.

Potential links between limited fiscal devolution and Welsh regional disparities

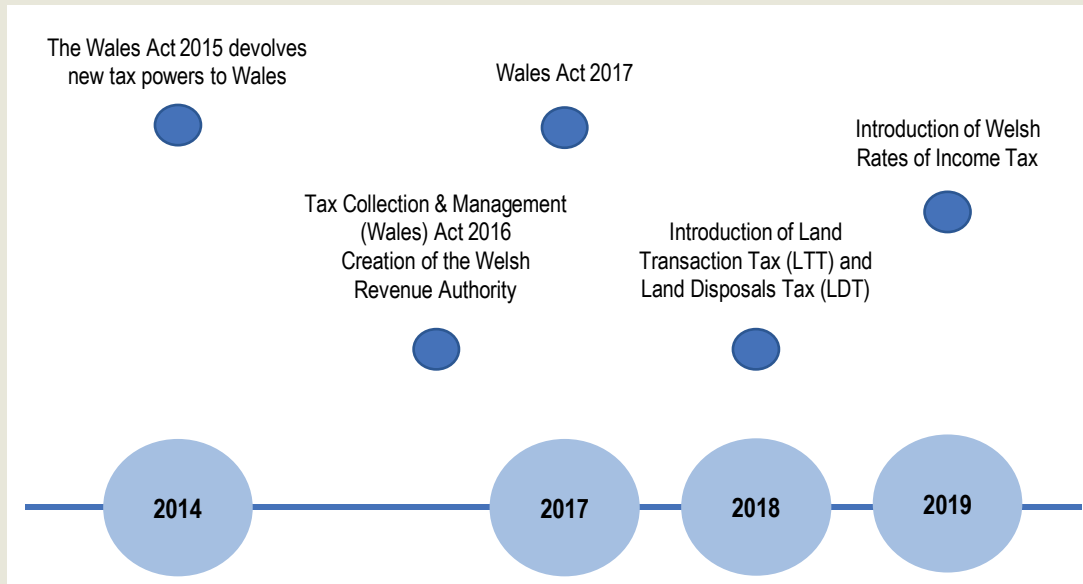
Devolution in Wales is an ongoing process that began in 1998. While political and administrative devolution were relatively quick to take hold, fiscal devolution has been slower and is more limited, with the most recent step taken in 2017 (Box 4.1).

Box 4.1. Fiscal devolution in Wales

Fiscal devolution began in 1998 with the Government of Wales Act, which devolved the Council Tax (a hybrid property/household tax) and Non-Domestic Rates (NDR) (non-domestic property rates) policy to Welsh ministers from 1999. More recently, the Wales Act 2014 granted limited borrowing powers to the Welsh Government and, separately, responsibility for the budgetary management of NDR was transferred on 1 April 2015. The act also devolved the Land Transaction Tax (LTT) and Landfill Disposals Tax (LDT) as of April 2018. Finally, the devolution of Welsh Rates of Income Tax (WRIT) went into effect in 2019. This resulted in a reduction of UK rates by 10%, which the Welsh Government could reapply at the same rate or higher. For the moment, the Welsh Government has maintained 10%. At the same time, the UK government retains responsibility for most aspects of the WRIT, including collection and administration, setting the personal allowance and income thresholds, and taxing income

from savings and dividends. In exchange for the tax revenue generated by the devolved taxes to the Welsh Government, the UK government reduced the block grant funding it provides Wales by an equivalent amount.

Figure 4.1. Timeline of fiscal devolution in Wales



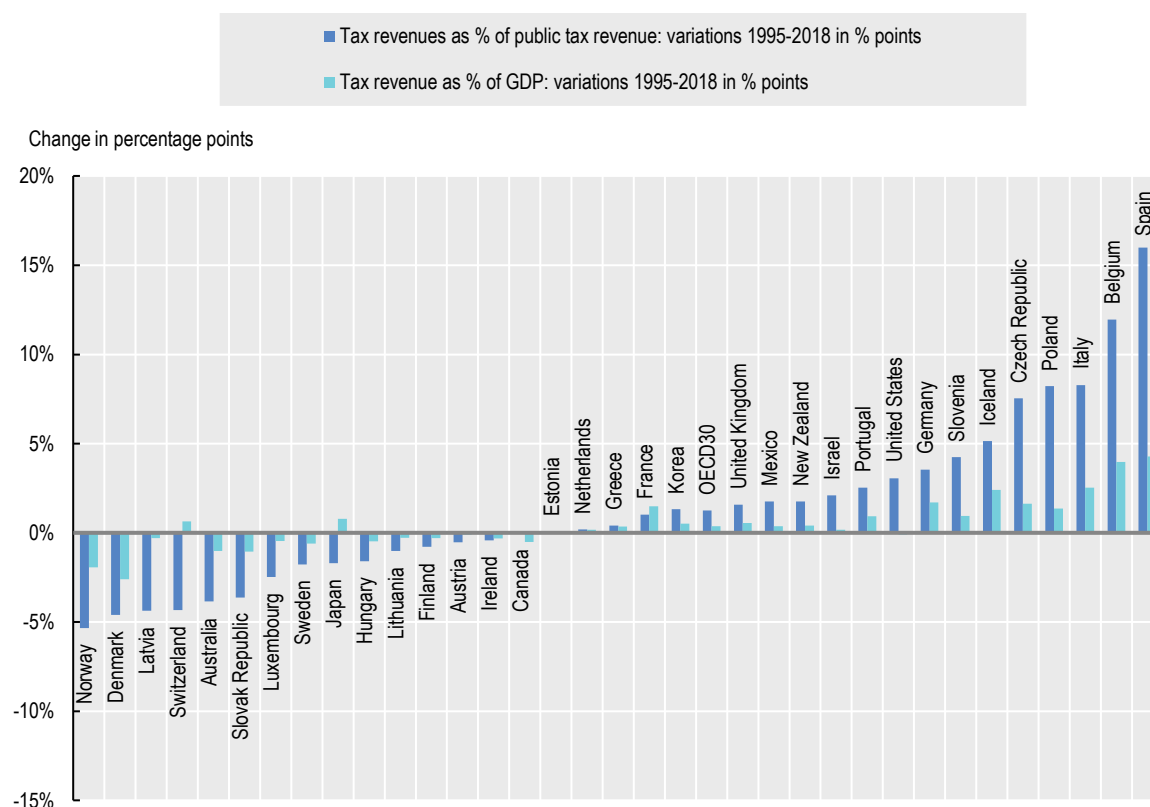
Source: Welsh Government (2019^[9]), *Welsh Tax Policy Report 2019*, <https://gov.wales/sites/default/files/publications/2019-12/welsh-tax-policy-report-2019.pdf>; graphic: Author's elaboration with data from the Wales Audit Office.

Thus far, the result of the Welsh fiscal devolution process appears mixed and somewhat unbalanced. On the one hand, there are indications it is increasing. This is evidenced by the periodic adjustments to the devolution agreement over time and an increase in measures of regional authority in the UK. Wales' cumulative score in the Regional Authority Index (RAI),² went from 2.0 in 1990 to 15.5 in 2010 and 17.5 in 2016, out of a maximum of 24.0. This is positive as it gives some indication of the degree of change in the Welsh Government's decision-making power and capacity to devise and finance policies within its jurisdiction. On the other hand, the application of fiscal decentralisation in Wales remains limited and there is an imbalance between devolved spending responsibilities and revenue-generating opportunities.

In general, decentralisation in the UK is low compared to other OECD countries when measured by subnational government contributions to GDP and total tax revenue (the higher the contribution, the more a country is considered to be decentralised) (Figure 4.2). Within the UK, the degree of fiscal devolution varies among the devolved nations. Since Northern Ireland, Scotland and Wales obtained their own elected assemblies and government in 1999, various degrees of "devolved" powers³ were granted to each. With time, the devolved institutions in Scotland and Wales have taken on greater powers, compared to Northern Ireland where devolution was suspended several times. Scotland has full legislative powers over a wide range of policy areas, whereas in Wales these are more limited, focused mainly on secondary legislation (OECD, forthcoming^[9]). This is one explanation, for example, as to why Scotland's score on the abovementioned RAI grew more than that of Wales in the same period. Like Wales, Scotland began with a score of 2.0 in 1990, which, in 2016, was 20.5 (compared to 17.5 in Wales) (Hooghe et al., 2016^[10]). The difference between Scotland and Wales is attributed to Scotland's higher ranking in indicators related to institutional autonomy (*vis-a-vis* the UK government), the capacity to set the base and rates for major taxes

and the degree of independence of the region's legislature and executive. Such imbalances may exacerbate inequalities among the devolved nations (Northern Ireland, Scotland and Wales) and England.

Figure 4.2. Decentralising and recentralising trends in the OECD over the 1995-2018 period



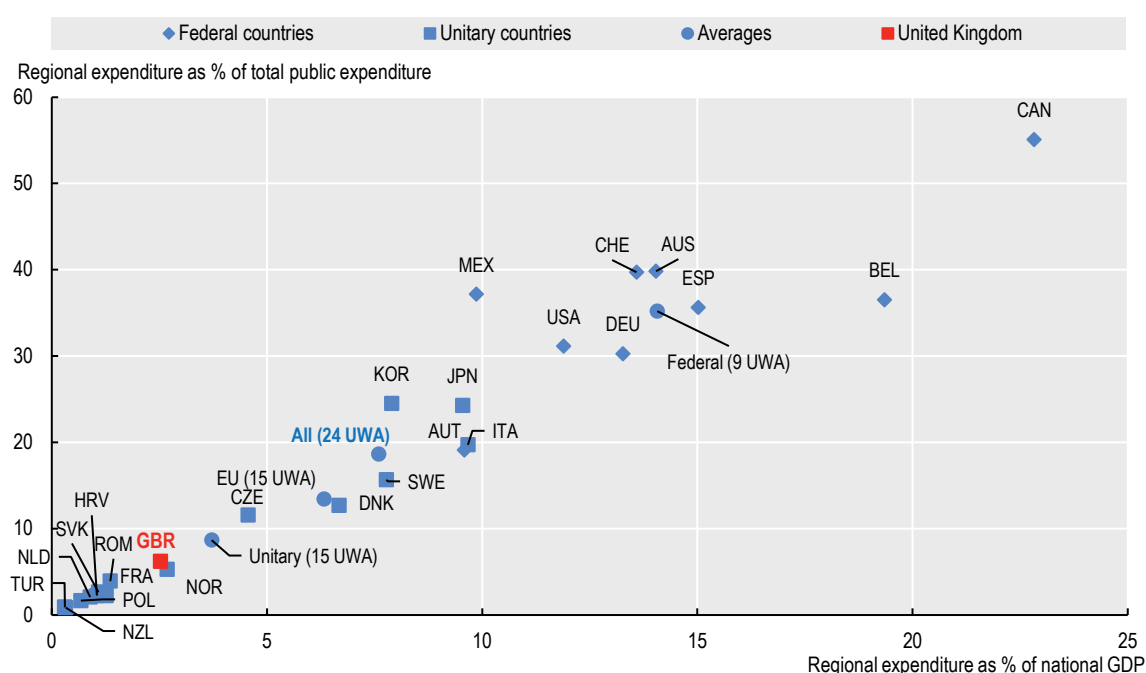
Note: Iceland 1998-2018; Mexico: 2003-18; Japan: 2005-18; Korea: 2007-18. No data for Chile and Turkey due to lack of time-series. For the UK, the subnational government sector does not include the accounts of the three devolved nations (included in central government accounts). OECD30 average is unweighted and does not include Chile, Iceland, Japan, Korea, Mexico and Turkey. Source: OECD (2019^[11]), *Making Decentralisation Work: a Handbook for Policy Makers*, <https://doi.org/10.1787/g2q9faa7-en>. OECD calculations based on OECD national accounts. Data accessed on 23 April 2020.

Within Wales, devolution in spending responsibilities is limited. A spending increase in Wales may not reflect a change in effective responsibility – i.e. decentralisation – because a large share of spending remains undertaken by the UK government.⁴ Thus, a distinction must be made between total expenditure for Wales (including by the UK government) and total expenditure by the Welsh Government and local authorities.⁵ While Figure 4.2 illustrates that decentralisation in the UK as a whole is around the OECD average, when this is broken down and examined at the regional level, the story is slightly different. Figure 4.3 highlights national averages of regional spending. It indicates that the UK's three devolved nations account for a low share of total public spending when compared to regions in the OECD and the EU (OECD, 2020^[12]) – pointing to the fact that actual devolution at the UK subnational level remains low.

Fiscal devolution is also unbalanced between the decentralisation of spending responsibilities and the decentralisation of revenue (i.e. the transfer of revenue-generating capacity versus grants). Decentralising revenue is often less popular with higher levels of government than decentralising spending as it can mean relinquishing income sources. Yet, it appears to be more strongly associated with GDP growth than spending decentralisation and potentially even more so in a context of fiscal gaps (Kim and Dougherty, 2018^[5]; Asatryan and Feld, 2014^[13]). Furthermore, recent empirical evidence indicates that revenue

decentralisation could be associated with smaller regional economic disparities by encouraging growth and convergence dynamics in lagging regions (Bartolini, Stossberg and Blöchliger, 2016^[14]). The Welsh Government and local authorities are responsible for a wide range of service and administrative responsibilities (Annex 4.A), representing a significant amount of expenditure. This is not matched by equally strong revenue devolution (explored below). Care needs to be taken to ensure balanced devolution of spending and revenue responsibilities – and ideally, spending and revenue decentralisation should match (though they rarely do). Otherwise, there is a risk of exacerbating territorial inequalities, including in the accessibility, type, diversity and quality of services that subnational authorities are able to provide, as well as in investment capacity. Approaching fiscal decentralisation in a balanced fashion can help address a fiscal gap, as has been the experience in Belgium (Box 4.2).

Figure 4.3. Regional government spending contributions as a percentage of total public expenditure and national GDP in OECD and EU countries



Note: Data for OECD countries except for the UK are for 2016. Data for the UK are for 2017; data are based on national averages for the regional government sector. In the UK, this corresponds to the three devolved nations and excludes local authorities.

UWA: Unweighted averages for all 24 OECD and EU countries, and separated averages for federal and unitary countries.

Source: Author's calculations based on OECD (2020^[12]), *Pilot Database on Regional Government Finance and Investment: Key Findings*; ONS (2019^[15]), *Country and Regional Analysis*, <https://www.gov.uk/government/statistics/country-and-regional-analysis-2018>; OECD (2020^[16]), *OECD Regional Statistics, Database*, https://stats.oecd.org/index.aspx?DataSetCode=REGION_DEMOGR.

Box 4.2. Balancing spending and revenue decentralisation in Belgium

Belgium's 6th state reform of 2014 marked a major change in the intergovernmental framework by transferring additional responsibilities and strengthening the financial autonomy of Belgium's three regions: the Brussels-Capital Region, Flanders and Wallonia. This reform is a continuation of a process of decentralising decision-making power to the federated entities that began in the 1970s.

This latest reform transferred additional responsibilities to regions in several areas and significantly increased regional own-source tax resources in order to reduce the vertical fiscal gap. Since 2014, the Brussels-Capital, Flemish and Walloon regions can levy a regional personal income tax (PIT) by means of an additional regional tax on the PIT. This tax is in addition to a fraction of the national PIT that is already shared with regions and to 12 other own-source taxes (e.g. registration duties, inheritance and gift taxes, etc.). The fiscal reform also increased the regional tax powers related to tax bases, tax rebates, exonerations and refundable tax credits. Furthermore, the reform transferred additional responsibilities to regions, particularly in the areas of mobility, labour market policy and justice. In parallel, the Flemish and Walloon regions are engaged in local government reforms within their own jurisdictions, aiming to increase the autonomy, scope of action and revenues of municipalities.

As a result of the reform process, the share of the revenue and expenditure of regions in Belgium in terms of GDP increased by slightly more than 4 percentage points between 2010 and 2016, and by 7 and 8 percentage points in total public expenditure and revenue respectively over the same period.

Source: OECD (2020^[12]), *Pilot Database on Regional Government Finance and Investment: Key Findings*; OECD/UCLG (2019^[17]), *2019 Report of the World Observatory on Subnational Government Finance and Investment – Country Profiles*, http://www.sng-wofi.org/reports/SNGWOFI_2019_report_country_profiles_DEC2019_UPDATES.pdf.

Managing a large fiscal gap: Spending responsibilities

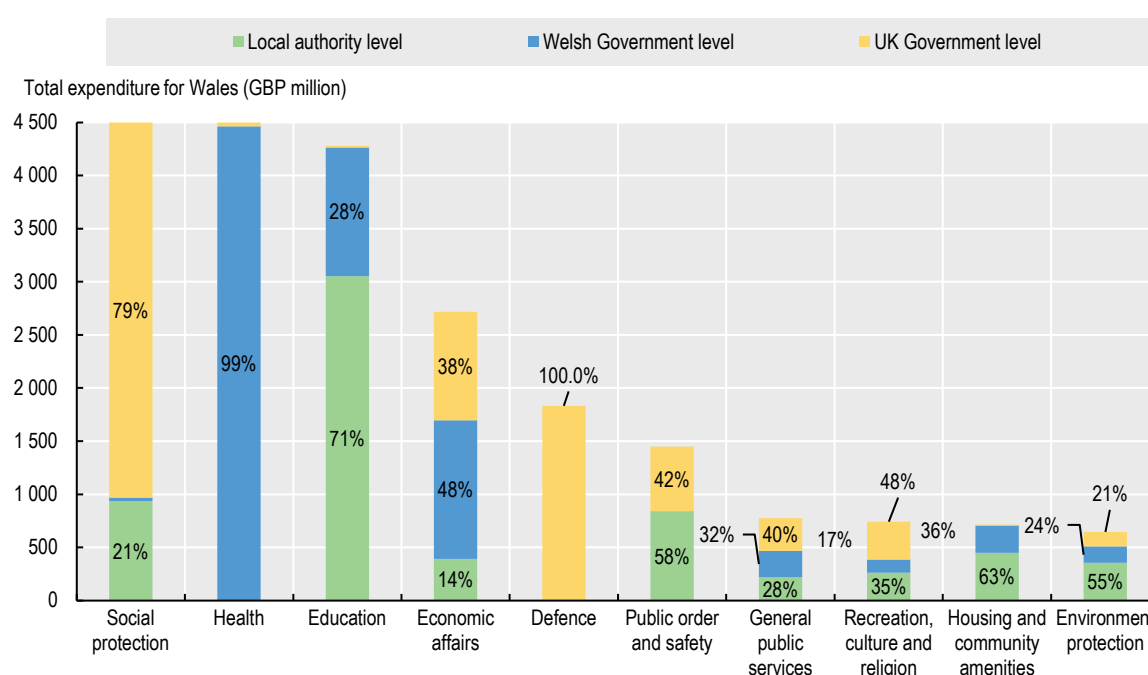
Approximately 60% of total public expenditure on services in Wales⁶ is financed by the Welsh Government and local authorities, with the remaining 40% funded by the UK government (HM Treasury, 2019^[18]; ONS, 2019^[15]). Most expenditure responsibilities are shared among levels of government and the distribution of spending responsibility for Wales is uneven (Figure 4.4). None of this is unusual. In any decentralised system, many tasks are shared to greater or lesser degrees among levels of government. What is striking, however, is the limited level of expenditure in economic affairs, which includes economic development, transport, communications, energy and construction, as defined by the COFOG⁷ classification. In 2017, on average, almost 14% of OECD subnational government spending focused on economic affairs (OECD, 2020^[6]), compared to 9% in Wales (the Welsh government and local authorities combined) for the same year (ONS, 2019^[15]; Welsh Government, 2019^[19]).

In terms of budget allocation, economic affairs accounted for 15% of the Welsh Government budget spending in 2017, compared to 21% on average among regions in EU and OECD countries (OECD, 2020^[12]). This may be one factor contributing to the below-UK-average performance of the road transport network in most Welsh small regions, as well as to the low performance of public transport efficiency and labour productivity in the metropolitan area of Cardiff (Chapter 5). At the local authority level, economic affairs represent 6% of their spending, compared to 12% on average for local governments across the EU (OECD, 2020^[6]). The fact that Welsh local authorities spend less on economic affairs than the Welsh or UK governments (Figure 4.4) is to be expected. Yet, this may signal limited development capacity in key areas that promote their growth. In light of the Welsh Government's regional development agenda, this foreshadows significant future budget pressure on the Welsh Government and local authorities.

Cuts in UK government spending arising from the fiscal and economic crisis and the austerity measures that followed, further strained the Welsh Government's spending capacity. These cuts had an uneven impact on sectors with a role in regional development, such as transport, education and training, environmental protection and in science and technology. Public investment in these areas was below the UK average in 2017 but relatively higher in economic development and public order and safety (Ifan, Siôn and Poole, 2019^[20]). This undoubtedly reflects strategic decisions taken by the Welsh Government in the face of budget cuts. However, it also reflects limited devolution – specifically in those sectors with lower-than-average capital expenditure that are only partially, or not, devolved. Analysis suggests that spending

on UK government programmes that have an incidence on economic development in Wales is significantly lower than comparable spending in England. For instance, capital expenditure by the UK government on new public infrastructure is lower in Wales. This is especially true in transport (76% of UK average) and science and technology (75% of UK average) (OECD, 2019^[11]; ONS, 2019^[15]). From a purely fiscal point of view, unless budget levels and own-source revenue increase post-Brexit, Wales' reliance on transfers for investment in economic development will likely continue, with long-term consequences on investment levels. The strain also affects the sub-municipal level where many town and community councils lack the human resources and/or specialised expertise (e.g. legal or procurement) to expand core service provision or take on the management of public assets. While sub-municipal governments may have reserves and long-term assets, their capacity to manage their spending, along with local taxation, is limited (Auditor General for Wales, 2018^[21]).

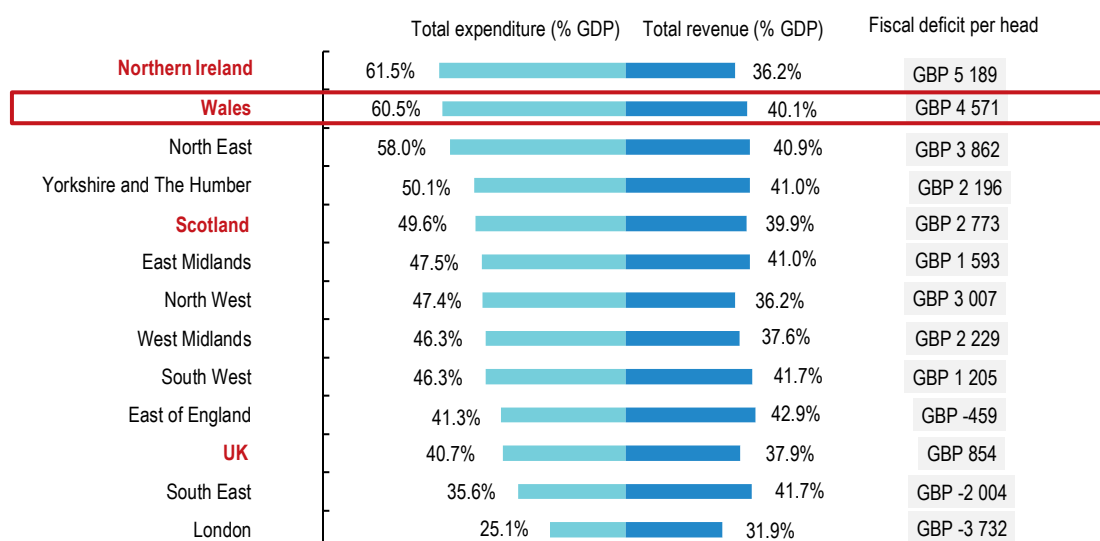
Figure 4.4. Total public expenditure on services in Wales, 2017-18



Note: General public services include common public services only (not including international services and public sector debt interest). Data for defence are primarily composed of non-identifiable expenditure. Social protection includes social protection spending such as state pensions, unemployment benefits, income support and housing benefits. Total expenditure on services (TES) represents total current and capital expenditure, similar to the UK National Accounts measure of total managed expenditure (TME). TES is used for the reporting of functional, economic category and territorial spending. Transfers to other parts of the public sector are not included.

Source: Author's calculations based on ONS (2019^[15]), *Country and Regional Analysis*, <https://www.gov.uk/government/statistics/country-and-regional-analysis-2018>; Welsh Government (2019^[22]), "Responses to OECD Questionnaire, unpublished".

To overcome its fiscal imbalance, the Welsh Government has undertaken a combination of fiscal consolidation measures and reduced public spending, leading to strong austerity effects. This has resulted in a drop in the deficit from 23.5% of GDP in 2013 to 19.4% of GDP in 2017 (Ifan, Siôn and Poole, 2019^[20]; ONS, 2019^[15]). Despite this, in 2017 Wales ranked second in the UK in terms of total public sector⁸ expenditure as a share of GDP. Furthermore, its total public revenue per capita is among the lowest in the UK over the past 20 years, resulting in one of the UK's highest total fiscal deficits per capita (Figure 4.5) (Ifan, Siôn and Poole, 2019^[20]). Given this situation, fiscal consolidation measures are expected to continue. To address this, boosting the Welsh tax base and the relative performance of the Welsh economy is necessary.

Figure 4.5. Total public expenditure and revenue as a percentage of GDP in UK regions, 2017-18

Note: Total expenditure refers to total managed expenditure (TME). Total revenue refers to total current receipts (including North Sea oil and gas revenues by geographic area). Data for each region corresponds to amounts spent or received by the UK government, devolved government (for Northern Ireland, Scotland and Wales) and local authorities in each area.

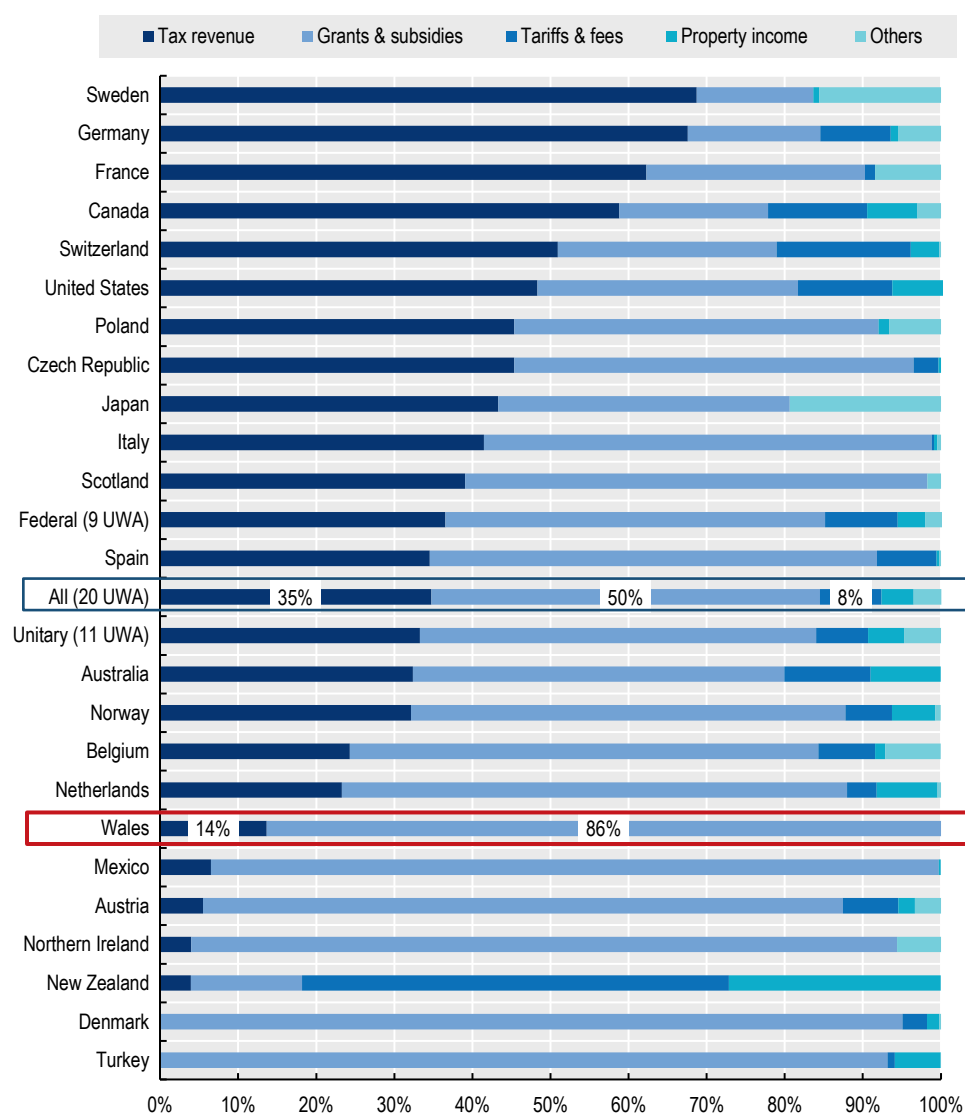
Source: ONS (2019^[15]), *Country and Regional Analysis*, <https://www.gov.uk/government/statistics/country-and-regional-analysis-2018>; OECD (2020^[16]), OECD Regional Statistics, Database, https://stats.oecd.org/Index.aspx?DataSetCode=REGION_DEMOGR

Managing a large fiscal gap: Revenue-generating capacity

One side of the fiscal gap is generated by expenditure requirements. The other is the result of limited revenue or revenue sources. Revenue diversity at the Welsh Government level is low (Figure 4.6). Currently, up to 80% of Welsh Government revenue is composed of a block grant from the UK government (determined by the Barnett formula). An additional 6% of the Welsh Government's total budget comes from specific grants from UK government departments (Welsh Government, 2018^[23]). Investment is mostly funded by grants from the UK government, borrowing and external financing (e.g. EU Structural Funds). Among regional governments⁹ in the EU and OECD, grant revenues account for 50% of total revenue, on average (OECD, 2020^[12]). This relatively high rate of revenue centralisation affects the Welsh Government's fiscal autonomy and limits its ability to spend on its identified expenditure priorities.

The opportunities of the Welsh Government and local authorities to generate own-revenue through taxes, user charges and fees are limited (Figure 4.7). First, the UK centralisation of tax revenue is a constraining factor. Second, the Welsh tax base is low. Third, own-source taxes are limited and new, and fees and user charges are used sparingly. Looking only at the Welsh Government's revenue, devolved taxes – the Land Transaction Tax (LTT), Landfill Disposals Tax (LDT) and Welsh Rates of Income Tax (WRIT) – are expected to account for approximately 14% of its revenue by 2019-20 (Welsh Government, 2020^[11]). While this adds to the revenue base, it is well below what is seen among regional governments in the EU and OECD, where the share of tax revenue as a portion of total revenue averages 35% (OECD, 2020^[12]). Adding to this are fiscal revenues from the Council Tax, and Non-Domestic Rates, collected at the local level. In 2019, in total, tax revenue in Wales represented approximately 17.5% of its total revenue (Ifan, Siôn and Poole, 2019^[20]). This can support greater fiscal autonomy in terms of spending decisions but the level is significantly lower than the 2018 average¹⁰ of 44.4% for subnational governments in the OECD (OECD, 2018^[24]) and does not itself bridge the fiscal gap. The balance between own-revenue (and particularly tax revenue) and expenditure is a factor of political accountability and a key driver for more place-based policies and responsiveness to people's needs (OECD, 2019^[11]).

Figure 4.6. Breakdown of regional government revenue by type in OECD countries, Northern Ireland, Scotland and Wales



Note: Data for Northern Ireland, Scotland and Wales are estimated data for 2019-20. General data for other countries are for 2016, except for Japan (2015). Averages are computed with duplicated 2015 data for Japan in 2016.

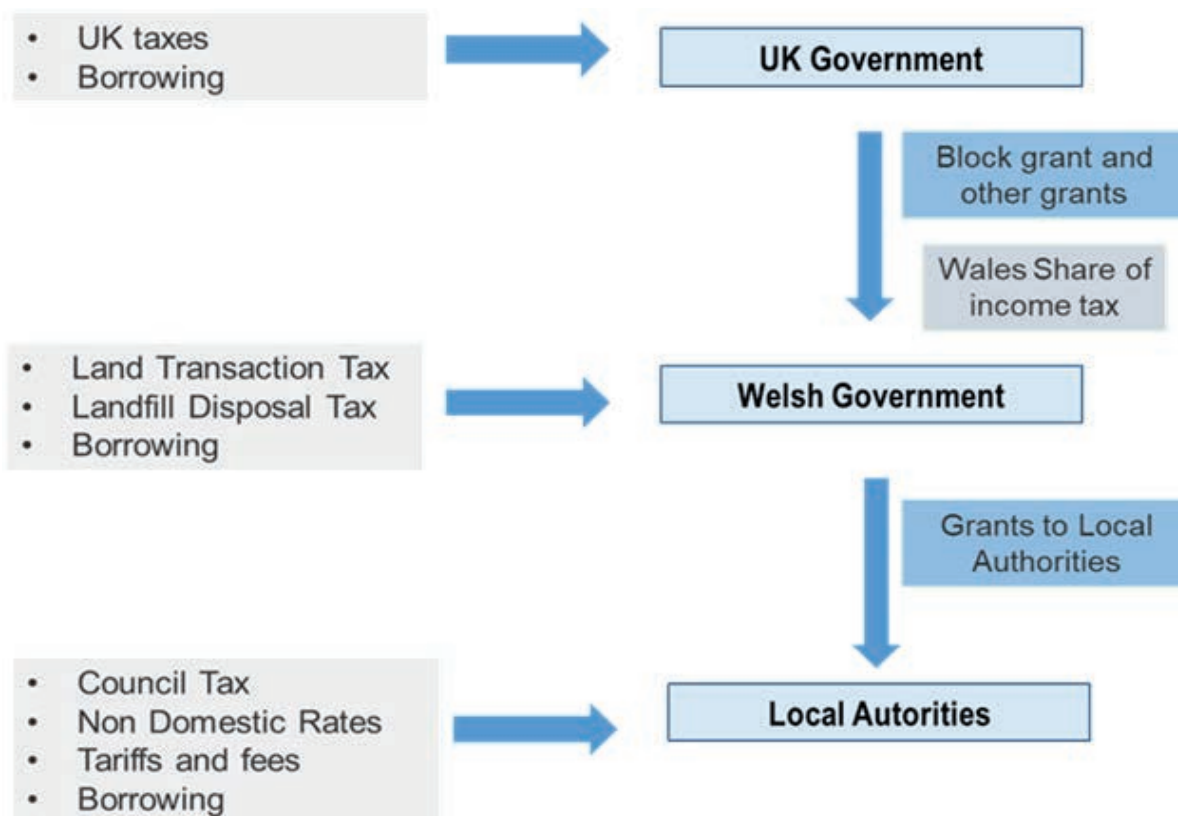
UWA: Unweighted average.

Source: OECD (2020^[12]), *Pilot Database on Regional Government Finance and Investment: Key Findings*; Welsh Government (2018^[23]), *Annual Budget Motion 2019-20*, <https://gov.wales/sites/default/files/publications/2018-12/final-budget-2019-2020-motion.pdf>; Scottish Government (2020^[25]), *Government Expenditure and Revenue Scotland (GERS) 2019-2020*, <https://www.gov.scot/publications/government-expenditure-revenue-scotland-gers-2019-20/>

The Welsh Government's underlying financing principle is to rely first on transfers before resorting to borrowing or other private finance schemes (Holtham, 2019^[26]). This is partly due to the constraints posed by its fiscal deficit and its low share of own-revenue but also because the UK's system of fiscal control caps¹¹ Welsh Government spending. When the Welsh Government does borrow in order to bridge its fiscal gap, most of it is through the UK Treasury's National Loans Fund. The Welsh Government can borrow up to GBP 150 million per year for capital expenditures and carry up to a total of GBP 1 billion in capital expenditure debt at any given time. It can also borrow up to GBP 200 million annually for current

expenditures, with a limit of GBP 500 million indebtedness at any given time (Audit General for Wales, 2018_[27]).

Figure 4.7. Main tax and grant revenue streams in Wales



Note: This scheme is not comprehensive and minor flows are omitted. Other revenue sources include earmarked grants for specific projects, capital grants and external funding for capital expenditure (e.g. EU funds).

LTT = Land Transaction Tax. LFT = Landfill Disposal Tax. Other grants from the UK government to the Welsh government may include, for instance, public sector pensions; HM Treasury allocates ring-fenced funding based on forecasts provided by the devolved administrations.

Source: Holtham, G. (2019^[26]), "Enhancing public investment capacity in Wales, A paper prepared for the OECD report to Welsh government", Unpublished; Adapted from Ifan, G., C. Siôn and E. Poole (2019^[20]), *Government Expenditure and Revenue Wales 2019*, https://www.cardiff.ac.uk/_data/assets/pdf_file/0004/1540498/Government-Expenditure-and-Revenue-Wales-2019.pdf.

The situation for Welsh local authorities mirrors the Welsh Government's dependence on transfers and its limited revenue generation capacity (Table 4.1), as they are heavily reliant on transfers from the Welsh and UK Governments. In 2017, 61% of total local authority revenue came from current grants, including the Revenue Support Grant (RSG, accounting for 56% of total grants) and specific grants (e.g. a housing benefit and police grants, accounting for 36%). The remaining 8% of transfers were capital grants to finance investment (capital expenditures). In addition, Welsh local authorities can raise tax revenue through Council Tax (their main source of tax revenue) and Non-Domestic Rates (NDR).¹² NDR receipts, mainly collected by local authorities, are channelled to the Welsh Government and are then distributed to local authorities through needs-based funding allocations. There are no highly polarised revenue models between the different local authorities as the distribution of NDR has an equalising function. Some additional revenue comes from UK government department-specific grants for non-devolved functions and from capital receipts for financing current and capital expenditure. Capital transfers (i.e. from the UK and Welsh Governments, European Structural Funds and National Lottery funds) and borrowing made up the

bulk of investment financing in 2017-18, followed by own-revenue and capital receipts from the sale of fixed assets belonging to local authorities (e.g. land, council homes).

Table 4.1. Local Authority revenue by category, 2017-18

| | Local currency (GBP thousand) | Percentage of local authority revenue | Percentage of Wales regional GDP |
|--------------------------|----------------------------------|--|-------------------------------------|
| Grants and subsidies | 5 517 295 | 61 | 7.9 |
| Revenue support grant | 3 107 570 | 34 | 4.4 |
| Specific current grants | 1 985 126 | 22 | 2.8 |
| Capital grants | 424 598 | 5 | 0.6 |
| Council tax | 1 192 917 | 13 | 1.7 |
| Non-Domestic Rates (NDR) | 1 002 491 | 11 | 1.4 |
| Tariffs and fees | 1 242 743 | 14 | 1.8 |
| Capital receipts | 79 216 | 1 | 0.1 |
| TOTAL | 9 034 662 | 100 | 12.9 |

Note: Local governments include the 22 unitary authorities. The council tax figure corresponds to amounts to be collected from the council tax, after council tax reductions and discounts. NDR correspond to the share of distributed NDR net of reliefs. Tariffs and fees correspond to total income from services. Capital grants correspond to capital grant and other contributions, including Major Repair Allowances and grants from European Community Structural Funds.

Source: Author's calculations based on Welsh Government (n.d.^[28]), Local Government Finance, StatsWales, <https://statswales.gov.wales/Catalogue/Local-Government/Finance>; OECD (2020^[16]), OECD Regional Statistics, Database, https://stats.oecd.org/Index.aspx?DataSetCode=REGION_DEMOGR

User charges and fees are frequently used by subnational governments in the OECD to generate additional revenue and are quite common at the regional and local levels in Finland, France, Switzerland and the United States (US). Welsh local authorities derive 14% of their revenues from this category, which is aligned with the 2018 OECD average of 15% for subnational governments (OECD, 2019^[11]; StatsWales, 2018^[29]; OECD, 2020^[6]). Generally, subnational governments have significant leeway in the collection of such revenue. They may face restrictions in certain sectors, however, such as in education and energy, (OECD/UCLG, 2019^[30]), and they can also be limited by their own ability to deliver services to which user charges and fees apply.

Despite few financial levers to cope with austerity, over the past decade, Welsh local authorities have strengthened their autonomy. This is evidenced by the reliance of Welsh councils on local tax rate increases to compensate for the reduced RSG (Ogle, Luchinskaya and Trickey, 2017^[31]). The share of tax revenues increased, from 19% for the NDR and Council Tax combined in 2007-08, to 24% in 2017-18, which was mirrored by a decrease in the share of grants received – from 65% to 61% in the same period. However, local authorities that rely more heavily on grants were only partially able to offset the reduction in transfers received from the Welsh Government, based on the revenue they could derive from the Council Tax (Holtham, 2019^[26]). This widened the fiscal gap, particularly for most deprived localities with more limited capacity to collect taxes.

Reducing the fiscal gap at the local authority level is necessary to ensure that local debt can be managed in a sound and sustainable fashion in the future. With the decrease of capital transfers from the Welsh Government since 2008, local authorities increasingly rely on unsupported borrowing and on their own-revenue to fund investment. This increased pressure on their ability to raise future income to pay off their debts. Local borrowing¹³ is mainly composed of prudential or unsupported borrowing (making up 77% of

total borrowing) and supported borrowing (22%), which attracts central government financial support (Audit General for Wales, 2018^[27]; StatsWales, 2018^[29]). The share of unsupported borrowing in local investment funding nearly tripled between 2008 and 2018 (mostly from the Public Works Loan Board). Recently, the cap on local borrowing to build housing was fully lifted in an effort to enhance local-level borrowing capacity. In 2017, local borrowing¹⁴ amounted to GBP 431 million, or 0.6% of Wales' regional GDP (StatsWales, 2018^[29]).

This fiscal gap is expected to be exacerbated in the face of the COVID-19 crisis. In the short term, the crisis is straining subnational spending given demands on public service delivery (Box 4.3). In the medium and longer terms, it will strain revenue for both the Welsh Government and local authorities. In the Welsh context, such setbacks should be financially compensated by similar drops in tax revenue in England and automatic adjustments of the Barnett formula. There are, however, several factors that may exacerbate the crisis' impact in Wales. These include the share of the population that is aged and/or infirm, its reliance on the tourism industry and the large share of small- and medium-sized enterprises (SMEs). An automatic adjustment of UK government transfers through the Barnett formula may not cover the financial impact of the COVID-19 crisis in Wales. To fund its coronavirus response, the Welsh Government has been relying on unallocated funds from the Wales Reserve Fund and reallocating further savings from other areas of the budget (e.g. EU-funded projects). It has also planned to borrow GBP 125 million for capital spending purposes in 2020-21, close to its annual borrowing limit of GBP 150 million. However, current borrowing rules do not allow it to cover the cost of new planned day-to-day spending, including financial responses to COVID-19, through borrowing (Cardiff University, 2020^[32]).

Box 4.3. Managing the impact of COVID-19 impacts on subnational finance

The COVID-19 pandemic and the subsequent economic crisis has a direct incidence on national and subnational government budgets. In the short term, locally delivered public services must be maintained and often adjusted to meet the requirements of the health emergency. In the medium and longer terms, the revenues generated by subnational taxes (e.g. income, property, corporate) will presumably decrease in the years to come. Subnational governments may also suffer from a strong decrease in user charges and fees, resulting from the decline or closure of numerous public services and facilities.

These setbacks are common to countries across the OECD and beyond. The pressure of the crisis on subnational government finance depends on a series of factors: the exposure of each location to COVID-19, the fiscal flexibility of subnational governments to absorb the exceptional stress, the existence of rainy-day funds or set-aside reserves, and the scope and efficiency of support policies from higher levels of government. The OECD has listed a range of measures that subnational governments can implement in the short, medium and long terms to face these challenges:

- Short-term measures to adapt subnational finances to the emergency can include increasing health- and social-protection-related public expenditure, postponing (national) account closures as well as the adoption of next year's budget.
- In the medium term, subnational government priorities should be focused on managing the economic, social and public finance crisis. This includes developing policies to compensate subnational revenue drops and help subnational governments cope with large expenditure increases arising from greater demand for social benefits, support to vulnerable groups, the general economic recovery, etc. It also means addressing a potential subnational debt crisis and anticipating a fiscal exit strategy.
- In the long term, subnational policies might need to focus on increasing the resilience of social and economic systems, to ensure preparedness for future shocks. Financially, this could mean

increasing investment in healthcare and other public services. It could also lead to rethinking multi-level governance and financing systems to make them more robust.

Note: The report on which this box is based was released in early April 2020. It does not take into account the development of the COVID-19 crisis or responses past that time.

Source: OECD (2020^[33]), "The territorial impact of Covid-19: Managing the crisis across levels of government", <https://www.oecd.org/coronavirus/policy-responses/the-territorial-impact-of-covid-19-managing-the-crisis-across-levels-of-government/>.

Addressing the fiscal challenges: From territorial equalisation to building local financial management capacity

The limitations arising from the Welsh Government's fiscal framework combined with a need to ensure long-term, place-based investment makes optimising its fiscal opportunities imperative (e.g. by reconsidering its equalisation system and expanding own-source revenue). A stronger fiscal framework would provide a more resilient foundation for leveraging access to external financing and enhancing Welsh national and subnational capacity to invest in regional development.

Striving for territorial equalisation

Equalisation policies help address disparities generated by differences in revenue-raising capacity and differences in public service expenditure (Box 4.4). In the first category, unequal tax-raising capacities come from differences in per capita GDP across jurisdictions. In the second, they are linked to specific geographic factors (e.g. mountains, islands, isolated or low-density areas, etc.) or special groups such as children, the elderly, the disabled, etc. that can contribute to a higher cost per service unit, raising the overall cost of public services. In most instances, the effect of equalisation on managing fiscal disparities among subnational governments is substantial across the OECD. For example, across OECD countries, it has diminished fiscal disparities from 29% to 10% (as measured by the Gini coefficient or variation coefficient). Furthermore, it has helped countries such as Australia, Germany and Sweden virtually eliminate revenue-raising disparities (OECD, 2019^[11]; 2013^[34]).

Box 4.4. The pros and cons of fiscal equalisation mechanisms

Equalisation mechanisms can be applied through transfers from the central/federal government to subnational governments that are financially weak (vertical transfers) or through horizontal from the wealthiest subnational governments to the poorest (horizontal transfers), or both. Equalisation schemes also aim to establish national standards that ensure equal access to local services and a minimum level of quality for local public service provision. While most OECD countries use various equalisation arrangements that combine horizontal and vertical equalisation with tax revenue and cost equalisation, vertical equalisation tends to prevail. However, equalisation is frequently the subject of technical and political debate and is often contested for its complexity and lack of transparency. An additional concern, particularly with respect to horizontal equalisation, is that it can reduce subnational government incentive to develop its own-tax base among the poorest and wealthiest local authorities. This is because poorer local governments may rely too heavily on the grant system to provide an adequate revenue base and wealthier ones may be reluctant to develop their tax base if they feel they will insufficiently benefit from the revenue generated.

Source: OECD (2019^[11]), *Making Decentralisation Work: a Handbook for Policy Makers*, <https://doi.org/10.1787/g2g9faa7-en>; Blöchliger, H. et al. (2007^[35]), "Fiscal equalisation in OECD Countries", <https://www.oecd.org/ctp/federalism/39234016.pdf>.

Given the territorial disparities in the UK, including in Wales, and the associated impact on spending and revenue-generating capacity, additional consideration should be given to using equalisation arrangements to address these. This is just as true between the UK and the Welsh Governments, as it is between the Welsh Government and local authorities. In the UK, revenue allocation to the three devolved nations aims to guarantee similar levels of public services. It is calculated using the Barnett formula, which is based on increases in spending incurred by the UK government in England and then redistributed to Northern Ireland, Scotland and Wales, based on population shares. At the Welsh local authority level, intergovernmental transfers are based on a Standard Spending Assessment (SSA) for each service area across local authorities (Box 4.5) (Holtham, 2019^[26]). As part of the 2019-20 settlement, the Welsh Government provided additional top-up funding to ensure no authority faced a reduction of more than 0.3% (Welsh Government, 2019^[36]).

Box 4.5. Calculating transfer allocations to the Welsh Government and local authorities

The Barnett formula for Northern Ireland, Scotland and Wales

Most of the UK government funding allocated to the devolved administrations is determined through the Barnett formula (applied since 1978 in Northern Ireland and Scotland, and 1980 in Wales). Each devolved administration's block grant is calculated by taking the previous year's grant and adding a population-based share of the changes in planned UK government spending on those comparable functions and services that have been devolved. This aims to ensure that the devolved administrations receive a population-based share of any changes in what the UK government is spending on the public services in England that are devolved in Northern Ireland, Scotland and/or Wales. It is estimated, however, that the formula tends to reduce the Welsh grant relative to English spending over time, because of higher expenditure per head in Wales than in England. Therefore, increments per head result in a smaller proportion of the Welsh grant than of English expenditure on the same items.

The formula was amended twice in recent years to adjust to the Welsh context. The first amendment was in 2015 and introduced a "funding floor". This was in response to the findings and recommendations of the Holtham Commission, which reported that Wales needed additional funding in recognition of its more dispersed population and greater prevalence of poverty. This funding floor should ensure that block grant funding for the Welsh Government does not fall below 115% of equivalent funding per head in England. In reality, this threshold has only been crossed twice since devolution (in 2008 and 2009). At present, Wales gets around 120% funding per head. The formula was amended a second time in 2017, following the devolution of fiscal powers to the Welsh Government. The Welsh Government's block grant was reduced to reflect the fact that revenues from devolved and partially-devolved taxes now go directly to the Welsh Government rather than the UK Exchequer. At the same time, a needs-based factor was included in the Barnett formula providing the Welsh Government with an additional 5% on top of new allocations. This needs-based factor will be increased to 15% if the relative funding position falls to 115% of equivalent funding per head in England.

The Standard Spending Assessment (SSA) for Welsh local authorities

Intergovernmental transfers for Welsh local authorities are made through the Revenue Support Grant (RSG), whose calculation is based on a SSA for each service area. SSAs are intended to reflect variations in the need to spend which might be expected if all authorities responded in a similar way to the demand for services in their area. The SSA is conducted annually based on three elements: i) the allocation of distributed Non-Domestic Rates (NDR), based on the population; ii) Council Tax income, based on a standard council tax figure, multiplied by the number of chargeable dwellings within the

authority; iii) a “balancing” sum, which tops up the amounts available from NDR and Council Tax, and enables an authority to spend its SSA.

Source: Audit General for Wales (2018^[27]), *Guide to Welsh Public Finance*, <https://www.audit.wales/system/files/publications/guide-to-welsh-public-finance-english.pdf>; Holtham, G. (2019^[26]), “Enhancing public investment capacity in Wales, A paper prepared for the OECD report to Welsh government”, Unpublished.

There are three main arguments for rethinking the Welsh fiscal equalisation system. First, the RSG tends to weaken the incentive for business development in a given local authority. Conversely, Non-Domestic Rates could have the potential to provide them with a significant instrument for local economic development. Second, it is estimated that equalisation grants do not sufficiently support the local authorities in rural, more sparsely populated areas (e.g. Powys), putting them at an even greater disadvantage due to their specific needs (OECD, 2019^[37]). Third, an equalisation system is fundamental for ensuring that greater decentralisation does not lead to greater territorial inequalities at the local and regional levels.

These arguments favour striking a new balance between fiscal incentives and fiscal equalisation in Wales. This is a problem encountered by many countries wishing to reduce or eliminate subnational disparities in fiscal capacity (Chan and Petchey, 2017^[38]). The OECD recommends designing and implementing equalisation policies that help promote balanced development throughout a territory, as long as the transfers advance the tax and development efforts of subnational governments (OECD, 2019^[11]). Equalisation mechanisms can be designed to only capture a part of subnational tax revenue in order to reward policy efforts and to unlock additional benefits for local authorities that engage in local development policies. Some countries have also opted to disentangle grants that serve several purposes at once and develop separate ones, for instance for subsidising services (Blöchliger and Kim, 2016^[39]).

Fiscal equalisation cannot meet both equity and efficiency targets in isolation, particularly when it comes to addressing territorial disparities. It should be accompanied by regional development programmes with allocations based on regional performance and needs (OECD, 2019^[11]). Monitoring mechanisms to report on the impact of equalisation on inequality and other economic outcomes are important in order to support such a system (OECD/KIPF, 2019^[40]; Blöchliger et al., 2007^[35]). Estonia’s system of revenue equalisation is relatively recent and tries to combine equity functions and fiscal incentives. Germany and Norway have developed strong fiscal equalisation systems that tend to enhance local tax incentives by focusing on vertical redistribution and partial equalisation of local tax revenue (OECD/UCLG, 2019^[17]).

Optimising user charges, receipts and borrowing

Welsh local authorities have discretionary power to set fees for a selected range of services (e.g. leisure, parking, cremation and burial), yet they tend to avoid doing so. This links to a philosophy of universalism in provision of public services (Holtham, 2019^[26]) that prohibits local authorities from charging more than the cost of provision in some areas (e.g. taxi licensing, building control fees, local land charges), or charging at all in others (e.g. children’s social care, household waste collection, library book provision and lending). It also results in fees set by the Welsh Government with little local discretion (e.g. adult social care, fees for planning applications and alcohol and entertainments licences) (Thomas, 2016^[41]). Easing these constraints would enable local authorities to set new fees as income-generating opportunities. For instance, the use of congestion charges has been rejected several times, while it could constitute a useful measure not only for cities like Cardiff and Swansea, but also for national parks (e.g. the Brecon Beacons and Snowdonia).

Another possibility is to facilitate the development of commercial instruments to generate additional income, an approach being used by English local authorities (Thomas, 2016^[41]). Although the power does not yet exist in Wales, it is mentioned in the proposed Local Government and Elections (Wales) Bill. This

could give more flexibility to local authorities to raise revenue from local services. Moreover, fees set at the national and UK levels are often less reflective of the true cost of running services, whereas giving more power to local authorities in this area could prove more effective (Thomas, 2016^[41]). Greater powers to set tariffs and fees can also encourage local authorities to improve their own performance in monitoring and evaluating public service delivery and the potential income this can generate.

Local authorities also receive capital receipts from the sale of fixed assets (e.g. land, council homes, etc.), which are dedicated to financing capital expenditure. A Welsh Government directive extended the use of capital receipts over the 2016-22 period (Welsh Government, 2018^[42]). Some local authorities, such as Powys, have already developed a capital receipt policy to optimise this new revenue opportunity (Powys County Council, n.d.^[43]). It would be important to consider extending this possibility into a longer-term option (i.e. beyond 2022) and making it available to other public bodies, such as Partnership Boards.

Introducing higher and less restrictive borrowing limits could also address fiscal challenges. Based on the revenue from devolved taxes and income tax rates, which will generate approximately GBP 2.4 billion annually in the years to come, one could reassess the borrowing capacity of the Welsh Government (currently set at GBP 1 billion) up to a certain prudential share of this amount (Holtham, 2019^[26]). The Welsh Government provides revenue support to local authorities for borrowing costs incurred to fund capital schemes, as long as the schemes align with the Welsh government's objectives (e.g. highway maintenance, part of the 21st Century Schools Programme).¹⁵ Additionally, more flexible use of Financial Transactions Capital (FTCs) (capital transfers from the UK government), which make up around 14% of the Welsh government capital resources, could also ease access to borrowing and loan repayment. FTCs are currently restricted to loan and equity investment in the private sector, and a part must be repaid to the UK government. However, FTCs could have a broader fiscal impact if they could be used to lower interest on loans (Holtham, 2019^[26]). This approach has been taken by the Development Bank of Wales (National Assembly for Wales, 2019^[3]). The COVID-19 crisis renders these considerations even more urgent and calls for exceptional measures to enable subnational governments to meet their expenditure requirements, including through greater use of their borrowing powers (OECD, 2020^[33]; 2020^[44]).

Shifting towards a new tax policy framework

The Welsh Government recognises the need to shift away from a grant-dependent system towards enhanced own-source revenue, and updating the tax policy framework – particularly in its design and implementation – can help achieve this. As a step in this direction, the Welsh Government launched its Tax Policy Framework, based on five principles (Welsh Government, 2017^[45]): i) raise revenue to support public services; ii) deliver policy objectives, particularly to support jobs and growth; iii) be simple, clear and stable; iv) be developed through collaboration and involvement; and v) create a more equal Wales.

To achieve these principles, reliable forecasts are necessary. A few years into the process, it remains difficult to assess the impact of fiscal devolution on the Welsh economy as well as on the impact of its fiscal policies. Aligning the statistical methodology among the devolved nations, and increasing collaboration among them, as well as with the UK's Revenue and Customs body, the Office for Budget Responsibility, and the Scottish Fiscal Commission could be valuable (ONS, 2019^[15]). Enhancing the collaboration among such bodies with the Welsh Government, including the Welsh Revenue Authority (WRA) could also help to generate quality data on Welsh devolved revenue.

There are plans to enhance fiscal decentralisation among Welsh local authorities as a means to encourage them to promote local economic growth, place-based policies and financial self-sufficiency. Addressing the design of the Council Tax and Non-Domestic Rates could be part of a comprehensive review of the local government funding system, particularly as further adjusting the UK/Welsh devolution settlement may not be a viable option at this time.

The margin for manoeuvre with the Council Tax appears relatively narrow due to the low tax base in many local authorities, in particular those experiencing population decline or stagnation (Chapter 3), and the

already high rates in response to the decline in transfers (Holtham, 2019^[26]). Despite this, consideration is being given to several aspects of the Council Tax to make it more effective, including revaluation and more buoyancy, updating tax bands and the progressivity of the tax rates, and collection efficiency and accountability. In the face of growing needs and the perspective of greater powers devolved to local authorities, it is necessary to determine how and when to put these considerations into practice. In addition, an increase in the share of local tax revenue usually goes hand in hand with enhanced accountability and better financial management (Blöchliger, Bartolini and Stossberg, 2016^[46]). One way to accomplish this is by improving the standardisation and regularity of national and local public finance statistics.

The design of the Non-Domestic Rates (NDR) is also being reconsidered. Currently, the system does not provide specific incentives for using NDR to pursue policies supporting businesses or to favour commercial development. This is despite legislation that permits such actions. The finance minister has invited local authorities to come forward with proposals for taking a gain-share approach to increasing rates revenues – with a limited response (OECD, 2019^[37]). The case for reforming the NDR to boost local resources relates to the English model of business rates retention. Through this model, English councils retain 50% of their rates revenues including the rates growth element. This reasoning, however, has to be tempered by other reports that point out the negative consequences of such a reform. Furthermore, past analysis of this scenario in Wales suggested that such a scheme would only generate small own-revenue gains (Holtham, 2015^[47]). Yet, this option could be advanced by progressively devolving NDR retention to subnational structures with sufficient human resource and financing capacity. As a new revenue stream, this would enable financing specific development projects and generate funds for further investment.¹⁶

Another option under discussion is diversifying the range of newly devolved taxes to include a vacant land tax, a social care levy, a disposable-plastic tax and a tourism tax. All of these could help sustain quality local services. International experience shows that among these options, tourist taxes are particularly successful at the local level and tax receipts could directly support the growing tourism business in Wales.¹⁷ Over the last 15 years, there has been a general increase in the number and scope of tourism-related taxes, fees, charges in the EU and OECD (Box 4.6) (OECD, 2014^[48]).

Box 4.6. Tourist taxes, fees and charges: Examples from OECD countries

Tourist taxes, fees and charges are quite common in OECD countries. Although generally small, tourism taxes can complement local government revenues. Tax collection mechanisms vary across countries and they are levied on a variety of bases (“per person, per night”, “per room, per night”, or as a proportion of room costs). They are generally administered at the subnational (primarily municipal) level and tourist tax receipts can be shared between regional and municipal bodies (as practised in Spain) or with other public bodies.

Greece introduced an Overnight Stay Tax in January 2018 to help reduce public debt. Visitors pay the tax to hotels and accommodations. In January 2019, Japan introduced a “sayonara tax” (paid by international visitors when they leave the country), whose revenue will contribute to Japan’s tourism infrastructure before the 2020 Summer Olympics in Tokyo. New Zealand introduced an International Visitor Conservation and Tourism Levy (IVL) in July 2019. Collected through visa fees and via the new Electronic Travel Authority, the levy supports environmental conservation and the development of tourism infrastructure. Scotland has recently introduced legislation allowing municipal governments to levy a tourist tax. This follows an extensive consultation exercise started in late 2018 and still underway (legislation is not expected until 2020-21).

Source: OECD (2016^[49]), *OECD Tourism Trends and Policies 2016*, <https://dx.doi.org/10.1787/tour-2016-en>; OECD (2019^[50]), “OECD Interviews in Cardiff 24-28 June”, OECD, Paris; OECD/UCLG (2019^[17]), *2019 Report of the World Observatory on Subnational Government Finance and Investment – Country Profiles*, www.sng-wofi.org/reports/SNGWOFI_2019_report_country_profiles_DEC2019_UPDATES.pdf.

Increasing local financial capacity by working in partnership

Empowering Welsh local authorities as autonomous fiscal and financial actors can also contribute to redressing fiscal framework challenges. Increasing their own-source revenue and encouraging them to borrow to finance their investment, however, puts a spotlight on their administrative and financial management capacities, including for investment. Financial management capacity – the ability to ensure the effective use of internal and external resources with integrity (including cash management, proper costing and budgeting, transparent procurement processes, internal controls and internal and external audits) – is an essential lever for increasing subnational government fiscal autonomy (OECD, 2019^[11]).

Pooling resources to deliver services, sharing costly administrative functions and sharing specialised expertise (e.g. to support innovative financing mechanisms, technical financing instruments, or land-based finance) frees revenue for other expenses, thereby contributing to greater fiscal capacity. This can be supported through inter-municipal co-operative arrangements (OECD, 2017^[51]; Forman, Dougherty and Blöchliger, 2020^[52]). There are several, positive experiences among Welsh local authorities that have joined forces to co-operate in financing functions. For example, the Conwy and Denbighshire county councils (who already share a joint Public Service Board) proposed to jointly implement and manage a financial ledger and other financial systems. Several other local authorities (e.g. Bridgend and Vale of Glamorgan, Rhondda Cynon Taff and Merthyr, and Monmouthshire and Newport) are also sharing internal auditing services. Furthermore, partnerships have been organised around procurement functions, including a pilot between Carmarthenshire and Pembrokeshire, Joint Head at Flintshire and Denbighshire, and also a Regional Contractors Framework in South West Wales (Welsh Government, 2019^[19]). This type of collaboration should be encouraged as a means to help build necessary fiscal and financial management capacity. It is all the more important in times of crisis and austerity, as a collaboration between local authorities themselves can help mitigate the costs when it benefits all local authorities within the region (Downe and Taylor-Collins, 2019^[53]).

Part 1: Conclusions and recommendations

Fiscal settlements between Wales and the UK pose a number of challenges for the Welsh Government. Spending and fiscal devolution remain partial, limiting the ability of the Welsh Government and local authorities to cope with a significant fiscal gap. In addition, after years of austerity, transfers throughout the fiscal system have declined, while the tax base has remained low. Combined, this has undermined own-source revenue-generating capacity at the national and subnational levels in Wales. In the early days of fiscal devolution and post-Brexit, it is important to closely observe and monitor the progress being made in terms of sustainability of own-source revenues, at both the Welsh Government and local authority levels. It is expected that fiscal resources will remain relatively low compared to other OECD countries, putting Wales in an ever more constrained situation. To address these fiscal challenges, the Welsh Government must consider optimising revenue sources as a whole. Proposed fiscal reforms could offer some limited relief through slight revenue increases, and contribute to increasing financial management capacity of the Welsh Government and local authorities. To maximise the benefits of fiscal devolution, however, a stronger fiscal framework will be necessary – one that not only includes the modest ability to raise own-source revenue but also additional access to borrowing and a diversified revenue base.

Box 4.7. Recommendations for strengthening the Welsh fiscal framework

1. Optimise the Welsh Government's capacity to reduce its fiscal gap and improve fiscal health

- Expand spending devolution to the extent possible, making sure shared responsibilities for economic development are clear among levels of government.
- Diversify Welsh own-revenue sources and make use of existing fiscal levers (e.g. tax rates, user fees, etc.) to fill the fiscal gap.
- Strengthen the fiscal management capacity of the Welsh Government and local authorities, including by monitoring revenue-raising capacity in order to produce long-term fiscal forecasts.
- Encourage local authorities to pool resources and work in partnership to build their administrative and financial capacity.

2. Further reform the subnational fiscal framework to increase own-revenue

- Optimise and diversify local taxes and tax bases to increase own-revenue among local authorities (e.g. vacant land tax, Non-Domestic Rates retention and tourist taxes).
- Review the fiscal equalisation system to reduce territorial disparities, support local authorities with a low tax base and encourage local economic development.
- Ease borrowing restrictions for the Welsh Government and local authorities, and make them more flexible, in order to help address fiscal challenges in the short and medium terms.

Part 2: Investment frameworks to support regional development in Wales

Since the advent of devolution in 1997, the Welsh Government has placed investment for regional development at the heart of its policy framework (Welsh Government, 2017^[54]). This came at a time of difficulty, however. The economic and financial crisis, in addition to structural challenges related to industrial transition and ageing, severely affected the capacity of the Welsh Government and local authorities to meet investment needs, especially in key development sectors such as education, transport, infrastructure and telecommunications (Ifan, Siôn and Poole, 2019^[20]). Over this period, European Structural and Investment Funds (ESIF) have helped Wales make up for an investment financing shortfall and meet its capital expenditure requirements by actively supporting a regionally-based investment approach. The Welsh Government has also built strong investment management capacity within its departments. Moving forward, as Brexit foreshadows a reshaping of the system for financing investment in regional development, ensuring sufficient financial capacity and effective mechanisms is even more critical for the Welsh Government to implement its ambitious development agenda of growth plus inclusiveness.

It will be important to continue building on Wales's significant experience in managing and administering investment funds. It will also be important to identify additional mechanisms that help maximise limited resources and public investment capacity in order to meet regional development objectives. This section explores the importance of an integrated approach to investment across sectors and among levels of government. It then moves on to examine how strengthening capacities and expertise can support place-based investment by all levels of government post-Brexit. Finally, it examines the potential for Wales to use innovative financing mechanisms to help fill its investment gaps. The section concludes with a series of recommendations to better support the Welsh Government and local authorities invest in regional growth, productivity and well-being.

Developing a coherent investment framework for regional development in Wales

Until now, Wales has managed two investment streams for implementing its regional development agenda: one from its own budget and a second from EU funds. Public investment (capital expenditure) by Welsh departments is financed from the Welsh Government's general budget. Public investment linked to EU programming and financed through EU funds is managed by the Welsh European Funding Office (WEFO). In addition to this, a significant share of investment targeted to regional economic activity takes place or is planned through the City and Growth Deals. These all contribute to regional development – the challenge is to ensure this is done strategically and coherently to maximise effectiveness. To accomplish this, reviewing the investment co-ordination structure with relation to Brexit, strengthening investment practices and building on the experiences of City and Growth Deals would be valuable. Finally, finalising and implementing the proposed National Framework for Investment can help align these different opportunities and priorities to better serve regional development.

Reviewing the investment co-ordination structure with relation to Brexit

The Welsh Government is confronted with rethinking the structure for investment co-ordination in a context where its future financial capacity is uncertain, post-Brexit and due to the COVID-19 crisis (O'Brien and Pike, 2018^[55]). At present, the Welsh Government's investment budget, powered by transfers, is prepared on the basis of funding forecasts for investments made by the UK government. Since 2000, European Structural and Investment Funds (ESIF),¹⁸ and especially European Regional Development Funds (ERDF) and European Social Funds (ESF), have sustained additional Welsh regional development financing (Welsh Government, 2017^[54]). In light of Brexit, it is expected that the UK government will establish an intended replacement for European funding (Box 4.8).

Box 4.8. Financing regional development in Wales: The intended replacement for European funding

The terms and conditions governing the intended replacement for European funding remain uncertain. A key question is whether this fund will be allocated to and administered by the Welsh Government, or whether the UK government will choose to deal directly with local or regional bodies (which may circumvent the devolution agreement between the UK and Wales). An additional question remains: will the intended replacement for European funding operate on a multi-year or annual basis?

In keeping with the structure of EU funds, the Welsh Government and its partners strongly advocate a replacement that is based on multi-annual funding. This facilitates medium and long-term investment programming and planning that can be necessary for large and costly infrastructure projects. It also advocates retaining autonomy over how the funds are spent, as per its devolution agreement. When allocating investment funds to support balanced regional development, it would be important to consider specific criteria, including differences in population growth, or the initial levels of funding received via ESIF (for instance, this could be achieved through an Indexed Per Capita (IPC) formula). Further criteria may be also used, such as local and regional socio-economic characteristics, in order to have a more distributed approach.

The UK government might allocate regional development funds on a competitive, auction principle, thereby spurring more competition across regions and local authorities. This would redefine the conditions of eligibility of UK regions and, consequently, the financing amounts received by Wales.

Source: National Audit Office (2019^[56]), *Investigation into Devolved Funding*, <https://www.nao.org.uk/wp-content/uploads/2019/02/Investigation-into-devolved-funding.pdf>; Holtham, G. (2019^[26]), "Enhancing public investment capacity in Wales, A paper prepared for the OECD report to Welsh government", Unpublished; Regional Investment Project Steering Group (2019^[57]), *A Wales Regional Investment Policy for the Future*, <https://gov.wales/sites/default/files/publications/2019-09/a-wales-regional-investment-policy-for-the-future.pdf>.

It is unclear how the intended replacement fund for European funding will be regulated, allocated and distributed, affecting the capacity of the Welsh Government to undertake long-term and medium-term planning. To manage this uncertainty, a new investment strategy has to be sufficiently flexible to evolve together with the country's governance structure and rules post-Brexit. One essential condition for the Welsh Government to plan a coherent investment strategy is a multi-annual approach to regional development funding. It provides necessary stability and reassurance for investors and long-term investment planning. Understanding the difficulties that arise from the devolution settlement between Wales and the UK, it would also be important for the Welsh Government to undertake a long-term approach to investment based on its own budget sources. Multi-annual funding also offers visibility and predictability with respect to resource availability, particularly for financing long-term and high-value projects, such as large infrastructure. This can help ensure that investment is effectively channelled throughout Wales, regardless of political events (Spackman, 2002^[58]). For instance, the Dutch Multi-Year Programme for Infrastructure, Spatial Planning and Transport (MIRT) features what it calls "adaptive scheduling", a method for allowing more flexibility in finding a collective solution to problems that may arise over the course of investment project implementation (Dutch Ministry of Infrastructure and Water Management, 2018^[59]).

A shift away from European funding for regional development investment also calls into question the future role and function of the Welsh European Funding Office (WEFO).¹⁹ WEFO has administered EU funds until now, playing a crucial role in co-ordinating EU investment for regional investment. Over the course of the three last EU programming periods, it has amassed extensive knowledge and experience in managing

and administering large sums, complex projects and diverse stakeholders. It has developed strong expertise in portfolio development, project management and project assessment, as well as effective monitoring, control, verification and record-keeping functions. Moreover, since it works closely with the Welsh Government departments, it has a track record in fostering cross-sector relationships, helping align policies and supporting the investment needs of diverse policy sectors (Auditor General for Wales, 2018^[4]; Holtham, 2019^[26]; Welsh Government, 2019^[19]).

To co-ordinate future public investment for regional development in Wales, the Welsh Government may wish to transition WEFO into an investment funding office for regional development that undertakes similar functions as WEFO and maintains its location in the office of the First Minister. These activities would include ensuring that investment decisions are aligned with regional development strategy/objectives and that the input of subnational, private, third-sector and other stakeholders is considered. It would be responsible for managing EU replacement funds through the National Framework for Regional Investment in Wales (proposed).

The new structure will need to make sure sector-driven investment that draws on the investment funds is integrated or, at a minimum, coherent across relevant policy sectors and with national development objectives. Beyond this, it could also facilitate a cross-sector co-ordination function. The Welsh Government could, for instance, extend the scope of policy sectors funded through the future fund for regional investment by including rural policies and health,²⁰ two sectors that were addressed through separate EU funding streams (OECD, 2019^[50]). Furthermore, it should also maintain its monitoring function and support regional-level or subnational investment (e.g. to realise Regional Economic Frameworks). In that sense, it would be important that such a body remain independent of departments in order to maintain an oversight/co-ordination role for the full investment cycle. It could easily partner with, complement, or evolve into a structure responsible for regional development thereby improving the co-ordination between strategic planning and investment implementation. Mechanisms for co-operation for regional development are further developed in Chapter 5 of this report.

Building on existing investment financing practices and introducing new ones

The current moment presents a *tabula rasa* to Wales in terms of its investment framework. It has a unique opportunity to adjust investment conditions that have been considered weaker while maintaining those that have worked successfully. To some extent, this is already underway. For example, Wales can now reconsider how it designs the investment process to mitigate or avoid some of the criticism associated with EU funding mechanisms, including excessively bureaucratic systems, high administrative burden, lengthy procedures to obtain funding and uncertainty in verification, control and audit processes etc. (OECD, 2020^[60]).

The Welsh Government also has the opportunity to avoid the criticism that public investment financing is difficult to access and use due to the multiplication of funding streams (OECD, 2019^[50]). This may be particularly true in the case of local authorities and private sector actors for whom borrowing may be easier in terms of administrative burden and timing. Regional development funding should align with the Welsh Government policy as part of the existing funding mix, rather than separate from it. With a shift away from the strategic investment framework associated with EU Cohesion Policy, the Welsh Government has the opportunity to ensure that regional development and investment priorities advance Welsh development objectives at a national level, as well as at a more “granular” regional one. For example, to support more integrated regional investment, bonus mechanisms could be envisioned that prioritise cross-sector and cross-government projects.

There is also a possibility to design investment frameworks and guidelines that are sufficiently flexible to encourage collaboration and investment across borders, certainly between Welsh jurisdictions, but also cross-border partnerships with UK regions or cities. In both instances, it would be important to set clear parameters, for example the types of bodies eligible for funds (i.e. statutory and/or non-statutory), the

conditions for funding (i.e. reporting, communication, accountability, and transparency) and co-financing requirements. For instance, co-financing rates could vary from one project to another based on specific needs – as opposed to the strict 50% co-financing rates associated with EU Cohesion Policy financing for all projects in Wales. This could encourage local authorities to design projects in close collaboration with other partners – ideally on a regional level – and to permit a higher local authority contribution to co-financing percentages by pooling together their own investment funds. In designing these incentives, the future investment management structure should build on WEFO’s experience in bringing together diverse stakeholders as part of the EU funding process, in particular for setting investment objectives and priorities in joint projects (OECD, 2019^[50]).

Special attention must also be paid to financing infrastructure investment given its cost and complexity. It requires well-established priorities, clear guidelines and transparent processes. The Welsh National Infrastructure Commission for Wales (NICfW), established in 2018 to support infrastructure planning over the long term (up to 30 years), could be an important body for supporting the co-ordination of infrastructure investment at the national level. To this end, its role could be extended beyond providing advice and recommendations to the Welsh Government on economic and environmental infrastructure needs. The NICfW could also build strong relationships with regional development actors (e.g. Chief Regional Officers [CROs], City and Growth Deal executive boards, and potentially corporate joint committees [CJCs]) to incorporate the subnational perspective into its work. The Welsh Government may want to consider clarifying and strengthening its mandate by establishing formal links with the UK National Infrastructure Commission, and possibly the Infrastructure Commission for Scotland. In addition, it could provide advice to all levels of governments and other stakeholders on potential synergies, conflicts, duplication and investment gaps (Regional Investment Project Steering Group, 2019^[57]).

Moving forward as investment structures shift post-Brexit, it would be very important to ensure that the responsibilities and expectations of parties involved in the investment processes are clear: the Welsh Government and local authorities but also City and Growth Deals stakeholders, regional partnership boards, the private sector, universities and third-sector organisations. Doing so contributes to setting realistic and accessible financing conditions. Given the number of actors in the investment space, establishing clear rules of engagement for investment becomes extremely important. This goes hand in hand with clearly articulated objectives and expected outcomes for each level of government. In Germany, for instance, the Joint Federal/*Länder* Task for the Improvement of Regional Economic Structures provide incentives for *Länder* as regards their regional investment policies, based on jointly-established priorities and rules for financial support (Box 4.9).

Box 4.9. The Joint Federal/*Länder* Task for the Improvement of Regional Economic Structures in Saxony-Anhalt

Saxony-Anhalt (*Sachsen Anhalt*) is located in the eastern part of Germany, part of the group of “new” *Länder*, which were re-established in 1990. Chemicals, food and machinery make up the majority of regional industries in Saxony-Anhalt. Thanks to its regional development policy, it has experienced strong growth and economic recovery since 2000, with a decrease in unemployment and an increase in investment, even though the latter remains below the national average for all indicators.

This growth was supported by two factors: the contribution of EU funding towards investment in regional development and a strong regional policy, supported by a common federal-state regional policy support scheme – the Joint Task for the Improvement of Regional Economic Structures (GRW), Germany’s main instrument for regional policy. The GRW was established in 1969 by the Federal Ministry for Economic Affairs and Energy (BMWi) to foster investments in economically lagging regions. The *Länder* can set their own priorities for investment, depending on the level of funding available. In recent years,

due to a decrease in transfers from the federal government and the EU, Saxony-Anhalt had to arbitrate among several priorities and reallocate funding, with a shift towards priority sectors such as energy and research. At the same time, the scope of GRW broadened to include the regional management of networks and support for services. Through the GRW, Saxony-Anhalt finances regional development by securing half of its funding from the federal government, and the other half from the *Länd* itself. In the funding period 2014-20, an additional EUR 115 million came from European funds. These funds are used to expand the effects of national-support programmes. Transfers can be allocated according to a maximum of 30% for direct grants to enterprises and maximum 90% for promoting investments in infrastructures to sustain the regional economy.

Together, these elements make GRW a key instrument for multi-level co-ordination, priority setting and financing of regional development policy. Built on consensus, the rules for financial support are fixed jointly by the federal and *Länd* governments, creating an enabling framework for economic development as a basis to guide the implementation of regional development funds.

Source: Pötzsch, S. (2019^[61]), *Regional Policy and Regional Cooperation in Saxony-Anhalt*, Ministry of Economy, Science and Digitalisation of Saxony Anhalt; OECD (2016^[62]), *OECD Regional Outlook 2016: Productive Regions for Inclusive Societies*, <https://doi.org/10.1787/9789264260245-en>; Gruševaja, M. and G. Heimpold (2013^[63]), "Evaluation of the main achievements of Cohesion policy programmes and projects over the longer term in 15 selected regions", https://ec.europa.eu/regional_policy/sources/docgener/evaluation/pdf/eval2007/cohesion_achievements/final_report.pdf.

Making the most of City and Growth Deals for investment opportunities

City and Growth Deals can be a relevant territorial scale for large-scale investment. This is particularly important for regional infrastructure that is targeted to increase productivity and growth, and implement a wide range of policies with a regional foothold (Ahrend et al., 2014^[64]). By bringing together a number of municipalities City and Growth Deals offer a way to manage territorially fragmented governance structures, thereby supporting growth and productivity (OECD, 2019^[65]).

To make the most of City and Growth Deals for targeting investment opportunities in Wales, it would be important to further integrate City and Growth Deals arrangements in Wales' wider regional development strategy (OECD, 2019^[50]). First, the Deals provide a structure for local authorities to fund and manage large-scale regional infrastructure and other investment needs. Second, they provide co-financing contracts drawing on funds from the UK government and Welsh Government, with commitments from ERDF and the private sector. Third, they support dialogue and mutual learning and provide mechanisms to guarantee proper implementation by party. City and Growth Deals may, therefore, be viewed as a particular funding route to help deliver each region's wider ambitions, while addressing the barriers that currently constrain investing in these regions thanks to their co-financing arrangements. It is estimated, however, that City Deal-making process and outcomes have been managed and agreed upon largely based on UK government terms and timetables (Pike et al., 2016^[66]). Moving forward with any future projects within the existing Deals, it would be important to ensure that their objectives align with the objectives of the proposed National Framework, including objectives of balanced regional development and equity among Welsh regional areas. It would also be important to ensure that the contractual arrangements do not contradict the devolution settlement, under which economic development and local governments are responsibilities devolved to the Welsh Government (Holtham, 2019^[26]). Examples from France and the Netherlands show how contracts and deal-making can benefit all levels of government involved (Annex 4.B).

There is, in addition, room for manoeuvre to make City and Growth Deals in Wales more competitive with other UK City Deals, particularly if they wish to attract competitive funding to replace EU funds post-Brexit, for example, funds from the UK Industrial Strategy and other competitive sources. While City and Growth Deals provide a funding stream for regional and local investment, the levels of infrastructure funding in the

Deals remain relatively low, compared to more traditional funding sources. The sum committed thus far to fund City and Growth Deals' projects totals less than GBP 3 billion over a period of 15 to 20 years, compared with the annual amounts of investment in Wales (by all levels of government) that reached GBP 3.4 billion in 2017 (Holtham, 2019^[26]). One of the main rationales behind City and Growth Deals is that they must help leverage additional funding from the private sector and trigger government investment that will generate spill-overs in lagging areas. For instance, in England, the Greater Manchester City Deal is experimenting with a revolving infrastructure fund, which will allow Greater Manchester to "earn back" a portion of additional tax revenue from growth in gross value added (GVA) generated by the initial investment (O'Brien and Pike, 2018^[55]). Adopting similar measures in Wales would require greater financial autonomy on the part of Welsh City and Growth Deal Boards, in order to earn back and apply additional tax revenue, as well as capacity to design and implement projects that could generate such benefits.

Increasing the impact of City and Growth Deals would imply reducing the administrative burden and simplifying access financing through regional structures. At the same time, it is important to address questions of accountability, transparency and scrutiny that surround these Deals (Pike et al., 2016^[66]). Doing so, for example by increasing the transparency and flexibility of co-financing contracts, could help attract new projects and facilitate reallocating funds if necessary over the course of the Deal. The introduction of citizen engagement mechanisms, such as public consultation and participatory financing mechanisms throughout Deal projects or the Deal lifecycle can provide greater transparency regarding the use of investment funds (O'Brien and Pike, 2018^[55]; OECD, 2019^[50]). Additional benefits of greater transparency include valuable public support for local projects. In Iceland, for instance, Contracts of Regional Plans have increased the transparency and efficiency of regional investment, and have also enabled regions to unlock competitive funding for specific projects (Box 4.10).

Box 4.10. Funding investment for regional development in Iceland

Iceland has a single-tier of subnational governments (municipalities) and an overall population the size of Cardiff. In 2013, the government renewed its regional development policy in order to make it more transparent and fit with the resources that were available. This was accomplished by introducing Contracts of Regional Plans to support decentralised funding to regional associations of municipalities. Iceland's regional associations of municipalities develop their regional action plans in consultative fora (one per region), bringing together stakeholders from the private sector, cultural organisations, academia and others. The associations are supervised by a Steering Committee on Regional Issues, formed by all ministries, together with associations of local authorities. The steering committee provides a direct link between the central government and municipalities and guides them in the preparation of the regional plans. These plans must set out the regional priorities within national and international development frameworks. They must also have measurable goals and clear success indicators.

Funding is allocated among the regional associations based on established criteria such as population, unemployment, municipal tax base, distance from the capital and service provision (except for the capital region, Reykjavik; which receives a fixed amount). Funding comes from the Ministry of Transportation and Local Authorities, the Ministry of Education and Culture, and contributions from municipalities. Over the course of successive contracts, other sources of funding have emerged, such as competitive funds for specific projects (e.g. infrastructure, and data centres); a funding pool for cultural centres; and funding pool for climate resilience and the circular economy.

The system enables policy learning across municipalities and among stakeholders. It also helped strengthen the cohesion among municipalities as well as their capacity to negotiate directly with the central government, by not placing them in direct competition for funding. It also resulted in increased trust from the central government towards regional associations. Regions are on their 3rd wave of contracts and

they are now trusted to allocate the funds emanating from diverse funding streams, such as competitive funds.

Source: OECD (2019^[67]), *Regional Outlook 2019: Leveraging Megatrends for Cities and Rural Areas*, <https://doi.org/10.1787/9789264312838-en>; OECD/UCLG (2019^[17]), *2019 Report of the World Observatory on Subnational Government Finance and Investment – Country Profiles*, http://www.sng-wofi.org/reports/SNGWOFI_2019_report_country_profiles_DEC2019_UPDATES.pdf; Hilmarsdóttir, U. (2019^[68]), *Regional Plans in Iceland: Decentralization of Funding and Power to Local Authorities through Regional Associations of Municipalities*.

Aligning priorities and objectives with a Welsh Framework for Regional Investment

Brexit represents not only a need but also a timely opportunity to further define an integrated approach to investment in Wales. In light of this, the Welsh Government is currently developing a Framework for Regional Investment (Box 4.11). If successful, such an approach can support investment financing for Welsh national, regional and local development plans and initiatives. By also supporting – but not substituting – the investment financing undertaken by each department, the framework could promote policy and investment coherence and facilitate effective investment programming post-Brexit. This requires ensuring that the framework includes mechanisms that can foster collaboration among public and private stakeholders, and enhance long-term planning practices.

Box 4.11. A proposed Framework for Regional Investment in Wales

The Welsh Government is designing a new regional investment framework to replace that associated with the European Structural and Investment Fund (ESIF), as it will no longer be applicable post-Brexit and once current funds are spent down. The new framework's aim is to offer public and private investment actors – national, subnational and international – consistent guidelines and clear objectives for public investment.

Based on socio-economic analysis and stakeholder feedback, the Welsh Government identified four priority areas for investment, using these to articulate desired investment outcomes:

- addressing income inequalities
- promoting productive and competitive businesses (e.g. SMEs, skills, research and industrial innovation, innovation diffusion)
- transitioning to a zero-carbon economy
- building healthier, fairer and more sustainable communities

Source: Welsh Government (2019^[69]), "Responses to OECD Questionnaire, unpublished".

The proposed Framework for Regional Investment can ensure that goals and priorities for regional investment align and are co-ordinated across government and sectors (horizontally), and among levels of government (vertically). It would contribute to managing investment fragmentation that can arise from working in a siloed policy culture, and to mitigating the risk of wasting resources through inefficient co-ordination. It can also increase the potential for identifying cross-sector investment synergies and limit investment overlap, ensure proper investment sequencing and contribute to improved investment transparency, visibility and accountability to citizens and businesses.

This type of framework can also be used to co-ordinate a regional, place-based approach for the whole of Wales. To this end, the national framework is considering investment at three territorial levels: national,

regional and local. At the national level, it will be aligned with the Wellbeing of Future Generations (WFGA) and will support the Economic Action Plan, the National Development Plan and government department programmes. At the subnational level, it is intended to support the Regional Economic Frameworks. It could also be useful for supporting local-level development programming and initiatives.

Furthermore, the Welsh Government should also incorporate the interests of the private and third sectors in this framework during the investment implementation and evaluation phases. This would enhance the Welsh Government's relationship with the private sector, universities, the third sector, etc., to advance regional development. It can also draw on the Economic Action Plan, which promotes the use of economic contracts to enhance social responsibility²¹ among businesses (OECD, 2019^[50]). At a minimum, incorporating diverse interests could help ensure coherence in investment priorities among levels of government. At best, effective co-ordination of investment priorities can lead to complementary or even joint investment opportunities, reducing investment costs (OECD, 2019^[65]). The Dutch and Irish governments have launched initiatives to align regional and national objectives and to drive regional policy and investment in an integrated fashion (Annex 4.B).

Strengthening Welsh national and subnational capacity for place-based public investment

The Welsh Government's approach to the proposed National Framework for Regional Investment reflects a willingness to maximise the learning and experience gained from managing public investment and projects of diverse size and scope, for example through ESIF. This is coupled with a need to ensure that limited investment resources are well channelled and contribute to balanced regional growth and well-being. There are three immediately identifiable levers at the Welsh Government's disposal that can contribute to this: i) increasing capacity and expertise for the design and implementation of projects; ii) enhancing the use of public-private partnerships (PPPs); and iii) using *ex ante* analyses and *ex post* evaluation to inform the investment decision process and to support investment quality.

Increase skills and expertise in designing and implementing projects

The lack of public sector investment management capacity, particularly at the subnational level, is considered a barrier to mobilising further capital funding sources for local investment in Wales (National Assembly for Wales, 2019^[31]). Whether it involves co-financing, land value capture mechanisms, PPPs or bonds issuance, investment financing processes at the subnational level are complex. Often, support from the central government and other technical and financial partners is required in order to build investor confidence. Among Welsh local authorities, capacity levels in human and financial resources, and project management, are heterogeneous. This compounds the difficulties surrounding a capacity deficiency for regional development investment, particularly among rural local governments, and can compound inequalities in their ability to access funding. These issues are exacerbated in Wales since the dismantlement of the Welsh Development Agency (OECD, 2019^[50]), and even more, since the financial crisis, resulting in a minimum level of in-house skills and expertise, and high turnover in procurement units (OECD, 2019^[37]). This is not an irreversible situation, however. There are recent moves to support subnational investment capacity in Wales, such as establishing the Development Bank of Wales (DBW) and Business Wales (Gareth, 2019^[70]). At the same time, more could be done to build on and disseminate the experience of investment actors working at the regional level, such as WEFO, and of the local authorities themselves.

The DBW and WEFO have valuable insight into investment financing for regional development thanks to their expertise in public and private financing mechanisms and management. Moving forward, the DBW could draw from its expertise in co-financing schemes between the private sector, SMEs and governments, and intervene to support local authorities at various stages of the project process (e.g. feasibility studies, negotiating with investors, reporting and monitoring and evaluation). It could also help match local authority

needs with investor requirements for quality projects in the infrastructure project pipeline, for example, as it already does with SMEs and other stakeholders. Additionally, the DBW's systems to monitor and map investment results (beyond the number of firms assisted and jobs created) in terms of secondary economic effects could be shared with the Welsh Government and used to develop indicators that capture investment outcomes (Holtham, 2019^[26]; Gareth, 2019^[70]). Meanwhile, WEFO has developed good practices in project management and reporting that should be safeguarded and maintained in future regional investment projects, and which could also be transferred to regional- or local-level bodies. These include setting performance criteria, clearly defining responsibilities throughout the investment cycle, separating managing and auditing functions, and ensuring the continuity and qualifications of staff. The Scottish Futures Trust provides an interesting example for strengthening local governments' capacity and expertise of investment financing and implementation (Box 4.12).

Box 4.12. The Scottish Futures Trust

In 2008, the Scottish Government established the Scottish Futures Trust (SFT) as a centre of expertise to improve the efficiency and effectiveness of infrastructure investment in Scotland. The SFT also carries out reviews for the Scottish Government on innovative financing mechanisms and works with Scottish local authorities to reinforce capacity by transferring knowledge and carrying out independent expert reviews at various stages of investment projects.

In 2010, the SFT launched "Hub" programmes, specifically to improve the planning, procurement and delivery of smaller public infrastructure projects that support community services across Scotland (primarily in the education and health sectors). This programme was tailored to meet the specific needs of five designated hub territories in Scotland (North, South East, West, East Central and South West hubs). It operates through joint venture arrangements between local public sector organisations and the private sector ("Hubco") in each territory. The objective is to increase efficiency and reduce the cost of community infrastructure procurement. In addition, it provides an opportunity to share skills and experience across several public sector organisations (health boards, local authorities, police, fire and rescue services, and other public bodies) and projects, enabling knowledge transfer and increasing public investment and procurement efficiency. To date, investment funded through the Hub programme amount to GBP 3.3 billion, with an almost perfect balance of funding allocation across the five "hub" regions.

Source: OECD (2018^[71]), *Subnational Public-Private Partnerships: Meeting Infrastructure Challenges*, <https://doi.org/10.1787/9789264304864-en>; Northern Ireland Assembly (n.d.^[72]), *The Hub Initiative*, <http://www.niassembly.gov.uk/globalassets/documents/education-2011---2016/visits/03-hub-briefing-paper.pdf>.

Furthermore, encouraging peer-learning among local authorities themselves and supporting them in pooling expertise also contributes to building investment capacity. Smaller local authorities are often very concerned with having the institutional capacity and professional skills necessary to make good investment decisions. In this sense, the willingness and ability to collaborate and work in partnership with other institutions as well as with other local authorities is crucial (Economy, Infrastructure and Skills Committee, 2017^[73]). Subnational capacity can be strengthened through peer-to-peer exchanges and pooling expertise across jurisdictions (e.g. for PPPs and climate finance). More could be done in this respect, by increasing the number of co-procurement initiatives among local authorities for example. Intermunicipal and regional co-operation can also be used to identify common interests and encourage economies of scale. National associations of municipalities are very effective as capacity-building and knowledge-sharing platforms, able to disseminate good practices and benchmark local and international experiences (OECD, 2018^[71]). In this regard, the Welsh Local Government Association (WLGA) could develop a working group

specialising in capacity building in the management of investment projects, or access to specific financing mechanisms.

Enhancing the use of public-private partnerships

The UK is recognised as a benchmark for PPPs among OECD countries given its private finance models (Private Finance Initiative [PFI] and Private Finance 2 [PF2]). Their benefits include opportunities to expand investment capacity beyond capital expenditure and borrowing limits, and generate additional resources for investment. They can also achieve greater efficiency through innovation and expertise emanating from the private sector (Scottish Futures Trust, 2019^[74]). However, the UK PFI and PF2 models are subject to increasing criticism. This criticism is based on their lack of flexibility, low value for money and the risks they represent to public authorities (McZenzie, Baker, 2018^[75]; National Audit Office, 2018^[76]). As a result, they have not been used in the UK since 2018 (HM Treasury, 2018^[77]). Traditionally, Welsh public bodies at the national and subnational levels seldom use PPPs or two finance models. As of June 2018, the 28 Welsh PFI projects represented 1.5% of the value of all UK PFI projects, the lowest in the UK (Senedd Research, 2018^[78]).

Searching for an alternative, Wales developed its own PPP model in 2014: the Mutual Investment Model (MIM) (Box 4.13), which targets leveraging GBP 1 billion of privately financed investment. Despite developing its own PPP model, this form of investment financing is still used sparingly in Wales. This is attributed to limited human capacity in terms of expertise and resource constraints (OECD, 2019^[37]). These challenges are, however, not unique to Wales. In 83% of OECD countries, PPPs represented less than 5% of public sector investment between 2015 and 2018 (OECD, 2018^[71]).

Box 4.13. The Welsh Mutual Investment Model (MIM)

The MIM arrangements are a form of public-private partnership wherein private partners can build and maintain public assets. The Welsh Government pays a fee to the private partner to cover the cost of the project's construction, maintenance and financing. In return, the Welsh Government is a direct investor in the project, able to take an equity stake of up to 20% in the holding company established to deliver the project and appoint a director to the holding company's board. At the end of the contract, the asset is transferred into public ownership.

One of the specificities of the MIM model is that it requires compliance with the Code of Practice on Ethical Employment in Supply Chains and it sets a number of conditions for the participation of the private partner. The MIM will fund three projects in Wales: the 21st Century School Programme, the A465 Major Road Scheme and a hospital project.

The MIM is progressively gaining recognition in the UK and further afield. The Scottish Government is reviewing how it can adapt the model and the G20 adopted some MIM elements as global infrastructure standards.

Source: Welsh Government (2019^[69]), "Responses to OECD Questionnaire, unpublished"; OECD (2019^[37]), "OECD Interviews in Wales, 25-29 November, 2019", OECD, Paris; Scottish Futures Trust (2019^[74]), *Tax Incremental Financing*, <https://www.scottishfuturestrust.org.uk/page/tax-incremental-financing>.

PPPs often have low uptake because of real or perceived government capacity gaps. International experience shows that establishing a PPP unit specialised in subnational projects can enhance the efficiency and the use of PPP models, together with financial support for technical assistance. Australia and Germany, for example, have introduced training and capacity-building PPP programmes (Annex 4.C).

Central governments also play an important role in supporting subnational capacity to develop PPPs by setting a long-term vision and clear priorities for investment (OECD, 2018^[71]). In Italy, instead of a specialised PPP unit, PPP functions belong to the National Department for Planning and Coordination of Economic Policy. These functions include an educational role, an assistance role, a “policy-making role” and a regulatory role. This enables the government to introduce new institutional guidelines and “soft law” to guide public sector entities in structuring successful PPPs. These guidelines emphasise the importance of maintaining a balance between the interests of the public and private entities involved. As of April 2019, the department had assisted more than 70 Italian local authorities on PPPs (Tranquilli and Milani, 2019^[79]).

To improve its delivery of MIM projects, the Welsh Government is currently reflecting on developing a commercial unit within its Treasury Department, and in parallel, a MIM equity unit in the DBW to deal with contracts (OECD, 2019^[37]). The establishment of these units will be conditioned to providing the necessary resources, from the Welsh Government and the DBW, for the proper functioning of these units and to the ability to recruit highly skilled staff.

Increasing investment performance with ex ante and ex post evaluation

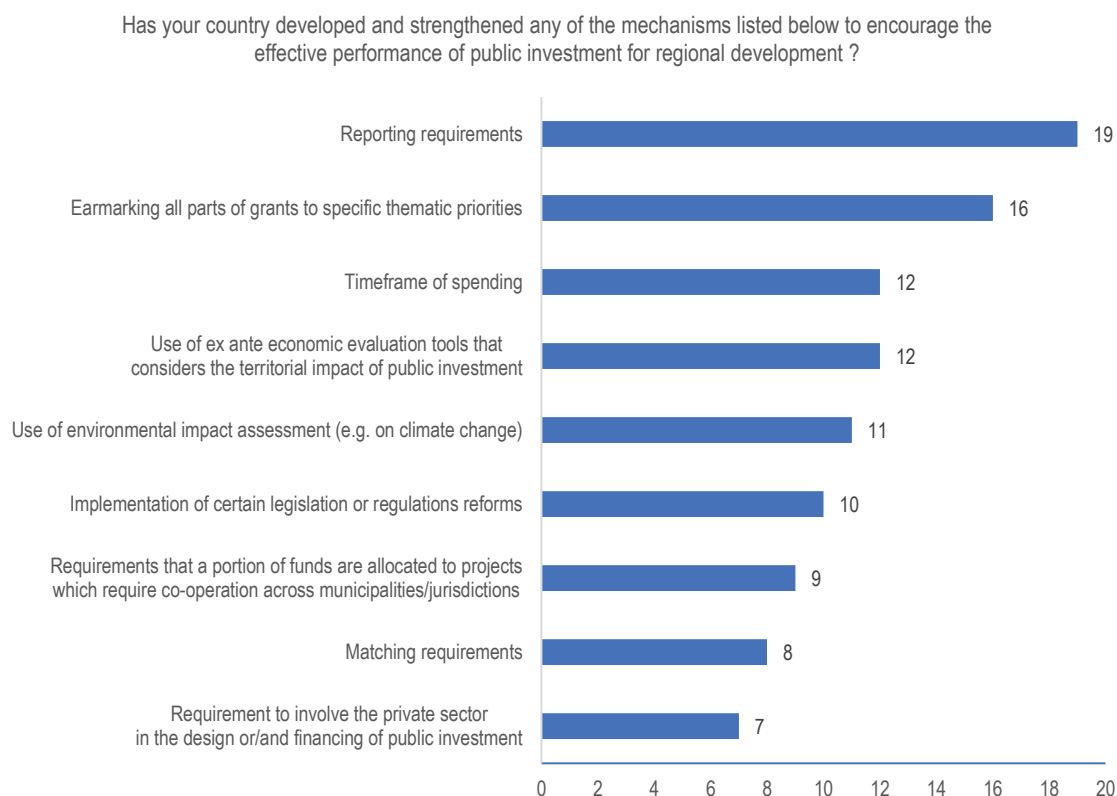
Evaluating investment decisions based on *ex ante* evaluation remains a challenge for the Welsh Government and should not be overlooked in its investment management practices. *Ex ante* evaluation helps identify the long-term impact and risk of public investment. This can help avoid “white elephant” investments and support identifying an investment’s social, environmental and economic impact, while also assessing which investment method can yield the best value for money. At the close of the investment cycle, *ex post* assessment contributes to evidence bases that support future investment decisions (OECD, 2019^[65]). Welsh local authorities comply with the UK’s Five-Case Business Model that guides the preparation of business cases and offers a number of benefits to investment appraisal, but the outcomes are not consistently used to guide decision-making (Welsh Government, 2019^[19]; Atkins, Davies and Bishop, 2017^[80]). Even within the EU experience, where regulations require cost-benefit analysis of major investment projects financed with Cohesion Funds, the incentive to initiate new projects or to absorb EU funds often overshadows the incentive to achieve value for money in public investment (Mizell and Allain-Dupré, 2013^[81]). This is a common situation among OECD subnational governments and notably among regions: performing *ex ante* appraisals (e.g. cost-benefit analyses, environmental impact assessments, territorial impact assessments) but not consistently using the result in decision-making (OECD/CoR, 2015^[82]). *Ex ante* appraisals could be used to encourage actors to produce high-quality/high-accuracy assessments, instead of producing high-benefit/low-cost project estimates that turn out to be inaccurate (OECD, 2019^[65]).

The use of *ex ante* economic evaluation tools that consider the territorial impact of public investment tends to be particularly limited among OECD countries (Figure 4.8) (OECD, 2019^[65]). These tools, however, are particularly important when considering a place-based approach to investment. They offer insight into a potential investment’s territorial impact and benefit (OECD, 2019^[67]), and support appraisal and prioritisation processes.

In the UK (and by extension in Wales), the procedures set out in the Green Book²² tend to centralise decision-making and often place consultation and deliberation late in the investment project approval process (Hurst, 2019^[83]). This can relegate social and environmental impact assessment, as well as public consultations, to a later stage, which increases the risk of disagreement and failure to implement investments. *Ex ante* assessments serve to assess long-term operational and maintenance costs from the early stages of the investment decision (OECD, 2019^[65]): to include fiscal, but also financial, political, social and environmental impacts. The 2018 Green Book update introduced new criteria relative to personal well-being in the evaluation process. This should pave the way for introducing more social cost-effectiveness analysis and help measure the impact of projects contributing to the Welsh well-being agenda. To achieve such comprehensive assessments, monitoring and evaluation criteria and mechanisms need to be defined

early in the policy design process and should not be limited to budget execution (OECD, 2018^[84]). Economic project appraisal in Ireland and Italy have focused on these aspects (Annex 4.C).

Figure 4.8. Indicators of performance of public investments



Note: Number of respondents (N)=27. Monitoring survey – Performance of public investment.

Source: OECD (2019^[65]), *Effective Public Investment across Levels of Government: Implementing the OECD Principles*, <https://www.oecd.org/effective-public-investment-toolkit/>.

Rigorous *ex post* analysis, including of outcomes, contributes to the overall effectiveness and efficiency of public investment and the quality of future investment choices (OECD, 2019^[67]). Evaluation processes for regional development investment should pay particular attention to avoiding duplications when evaluating cross-sectoral projects, which was raised as a concern within the current Welsh Government administration (OECD, 2019^[37]). The Welsh Government could also make better use of its current investment evaluation framework through increased public consultation, long-term project assessments, social impact analyses and *ex post* evaluation mechanisms with an outcome-based approach. Together, these can indicate whether the investment has supported meeting development objectives. New Zealand manages this through its Long Term Investment Plan Assessment Framework (Box 4.14).

Box 4.14. The Long Term Investment Plan assessment framework in New Zealand

The New Zealand Treasury has developed Long Term Investment Plans (LTIPs) as part of the cabinet policy. LTIPs are government department planning documents, with a minimum 10-year horizon and are reviewed every 2 years. The plans serve to guide departments, informing the factors driving investment needs and providing the rationale for the preferred way forward. The Treasury uses LTIP to support the development of the National Infrastructure Plan and of infrastructure more generally.

LTIPs are supported by a LTIP assessment framework. This framework is composed of a list of 10 criteria that is assessed on a 0 to 5 scale in the evaluation process: future focus; strategic alignment; service delivery; achievability; alignment of intentions; value; financial impact; procurement choices; asset performance; and capital efficiency. While LTIPs focus primarily on capital expenditure, they also consider the connections among demand, resources, services and benefits over the long term and pay attention to the consequences of investment choices on financial and service provisions.

Source: New Zealand Treasury (2017^[85]), *Guidance for Developing and Maintaining a Long Term Investment Plan*, <https://treasury.govt.nz/sites/default/files/2018-01/investmentmanagement-ltip-guidance.pdf>.

Exploring innovative sources of public investment financing for Wales

In order to mitigate the impact of Wales' fiscal framework on its future regional investment capacity, the Welsh Government will need to mobilise additional sources of investment finance, primarily from external sources and the private sector. Establishing a robust investment framework, while strengthening national and subnational investment capacities, is a step in this direction. However, the government will also need to carefully evaluate available and potential funding sources, and determine to what extent these can realistically contribute to financing regional investment priorities. In most cases, it is possible to combine a variety of financial instruments at different stages of the investment cycle. Some options explored below include land value capture mechanisms, enhanced access to private finance through climate-based instruments, and participative financing.

Land value capture mechanisms for funding

Financing investment through land value capture is increasingly prevalent in urban areas. This is generally attributed to the size of the required investments and constraints in national and subnational finance (Box 4.15). There are two broad categories of land value capture mechanisms: taxation-based schemes and development-based mechanisms, both supported by diverse financial instruments (Suzuki et al., 2015^[86]):

1. **Taxation-based schemes** encompass the sale of public land, land taxes or taxes related to the change of land use. They aim to generate land-based revenue to finance infrastructure. This assumes that the national or local authority responsible for financing the urban development initiative is endowed with the administrative and legal capacity to set and collect the generated tax revenue.
2. **Development-based mechanisms** include taxes and fees, such as betterment levies, development impact fees, land readjustment and tax increment financing. These mechanisms aim to shift the costs (in part or in full) of development projects to landowners and developers, or to ensure that developers contribute to surrounding infrastructure and public amenities.

Development fees can be particularly useful to generate additional revenue in the framework of large-scale infrastructure projects and are used in about half of OECD member countries. However, as development

fees force developers to bear part of the cost of new construction, they can also slow down urban development and should therefore be used with caution (OECD, 2017^[87]). Land value capture mechanisms are suitable in a variety of contexts and have been applied successfully in several Latin American and European countries (e.g. development fees in the US, sale of land use rights in Brazil, public land leasehold in the Netherlands and land taxes in Australia and Denmark) (OECD, 2017^[88]).

Box 4.15. Why use land value capture mechanisms?

Land value capture provides an opportunity for local authorities to generate additional sources of revenue from land developments to finance investment projects, completely or in part. In addition, land value capture mechanisms can also encourage local authorities to increase their tax base by taxing commercial or residential developments, and provide incentives to focus investments on the most efficient locations.

The rationale behind land value capture is that it enables governments to secure uplifts in land and real estate value associated with public interventions, which otherwise would be captured by private developers and landowners. It is a tool particularly adapted to financing urban regeneration projects, as well as public transit and transport projects, including railways or metros, which tend to have a strong impact on the value of nearby land and real estate.

Source: Albrecht, D. (2016^[89]), *Local Financing and Land-real Estate Capital: What Options and Conditions for Implementation?*, http://www.uclg-localfinance.org/sites/default/files/instruments/UCLG_Study_Land_valuation_EN.pdf; Peterson, G. (2009^[90]), "Unlocking land values to finance urban infrastructure", <http://documents.worldbank.org/curated/en/723411468139800644/Unlocking-land-values-to-finance-urban-infrastructure>.

Successfully implementing land value capture mechanisms is based on a series of prerequisites: transparency and accountability, a strong legal framework and institutional structure, as well as specific skills and expertise to ensure equity objectives. The risks related to each value capture mechanism can and should be addressed directly with all relevant stakeholders (businesses and communities), through clear and transparent communication (Blanco et al., 2016^[91]). In addition, the Welsh Department for Economy and Transport has a key role to play by applying an integrated methodology when implementing various forms of value capture to a location area.

Land value capture could contribute to financing public sector infrastructure investment at the local level, which could otherwise be unaffordable for local authorities, it can also generate spill-overs that could benefit broader territorial areas. To date, however, its use remains relatively constrained due to several factors, in particular the rigidity of the UK spatial planning system and low degree of fiscal decentralisation (OECD, 2017^[87]). However, the growing body of international knowledge on land value capture shows that it can be used within relatively strict, national regulations. The choice of instrument is determinant, depending on the type of infrastructure to be funded. Identifying the desired time period for income generation is also relevant in order to choose instruments that will generate either recurring income or one-time income.

Welsh local authorities must carefully consider which specific instruments would be most suitable to their circumstances and needs, and look at how their choices can be efficiently combined (Olajide and Arcé, 2017^[92]). These instruments could include, for instance, the use of a vacant land levy in urban areas, used in Ireland since 2017 (Urban Regeneration and Housing Act 2015). However, initial assessments in January 2019 indicate that the administrative burden of the process and the lack of adequate staff first prevented Irish local authorities from making full use of this levy (RTÉ, 2019^[93]). Welsh local authorities involved in City Deals are considering mechanisms that would use non-domestic rate retention to help them pay back borrowing costs. To extend the use of non-domestic rate retention to fund large-scale

infrastructure, through mechanisms such as tax increment financing (Box 4.16), however, would require an increase in fiscal powers to be viable.

Box 4.16. Tax increment financing

Tax increment financing (TIF) is an economic development instrument aimed at anticipating increases in tax revenues generated from developing new commercial/real-estate activities or rehabilitating run-down areas financed through public investment. When applied to regeneration/redevelopment projects, the public authority can take out loans or bonds pledged on the area's potential. The tax base is frozen when TIF is introduced. Additional tax revenue is allocated to repaying loans taken out to finance local projects within the perimeter and to support additional investment in the area.

TIF is implemented by creating a specific geographic district, administered by a TIF authority (i.e. special taxing districts, development authority districts, community facilities districts or community management districts). After the district is created, the assessed property value is frozen for a period of time, usually 10 to 25 years. As new funds are invested, the property values in the district increase, as do on-site property tax revenues. The property tax increment (the new property tax minus the property tax on the frozen property values) is diverted to the TIF authority, which has to reinvest it within the TIF district.

This instrument was first introduced in California in 1952 and is now used in all US states except Arizona. It is most often applied to financing the rehabilitation of under-developed areas, the development of public spaces and facilities, or public transit schemes.

In the UK, England has been piloting TIF since 2013 by allowing the retention of Non-Domestic Rates by local authorities, through the Business Rates Retention Scheme. However, their main use remains limited to support recurrent service expenditure, instead of investment funding. In 2010, Scottish legislation also introduced TIF. To assess the feasibility of expanding TIF use, the Scottish Futures Trust is developing criteria that will apply to local authorities for submitting TIF proposals such as: identifying a geographic area of development that would lead to sustainable and inclusive economic growth; and identifying public assets to be funded by TIF that are not able to be funded through traditional means (e.g. prudential borrowing). As of 2019, there were four TIF pilot-projects in Scotland (and two waiting for business case approval).

Source: OECD (2019^[94]), *The Governance of Land Use in Korea: Urban Regeneration*, <https://dx.doi.org/10.1787/fae634b4-en>; Albrecht, D. (2016^[95]), *Local Financing and Land-real Estate Capital: What Options and Conditions for Implementation?*, http://www.uclg-localfinance.org/sites/default/files/instruments/UCLG_Study_Land_valuation_EN.pdf; Scottish Futures Trust (n.d.^[95]), *Tax Incremental Financing*, <https://www.scottishfuturestrust.org.uk/page/tax-incremental-financing>.

To enhance the use of land value capture mechanisms in Wales, two main issues should be addressed. First, the administrative burden associated with these mechanisms should not be too onerous for local authorities. This could be managed by an independent land commission (akin to the old Land Authority for Wales), responsible for managing the inventory and sale of land, an approach adopted by Scotland. If this requires adjusting the devolution settlement, it may be more difficult to implement (at least in the short term) in the Welsh case. Second, if a more sophisticated mechanism is used, such as TIF schemes, this implies further devolving revenue-generating capacity to local authorities, in order to generate additional revenue at the local level. In the framework of TIF instruments, the revenue generated would be retained by the TIF authority itself as a financial guarantee against a loan for financing its infrastructure project. In the case of Wales, these revenues could come from the partial retention of Non-Domestic Rates (NDR), as briefly explored earlier. Such a scheme would not entirely substitute the distribution model of NDR but

would add another component – one that enables local authorities to retain a certain share of their NDR revenue. This can be applied to specific contexts, such as City and Growth Deals with ongoing redevelopment projects, where its use is still very recent (Holtham, 2019^[26]).

Better exploiting green procurement and climate-related funds

Local policymakers across the OECD are working to strengthen their knowledge of and capacity to leverage alternative sources of finance for green investments. It generally requires additional investment in upskilling programmes to train government staff in managing such projects in partnership with private and third sectors parties (OECD, 2019^[96]). Climate-oriented finance and investment also present opportunities to mobilise funding from international organisations and national governments, to leverage external funding from the private sector and to combine climate and inclusion objectives while financing infrastructure investments (OECD/World Bank/UN Environment, 2018^[97]).

Wales has a number of assets enabling it to make use of climate-finance mechanisms, which align with its objectives of decarbonisation and biodiversity. According to recent information, the Development Bank of Wales is creating a “Green Fund” for investment (Gareth, 2019^[70]). Its knowledge and expertise gained in this area could be shared with the Welsh Government and local authorities to help fill information gaps on climate finance, and available climate-driven funding streams available at the national and international levels. This could also support Wales’ requirement to report on the level of its carbon budgets every five years as part of its commitment to targeting net-zero greenhouse gas emissions by 2050 (Committee on Climate Change, 2019^[98]).

Green public procurement supports environment-friendly policies and investment strategies by integrating environmental and social considerations into the procurement process. First introduced in the Netherlands and then in Belgium (Box 4.17), it has been spreading throughout Europe in the form of Green Deals. Generally, a Green Deal is a voluntary agreement between private partners, civil society and the national and/or regional government to establish a joint green project. In Wales, green public procurement could give Welsh Government, and potentially local authorities, margin to use its purchasing power in a way that upholds regional and local environmental objectives, while also benefitting the local economy.

Box 4.17. Green Deal Circular Procurement in the Netherlands

In 2013, the Netherlands' government launched a Green Deal for Circular Procurement in order to stimulate the circular economy. The programme supports local governments, such as the city of Amsterdam, to set up PPPs and collaborate with the private sector and civil society organisations to enter purchasing arrangements inspired by circular economy principles. When they sign up to this Green Deal, organisations must commit to participating in at least two circular procurement projects and to including circular principles in their internal procurement guidelines.

This Green Deal has led to the development of a learning network – co-ordinated by a consortium of Dutch partners – that mixes public and private actors and shares knowledge and experiences around the principles of circular principles. Following the success of this initiative in the Netherlands, the regions of Flanders and Wallonia in Belgium launched their own Green Deal on Circular Procurement in 2017 and 2019 respectively, with the support of the Dutch organisation.

Source: One Planet Network (n.d.^[99]), *Green Deal Circular Procurement*, <https://www.oneplanetnetwork.org/initiative/green-deal-circular-procurement>; Wallonie Service Public (n.d.^[100]), *Economie Circulaire*, <http://economiecirculaire.wallonie.be/>.

In addition to green procurement, the green bond market is still young but it has rapidly gained traction in financing green projects that deliver environmental benefits (OECD, 2019^[67]; 2017^[101]). Green bonds share the same financial characteristics of conventional bonds, with the exception of the ring-fencing or earmarking of proceeds required by the green label. They are usually issued by large-size cities or groups of cities that pool together their financing and human capacities, for example in France and the Nordic countries (Box 4.19). They are complementary to social bonds, intended to finance socially-responsible investment. However, for green bonds to be successful, governments need to develop a pipeline of quality, bankable projects.

Box 4.18. Green bonds issuance at the regional and local levels

Green bond framework for the *Région Île-de-France*, France

The *Région Île-de-France* has made climate finance a trademark for its investors. It has been a frequent and regular issuer in the green and sustainable bond market since 2012, with eight transactions. The 6th Green and Sustainable Bond Issuance of the *Région Île-de-France*, launched in June 2018, amounted to EUR 500 million. As part of the process and under the supervision of the region's finance directorate, each sectoral department in the region is asked to identify priority projects having a high environmental and social impact within a certain budget. The finance directorate then consolidates the information across departments and finalises the budget allocation by sector. Nine eligibility criteria have been established to guide the purpose and management of the projects (e.g. environmental responsibility, social and societal responsibility, economic responsibility and governance).

Looking at the funds received from the green bond during the 2014-18 period, half went to public transport and sustainable transport projects. Social housing and facilities for education and leisure accounted for 16% and 15% respectively. Minor shares of funding were also allocated to projects related to biodiversity (5%), economic and socially inclusive development (7%), support to vulnerable groups (5%) and energy efficiency (2%).

Municipal green bonds markets in Nordic countries

The first municipal green bond in the Nordic countries was issued in 2013 by the City of Gothenburg, Sweden, to fund energy, transport, water management and waste management projects. It has renewed the experience on several occasions, almost annually since then. To support its green bond strategy, the city has developed its own Green Bond Framework, which specifies terms and conditions for the selection of eligible projects, follow-up and transparency requirements. Nordic local government funding agencies, such as *Kommuninvest* (Sweden) and Municipality Finance (Finland), are also regular issuers of green bonds. In general, Nordic green bond issuers rely extensively on the use of external reviews and second party opinions to support their green bond issuances, which confirms compliance with the Green Bond Principles and the climate components of the proposed investments.

Source: Région Île de France (2019^[102]), *Regional Finances: Key Figures*, <https://www.iledefrance.fr/sites/default/files/medias/2019/10/4PAGES%20Region%20IDF%20key%20figures.pdf>; Climate Bonds Initiative (2018^[103]), *The Green Bond Market in the Nordics 2018*, Handelsbanken, <https://www.climatebonds.net/files/reports/cbi-nordics-final-03b.pdf>; Nassiry, D. (2018^[104]), "Green bond experience in the Nordic countries", <https://www.adb.org/sites/default/files/publication/408336/adb-wp816.pdf>.

Participatory budgeting and crowdfunding platforms to fund local investment

Participatory budgeting and civic crowdfunding can channel funds towards small-scale projects and, in particular, projects that traditional funders will not finance due to limited profitability. These financing mechanisms carry value related to common good and social, cultural or environmental purposes. They are particularly well suited for lower cash-value, short-term projects with high visibility and impact, such as local community projects that would have trouble raising external funding. In the case of infrastructure, participatory mechanisms can support investment for construction and restoration, for creating or improving green and public spaces, and providing community infrastructure and equipment. To maximise the impact of such instruments, local authorities can match the amounts committed through participatory and crowdfunding budgets with a certain share of their own budget, and replicate the exercise on a regular basis (annual, bi-annual, etc.). These instruments need to be analysed in the light of local contexts and they can be combined with other instruments at several stages of the investment process. For instance, donation crowdfunding can secure early-stage investments and build support among the local community. Later in the process, as the project's scope is defined and financial conditions are established, equity crowdfunding markets can become suitable, in combination with other local revenue streams, to finance the project's construction (Gasparro, 2019^[105]).

Participatory budgeting, a practice considered "laboratory federalism", can stimulate community engagement and involvement, generate project ideas emanating from the community itself, and strengthen inclusive governance, which can be of interest to Wales. It may contribute improving the quality and the efficiency of public policies at the national and subnational levels, by increasing transparency, and making infrastructure and services more relevant to the community (OECD, 2019^[11]). It is applicable to local authorities of all sizes, with varying degrees of participation, and is particularly suited to highly vulnerable areas where the social fabric is at risk. It enables citizens to choose how to spend a predefined sum of funding, most generally for investment purposes, in specific sectors (often culture, environment, sport, etc.). Local authorities should have control and ownership over the participatory budgeting process and effectively manage citizen participation to ensure success. Local governments are responsible for ensuring citizen input is properly taken into consideration and projects are effectively implemented, in order to guarantee the sustainability of the initiative. In more participatory processes, the citizens are engaged at the early stages of the process – i.e. when determining the sum allocated and the sectors concerned. Several local governments across the OECD have piloted with participatory budgeting and some cities have institutionalised it, with a fixed share of their investment budget subject to the citizen vote (Box 4.19).

Box 4.19. Participatory budgeting at the local and national levels

Local-level participatory budgeting in Paris, France

Since its launch in 2014, Paris' experience with participatory budgeting has been positive. Through an interactive and easy-to-use web platform, Parisians decide on the use of 5% of the city's investment budget, amounting to EUR 500 million in 2014-20. As of February 2020, 2 160 projects were implemented through this process and the web platform allows citizens to follow implementation progress step-by-step. Participatory budgets have flourished in Paris with a growing number of sub-categories, from participatory budgets in public schools to participatory budgets in sub-municipal districts (*arrondissements*) and in social housing.

Local and national level participatory budgeting in Portugal

There are approximately 118 participatory budget initiatives at the local level in Portugal, which account for approximately EUR 91 million of total investment between 2007 and 2017. Lisbon's city council was one of the first to develop "green" participatory budgeting, with a budget of EUR 5 million. In addition, Portugal is the first OECD country to initiate a nationwide public participatory budget, the Portugal Participatory Budget (OPP). The OPP is conceived as a democratic, direct and universal process that allows civil society to decide on public investments in different government sectors. These sectors include culture, science, adult education and training, and agriculture, for a total of 38 projects (as of 2017). In the two Autonomous Regions of Azores and Madeira, the sectors were different and the participatory budgeting concerned justice and internal affairs. More than 900 proposals were submitted by the citizens, primarily in the sector of culture. People can vote by SMS or on the Internet, for one national and one regional project each. The 2017 OPP pilot phase was allocated EUR 3 million, split between distinct allocations for national projects and regional projects. The 2018 OPP budget was raised to EUR 5 million. In 2019, a "light version" of the OPP was organised, based on previous project submissions, due to the large number of electoral processes that year.

Source: Ville de Paris (n.d.^[106]), *Le mode d'emploi du Budget Participatif*, <https://budgetparticipatif.paris.fr/bp/la-demarche-sommaire.html>; OPSI (n.d.^[107]), *Portugal Participatory Budget*, <https://oecd-opsi.org/innovations/portugal-participatory-budget/>.

Civic crowdfunding provides another opportunity for Welsh local authorities to finance community-level infrastructure and services. Crowdfunded projects are financed by a group of individuals instead of private sector entities. It is increasingly used by SMEs and entrepreneurs across the OECD as an alternative financing instrument (OECD, 2015^[108]). Civic crowdfunding emerged at the beginning of the 2010s as crowdfunding for local projects and infrastructure of benefit to a community. Crowdfunding models vary, ranging from donation-based to municipal bonds. Donation-based crowdfunding models offer limited opportunities in terms of amount and scale, and should be reserved for social projects led by local authorities and town and community councils. Projects requiring larger financing contributions can rely on crowdfunding in the form of municipal bonds (Davis and Cartwright, 2019^[109]). Municipal bonds are a more regulated type of crowdfunding where investors are guaranteed a stream of future interest payments over the period of the bond, in addition to the invested amount paid back in full. They are used by local governments in the US to finance projects such as green space improvements or school upgrades (Future Cities Catapult, n.d.^[110]).

Crowdfunding could be relevant to support the Welsh community and well-being agenda, under the form of local authorities partnerships to improve public spaces and infrastructure. Recently, the Valleys Taskforce launched a proposal for a partnership funding arrangement between the Welsh Government (main funder) and Blaneau Gwent, Bridgend, Caerphilly, Merthyr Tydfil, Neath Port Talbot and Torfaen, to

which each community contributes to a specified amount (Caerphilly Country Borough Council, 2020^[111]). The terms of this fund remain to be defined. However, it could serve as an example for other Welsh local authorities who wish to engage in local regeneration and development projects. Recent academic work on the use of crowdfunding for urban infrastructure has highlighted that crowdfunding is most often used as an engagement mechanism, to demonstrate social support and with the aim of attracting additional funding. It is not used as a mechanism to increase investment financing/resources. In addition, the participation of subnational governments in crowdfunded exercises is essential to support the costs related to the construction of the projects being funded as well as to the longer-term operation/maintenance costs.

Part 2: Conclusion and recommendations

Developing a coherent investment framework at the national level in Wales can bring significant benefits in terms of maintaining a sustainable investment strategy for regional development. The transition towards a new structure for investment co-ordination post-Brexit could be a key driver to ensure that investment decisions are aligned and that the inputs of all stakeholders are taken into account. Streamlining financing processes at the level of City and Growth Deals, and integrating these arrangements further into broader regional economic strategies, will also be crucial. By developing its National Framework for Investment in regional development, the government can ensure that all government levels and stakeholders work together towards a common goal. To reach its objectives, public investment in regional development in Wales must also be supported by in-house technical capacities and in particular strong capacities to design and implement projects, expertise to expand the use of the Welsh MIM, and adapted *ex ante* and *ex post* evaluation mechanisms. Under these conditions, the Welsh Government and local authorities will be in the best position to explore the available sources of funding for investment, including innovative sources such as land value capture instruments, climate-related finance and participatory-funding mechanisms.

Box 4.20. Recommendations for action to optimise Welsh public investment resources for regional development

1. Address investment strategy fragmentation for better-co-ordinated investment post Brexit

- Adopt the proposed National Framework for Investment and use it to support investment initiatives across sectors and among levels of governments.
- Transition WEFO into an investment administration and management body for regional development, maintaining its location in the office of the First Minister.
- To the extent possible, implement a multi-annual approach to financing investment projects for regional development.
- Encourage cross-sector or cross-jurisdiction projects, including cross-border co-operation and with specific incentives for local authorities.

2. Ensure all levels of government have sufficient capacity to support place-based investment

- Increase capacity and expertise of local authorities in the design, implementation and evaluation of investment projects through knowledge transfer from WEFO and the DBW (among other agencies).
- Create an appropriately resourced PPP unit with sufficient resources and continue strengthening the use of the MIM.
- Ensure that *ex ante* analysis comes early in the investment cycle and that *ex post* evaluation includes outcomes,

3. Pursue additional sources of investment financing for regional development.

- Make City and Growth Deals more competitive with other UK City Deals by reinforcing their ability to leverage additional revenue and by improving their transparency and accountability.
- Promote the use of external financing mechanisms by local authorities (e.g. climate finance and land value capture) on a case-by-case basis and subject to mutually agreed-upon preconditions.
- Encourage the use of participatory budgeting and crowdfunding as complements to local authority financing for small-scale investment projects with high local visibility (e.g. community infrastructure, green and public space improvement, etc.).

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Notes

¹ The Welsh fiscal framework is composed of regulations relating to matters such as interactions between the Welsh and UK fiscal policies, intergovernmental arrangements and grants, borrowing limits and fiscal forecasting.

² The Regional Authority Index (RAI) is a measure of the authority of regional governments in 81 democracies or quasi-democracies on an annual basis over the period 1950-2010. Regional authority is measured along ten dimensions: institutional depth, policy scope, fiscal autonomy, borrowing autonomy, representation, law making, executive control, fiscal control, borrowing control and constitutional reform.

³ This is in contrast to “reserved powers” which remain at the level of the UK parliament.

⁴ The contribution of the UK government to expenditure made for Wales can be misleading and must be considered with caution. For instance, over GBP 480 million of UK capital expenditure was spent on defence in 2017, allocated as Wales’ share of the UK total, but very little was actually spent in Wales (Holtham, 2019^[26]).

⁵ According to the definition used by the Office for National Statistics (ONS) in the Country and Regional Public Sector Finances Release (UK Office for National Statistics, 2019^[120]), public expenditure is determined to be “for” Wales “if the benefit of the service derived from the expenditure is thought to accrue to the residents of Wales”. It is also defined by the ONS as identifiable expenditure. Conversely, non-identifiable expenditure is defined as “expenditure on services that is incurred to benefit the UK as a whole and cannot be identified as benefiting a particular country or region of the UK” (e.g. defence). In the Country and Regional Analysis Methodology (UK Government, 2019^[121]), non-identifiable expenditure is apportioned to devolved nations based on several indicators, such as population and GVA. Out of the total of identifiable and non-identifiable expenditure, part of these come from the UK government, some from the Welsh Government and some from local authorities.

⁶ Of this 59%, the Welsh Government is responsible for 33% and local authorities for 27%.

⁷ The Classification of the Functions of Government (COFOG) comprises 10 functional areas: general public service; public order, safety and defence; economic affairs; environmental protection; housing and community amenities; health; recreation, culture and religion; education; social protection.

⁸ Public sector refers to the general government sector, composed of total amount spent or received by the UK government, Welsh Government and local authorities, for Wales.

⁹ This average is based on revenue of the regional government sector (or state government sector in federal countries) only, in 20 EU and OECD countries, not including the local government sector.

¹⁰ Weighted average.

¹¹ All borrowing by publicly owned entities in the UK is treated part of the fiscal target the Public Sector Net Borrowing (PSNB). No distinction is made, as in other OECD countries, between general government borrowing, which has to be serviced from future taxation, and the borrowing of state-owned entities with their own-revenue and balance sheets. For these purposes, the Welsh Government is treated like a department of the central government (Holtham, 2019^[26]).

¹² Council Tax is a hybrid tax based on levied on the banded value of residential properties and household composition. Non-Domestic Rates are based on the assessed rental value of the property.

¹³ Local authorities and town and community councils can determine their own affordable borrowing limits within the framework set by the CIPFA Prudential Code, which sets indicators of affordability, sustainability and prudential rules for all local authorities at the UK level (Holtham, 2019^[26]). They can borrow to finance capital expenditure only (golden rule).

¹⁴ Excluding Major Repair Allowances (MRAs), which are funding paid by the central government to local housing authorities to maintain the housing stock.

¹⁵ Local Government Borrowing Initiative (LGBI).

¹⁶ A first agreement to retain part of the gains generated through development project was passed in 2019 with local authorities participating in the Swansea Bay City Deals.

¹⁷ COVID-19 presents opportunities and challenges regarding the introduction of tourist taxes. While crisis situations can facilitate introducing reforms, such as a new tax, the revenue that will be generated may be substantially lower than planned due to the impact of the crisis on the tourism sector.

¹⁸ Until 2020, European Structural and Investment Funds (ESIF) include the European Regional Development Fund (ERDF), the European Social Fund (ESF), the Cohesion Fund (CF) – all three of them compose the EU Cohesion Policy –, as well as the European Agricultural Fund for Rural Development (EAFRD), the Youth Employment Initiative (YEI), and the European Maritime and Fisheries Fund (EMFF).

¹⁹ WEFO is a special agency created by the Welsh Government to fulfil administration, management control and audit functions, as well as the creation of partnerships between public or private entities (sponsoring authorities). As a “Managing Authority”, WEFO is responsible for the efficient management and implementation of the ESIF programme.

²⁰ The delivery of health services is generally the responsibility of member state, and does not fall under the prerogatives of EU funding. However, to overcome its budgetary limitations in facing the COVID-19 crisis, the Welsh Government has been able to reallocate funding from EU projects which are no longer taking place into daily expenses related to the crisis (Cardiff University, 2020^[32]).

²¹ To be eligible for public financing, the investment project proposed by firms must demonstrate commitment to four requirements: growth potential, fair work, health promotion and reducing the carbon footprint. In return, the national framework could support those companies that align with the Welsh Government’s objectives (e.g. decarbonisation).

²² The Green Book is issued by HM Treasury to guide UK subnational governments on approved techniques and approaches to appraisal and evaluation issues.

Annex 4.A. Allocation of responsibilities in Wales

Annex Table 4.A.1. Responsibility sharing across levels of government: Wales

| Main responsibility/sector and sub-sector | Welsh local authorities | Welsh Government | UK Government |
|---|-------------------------|---|--------------------------------------|
| 1. General public services (administration) | | | |
| Administrative services (marriage, birth, etc.) | X | | X |
| Public buildings and facilities (townhouses, etc.) | X | X | X |
| Administration and operation of general services (not assigned to specific functions) | X | X | X |
| Basic research activities (not assigned to specific areas) | X | X | X |
| 2. Public order, safety and defence | | | |
| Police | X | X | X |
| Firefighting | | | X |
| Civil protection and emergency services | | X (Emergency services, Welsh Ambulance) | X (Civil Protection Mechanism) |
| Road traffic control/Traffic signs and lights | X | X | |
| Defence (military and civil) | | | X |
| 3. Economic affairs/Transport | | | |
| Road networks and facilities (highways, national, regional, local) | X | X | |
| Parking | X | | |
| Railway networks and facilities (national, regional, local) | | X | X |
| Airports (international, national, local) | | X | X |
| Ports (sea and fishing; inland waterways) | X | X | X |
| Public transport (road) | X | X | |
| Public transport (rail and tramway) | X | X | X |
| Special transport services (e.g. pupil and student transport) | X | X | |
| Employment policies/services | | X | X |
| Support to local enterprise and entrepreneurship | | X | |
| Agriculture, rural development, irrigation | | X | |
| Telecommunications/IT | | X | X |
| Manufacturing and construction | | X | X |
| Mining | X | X | X |
| Tourism | X | X | |
| Commerce | | X | X |
| Energy (electricity and gas) | | X | X |
| 4. Environment protection | | | |
| Parks and green areas | X | X | |
| Nature preservation | | X | X |
| Noise and vibration abatement | X | X | |
| Air pollution | | X | X |

| Main responsibility/sector and sub-sector | Welsh local authorities | Welsh Government | UK Government |
|---|-------------------------|------------------|---------------|
| Soil and groundwater protection | | X | X |
| Climate protection | | X | X |
| Waste management (collection, treatment and disposal) | X | X | |
| Sewage (wastewater management) | | X | |
| General drainage | X | X | |
| Street cleaning | X | | |
| 5. Housing and community amenities | | | |
| Drinking water distribution | X | X | |
| Public lighting | X | | |
| Urban heating | | | |
| Housing (subsidies) | | X | |
| Housing (construction and renovation) | | X | |
| Housing (management) | X | X | |
| Urban and land use planning | X | X | |
| Urbanism | | | |
| 6. Health | | | |
| Pharmaceutical and medical products | | X | X |
| General and specialised medical services and paramedical services | | X | |
| Primary healthcare (medical centres) | | X | |
| Hospital services (general and specialist) | | X | |
| Preventive healthcare | | X | |
| Public health services | | X | |
| 7. Culture, recreation and religion | | | |
| Sports and recreation | X | X | |
| Libraries | X | X | |
| Museums | X | X | |
| Cultural activities (theatres, exhibition halls, zoos, botanical gardens, etc.) | X | X | |
| Cultural heritage/monuments | | X | |
| Media/Broadcasting and publishing services | | X | X |
| Religious affairs | | | X |
| 8. Education | | | |
| Pre-primary education | X | X | |
| Primary education | X | X | |
| Secondary education | X | X | |
| Higher education (universities, other tertiary education institutions) | | X | |
| Vocational education and training (VET) | | X | |
| Special education | X | X | |
| Research and development | | X | X |
| 9. Social welfare | | | |
| Social care for children and youth | X | X | |
| Support services for families | X | X | |
| Elderly care | X | X | |

| Main responsibility/sector and sub-sector | Welsh local authorities | Welsh Government | UK Government |
|---|-------------------------|------------------|---------------|
| Care for disabled people | X | X | |
| Social exclusion/poverty (policies and benefits) | | X | |
| Immigrants | | | X |
| Integration of foreigners | X | X | |
| Social welfare centres | X | X | X |
| Housing subsidies/benefits | | X | |
| Unemployment subsidies/benefits | | | X |
| Total number of ascribed responsibilities | 38 | 64 | 28 |
| Total number of exclusive responsibilities | 3 | 26 | 3 |

Source: Welsh Government (2019^[19]), "Responses to OECD Questionnaire, unpublished"; OECD international experience with equalisation mechanisms: Some examples.

Estonia

In 2017, in order not to discourage municipalities from increasing their revenues, the Estonian government established an equalisation threshold. Even though a municipality's "estimated costs" (financing needs) have decreased due to higher local revenue, the corresponding share of the equalisation grant that it receives cannot decrease by more than 2% annually (OECD/UCLG, 2019^[17]).

Germany

Over the past 15 years, Germany's fiscal federalism has undergone several rounds of reform. Until 2020, there were two processes of equalisation at the *Länder* level: a vertical equalisation scheme, from the federal to the regional level, through a system of shared tax (VAT); and a horizontal equalisation scheme based on a system of shared taxes between states and funded by the *Länder* themselves, to ensure public services are equitably delivered in all regions. Wealthy *Länder* financially contribute to the revenue pool, and the funds are then redistributed to *Länder* with lower-than-average fiscal capacity (according to a formula based on per capita tax revenue of both the *Länder* and the municipalities). As of 2020, this system has been transformed. The new system shifts the former horizontal compensations, which are being abolished, into the vertical distribution of shared taxes (VAT). By doing so, it emphasises a reliance on shared taxes and the role of the federal government in the equalisation system to correct horizontal imbalances (Buettner and Krause, 2018^[112]).

Norway

Norwegian municipalities all share the same extensive responsibilities, but they generate significantly different levels of tax-based income. However, there is limited scope to increase local tax revenues. The fiscal equalisation system was developed on the principles of a partial equalisation of local taxes and a distribution of general grants to equalise expenditure needs (which can vary given differences in geography, demography and social characteristics). The system, however, does not subject municipal own-source revenues (e.g. property tax, hydro-power revenues, aquaculture revenues) to equalisation, as these are becoming increasingly important to municipalities, especially smaller ones (OECD, 2019^[11]; OECD/UCLG, 2019^[17]).

Annex 4.B. Developing a coherent investment framework: OECD international experience

Contracts and deal-making

France: State-Region Contracts

France has a long history of contractual arrangements linked to the decentralisation of specific tasks to regions, departments and, to some extent, municipalities. State-Region Contracts (*Contrats de plan État-Région*, CPER), launched in 1984, initially aimed at building regional capacity through a long process of negotiation between subnational governments and the central government's deconcentrated bodies. These contracts established the objectives, implementation and funding modalities for specific tasks. They can also have an incidence on financial transfers from the central level to the subnational one. France is now in its 6th generation of CPER and, through this process, regions have developed extended capacities and responsibilities in terms of economic development, employment and vocational training, including larger budgets and new actors involved (e.g. academics, civil society).

Other types of contracts have also blossomed: State-Metropolis Pacts were launched in 2016 in order to empower and support investment in metropolitan areas; between 2016-18, 485 contracts for rural development were signed to revitalise rural areas through initiatives in social cohesion, economic attractiveness, access to public services, mobility solutions, access to digital technologies, and the ecological and energy transition (OECD/UCLG, 2019^[17]; Charbit and Romano, 2017^[113]; CGET, 2017^[114]).

The Netherlands: City Deals

The Netherlands has recently introduced City Deals signed between the central government and subnational governments, as part of its New Urban Policy (*Agenda Stad*). They are designed to pool together existing funding streams to stir investment in Dutch cities in priority sectors. Dutch City Deals are not exclusive and Amsterdam has signed no less than six separate City Deals on different topics and in partnership with different combinations of other Dutch cities. For example, the first deal was signed for the development of a roadmap for the future economy and the second on climate adaptation. City Deals in the Netherlands are considered a way to encourage greater collaboration at the local and regional levels on topics such as economic development, clean energy and digitalisation, and to promote learning and innovation (OECD, 2019^[67]).

Aligning policy, planning and investment frameworks

“Project Ireland 2040”

“Project Ireland 2040” provides an overarching policy and planning framework for the country's social, economic and cultural development. This framework helps align the country's investment decisions with its planning framework to support better co-ordination and more efficient planning of public infrastructure investment across the country. It weaves together a detailed investment plan – the National Development Plan 2018-2027 (NDP), and a 20-year spatial plan, the National Planning Framework 2040 (NPF), to shape the future growth and development of the country to 2040. This provides the structure for the Regional Spatial and Economic Strategies (RSES), which are prepared by the country's three regional assemblies

and take into account the high-level frameworks and principles in the NPF and, in turn, informs local city and county planning and economic policy. The RSES take a cross-sector approach, combining a spatial strategy, an economic strategy and a climate strategy, and set the parameters for a number of funding sources – including the Urban and Rural Regeneration Funds, the Climate Response Funds, the Disruptive Technologies Fund and various enterprise funds. Each of these strategies is prepared with input from local authorities and other relevant stakeholders (such as government departments, state agencies, infrastructure and economic bodies) (e.g. the Minister and Department of Housing, Planning and Local Government, and the Irish Department of Public Expenditure and Reform) to set a regional co-ordination framework.

RSES inform decisions related to future regional public infrastructure aligned with the 10-year National Development Plan in order to enhance access to further funding opportunities. The investment framework is now in the process of being translated into an implementation and monitoring structure, with the concrete objective to enable and drive regional development and investment (Bradley, 2019^[115]).

The Multi-Year Programme for Infrastructure, Spatial Planning and Transport in the Netherlands

In the Netherlands, the Multi-Year Plan for Infrastructure, Spatial Planning and Transport (MIRT) is an investment programme set up by the Ministry of Infrastructure and Water Management, with the objective to improve coherence among investments across several areas: spatial planning, economic development, mobility and liveability. In addition, the MIRT is organised in “area agendas” (to be referred to in the future as “regional agendas”), where co-operation among national, provincial and municipal governments and third-sector actors can take place.

Any Dutch ministry and regional partners (provinces, municipalities, transport regions, or district water boards) can launch and/or participate in MIRT programmes. Each submitted project must pass through a MIRT Consultation Committee, guided by regional agendas, before being finalised in a collective agreement. This programme is funded through two funds emanating from the ministry: an Infrastructure Fund and a Delta Fund for water projects. The MIRT also set a framework with rules and procedures to access national investment funding in order to guide project proposals and project selections (Dutch Ministry of Infrastructure and Water Management, 2018^[59]; Government of the Netherlands, 2019^[116]).

Annex 4.C. Strengthening public investment management capacities: OECD International experience

Improving PPP performance with specialised units

Australia

In Australia, PPP units exist at both the national and regional levels. At the national level, Infrastructure Australia was established as an independent agency to provide advice on Australia's infrastructure priorities. Infrastructure Australia and the Australian government have jointly prepared and endorsed national guidelines for the delivery of infrastructure projects, to promote the use of good practice approaches covering three main modes of project delivery: traditional contracting, alliance contracting and PPPs. At the state level, three states have established PPP units (New South Wales Public-Private Partnerships, Projects Queensland and Partnerships Victoria). These units provide a wide range of services, including training in PPP contract management (dedicated to public sector employees) and fora where PPP contracts managers, from public and private sectors, can share best practices (World Bank Group, 2020^[117]).

Germany

In Germany, Partnership Germany (ÖPP Deutschland AG) was established in 2009 as a central unit to provide advisory services to government entities (e.g. federal government, federal states and municipalities). In 2017, Partnership Germany was converted into "PD – Consulting Agency for the Public Sector", a wholly publicly owned limited liability company, extending its consulting activities beyond PPP contracts alone. PD's particular focus today is to help local authorities implement public investment projects. Among other activities, PD manages a database of PPP projects all across Germany and organises an annual summer school dedicated to knowledge transfer among public sector practitioners. At the state level, *Länder* have also developed regional taskforce (e.g. in Bade-Württemberg) or networks of expertise (e.g. Lower Saxony), hosted in the Ministry of Economy or the Ministry of Finance, universities or regional investment banks, depending on the *Länd* (Federal Ministry of Finance, n.d.^[118]; Niedersachsen, n.d.^[119]).

Economic project appraisal in Ireland and Italy

Ireland

In Ireland, up-front investment prioritisation, planning and appraisal enable better value for money and performance monitoring. Robust appraisal brings analytical discipline and baseline data provides the platform for subsequent performance monitoring and evaluation. Ireland publishes all investment plans starting with the National Development Planning Process. Government departments and state agencies publish sectoral plans, which are consistent with the overall financial allocation. These set strategic policy and frame the context for major projects.

Individual projects must also stand up on their own merits. The central government issues rules on the type of appraisal that must be undertaken for a public investment according to the investment's financial scale. Compliance with this framework is a condition of delegated control over capital budgets.

Government departments are free to adopt their own sector-specific frameworks, consistent with the overall rules (OECD, 2018^[84]).

Italy

Italy has a new planning procedure to ensure more efficient and effective infrastructure spending, which includes economic project appraisal. The process is transparent and verifiable and the quantitative and qualitative decision-making criteria are explicit. Expenditure departments must prepare sectoral appraisal guidelines to define standard procedures for project appraisal in different investment sectors (e.g. mobility, energy, water management, etc.). The Programming, Evaluation and Analysis Unit (NUVAP) is responsible for providing methodological support to national and subnational (including local) public administrations, defining national standards for the evaluation of the economic and financial aspects of projects and spreading best practices (OECD, 2018^[84]).

5

Reinforcing the governance of regional development and public investment in Wales

Chapter 5 features an extensive discussion of the strengths and challenges of Welsh governance structures in their ability to support regional development and public investment. It focuses on the role of strategic frameworks and makes a case for introducing a unique national regional development policy, in order to align priorities and maximise limited resources, and for taking an integrated approach to development planning by regional and local bodies. It examines existing co-ordination mechanisms for regional development policy and public investment, and identifies potential new ones. It also explores obstacles to policy implementation and options for overcoming these, such as cross-jurisdiction co-operation, “learning by doing” and outcome-based monitoring and evaluation. The chapter emphasises the importance of building trust-based partnerships among different government actors, as well as with citizens, and closes with a series of recommendations for action.

Infographic 5.1. Key messages

Introduction

Designing and implementing an investment portfolio that advances regional development rests on a number of different capacities. Among these is the ability to invest using an integrated strategy tailored to different places. This means first articulating a strategic vision with clear objectives, defining the policy to support it and then engaging in regional development planning that is cross-sector, “place-tailored”, results-oriented, realistic, forward-looking and coherent with national objectives (OECD, 2013^[1]). Implicitly, it demands the ability to bring together and guide diverse policy sectors and interests to identify and implement regional development and investment priorities in a coherent, appropriately sequenced manner that optimises resources. Success can also depend on ensuring that activity takes place at the proper territorial scale (i.e. national, regional or local), and on taking a learning-based approach to building capacity at the national and subnational levels. Behind this is the need for a multi-level governance system that is fit for purpose – able to support all levels of government in making and implementing successful investment decisions for regional development.

The governance structures enabling the Welsh Government to undertake place-based and results-oriented investment planning for regional development post-Brexit are evolving. The NUTS2-level division for European Union (EU) funding and the Welsh European Funding Office (WEFO) have already introduced and generated a place-based approach to regional development and investment in Wales. The Welsh Government is poised to take this to a new level, putting in place public investment and multi-level governance mechanisms to support a stronger place-based approach as a means to better meet its growth plus inclusiveness aims and to generate greater well-being. To make the most of the opportunities associated with place-based regional development, the Welsh Government may need to further consider its strategic and policy frameworks¹ for regional development (Box 5.1). It may also need to diversify its policy co-ordination and implementation mechanisms in order to increase policy effectiveness and to build and generate trust-based partnerships. This is potentially one of the largest challenges facing multi-level governance in Wales and can affect the ability to create a governance environment that maximises investment potential.

Box 5.1. The scope of regional development

Regional development is a broad term that can be considered as a general effort to reduce regional disparities and foster balanced and inclusive growth in a country, an individual region or a metropolitan, urban or rural area. Since its introduction as a policy area in the 1950s and 1960s, the principal objective of regional policy among OECD countries has been greater equity and balanced development. Over time, this has evolved from top-down, subsidy-based interventions designed to reduce regional disparities into a much broader approach designed to improve regional competitiveness, often by adopting a strategy that advances “place”. This translates into focusing on specific regional assets rather than top-down investments and transfers, and covers a wide range of direct and indirect factors that affect performance, emphasising opportunity and promoting a collective or negotiated governance approach with national, regional and local government, as well as other stakeholders.

Regional development strategies and policies

A **regional development strategy** is a long-term plan to achieve a specified territorial goal or goals. It brings together the strategies of diverse policy sectors to support their coherent implementation and contribution to a territory’s productivity, growth, well-being and attractiveness. Such a strategy depends on coalescing a number of other elements, including various sectoral policies (e.g. education, economic development, employment, housing, innovation, land use, transport, welfare, etc.), the regional and local governments with whom policy responsibilities are shared, and the private sector and citizens.

A regional development policy represents an agreed-upon approach for action, charting a consistent course of action to achieve the goal(s) articulated in the regional development strategy. Policies may change with new government administrations, and thus tend to have shorter time horizons than strategies.

The terms strategy and policy are often used interchangeably but they differ in purpose (vision and objective setting versus guiding action and decision-making) and time frames (long term versus short or medium term).

Source: Adapted from OECD (2019^[2]), *OECD Regional Outlook 2019: Leveraging Megatrends for Cities and Rural Areas, Country Profiles*, <https://doi.org/10.1787/9789264312838-en>; OECD (2020^[3]), *Regional development Policy, Regional, rural and urban development*, <http://www.oecd.org/regional/regionaldevelopment.htm>; OECD (2013^[4]), *Poland: Developing Good Governance Indicators for Programmes Funded by the European Union*, <https://dx.doi.org/10.1787/9789264193543-en>.

This chapter focuses on the multi-level governance structures that support regional development and investment in Wales. It begins by highlighting OECD country approaches to establishing strategic frameworks for regional development, as well as the Welsh approach. It then moves to explore the mechanisms necessary to reinforce regional development policy co-ordination and integration in Wales. The chapter further considers national and subnational mechanisms that can help boost policy and investment implementation capacity, emphasising the importance of collaborative governance and arrangements. It also examines the role of outcome-based performance measurement in decision-making as a means to promote policy learning and strengthen accountability to citizens. Finally, the chapter considers the national/subnational disconnect in stakeholder engagement practices, offering insight into bridging this gap. The chapter concludes with recommendations for action to help all levels of government in Wales to reinforce their strategic planning and implementation capacity.

Strategic planning frameworks for regional development in OECD countries and Wales

A regional development strategy sets out a vision-based, long-range plan to achieve national, regional or local aims for growth. In doing so, it anchors sector policy interventions for regional development, for example in transport, housing, education, economy, innovation, etc., and facilitates integrated action by helping each sector understand and work towards realising agreed-upon, long-term development objectives. It differs from a regional economic development strategy (or other policy sector strategies) in scope and the breadth of policy levers used. Governments often struggle with the “vision” dimension of strategic frameworks because it requires thinking about a future state beyond immediate government cycles and political concerns. It means identifying what the nation (or region) wants to achieve over time while staying true to the government’s objectives during its mandate (OECD, 2010^[5]). The process involves drawing on capacities and capabilities that are often not fully developed or easily implemented in government, for example: distinguishing analysis horizons and acting accordingly (Table 5.1), and eliciting and considering diverse perspectives and sources of input for a long-term strategy, and for medium- and long-term budget planning; well-established evidence bases and a civil service able to provide evidence-based analytical advice; and being comfortable with opening dialogue up to private sector, third sector, civil society and citizen stakeholders (OECD, 2010^[5]).

While fundamental, vision setting is challenging and the lack of a long-term vision is not uncommon, many countries (e.g. Brazil, Canada, Chile, Germany, Greece, Ireland, Malaysia, the Netherlands, Portugal, Switzerland, Turkey and the United Kingdom [UK]) have a document outlining a strategic vision for their country. However, these often have a time horizon of one to five years. Thus, “vision” is often synonymous with a political strategy rather than a long-term future perspective. Increasingly, countries are aiming to

develop strategies that run 11-20 years (e.g. Costa Rica, the Czech Republic, Finland, Hungary, Israel, Lithuania, Mexico, the Slovak Republic and Slovenia) and a very few (e.g. Japan, Luxembourg and Norway) have documents beyond a 20-year horizon (OECD, 2018^[6]). As a subset of this trend, countries are turning their attention to vision setting for regional development concerns and are adopting a variety of approaches to do so. Two common ones are national-level dialogue through extensive consultation and establishing strategy or foresight units within the government (Box 5.2 and Annex 5.A).

Table 5.1. Horizons for strategic planning and decision-making

| Analytical needs | Characteristics | Requirements | Examples |
|---|---|--|--|
| Foresight (long term: > 10 years) | Anticipation of and preparation for foreseeable and disruptive/discontinuous trends; including future costs of today's decisions | Continuous scanning and consultation; pattern recognition; analysis of "weak signals"; future studies; consensual views | Futures reporting (e.g. on climate change); horizon scanning; long-term budget estimates; scenario planning |
| Strategic planning (medium term: 3-10 years) | Anticipation of and preparation for foreseeable changes; prioritisation, including future costs of today's decisions; risk management | Analysis of historical and trend data; comparable information and analysis across government; consultation on values and choices | Government strategy; medium-term budget frameworks; workforce planning; spatial and capital investment planning; innovation strategies |
| Decision-making (short term: 1-2 years) | Responsiveness; rapidity; accountability; ability to determine at what level decisions need to be taken | Quick access to relevant information and analysis; capacity for re-allocation of resources; overview of stakeholder preferences | Executive action; annual and mid-term budgets; crisis response |

Source: OECD (2010^[5]) (2010), *Finland: Working Together to Sustain Success*, <https://dx.doi.org/10.1787/9789264086081-en>.

Box 5.2. Approaches to long-term vision setting at the national level

An expanded list of country examples, including the two below, is available in Annex 5.A.

Vision setting using civic engagement and dialogue in Australia

In April 2008, the Australian government convened the Australia 2020 Summit to foster a national conversation on Australia's long-term future. The summit aimed to harness the best ideas for building a modern Australia, ready for the challenges of the 21st century. It brought together 1 000 participants from across the country to think about long-term challenges confronting Australia's future and requiring responses at the national level that would not be limited to the span of the usual electoral cycle. The summit generated more than 900 ideas over 2 days. Participants came from business, academia, community and industrial organisations and the media. They debated and developed long-term options for Australia across ten critical areas: productivity (education, skills, science and innovation); the economy; sustainability (e.g. population, climate change, water); directions for rural industries and communities; a long-term national health strategy; strengthening communities (e.g. social inclusion); indigenous populations; culture (e.g. art, film, design); governance; security and prosperity. The Department of the Prime Minister and Cabinet provided the Secretariat for the Summit and was responsible for co-ordinating the development of the summit report and the Australian government's response to the summit, as well as the implementation of the policies and programmes generated.

Vision setting using foresight and strategy units in Estonia

At the national level, the Strategy Unit, housed in the Government Office, is Estonia's centre-of-government long-term planning unit. The Strategy Unit is responsible for developing and implementing

government action plans and strategic development plans to increase the country's competitiveness and sustainable development. For example, preparations are underway to develop a long-term strategic vision called Estonia 2035, to reduce bureaucracy, fragmentation and the number of government level development plans. Estonia 2035 will take into consideration inputs from political and opinion leaders; top experts; and private, third and public sector organisations.

Source: OECD (2010^[5]) (2010), *Finland: Working Together to Sustain Success*, <https://dx.doi.org/10.1787/9789264086081-en>; OECD (2019^[2]), *OECD Regional Outlook 2019: Leveraging Megatrends for Cities and Rural Areas, Country Profiles*, <https://doi.org/10.1787/9789264312838-en>.

Regional development can be approached top-down. In such a case, the national government establishes the development vision and takes a command and control approach to policy design and implementation, identifying growth objectives, development opportunities and investment priorities. It can also be approached bottom-up, where subnational governments or other subnational actors identify local needs, establish plans to meet these needs and do their best to implement them. On their own, neither approach will fully satisfy stakeholders nor is likely to be sustainable in the long run. In many, if not most, OECD countries, top-down approaches are likely to meet strong implementation resistance. At the same time, bottom-up development may generate incoherence, disconnected investments across a territory and may rapidly face financing constraints. The challenge is to strike an appropriate balance. There is evidence indicating that strategies mixing a top-down and bottom-up approach are among the most effective (Crescenzi and Giua, 2016^[7]). A regional development strategy relies on an agreement between government, economic and social actors and citizens. Approached in this manner, it helps coalesce stakeholder opinion, supports decision-making, guides priority setting, sets a course of action and provides clarity with respect to the responsibilities and lines of accountability (Cuadrado-Roura and Fernández Güell, 2008^[8]). It can also help ensure that the resources and capacities inside and outside of government are aligned with priorities and actions. Additionally, strategic planning can help build social capital by promoting new forms of subnational governance, fostering co-operation and building ties among stakeholders. Finally, it can help establish agreements among the players involved, thereby building trust among diverse parties and interests and reducing risk at the implementation stage (Cuadrado-Roura and Fernández Güell, 2008^[8]). A well-articulated, long-term regional development strategy can promote policy coherence among sectors, and across jurisdictions, and enhance the use of scarce resources. In essence, it is the framework for action that enables different actors and interests to take responsibility for implementing the initiatives necessary to realise a society's long-term development vision (Cuadrado-Roura and Fernández Güell, 2008^[8]).

The majority of OECD countries present their long-term regional development strategies within a regional policy framework (Table 5.2), using one or more documents (on average two) to articulate their objectives and plans. In some countries, a legal framework is complemented by a more regularly updated plan (e.g. seven years is common in EU countries to align with the EU policy cycle). This permits maintaining a balance between stability and flexibility to adapt to changing circumstances. Slovenia takes such an approach, for example. In other cases, higher-level strategic planning documents are tightly associated with explicitly articulated investment strategies (this is true in Ireland, for instance). Often, countries will have a strategy for regional development together with an urban development policy and a rural development policy. In many instances, the national-level documents are complemented by regional development plans designed by subnational actors (OECD, 2016^[9]; 2019^[2]).

Table 5.2. OECD countries with and without an overarching framework for regional development

| With a regional policy framework | | Without a regional policy framework |
|----------------------------------|-----------------|-------------------------------------|
| Australia | Korea | Belgium |
| Austria | Mexico | Canada |
| Czech Republic | New Zealand | Chile |
| Denmark | Norway | Israel |
| Estonia | Poland | Germany |
| Finland | Portugal | Luxembourg |
| France | Slovak Republic | Netherlands |
| Greece | Slovenia | United Kingdom |
| Hungary | Spain | United States |
| Iceland | Sweden | |
| Ireland | Switzerland | |
| Italy | Turkey | |
| Japan | | |

Source: Originally in OECD (2015^[10]), “OECD Regional Outlook Survey”, GOV/RDPC(2015)8, OECD, Paris. Adapted from OECD (2016^[9]), *Regional Outlook 2016: Productive Regions for Inclusive Societies*, <https://doi.org/10.1787/9789264260245-en>.

Countries implement their regional development strategic frameworks in diverse ways. One is via well-co-ordinated sector policies that advance sectoral aims while contributing to growth and development at a regional level. Another is through a single, national regional development policy that establishes a consistent course of action, identifies priorities and articulates realistic objectives for territorial growth and development, serving as a guide for the regional interventions of sector policies. In both cases, the strategic framework – and the policies supporting it – provide national and subnational actors with a roadmap for designing programmes and projects to advance growth, productivity and well-being in a territory (Box 5.3 and Annex 5.A).

Box 5.3. Strategic planning frameworks in OECD countries: Some examples

An expanded list of country examples, including the three below, is available in Annex 5.A.

Australia

The national-level 2017 strategy document “Regions 2030: Unlocking Opportunity” outlines the Australian government’s regional development agenda. To support the development of the strategy, a ministerial taskforce was established and chaired by the Prime Minister. The strategy places regional Australia at the heart of government decision-making, where implementation is realised through investment and activity in five focus areas across government: i) jobs and economic development; ii) infrastructure; iii) health; iv) education; and v) communication. At the subnational level, several state governments have undertaken long-term strategic regional planning. For example, the state government of New South Wales (NSW) released “The Vision”, outlining its 20-year vision for economic development in regional NSW. The NSW state government assisted local councils to develop regional economic development strategies based on the concept of functional economic regions. Developing these enables faster access to dedicated state funding and may be used to support other types of government grant applications. Similarly, the Victorian state government has established nine regional partnerships. Through ongoing consultation, including nine annual regional assemblies, the

partnerships ensure that regional communities have a greater say about what matters to them and that the voices of these communities are heard by the government.

Ireland

Regional spatial and economic policy in Ireland is made by three regional assemblies established in 2015. The framework for this policy is set by “Project Ireland 2040” – the National Planning Framework (NPF) 2018, a long-term spatial development framework. This is complemented by the National Development Plan (NDP) 2018, a ten-year public investment strategy to 2027. Together, both the NPF and the NDP comprise a planning and investment programme for the future growth of Ireland’s regions, cities, towns and rural areas, focused on a common set of ten shared national strategic outcomes. The overall Project Ireland 2040 strategy is based on the enhanced growth of Ireland’s regions and in particular the four cities other than Dublin (i.e. Cork, Limerick, Galway and Waterford) to become accessible cities of scale. At the same time, it supports Dublin’s continued role as a key national growth driver. The strategy also identifies five smaller regional and cross-border growth drivers that complement the five-city catchment areas. Ireland’s regional assemblies develop spatial and economic plans for their territories. The Regional Spatial and Economic Strategy is the Eastern and Midland Regional Assembly’s approach to supporting Project Ireland 2040. It is based on a vision statement advancing sustainability, competitiveness and regional well-being and combines a spatial strategy with economic and climate strategies, as well as plans for “place-making” and for the first time a strategic plan for Dublin’s metropolitan development.

Slovenia

The Law on the Promotion of Balanced Regional Development provides a framework for making regional development policy more predictable and transparent, as well as fairer and more efficient. One of its main innovations is a mechanism to avoid needing ad hoc measures and region-specific legislation in response to shocks. Greater reliance on contractual arrangements for national co-financing of regional projects and emphasis on improving monitoring and evaluation is also used to strengthen accountability and co-ordination. Development decisions are adopted by Slovenia’s 12 regional development councils and the 2 development councils of the cohesion regions. The Development Strategy of Slovenia 2030 defines key challenges for improving the lives of current and future generations. It emphasises the sustainable use of natural resources to create a healthy living environment, ensure long-term food safety, create high-value-added economic activity and provide quality jobs. It includes environmental objectives such as introducing an ecosystem-based way of managing natural resources that overcomes sectoral silos; managing surface and groundwater effectively; developing forests sustainably to allow them to play an ecological, economic and social role; the prevention of excessive pollution; and maintaining high levels of biodiversity.

Source: OECD (2019^[2]), *OECD Regional Outlook 2019: Leveraging Megatrends for Cities and Rural Areas, Country Profiles*, <https://doi.org/10.1787/9789264312838-en>; Bradley, M. (2019^[11]), *Regional Spatial and Economic Strategy (RSES) for the Eastern and Midland Region*, Eastern and Midland Regional Assembly (Ireland).

The current Welsh regional development framework

The Welsh regional development agenda prioritises growth, inclusiveness and well-being, taking a place-based approach and aiming to strike a “top-down”/“bottom-up” balance. Implementing this agenda is challenged by two large considerations. First is defining – or better communicating – a strategic vision. Welsh stakeholders have expressed frustration with a lack of strategic vision for regional development by the government (OECD, 2019^[12]; 2019^[13]). This is understandable as an articulated vision can serve as a beacon not only for policymakers and local authorities but also for the private sector, civil society and

citizens. It can also lead to a common understanding among government and non-government actors of what is meant by and expected from regional development in a country, region or local authority. This could be particularly valuable for Wales. Second is managing policy fragmentation and optimising financing streams in order to best delineate and meet regional development aims. Articulating a long-term vision and strategy for Wales' regional development, combined with a dedicated regional development policy designed in concert with national and subnational stakeholders and supported by a targeted investment approach, could prove advantageous.

The current framework supporting decision-making for regional development in Wales is comprehensive, but fragmented across policy sectors and government departments. This puts policy coherence at risk and renders integrated, cohesive implementation potentially difficult. The framework rests on a legal foundation (as seen in a number of OECD countries) that is complemented by a number of strategy and policy documents, active and proposed. It is further reinforced by sector policies, EU Operational Programmes and financed through department budgets and EU funding, which will change post-Brexit. Moving forward there is value in considering a more integrated, streamlined approach to regional development policy.

The Welsh Well-being of Future Generations Act (WFGA) provides the statutory underpinnings for all policy action in Wales, including regional development. The WFGA sets the framework for accomplishing seven high-level well-being goals that dovetail with Welsh development ambitions (Welsh Government, 2017^[14]). The law requires that all government departments consider growth plus well-being in their policies and actions, and expects the same of local authorities through their Well-Being Plans. This statutory foundation is one strength of the Welsh regional development framework and could be considered the platform for developing a vision-based, long-term regional development strategy. In addition to the WFGA, a series of other strategic and policy documents set guidelines for regional development and investment: the Prosperity for All strategy, the Economic Action Plan, the National Development Framework for spatial planning, and the proposed National Framework for Regional Investment (Box 5.4). This latter document represents the intended mechanism to ensure investment financing and management in support of regional development aims, post-Brexit and now post-COVID-19. Ideally, it should serve as an “umbrella”, guiding regional development investment processes among policy sectors and levels of government in the short and long terms. By doing so, it can help advance long-term development aims, as well as current government documents, such as the Prosperity for All strategy and the Economic Action Plan, for example.

Box 5.4. Primary Welsh legislative, strategic and policy documents for regional development

The Well-being of Future Generations Act

The 2015 Well-being of Future Generations Act (WFGA) is an innovative piece of Welsh legislation and is the cornerstone of Wales's developmental framework. It aims to help Wales better address critical challenges, such as climate change, poverty, health inequalities, jobs and growth and promote long-term thinking when making policy decisions. While place-based development policy has traditionally aligned with gross domestic product (GDP)-based metrics, the WFGA requires that policymakers at all levels of government broaden their approach and ensure that development activities contribute to seven well-being goals: prosperity, resilience, health, equality, cohesiveness, culture and heritage, global responsibility. In addition to these goals, the WFGA recommends that the relevant public bodies adopt five working values – long term, prevention, integration, collaboration and involvement – to help them implement the act's “sustainable development principle”. There is a national-level Future Generations Commissioner and Public Service Boards were established at the local authority level with an obligation to produce well-being plans for their localities, identifying how they will engage with the WFGA's goals.

The Prosperity for All strategy

The Prosperity for All national strategy establishes the government's commitments for the 2016-21 period, including to adopt a regionally focused route to economic development, and aligns these to the WFGA. It promotes an integrated and place-sensitive approach to addressing five priority areas that contribute to economic development, well-being and quality of life: i) early childhood; ii) housing; iii) social care; iv) mental health provision; and v) skills and employability. These themes underscore the need to take a joined-up approach to policy design and implementation. They also require successful co-ordination within the Welsh Government as well as between the Welsh Government and its key national and local-level partners in the public, private and civic sectors.

The Economic Action Plan

The Economic Action Plan sets Welsh economic policy, combining a traditional growth and productivity approach with an emphasis on a vibrant foundational economy. It guides economic decision-making based on three economic regions (North Wales, South East Wales, and Mid and South West) and three national thematic sectors: i) tradeable services; ii) high-value manufacturing; and iii) key enablers such as digital technology and renewables. It also calls for an economic contract between government and the private sector. This is to ensure more public value from enterprises receiving public funds (e.g. co-financing private sector investment projects), and that enterprises receiving public funds support a series of calls to action – namely decarbonisation, innovation, digitalisation, exports and fair work – which also align with the WFGA and objectives in the Prosperity for All strategy. Finally, the Economic Action Plan emphasises developing a foundational economy by actively targeting support to “foundation sectors” – specifically food, tourism, retail and social care – that contribute to the country's ability to provide essential goods and services and support inclusive growth. To advance in this area, a Foundational Economy Challenge Fund was established. Fifty-two projects were selected to receive financing in the first round of project submissions. The Economic Action Plan's implementation requires cross-government support, particularly in terms of budget. Its implementation and financing depend not only on the Welsh Government but also on local authorities and the Economic Contract between the government and those actors (e.g. businesses) drawing on public funds.

The National Development Framework (currently in draft form)

The National Development Framework will identify and co-ordinate sectoral policies with spatial implications, for example among these sectors are education, energy, health, housing, skills, tourism, transport, etc. It will also set out strategic policies for (spatial) planning for each region and provide a framework for co-ordinating sectoral regional policies with spatial implications. The intent is to complement this national framework with statutory provisions for regional-level land use planning through Strategic Development Plans (SDPs).

A Framework for Regional Investment in Wales (proposed)

The investment framework being developed to manage and administer EU replacement funds would replace the investment programme and processes supporting regional development and currently associated with the European Structural and Investment Funds (ESIF) managed by the Welsh European Funding Office (WEFO), post-Brexit. It looks at investment from a national, regional (below NUTS2) and local perspective and intends to serve as a framework to ensure well-targeted investment, and optimisation of investment resources. It targets four national investment priorities based on socio-economic analysis and stakeholder feedback: i) addressing factors affecting income inequalities; ii) promoting more productive and competitive business; iii) transitioning to zero-carbon; and iv) building healthier, fairer, more sustainable communities. It establishes desired outcomes for each of these four areas, developing the overall investment approach around aligned investment and outcome priorities. The framework aims to support and will likely favour integrated investments and those that

are co-ordinated within regions, as well as at the national level (among Welsh Government departments).

Source: Welsh Government (2017^[14]), *Well-being of Future Generations (Wales) Act: The Essentials*, <https://futuregenerations.wales/wp-content/uploads/2017/02/150623-guide-to-the-fg-act-en.pdf>; Welsh Government (2017^[15]), *Prosperity for All: The National Strategy*, <https://gov.wales/sites/default/files/publications/2017-10/prosperity-for-all-the-national-strategy.pdf>; Welsh Government (2017^[16]), *Prosperity for All: Economic Action Plan*, <https://gov.wales/sites/default/files/publications/2019-02/prosperity-for-all-economic-action-plan.pdf>; OECD (2019^[12]), "OECD Interviews in Cardiff 24-28 June, unpublished", OECD, Paris.

As the Welsh Government's economic development policy, the Economic Action Plan provides a platform for growth and productivity and adopts a regional approach. Its implementation, however, may fall short of advancing integrated, place-based policy in the future. There are at least two reasons for this. First, it is grounded in a strategy with a lifespan of the present political cycle – i.e. Prosperity for All. While its aims may be longer-term, it is a policy document for the current government period. As such, while it may successfully guide economic decision-making now, its nature as a government policy document can contribute to policy instability and uncertainty, ultimately affecting potential public investment that relies on a longer-term vision and funding capacity. Second, the Economic Action Plan, while innovative, remains a sector policy, developed and implemented by the Department of Economy and Transport. As such, and given a tendency within the Welsh Government to work in silos (as is true in many governments) (OECD, 2019^[12]; OECD, 2019^[13]; Morgan, 2019^[17]; Beecham et al., 2006^[18]), engagement with other departments may be limited, in turn limiting a truly cross-sectoral, integrated approach to regional development and investment under this plan. Its success in advancing the country's growth, productivity, inclusiveness and well-being objectives depends precisely on transcending sectoral boundaries. Currently, there appears to be no formal or institutional incentive for ministers to actively engage with the Economic Action Plan, for example by aligning their sector's priorities or by ensuring that their policies and programming complement and build on those of the Economic Action Plan (OECD, 2019^[12]). At the same time, there is also little intrinsic incentive for those implementing the Economic Action Plan to "join-up" with other sectors. Third, an integrated approach to regional development and investment is ideally introduced at the inception of a strategy and policy. It is very difficult to build it in and ensure it *ex post* through an individual policy.

Welsh regional development at the national level is also supported by two distinct yet interdependent strands of policies and development programming and financing. The first strand is composed of sector policies and their programming that can contribute to regional development, for example, education, energy, housing, innovation, tourism, transport, etc. These policies have a national and subnational (regional and/or local) implementation logic and are funded by the budgets of the relevant government departments, as well as diverse EU financing mechanisms (e.g. Horizon 2020, COSME).² Regional-level development planning and programming occur through the various City and Growth Deals implemented at a cross-jurisdiction or "functional" scale in the Cardiff Capital region, Swansea Bay and North Wales.³ At the local level, local authorities are responsible for a variety of plans to support or advance their growth and development, including local transport plans, local housing strategies, Welsh in Education strategic plans and local development plans. Finally, the Well-Being Plans designed by Public Service Boards can also contribute to regional development in their ability to pinpoint where attention needs to be placed to foster a better quality of life for residents in one or more local authorities.

In the second strand are the Welsh EU Operational Programmes (OPs) and their associated initiatives and projects financed through European Structural and Investment Funds (ESIF). These have an implementation logic that is at once broadly regional – focused on the NUTS2 levels of West Wales and the Valleys, and East Wales – and local, since many projects are designed and implemented by local public, private and third sector actors. OP activities and EU funds help Wales realise broad development objectives (e.g. greater competitiveness and productivity) as well as sector policy goals (e.g. in tourism). Table 5.3 provides an indicative list of the Welsh strategy documents, policies and plans contributing to

regional development and funded by one of the two main funding strands (i.e. national budget and/or EU financing). It is not an exhaustive list. With the exception of the Regional Economic Frameworks and the Mid Wales Growth Deal, which appear in subsequent discussions of this report and its case study, the table only includes strategies, policies or plans that are currently operational.

One of the most significant challenges confronting Welsh regional development and investment planning is its fragmentation. As indicated in Table 5.3, it is crowded with many discrete national- and subnational-level policies and plans that have an explicit or implicit regional development logic. While such fragmentation is not unique to Wales, it does require high levels of co-ordination to ensure policy coherence and an integrated approach, as well as clearly established investment priorities. This is especially the case in light of the current uncertainty regarding investment financing levels arising from Brexit and the impact of COVID-19, particularly on finances and investment needs. With Brexit, Strand 2 (see Table 5.3) will eventually disappear, presenting an opportunity to streamline and reduce fragmentation. Uniting both strands under the proposed Framework for Regional Investment and better harmonising and co-ordinating public investment financing to meet regional development goals is one step towards generating greater co-ordination. It does not mean, however, that individual departments with their individual policy areas are no longer responsible for or should stop financing regional-level policy interventions or programmes to meet their sector's objectives.

Table 5.3. Two strands for Welsh regional development planning, implementation and funding

| Policy planning and/or implementation | Funding Strand 1 (national or combined) | Financing sources | Policy planning and/or implementation | Funding Strand 2 (EU) | Financing sources |
|---------------------------------------|---|--|--|---|-------------------------------------|
| Welsh Government | Select department/sector policies contributing to regional development: - Economy - Education - Energy - Housing - Innovation - Agriculture/food - Tourism - Transport | Welsh government departments and EU funds | Welsh Government (WEFO) | EU Operational Programmes (OP) Priority axes: - Research and innovation - Competitiveness - Renewable energy and energy efficiency - Connectivity and urban development - Sustainable employment - Skills for growth - Youth employment | EU ESIF ERDF/ESF Co-financing |
| Cross-jurisdiction/functional areas | City and Growth Deals: - Cardiff Capital Region City Deal - Swansea Bay Region City Deal - North Wales Growth Deal - Mid-Wales (planned) Regional Economic Frameworks (not yet in place) | UK government Welsh government Local authorities Other public and private sectors | NUTS2 Regions: West Wales and the Valleys East Wales | OP Thematic Objectives (various) | |

| Policy planning and/or implementation | Funding Strand 1 (national or combined) | Financing sources | Policy planning and/or implementation | Funding Strand 2 (EU) | Financing sources |
|---------------------------------------|---|---|---------------------------------------|---|--------------------------|
| Local authorities | Select local-level planning documents: - Local Transport Plans - Local housing strategies - Welsh in Education strategic plans - Local Development Plans (land use) | Welsh Government grants/transfers Local authority budget | Local authorities | Individual programmes and projects supporting Thematic Objectives | ERDF/ESF Co-financing |
| Public Service Boards | Well-Being Plans | | Other beneficiaries | Individual programmes and projects | ERDF/ESF Co-financing |

Note: The above list of strategy documents, policies and plans contributing to regional development is not exhaustive. Not incorporated is the priority axis for the European Regional Development Fund (ERDF) and European Social Fund (ESF) dedicated to technical assistance.

Source: Welsh Government (2019^[19]), "Responses to OECD Questionnaire, unpublished"; OECD (2019^[12]), *Promoting Growth in All Regions*, <https://dx.doi.org/10.1787/9789264174634-en>; OECD (2019^[13]), "OECD Interviews in Wales, 25-29 November, 2019, unpublished", OECD, Paris; Welsh Government (2014^[20]), *ESF East Wales Operational Programme Summary*, <https://gov.wales/sites/default/files/publications/2019-06/east-wales-esf-operational-programme-summary.pdf>; Welsh Government (2014^[21]), *ERDF West Wales and the Valleys Operational Programme Summary*, Welsh Government, <https://gov.wales/sites/default/files/publications/2019-06/west-wales-erdf-operational-programme-summary.pdf>.

Taking a long-term and streamline approach to regional development policy in Wales

A standalone, long-term national regional development policy is not a panacea for low regional growth but it can be a step towards promoting a stable, long-term regional development path for Wales. It offers the opportunity to create a truly integrated policy approach and is associated with some distinct advantages (Box 5.5). Significantly, it helps coalesce investment priorities, ideally contributing to synergies and complementarities in investment initiatives rather than engendering competition. Designing and implementing an integrated, national regional development policy supported by a comprehensive public investment policy necessarily requires effective collaboration and co-operation among diverse stakeholders across government. This can help build a stronger sense of ownership for the policy, its objective and outcomes. It can also provide an opportunity for more innovative solutions, and smooth out potential implementation difficulties at the design stage. Introducing such a policy could help Wales address the problem of fragmentation in its policy documents for regional development, contribute to a more "joined-up" approach to policymaking and most importantly serve as an essential roadmap for sector strategies and policies that contribute to the Welsh regional development agenda of growth plus inclusiveness.

Box 5.5. The benefits associated with a national policy for regional development

The added-value to introducing a discrete national policy for regional development is several-fold:

1. When well designed, executed and monitored, national regional development policy is a mechanism to align priorities and build greater coherence and complementarity among the various sectors involved, particularly since sector priorities and approaches may differ among them. When regional development is approached in terms of an integrated policy package

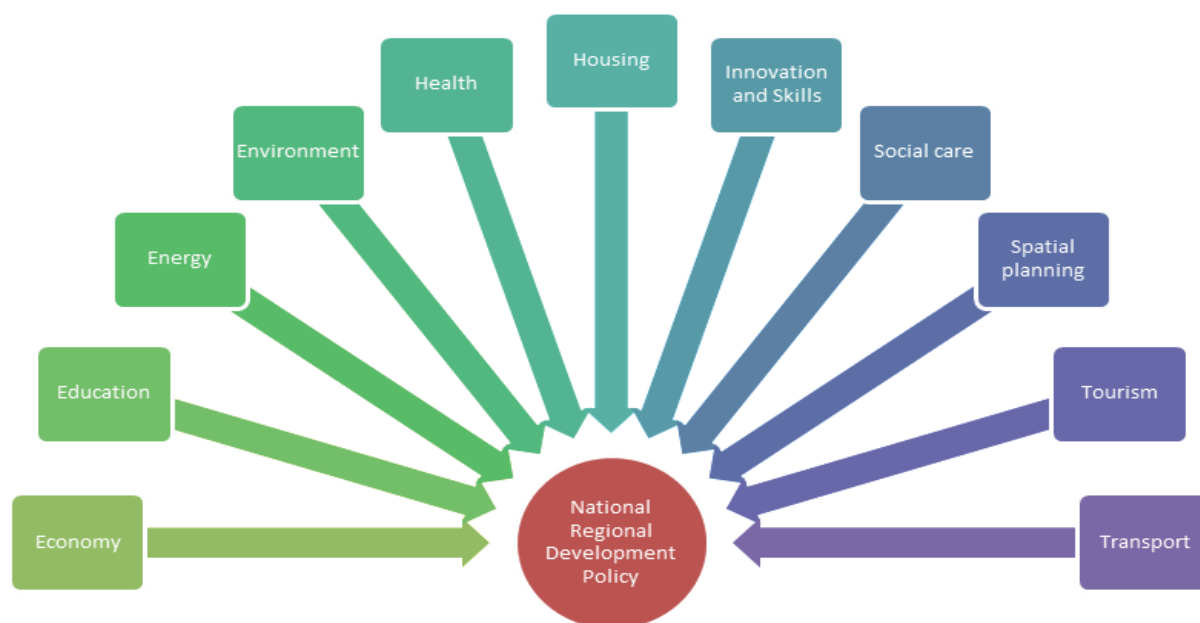
rather than individual sector interventions, there is less potential for the unintended and undesirable effects that can arise when policy measures are undertaken in isolation.

2. It sets clear guidelines for decision-making and action in a complex, cross-sector, multi-stakeholder policy area.
3. It facilitates capitalising on cross-sector policy synergies that can better promote inclusive and sustainable growth.

Source: OECD (2012^[22]), *Promoting Growth in All Regions*, <https://dx.doi.org/10.1787/9789264174634-en>.

The WFGA establishes a legal framework for Welsh development policy overall, and the Economic Action Plan can provide immediate guidance regarding economic investment priorities. Thinking ahead, however, establishing a national regional development strategy that guides growth and investment efforts over the long-term, across electoral cycles, and which has benefitted from the contributions of diverse sectors and stakeholders (including other political parties), would be valuable. Accomplishing this takes time and now may be the moment to begin the vision setting and strategic planning exercises. This could clarify a societal vision of what regional development means and looks like in Wales, as concretely as possible. Consideration should also be given to articulating and implementing a cross-sector national regional development policy designed in collaboration with the departments of relevant policy areas (Figure 5.1) and local authority representatives, well-co-ordinated in its governance and supported by effective implementation mechanisms. Such a document could guide regional development activities and national and subnational actors in their investments – establishing priorities, allocating funds and implementing growth-oriented projects.

Figure 5.1. Examples of policy sectors contributing to national regional development policy



Note: This schematic is not an exhaustive presentation of all policy sectors that contribute to regional development policy. It is indicative and intended to show how national regional development policies bring together various sectors.

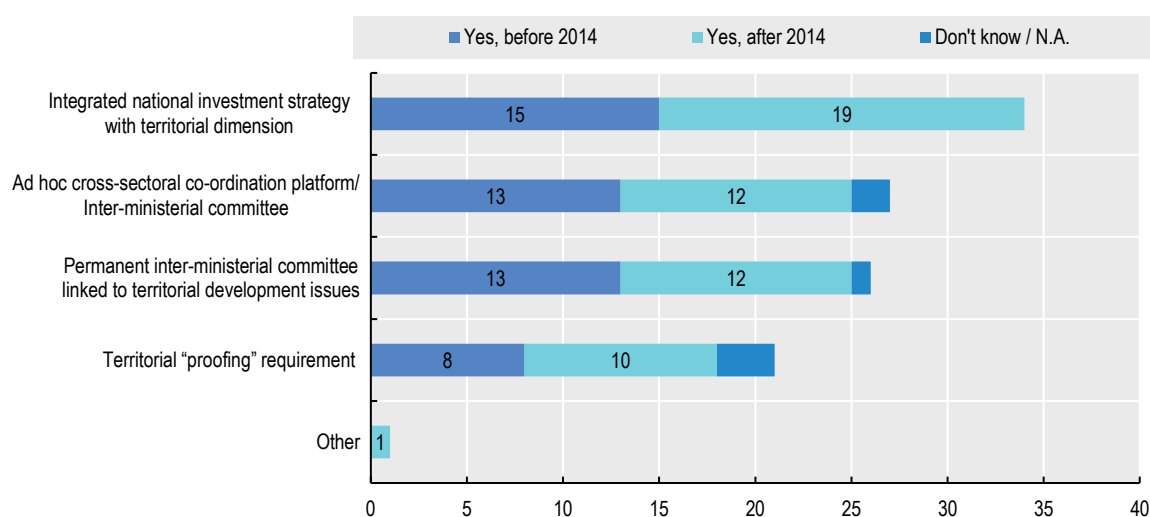
Moving forward, a more streamlined approach to regional development and investment in Wales would be valuable. This can entail integrating the two strands by introducing a unique, vision-based development strategy and supporting this with a dedicated, cross-sector policy for regional development, supported by the proposed Framework for Regional Investment. It also means that this revised strategic and policy framework for regional development (as discussed above), combined with the proposed Framework for Regional Investment, be applied more broadly than regional development and investment initiatives undertaken through the proposed EU replacement funds. It should serve as the national strategic policy and investment guidance for regional development throughout Wales and Welsh Government. Significantly, it should not at all limit sector activity at a regional level, nor taking a subnational approach to identifying and realising development priorities in a place-based manner, but rather it should guide a co-ordinated, collaborative effort. In the immediate term, Wales should also maximise what its current regional development framework offers, while also preparing for a post-Brexit future and managing the economic, societal and fiscal impact of the COVID-19 crisis. To accomplish this, the Welsh Government will need to strengthen and diversify its co-ordination mechanisms supporting regional development.

Reinforcing regional development policy co-ordination and integration in Wales

There has been an ongoing trend among OECD governments to reinforce cross-sector co-ordination mechanisms to better co-ordinate public investment strategies for regional development. Placing greater emphasis on strategic planning for regional development investment is the most common approach. This is followed by introducing a cross-sector co-ordination platform, be it ad hoc or permanent (Figure 5.2).

Figure 5.2. Reinforcing cross-sector co-ordination mechanisms for regional development

At the national/federal level, has your country developed or strengthened any of these mechanisms as a means to better co-ordinate public investment strategies for regional development?



Note: Number of respondents (N)=27.

Source: OECD (2019^[23]), *Effective Public Investment across Levels of Government: Implementing the OECD Principles*, <https://www.oecd.org/effective-public-investment-toolkit/>.

The Welsh Government could take a deeper look at the co-ordination mechanisms and incentive structures it applies to regional development and integrated investment initiatives. Responsibility for advancing the Welsh Government's regional development agenda is spread throughout the government. It rests with the First Minister's office and in the hands of its ministers and their departments. There is nothing intrinsically wrong in this. However, effective policy implementation in the Welsh configuration, with its policy fragmentation and a tendency to work in silos, requires strong horizontal and vertical co-ordination among actors, and a high degree of incentive to work together. Finding the right mix among various co-ordination mechanisms is fundamental and is generally considered one of the main challenges to effective subnational public investment, as well as regional development. One objective is to avoid unilateral decision-making (OECD, 2018^[24]) and another is to break down silos by building or reinforcing a culture of cross-sector collaboration. The use of formal instruments, such as contracts or agreements, can help build trust between parties, as can mechanisms that bring together diverse national and subnational, public and private stakeholders.

For the Welsh Government, reinforcing and diversifying the co-ordination mechanisms it uses would help optimise the current regional development framework and successfully implement any future regional development strategy and/or policy. At the national level, consultation and consultative bodies are strongly emphasised. There are advantages to this, particularly in terms of trust and relationship building. As it moves to reinforce the governance of regional development and investment, establishing co-ordinating bodies, better targeting the use of consultative bodies, enhancing the role of the centre of government and establishing or identifying a "champion" for regional development would all be useful, particularly at the national level. Meanwhile, at the subnational level, there is room to continue strengthening some of the newly introduced policy co-ordination mechanisms, such as the Regional Economic Frameworks.

Making the most of national-level co-ordinating bodies and dialogue mechanisms

National-level co-ordination mechanisms in Wales centre on consultation. There are a number of high-level government bodies, both permanent and ad hoc, that focus on various aspects of regional development but are not necessarily tasked to ensure its co-ordination. These bodies include the First Minister's cabinet, the Executive Committee/Council and a Senior Leadership Group (Welsh Government, 2019^[19]). They are complemented by a series of high-level consultative bodies, such as the Regional Investment for Wales Steering Group, the Council for Economic Development and the Workforce Partnership Council (multi-level dialogue bodies are discussed below). With the exception of the First Minister's cabinet, none of these bodies is recognised as having a co-ordination role and statutory underpinnings are limited⁴ (Morgan, 2019^[17]).

Welsh consultative bodies offer expert insight, advice and perspective to the Welsh Government and are very useful dialogue arrangements, the value of which is often overlooked. However, it is important to consider the number and effectiveness of consultative and other dialogue arrangements and the motivation of actors to participate in them. Ignoring this can lead to "consultation fatigue", particularly in small public administrations and small countries where actors play a number of roles and sit on various such bodies. This is not to say that Welsh consultative bodies should be eliminated, not at all. However, they are what they are called upon to do – consult – not co-ordinate or guide or support policy and investment implementation.

Inter-ministerial co-ordinating bodies

Regional development policy is, by nature, cross-sectoral. As such, it is called upon to foster a sense of ownership among the various relevant sectors (i.e. line ministries/departments) and stakeholders and ensure leadership. Without these, there may be implementation difficulties and accountability can be vague. High-level inter-ministerial bodies can help create a sense of ownership and responsibility for the policy among the relevant line ministries/sectors/departments while crystallising leadership and

accountability overall. Over time, they can also strengthen a shared value set at the leadership level and build trust among potentially divergent interests (OECD, 2011^[25]).

A high-level, inter-ministerial co-ordinating body for regional development can be an effective mechanism to align interests and priorities across government departments (i.e. line ministries). It can help identify complementarities among sector strategies and programmes, harmonise rules and support joint investment pools across departments or public agencies. It may also serve to establish a clear and transparent priority-setting process that considers the territorial impact of development initiatives and investment projects (OECD, 2019^[23]). Ultimately, such a body is valuable for ensuring high-level guidance, co-ordination and discussion of matters related to regional development. In France, for example, an inter-ministerial committee is the lead body for regional development at the national level (OECD, 2016^[9]).

Inter-ministerial committees and commissions are one of the simplest systems for horizontal governance, as they are based on already established government structures. Their effectiveness, however, is mixed. Experience from OECD member countries indicates that a horizontal commission chaired by one sectoral ministry may be limited in pursuing multi-sectoral objectives and hinder full involvement of other ministries, rendering the mechanism potentially less appropriate for co-ordinating cross-sector policies, such as regional development. Alternating the chair among participating ministries or introducing meta-ministerial leadership is one way to address this. The higher the leadership within these types of commissions, the stronger the incentive to participate and the greater the engagement of the different actors. In general, the dominant approach to inter-ministerial committees for regional development at the national level has been to endow them with a co-ordination function to streamline policy implementation. Committees that do not meet regularly or lack a permanent structure tend to have significantly less influence in defining relevant policies. Despite these challenges, some inter-ministerial committees and bodies provide a genuine forum to advocate policy reforms at the national level through horizontal co-ordination, such as Australia's Council of Australian Governments (COAG) (OECD, 2016^[9]). Iceland and Poland have effective inter-ministerial co-ordinating bodies for regional development (Box 5.6). In the case of Poland, the high-level body is supported by sub-committees that examine more technical issues. Such technical bodies – sub-committees, working groups or potentially consultative bodies – may be well placed to review policies at an early stage in order to ensure that the impact on different types of regions and localities are adequately considered.

Box 5.6. Inter-ministerial co-ordinating bodies for regional development: Iceland and Poland

Iceland

Iceland's governmental Steering Committee for Regional Development is the government's long-term planning and strategic foresight unit. The role of the committee is to ensure harmonisation among ministries for the implementation of regional policy and to ensure active consultation with local governments. Headed by the Ministry of Regional Development, the committee brings together representatives from all ministries, as well as one a representative from the Icelandic Association of Local Authorities. The Icelandic Development Institute and the Regional Association of Municipalities are observers on the committee. The committee also meets annually with local governments to develop and oversee the objectives of regional action plans.

Poland

Poland has established the Co-ordinating Committee for Development Policy (CCDP) as a permanent inter-ministerial committee linked to regional development issues through sub-committees (e.g. sub-committee for rural areas development, sub-committee for territorial dimension). The CCDP

carries out analysis and draws documents to facilitate the implementation of the country's Strategy for Responsible Development, which has a strong territorial dimension.

Source: Iceland: OECD (2019^[21]), *OECD Regional Outlook 2019: Leveraging Megatrends for Cities and Rural Areas, Country Profiles*, <https://doi.org/10.1787/9789264312838-en>; Hilmarsdóttir, U. (2019^[26]), *Regional Plans in Iceland: Decentralization of Funding and Power to Local Authorities through Regional Associations of Municipalities*; Poland: OECD (2019^[23]), *Effective Public Investment across Levels of Government: Implementing the OECD Principles*, <https://www.oecd.org/effective-public-investment-toolkit/>.

Multi-level and/or multi-stakeholder co-ordination and dialogue platforms

OECD experience shows that countries with well-developed vertical co-ordination arrangements, such as inter-governmental committees and regular formal meetings, have a comparative advantage when introducing and implementing reform (OECD, 2017^[27]). These bodies can take different forms, such as a dedicated permanent policy exchange conference or council. Australia's Council of Australian Governments (COAG), Spain's Conference of Presidents and Portugal's permanent Council for Territorial Dialogue are examples. In each case, the body is chaired by the Prime Minister and brings together the presidents or heads of subnational governments (OECD, 2017^[27]). Poland has taken a slightly different approach with its Joint Central Government and Local Government Committee. Sweden has established a national multi-level, multi-stakeholder forum to support its regional development agenda, and some Swedish regions, such as Örebro County, create similar opportunities as well (Box 5.7). Multi-level dialogue fora bring together a combination of national and subnational public, private and third sector actors in a regular, formalised manner are frequently used for co-ordinating regional development and investment priorities (OECD, 2018^[24]). Such bodies: provide actors with the opportunity to share perspectives and experiences; understand the needs and problems of different levels of government; submit proposals and comments; negotiate with each other; and obtain help in the design, implementation and monitoring of policies or reforms. The Partnership Council for Wales provides a forum for multi-level dialogue. It brings together the Welsh Government and local authorities to discuss and agree upon matters affecting the local level and promote more effective and efficient public service. It is a statutory body chaired by the Minister for Housing and Local Government and could offer a platform for more targeted exchange on regional development (WLGA, n.d.^[28]).

Box 5.7. Dialogue bodies in Poland and Sweden

Poland

Poland supports dialogue between levels of government with its Joint Central Government and Local Government Committee. This body is composed of the minister responsible for public administration and 11 representatives appointed by the prime minister (at the request of the chair), together with representatives of national organisations of local self-government units that work in 12 "problem teams" and 3 working groups. It considers issues related to the functioning of municipalities and the state policy on local government, as well as with issues related to the local government within the scope of operation of the EU and the international organisations to which Poland belongs. It develops a common position among levels of government and contributes to establishing the economic and social priorities of national and subnational government on matters such as municipal service management and the functioning of communal and district government, as well as regional development and the functioning of *voivodeship* (province) government. The Joint Committee develops social and economic priorities that can affect subnational development, evaluates the legal and financial circumstances for operating

territorial units, and gives an opinion on draft normative acts, programmes and other government documents related to local government.

Sweden

In Sweden, the Forum for Sustainable Growth and Regional Attractiveness facilitates and maintains a continuous dialogue among a wide and diverse array of stakeholders (e.g. central government, central government agencies, regional governments, municipalities, third sector actors and the private sector). The forum is part of the implementation of Sweden's National Strategy 2015-2020. It is considered an important tool for multi-level governance and to support national- and regional-level policy development through dialogue and co-operation. It is divided into two groups: one that promotes dialogue between national- and regional-level politicians, and one that fosters dialogue between national- and regional-level civil servants (director level). Associated with the forum are networks and working groups, such as an "analysis group" that brings together 16 state agencies. The forum is led by the state secretary responsible for regional growth policy and participants are regional leaders and civil servants with regional development responsibilities in their portfolios; there are about 50 regular participants at the political level. Additional participants, such as ministers, state secretaries and directors within state agencies, can be invited on an ad hoc basis, depending on the agenda topics. The forum can serve as a "regional lens" or "prism" through which to consider diverse sector initiatives, e.g. in housing, innovation and transport.

Institutionalising events or other opportunities to gather a range of stakeholders together to contribute to the policy process can contribute to building trust, fostering collaboration and generating partnerships. In Örebro County, Sweden, for example, regional development planning and implementation are considered a constant cycle, undertaken in collaboration with government agencies, municipal authorities, the county government, universities, industry and civil society. Consultation occurs through different mechanisms, including workshops on prioritised subjects, follow-up seminars, project meetings, dialogue meetings with partner organisations, a regional development forum, and "Loka Days". Regularly, for two days every August, county decision-makers gather in Loka, a spa village in northern Örebro County, to discuss matters associated with the regional development plan. Approximately 150 politicians, high-level civil servants, private sector representatives and representatives from civil society organisations participate. This effectively serves to institutionalise a practice of exchange and build stronger ties among the participants. Additionally, by creating a variety of opportunities for stakeholder consultation, Örebro County offers a consultation platform or mechanism is easy, accessible and relevant to the participants.

Source: Poland: adapted from: Lublinksa, M. (2017^[29]), "Decentralisation and multi-level governance in Poland: Ensuring coherence between national and subnational development strategies/policies", <https://www.oecd.org/regional/regional-policy/Decentralisation-and-multi-level-governance-in-Poland.pdf>; Government of Poland (n.d.^[30]), "Unpublished Documents", Department for Development Strategy, Ministry of Economic Development; Sweden: OECD (2017^[31]), *OECD Territorial Reviews: Sweden 2017: Monitoring Progress in Multi-level Governance and Rural Policy*, <https://dx.doi.org/10.1787/9789264268883-en>; Persson, M. (2019^[32]), "Success factors in regional development reform and investment: The Örebro County perspective", Presentation given at the OECD Seminar "The Future of Regional Development and Investment in Wales".

Ensuring effective dialogue, one that also advances the implementation of a policy or policy agenda, offers a number of advantages. It can help governments share evidence, gain insight into what works well and what does not work, where to focus implementation and investment efforts, and under what conditions. However, merely establishing dialogue mechanisms does not automatically guarantee the effective co-ordination of objectives and actions, and some conditions can facilitate effective exchange. Transparent rules, the simplicity of the information shared, the credibility of actors and cross-government commitment are important ingredients to encourage all parties to engage in a fruitful dialogue (OECD, 2019^[23]).

Box 5.8 offers a summary of some points to keep in mind when designing and engaging with co-ordination mechanisms for regional development and investment.

Box 5.8. Pointers for successful co-ordination of regional development and investment

- Ensure regular and formalised consultation of subnational government when developing national strategies and plans.
- Share information simply, credibly, transparently and continuously.
- Ensure that platforms for regular inter-governmental dialogue are established and used throughout the investment cycle and include multi-stakeholder involvement.
- Co-ordinate with other levels of government early on in the policy and investment decision-making process.
- Ensure that co-ordinating bodies involved in a decision-making process have a clear and clearly understood value-added.
- Consider the need, effectiveness, and motivation of actors to engage in a formal co-ordination arrangement, and balance formal mechanisms with informal dialogue and social networks that favour establishing and advancing co-operative relationships.

Source: Adapted from OECD (2019^[23]), *Effective Public Investment across Levels of Government: Implementing the OECD Principles*, <https://www.oecd.org/effective-public-investment-toolkit/>.

As it advances with its regional development agenda, in order to better support the horizontal, high-level co-ordination of its regional development agenda, the Welsh Government may wish to:

- Establish an inter-ministerial co-ordinating body for regional development, ideally chaired by the First Minister and on which sit the ministers whose portfolios have a regional development logic.
- Complement the above inter-ministerial co-ordinating body with a technical body of civil servants representing each ministry to explore specific matters.
- At a minimum, consider establishing a sub-committee for regional development attached to an appropriate cabinet-level committee, and with a clear co-ordinating mandate coming from above.

Furthermore, introducing a multi-level, multi-stakeholder regional development dialogue forum would be valuable. This should include not only representatives from the Welsh Government responsible for regional development but also the Welsh Local Government Association (WLGA), local authorities and other stakeholders. It should be able to play a strategic role in supporting the realisation of regional development objectives, for example not only identifying regional development needs and priorities, but contributing to possible solutions for regional development challenges. The Partnership Council for Wales could form the basis for such a body. As a subset of a multi-level, multi-stakeholder dialogue forum or as a standalone entity, a national-level dialogue forum for Public Service Board (PSB) representatives could be useful to share knowledge, exchange good practices and further advance the Welsh well-being agenda. There is discussion in Wales to establish such a body. Doing so could help build capacity among PSBs in developing their well-being plans and taking a place-based approach to well-being assessments (Netherwood, Flynn and Lang, 2017^[33]).

Reinforcing the centre of government to meet the demands of government's changing role

In Wales, an integrated and co-ordinated effort for regional policy may need to be more strongly reinforced by the centre of government. Among many OECD countries, centres of government are emerging as major actors in articulating overall government priorities and supporting an outcome-oriented approach to achieving them, including through cross-departmental action plans (Box 5.9) (OECD, 2017^[34]). They are also becoming more involved in the implementation of horizontal policies, e.g. through delivery units. This evolution does not necessarily imply greater centralisation but rather reinforces a supporting and advisory role, thereby enabling line ministries to contribute to horizontal projects without questioning their autonomy or expertise (OECD, 2017^[34]).

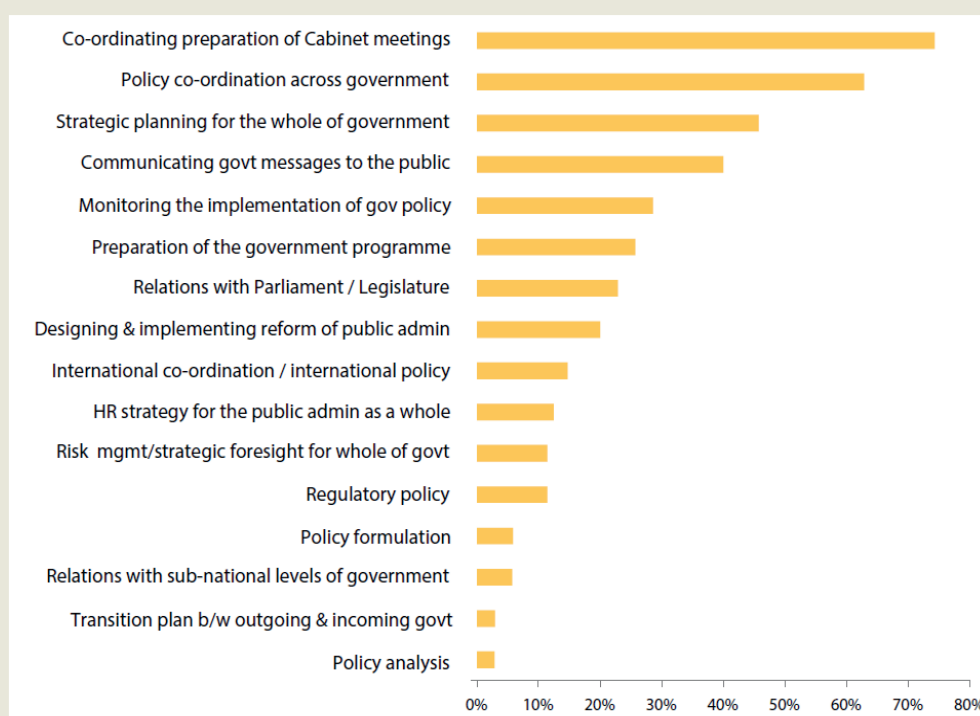
The emerging strategic importance of centres of government goes hand in hand with the changing role of government – a key trend in multi-level governance. Among decentralised or decentralising countries, national-level governments are playing a more strategic role, focusing on setting objectives and co-ordinating policy, monitoring performance, and enabling and guiding subnational authorities in meeting their service responsibilities (OECD, 2019^[35]). This shift, and the capacity to undertake, becomes all the more relevant in the context of crises and crisis management, as highlighted by COVID-19. Regional and local governments are at the frontline in responding to the immediate emergency and will be at the forefront of implementing exit strategies and recovery policies. At the same time, it will be critical for national governments to fulfil their strategic role, setting the course and steering and guiding the response. Success – or failure – will depend on successful co-ordination among the actors and levels of government, not the degree to which responsibilities have or have not been devolved (OECD, 2020^[36]).

Box 5.9. The centre of government: Its importance and role

The term “centre of government” refers to the administrative structure that serves the executive (president, prime minister, or governor at the subnational level, and the cabinet collectively). The centre, therefore, includes entities referred to in various countries as the: Cabinet Office, Casa Civil, Chancellery, Department of the Prime Minister and Cabinet, Executive Office, Office of the President, *Presidencia*, Privy Council Office, etc. It does not include other units, offices, agencies or commissions (e.g. offices for sport or culture) that may report directly to the executive but are, effectively, carrying out line functions that might equally well be carried out by line ministries.

An effective centre of government is essential for steering policy development and implementation. It can help overcome ministerial and departmental silos that thwart co-operation and create wasteful duplication of policies and institutions. A well-functioning centre of government helps sustain a comprehensive long-term vision, manage risks and crises and ensure an integrated approach to policy and reform. It has a key role in communicating, as well as securing support and monitoring action. Who is at the centre of government varies by country; it will always include the body or bodies that serve the head of government and/or head of state, and frequently partners with the Ministry of Finance.

The main responsibilities of centres of government focus on supporting effective decision-making, overseeing the quality of the policy process, facilitating policy co-ordination, communicating relevant policy messages and monitoring and evaluating outcomes (Figure 5.3). None of this means that activity is centralised or concentrated at the highest level. In most instances, key responsibilities – such as strategic planning, policy co-ordination, monitoring and evaluation and relations with subnational government – are shared between the centre of government and other government actors, including ministries, with the centre of government frequently playing an advisory and supporting role.

Figure 5.3. Key responsibilities of the centre of government

Source: Figure: OECD (2018^[6]), *Centre Stage 2: The Organisation and Functions of the Centre of Government in OECD Countries*, <https://www.oecd.org/gov/centre-stage-2.pdf>.

Source: The original data source is the Survey on the Organisation and Functions of the Centre of Government, OECD (2017). OECD (2014^[37]), *Slovak Republic: Developing a Sustainable Strategic Framework for Public Administration Reform*, <https://dx.doi.org/10.1787/9789264212640-en>; OECD (2018^[6]), *Centre Stage 2: The Organisation and Functions of the Centre of Government in OECD Countries*, <https://www.oecd.org/gov/centre-stage-2.pdf>; OECD (2014^[38]), *Centre Stage: Driving Better Policies from the Centre of Government*, <https://www.oecd.org/gov/Centre-Stage-Report.pdf>; OECD (2015^[39]), "Roles of the centres of government", https://dx.doi.org/10.1787/gov_glance-2015-26-en.

A clearly articulated and supported role for the centre of government could help quickly build Welsh Government capacity in assuming this more strategic role. It could also contribute to stronger cross-sector policy co-ordination, integration and coherence, including for regional development policy, in a number of ways. Most critically it can proactively encourage policy co-ordination and co-operation among departments (Box 5.10). This is a centre of government responsibility and not an easy one. It often depends on the incentive to co-operate, which currently seems limited in Wales. Individual or collective performance targets are one mechanism that OECD countries use to promote cross-sector co-operation. Another is having the centre involved in supporting the head of government to prepare and communicate specific mandates to signal priorities to ministers and their departments. Financial incentives, generally funding for cross-cutting projects, are sometimes used, as is financing for the centre to fund task forces and the analysis of cross-cutting issues (OECD, 2018^[6]). Promoting outcome-based policy evaluation, as well as fostering consensus building with respect to internal policy debates are two additional ways the centre could support greater co-ordination. Most centres of government play a strong role in facilitating or supporting policy processes, playing an oversight, quality control and co-ordination role (OECD, 2018^[6]).

Box 5.10. Centres of government and policy co-ordination

A variety of actions permit centres to play a proactive role in co-ordinating government responses to complex policy problems, including sustained and sustainable growth, productivity and inclusiveness, including:

1. A strategic, cross-governmental vision and objectives need to be defined. High-level political support for these goals and a clear mandate for the centre of government to implement the strategy help reinforce their acceptance and create the framework conditions for implementation.
2. Challenges to achieving established goals and ways to overcome said challenges should be identified early in the implementation process in close co-operation with departments. Implementation should be continuously monitored and, if necessary, adjusted.
3. The centre of government should play a key role in clearing obstacles to implementation, e.g. by establishing dedicated delivery teams that manage implementation and help solve upcoming problems. The centre of government also needs to emphasise the importance of the strategic goals to be achieved to all actors involved in their implementation and promote a culture of delivery across government structures by offering technical support, advice and expertise.
4. From the outset, the centre of government should clearly communicate the division of labour among different parts of the public administration, rally support from key actors involved, engage with external stakeholders to better understand the problem to be tackled, and design the most suitable solutions.

Source: OECD (2014^[38]), *Centre Stage: Driving Better Policies from the Centre of Government*, <https://www.oecd.org/gov/Centre-Stage-Report.pdf>.

With respect to the current regional development framework in Wales, the centre of government can play a critical role by facilitating its co-ordination, curating good policy processes, reviewing advice to decision-makers and promoting good policy advice. Stakeholder demand for more collaborative strategies to achieve policy goals suggests a role for the centre that is less about being a watchdog or internal auditor and more about providing active facilitation, support and implementation advice to ministries or groups of ministries (OECD, 2018^[6]). This is especially the case for meeting cross-cutting or cross-sector policy goals, such as regional development.

Moving forward with regional development, the Welsh centre of government may need to reconsider how it executes its leadership role. In a decentralised context, part of government's role is to ensure quality relationships – those characterised by mutual trust and respect, credibility and collaboration – which in turn help align objectives and priorities, and clarify roles and responsibilities. A centre of government that effectively promotes policy co-ordination across government, fosters partnerships among diverse actors and encourages cross-sector collaboration can support this process. It also means clear lines of responsibility and accountability among actors and the ability of government to experiment and learn, not only in terms of policy but also in its ability to cope with new functions and give up some of its traditional power bases.

Establishing a national office for regional development and investment

In the current Welsh framework for regional development, responsibility and leadership are dispersed. This is consistent with its fragmentation and the regional development logic in Welsh sector policies. The framework is rooted in advancing sector aims at a regional level. It is not necessarily rooted in advancing

regional development aims through sector interventions. The result is that there is no single, national-level “champion” for regional development. Everyone is a champion, based on their own agendas. This can reinforce silos when designing, financing and implementing regional development initiatives. Ultimately, it is contrary to the government’s objective of a more integrated policy approach and can “lock out” or isolate integrated regional development initiatives and investment opportunities, limiting implementation success. This can be particularly true when there is no incentive (voluntary or required, financial or non-financial) for departments to co-ordinate their regional- or local-level interventions, or to join forces in their design.

Because of the cross-sectoral nature of regional development, and a need to break down silos, Welsh regional development policy could use its own “champion”. By this is meant a technical-level entity with full cabinet (political) support and a formally recognised mandate, ideally with statutory underpinnings, to:

- Co-ordinate regional development policy aims and the full regional development policy cycle (i.e. from problem identification and objective setting to monitoring, evaluation and adjustment).
- Ensure vertical and horizontal co-ordination of stakeholders and initiatives.
- Promote policy implementation.

This champion should be “sector-neutral” – i.e. not associated with a specific policy domain, sit within an existing government department, or be its own ministry/department. As such, it may be better able to promote an integrated and place-based approach, as it would not be associated with a specific policy area, department agenda or political interest. This by no means implies that departments relinquish their role or mandate to consider and act on the regional development implications of their policies or initiatives. It does, however, mean that there would be a stronger co-ordination mechanism to support departments in realising their objectives, promoting coherence and collaboration at the Welsh Government level, and, ideally, with local authorities.

There are two immediately evident, broad options for such a “champion”. One is to establish a Department for Regional Development within government, with a cabinet minister. Doing so, however, would put at risk its ability to remain sector-neutral and work effectively across government – particularly in an environment where there is a strongly siloed approach to policymaking and implementation. It could engender competition and territorialism with other ministries or departments, possibly be associated with a specific political agenda and potentially carry resource implications.

A more preferable option in the Welsh governance context is to introduce an office for regional development under the office of the First Minister, with a positioning similar to that of the Welsh European Funding Office (WEFO). Doing so effectively puts responsibility for overseeing the co-ordination of regional development at the centre of government, makes the body sector-neutral and better positions it to work across Welsh Government departments. It could also be well-positioned to co-ordinate work vertically, with the local authorities. Finally, a regional development office could partner with WEFO’s post-Brexit incarnation to ensure that regional development priorities and public investment capacity align.

This model could also be reinforced by combining such an office with one responsible for financing regional development (i.e. the post Brexit incarnation of WEFO) under the office of the First Minister. This would effectively combine responsibility for co-ordinating the strategic aspects of regional development with the investment financing dimensions. Doing so could add value in a number of ways. First, WEFO’s experience in managing public investment for regional development could remain intact, and continue to support institutional learning through knowledge transfer. Second, as part of the First Minister’s office, such an office would remain independent of sector policy departments. This independence may be one factor facilitating WEFO’s ability to promote and support investment across sectors and build effective relationships with Welsh Government departments, local authorities, other EU fund beneficiaries and public and private investment stakeholders more generally. Third, WEFO has honed its capacity to support the design, implementation and monitoring of a wide range of territorial development projects in terms of scope and financial value. As regional development structures/institutions/actors settle post-Brexit, maintaining

and fully tapping into this expertise will be essential to maximise the effectiveness of EU replacement fund investment.

A combined office for regional development and investment would unite the strategic planning and the investment planning dimensions of regional development into one entity, consolidating the responsibility for regional development vision and strategy setting, policy co-ordination and investment management. As stated earlier, it does not mean that other sectors (e.g. economy, education, energy, housing, tourism, transport, etc.) relinquish responsibility for ensuring their sector policies support regional development or for ensuring that regional development goals in their sector are established and met. Figure 5.4 provides a schematic representation of how this combined option fits within a general multi-level governance system for regional development in Wales.

Figure 5.4. A potential multi-level governance structure for regional development and investment in Wales

| Territorial level | Statutory Body | Lead Strategic Planning Document(s) | Regional Development and Strategic Planning Lead | Coordinating Mechanisms |
|-------------------|--|---|--|---|
| National | Welsh Government | WFGA | Office of the First Minister/Cabinet | Inter-Ministerial Committee for Regional Development (or a Sub-committee) |
| | | National Framework for Investment | Office for Regional Development and Investment | Regional Development Strategy and Policy team |
| | | Regional Development Framework/Policy* | | Regional Development Investment Finance team |
| Regional | CJCs (proposed) City and Growth Deal Boards | Regional Economic Frameworks/or cross-sector regional-level development plans** | CRO | CRO Teams |
| | | City Deals | City Deal Executive Body | City Deal Executive Boards |
| | | Growth Deals | Growth Deal Executive Body | Growth Deal Executive Boards |
| Local | Local Authorities | Regional Economic Frameworks | Local Authorities working with their CJC's Secretariat | CRO |

Note: *Regional Development Framework is a broad term that can encompass the current Economic Action Plan plus sector strategies or plans with a regional intervention dimension, or it can be a future national Regional Development Policy; the Office for Regional Development and Investment could also be split into two – one responsible for regional development and one that is responsible for regional development investment funds and finance. **Cross-sector regional-level development plans are introduced in the next section of this chapter and would complement a national Regional Development Policy.

Ensuring statutory underpinnings to co-ordinate regional development is crucial. Without such support, a new office is subject to potential instability or uncertainty with shifts in government. This could negatively affect the ability to meet regional development goals, attract investment opportunities and make the best use of limited investment resources.

What this structure implies is establishing an office within that of the First Minister, responsible for leading and co-ordinating the strategic work associated with regional development and investment in Wales. This placement should permit it to remain independent from specific policy sector considerations, retain neutrality *vis-à-vis* government departments and facilitate the ability to work across departments and build dialogue among them. This should also permit it to more easily work with subnational levels of government

and relevant bodies. To support the co-ordination of national and subnational regional development objectives, priorities and plans, as well as to support regional development initiatives in specific regions, it could be reasonable, with ministerial agreement, to fold the Chief Regional Officers (CROs) and their teams into this office as well. It would expand their role beyond the economy sector into broader regional development policy. Whether such a shift occurs, however, should not affect the establishment of an office for regional development and investment. By working both horizontally, with different government policy sectors, and vertically, with subnational governments and actors, such an office could better advance the strategic planning and implementation of an integrated and place-based approach to regional development and the investment that supports it. Sector neutrality and independence from a specific department are fundamental to the success of this office. It must be able to effectively co-ordinate and calibrate the objectives and priorities of various actors and levels of government, and not be perceived as a competitor. This will require clearly establishing roles and responsibilities, as well as ensuring that interactions and relationships underlying these structures and interactions are grounded in trust and mutual respect.

Optimising regional and local development planning and investment

A national policy for regional development is important. Just as important is to complement it with place-specific development plans, designed and implemented at the relevant scale, for example at the regional, metropolitan or local levels. Such plans help maximise the growth potential of each region by reflecting subnational needs and capacities. When well designed and implemented, they should also contribute to meeting national-level development objectives. Ideally, they support better-targeted investment by clearly articulating subnational priorities and identifying opportunities to build investment scale and scope through complementarities among proposed initiatives. While these types of plans could be designed by the national level, such a tactic is likely to be insufficiently sensitive to place, resulting in significant problems of ownership and limiting successful policy delivery. A more effective approach includes the participation of subnational actors throughout the process and can be led by subnational actors at the relevant scale. This is particularly true in cases such as Wales, where national/subnational collaboration in policy endeavours is prized, though reportedly difficult to realise (OECD, 2019^[12]; 2019^[13]).

The Economic Action Plan calls for designing and implementing economic plans – Regional Economic Frameworks – at a regional level.⁵ Regional Economic Frameworks would help ensure that subnational economic development and investment activities align with the broader economic and growth goals outlined by the Welsh Government. This is consistent with good practice. However, the Welsh Government may need to refine and streamline its approach here, too, as the fragmentation in the regional development framework seen at the national level appears to be replicated at the subnational level.

There is an extensive amount of regional-scale planning already occurring in Wales (OECD, 2019^[12]; 2019^[13]) together with a large number of existing local-level planning requirements. Many local authorities undertake some form of development planning with an incidence on economic growth. This is particularly true of the ten local authorities involved in the Cardiff Capital Region (CCR) City Deal, the four local authorities contributing to the Swansea Bay City Deal and the six that are active in the North Wales Growth Deal. A Mid Wales Growth Deal, with two local authorities, is also being developed. It could be argued that the implementation of these deals has not advanced as quickly as expected (OECD, 2019^[13]), however, they are in place, have financing and are supported by their own governance structures. In addition, there is the CCR Industrial and Economic Plan and its Investment Plan, and the Swansea Bay City Region Economic Regeneration Strategy 2013-2030. Meanwhile, all local authorities are responsible for developing strategies and plans with some sort of development logic. These include local transport plans, local housing strategies, Welsh in Education strategic plans, Well-Being Plans, and local development plans (as featured in Table 5.3).

There are a number of risks arising from so many planning requirements at a subnational level, including policy incoherence and implementation overlap, planning fatigue and opaque accountability. It can also dilute investment resources and stretch thin the planning and implementation capacities of subnational authorities. A mechanism that can ensure these existing regionally-driven, locally-developed and growth-oriented plans are co-ordinated would be valuable but appears to be lacking. The Regional Economic Frameworks may be intended to play such a role but they currently do not appear structured to do so. First, they focus necessarily on economy and productivity, including the foundational economy, but may fall short of supporting an integrated development planning approach, which would bring together multiple sectors. Second, it is reported by some local authorities that Regional Economic Frameworks do not fully consider existing regional-level plans, such as the City and Growth Deals, and questions arise as to their necessity (OECD, 2019^[12]; 2019^[13]).

The CCR City Deal, the Swansea Bay City Deal, the North Wales Growth Deal all focus on regional, place-based economic development and, while they may take a different approach than the Regional Economic Frameworks, there appears to be at least some overlap in purpose and territorial coverage. First, in the case of the City Deals, these are joint growth agreements among the relevant local authorities, the UK government and the Welsh Government, and are primarily funded by the same parties. Second, if they do not cover the same territory as the intended Regional Economic Frameworks, their footprints are similar. Failing to take them into consideration could lead to overlapping plans, a lack of clarity regarding planning responsibilities, conflicting initiatives and additional density in the already crowded geographic footprint created by Welsh subnational policy and service activities. It can also affect transparency and accountability.

In the short term, first, it would be valuable if the Welsh Government clearly articulated to stakeholders why Regional Economic Frameworks together with the various planning documents are needed, and how they can be complementary and not competitive with respect to financial resources. Second, it must find a way for the existing City and Growth Deals to sit comfortably with the Regional Economic Frameworks. This could mean that City and Growth Deals form part of the Regional Economic Frameworks in the relevant regions, and potentially take the lead in supporting initiatives that fall within their sphere of operation (e.g. transport in the case of the CCR City Deal). Third, it should ensure that Regional Economic Frameworks do not simply add new planning requirements to existing ones, compounding strategy and planning fragmentation. This would also contribute to planning proliferation, obscure priorities and limit policy coherence and investment effectiveness.

In the medium term, one way to address this fragmentation would be to rationalise many of the existing plans, including Regional Economic Frameworks, into comprehensive, cross-sector regional-level development plans. Just like a cross-sector national regional development policy, the subnational plan should reflect subnational (regional) development priorities and needs across policy sectors (e.g. economy, education, energy, environment, housing, innovation and skills, tourism, transport, etc.), with an eye on integrated investment planning. It should also contribute to meeting the aims articulated in the national regional development policy mentioned earlier. This could harmonise subnational planning – including with the City and Growth Deals – and help identify synergies across sectors, and potentially across jurisdictions, in order to better optimise resources and investment financing. Responsibility for ensuring national/subnational coherence and coordination should rest with the sector-neutral proposed office for regional development and investment (if introduced), spearheaded for example by the Chief Regional Officer (CRO) teams, assuming they move to an office for regional development and investment. Ideally, they should be developed at the subnational level, for example by corporate joint committees (CJCs) in collaboration with the relevant local authorities, and could be refined in a dialogue process with the national government. This approach reflects what is currently being considered for the Regional Economic Frameworks.

In the longer term, effort should be made to streamline the planning requirements at the local authority level. This does not mean reducing or eliminating their development responsibilities or planning functions.

It means consolidating the effort, for example through consolidated plans, or inter-municipal co-operation for larger-scale development planning tasks. Consideration needs to be given to local-level capacity. Local authorities not only have many planning requirements but they are also expected to put all of these plans into action and, in many cases, their capacity in terms of available human and financial resources is already strained (Morgan, 2019^[17]; OECD, 2019^[12]; 2019^[13]). Achieving an integrated approach to regional development not only requires diverse government sectors (policy areas) to work together in a joined-up manner at a national level, it also requires that this be mirrored by an integrated approach at a subnational level.

Boosting policy and investment implementation capacity through collaborative arrangements

The effective design of a regional development and investment framework is half of the equation. The other half is its successful implementation. A significant amount of time and resources are dedicated to developing Welsh strategies and frameworks. However, policy implementation or delivery is reported to be more challenging (Welsh Government, 2019^[19]; Morgan, 2019^[17]; Guilford, 2019^[40]). One factor behind this difficulty is a degree of policy instability that arises with changes in government (Morgan, 2019^[17]; Guilford, 2019^[40]). This can be particularly detrimental to investment for regional development and to the regional development process itself, as both need stability over time. Such stability creates a safe environment for investment, especially for private sector financing and larger-scale borrowing, and gives sufficient time to generate results. An additional factor contributing to this gap is reportedly a disjointed policy delivery process, wherein policy actors work on their own rather than proactively working together in a collaborative or “joined-up approach” (Morgan, 2019^[17]; Guilford, 2019^[40]).

This disconnect in capacity between policy design and policy implementation is also present at the subnational level. Without strong commitment on the part of the Welsh Government and local authorities to build capacity, the disconnect risks becoming more acute as local authorities gain responsibilities for regional development and managing investment funds. To avoid this, strengthening the relationships among actors, building trust and working in tandem to design policies and identify implementation responsibilities will be fundamental. The current regional development framework calls on Welsh local authorities to collaborate more than ever with the Welsh Government and with each other, for example in designing their Well-being Plans (Morgan, 2019^[17]), in structuring and administering City and Growth Deals (Morgan, 2019^[17]), and in planning Regional Economic Frameworks. Trust-based institutional relationships are the basis for a genuine national/subnational partnership for governance, facilitating agile and impactful public investment and regional policy delivery. Further developing quality multi-level governance mechanisms that can foster such relationships will better support policy implementation and strengthen the returns on Welsh public investment.

There is no doubt that the Welsh government is aware of the importance of collaborative governance. Yet there appears to be a gap between intention and execution. This is evidenced by a clearly expressed apprehension among key Welsh regional development partners (e.g. local authorities, City and Growth Deal Boards, and the Welsh Local Government Association) that institutional processes in regional development planning are centrally driven and top-down (OECD, 2019^[12]; 2019^[13]). Behind this could be governance culture, a wariness of intention among national and subnational actors, a lack of appropriate tools, or a combination of these and other factors. While this may not be what the Welsh Government intends (or itself perceives), it should not be ignored. Success moving forward will rest on building capacity for playing new roles: a more strategic and less “implementation-oriented” role for the Welsh government as explored above, and a more empowered role for local authorities. This can imply introducing new structures, new mechanisms and new ways of working, as explored below.

Strengthening national/subnational exchange for regional development planning

In 2017, the Department of Economy and Transport introduced Chief Regional Officers (CRO) for South East Wales, Mid and South West Wales, and North Wales. They, together with their offices, are responsible for co-ordinating the design and implementation of the Regional Economic Frameworks with local authorities, and for ensuring a co-ordinated approach to regional economic development as well as alignment with national goals. The idea is for each CRO and their offices to work with the local authorities in their region to identify common economic development needs and priorities and then collaboratively develop the region's Regional Economic Framework to realise these.

CROs, and their offices, could play a strong role in co-ordinating national and subnational-level economic interests and priorities, for example as brokers between the Welsh Government and local authorities. Ideally, they are able to combine a national-level perspective of economic development and its associated objectives with an understanding of a region's economic development needs, priorities and capacities. The intention is that they work closely with local authorities as well as other stakeholders in their regions to identify these needs and build consensus around investment priorities. As the CRO offices continue evolving, they could also further support policy and plan implementation by working with local stakeholders, including small- and medium-sized enterprises (SMEs) and the third sector, to identify investment and financing opportunities. This potential for uniting an understanding of national economic development objectives with clear insight and understanding in the specificities of their regions places CRO and their offices in a good position to serve as a national/subnational bridge for economic development efforts. To do so most effectively, however, some of the early difficulties confronting CROs and their offices will need to be fully addressed. Not only are they relatively new, but the general, two-way mistrust that characterises national/local relations in Wales (OECD, 2019^[41]) (Morgan, 2019^[42]) can also create obstacles to an effective CRO/local authority working relationship (OECD, 2019^[12]; 2019^[13]).

Ensuring that CROs and their offices successfully engage local authorities in the design and implementation of their region's Regional Economic Framework is fundamental for building ownership, responsibility and accountability for results. While this seems to be fully recognised, establishing this degree of partnership appears challenging. This may be due to an inherent contradiction in the role CROs are expected to play – on the one hand as regulators and assurance officers for the Welsh Government, and on the other as economic development partners for local authorities. The result may be that while local authorities would be receptive to CROs as genuine partners, this is less possible or will require more effort, given their other roles, a government culture that is more accustomed to a centralised, top-down approach and the aforementioned mistrust. It can be compounded by a misalignment of definitions and expectations, as well. While the intention is to build a collaborative working relationship, one that supports co-produced plans, there seems to be some discrepancy in what this means practically for the CRO as well as for the local authorities, what to do to ensure it occurs and when. It may be valuable for CROs and local authorities to: discuss and agree upon clear definitions of and parameters around what collaboration and co-production mean; clarify the roles, responsibilities and deliverables of each party; and determine an appropriate form of collaboration for each stage of the policy cycle.

As they grow into their roles, CROs and their teams could become strong allies for local and regional actors, advocating for the subnational position from within the Welsh Government. They could also potentially offer support and guidance to regional/local, public and private actors in designing projects eligible for support through public investment funding mechanisms. Yet, they may need to build and support partnership capacity when working with subnational actors – be they local authorities, regional-level bodies, the third sector, the private sector or other local organisations – throughout the policy and investment cycles.

If an office for regional development and investment is institutionalised, that might become the logical home of CROs and their teams. Such placement could facilitate their role as brokers of subnational interest within the Welsh Government, by placing them in a “department-neutral” context, expanding their scope beyond

the economy sector into broader regional development policy. Another place where their practical knowledge and support for local authorities may be highly effective is within a regional development agency (explored below). Both possibilities could make it easier for CROs and CRO offices to work with multiple stakeholders, support local authorities or other subnational bodies in designing and implementing regional development initiatives, and effectively become the locus of a top-down and bottom-up approach to advancing regional development priorities. Barring this, they could still effectively play their roles as currently defined – supporting national economic objectives and helping advance economic development goals at a regional level.

Using cross-jurisdictional co-operation to build scale for regional development and investment

With a move towards stronger place-based regional development and investment, the Welsh Government is calling upon local authorities to assume more responsibility in cross-jurisdiction development and investment planning. This calls for a “rescaling” of activity by local authorities (Morgan, 2019^[17]) and accentuates a need to build implementation capacity. For many local authorities, overcoming capacity constraints will be critical to their success in regional development planning and investment. Municipal size does not automatically dictate the degree of local capacity but it can play a role. When this is the case, formal inter-municipal co-operation arrangements offer a flexible way to generate capacity, efficiency gains and costs savings (Figure 5.5) (OECD, 2019^[35]). OECD countries and regions approach such co-operation in a variety of ways (Annex 5.B) and generally associate specific incentives with such arrangements (OECD, 2019^[23]). At a municipal level, these arrangements can range from “soft” formats to strongly integrated ones. On the “soft” side are single or multi-purpose co-operative agreements or contracts, including shared services arrangements or shared programmes (e.g. used in Australia, England (UK), Ireland and New Zealand). Among the more strongly integrated formats are supra-municipal authorities with delegated functions. For example, in France, Portugal and Spain, associated municipalities have the status of supra-municipal authorities with delegated functions. Inter-municipal co-operation covers a range of areas, from technical and service delivery needs to strategic co-operation for economic and social development (OECD, 2017^[27]; 2019^[35]). In Saxony-Anhalt, Germany, there are three forms of inter-municipal co-operation: working groups (*Arbeitsgemeinschaft*), purpose agreements (*Zweckvereinbarung*) and full associations (*Zweckverband*) formed to deliver on a specific task. Co-operation is voluntary between municipalities, depending on the task at hand and regional characteristics (Pötzsch, 2019^[43]).

Currently, it is generally agreed that many Welsh local authorities face difficulty delivering on their responsibilities, especially the larger, more costly ones. Welsh local authorities are responsible for providing statutory services, such as social care, environmental health inspection and planning. Discretionary services, for example economic development, libraries, leisure and art centres, are provided based on choice and capacity (Morgan, 2019^[17]; Welsh Government, 2019^[19]). Although the services provided by local authorities are subject to laws, strategies and targets set and monitored mainly by the Welsh Government, they can choose how they meet their responsibilities and provide services: directly, in partnership with other authorities or organisations (e.g. third sector) or by commissioning the provision to a third party. Yet, many local authorities have downsized because of austerity, resulting in a hollowing-out of offices and generating capacity constraints (OECD, 2019^[12]; 2019^[13]). Fiscal and financial capacity is one challenge, as explored in Chapter 4. Human resources are a second challenge. “Soft” capacity⁶ constraints are a third. These include leadership, strategic thinking and planning, specialised expertise (e.g. procurement, project management, and human resource management) and “soft skill” sets (e.g. communication, relationship management) (Beecham et al., 2006^[18]; Simpson, 2011^[44]).

Figure 5.5. Drivers of inter-municipal co-operation in the OECD



Source: OECD (2019^[35]), *Making Decentralisation Work: A Handbook for Policy-Makers*, <https://dx.doi.org/10.1787/g2g9faa7-en>.

Local authorities in Wales that are struggling to deliver their core responsibilities will also face difficulty delivering on regional development and investment responsibilities. These challenges may become even more accentuated in light of the COVID-19 pandemic, its impact on subnational fiscal and financial health, and the role that subnational authorities are expected to play in medium- and long-term recovery packages, including for public investment. Taken together – i.e. the capacity challenges existing pre-COVID-19, combined with any strain arising from the immediate emergency, as well as from demands generated by implementing exit and recovery strategies – this can create or exacerbate inter- and intra-regional disparities and limit investment attractiveness. In extreme cases, a local authority's ability to partner effectively with peers and the Welsh Government in realising national and local development aims will be affected. Using inter-municipal co-operative arrangements to build territorial scale can help local authorities mitigate these capacity constraints. First, they enlarge the area of intervention, permitting investment resources to be used across several local authorities or throughout a region. This maximises the use of limited resources, ensuring that more citizens are reached while also reducing cost. Second, by pooling their needs and resources, local authorities can share the cost of hiring necessary expertise for administrative and management functions associated with investment planning and implementation (e.g. for project design, evaluation, administration, co-financing, etc.) if necessary. At the same time, it is also important to set parameters for co-operative arrangements. Ad hoc partnerships or proliferation of partnerships can be costly (Williams, 2014^[45]), strain resources by increasing workload (Williams, 2014^[45]) and spreading staff too thin, create confusion and compound fragmentation, and limit transparency and accountability to citizens.

Recognising the capacity challenges local authorities face, the Welsh Government is putting forward two options to build territorial scale and cross-jurisdictional collaborative working. The first is by establishing guidelines for the voluntary merger of local authorities. The second is by institutionalising cross-jurisdiction co-operation through corporate joint committees (CJs) (Box 5.11) (National Assembly for Wales, 2019^[46]).

Box 5.11. Proposed corporate joint committees (CJs) in Wales

The Local Government and Election (Wales) Bill proposes establishing CJs as a formal inter-municipal co-operative mechanism in order to support local authorities in economic development planning and policy implementation. The bill aims to provide a mechanism for consistent regional working and collaboration with a clear framework for governing collaborative arrangements, setting clear expectations in those areas where regional-level collaboration is important. It also seeks to reinforce the ability of local authorities to work at a regional scale.

The purpose of CJs would be to provide:

- a more consistent governance mechanism and model for collaboration between the national and local levels
- a clear framework to underpin regional working approaches
- a model to help simplify regional arrangements, reducing duplication and complexity in regional working and collaboration arrangements
- a more efficient and effective model for collaboration, reducing the effort required in creating and recreating new collaborative working arrangements.

There are two possible paths for establishing CJs. Via the first path, local authorities can voluntarily establish a CJ for delivering on any policy or service area as long as they have made a formal application to relevant Welsh ministers, have respected the requirements governing a CJ's establishment, and Welsh ministers have agreed to make the regulations establishing a specific CJ. The second path allows Welsh ministers to establish a CJ in order to undertake functions in relation to any (or all) of the following four areas – all of which contribute to building and maintaining regional growth, inclusiveness and attractiveness:

1. Economic development.
2. Strategic planning for the development and use of land.
3. Transport.
4. Improving education.

Regulations would enable CJs to establish sub-committees; acquire, appropriate or dispose of property; and hold and manage funds, including borrowing or lending, providing or receiving financial assistance, and charging fees. General CJ financing would come from the constituent local authorities. CJs would also be able to employ and remunerate support staff.

Source: Morgan, K. (2019^[17]), "Enhancing multi-level governance capacity: A paper prepared for the OECD Report to Welsh Government", Unpublished; National Assembly for Wales (2019^[46]), *Local Government and Elections (Wales) Bill - Draft Law*, <http://senedd.assembly.wales/mgIssueHistoryHome.aspx?lId=26688>; WLGA Council (2019^[47]), *Local Government Reform*.

CJs could contribute to the multi-level governance of regional development and investment in Wales in a number of ways, depending on the final legislation. First, by bringing together local authorities within a specific area, CJs facilitate intervention at a regional level, generating scale. This could help local authorities more effectively deliver on specific policy and investment priorities and project decisions, particularly if the CJs are attributed human and financial resources (drawn from the resources of constituent councils) and are given responsibility for managing these within their remit. Second, the degree of flexibility in how (voluntary versus requested) and why CJs are established can permit tailoring their responsibilities or activities to the needs and capacities of local authorities in a specific territory (Regional Investment for Wales Steering Group, 2019^[48]; WLGA Council, 2019^[47]). An asymmetric approach to

devolving policy and service responsibilities (Box 5.12), particularly those associated with regional development, can be valuable in Wales, and permit it to be more place-sensitive in its regional development approach. Local authorities may find that CJsCs become useful tools for regional development planning as well as large-scale service delivery and investment projects. Finally, because CJsCs are composed of local authority officials and act on behalf of their constituent local authorities, they should be able to operate on a larger scale while still reflecting local needs and decisions, and being accountable to these. Doing so, however, will mean that local authorities must work with each other to make decisions that benefit a wider area than their administrative boundaries and to act collectively in their implementation. They will also need to explain this level of action to citizens and other stakeholders through active and ongoing dialogue and engagement.

Box 5.12. Asymmetric arrangements for policy and service delivery

Asymmetric decentralisation arrangements – i.e. when governments at the same subnational government level have different political, administrative or fiscal powers (Congleton, 2015^[49]) – have been common since at least the 1950s and are still growing in popularity. Initially, the drivers of asymmetric arrangements were political but, increasingly, they are also driven by economic and administrative motives (Bird and Ebel, 2006^[50]). Behind this is a growing need for governments to contend with capacity challenges and ensure that institutional and fiscal frameworks are tailored to local capacities, to address questions of scale and to generate an opportunity for national and subnational governments to experiment and test new approaches for policy implementation and service delivery. Governments are also using asymmetric arrangements as a mechanism to recognise the specificity of metropolitan areas.

There are a series of risks and benefits associated with asymmetric decentralisation in regional development policy. The risks include increased territorial disparities and a lack of clarity for citizens in terms of who is responsible for what and where. A lack of accountability and transparency, increased administrative and institutional complexity and associated co-ordination costs are other risks that must be considered. At the same time, an asymmetric approach can help ensure flexibility, accommodate diverse preferences for autonomy among regions and sequence a broader decentralisation reform. It can also permit adapting institutional and fiscal frameworks to the capacities of regional and local governments. By doing so, it contributes to a more supportive institutional environment. This can help regional and local actors design more regionally-responsive policies and programmes, and better target investment financing. It can also help these same actors become more innovative. Yet, institutional quality is important. Where institutional quality is high, decentralisation appears to foster territorial convergence. However, where institutional quality is low, the opposite can be true, with decentralisation exacerbating territorial disparities. Revenue decentralisation may also play a role in addressing potential disparities arising from decentralisation. Recent empirical evidence indicates that revenue decentralisation could be associated with smaller regional economic disparities. This could be because own-source revenue may spur growth. This is particularly relevant in poorer regions, as it could also enhance their convergence towards the better-performing ones.

Source: OECD (2019^[35]), *Making Decentralisation Work: A Handbook for Policy-Makers*, <https://dx.doi.org/10.1787/g2q9faa7-en>.

Welsh local authorities, while generally recognising the value of joint working and collaboration at the local level, have voiced concern about democratic accountability and higher-level bodies (e.g. CJsCs) executing policy and service tasks (WLGA Council, 2019^[51]; OECD, 2019^[12]). Such concerns are not uncommon. One reason why governments ascribe tasks to local levels of government is their proximity to citizens, an advantage of which is the democratic accountability of local politics. There are arguments that inter-

municipal co-operation jeopardises – or at a minimum confuses – accountability, particularly when there are many co-operative arrangements in the same territory. However, this should also be balanced by the ability of such arrangements to mitigate capacity problems due to size (Teles and Swianiewicz, 2018^[52]). If structured with accountability in mind, cross-jurisdiction arrangements and the bodies that support them, should be able to incorporate a strong accountability function while still permitting municipalities to maintain autonomy and benefit from greater scale where necessary. In the current legislation, the local authorities are responsible for establishing the accountability (scrutiny) mechanisms governing their CJC. This should help ensure a level of accountability with which they are comfortable. Ultimately, local authorities are responsible for their CJC and the local officials composing them.

Joint action across jurisdictions also enables actors to implement complementary measures and take advantage of policy synergies that can contribute to making the most of investment returns. This is frequently the case for physical infrastructure investment, where the most efficient scale often exceeds the administrative boundaries of individual localities or regions. It can be easier, however, to encourage co-ordination around investment in basic infrastructure and services (e.g. water, sewage, waste management) and more difficult around “strategic” investments where subnational governments find themselves competing to secure public facilities, attract public and/or private financing, and hire qualified expertise for investment implementation. Achieving an efficient scale can also make an investment opportunity more attractive for private sector involvement, for example through public-private partnerships, which can help support investment financing (OECD, 2019^[23]).

Overall, CJs align with current multi-level governance trends in managing territorial or administrative fragmentation, “up-scaling”, and ensuring policy and service delivery capacity through formalised inter-municipal arrangements. They could offer a consistent but flexible structure for working at a higher territorial (regional) level. Furthermore, the CJC format could represent a space for local authorities to jointly identify and agree on development and investment priorities at a regional scale, especially for those initiatives that may be too costly for individual or small groups of local authorities to undertake on their own. By also acting as platform for local authorities to discuss development needs and identify investment priorities, CJs could support the design and implementation of Regional Economic Frameworks. Furthermore, they could delineate a more formal, regional level to which public investment funds for development projects may be distributed – be they funds that originate with the Welsh Government or through the intended UK mechanism to replace EU funds. In the long run, CJs may also become a tool to rationalise the geographic footprint of service delivery at the Welsh subnational level.

There should be some caution with respect to the institutional (statutory or otherwise) foundations of CJs, however. Weak or unclear underpinnings could result in CJs becoming yet another policy and service delivery partnership. This could exacerbate the existing problem of an already extensive number of municipal co-operative bodies in Wales and the multiple geographic footprints already generated by such entities across the Welsh territory. For example, some attention will need to be paid to clarifying and harmonising the roles, responsibilities and activities of CJs and City and Growth Deal Executive Boards, should CJs be introduced in the same geographic areas. CJs could also contribute to greater inequality in service access and quality, inter- and intra-regionally. Avoiding this may require the Welsh Government to take a clearer and possibly firmer stance on the what, when and how of CJs. It may also mean streamlining or rationalising some of the existing bodies. Any action towards such streamlining will be difficult and takes time. It should also be undertaken with clear leadership as well as the input of local authorities and the government and/or third sector organisations that would be affected.

If fully supported by the Welsh Government and local authorities, CJs have significant potential to build regional development and public investment capacity among local authorities and evolve into an effective regional-level partner for local authorities and the Welsh Government. To accomplish this, their composition, structure, competency attribution, resource levels and actual role as policy and investment actors will need to be clear.

Supporting devolution and building trust with partnership agreements and “learning by doing”

The decentralisation of responsibilities, including for regional development, often confronts governments with a “chicken and egg” dilemma: a desire to decentralise responsibilities to subnational entities and a fear that there is insufficient subnational capacity to undertake them. Governments can be reluctant to attribute new tasks to subnational governments that may lack the experience and capacity (resources, knowhow, skills) to undertake new responsibilities. The result can be an attribution of responsibilities that is partial, under-funded or limited by very tight control mechanisms. At the same time, subnational authorities may never have the opportunity to build the capacity necessary unless the responsibilities are in fact attributed, and they are granted sufficient space to build capacity by actively delivering on them. Often, they can only build capacity if given the opportunity to try. This does not mean that national governments relinquish oversight capacity or their ability to set parameters for action. What it does mean is that national actors must trust their subnational counterparts to deliver on their responsibilities (and vice versa), and that subnational authorities will actively build their task-implementation capacity. It is ultimately a “learning by doing” process that can be framed by formal partnership agreements and further supported by “pilots”. This could be particularly important in Wales where devolution is still evolving and not as strongly as it could be.

Formal partnership agreements between levels of government can help generate trust-based relationships, regardless of the size of the government. They can clarify “grey areas” where responsibility for action or outcomes has not been concretely established. This can be a particular problem in devolved contexts where there is an overlap of responsibility among levels of government. Memoranda of understanding, terms of reference and contracts are all examples of formal agreements. Over time, these agreements can help foster comfort and trust in the capacity of each party to meet their obligations, while also helping manage joint responsibilities for public investment planning, including for regional development. Contracts between the French central government and its regions (*Contrats de plan État-Région*, CPER) serve as a key planning, governance and co-ordination instrument in regional development policy. Iceland also makes extensive use of contracts between the national government and its regions. This has led to building greater trust, capacity and advancing decentralisation (Box 5.13).

Box 5.13. Formal agreements to support investment funding and build trust in Iceland

Since 2013, Iceland has used successive five-year contracts between its regions and the national government to ensure the financing and implementation of the regional-level plans. For example, the Northwest Region has signed three consecutive contracts with the Ministry of Transport and local authorities and the Ministry of Education and Culture to support implementing its regional plan, which emphasises regional development and innovation, culture, environmental issues and education and population. These contracts ensure funding against clear and measurable success indicators established by the region. The Northwest Region’s experience is that this approach has helped increase trust on behalf of the government. Over time, the region has fewer rules to abide by, an increased allowance for administrative costs and the elimination of constraints on the distribution of funding between priority projects and competitive funds. In addition, more autonomy has been granted concerning who is appointed to Competitive Fund Distribution Committees. There is also a possibility now for other ministries to be part of the contract. Trust has also increased on the side of the regions, as has capacity. There has been a visible increase in the degree of decentralisation on the part of the national government. Building on experience from the past, regions are developing increasingly stronger plans. For example, also in the Northwest Region, their 2020-24 contract has received support from expert consultants, the costs of which were paid by the Ministry of Transport and local authorities.

The plan has a stronger local focus than in the past thanks to the greater degree of autonomy, and measurability is considered stronger.

Source: Hilmarsdóttir, U. (2019^[26]), *Regional Plans in Iceland: Decentralization of Funding and Power to Local Authorities through Regional Associations of Municipalities*.

Not only does successful management of a devolution process entail building delivery capacity among the subnational level, but it also means that the national level must be willing and able to shed the policy and service implementation role it has traditionally played in order to step into the role of a more strategic actor. The ability to make such a shift by the Welsh Government could improve the national/subnational relationship and contribute to advancing devolution in Wales. The Welsh Government will need to build its capacity to co-ordinate and guide, and grow comfortable in a new role, particularly with respect to regional development and investment. At the same time, it will need to creatively build capacity among local authorities so that they can assume new and more complex responsibilities. For example, the Welsh Government could work with local authorities to identify which responsibilities could be proactively devolved, trust that new tasks can be successfully undertaken, and guide them to do so. This can include mentoring, consulting, providing technical assistance or encouraging learning exchanges between peers or between national- and subnational-level government officials, for example. It can also mean ensuring sufficient resources so that local authorities can “rebuild” their planning capacity, which is reported by many communities to have diminished due to austerity (OECD, 2019^[12]; 2019^[13]).

Furthermore, the Welsh Government and local authorities could work together more effectively to pilot initiatives as a means to build capacity. This would permit parties to “test” new or different approaches, new structures, executing new responsibilities and then to identify what works, what does not and recalibrate the approach if necessary. A decision could then be made to determine whether or not the initiative should be rolled out more extensively or not. As a gradual, step-by-step approach to introducing a governance mechanism or reform, including the devolution of responsibilities, pilots offer national and local actors “time to learn” and “time to adjust”. An asymmetric approach to the devolution of future responsibilities, including for regional development, can facilitate pilots in specific tasks or targeted regions in order to test new approaches for policy implementation and service delivery (OECD, 2019^[35]), thereby creating the space to learn and supporting capacity building in the devolution process.

Using more formalised partnership agreements that clearly establish expectations and also incentives, and piloting initiatives with certain local authorities, before introducing them more broadly, could be effective mechanisms to support devolving regional development and investment responsibilities. By doing so, the Welsh Government might build its own trust in the ability of local authorities to deliver on their competencies and it may help increase the sense of partnership between the two parties. Meanwhile, local authorities must recognise capacity limitations and take the steps necessary to overcome these, including by working at a larger scale, actively monitoring and evaluating performance, and being clear in what they can accomplish in the short versus medium and long terms.

Revisiting regional development agencies to support day to day implementation capacity

Regional development agencies are one governance tool used to generate proactive, “on the ground” implementation of a regional development and investment agenda. Among OECD countries, there is an upward trend in their use as contributors to the design and implementation of national development programmes and in better co-ordinating public investment for regional development (OECD, 2019^[23]). One advantage of regional development agencies is their ability to foster greater understanding and stronger working relationships between national and subnational actors. They can also support generating

international ties and expanding markets for businesses of all sizes. Regional development agencies can take a number of forms and serve diverse functions (Annex 5.C) (OECD, 2016^[9]), including:

- As a network to organise national interventions for regional development within a decentralised context (e.g. Canada).
- To help national and subnational actors capitalise on complementary actions across policy sectors in a given region (e.g. Finland).
- To support entrepreneurs and SMEs promote innovation and cluster development, and attract investment, acting also as a one-stop-shop for firms to obtain information on programmes and support in accessing funding for projects (e.g. Ireland and Scotland).
- To ensure that policymakers have the evidence necessary to make informed decisions on a wide variety of topics that influence regional development and investment, and to work with regional partners to advance development objectives (e.g. France).

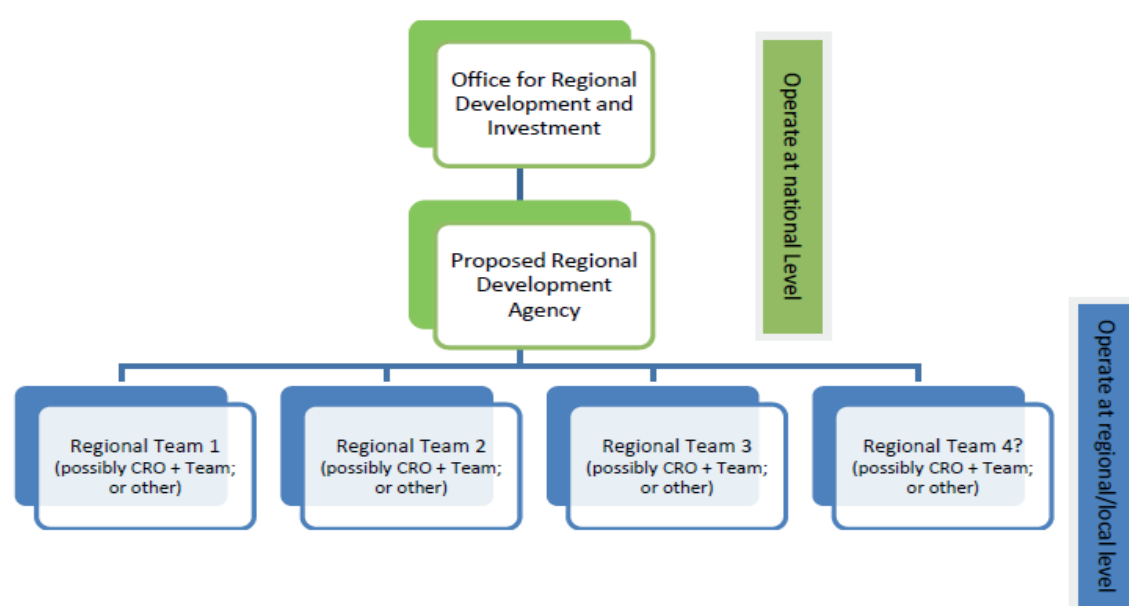
Wales has mixed experience with regional development agencies. The Welsh Development Agency (WDA) was established in 1976⁷ and was dissolved in 2006, with its functions merged into the Welsh Department of Economy and Transport. During its years of activity, it encouraged local and international business development, inward and foreign direct investment, and the clearing of derelict land (UK Government, n.d.^[53]). It was well recognised for its contribution to business competitiveness but associated with significant controversy over irregularities in its management practices. Despite this, national and subnational actors, including in the private sector, continue to identify it as a model that worked well for stakeholders (OECD, 2019^[13]). The WDA had a clear economic brief permitting it to focus on its tasks and (theoretically) it was a step removed from political constraints. While institutionally it was part of the Welsh Government, it had offices at a regional level. This permitted officers to build relationships with regional and local economic actors, generating a sense of partnership for an area's development and fostering a strong sense of trust between the parties. These officers were able to identify what firms in their region needed, as well as the most suitable or appropriate type of help available to meet these needs. They also offered stakeholders a "local" Welsh Government contact that understood their region, the opportunities it offered and the regional business profile, effectively supporting business growth (OECD, 2019^[13]). Currently, many basic business support services are housed in Business Wales, which helps businesses to start up and grow, offering support for business development, financing, skills and training, innovation, marketing and information technology (IT) (Welsh Government, 2020^[54]).

Reintroducing a regional development agency that is strategically oriented to support implementing regional development and investment policy (including internationally) could help build capacity in both the public and private sectors. By creating a horizontal agency, potentially housed within the proposed office for regional development and investment but not responsible to any individual line minister or department, it can operate across sectors and across silos. Doing so could advance regional-level policy implementation by building and managing relationships that contribute to productivity and investment, as well as to well-being and regional attractiveness. The overall objective of such an entity would be to support national and subnational regional development actors implement policy and investment initiatives, complementing the strategy and co-ordination role of the office for regional development and investment. On the policy side, this can range from identifying realistic development priorities for the region to providing data that supports performance measurement and policy evaluation, for example. On the investment side, it could serve as a one-stop-shop, advising local authorities, entrepreneurs, SMEs, the third sector and other interested stakeholders on the design and eligibility of projects for public funds and navigating the public financing channels that would support these. Most importantly in the Welsh context, such an entity could contribute to building trust among stakeholders.

Such an entity must be able to work effectively across Welsh Government departments. Structurally, it could have a head office located at the national level, for example within the proposed office for regional development and investment. It could – and should – be complemented by regional "arms". Ideally located

in each region (South East Wales, North Wales, and Mid and South West Wales, or Mid Wales and South West Wales), these offices could be active at the regional and local levels, working with the region's CJC, local authorities, private and third sectors representatives, and other regional development stakeholders. If CROs and their teams become part of an office for regional development and investment, they could transform into the regional “arms” of a regional development agency, working with regional development actors in the public, private and third sectors in implementing regional development interventions (Figure 5.6).

Figure 5.6. Potential organisational placement of a Regional Development Agency in Wales



Note: CROs and their teams fit at the regional level only if they are folded into the proposed office for regional development and investment. If they are not, then the development agency would need to establish its own teams that work to support policy and investment at the subnational (regional and local) level.

It is essential that such an agency is properly resourced and has decision-making power within defined parameters. Funding could come from across the Welsh Government particularly if the body is working to support departments in meeting objectives with a regional logic. It would also be important that it is sufficiently institutionalised to withstand election cycles. This reinforces the need to create a body independent of a single cabinet department. The above described institutional set up may best position it to advance implementing cross-sector policy objectives and investment opportunities, while also establishing clear lines of accountability.

The Welsh Government should take into account that two important elements are already in place with respect to such a body. First, is previous institutional experience. However, it would be fundamental to apply learning from the past. Second, is previous practical experience. There are experienced people within the Welsh Government who have worked both within the WDA and with government offices, and appear to maintain the contacts and good relationships established during the WDA era (OECD, 2019^[13]).

Using outcome-based performance measurement to support regional development and investment

Well-developed, outcome-oriented performance measurement systems contribute to the success of regional development policies and investment by measuring and monitoring the effectiveness of policy and spending, be it by national- or subnational-level authorities (Mizell, 2008^[55]; Phillips, 2018^[56]). Performance measurement systems combine monitoring and evaluation mechanisms with indicator sets and can help governments determine if their actions are yielding the results desired or if an adjustment is necessary (Annex 5.B, Annex 5.D). An effectively designed indicator system – one that relies on the appropriate type of indicator for the objective at hand (Box 5.14) – offers regional policy actors information to enhance decision-making throughout the policy and investment cycles, from resource allocation to policy or programme adjustments. When developed collaboratively with subnational actors for their design, implementation and use, and carefully coupled with specific incentive mechanisms and realistic targets, indicators can also promote capacity development and good management practices, encourage performance improvements and improve transparency and accountability at all levels of government (OECD, 2009^[57]; Mizell, 2008^[55]; Phillips, 2018^[56]).

Box 5.14. Distinguishing and selecting types of indicators

An "indicator system" refers to the systematic collection of information to measure and monitor the activities of government. An indicator is a measure that captures important information and provides insight that can be used in the context of decision-making. Indicators are generally divided into four categories:

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

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.

Source: OECD (2009^[57]), *Governing Regional Development Policy: The Use of Performance Indicators*, <https://doi.org/10.1787/9789264056299-en>.

A more robust practice of performance measurement would permit Welsh public authorities at all levels to better understand the impact of their policies, programmes and investments on regional development. It could also offer insight into the factors contributing to or detracting from local and regional attractiveness, and potentially improve policy continuity. If a government cannot determine whether a policy or investment is performing over time, then it is easier for a successive government to replace it. To operate effectively, however, performance measurement systems, and particularly indicator systems, require financial and human resource capacity and capability, time to develop and test, and an ability to be self-critical. This all depends on political will and an openness to scrutiny, as well as on institutional, national and subnational

actors that are interested in understanding performance. Wales could better seize the opportunities offered by performance measurement systems, including indicators, to promote learning and build accountability for regional development and investment. To do so will require overcoming a tendency to perceive performance measurement for regional development and investment as a control or compliance tool – a characteristic frequently associated with EU performance measurement requirements (Morgan, 2019^[17]) – and to use it more proactively as a learning tool.

Combining output and outcome indicators for insight into policy and investment success

Wales's performance measurement experience for regional development and investment is linked at least in part to its experience in managing and using EU funds. Yet, while EU funds have robust evaluation mechanisms, these focus on measuring project and investment outputs. They emphasise capturing what activities or investments produce with respect to specific, agreed-upon funding objectives and commitments. They are not generally designed to capture the outcome, i.e. the expected or desired change arising from the investment or policy intervention. This limits their ability to offers insight into an action's broader success and may not help policy and decision-makers identify where to invest more or better.

Working with departments and other public bodies to identify a short set of relevant targets and indicators for desired regional development and investment outcomes could contribute to necessary policy and investment evidence bases, give greater insight into where policy and investment attention needs to be placed and support *ex ante* and *ex post* investment evaluation, including the Better Business Case approach used by the Welsh Government. This same principle applies subnationally to the Regional Economic Frameworks. Developing such plans without clear measures for success will provide limited insight into whether the Welsh Government's place-based approach to regional development and investment is working, and to the impact of regional-level investment activities. It will also limit the ability to identify whether the capacity of regional-level bodies and local authorities to manage regional development and investment is increasing.

Indicator systems to support good governance, build accountability and foster trust

The Welsh Government also has the opportunity to better use performance measurement, and particularly indicators, as an accountability mechanism. At the national level, this can be accomplished by establishing a performance framework that can be easily tracked by citizens and stakeholders. This could help the government and citizens understand if regional development spending is meeting the government's objectives of growth, greater inclusiveness and higher levels of well-being. The WFGA and its indicators could be used as a basis to pilot such an initiative. This would permit the government to highlight its performance and the effectiveness of policies and investment that support growth, inclusiveness, service delivery, the foundational economy and citizen well-being, and to what result. It will require publicly communicating objectives, targets, indicators and results, in clear, easy to understand language and in an accessible manner – for example via a dedicated public website. Scotland has undertaken this exercise since 2007, and today its National Performance Framework is used by policy and decision-makers to shape policy and as a beacon for policy choices (Annex 5.D) (Johnstone, 2019^[58]). With its annual *Report on Government Services*, Australia reviews government service provision in order to compare the performance of government services and to share service reforms already implemented or under consideration. In addition, the report outlines agreed-upon national performance standards for government services and analyses service provision reform. Among the services covered in the review for 2019 were: childcare, education and training; justice; emergency management; health; community services; and housing and homelessness (Australian Government, 2020^[59]). The reports are publicly available, with detailed content that can be valuable to policy and decision-makers.

Opening itself and its performance to public scrutiny would effectively permit the Welsh Government to lead by example and support efforts to increase performance measurement, including the use of performance indicators, at the subnational level. The Cardiff Capital Region (CCR) and Swansea Bay City Region City Deals are both required to develop a monitoring and evaluation plan establishing how they will deliver and evaluate the impact of their investments (UK Government, n.d.^[60]; n.d.^[61]). They both monitor and evaluate the impact of the investment fund through diverse bodies. This is undertaken by the Economic Growth Partnership and the Skills and Employment Board, as well as by the CCR, the Welsh Government and the UK government for the CCR City Deal (UK Government, n.d.^[60]). For the Swansea Bay City Region City Deal, it is undertaken by the Economic Strategy Board, an Operational Delivery Unit and a City Deal Delivery Team under a joint committee (UK Government, n.d.^[61]). There are a number of oversight bodies for each City Deal, fragmenting the exercise and potentially obscuring the basis for oversight and who is responsible for overseeing what. While this may be evident to the internal City Deal stakeholders, it may be valuable to communicate to external stakeholders, including citizens, what they can expect from City Deal investments, based on a clear and systematic way to measure and communicate outputs and outcomes. This could improve transparency and accountability. Additionally, if properly managed it could garner additional support for projects and also stimulate a more dynamic investment process. Similar consideration should be given to the Regional Economic Frameworks being developed. These too would gain from an effective indicator system to support the monitoring and evaluation of development projects and their financing, with publicly shared results. This would help the Welsh Government and local authorities understand the impact of their frameworks. It would also show citizens where changes are occurring thanks to a new, more targeted approach to regional development investment. Furthermore, it can permit citizens to hold national and local government accountable for growth, development and well-being in their region.

To successfully use indicators systems as an accountability mechanism requires clarity with respect to objectives, lines of responsibility, openness and transparency, a systematic approach and political will. It also requires selecting indicators that are relevant to citizens. For example, indicators that feature administrative reforms to the public sector or composite economic performance (e.g. gross value added [GVA]) are too abstract and have little significance for citizens as there is no direct link with daily life and citizen well-being. A system that focuses on indicators with more observable results for citizens (e.g. to improve the capacity to solve waste management problems, to offer sufficient care for children and the elderly, to improve the level of education of young students, to address a housing shortage, etc.) is more likely to be effective as an accountability mechanism. Furthermore, media coverage and commitment by policymakers to hold themselves accountable to results is required if indicator systems are to be effective public accountability and transparency levers (OECD, 2009^[57]). Citizen input into government performance is a dynamic way to use performance measurement as an accountability mechanism. In the city of Córdoba, Argentina, citizens participate in defining municipal objectives and holding local government accountable for achieving them (Annex 5.B) (OECD, 2016^[62]). The advantage is that when well designed, such systems can contribute to increasing citizen – and stakeholder – confidence in government activities, spending and performance. Not only can this contribute to strengthening accountability (OECD, 2009^[57]) and transparency, it can further promote trust in government.

Stakeholder engagement in Wales: Reconciling a national/subnational disconnect

Successful policy and investment processes rely on effective stakeholder engagement. Public, private and civil society actors (including the third sector) have a stake in establishing and realising a vision and strategy for the development of where they live and work (OECD, 2019^[23]). This is especially true as they are also among those most affected by subnational public investment, as funds are frequently used for a variety of infrastructure projects, often large, costly and with significant social impact. Involving a broad

range of stakeholders – from local authorities and public boards, to private enterprises, academia, civil society organisations, etc. – at the right time, for the right reasons and in the right ways, can improve the quality of investment projects and policy outcomes. Yet, stakeholders are seldom engaged early enough in the policy or investment cycle. This can be due to inertia, to engagement that is a “box-ticking” exercise or to consultation processes and mechanisms that are inappropriate to the objective at hand, for example. While many governments require stakeholder consultation when developing laws, policies, infrastructure projects, etc., the engagement process is often not undertaken in a strategic manner.

The Welsh Government frequently uses consultation bodies, working groups, sub-groups, reflection exercises, etc., to support the policy design process. These consultative mechanisms bring together diverse stakeholders, relevant to a specific topic, such as investment for regional development. They offer a channel for the Welsh Government to consult with experts and other stakeholders and then further refine its thinking. It is a useful practice. There are also limitations to it, however. As a small nation, many of the key players and experts called upon to participate in these bodies are the same. The advantage is that everyone knows each other and this can generate the levels of trust necessary to openly discuss complex or sensitive policy issues. The risk is discussion of challenges that is self-reinforcing across consultative bodies and limited innovation in potential solutions. In addition, because people may participate in multiple bodies, an additional risk is consultation fatigue and drawing down on already limited human resources. Beyond internal-to-government consultation processes, the Welsh Government undertakes public consultation exercises prior to introducing a new policy. However, public consultation may be coming too late, particularly if the policy has already been informed (by the consultative bodies) and designed (by the government). While valuable, these mechanisms can be static. They are concentrated on the left end of the stakeholder engagement spectrum (i.e. inform and consult) (Annex 5.E) and may have limited strategic impact.

At the local level, officials seem to expect engagement that is active involvement in the design and delivery of policies and investments. This places them to the right on the stakeholder engagement spectrum (i.e. collaborate and empowerment). Both the Welsh Government and local authority representatives consistently refer to “co-production”⁸ and its importance. Yet, there is a gap between the parties in what co-production means and how it is realised. This dynamic is evidenced at least in part by the reported tensions between Chief Regional Officers (CROs) and local authorities in managing the engagement process for identifying development problems, needs and priorities for the Regional Economic Frameworks. Some local authorities feel that the dialogue is being launched too late in the design process and results in less space for their input (OECD, 2019^[12]). The approach seems at odds with a stated desire to bring the Welsh Government and local authorities to work together on identifying development priorities and relevant investment programming. There is a risk that top-down processes are reinforced, whether intentionally or not, further eroding trust between the national and subnational levels of government. Unless bridged, this gap could significantly weaken the Welsh Government’s ability to invest effectively in place-based, and place-driven regional development.

There also seems to be room to improve engagement practices between the Welsh Government and non-government stakeholders, including the private sector, higher education institutes and the third sector. It is reported that the relationship between the Welsh Government and the business sector, for example, is not sufficiently open and a free flow of communication and information exchange is challenging (Morgan, 2019^[17]). This can limit the ability of policymakers to understand the needs, opportunities and capacity constraints experienced by the private sector, which in turn will affect the sector’s ability to contribute to development. It is also reported that more effective and strategic engagement could be undertaken with higher and further education communities. The strong relationship among governments, businesses and research centres can advance productivity and competitiveness, better-developing innovation opportunities (Morgan, 2019^[17]; Reid, 2018^[63]) and boost the well-being levels in individual regions. Welsh third sector organisations are critical partners for the delivery of public services in Wales. In addition to being service providers, they can bring first-hand insight into the services citizens need and want now and,

in the future, identify problems in service delivery or quality, as well as contribute innovative solutions. In many respects, realising the Welsh well-being agenda rests in great part with them. Ensuring they are actively engaged in regional development and investment processes will increase their capacity to deliver accessible and quality services. It can also contribute to their sense of ownership in societal outcomes, for example in social care, affordable housing, food provision and health – all of which advance the Welsh inclusiveness, well-being and foundational economy agendas (Morgan, 2019^[17]). Finally, these stakeholders are valuable accountability mechanisms (Morgan, 2019^[17]) and can call governments to task for falling short on their responsibilities.

Tools to support a more strategic approach to stakeholder engagement

The Welsh Government and local authorities agree that active engagement – with each other and with stakeholders and citizens – and a partnership-based approach to regional development and investment are essential. However, they appear misaligned in what this means, which creates conflict and contributes to misunderstanding and distrust. The Welsh Government and local authorities may need to embark on a more strategic and clearer path for engagement, while also building the engagement capacity of the “engager” and “engagee”. Actively managing the expectations surrounding engagement is necessary – i.e. why the consultation and what there is to gain by participating in a constructive manner. It is the government’s responsibility to communicate how – and, ideally, when – these expectations will be met and why they cannot be met if such is the case. There are a number of ways to bridge gaps that arise from mismatched expectations, highlighted by different government experiences (Annex 5.E).

Stakeholder engagement strategies are one mechanism. These are generally an overarching document on citizen or stakeholder participation in policymaking, developed by a national or subnational government, a government ministry/department, or another type of public body. Stakeholder engagement strategies not only contribute to building engagement capacity among civil servants they can support such capacity among non-government stakeholders, as well. They can help align conceptual understanding and definitions (OECD, 2017^[34]), clarify expectations, identify necessary resources and provide guidance to using and communicating the results from an engagement process. These strategies can be complemented by manuals or guidelines and often are part of a country’s open government initiative. For example, the Australian government’s Department of Health, and the State Government of Victoria’s Department of Health and Human Services have both developed frameworks for stakeholder engagement. Meanwhile, the Victorian Health Promotion Foundation, VicHealth, published a Stakeholder Engagement Framework 2018-23 that speaks directly to its constituency (Annex 5.E) (VicHealth, n.d.^[64]).

A similar framework document for supporting the internal engagement process with other government actors and also with local authorities in Wales may be beneficial. This could help better establish the roles of each party, clarify definitions, identify appropriate engagement methodologies and align expectations with respect to participatory processes. Such a document may contribute to strengthening collaborative relationships with CROs, for example. It could also provide a mechanism to ensure effective participatory processes between the Welsh Government and CJs, as well as CJs and the communities they would serve, should CJs be established. Ensuring that subnational “voice” is appropriately integrated into the policy and investment processes that support regional development should be actively pursued and supported. However, it should also be undertaken with clearly established and agreed-upon parameters. This includes with respect to Regional Economic Frameworks but goes beyond them as well. There is still work to be done among Welsh national and subnational-level stakeholders to ensure effective engagement processes.

Engagement through active, continuous and clear communication with government and non-government stakeholders, including other political parties, the private sector, the third sector and citizens is another important tool that can build support for regional development and investment initiatives. This can be particularly crucial when undertaking any transformational reform or large-scale investment project. Not

only does this help align objectives, interests and priorities, it “brings people on board” with the reform and increases the legitimacy of government investment and policy decisions. Bilbao, Spain, is a good practice example of active stakeholder engagement in the successful physical and economic transformation of the city (Annex 5.E) for a number of reasons. It worked with the spectrum of political parties and local interests, and dedicated sufficient resources and managed stakeholder expectations throughout the multi-year process. It also used the engagement process to inform its decisions, rather than use it to drive the decisions it had already made. Finally, it was responsive to the accountability mechanisms embedded into engagement processes. During this transformative period associated with Brexit, the Welsh Government and local authorities may wish to continue strengthening the active communication and dialogue with respect to public investment initiatives with each other and with a broader range of stakeholders. Engagement processes that incorporate diverse stakeholders, including non-government sectors (e.g. private sector and higher education institutes, the third sector, etc.) can provide a wealth of ideas, innovation and new contribution to the design of policy content and public services. While Bilbao created a framework for participation that helped the government proactively engage with communities and nourished a more participative and empowered relationship between government and citizens, Australia has taken this capacity to a national level through its 52 Regional Development Australia Committees. These are composed of local leaders who work with all levels of government, business and community groups to support their region’s development (Annex 5.E) (OECD, 2019^[23]).

Taking a more strategic and policy-driven approach to stakeholder engagement in regional development and investment could contribute to trust-building between the Welsh Government and a diverse set of stakeholders. Setting out the “rules of engagement”, providing principles for engagement and a clear statement of purpose, as well as definitions and engagement methodologies, could make the engagement processes clearer, easier and more transparent. Combining this with offering tools that build capacity and support successful engagement processes could further contribute to managing expectations and lead to more satisfying, and effective, engagement processes – for the “engager” and the “engagees”. Reinforcing an engagement culture, building the trust necessary to engage, and building engagement capacity all take time. Box 5.15 offers some pointers to consider when engaging with stakeholders.

Box 5.15. Pointers for engaging with stakeholders for regional development and investment

- Develop and implement a stakeholder engagement plan.
- Make information – including on development and investment objectives – publicly available in a timely, visible and easy to understand way.
- Involve stakeholders at the beginning of a policy or investment cycle.
- Ensure engagement procedures are transparent and consistent with the OECD Principles for Transparency and Integrity in Lobbying.
- Develop formal fora to encourage dialogue and build trust by focusing on the simplicity of the information and the feedback communicated.
- Be transparent on the purpose of the process and whether it is for information, consultation or if more direct involvement is being sought (e.g. collaboration).
- Report back to stakeholders on how their contribution will be or was integrated, and if it is not integrated, explain why.
- Share clear and simple information with all stakeholders involved.
- Be prepared to negotiate on consulted points, and if the point is non-negotiable, avoid consulting on the point.

Source: OECD (2019^[23]), *Effective Public Investment across Levels of Government: Implementing the OECD Principles*, <https://www.oecd.org/effective-public-investment-toolkit/>.

Conclusion and recommendations

There is ample possibility to achieve the Welsh development agenda of growth, inclusiveness and well-being through place-based, integrated regional development and public investment. Doing so successfully calls for reconsidering diverse aspects of the multi-level governance system. Brexit offers a window of opportunity to refine the relationship between the Welsh Government and the UK government, and it also creates space to redefine the relationship supporting regional development and investment between the Welsh Government and local authorities.

Taking a more precise place-based approach to that supported by ESIF structures is a strong step forward. The Welsh Government is introducing mechanisms to reinforce this, such as CROs and their teams, Regional Economic Frameworks and CJC's. At the same time, there is room to improve the capacity to create and implement integrated policies, as currently the strategic framework for regional development and investment is fragmented across government. A fresh look at the toolkit supporting the design and implementation of regional development policy and its delivery will be valuable in the short, medium and longer terms. A clearer strategic approach will be valuable, as would be a single dedicated regional development policy – one that considers and helps integrate the regional ambitions of diverse policy sectors. Expanding the mix of co-ordination mechanisms used, including at the centre of government and particularly with an eye on managing the policy fragmentation and mitigating its impact, would help. Creating an office for regional development and investment could effectively boost cross-sector co-ordination and policy delivery, as well as investment management. It could also support co-ordination efforts among levels of government. Finally, having a clear understanding of what works and what does not work in terms of policy interventions and investment is fundamental, and an outcome-based performance measurement system for regional development could provide this level of insight, as well as serve as an accountability mechanism to citizens.

The Welsh Government is also examining how to implement its regional development and investment agenda by increasing devolution. As it looks to do so, there is a need to ensure capacity is built among all parties, national and subnational. At the national level, the government will need to become more comfortable assuming a strategic role and moving away from one that emphasises delivery. At the same time, local authorities will need to recognise their capacity “cans” and “cant’s”. For all parties, managing this will mean being open to new structures, new mechanisms and new ways of working. This can include taking an asymmetric approach to devolving tasks, based on capacity rather than the task itself, and establishing pilots to identify what works and what might not. Formalising partnership agreements is another useful mechanism. Ensuring that a wide range of stakeholders can support the agenda is fundamental. This can mean building “on the ground” implementation support for SMEs, urban and rural area entrepreneurs, larger private sector actors, the third sector, etc. A regional development agency here is a possibility.

There is broad consensus among Welsh stakeholders that place-based regional development is the right approach to meeting the government’s agenda, as well as subnational priorities and needs. Gaps arise in what this means and the forms it could or should take. These will need to be bridged. The process of doing this through multi-level governance could bring regional development and investment actors closer together in their efforts to advance productivity, growth and well-being throughout Wales.

Box 5.16. Recommendations for action to reinforce Welsh governance structures for regional development and investment

1. Establish a vision-based, long-term regional development strategy for Wales

- Undertake an active, cross-sector, multi-stakeholder consultation process.
- Potentially use the WFGA as a basis for the strategy.
- Set clear, societally agreed-upon long-term objectives for the territory.

2. Introduce a single, integrated national regional development policy to realise strategic aims

- Take a cross-sector (whole-of-government), multi-stakeholder approach to policy design.
- Establish clear, measurable objectives that support the long-term development strategy.
- Ensure co-ordination between the regional development policy and sector policies with regional logic and regional goals.
- Create an outcome-based performance measurement system to evaluate regional development policy and investment implementation and success; adjust when necessary.

3. Strengthen and diversify co-ordination mechanisms for more effective policy and investment integration

- Reinforce the role of the centre of government as a guide and co-ordinator of regional development and investment policy.
- Establish a high-level inter-ministerial co-ordinating body for regional development chaired by the First Minister; complement with a technical/implementation subcommittee.
- Introduce/strengthen a multi-level, multi-stakeholder dialogue body and activate its innovation and knowledge-sharing potential via a strategic role in regional development and investment.

4. Establish an office for regional development and investment

- Link strategic regional development planning with regional development investment planning and management activities (currently in WEFO) by uniting them into one office.
- Ensure the office is “sector-neutral” by placing it in the office of the First Minister.
- Give this office a mandate (ideally statutory) for leading regional development strategy and co-ordination efforts across government.
- Potentially move CRO teams into this office.

5. Reinforce subnational capacity to deliver on regional development planning and implementation responsibilities

- Better articulate complementarities between Regional Economic Frameworks and other City and Growth Deals, as well as other existing planning requirements and plans.
- In the medium term, introduce regional-level development plans, designed by subnational entities and aligned with a broader national regional development strategy, consolidating other relevant planning requirements into these.
- Establish formal agreements/contracts as a capacity building mechanism.
- Adopt a learning-by-doing and asymmetric approach to devolving responsibilities.

6. Reintroduce a regional development agency to support regional development policy and investment implementation

- Orient this body toward strategic support for realising national and subnational regional development and investment aims at the regional and local levels, working with the public, private and third sectors.
- Ensure a sectorally independent head office, with accountability to the proposed office for regional development and investment.
- Establish regional-level “branch” offices (one per region). CRO teams may be effective support agents.
- Ensure adequate human and financial resources and decision-making power within its remit.
- If placed in an office for regional development and investment, CRO teams may also effectively support such an agency at the subnational level.

7. Adopt an outcome-based approach to performance measurement of regional development and investment

- Use the system as a learning tool, to evaluate and adjust regional development policy interventions and investment effectiveness and to build accountability to citizens.
- Support CJs and/or local authorities in the design, implementation and use of a monitoring and evaluation system for their regional development plans.
- Ensure system measures are easy to capture and to understand and are relevant to policymakers and citizens.
- Use the system to support accountability to citizens.

8. Adopt a more strategic approach to stakeholder engagement

- Establish clear engagement definitions and expectations for the Welsh Government and local authorities.
- Reinforce engagement practices with external regional development stakeholders (e.g. private and third sectors, academia, etc.).
- Reconsider the toolkit used to support stakeholder engagement.

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Notes

¹ The differentiation made between strategy and policy is the difference between a long-term plan for achieving a stated objective (strategy) and the agreed-upon approach that guides action in specific sectors or situations (policy) to achieve that objective. Policies are likely to be shorter term (e.g. a government's period in office) but ideally should help meet the strategy's objectives.

² Despite Brexit on 31 January 2020, the UK and Wales have until the end of the 2014-20 programming period (31 December 2020) to use allocated funds. Additionally, while the programming period officially ends in 2020, funding can be extended up to 3 years with the N+3 rule. Thus, EU funding for Wales will not disappear from one day to the next but rather be effectively phased out.

³ At the time of writing, Mid Wales is in the process of developing a Growth Deal.

⁴ In the case of the Council for Economic Development and the Workforce Partnership Council, this may change with the introduction of the Social Partnership Bill.

⁵ The Welsh government intends to establish "economic regions" to arrive at the desired scale for regional development planning. The Economic Action Plan is based on three such regions though, *de facto*, regional thinking and current subnational activity divides the country into four regions. The exact number of these regions is explored in this report's case study.

⁶ "Soft" capacity is often associated with the capability to undertake and execute tasks.

⁷ The Development Board for Rural Wales was also established in 1976, with a sub-regional responsibility for the economic and social development of Mid Wales. The DBRW was merged into the WDA in 1988.

⁸ At the OECD, co-production corresponds to the direct involvement of individual users and groups of citizens in the planning and delivery of public services. This umbrella term covers a range of more specific concepts, such as co-design, co-creation, co-delivery, co-management, co-evaluation and co-review, which reflect the different stages and types of stakeholder involvement and input. For example, governments co-produce with citizens when they release information which is then reused by citizens to produce improved or new services (e.g. using open data to combine information on local bars and crime data to help people plan safer routes home); or when they partner with citizens or volunteer groups to monitor the physical conditions of public infrastructure and services, or to increase safety in their neighbourhood.

Annex 5.A. OECD international experience with regional development strategies: Some examples

Approaches to long-term vision setting at the national level

Vision setting using civic engagement and dialogue

Australia

In April 2008, the Australian government convened the Australia 2020 Summit to foster a national conversation on Australia's long-term future. The summit aimed to harness the best ideas for building a modern Australia, ready for the challenges of the 21st century. It brought together 1 000 participants from across the country to think about long-term challenges confronting Australia's future and requiring responses at the national level that would not be limited to the span of the usual electoral cycle. The summit generated more than 900 ideas over 2 days. Participants came from the business sector, academia, community and industrial organisations, and the media. They debated and developed long-term options for Australia across ten critical areas: productivity (education, skills, science and innovation); the economy; sustainability (e.g. population, climate change, water); directions for rural industries and communities; a long-term national health strategy; strengthening communities (e.g. social inclusion); indigenous populations; culture (e.g. art, film, design); governance; security and prosperity. The Department of the Prime Minister and Cabinet provided the Secretariat for the Summit and was responsible for co-ordinating the development of the Summit report and the Australian government's response to the Summit, as well as the implementation of the policies and programmes generated.

Slovenia

Vision of Slovenia 2050 was developed using a strategic foresight process designed and implemented in co-operation with the OECD. Its preparation included discussion with ministries, an extensive civic engagement process, a public opinion survey and a total of 27 events. The vision played a key role in identifying global megatrends that are likely to affect Slovenia over the coming decades and developing appropriate policy responses to them. It served as an important input into the Development Strategy of Slovenia 2030.

Vision setting using foresight and strategy units

Canada

Canada's Policy Horizons Canada, a centre-of-government unit, conducts scanning and foresight to anticipate emerging policy challenges and opportunities. The unit monitors and explores social, economic, environmental and technological changes in Canada and across the world, and analyses how these changes may come together in the future. Its work supports medium-term policy development by the government of Canada, by helping federal organisations to take a comprehensive, longer-term approach while dealing with their short-term priorities. The unit does not formally analyse regional dimensions, but some of its prior work has considered how trends might have different impacts across regions.

Estonia

At the national level, the Strategy Unit, housed in the Government Office, is Estonia's centre-of-government long-term planning unit. The Strategy Unit is responsible for developing and implementing government action plans and Strategic Development Plans (SDPs) to increase the country's competitiveness and sustainable development. For example, preparations are underway to develop a long-term strategic vision called Estonia 2035, to reduce bureaucracy, fragmentation and the number of government level development plans. Estonia 2035 will take into consideration input from political and opinion leaders, top experts, and private, third and public sector organisations.

Sweden

The Unit of Economic Policy Analysis within the Economic Division of Sweden's Ministry of Finance is responsible for economic development and long-term strategic foresight. Through that role, the unit develops and publishes a "long-term inquiry" (*Långtidsutredningen*) on a regular basis, with several sub-reports on specific territorial and regional issues: e.g. migration, commuting, places of economic growth and demographic challenges for regions. Regional GDP, workforce and population projections to 2035 are also included, based on the Regional Analysis and Forecasts (Raps) tool for regional planning. This tool can be used for analyses on historical developments, forecasts, forward-looking scenarios, comparative regional descriptions, groupings of regions by structure and trends, and regional simulations and impact assessments.

Source: OECD (2010^[5]), Finland: *Working Together to Sustain Success*, <https://dx.doi.org/10.1787/9789264086081-en>; OECD (2019^[2]), *OECD Regional Outlook 2019: Leveraging Megatrends for Cities and Rural Areas, Country Profiles*, <https://doi.org/10.1787/9789264312838-en>.

Examples of strategic planning frameworks in OECD countries

Australia

The national-level 2017 strategy document "Regions 2030: Unlocking Opportunity" outlines the Australian government's regional development agenda. To support the development of the strategy, a ministerial taskforce was established and chaired by the Prime Minister. The strategy places regional Australia at the heart of government decision-making, where implementation is realised through investment and activity in five focus areas across government: i) jobs and economic development; ii) infrastructure; iii) health; iv) education; and v) communication. At the subnational level, several state governments have undertaken long-term strategic regional planning. For example, the state government of New South Wales (NSW) released "The Vision", outlining its 20-year vision for economic development in regional NSW. The NSW state government assisted local councils to develop regional economic development strategies based on the concept of functional economic regions. Developing these enables faster access to dedicated state funding and may be used to support other types of government grant applications. Similarly, the Victorian state government has established nine regional partnerships. Through ongoing consultation, including nine annual regional assemblies, the partnerships ensure that regional communities have a greater say about what matters to them and that the voices of these communities are heard by the government.

Estonia

Estonia's regional policy, managed by the Ministry of Finance, focuses on the living and business environment in urban and rural areas, on better using regional assets and on promoting greater cohesion and development capacity among regions. While past regional policy has focused on infrastructure and public services, it has now placed greater emphasis on economic development and employment based on regional strengths. Some examples include a new programme for regional competency centres; programmes for developing the competitiveness of regions and supporting regional entrepreneurship; and employment development initiatives. At the subnational level, county governments develop ten-year county development strategies and county development plans. These are developed jointly with local

municipalities and the Ministry of Finance. Local government action plans (four-year plans) are also developed and serve as mid-term plans to support country development strategies.

Iceland

The Regional Policy of Iceland 2018-24 is an integrated social and economic development plan that provides a framework for regional support. Its main goals are to address depopulation in individual regions; address the lack of economic and industrial diversity; support technological changes and the development and adaptation of individual industries; outline necessary adaptation measures to counter the impacts of climate change; ensure smooth communications and access to services; and respond to increasing international competition for people and companies. Special emphasis is placed on economically disadvantaged regions. On the basis of the regional policy, each of Iceland's eight regions develops its own regional plan of action (*Sóknaráætlun*), which is financed through eight regional plan-of-action contracts. The governmental steering committee of regional development provides support to regional associations of local authorities in preparing plans of action and in negotiations between the associations and ministries. Regional plans of action are drafted in a consultative forum in each region with the participation of stakeholders. The Icelandic Regional Development Institute supports regions (all rural areas) through financial assistance and loans, regional strategy development to implement government goals and a network of eight industrial regional development agencies whose goal is to provide support to businesses in each area as well as to promote innovation.

Ireland

Regional spatial and economic policy in Ireland is made by three regional assemblies established in 2015. The framework for this policy is set by Project Ireland 2040 – the National Planning Framework (NPF) 2018, a long-term spatial development framework. This is complemented by the National Development Plan (NDP) 2018, a ten-year public investment strategy to 2027. Together, both the NPF and the NDP comprise a planning and investment programme for the future growth of Ireland's regions, cities, towns and rural areas, focused on a common set of ten shared national strategic outcomes. The overall Project Ireland 2040 strategy is based on the enhanced growth of Ireland's regions and in particular the four cities other than Dublin (i.e. Cork, Galway, Limerick and Waterford) to become accessible cities of scale. At the same time, it supports Dublin's continued role as a key national growth driver. The strategy also identifies five smaller regional and cross-border growth drivers that complement the five-city catchment areas. Ireland's regional assemblies develop spatial and economic plans for their territories. The Regional Spatial and Economic Strategy (RSES) is the Eastern and Midland Regional Assembly's approach to supporting Project Ireland 2040. It is based on a vision statement advancing sustainability, competitiveness and regional well-being, and combines a spatial strategy with economic and climate strategies, as well as plans for "place-making" and for the first time a strategic plan for Dublin's metropolitan development.

New Zealand

The New Zealand government's key regional economic development policy is the Provincial Growth Fund (PGF). The PGF provides NZD 3 billion between the 2018-19 and 2020-21 financial years to improve the productivity potential of regional New Zealand. Its priorities are to create more and better-paying jobs, increase social inclusion and participation, support Māori development, encourage environmental sustainability and improve infrastructure and economic resilience. All regions (except for the three main metropolitan areas of Auckland, Christchurch and Wellington) are eligible for PGF funding, although regions identified as needing the most assistance are prioritised. The PGF provides funding for initiatives that have been prioritised by regions, sectors of the economy and the government to address social and infrastructure deficits in regional New Zealand. The PGF is administered by the newly established Provincial Development Unit (within the Ministry of Business, Innovation and Employment), and is overseen by a group of relevant regional economic development ministers.

Slovenia

The Law on the Promotion of Balanced Regional Development provides a framework for making regional development policy more predictable and transparent, as well as fairer and more efficient. One of its main innovations is a mechanism to avoid needing ad hoc measures and region-specific legislation in response to shocks. Greater reliance on contractual arrangements for national co-financing of regional projects and emphasis on improving monitoring and evaluation is also used to strengthen accountability and co-ordination. Development decisions are adopted by Slovenia's 12 regional development councils and the two development councils of the cohesion regions. The Development Strategy of Slovenia 2030 defines key challenges for improving the lives of current and future generations. It emphasises the sustainable use of natural resources to create a healthy living environment, ensure long-term food safety, create high-value-added economic activity and provide quality jobs. It includes environmental objectives such as: introducing an ecosystem-based way of managing natural resources that overcomes sectoral silos; managing surface and groundwater effectively; developing forests sustainably to allow them to play an ecological, economic and social role; the prevention of excessive pollution; and maintaining high levels of biodiversity.

Sweden

The National Strategy for Sustainable Regional Growth and Attractiveness 2015-20 focuses on a wide array of considerations ranging from innovation and employment to public services and transport. It adopts a cross-sectoral approach and implementation relies on multi-level governance mechanisms for dialogue and learning along with a strong focus on results, monitoring and evaluation. The strategy emphasises regional sustainability and inclusiveness. It has strengthened the dialogue with regional-level stakeholders through a formalised forum for dialogue between the national government and politicians as well as civil servants at the regional level. Regional policy includes rural as well as urban growth considerations. At the regional level, regional development strategies are produced in every county by its county council (except for Gotland). Moreover, regions, in conjunction with national forward-looking agencies, participate in the Region 2050 project in order to build awareness around processes of change, discuss territorial consequences and strategies, and increase strategic foresight competencies among stakeholders.

Source: OECD (2019^[2]), *OECD Regional Outlook 2019: Leveraging Megatrends for Cities and Rural Areas, Country Profiles*, <https://doi.org/10.1787/9789264312838-en>; Bradley, M. (2019^[11]), *Regional Spatial and Economic Strategy (RSES) for the Eastern and Midland Region*, Eastern and Midland Regional Assembly (Ireland).

Annex 5.B. Cross-jurisdiction co-operation in OECD countries and regions: Some examples

Finland

Finland's single-tier subnational government level is formed by 320 municipalities. Finnish municipalities are often too small to provide health, secondary education or social services by themselves, making voluntary inter-municipal co-operation very common. This is most frequently structured through a joint municipal authority, which is a legal entity, financed by member municipalities and led by a board assigned by member municipalities. Joint municipal authorities do not receive central government transfers. While inter-municipal co-operation is generally voluntary, municipalities must a joint municipal authority for specialised healthcare (hospitals) and regional planning. Although there have been voluntary municipal merger reforms, inter-municipal co-operation is still common, as it enables utilising economies of scale especially in rural and sparsely populated areas. Inter-municipal co-operation has allowed municipalities to focus on tasks that best suit their capacities. Currently, the trend is to form even larger co-operative units that integrate all health and social services in order to utilise both economies of scale and scope.

Source: OECD (2019^[35]), *Making Decentralisation Work: A Handbook for Policy-Makers*, <https://dx.doi.org/10.1787/g2g9faa7-en>.

France

To facilitate horizontal co-operation among 36 000 municipalities, France has 2 145 inter-municipal structures with own-source tax revenues. Each municipal grouping constitutes a “public establishment for inter-municipal co-operation” (EPCI). EPCIs have limited, specialised and exclusive powers transferred to them by member municipalities. They are governed by delegates of municipal councils and to have legal status, they must be approved by the French state. To encourage the formation of EPCIs, the central government provides a basic grant plus an “inter-municipal grant” to preclude competition on tax rates among participating municipalities. EPCIs draw on budgetary contributions from member municipalities and/or their own tax revenues.

Slovenia

In Slovenia, inter-municipal co-operation is increasing. In 2005, amendments to the Financing of Municipalities Act provided financial incentives for joint municipal administration by offering national co-financing arrangements: 50% of a joint-management body's staff costs are reimbursed to the municipalities by the central government in the subsequent fiscal period. The most frequently performed tasks covered by this arrangement are inspection (e.g. waste management, roads, space, etc.), municipal warden services, physical planning and internal audit.

Spain

The Autonomous Community of Galicia encourages economies of scale by improving the flexibility for voluntary inter-municipal co-ordination arrangements, and offering financial incentives to encourage them. Investment projects involving several municipalities are prioritised for regional funds. Local co-operation is encouraged in urban mobility plans for public transport involving the region's seven largest cities.

Source: OECD (2019^[23]), *Effective Public Investment across Levels of Government: Implementing the OECD Principles*, <https://www.oecd.org/effective-public-investment-toolkit/>.

Annex 5.C. Regional development agencies in OECD countries: Some examples

Regional development agencies can take a number of forms and serve diverse functions. Below are a series of examples of some of the more common forms.

Canada

The Canadian Regional Development Agencies are part of the government's Innovation and Skills Plan and are dedicated to advancing and diversifying their regional economies and ensuring that the communities therein thrive. These agencies have also served to address economic challenges in their regions by providing tailored programmes, services, knowledge and expertise. This includes: building on regional and local economic assets and strengths; supporting business growth, productivity and innovation; helping SMEs effectively compete globally, providing adjustment assistance in response to economic downturns and crises, and supporting communities. Each of the six regional development agencies brings a regional policy perspective to advance the national agenda by providing regional economic intelligence to support national decision-making; contributing to federal regional co-ordination and co-operative relationships with other levels of government, community and research institutions, and other stakeholders, and supporting national priorities. Regional development agencies work collaboratively with each other and with the provincial and local development agencies in their territories to ensure national co-ordination and a maximum of efficiency. They represent Canada on territorial development matters and in developing or renewing national programmes or services delivered at a regional level.

Finland

While not regional development agencies per se, Finland's 15 ELY Centres (Centres for Economic Development Transport, and the Environment) are a form of cross-sectoral, decentralised national action to support regional competitiveness, well-being and sustainable development in each region. Thus, they cover a wide range of issues from business and industry support (including labour force and skills), transport and infrastructure to the environment and natural resources. While the Ministry of Employment and the Economy oversees the ELY Centres, they also deliver policy coming from other ministries, including those of the Environment, Transport and Communications, Agriculture and Forestry, Education and Culture, and the Interior.

France

Originally established in 1960 as the *Institut d'aménagement et d'urbanisme de la Région parisienne* and later transformed into *Institut d'aménagement et d'urbanisme de la Région Ile-de-France (IAU-IdF)*, the *Institut Paris Région* (Paris Region Institute) is the development and urbanism body for the Ile-de-France region, which includes the Paris metropolitan area. It carries out studies and other work (e.g. data and cartography) to support decision-making for the Ile-de-France region and its diverse base of partners. Its activities cover various domains, including urbanism and transport, environment data and maps, and economic and social matters. In this last category, it contributes to different drivers of economic development, today, such as the green and circular economy, digitalisation, innovation and clusters, tourism and regional attractiveness, as well as employment, territorial disparities, housing and health.

Ireland

Enterprise Ireland is a government entity with responsibility for developing and growing Irish enterprise globally. It is co-financed by European Structural and Investment Funds (ESIF). Its mission is to support

sustainable economic growth, regional development and employment. It works with each of Ireland's regions to build business scale, innovate and expand their reach, as well as to develop and implement Brexit plans and diversify exports. It is also dedicated to promoting balanced regional development, ensuring growth and investment throughout the country. Examples of Enterprise Ireland impact in 2019 include 126 new start-ups supported by Enterprise Ireland funds, supporting 2 000 Brexit-exposed companies, assisting in securing 1 554 new contracts overseas, and supporting over 1 000 collaborative innovations between industry and higher education institutes.

Scotland

Scottish Enterprise is Scotland's national economic development agency. While part of the Scottish government, it is a non-departmental public body that partners with the public and private sectors. Enterprise Scotland is dedicated to reaching national objectives by ensuring that the government's National Performance Framework is realised, as well as local development by supporting local business growth, increasing employment, creating quality jobs and addressing inequalities. It supports companies throughout Scotland increase their international trade, boost innovation capacity, access funding and invest in people and capital. Scottish Enterprise has some very clear performance goals, including creating or safeguarding up to 10 500 jobs that pay at least the real living wage, enabling up to GBP 300 million of research and development (R&D) investment, enabling up to GBP 200 million of capital investment, and helping businesses raise their growth funding of up to GBP 255 million.

Source: OECD (2019^[23]), *Effective Public Investment across Levels of Government: Implementing the OECD Principles*, <https://www.oecd.org/effective-public-investment-toolkit/>; Government of Canada (2020^[65]), *Canada's Regional Development Agencies*, https://www.ic.gc.ca/eic/site/icgc.nsf/eng/h_07662.html; Government of Canada (2016^[66]), *Regional Development Agencies*, <https://www.wd-deo.gc.ca/eng/19092.asp>. OECD (2016^[9]), *Regional Outlook 2016: Productive Regions for Inclusive Societies*, <https://doi.org/10.1787/9789264260245-en>; L'Institut Paris Région (2020^[67]), *L'Institut Paris Région*, <http://www.institutparisregion.fr/institutparisregion.html>; Scottish Enterprise (2020^[68]), *Homepage*, <https://www.scottish-enterprise.com/>; Scotland Highlands and Islands Enterprise (2019^[69]), *Homepage*, <https://www.hie.co.uk/>; Invest Northern Ireland (2020^[70]), *Homepage*, <https://www.investni.com/>; Enterprise Ireland (2020^[71]), *End of Year Statement 2019: Innovate, Compete, Diversify*, <https://enterprise-ireland.com/en/Publications/Reports-Published-Strategies/Enterprise-Ireland-End-of-Year-Statement-2019.pdf>.

Annex 5.D. Indicator systems to support the governance of regional development and investment: Some examples

Performance measurement systems: Monitoring, evaluating and why bother?

Monitoring versus evaluation

When measuring the performance of regional development policy or investments, it is important to distinguish monitoring activities from evaluation. Monitoring is an ongoing process of collecting and assessing qualitative and quantitative information on the input, processes and output 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, regional disparities and regional 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, combined and provide a comprehensive approach to enhancing policy performance.

Why measure performance?

Performance measurement can be used for a variety of purposes – ranging from steering and controlling, to learning and promoting accountability. The reasons for each approach, their focus and the potential instruments used will vary. Thus, the government needs to understand why it undertakes performance measurement, what it wants to achieve from it and how it wants to use the information once obtained.

Source: OECD (2009^[57]), *Governing Regional Development Policy: The Use of Performance Indicators*, <https://doi.org/10.1787/9789264056299-en>; Van Dooren, W., G. Bouckaert and J. Halligan (2010^[72]), *Performance Management in the Public Sector*, Routledge.

Scotland Performs and Scotland's National Performance Framework

Scotland Performs

In May 2007, the government of Scotland set out to streamline government resources and improve overall territorial performance. To do so, it aligned the government around five strategic objectives – a Scotland that was wealthier and fairer, smarter, healthier, safer and stronger, and greener. From these 5 objectives, it established a series of 16 national outcomes articulating what Scotland wished to achieve over the subsequent 10 years. It then established a set of 50 quantitative and qualitative indicators that cut across

many of the national outcomes, helping decision-makers and policy designers identify policy complementarities, and helping citizens identify where progress could be made in more than one area. These indicators were primarily outcome-oriented and ranged from improving people's perception of their neighbourhood to reducing child deprivation. On its website, "Scotland Performs", the government clearly communicated its strategic objectives and what it sought to achieve. It explained why each national outcome was important, the factors that could impact outcomes and the role of the government in achieving them. It also identified the related strategic objectives and relevant national indicators. Performance in each indicator was easy to interpret as it was based on an arrow – up, down or horizontal – to indicate improvement, decline or no change over time. The importance of each indicator was also explained on the website, as well as its current status, the indicator measure, what influenced change, the government's role, how Scotland was performing in the indicator over time, criteria for change, partners engaged in creating change, and any related strategic objective. These latter two points highlighted not only the different stakeholders engaged but also the multidimensionality and complementarity of measuring well-being and taking an integrated approach to policymaking. Scotland constantly monitored its performance, updating its objectives, desired outcomes and indicators accordingly. For example, in 2011, a national outcome relating to older people was added. Some of the initial indicators remained untouched, while others were adjusted, added or removed as they related to targets that were already achieved or were replaced by more appropriate measures of progress. Over the subsequent years, Scotland Performs was transformed into the National Performance Framework.

Scotland's National Performance Framework

Much like Scotland Performs, Scotland's next-generation performance framework clearly communicates broad national objectives (its purpose), the values that guide the approach to meeting its aims, and the national outcomes it is working toward and which will help it achieve its purpose. It is designed to help citizens and other stakeholders track the nation's progress with respect to its desired national outcomes in 11 dimensions. Each dimension is associated with a vision statement, linked to the United Nations Sustainable Development Goals, and a series of indicators that citizens can follow to see progress over time. The performance measurement dimension includes a performance overview, which tracks progress towards national outcomes, highlighting Scotland's performance on the 81 National Indicators and giving a graphic representation if performance is considered to be improving, maintaining or worsening. Significantly, the performance assessment is made by senior Scottish government analysts, independently of Scottish government ministers. In addition, there is an interactive data dashboard that breaks indicator data into sub-groups of people (e.g. age, gender, disability, etc.). The Scottish government has made the performance framework and indicators available on a government website, produced a brochure consolidating the relevant information and is committed to maintaining its framework up to date and relevant. For example, in 2018 indicators such as gender balance in organisations, child well-being and happiness and the importance of a secure network were added. The government is currently tracking 81 indicators. Significantly, the framework was adopted by the Scottish parliament as part of the Community Empowerment (Scotland) Act 2015.

Source: Adapted from Scottish Government (2014^[73]), *About Performance*, <http://www.scotland.gov.uk/About/Performance/scotPerforms>; Scottish Government (n.d.^[74]), *National Performance Framework*, <https://nationalperformance.gov.scot/>; Johnstone, R. (2019^[58]), "Feature: National treasure - How the Scottish government's National Performance Framework is linking policies to outcomes", <https://www.civilserviceworld.com/articles/feature/national-treasure-how-scottish-government%E2%80%99s-national-performance-framework-linking>.

Using citizen input to establish performance measures in Córdoba, Argentina

Our Córdoba (*Nuestra Córdoba*) is a non-partisan, non-governmental network that works with the participation of more than 200 citizens and 60 organisations (academia, civil society organisations,

foundations, private enterprise, research institutes, etc.). Its citizen network (*Red Ciudadana: Nuestra Córdoba*) established a set of ten quality of life dimensions¹ with quantitative and qualitative data to measure the city's performance over time in relevant dimensions (e.g. green space, particulate matter, wealth distribution, number of licensed vehicles).

As part of its activities and at the beginning of each mayoral term, the Our Córdoba Citizen Network presents the mayor of the city of Córdoba with a proposed “Plan of Objectives” (*Plan de Metas*) for the administration's consideration and adoption. Adopting a plan is required of the municipal government by Municipal Ordinance No. 11942 signed in June 2011, which was spearheaded by the network. The plan is intended as an instrument to enhance the clarity and transparency of the government's proposed plans and actions. In practical terms, the plan is a planning and information instrument through which the sitting mayor must, before completing 120 days in office, present their goals, identify the strategic actions that will be undertaken by each branch of the municipal administration in order to meet the goals, and requires that objectives and indicators be fixed to facilitate monitoring and evaluation. The plan also requires that the mayor provide an annual performance report (before 10 March) with respect to the goals and indicators. Unfortunately, there is no requirement to provide a summary report at the end of the mayoral mandate. The network puts forth a proposal of objectives for the government to adopt. The 2015-19 proposal was developed with the participation of over 200 citizens and covers 3 themes, each of which is associated with sub-dimensions and quantifiable objectives: sustainable urban development (20 objectives); institutional development (19 objectives); inclusive development (10 objectives).

Source: OECD (2016^[62]), *OECD Territorial Reviews: Córdoba, Argentina*, <https://dx.doi.org/10.1787/9789264262201-en>; Red Ciudadana: Nuestra Córdoba (n.d.^[75]), *Plan de Metas*, <https://www.nuestracordoba.org.ar/plan-metas-gob>.

Annex 5.E. The spectrum of stakeholder engagement and OECD country practice examples

Placing stakeholder engagement along a spectrum of action

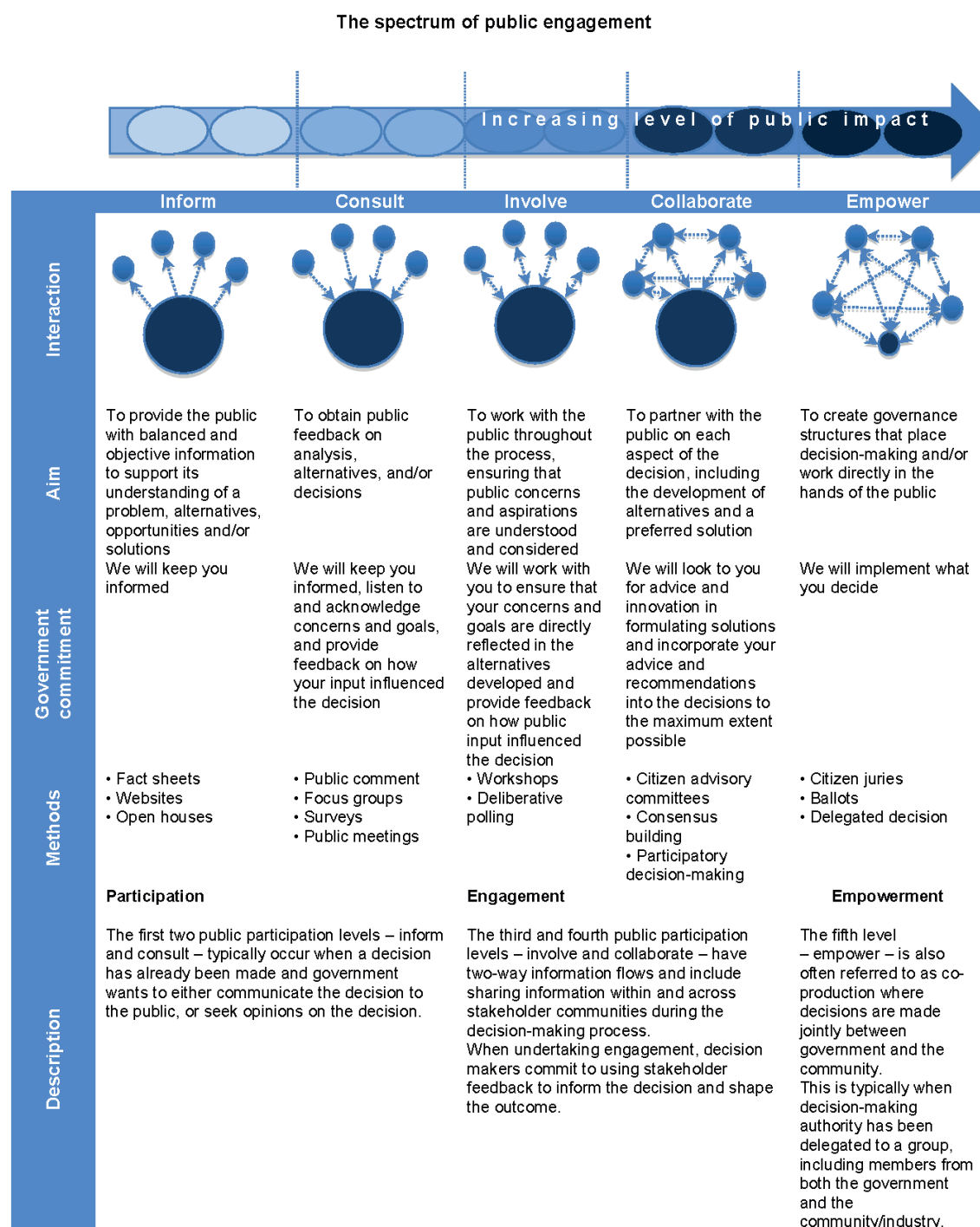
Stakeholder engagement can be conceptualised along a spectrum of increasingly collaborative interaction (Annex Figure 5.E.1). The most basic interaction is a one-way exchange with either the government providing information to stakeholders (inform) or stakeholders providing information to the government (consult). Interaction becomes increasingly complex, and arguably richer when the exchange goes in both directions and promotes dialogue between the parties. As engagement practices become more sophisticated, the level of public impact increases, together with the level of government commitment to stakeholder input. At the same time, it is important to recognise that each level of participation is associated with a specific aim and is supported by distinct methods or tools. Thus, it is fundamental to match the objectives with the level of participation. It is also fundamental for the government to be honest with itself and stakeholders about the degree to which it is willing to commit to participatory outcomes and be clear about its intentions in this respect. Finally, the participatory methods used must be realistically within a government's capacity to undertake (OECD, 2017^[76]). Engagement processes and particularly the more complex levels of involvement, collaboration and empowerment, take time. Their implementation and the use of the results depend on political will and political support. They also require financial and human resources – as well as capacity – to design, implement and apply to the policy or investment project at hand. Importantly the resource factor works both ways. Not only do governments require adequate resources and capacity for engagement processes, so do stakeholders. Stakeholders need to have the time to spend in an engagement process. They also need the ability to access the engagement mechanism – be it electronically or physically; and they need to understand why they are called upon to engage as well as their role and responsibilities within such a process. Finally, successful engagement depends on a culture of openness among all parties, and this, too, can take time to generate.

Stakeholder engagement frameworks in Australia

A stakeholder engagement framework by the Australian government's Department of Health

The Australian government's Department of Health established a stakeholder engagement framework to outline its models for engagement, key actions, a capability improvement agenda, an approach to risk oversight and management, and its performance framework. The framework establishes the department's strategic approach to engagement, clearly establishing engagement principles. These centre on being purposeful, inclusive, timely, transparent and respectful. In addition, it provides a five-step model for undertaking engagement activities: to think strategically; to analyse and plan; to provide resources and prepare; to design and engage; to review and measure. It also provides a matrix to help tailor the level of engagement to the purpose, highlights potential challenges and outlines strategies for success.

Annex Figure 5.E.1. The spectrum of stakeholder engagement



Note: This spectrum is equally valid when discussing public participation, citizen engagement or stakeholder engagement. For the purposes of this report, the title has been adjusted to stakeholder engagement in order to include a broader range of stakeholders – from private citizens to subnational governments.

Source: Elaborated by the author, adapted from IAP2 (2007^[77]), *IAP2 Spectrum of Public Participation*, http://c.ycomdn.com/sites/www.iap2.org/resource/resmgr/imported/IAP2%20Spectrum_vertical.pdf; VAGO (2015^[78]), *Public Participation in Government Decision-Making: Better Practice Guide*, <http://www.audit.vic.gov.au/publications/20150130-Public-Participation-BPG/20150130-Public-Participation-BPG.pdf>.

A public participation and stakeholder engagement framework by the Victoria State Government's Department of Health and Human Services

Similar to the stakeholder framework developed by the national-level Department of Health, the State of Victoria's framework also sets out the Department of Health and Human Service's principles of engagement and it provides a six-step model for engagement. The framework begins by stating its public engagement vision, which includes outcomes for communities as well as the public sector. It recognises the need to foster a culture of engagement and grow capacity for engagement, and identifies a series of mechanisms to do so. It also provides clear definitions of how it uses the terms "stakeholder", "stakeholder engagement", "public participation and public engagement", "co-design" and "human-centred design". Furthermore, it provides engagement planning tools and insight into undertaking an engagement process. The framework is supported by a separate Stakeholder Engagement Toolkit that outlines steps to successful stakeholder engagement and barriers to the same. It also provides stakeholder engagement templates to support an effective process.

A stakeholder engagement framework targeting a broad constituency base by VicHealth

VicHealth, a health promotion foundation supported by the Victoria State Government, published a Stakeholder Engagement Framework 2018-23 that speaks directly to its constituency, which includes not only all levels of government and diverse government actors but also public health groups, community and not-for-profit organisations, sports organisations, universities and researchers, the media, the private sector, the arts and creative industries, "innovation partners" and local communities within Victoria. The framework is written in clear, simple language and explains not only VicHealth's commitment to its stakeholders but also its engagement objectives. It provides definitions and examples of the forms and methods of engagement it undertakes, its stakeholder landscape and a monitoring and outcome framework for its objectives. A variety of case studies show how its engagement processes work and how the strategic partnerships developed not only contribute to realising the engagement objectives but also the broader policy goal.

Source: Department of Health (n.d.^[79]), *Stakeholder Engagement Framework*, <https://www.health.gov.au/resources/publications/stakeholder-engagement-framework>; Department of Health and Human Services (2019^[80]), *Public Participation and Stakeholder Engagement Framework*, <https://www.dhhs.vic.gov.au/publications/stakeholder-engagement-and-public-participation-framework-and-toolkit>; Department of Health and Human Services (2019^[81]), *Stakeholder Engagement Toolkit*, <https://www.dhhs.vic.gov.au/publications/stakeholder-engagement-and-public-participation-framework-and-toolkit>; VicHealth (2018^[82]), *Stakeholder Engagement Framework 2018-2023*, <https://www.vichealth.vic.gov.au/-/media/Files/PDFs/VicHealth-Stakeholder-Engagement-Framework-2018-23.pdf?la=en&hash=00363DAB04FB0F66CFF8AD27B6EF7EAFFD49635B>.

Maintaining stakeholder dialogue and communication in Bilbao, Spain

In 2008, Bilbao, Spain, launched a highly successful renewal project to transform from an industrial city to a service-based one. In addition to establishing a clear vision and an implementation plan sufficiently flexible that it could be changed if the situation warranted, it also had leadership that was committed to ensuring citizen participation when preparing and implementing policies and programmes. Public consultation opened the door for citizens to express their concerns and discuss potential solutions to the problems the city faced, including unemployment, slow economic growth and poor-quality education. This provided the city with an overview of citizen priorities and the issues and challenges that a plan had to address. The city was committed not only to speaking with citizens but also to listening. At the same time, citizens had to be willing to enter the conversation. This often required them to trust that they would be heard and that they would see their wants and needs reflected in project plans and outcomes. This is particularly sensitive and important at the subnational level, where actors often know each other, community interests and individual interests may not align and outcomes directly affect individual households.

Bilbao's mayor not only listened carefully to the needs of citizens but also explained potential solutions to problems, acknowledging that the citizens should be heard and brought into the decision-making process. Communicating transparently with citizens meant not only informing about what the government intended to do but it also meant explaining why something was or was not being done, why some policies were favoured more than others, etc. The challenge was to do so in a way that diverse audiences could understand and accept. One lesson stemming from Bilbao's experience is that policymakers not only need to communicate their plans; they also have to remain open-minded about criticism and scrutiny of the decisions they make and to be ready to accept responsibility for the outcomes of their decisions.

Source: Bengoetxea-Otaolea, I. (2014^[83]), *Open Government at the Local Level*; OECD (2017^[76]), *Making Decentralisation Work in Chile: Towards Stronger Municipalities*, <https://dx.doi.org/10.1787/9789264279049-en>.

Ensuring a broad stakeholder mix in Australia

Regional Development Australia (RDA) brings together 52 communities into a network of local leaders who work with all levels of government, the private sector and community groups to support the development of their regions. Bringing together all levels of the Australian government, it is funded by the Australian government, together with the state, territory and local governments in some jurisdictions; and it is administered by the Department of Infrastructure, Transport, Cities and Regional Development.

RDA is made up of a network of committees comprised of local people. They serve as the “regional development voice” of their communities, taking a partnership-based approach to developing strategies and delivering sustainable infrastructure and services to their regions. RDA committees work together to identify cross-regional issues as well as consulting and engaging with communities, promoting and participating in regional programmes and initiatives, providing information and advice on their region to all levels of government and supporting informed regional planning. Each RDA committee has developed a regional plan that priorities for the region and serves as a guide to strengthening communities.

Source: Regional Development Australia (2019^[84]), *About*, <https://www.rda.gov.au/>.

Note

¹ Environment, participative democracy, socio-economic development, urban development and housing, education, health, budgeting, safety, transparency and access to public information, transport and urban mobility (OECD, 2016^[62]).

6

OECD case study: Considerations for economic regions in Mid Wales and South West Wales

This case study on Mid and South West Wales offers an economic analysis of the advantages and disadvantages of establishing three versus four economic regions. It considers the economic, administrative and institutional capacities of Welsh local authorities, examining their fiscal autonomy in terms of spending, revenue and the need to generate economies of scale. The case study then compares the potential of a Mid and South West Wales model (one region) versus a Mid Wales and South West Wales model (two regions). In doing so, it focuses on such aspects as population, demographics, labour markets, community patterns, gross value added (GVA), deprivation, connectivity and local government spending. Using a SWOT (Strengths, Weaknesses, Opportunities, Threats) analysis, the advantages, disadvantages, risks and opportunities of both possibilities are highlighted. The case study concludes with recommendations for moving forward when establishing economic regions, certainly in Mid and South West Wales, but more generally as well.

Infographic 6.1. Key messages



Introduction

Regional economic divergence may threaten well-being, economic development, social cohesion and political stability. On the other hand, a concentration of people and business can facilitate faster economic growth. Policymakers all over the world grapple with the trade-offs between the benefits from agglomeration economies and territorial equity aspects. How can the question of lagging regions – often rural – be tackled without compromising the drive of the most dynamic areas?

Regional development aims to reduce regional disparities by supporting economic activities at a regional level. The Welsh Government intends to strengthen regional development in Wales by reforming the economic regions for economic growth. This is driven by a number of considerations: to support a stronger place-based approach to regional development, to devolve regional development planning to the subnational level and to build the capacity of local authorities in regional economic development planning and the implementation of such plans. There are different ways to accomplish this, for example through stronger decentralisation, or by promoting inter-municipal co-operative arrangements, or both. In Wales, it has been proposed to set up co-operative units, the corporate joint committees (CJCs),¹ formed by representatives of the local authorities in the economic region.

Wales, like the United Kingdom in general, is characterised by a high degree of institutional and fiscal centralisation by international standards. Welsh local authorities are responsible for delivering a considerable share of public services but, at the same time, nearly 70% of their revenues² consist of central government transfers. The low degree of fiscal autonomy among Welsh local authorities underlines the Welsh Government's responsibility for public service delivery in general and has implications for the reform proposals concerning the economic regions. Since the national level is responsible for financing the bulk of the activities and thereby is also responsible for the outcomes of the reform, an active role is needed not just in setting the rules but also in supporting implementation. Therefore, the role of the Welsh Government is important to ensure that the reform meets the goals set for the reform. For successful implementation of the economic regions, the co-operation between the CJCs and Welsh government authorities, notably the recently established Chief Regional Officers (CROs), should be seamless.

Furthermore, in order for Wales to reap the benefits it seeks from economic regions, the economic, administrative and institutional capacities of local authorities should be considerably strengthened. Establishing co-operative bodies can help solve problems of economies of scale and benefit spill-overs, which can lead to more effective regional development policies. One key to success, however, will be to ensure that the implementing bodies – i.e. local authorities – are in good fiscal condition.

The purpose of this case study is to discuss the benefits and challenges of establishing economic regions in Mid and South West Wales. Currently, the Economic Action Plan has established three regions but also the alternative to establish a separate region for Mid Wales is being considered. This case study explores the conditions under which such economic regions, whether one or two, could deliver more economic efficiency and regional equity. The study is based on economic research on the effects and conditions of decentralisation, and good policy practices from OECD member countries.

This case study starts with a short analysis and discussion of the Welsh local authorities in light of economic research on the opportunities and risks of decentralisation. The next section goes deeper in the case of Mid and South West Wales by comparing the situation of Mid Wales and South West Wales from aspects that are relevant for regional development. The third section focuses on the potential effects of establishing one or two economic regions in Mid and South West Wales. The final section concludes and presents the recommendations.

Welsh local authorities are at the heart of the proposed economic regions

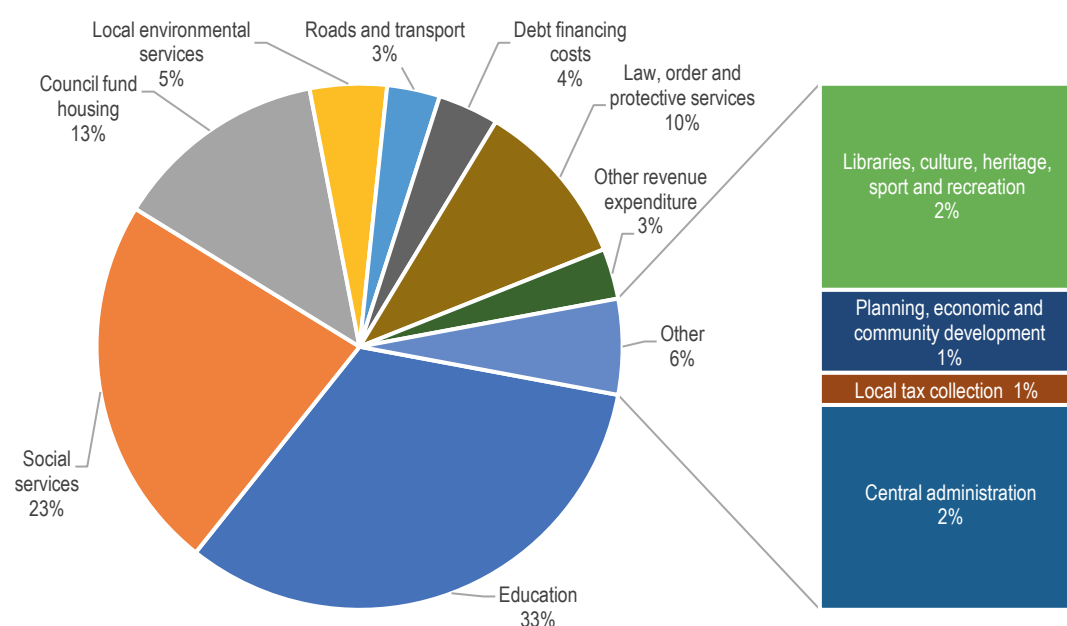
This section analyses the current situation of Welsh multi-level governance with respect to the local authorities, which represent the main implementing bodies for public services in Wales. The Welsh case, in particular the situation in Mid and South West Wales, is discussed using the key aspects of economics research on decentralisation and by presenting examples of policy practices from OECD member countries. The main aim of this section is to build an empirical and theoretical base for the comments presented at the end of the report on establishing the economic region(s) for Mid and South West Wales. The analysis presented here focuses on the governance aspect and discusses the structures within which policy is made. While the role of the private sector is key for economic growth and development, this aspect is beyond the scope of this paper.

Spending assignments at the local authority level

Welsh local authorities deliver over 700 services rendering them very important public service providers in Wales (Welsh Local Government Association, 2020^[1]). According to Welsh Government accounts, the largest single function of Welsh local authorities is education, which accounts for 33% of the total gross local government spending (Welsh Government, 2020^[2]).³ Other core local government services are social services, which account for 23% of total expenditures, housing (13%) and security (10%) (Figure 6.1). The difference between the lowest and highest per capita expenditure is GBP 641. The lowest per capita spending is found in Monmouthshire (15.5% below average per capita expenditure) and highest spending is found in Rhondda Cynon Taf (12.6% above the average) (Figure 6.2). For most local authorities of Mid and South West Wales, the per capita spending does not differ markedly from the other Welsh local authorities. The highest spending per capita in this area is in Neath Port Talbot (above the country average) and the lowest is in Pembrokeshire (clearly below country average).

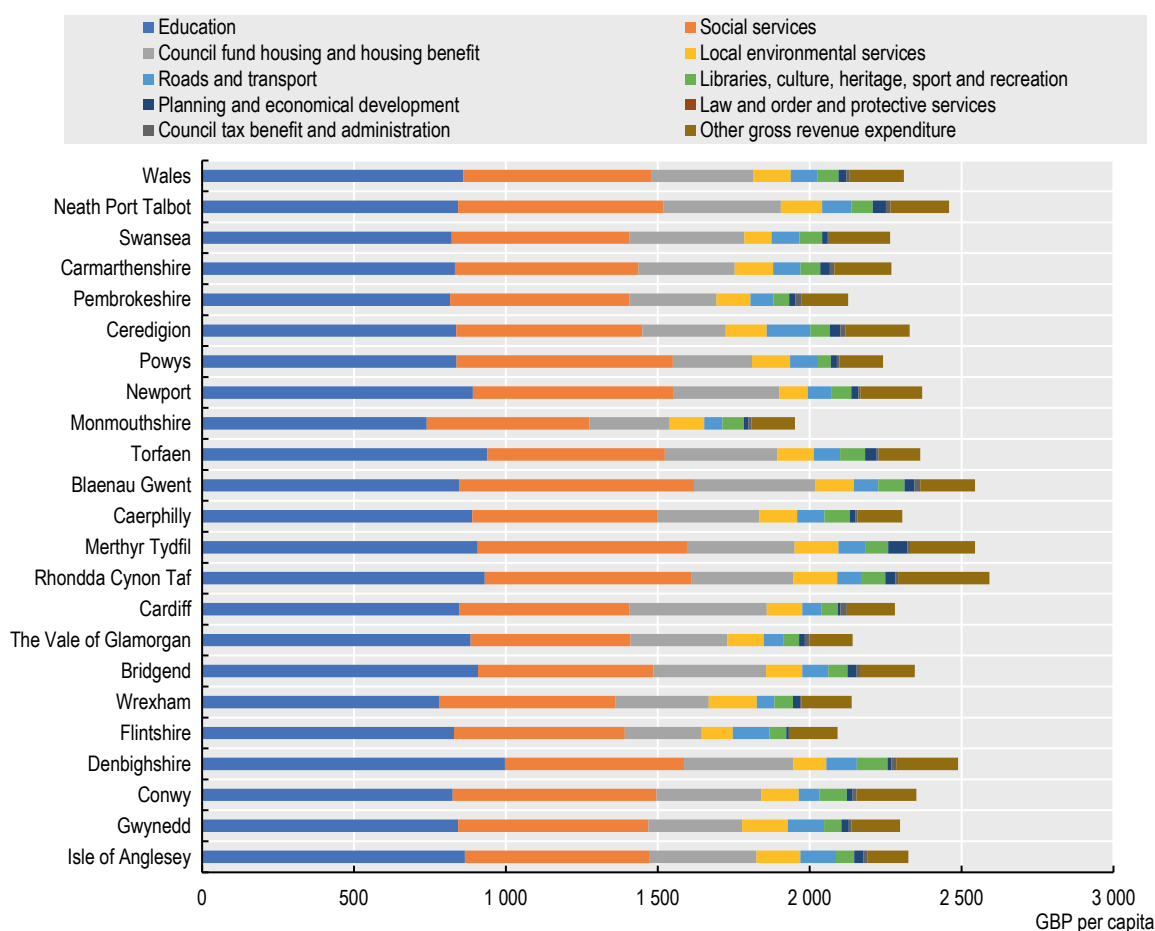
Figure 6.1. Expenditures of Welsh local authorities by main spending category

Gross revenue expenditure, 2019



Source: Author's elaboration based on Welsh Government (2020^[2]), *Budgeted Revenue Expenditure by Service Detail*, <https://stats.wales.gov.wales/Catalogue/Local-Government/Finance/Revenue/Budgets/budgetedrevenueexpenditure-by-servicedetail> (accessed on 2 March 2020).

Figure 6.2. Local government expenditure by Welsh local authority, GBP per capita gross revenue expenditure, 2017-18



Note: The figures for “Wales” are averages of the local authorities.

Source: Author’s elaboration based on Welsh Government (2020^[2]), *Budgeted Revenue Expenditure by Service Detail*, <https://stats.wales.gov.wales/Catalogue/Local-Government/Finance/Revenue/Budgets/budgetedrevenueexpenditure-by-servicedetail> (accessed on 2 March 2020).

In light of the available information, Welsh spending decentralisation is not in conflict with what is usually recommended for decentralised service provision, especially at the local government level (Box 6.1). Moreover, even though many service responsibilities appear to be shared, Welsh local authorities play an important role because they are the main spending agents (Annex 4.A., Chapter 4).

Box 6.1. Assigning spending tasks across levels of government

Economic theory on fiscal federalism divides public functions into three branches: allocation, redistribution and stabilisation (Oates, 1972^[3]; Musgrave and Musgrave, 1980^[4]). In this framework, stabilisation is considered mostly a central government responsibility,⁴ because the central government is best suited to deal with monetary and fiscal policy. Redistribution is also regarded mostly as a central-level responsibility because the central government is much better positioned to carry out income

redistribution from the wealthy to the poor and in establishing minimum standards of public service across regions.

The allocation function – i.e. public service provision – can be the responsibility of both central government and subnational governments. In allocation, the central level of responsibility is best applied when the services have no specific local interest. Subnational government responsibility is justified when the benefits of the public service are spatially limited and if the preferences for a service-tax mix are heterogeneous. Subnational governments often hold valuable information on local demands and conditions, helping them allocate public sector resources more efficiently than the central government.

The central government usually has a strong interest in ensuring equal treatment of citizens in different parts of the country, especially in the case of a decentralised redistribution. Therefore, central governments tend to retain responsibility for designing and planning policy, setting the standards and carrying out the oversight (Column 1, Table 6.1). Even in cases of strong central government steering and monitoring, it is justified that regions and local authorities are involved in planning the policies and service standards because subnational governments have important information on local conditions. For public services with mostly local effects (e.g. primary schools, streets, water/sewage, etc.), the regions and local government can more freely design their own policies and service delivery methods.

Table 6.1. Assigning spending responsibilities in a multi-level governance framework

| Activity | Policy, standards, oversight | Provision, administration | Production, distribution | Comments |
|---|------------------------------|---------------------------|--------------------------|---|
| Local land use planning, building permits | N, R, L | L | L | Mainly local benefits |
| Regional land use planning | N, R, L | R | R | Externalities, mainly regional benefits |
| Water and sewers | N, R, L | L | L, P | Mainly local benefits |
| Solid waste | N, R, L | L | L, P | Mainly local benefits |
| Fire protection | N, R, L | R, L | R, L | Mainly regional or local benefits |
| Police | N, R, L | R, L | R, L | Mainly regional or local benefits |
| Parks, recreation | N, R, L | R, L | R, L, P | Benefits vary in scope |
| Public transport | N, R, L | R, L | R, L, P | Externalities vary in scope |
| Economic development | N, R, L | R, L | R, L, P | Externalities vary in scope |
| Roads | N, R, L | N, R, L | R, L, P | Benefits vary in scope |
| Natural resources | N, R, L | N, R | N, R, L, P | Benefits vary in scope |
| Environment | N, R, L | N, R, L | N, R, L, P | Externalities vary in scope |
| Education | N, R, L | N, R, L | R, L, P | Externalities, transfers in kind |
| Health | N, R, L | N, R, L | R, L, P | Externalities, transfers in kind |
| Social welfare | N, R, L | N, R, L | R, L, P | Redistribution |

Note: N = National, R = Regional, L = Local, P = Private or non-governmental.

Source: Author's modification and extension of the material presented in Bahl, R. and R. Bird (2018^[5]), *Fiscal Decentralization and Local Finance in Developing Countries*, Edward Elgar.

As for service provision and administration (Column 2, Table 6.1), the responsibility of regions and local governments is justified particularly in the case of services with mostly local or regional benefits, such as local and regional land use planning, water and sewage, solid waste, fire protection and police. Regional government should be responsible for services with region-wide benefits, such as regional economic development or transport. In the case of some services, central government responsibility for service delivery can also be justified if there are considerable externalities involved. Examples of such services include roads of national importance, services dealing with natural resources, specialised

health, higher education and social welfare. Shared responsibility among levels of government in these cases is also often justified, as the externalities may vary in scope.

The abovementioned arguments also apply to service production. The difference is that in some cases local and regional governments may outsource local service production to private companies (Column 3, Table 6.1). This can happen, for example, if private producers can better utilise economies of scale in service production and if public tendering is possible. In such situations, outsourcing to private entities can bring expenditure savings to local authorities.

Source: Oates, W. (1972^[3]), *Fiscal Federalism*, Harcourt Brace Jovanovich, New York; Musgrave, R. and P. Musgrave (1980^[4]), *Public Finance in Theory and Practice*, McGraw Hill Kogahusha.

Revenue assignments at the local authority level

Local taxes in Wales are comprised of the Council Tax and Non-Domestic Rates. In 2017-18, the Welsh local authorities received approximately 9.3% of the total tax revenue collected in Wales (Ifan, Siôn and Poole, 2019^[6]). The Council Tax is collected by local authorities. In 2017-18, the revenue generated from the Council Tax was worth approximately GBP 1.6 billion, funding about 18% to 19% of local authority spending. The Council Tax base is regulated by the Welsh Government by classifying homes into “bands” by value and fixing how the tax varies across the bands. Local authorities set the rate for the central band, so the local governments define the overall tax rate (Holtham, 2019^[7]). The austerity measures which have reduced the amount of Welsh Government transfers to local governments have resulted in local authorities gradually raising the Council Tax.

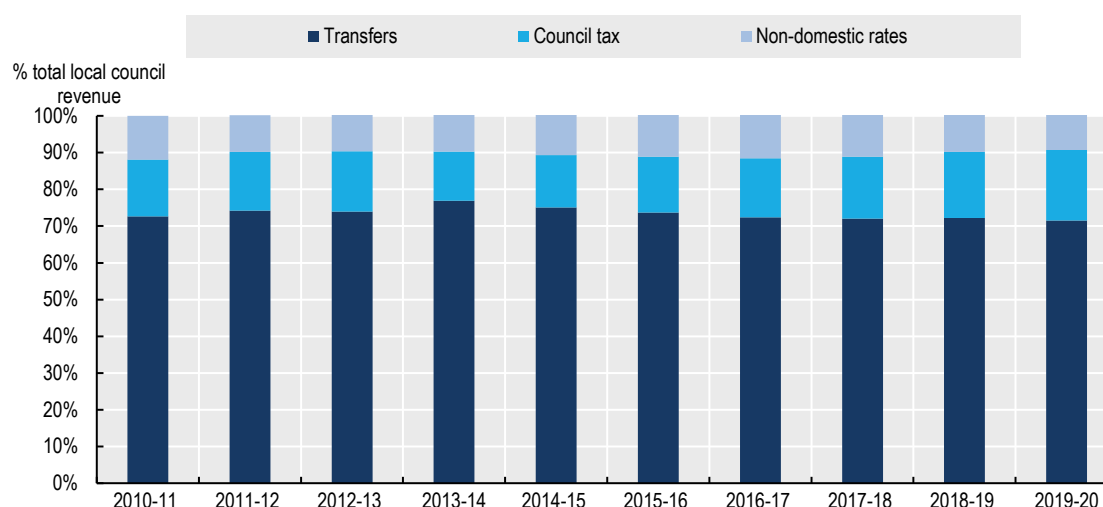
The other tax collected locally is a tax on non-domestic properties, the Non-Domestic Rates (NDR). This tax rate is set by the Welsh Government but the majority of revenue is collected by local authorities and paid into an equalisation fund. From the fund, the money is distributed to local authorities using needs-based formulas (population measures, dependency ratios, measures of poverty or deprivation and sparsity of population). The NDR yields over GBP 1 billion per year. The tax provides a stable revenue to local authorities irrespective of the economic cycle (Holtham, 2019^[7]).⁵

Welsh Government grants are the main revenue source for the local authorities. Despite austerity measures, which have decreased the amount of transfers both in real and in nominal terms, transfers still form almost 70% of the revenues of local authorities (Figure 6.3). There are currently two main types of transfers, the Revenue Support Grant (RSG) and the specific Welsh Government grants. The RSG is non-earmarked, i.e. the local authorities have full discretion on its use. More specifically, the RSG is a formula-based “block grant” in the sense that while the grant is defined by taking into account the needs of different service categories, there is no obligation that local authorities spend the transfer in line with these allocations (Wales Audit Office, 2018^[8]). The RSG is determined by the Standard Spending Assessment. The assessment estimates the differing costs of delivering services in each area based on their different demographic, physical, economic and social characteristics.

The small share of own revenues available to Welsh local authorities (basically just Council Tax since the NDR are regulated by the Welsh Government) inevitably raises the question of the adequate degree of revenue autonomy in Wales. Without a larger share of local government spending financed from local authority own-revenue sources, some of the benefits of decentralisation are lost⁶ (Box 6.2). This does not mean, however, that transfers and the equalisation system should not play a role in financing local authorities.

Figure 6.3. Composition of local council revenue in Wales, 2010-11 to 2019-20

Revenue expenditure



Note: These revenues fund the “revenue expenditure”, in Chapter 4 user charges were also discussed.

Source: Author’s elaboration of Welsh government data. Statistics Wales (2020^[9]), *Financing of Revenue Outturn Expenditure*, <https://gov.wales/statistics-and-research?lang=en> (accessed on 4 March 2020).

Box 6.2. Assigning subnational government revenues: The “finance follows function” principle

There are two decisions to be made with respect to revenue assignment to subnational governments: first, given the spending assignments it must be decided which revenue bases should be allocated to subnational government levels, and second, how much responsibility the subnational governments should have in financing their own expenditures.

Table 6.2 summarises the appropriate subnational government revenues for different expenditure categories. *User charges* are considered the most efficient local financing instruments, provided that two conditions are fulfilled: i) the benefits of local public services and goods in question are spatially limited within the borders of the jurisdiction; and ii) the exclusion principle⁷ can be applied in pricing. User charges can form the primary source of funding in public utilities, such as water, sewage, public housing and public transport (Bahl and Bird, 2018^[5]).

Local taxes should be the primary revenue source for most other local public spending categories, provided that the benefits of these services accrue mostly to the local population. This would secure the principle that those who bear the local tax burden also receive the benefits from the expenditures that are financed by the local taxes paid. Such services include general administration, primary and secondary education, local streets, lighting, drainage, garbage collection, public parks, fire protection, police and recreation services (Bahl and Bird, 2018^[5]).

Transfer systems form an important element of subnational government financing. Transfer systems ensure that different subnational governments are able to provide at least the minimum level of services. In general, transfers are used to reduce fiscal disparities at two levels: i) between the central government and subnational government (vertical fiscal gap); and ii) between subnational governments (horizontal fiscal gap). A vertical fiscal gap can be diminished by paying lump-sum transfers to subnational governments. A horizontal fiscal gap is usually tackled with equalisation system, which is

based on indicators and formulas that take into account differences between subnational governments in tax bases (tax base equalisation), service needs and special circumstances (expenditure equalisation).

A well-working transfer system ensures that subnational governments can provide comparable levels of public services at comparable tax rates. Comparability is important mainly for two reasons: i) the central government can better monitor the subnational governments using indicators on service availability and quality; and ii) the local residents can compare the local public services and tax rates in their own jurisdiction to situations in their neighbouring jurisdictions.

For services with major externalities and benefit spill-overs to other jurisdictions or the whole country, (e.g. major roads and highways, health services or higher education), inter-governmental transfers should be the primary source of local revenue. This is because local authorities are likely to neglect the potential benefits received by users in other jurisdictions, which would lead to an under-provision of these services from a wider (national and regional) perspective (Bahl and Bird, 2018^[5]; King, 1984^[10]).

Table 6.2. Appropriate subnational government revenue by category of expenditure

| Service | Local taxes | User charges | Transfers | Borrowing |
|------------------------|-------------|--------------|-----------|-----------|
| General administration | P | - | - | - |
| Education | P | S | P | (A) |
| Health | S | S | P | (A) |
| Welfare | S | - | P | - |
| Water supply | S | P* | - | A |
| Sewerage | S | P* | - | A |
| Drainage | P | P* | - | A |
| Markets and abattoirs | S | P* | - | (A) |
| Housing | S | P | S | A |
| Land development | - | P* | - | A |
| Streets | P | S* | - | A |
| Motorways | S | P* | P | A |
| Public transportation | S | P | - | A |
| Garbage collection | P | P | - | (A) |
| Garbage disposal | S | P | S | A |
| Parks and recreation | P | - | - | (A) |
| Fire protection | P | - | - | (A) |
| Police | P | - | - | - |

Notes: P= Primary source funding for a task, S = Secondary source funding for a task, A = Borrowing appropriate for major capital expenditures, (A) = Borrowing is appropriate for capital expenditures but likely to account for a small share of spending.

* = Development charges (special assessments, valorisation charges, etc.) are appropriate where benefits are spatially well defined within a jurisdiction.

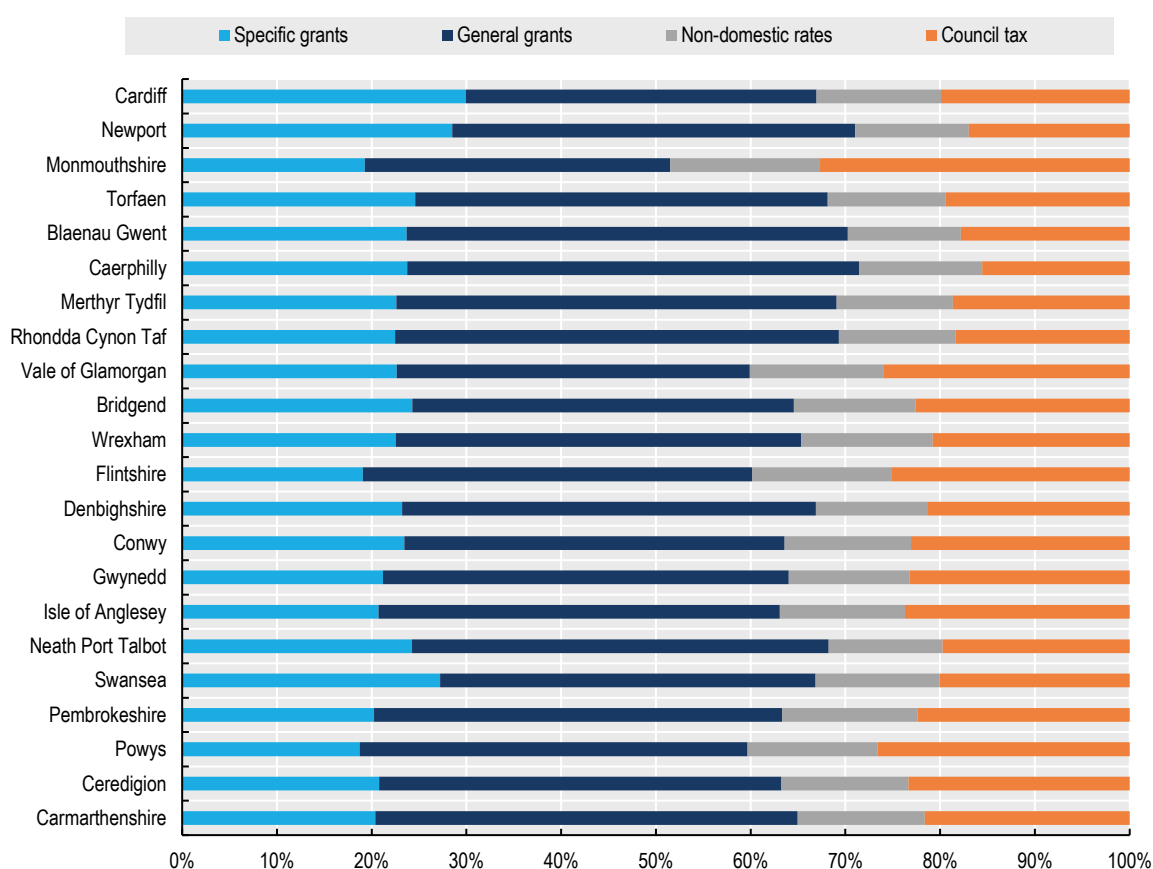
** Transfers may be from regional or central government.

Source: Adapted and modified from Bahl, R. and R. Bird (2018^[5]), *Fiscal Decentralization and Local Finance in Developing Countries*, Edward Elgar.

Another potential financing issue is the role of specific transfers in Welsh local authority financing. Since 2010, specific (earmarked) transfers have represented around 36%-38% of the total amount of transfers received by all Welsh local authorities and 25%-28% of their total revenues, thereby forming a considerable share of local authority financing. At the local authority level, the share of specific transfers varies between 31% (Powys) and 45% (Cardiff). In terms of total revenue from transfers, this varies between 19% (Powys) and 30% (Cardiff) (Figure 6.4). In general, extensive use of earmarked grants is not recommendable, because earmarking may draw subnational government attention too far away from local needs and preferences. This may distort local decision-making and eventually weaken the allocative efficiency. For example in Norway, the use of earmarked grants aiming to boost elderly care services was successful in increasing the elderly care service but the side effects included reduced spending on education, reduced childcare coverage and an increased budget deficit (Borge, 2016^[11]). Earmarking may also weaken the transparency and accountability of local decision-making compared to a situation where the local governments are steered with legal obligations and funded by general grants. It is usually recommended that transfers to subnational governments should be mostly non-earmarked, and the use of earmarked transfers should be limited to special cases (OECD, 2019^[12]). In sum, there appears to be room to reform the transfer system in the direction of using more general transfers for Welsh local authorities in order to increase local fiscal autonomy.

Figure 6.4. Welsh local authority revenue, 2019-20 budget data

Revenue expenditure



Source: Author's elaboration based on Welsh government data. Statistics Wales (2020^[9]), *Financing of Revenue Outturn Expenditure*, <https://gov.wales/statistics-and-research?lang=en> (accessed on 4 March 2020).

It is interesting to note that while transfers to Welsh local authorities have been cut, there has been no accompanying reform of the overall local government financing system. Although the local authorities have reacted to grant cuts by increasing Council Tax, it is not realistic to expect that local authorities can close the gap only with Council Tax revenue. If this situation continues, negative effects on local service quality and availability are likely, despite efforts to improve the efficiency of local public service delivery. Taking into account the wide-ranging services assigned to Welsh local authorities, the cuts in local authority revenues form a serious threat to the public service system in the medium and long run.

As for the NDR, it seems that the current system of using revenue for redistributing funds between local authorities does not encourage the local authorities to develop their business property tax bases. One alternative could be to concentrate the equalisation mechanism on the transfer system and let the local authorities keep their business property tax revenues.⁸ Equalisation within the transfer system should be relatively easy to carry out, taking into account the size of the transfer system. There are several examples among the OECD countries of how to build such a transfer system (Box 6.3).

Box 6.3. Sweden's formula-based equalisation

The income equalising formula

Sweden's income equalisation grant equalises calculatory tax revenues between municipalities and between counties. The calculatory tax revenue is defined using the actual tax base per capita times the average tax rate. Local governments with a per capita tax revenue below 115% of the average tax receive a grant, and local governments with a tax above 115% of the average tax pay a fee according to a special formula. The formula can be written as follows for the receiving municipality/county:

$$Grant_i = tax\ rate_j \times (1.15 \times tax\ base_j - tax\ base_i) \times C_k$$

where $Grant_i$ is the tax equalising grant for municipality/county i , $tax\ rate_j$ is the country average municipal/county tax rate, $tax\ base_j$ is the average municipal/county tax base, and $tax\ base_i$ is the tax base of municipality/county i . The result is multiplied with the compensation rate C_k , which is 0.95 for municipalities and 0.9 for counties.

The main purpose behind the income equalisation grants is to equalise differences in the local tax base. In 2015, there were large differences in municipal tax bases: from a minimum of SEK 191 500 per capita to a maximum of SEK 504 400 per capita. The majority of the municipal tax bases, however, were grouped near the mean tax base (239 934 SEK per capita).

The municipalities/counties where the tax base is above 115% of the country average, have to pay a contribution to the equalisation system. If the tax base is between 115% and 125% of the country average, the compensation is 0.60 times the exceeding amount of tax base. For the part of the tax base that exceeds 125% of the country average, the municipality pays 0.85 times the exceeding amount.

In 2015, 38 out of Sweden's 290 municipalities had a tax base higher than 115% of the average tax base in the country, and hence had to pay a fee into the system. Of these 38 municipalities, 20 are located in the Stockholm County area.

Cost equalising formulas

Cost equalising grants are based on standard costs which are calculated using several formulas. The Swedish cost equalising system is very detailed as it includes a separate model for each mandatory subnational service (there are ten sub-models). The formulas are based on research results highlighting factors that affect subnational costs. The models include indicators describing different aspects of subnational costs, such as demographic structure, ethnicity, socio-economic situation and geography.

The indicators used in the formulas are selected so that subnational governments themselves cannot affect the equalisation. Only differences between estimated costs and the average standard cost are taken into account. Contrary to income equalisation, which is mostly centrally funded, Swedish cost equalisation is strictly between municipalities/counties, though there is a different system of each of these subnational government levels.

Source: OECD (2017^[13]), *OECD Territorial Reviews: Sweden 2017: Monitoring Progress in Multi-level Governance and Rural Policy*, <https://dx.doi.org/10.1787/9789264268883-en>.

With respect to tax assignment (Table 6.3), the usual recommendation in the economics literature is that subnational government tax revenues be mainly based on land or property taxes and user fees (Boadway and Tremblay, 2012^[14]; Bahl and Bird, 2018^[5]). But, if the service menu consists of services with high spending needs and if subnational governments are expected to finance a considerable share of their spending from their own-revenue sources, property tax bases and other user-charge types of revenue are likely to be insufficient to generate adequate levels of own-revenue. In such cases, subnational governments could be given some broad residence-based tax bases such as income tax, payroll tax or sales tax. If attributed to subnational governments with some power to decide tax rates, each of these taxes can influence the mobility of households, business location and shopping. To avoid unwanted effects of these taxes, it is usually recommended that subnational governments are given powers to choose tax rates but not the power to affect the regulation on tax bases. If subnational governments were able to affect the rules on tax bases and set the tax rates, the national redistributive objectives and equity of taxpayers in different subnational governments could be compromised. There could also be problems with vertical tax externalities (Boadway and Tremblay, 2012^[14]). Other taxes suitable for subnational governments include resource royalties, conservation charges, excise (sin) taxes, motor vehicle registration taxes, frontage charges and poll taxes. In addition, subnational governments may be allowed to piggyback on national taxes on personal income (residence-based), wealth and carbon taxes (OECD, 2019^[12]).

Table 6.3. Tax assignment among levels of government

| National | National/Provincial | State/Provincial | Local | All levels |
|----------------------------|---|-----------------------------|----------------------------------|--|
| Customs | Personal income taxes (residence-based) | Single-stage sales taxes | Property taxes | Excise taxes |
| Value added tax (VAT) | Payroll taxes | Motor vehicle registrations | Land taxes | Tax on “bads” (e.g. environmental pollution) |
| Corporate income tax (CIT) | Excises on alcohol and tobacco | Business | Betterment/Frontage charges | Poll taxes |
| Resource rents/profits | | Royalties | Surcharge on personal income tax | User charges |
| Wealth/Inheritance | | Conservation charges | | |
| Carbon | | | Parking fees | |

Source: OECD (2019^[12]), *Making Decentralisation Work: A Handbook for Policy-Makers*, <https://dx.doi.org/10.1787/g2g9faa7-en>.

Economies of scale, externalities and benefit spill-overs

Benefit spill-overs exist in all decentralised systems because it is often difficult to ensure that jurisdiction’s administrative boundaries coincide with the service benefit areas. Benefit spill-overs mean that residents in neighbouring jurisdiction benefit from services paid for by taxpayers in other jurisdictions (e.g. roads/streets, parks, sports facilities, theatres). This can be a problem if it leads to an under-provision of public services, notably if subnational governments do not take into account the benefits received from the service consumed by residents of other jurisdictions. While “internalising” such externalities is not easy, mainly because information on the size of externalities is usually scant, the potential solutions are relatively

straightforward. The national government may intervene using earmarked transfers to subnational governments in order to encourage extended service delivery that also considers non-resident users. Yet, as discussed in the previous section, widespread use of specific transfers is not generally advisable. Another potential solution is co-operation among subnational governments (Box 6.4). Joint service delivery enlarges the service area and helps divide the cost among the services users. Co-operation also has its risks, however, especially from an accountability and transparency standpoint. A third potential solution is to move service responsibility from a lower to a higher level of government.

Box 6.4. The rationale, benefits and challenges of cross-jurisdiction co-operation

Inter-municipal co-operation can be voluntary or compulsory. With voluntary inter-municipal co-operation, municipalities are free to establish long- or short-term co-operation arrangements and also to withdraw from them. Mandatory co-operation is defined by law and compliance is monitored and sanctioned by the national government.

The motivation for voluntary inter-municipal co-operation varies, but often it is simply to enable more efficient service delivery and better services for the local residents. In order to achieve this, utilising economies of scale and creating better capacity for know-how or human resources is essential.

Voluntary inter-municipal co-operation involves a sort of a “minimal” government restructuring and this probably explains why it has been so popular in many countries (Slack and Bird, 2010^[15]; OECD, 2019^[12]). Given the simplicity of the arrangement, a municipality can easily engage in many different co-operative deals without high administrative costs. Inter-municipal co-operation is also flexible. As times change, co-operation can be strengthened, scaled back or ended according to the needs of the co-operating partners. Joint service provision can lead to deeper engagement. For example, successful inter-municipal co-operation in one service area may generate widened co-operation in other services, and, in some cases, eventually result in a voluntary merger.

Economies of scale form the major benefit of inter-municipal co-operation. Especially capital-intensive public services (e.g. utility systems) often require a certain minimum size for efficient delivery. In such a framework, inter-municipal co-operation can be an option because it enables both improved economies of scale and tailoring services to local needs. Inter-municipal co-operation may also help secure local democracy, as the number of elected local politicians does not diminish as a result of co-operation.

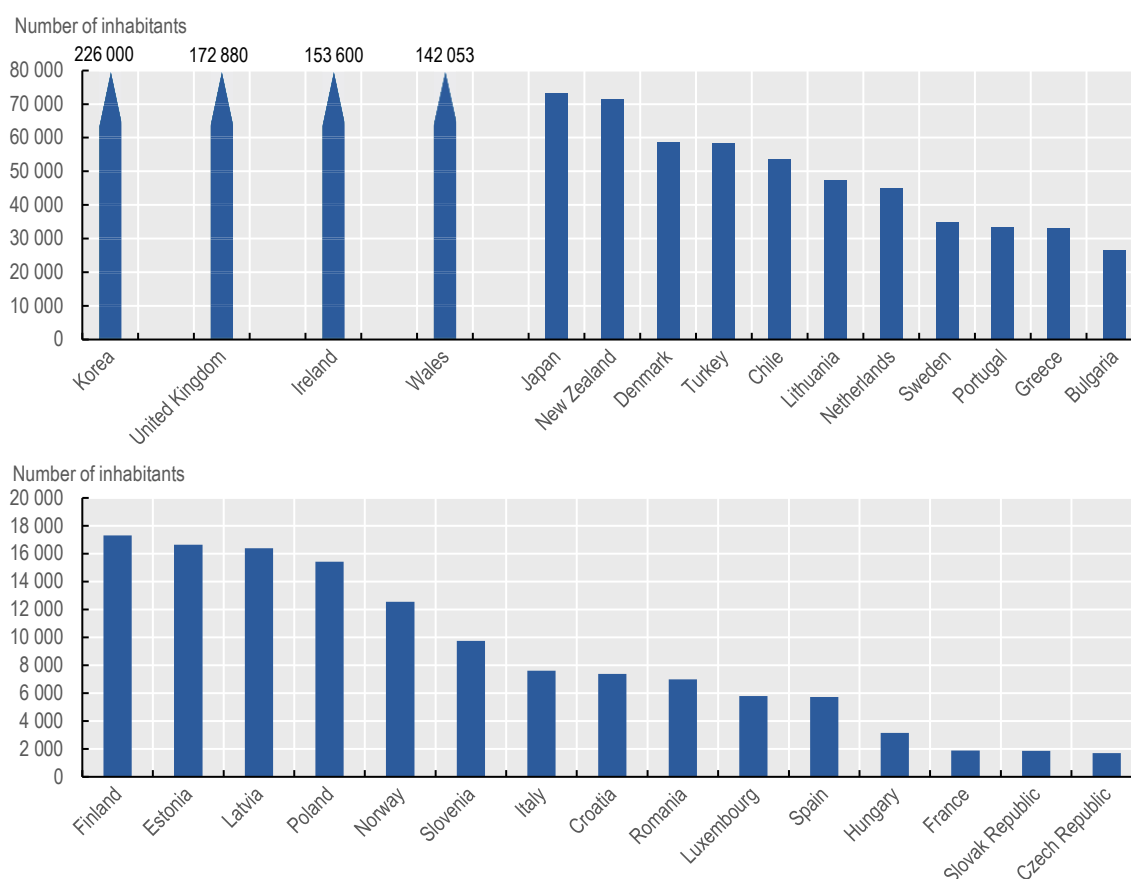
Inter-municipal co-operation is not without its challenges, however. It introduces a *de facto* extra tier in the hierarchy, which may increase administration and monitoring costs. Inter-municipal co-operation may also result in a “democratic deficit”, as inter-municipal organisations are usually governed by representatives nominated by the member municipalities. This may reduce the accountability and transparency of local decision-making, compared with directly elected municipal councils.

It has also been argued that inter-municipal co-operation may create a harmful “common pool”, which can lead to increased costs and inefficiency. A common pool situation could arise if public services provided through co-operative public bodies are financed by sharing the costs with members. In such a situation, the members of the pool have an incentive to utilise the resources more than their share of costs. Such behaviour is more likely to happen when the number of members grows (the so-called “law of 1/n”). This problem could be mitigated by charging members according to their service use for example. Yet the common pool problem may also appear in other situations. For instance, monitoring of inter-municipal co-operation activities and use of funds by member municipalities may be less active than in case of own production (Allers and van Ommeren, 2016^[16]).

Source: Slack, E. (1997^[17]), *Intermunicipal Cooperation: Sharing of Expenditures and Revenues*; Slack, E. and R. Bird (2010^[15]), "Merging municipalities: Is bigger better?", <http://www.doria.fi/handle/10024/148891>; Moio, A. and R. Uusitalo (2013^[18]), "The impact of municipal mergers on local public expenditures in Finland", <https://www.researchgate.net/publication/272795680>; Blom-Hansen, J. et al. (2016^[19]), "Jurisdiction size and local government policy expenditure: Assessing the effect of municipal amalgamation", <http://dx.doi.org/10.1017/S0003055416000320>; Allers, M. and B. van Ommeren (2016^[16]), "Intermunicipal cooperation, municipal amalgamation and the price of credit", <http://dx.doi.org/10.1080/03003930.2016.1171754>; OECD (2019^[12]), *Making Decentralisation Work: A Handbook for Policy-Makers*, <https://dx.doi.org/10.1787/g2q9faa7-en>.

In Wales, the possibility of large benefit spill-overs is limited by the fact that the local authorities are far larger by population than their counterparts in a variety of EU or OECD countries (Figure 6.5). Moreover, the services relating to natural resources, police, national parks, and fire and rescue have been assigned to co-operative bodies, which already supports utilising economies of scale and helps internalise spill-overs. The current proposal by the Welsh Government to establish the CJs is a further step towards building additional scale in local service provision. The benefits received from co-operation are case-specific however and depend largely on implementation (i.e. how the co-operative units are financed and governed). For the moment, the details of the co-operative arrangements and the content of the services covered by the CJs are still to be defined.⁹

Figure 6.5. Average municipal population in Wales and selected OECD countries and EU-unitary member states, 2017



Note: Data for the United Kingdom includes Wales.

Source: Moio, A. (forthcoming^[20]), "Uncovering the unknown: Spending indicators on municipal decision-making authority", OECD Publishing, Paris.

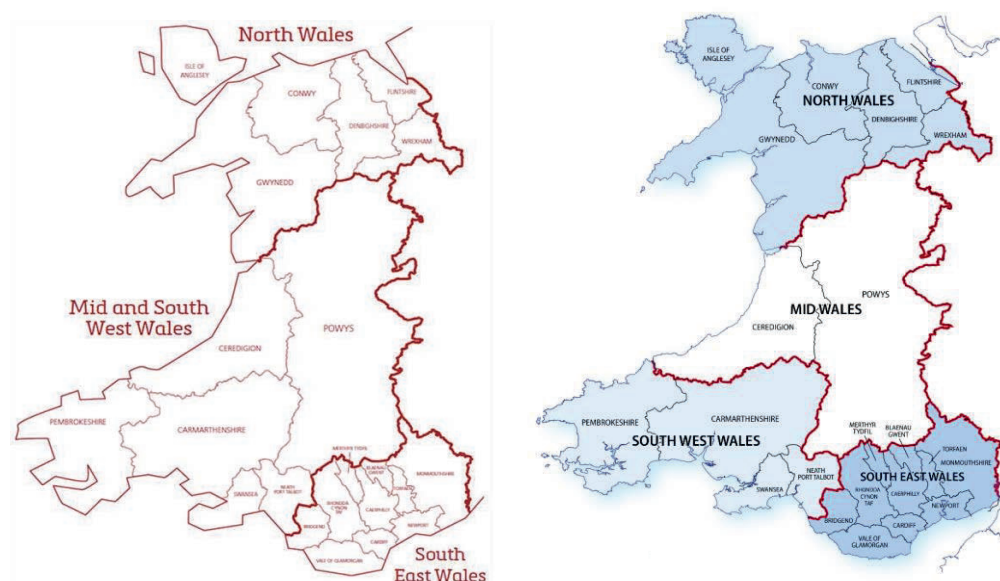
Mid Wales and South West Wales: A comparative perspective

This section goes deeper in comparing Mid Wales and South West Wales. It focuses on aspects that are particularly relevant for regional development and for forming functional regions: the population base, demographic development, labour market, commuting, GVA, deprivation, Internet connectivity and local government spending. The observations of the comparison are used as arguments in the SWOT analysis in the next section and for presenting the recommendations in the final section.

The economic regions

The Welsh Government has established three economic regions for the Economic Action Plan:¹⁰ North Wales, South East Wales, and Mid and South West Wales. Mid and South West Wales may be later split into Mid Wales and South West Wales, but at the time of writing, no decision has been made. The current Mid and South West Wales economic region is comprised of six local authorities: Carmarthenshire, Ceredigion, Neath Port Talbot, Pembrokeshire, Powys and Swansea (Figure 6.6). A four-region model would place Ceredigion and Powys together in Mid Wales, and Carmarthenshire, Neath Port Talbot, Pembrokeshire and Swansea in South West Wales.

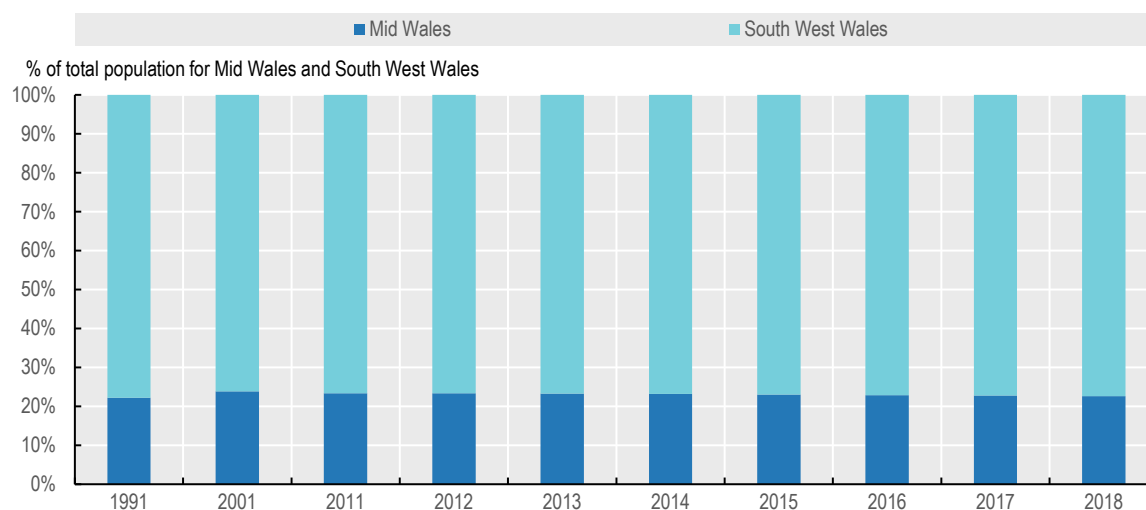
Figure 6.6. Mid Wales and South West Wales: Proposed three- and four-region models



Source: Welsh Government (2017^[21]), *Prosperity for All: Economic Action Plan*; Welsh Government (2020^[22]), *Cartographics Open Government License (OGL)*, Welsh Government.

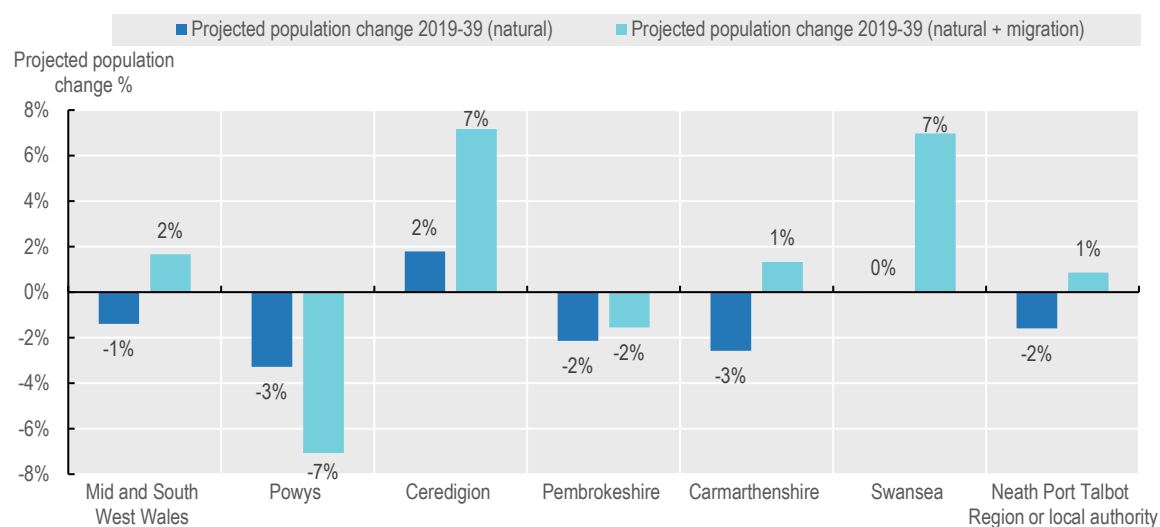
The population base

In 2018, the area covered by the Mid and South West Wales was home to about 907 000 inhabitants, approximately 29% of the total population in Wales. The land area represents 57% of the total area of Wales, making the region the least densely populated of the three regions. The four local authorities in South West Wales make up 77% of the total population of the proposed Mid and South West Wales economic region. This share has been stable over time, suggesting similar population growth rates for these two areas (Figure 6.7). The Mid Wales population is only about 7% of the total Welsh population.

Figure 6.7. Population shares of the region for Mid Wales and South West Wales

Source: Author's elaboration based on the Welsh Office for National Statistics data.

The Mid and South West Wales region has the lowest projected population growth in Wales over the next 10 and 20 years (Welsh Government, 2019^[23]). The natural change (i.e. excluding immigration) of the population in Mid and South West Wales has been negative¹¹ since the beginning of the 1990s and, overall, the future projected natural population change is negative for the full region (Figure 6.8). It is also interesting to note that in case of Powys, both natural population growth and migration projections predict negative population change, whereas, in the case of Ceredigion, the population is expected to grow by both measures. The overall population growth of Mid and South West Wales relies solely on positive net migration.

Figure 6.8. Percentage change in the projected population of local authorities in Mid Wales and South West Wales, 2019-39

Note: The projected natural population growth for Swansea is zero.

Source: Author's elaboration based on the Welsh Office for National Statistics data.

Labour market considerations

In 2018, the total number of working residents in Mid and South West Wales was about 402 500 persons. At the same time, the total number of people working in the area was 393 400 persons. Hence, the net commuting across the region was about -9 000 persons: more people commuted out of the region than into the region (Welsh Government, 2019^[23]).

At the local authority level, commuting generally occurs within the region. There are exceptions, however. For example, in Powys, people commute more to England than to South West Wales or Swansea (Table 6.4). This works both ways, as there is a considerable amount of commuting from England to Powys. For Ceredigion, commuting is mainly to Carmarthenshire, followed by England and then Pembrokeshire. It is interesting to note that commuting between Powys and Ceredigion does not seem to be very common. This indicates that the labour market links between these two local authorities are not very strong. Instead, in the case of Ceredigion, commuting from Carmarthenshire to Ceredigion is important. As for the local authorities in South West Wales, Carmarthenshire and Swansea seem to be the most important receivers of commuters. Overall, commuting seems to be quite active between the local authorities, also from Swansea to neighbouring local authorities and England.

Table 6.4. Commuting in Mid Wales and South West Wales

| Home area | Work area | | | | | | | |
|-------------------|------------|--------|---------------|-----------------|---------|-------------------|------------------|---------|
| | Ceredigion | Powys | Pembrokeshire | Carmarthenshire | Swansea | Neath Port Talbot | South East Wales | England |
| Ceredigion | 30 600 | * | 700 | 1 900 | * | * | * | 800 |
| Powys | * | 48 700 | * | * | 1 600 | * | 2 800 | 6 300 |
| Pembrokeshire | * | * | 49 900 | 1 800 | * | * | * | 1 000 |
| Carmarthenshire | 1 600 | * | 2 300 | 62 000 | 10 700 | 1 700 | 1 800 | * |
| Swansea | * | * | * | 5 600 | 86 300 | 5 300 | 5 000 | 2 600 |
| Neath Port Talbot | * | * | * | 2 800 | 15 100 | 35 100 | 7 400 | * |
| England | * | 4 400 | * | * | * | * | * | * |

Note: The table summarises commuting within region (between local authorities) and across regions borders. According to data, the commuting to outside Mid Wales and South West Wales is mostly to South East Wales or England.

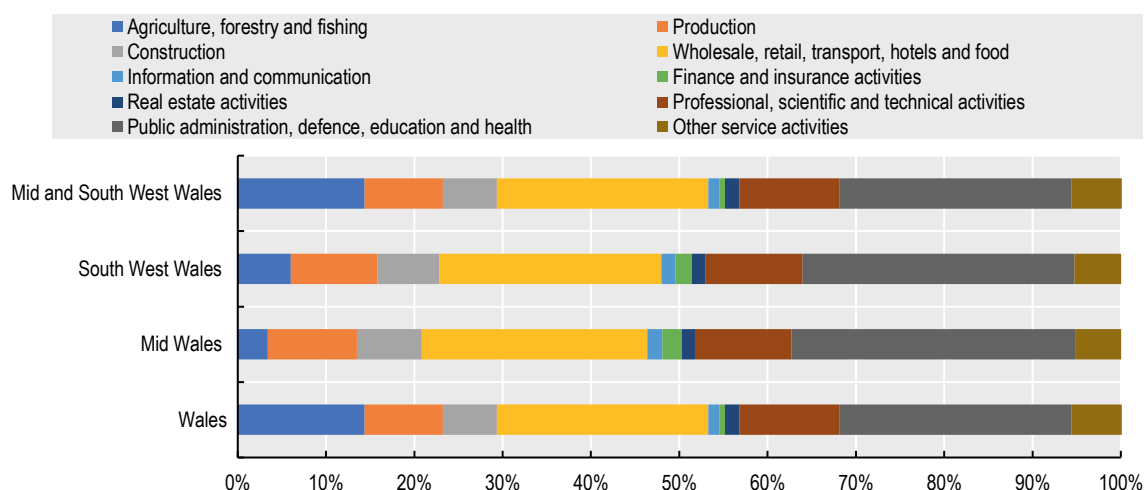
* indicates no data available, or that data are inaccurate or there are too few cases to enable reporting.

Source: Author's elaboration on the detailed commuting patterns for Mid Wales and South West Wales by local authority, retrieved from Welsh National Statistics database. Welsh National Statistics (2020^[24]), *Detailed Commuting Patterns in Wales by Welsh Local Authority*, <https://stats.wales.gov.wales/Catalogue/Business-Economy-and-Labour-Market/People-and-Work/Employment/Commuting/detailedcommutingpatterns/wales-by-welshlocalauthority> (accessed on 9 March 2020).

Based on the Welsh Local Labour Force Survey,¹² the employment rate in Mid and South West Wales (72%) is lower than the Welsh average (73.5%). In Mid Wales, the employment rate (72.3%) is slightly higher than in South West Wales (71.9%). The unemployment rates differ much less, however: 4.2% in Wales and 4.1% for Mid and South West Wales.¹³ For South West Wales, the unemployment rate is 4.4%. For Mid Wales, however, the unemployment rate seems to be particularly low (2.7%),¹⁴ although the survey for Mid Wales may not be fully comparable due to the low number of responses.

The public sector is the most important employer in both Mid Wales (26% of all jobs) and South West Wales (32%) (Figure 6.9). The wholesale, retail, transport, hotels and food sector are the second largest in terms of the number of jobs in Mid Wales (24%) and South West Wales (26%). Agriculture, forestry and fishing is the third most important sector in Mid Wales (14.4%), whereas for South West Wales, this is not among the most important sectors (3%). This demonstrates the rural nature of the Mid Wales region compared to South West Wales. Overall, the jobs in production or construction and especially in the finance and insurance sectors form a much smaller share of total jobs in Mid Wales than in South West Wales.

Figure 6.9. Workplace employment in Mid Wales and South West Wales compared with total Wales



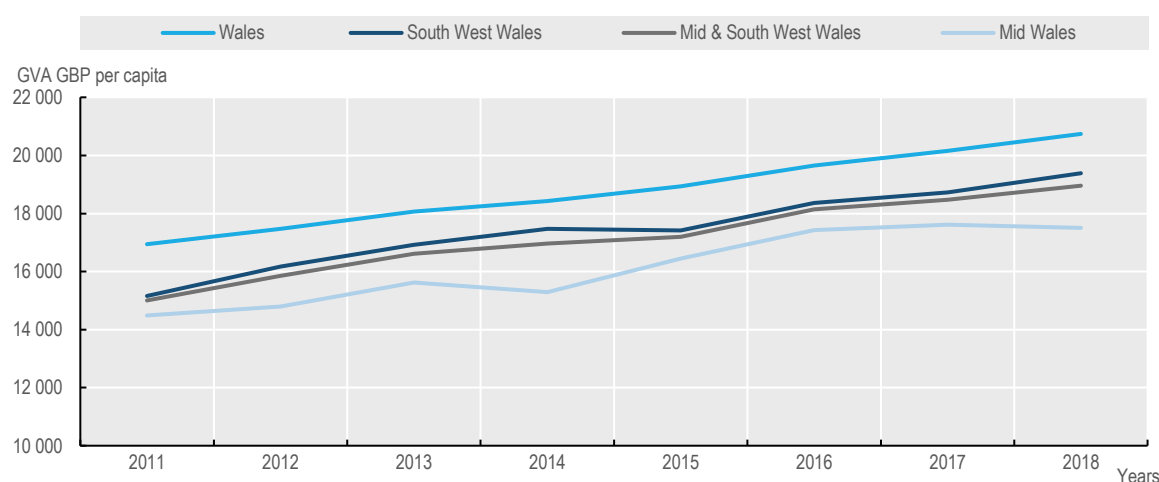
Note: Workplace employment estimates. Professional, scientific and technical activities include administrative and support service activities.

Source: Author's elaboration of data presented by Welsh Office for National Statistics. Welsh Government (2019^[23]), *Summary Statistics for Welsh Economic Regions: Mid and South West Wales*, and the data links therein.

Gross value added

In 2018, the GVA per head in Mid and South West Wales was GBP 18 958 on average. Specifically, it was GBP 17 509 in Mid Wales and GBP 19 382 in South West Wales (Figure 6.10). The GVA in Mid Wales is clearly lower than that of South West Wales. Both figures, however, are well below the Welsh average of GBP 20 738 and are the lowest of the three economic regions. At the local authority level, Carmarthen has the lowest GVA per capita (GBP 16 751). Only Swansea had a higher per capita GVA (GBP 21 910) than the Welsh average. All other local authorities in Mid Wales and South West Wales had a lower GVA per head than the Welsh average (GBP 20 738) and the UK GVA per head value (GBP 28 489). The trends in the GVA growth rate differ markedly between Mid Wales and South West Wales, as in Mid Wales GVA growth has slowed since 2016 and decreased from 2017 to 2018 (Figure 6.10).

Figure 6.10. Gross value added in Mid Wales and South West Wales, current prices, 2011-18

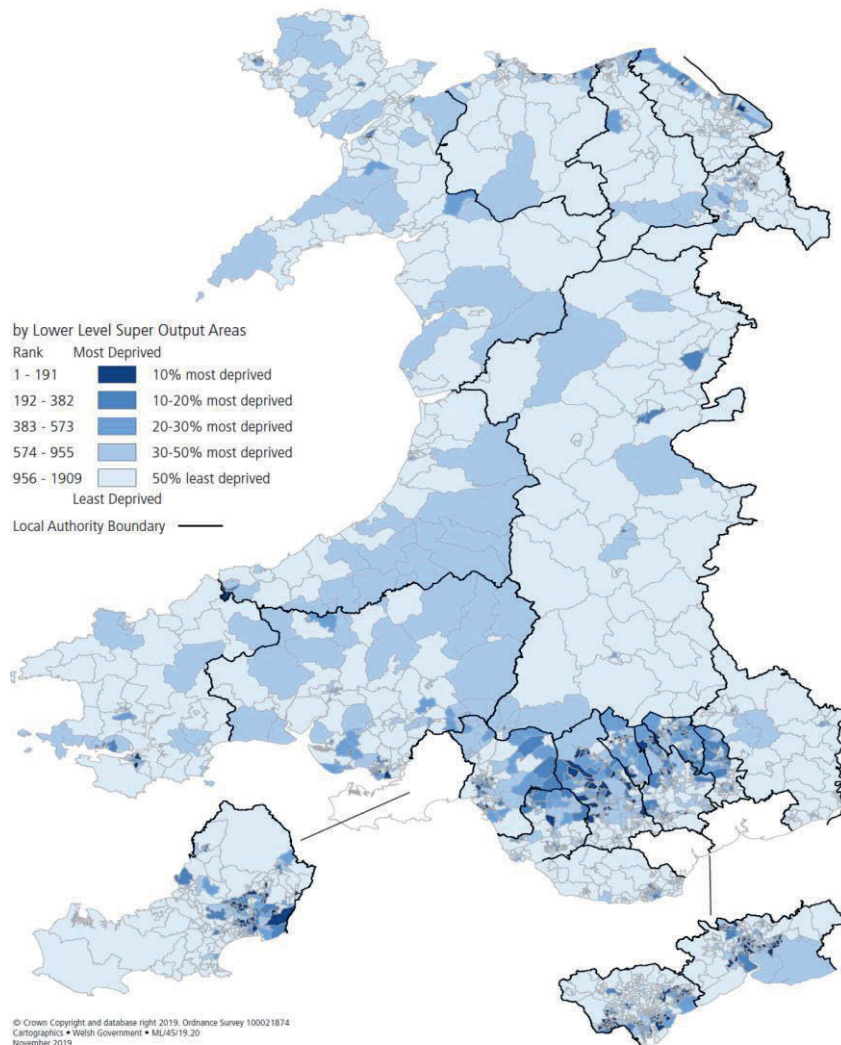


Source: Author's elaboration of data from the Welsh Office for National Statistics. Welsh Government (2019^[23]), *Summary Statistics for Welsh Economic Regions: Mid and South West Wales*, and the data links therein.

Deprivation

The Welsh Index of Multiple Deprivation (WIMD)¹⁵ was developed as a means to identify and understand local area deprivation in Wales. It is used to support policy development and target resources and services. It shows better rankings for Mid Wales in particular but partially also for South West Wales compared with Wales in general. The Mid Wales region stands out as an area with a comparatively low level of deprivation, with Powys being the second least deprived local authority area in Wales (Figure 6.11).¹⁶

Figure 6.11. Welsh Index of Multiple Deprivation



Source: Welsh Government (2019^[25]), *Welsh Index of Multiple Deprivation 2019*, <https://statswales.gov.wales/Catalogue/Community-Safety-and-Social-Inclusion/Welsh-Index-of-Multiple-Deprivation> (accessed on 10 March 2020).

Internet connectivity

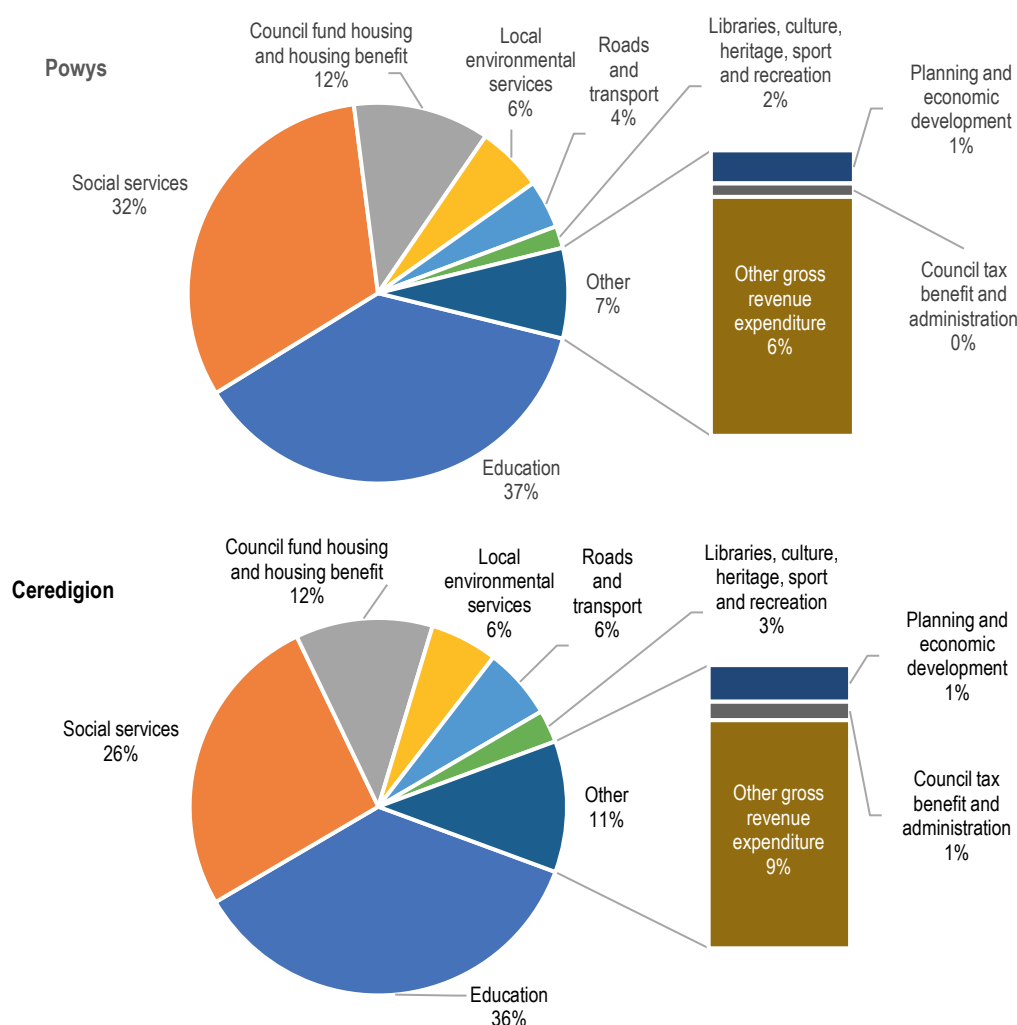
In September 2018, 35% of homes and businesses in Mid and South West Wales had access to an ultrafast fixed broadband speed (300Mbit/s or higher). This was 14 percentage points lower than the UK rate of 49% in September 2018. Access ranged from 5% in Pembrokeshire to 75% in Swansea (Welsh Government, 2019^[23]). Mid Wales has the smallest share of homes and businesses in Mid and South West

Wales with superfast or ultrafast broadband availability. Similarly, Mid Wales (Powys and Ceredigion) had the highest share of homes and businesses in Mid and South West Wales not meeting the Universal Service Obligation of the Welsh Government¹⁷ (Welsh Government, 2019^[23]). Furthermore, the percentage of homes and businesses in Mid Wales with indoor 4G coverage was the lowest in Mid and South West Wales.

Local authority spending

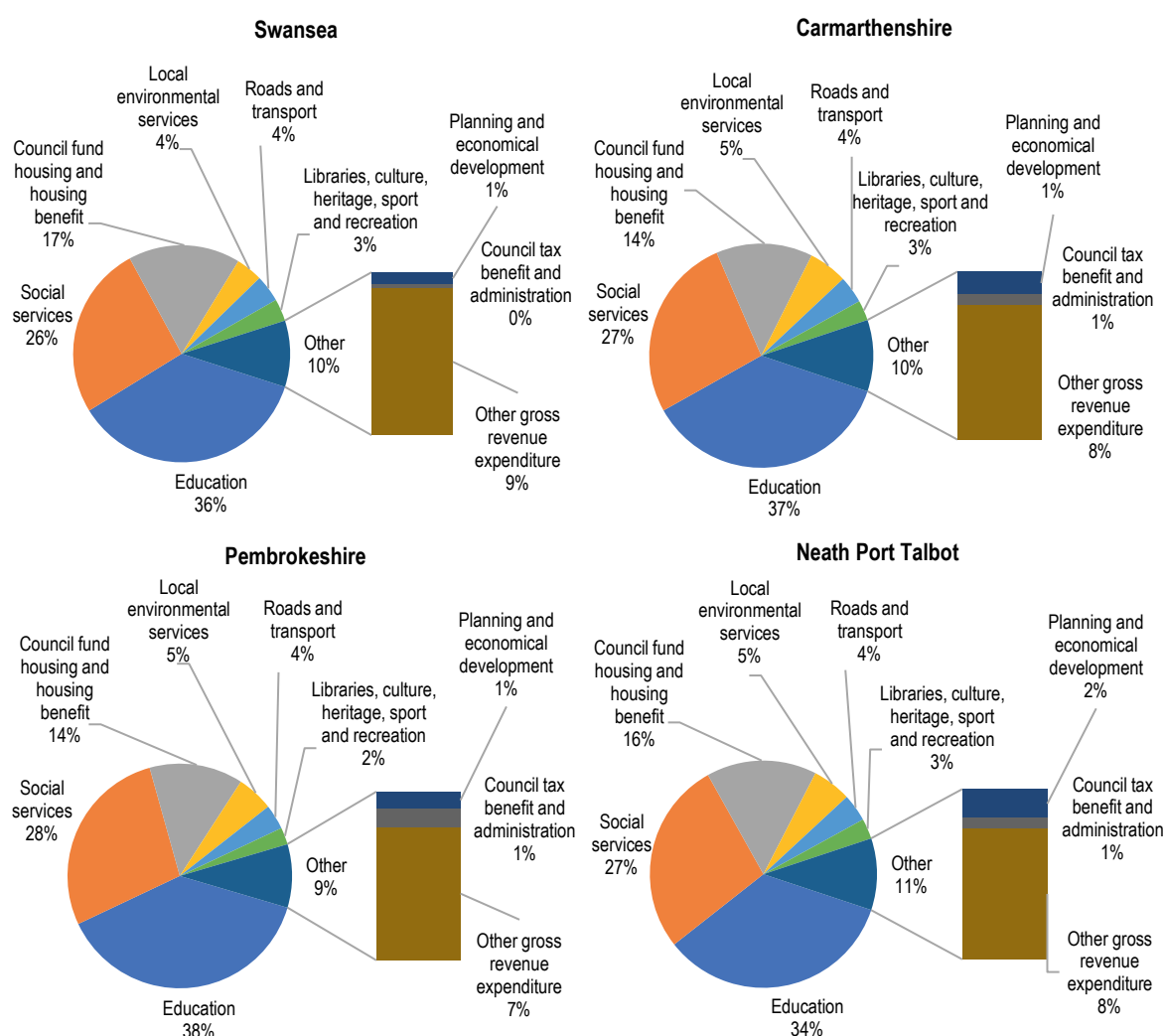
Local government expenditure can reveal information on differences in local spending needs. The expenditure structure differs surprisingly little between the six local authorities in Mid and South West Wales, despite some interesting variations. Powys spends proportionately more on social services than the other local authorities, and Swansea spends a larger share on housing than other local authorities (Figures 6.12 and 6.13). Overall, however, these differences seem quite small. More detailed analysis is needed for conclusive comments but the spending structure comparison does not strongly contribute to arguments for establishing one versus two economic regions.

Figure 6.12. Gross local authority expenditure in Powys and Ceredigion, GBP per capita, 2018



Source: Author's elaboration based on Welsh Government (2020^[21]), *Budgeted Revenue Expenditure by Service Detail*, <https://statswales.gov.wales/Catalogue/Local-Government/Finance/Revenue/Budgets/budgetedrevenueexpenditure-by-servicedetail> (accessed on 2 March 2020).

Figure 6.13. Gross local authority expenditure in Swansea, Carmarthen, Pembrokeshire and Neath Port Talbot, GBP per capita, 2018



Source: Author's elaboration based on Welsh Government (2020^[2]), *Budgeted Revenue Expenditure by Service Detail*, <https://stats.wales.gov.wales/Catalogue/Local-Government/Finance/Revenue/Budgets/budgetedrevenueexpenditure-by-servicedetail> (accessed on 2 March 2020).

Building governance capacity for a Mid (Wales) and South West Wales economic region

This section begins by discussing some general aspects behind establishing economic regions. Thereafter, a more detailed discussion on the pros and cons of a one- versus two-region models are discussed using a SWOT analysis of the alternatives.

Functional areas and multi-level governance aspects for designing economic regions

The Welsh Government is proposing to support planning and service delivery at the regional level through corporate joint committees (CJCs). These would be co-operative units, formed and financed by local authorities in the area. Forming the CJCs could be either voluntary, or the co-operation could also be

initiated by Welsh ministers in cases where the benefits of an enlarged scale can be clearly identified. For this, the proposal is that CJsCs be responsible for any combination of the following four tasks: i) transport; ii) economic development; iii) strategic planning for the development and use of land; and iv) improving education. While the exact content of these tasks still remains to be defined, in general, they represent typical examples of public services that are associated with benefit spill-overs and economies of scale. For example, based on the general principles of public spending assignments, in the case of public transport, major externalities across local government boundaries should be contained within a larger regional area. In the same vein, economic development is best suited for a larger (regional) area because local measures for economic development are often deemed inefficient. Similar arguments apply to land use and development. It is generally recommended that land use planning not be strictly a municipal responsibility, because it needs to take into account wider needs and effects. For this purpose, a regional-level body could help co-ordinate the local government plans. Finally, while education is mostly a locally provided service, especially at the primary education level, a larger scale could be useful, for example to provide services to pupils with special education needs.

There is no blueprint or universal best practice for the “right” number of planning regions and it is seldom the case that regional structures can be designed “from scratch” without any pre-existing regional or local organisation. Regional reforms, therefore, are often path-dependent processes, affected by the existing administrative borders of subnational governments and the prevailing governance models. On the other hand, historical, cultural and ethnic circumstances may affect the formation of regions in an important way. There can be a strong sense of “common past and destiny” behind regional identity even without existing administrative borders.

Some interesting approaches have been developed to help plan and implement regional reforms in OECD countries. One is the concept of functional regions, which are geographic areas defined by their economic and social integration. A functional region is a self-contained economic unit according to the functional criteria chosen (for example, commuting and/or other daily or weekly movements, like shopping) (OECD, 2019^[26]). The time available for daily travelling limits the movement of everyday life, which is why functional areas are often regional in size. The specialisation of labour markets, the development of transport systems and the concentration of services have increased daily journeys. Moreover, the increased attractiveness of the urban centres and improved accessibility have a greater impact than before, leading to an expansion of commuting areas. As a result, over time, the importance of functional areas has increased, especially in regional planning.

It should also be noted that functional regions often differ from existing administrative boundaries. Functional areas evolve over time and such changes usually become arguments for reforming the established administrative structures or governance models. Demand for reforms in metropolitan governance and the financing systems of metropolitan areas are examples of such changes (Slack and Côté, 2005^[27]; Bird and Slack, 2007^[28]). It is widely accepted that urban areas are “engines of growth” in an economy, notably because the agglomeration economies may boost productivity by generating more innovations. Not only do major urban areas benefit from such development, but other areas do also as well since innovations eventually spill over, leading to higher productivity growth throughout the country (OECD, 2019^[26]). Solving the problems of major urban areas is of vital importance because the agglomeration economies created by cities can have advantages for the entire country. Well-functioning metropolitan governance is one important factor for urban success but the existing administrative borders in metropolitan areas may no longer reflect the current activities in these regions. Moreover, if the land use policies are not intensified in metropolitan areas, the promise from agglomeration economies and human capital spill-overs may be missed (Glaeser and Gottlieb, 2008^[29]).

In sparsely populated rural areas, the stimulus for reform is different. The demand for reform is often based on a diminishing population base, an ageing population, eroding tax bases and upward pressure on spending. Regional policies targeted to rural regions that are lagging behind aim to strengthen the capacity of these regions, and also to improve the urban-rural links and policies. The governance solutions vary by

country and are highly case-specific but mergers of local authorities, intensified inter-jurisdictional co-operation and regionalisation have often been used (OECD, 2019^[12]). In addition, reforms to the financing system, notably the transfer systems, have been carried out to support the financial capacity of lagging regions and local governments. In many countries, equalisation systems take into account the special circumstances such as remoteness and rurality of regions and local authorities.

The question of optimal regional unit size can be approached from the economies of scale and benefit spill-overs aspects. In such considerations, the existing spending assignments and available resources matter a great deal because they largely define the policy implementation and the service delivery capacity.

In Wales, the ability of the local authorities to jointly carry out their tasks through the CJsCs will depend on their fiscal, administrative and institutional capacities. It is well known that the financial resources of the local authorities in Wales are scarce, not least because of the cuts made to transfers from the Welsh Government during the past decade or so. Moreover, as discussed earlier (Figures 6.12 and 6.13), the statistics on local authority spending show that local authorities in Mid and South West Wales allocate very few resources (1% of total spending) to the “planning and economic development” category. Since it is unlikely that all local authority resources for planning would be transferred to the CJsCs, the budget resources available for CJsCs risks being limited unless extra funding is made available.¹⁸

While it can be argued that combining the resources of two or more poor local authorities may not bring much value-added, it can be equally difficult to operate in a situation where the members of CJsCs have very different capacities to finance the co-operation. Although the capacity aspect seems to lend support to the proposal for arranging the economic regions based on one region for the whole Mid and South West Wales area, the details of the tasks assigned to the CJsCs, the administrative model, the implementation and the financing available will eventually define the outcome.

The optimal structure of the Welsh economic regions (i.e. the number of economic regions) does not only depend on economic efficiency arguments. Cultural, historical and local identity aspects are also important. From the cultural and regional identity and perspective, Ceredigion and Powys together could form a rural region with a unique natural environment and cultural heritage. Moreover, these two local authorities have themselves proposed forming a CJC to cover their territory, showing strong motivation and desire for own service provision in their area. It is also noteworthy that the local authorities of South West Wales do not resist the idea for a separate Mid Wales economic region. There is apparently also an administrative tradition in Wales for a separate Mid Wales, as from 1976 to 2006 Mid Wales was treated as a separate region within the context of the Welsh Development Agency – the WDA. From 1976-88 more or less, Mid Wales had its own entity – the Development Board for Rural Wales. After 1988, this was folded into the WDA and Mid Wales was considered its own WDA region. Taking into account the background, it is not surprising that the local authorities in Mid Wales prefer forming their own economic region.

A Mid Wales economic region would likely result in a relatively homogeneous entity in terms of service demands and needs, which would be beneficial for organising local public services and maintaining better allocative efficiency. This is a strong argument from the economic perspective. On the other hand, taking into account the tasks planned for the CJsCs (transport, economic development, strategic planning for the development and use of land, and improving education), the economic and administrative efficiency arguments such as economies of scale and capacity to provide services do not seem to strongly support the idea of a separate Mid Wales economic region.

Wales is by no means alone in its efforts to design and implement economic regions. Similar preparatory work is currently ongoing in many countries considering a change in their regional structures. From this standpoint, the experiences of small unitary counties may be particularly interesting for Wales, including Finland (Box 6.5).

Box 6.5. Five, nine, twelve or eighteen regions? The debate on regional reform in Finland

Background: Reforms in regional state administration

In 1997, Finland undertook a major reform in regional state administration, when the number of provinces¹⁹ was reduced from 12 to 6. The second major step came in 2010, when the provinces were abolished and the tasks of the provinces were transferred to the 6 newly established regional state Administrative Agencies (AVI) and 15 Centres for Economic Development, Transport and the Environment (ELY). The AVIs, organised under the Ministry of Finance, follow citizen access to basic public services and monitor environmental sustainability, as well as public safety and the labour working conditions in their areas. The ELYs (organised under the Ministry of Economic Affairs and Employment) aim to promote entrepreneurship, labour market functioning, competency and cultural activities, ensure safe and smooth transport operations, a healthy environment and sustainable use of natural resources in the regions. They are also in charge of functions relating to immigration. In addition to AVIs and ELYs, the local state administration consists of the police and prosecuting authorities, registry offices and tax offices (OECD, 2017^[13]). As the Finnish municipalities have a strong autonomous status defined in the constitution, the regional central government agencies usually do not interfere with municipal affairs.

Regional development is organised by co-operative municipal bodies, the regional councils

The only local government units in Finland are the municipalities, currently numbering 311. They differ in size but have the same tasks. Municipalities are responsible for a wide range of services and inter-municipal co-operation is common, especially among the smallest municipalities that would be too weak to arrange all services alone. There are currently about 190 inter-municipal co-operative organisations, covering various tasks such as healthcare, education, social services and regional development. Inter-municipal co-operation is voluntary except in specialised healthcare and regional development. In these services, municipalities are obliged to be members of co-operative units.

To carry out the statutory regional development and regional land use planning tasks, the municipalities have formed 18 regional councils in mainland Finland. All regional councils produce the same plans and documents:

- Regional Strategic Plan (long term).
- Regional Programme (four-year period).
- Regional Land Use Plan (long term).
- Regional Implementation Plan (annual).

As for the regional land use plan, the regional council use plan defines the use of land needed for particular purposes from the viewpoint of regional development (within the borders of the region). The municipalities develop and implement their own local master plans and the local detailed plans in their own areas. Municipalities must, however, take the regional land use plan into account when they make their own plans.

Ambitious plans to establish self-governing regions failed

In 2015, the government proposed establishing a self-governing regional government tier with 18 regions. This proposal was preceded by a heated debate on the suitable number of regions. Various models were proposed, with the number of regions varying between 5 and 20. The original proposal made was for arranging health and social services through the regional provision. Eventually, the proposal included transferring fire and rescue, regional development and land use planning as well as

most tasks of the regional state administration (AVI's and ELY's) to the self-governing regions. The healthcare experts argued that 18 regions would be too many for healthcare provision because that would lead to population bases too small for the service. The experts suggested that 4-5 regions would provide the best base for the health and social services reform but also 9-12 region model could be supported. Eventually, the political compromise made by the government was to create 18 regions of which 15 could have full responsibility for healthcare.

This reform plan led to severe political disputes and the plan was abandoned in April 2019. The current government, formed in May 2019, decided to continue the regionalisation reform, albeit with a less ambitious approach. The plan is now to create 18 regional councils, with elected decision-makers and own budgets, mainly to provide health and social services in their areas. Regional development would continue to function as it does now, remaining with the current co-operative municipal bodies, the regional councils, and also the central state administration.

Sources: OECD (2017^[13]), *OECD Territorial Reviews: Sweden 2017: Monitoring Progress in Multi-level Governance and Rural Policy*, <https://dx.doi.org/10.1787/9789264268883-en>; OECD (2020^[30]), *Decentralisation and Regionalisation in Portugal: What Reform Scenarios?*, <https://dx.doi.org/10.1787/fea62108-en>.

Food for thought: A descriptive SWOT analysis of establishing one or two economic regions for Mid Wales and South West Wales

A separate economic region for Mid Wales would come with benefits and challenges. The main opportunities of a separate Mid Wales economic region are associated with the closeness of administration to the people, which could bring both efficiency and information benefits, potentially resulting in better quality services and ones that respond more directly to local needs (Table 6.5). It is also possible that co-operation between Ceredigion and Powys would be relatively easy to organise and lead to low administrative costs. These two local authorities have a strong common interest and motivation to establish a separate economic region and to develop their area further. Without creating a separate Mid Wales region, there is a real danger that the problems and potentials of Mid Wales get overlooked, especially if there is a focus on urban and large-scale developments.

The main challenges of Mid Wales economic region include the weaker financial, administrative and institutional capacities of Ceredigion and Powys to plan and implement effective policies, compared with a larger unit comprised by all six of the local authorities in Mid and South West Wales. It should also be recalled that the population base of Mid Wales is only 7% of Wales, with low population density. Such characteristics would make the Mid Wales economic region rather a special case in the Welsh economic region context.

In general, Mid Wales would suffer from weaker critical mass in economic and administrative terms compared with all other economic regions. Moreover, the information on commuting patterns between local authorities indicates that the labour market connections between Ceredigion and Powys are not particularly strong. All this could at least partly compromise the benefits received from proximity and better information (the allocative efficiency). It is also possible that Ceredigion and Powys would not be sufficiently attractive for new businesses and that the region could fail to encourage graduates to stay (or move into) the region. While Mid Wales is still expected to attract new inhabitants during the coming decades, the natural rate of population growth is predicted to be negative.²⁰

Table 6.5. SWOT for a four-region model with a Mid Wales economic region

| Strengths | Weaknesses |
|--|---|
| <ul style="list-style-type: none"> • Administration is close to the people, facilitating accountability and transparency of decision-making. • Strong will and initiative of the local authorities to form a Mid Wales economic region to advance common interests. • Good information and knowledge of local needs and circumstances, enabling allocative efficiency of service delivery. • Communication is easy with local councils, enabling timely decisions and revisiting measures when needed. • Homogeneous business structure simplifies the operating environment and allows direct links between business and administration. • University in the region. | <ul style="list-style-type: none"> • Mostly peripheral location and sparse population. • Weak financial, administrative and institutional capacity to deliver the services. • Very small population base (only 7% of the Welsh population) and an ageing population. • Weak labour market links between Ceredigion and Powys. • Weaker links and co-ordination with South West Wales compared with one region (Mid and South West Wales together). • Limited co-operation between universities and the private sector. • Few graduates remain in the area. • Would create a problematic situation with small towns in the Swansea valley, which are part of the Swansea functional economic area. May require redrawing boundaries. |
| Opportunities | Threats |
| <ul style="list-style-type: none"> • The recently announced GBP 55 million Growth Deal for Mid Wales provides opportunities to generate private investments. • Strong co-operation between Ceredigion and Powys and with other relevant bodies. • Possibility to develop new educational environment around the local strengths. • Closer co-operation between local councils, CJC, researchers and businesses. • Possibility to co-ordinate policies within a smaller area. • Utilising economies of scale compared with local authority provision, enabling improved quality of services in key areas. • Unique culture and identity as a developmental strength. | <ul style="list-style-type: none"> • Decreasing population and continuing demographic imbalance. • Competency building and support cannot be maintained due to limited resources. • Inability to tackle labour market issues leads to constant lack of qualified labour force in key economic areas. • Not enough economies of scale in education support results in equity problems. • Weak input on job creation leads to situation where graduates cannot or will not stay. • Competition with South West Wales for investments and business. • Potentially need to consider changes in local authority areas (Swansea Valley). |

Note: This table is only meant to be descriptive and it does not provide an exhaustive SWOT analysis.

However, the recent decision to establish the Mid Wales Growth Deal for GBP 55 million will certainly help build capacity and indeed provides local decision-makers with momentum to tackle many development issues (Box 6.6). The Mid Wales Growth Deal, together with the allocative efficiency arguments, forms the main economic justifications for a separate Mid Wales economic region.

Going beyond the purely economic arguments, as was discussed above, it should be acknowledged that the local authorities in Mid Wales form a unique area both culturally and geographically. They build on strong joint local identity, especially on the rurality aspect. Moreover, the local authorities of Ceredigion and Powys have made it clear that they are motivated and committed to developing their area based on a separate Mid Wales economic region. Such dedication would undoubtedly form an important factor for building an economic region and for a potentially successful co-operative arrangement (CJC).

Box 6.6. The Mid Wales Growth Deal

The UK Coalition Government (2010-15) initiated a series of “Deals” (City Deals, Growth Deals and Devolution Deals) with selected cities to devolve powers and resources in particular policy domains. The City Deals and Growth Deals have aimed to help cities deliver local strategies through investment in housing, transport, employment, skills and business support. Some cities have used the Deals to invest in support for the unemployed (Green, 2018^[31]).

Conclusive information on the impact of the Deals is not yet available. The problem of impact evaluation is to isolate the impact of City Deals and Growth Deals on employment and skills from the effects of other national and local reforms. An additional problem for impact evaluation is the implementation of austerity measures during the same period (Green, 2018^[31]).

In October 2019 it was announced that the implementation of Growth Deals will be extended to Mid Wales. The deal is called the Mid Wales Growth Deal and the GBP 55 million of UK government funding will be used to generate further investment from the private sector in order to deliver local projects. The Mid Wales Growth Deal was motivated by its structural dependence on agriculture, dispersed population, historically low rates of productivity and the high proportion of small- and medium-sized enterprises (SMEs) in the region. It was also argued that the Growth Deal would help develop a cohesive Welsh nation and to address historically low levels of investment (House of Commons Welsh Affairs Committee, 2019^[32]).

Source: House of Commons Welsh Affairs Committee (2019^[32])(2019), *City Deals and Growth Deals in Wales*, <http://www.parliament.uk/copyright>; Green, A. (2018^[31]), “Developing more local strategies for a changing labour market (unpublished manuscript)”.

A single economic region for Mid and South West Wales would also have its benefits and challenges (Table 6.6). The main strengths and opportunities include the potential for utilising economies of scale and internalising externalities, thereby giving the opportunity to minimise the benefit spill-overs across regions and ensuring low administrative costs. Furthermore, the information on commuting suggests that Mid and South West Wales forms an economic area, which would give a good base for effective policies. Swansea, as the region’s main urban area, could be further strengthened as an engine of regional growth, innovation and productivity, benefitting the wider area. One economic region for the whole Mid and South West Wales, with 29% of the Welsh population, would enable the critical mass needed to generate on strong regional development. One region covering all six local authorities could also enable building on synergies between the two “Deals” in the region: the Swansea Bay City Deal and the Mid Wales Growth Deal. The relatively diversified economic structure of Mid and South West Wales could also ensure the potential for growth and innovation. Moreover, with one economic region model, there would likely be sufficient resources to develop the key business sectors and also to diversify the policies, to take into account the development needs in the northern part of the region formed by Ceredigion and Powys for example.

The challenges of a Mid and South West Wales economic region are linked with the potential problems caused by the heterogeneity of the local authorities. There are considerable differences between the six local authorities in terms of service needs, organisation and population size, financial and administrative capacities, industrial mix and operating circumstances. A single CJC for the whole region may be unable to take the specificities of the region into account to the same degree or level of detail as a two-region model. The risk is therefore that the rural Mid Wales area could suffer. The distances and travel times within the larger Mid and South West Wales economic region could prove to be problematic for equity of access and service delivery. All this could lead to lower allocative efficiency, i.e. reduced ability to meet service needs and demands. In a larger co-operative unit, there is also a risk that each member tries to maximise their own benefit at the cost of others. At worst, this could lead to excessive spending.

Table 6.6. SWOT for a three-region model with a Mid and South West Wales economic region

| Strengths | Weaknesses |
|--|---|
| <ul style="list-style-type: none"> • The region would cover most of the commuting among the six local authorities. • Proximity to larger labour markets and growth centres. • Diversified economic structure with potential for growth and innovation. • Several universities and university campuses/centres of expertise and other knowledge resources. • Large population base with 29% of the Welsh population. • Swansea as the major urban and commuting centre of the region could at best be the engine of growth for the whole region. • No major discrepancies in terms of existing economic activities. • Potential for enhanced agglomeration economies. | <ul style="list-style-type: none"> • Heterogeneity of the six local authorities (in needs, demands, size, capacity and circumstances) may weaken the unity of the region and make it harder to fulfil service delivery expectations. • Difficulties ensuring allocative efficiency due to distances. • Expenditure containment may be hard if all local authorities want to maximise their own benefit. |
| Opportunities | Threats |
| <ul style="list-style-type: none"> • Agglomeration economies may create human capital and innovation that could benefit the whole region. • Economies of scale in service delivery help keep per capita costs in control. • Benefit spill-overs from transport, land use, economic development will be internalised within the region. • Sufficient resources to develop the key business sectors and also to diversify. • One region enables building on synergies between the growth deals in the region (Swansea Bay City Deal and Mid Wales Growth Deal). • Enough critical mass to build on strong regional development. | <ul style="list-style-type: none"> • Swansea may not be big enough to provide considerable benefits of agglomeration economies for the whole region. • Allocative efficiency resulting from the closeness of decision-makers and their voters may diminish. • Challenges to integrate Mid Wales to the region, at worst a regional “majority against opposition” situation will emerge. • The specific demands of the most remote parts will be hard to meet, in particular for rural Mid Wales. • Building a common identity will not be easy. • Decision-making will result in “common pool problems”, leading to excessive spending. |

Note: This table is only meant to be descriptive and it does not provide an exhaustive SWOT analysis.

Piloting the Mid Wales economic region could be a way forward

Since the current plan is to organise CJs as co-operative units formed by local authorities, the structure of CJs can be relatively easily modified later on, if needed. This is particularly true if the economic regions are first organised around four regions. For example, after five years, the situation could be re-evaluated. Decisions to carry on with the existing structure or with a reduced number of regions could be made based on the analysis. In order for such an *ex post* evaluation to be useful, the evaluation should be planned and carried out jointly with the academia and other independent policy evaluation experts.

Such piloting of a regional model is not exceptional in an international context. In Sweden, successive governments have used various approaches to pilot with different models to implement regional development (Box 6.7). In Finland, a regional self-governance model was piloted in the remote and rural Kainuu region, between 2005 and 2012. The Kainuu region pilot aimed to gain experience in regional development, health and education services, citizen activity and managing the relationship between the regional and the central government.

Box 6.7. The Swedish plans for reforming the regions and regional development assignment

In Sweden, there are currently 21 regions with elected regional councils, which have traditionally been responsible for health and social services and recently, since 2019, also for regional development.

In recent decades, however, there have been a number of attempts to reform the regional structure and their tasks. In 2003, a Committee on Public Sector Responsibilities was appointed to clarify the division of responsibilities between the different levels of government. Despite the work and proposals made by the committee, the government decided to decentralise the reform process to the regions and left it up to them to propose regional amalgamations. An additional element of complexity in the Swedish case was that the regional state administration, called the County Administrative Boards, initially had the power for regional development, as the self-governing regional councils focused mainly on health and social services and transportation.

As a result of the voluntary process, an asymmetric model for regional development was adopted between 1996 and 2015. In four counties, the County Administrative Board continued to be responsible for regional development issues. In ten counties, the responsibility was assigned to the directly elected county council. In seven counties, it was decided that a specifically installed inter-municipal co-operation agency was in charge of the regional development.

In March 2015, the new government began looking into regional mergers in response to the complex structure formed by the different bodies responsible for regional development. In 2017, the committee proposed a new division of the counties based on the needs of citizens and businesses in terms of transport, labour, health, education, culture and a good environment. One important principle in this work was to take into account functional labour markets. As a result, a proposal to reduce the number of regions from 21 to 6 was presented to take effect in 2023. However, this proposal was eventually abandoned. Instead, it was decided that, beginning in 2019, all 21 counties would be responsible for their regional development.

Source: Nordregio (2020^[33]), *Administrative Municipal and Regional Reforms: Overview*, <https://archive.nordregio.se/Metameny/About-Nordregio/Nordic-working-groups/nwgcityregions/Administrative-municipal-and-regional-reforms/#Sweden> (accessed on 9 March 2020).

Seamless co-operation between chief regional officers (CROs) and the economic regions is essential

The Welsh Government has introduced CROs to support regional-level planning and implementation capacity, and ultimately to work together with local authorities as well as CJs. With the CROs, the intention is to ensure a more integrated and place-based approach to economic development policy in Wales, in part through their role in supporting the design and implementation of Regional Economic Frameworks (Welsh Government, 2018^[34]).

The CROs, as Welsh Government officials, together with CJs, would play a key role in ensuring co-operation between the local authorities and the Welsh Government. Since the main task of CROs is to support the regional-level planning and implementation capacity (discussed in Chapter 5), there should be a strong partnership between CRO offices and CJs. The experience and contacts of CROs in the Welsh Government could be valuable for CJs, especially in the beginning. CROs can ease the burden of maintaining contact with the diverse parts of the Welsh Government and co-ordinating the measures with other CJs as needed. Moreover, the CROs could help ensure equal treatment of the economic regions from the Welsh Government side. However, in order to reap the benefits from local decision-making and local information, the CROs should probably not be given decisive power over the CJs, such as the power

to accept or reject plans prepared by the CJsCs. The dialogue between CROs and CJsCs could be arranged mostly on an informal basis but the CJsCs could, for example, invite the CROs to their meetings time to time, so that all participants get the relevant information. The CJsCs could also ask the CROs their written opinion on specific matters, for example.

In their role as enabling Welsh Government representatives, the exact number of CROs and their offices may not be the most fundamental question, as long as CRO staff have strong local knowledge. The eventual number of regions and the number of CROs does not necessarily need to be the same. It is plausible therefore that one CRO could operate in both Mid Wales and South West Wales if the Welsh Government decides to establish four economic regions. Given that the CROs are still relatively new and the CJsCs are yet to be introduced, there is room for clarification and reorganisation. In order to increase the effectiveness of the CROs, the role and status of CROs and their staff should be clarified and strengthened within the Welsh Government.

Conclusion and recommendations

The Welsh multi-level governance model is characterised by extensive spending decentralisation and centralised financing. In this, Wales reflects the UK tradition, which is distinguished by a high degree of institutional and fiscal centralisation by international standards.

A decade of austerity measures has left its mark on Welsh local authorities. The cuts in transfers to local authorities have affected local services across the board, and local investments and non-statutory tasks have been hit particularly hard.

With nearly 70% of local authority revenues coming from transfers, the incentive for economic development among local decision-makers is restricted. Increasing the share of own revenue of local authorities' incomes would increase local government accountability to own residents and help ensure that decisions to expand local public programmes are made keeping in mind the additional costs. Solving the lack of own-revenue bases is not easy, but the way forward should include reforming the financing system for local authorities. Such considerations should include diversifying tax bases for the local authorities, reducing the amount of specific transfers (with an increased share of general transfers) and gradually increasing the overall level of financing available for local authorities. This does not mean that a revenue and cost equalisation system would be unnecessary, however. Practically all countries with decentralised systems utilise equalisation. The best equalisation systems work to ensure that local governments operate at comparable tax rates, so that differences in tax rates reflect differences in efficiency and/or service demands, not their tax bases.

Co-operative arrangements help solve problems of decentralisation. This is particularly the case for services with benefits spill-overs and externalities, and for services where effective delivery requires a larger scale than a single local authority is able to provide. The proposed corporate joint committees (CJsCs) can help solve such problems but the outcome depends largely on the services in question and how the co-operation is implemented. Furthermore, without adequate resources and financing from the local authorities, and in the case of decentralised services from the Welsh Government,²¹ the threat is that the effectiveness of the proposed CJsCs could be limited.

There are benefits and risks associated with establishing a Mid Wales economic region. A Mid Wales economic region would likely result in a relatively homogeneous entity in terms of service demands and needs, which would be beneficial for organising local public services and maintaining better allocative efficiency. This is a strong argument from the economic perspective. The main risk is formed by the weak economic and administrative capacities of both Ceredigion and Powys to operate an economic region. The recent decision to introduce a Mid Wales Growth Deal may help secure adequate resources for regional development and build regional attractiveness, however. It should also be noted that cultural, traditional

and political arguments are also important in establishing regional-level co-operation and in attempts to generate well-being in Mid Wales. From this aspect, Ceredigion and Powys could together form a rural region with a unique natural environment and cultural heritage. On the other hand, the tasks planned for the CJsCs seem to emphasise the economic and administrative capacity arguments. Launching a pilot experiment with a Mid Wales economic region would enable evaluating the benefits and costs of establishing a fourth region. Such a pilot should be carefully planned with academia and independent research institutes.

The CROs can help local authorities operate in the complex structural framework that characterises Welsh multi-level governance. The experience and contacts of the CROs in the Welsh Government could provide valuable help to CJsCs especially when they start their work. This enabling and consultative role of CROs is natural because the CROs are expected to work co-operatively with the local authorities in their respective regions. Establishing economic regions in Wales should be based on tight co-operation between the CJsCs and Welsh Government officials, notably the CROs.

Box 6.8. Recommendations for action to implement economic regions in Mid (Wales) and South West Wales

1. Strengthen the administrative and service provision capacity of local authorities

- Increase local authority fiscal autonomy by reducing the role of earmarked grants and increasing general grants.
- Concentrate the equalisation mechanism in the transfer system rather than in the NDR.
- Increase the local authority own-source revenue (e.g. diversify local taxes; introduce a surcharge on personal income tax; reform the Council Tax; generate revenue from charges and fees).
- Adjust the equalisation system to ensure all local authorities can provide a standard/minimum level of service.
- Increase cross-jurisdiction co-operation (e.g. through CJsCs) to minimise territorial inequalities and build scale for key services, ensuring strong governance mechanisms, adequate resources and clear lines of accountability.

2. Take a strong evidence-based approach to establishing economic regions in Mid Wales and South West Wales

- Consider diverse territorial factors when establishing an economic region (e.g. population base, demographic trends, labour market conditions, commuting, deprivation, GVA, Internet connectivity, local government spending).
- Take a functional area approach when considering a Mid and South West Wales economic region(s), balancing between economic, administrative, social, cultural and identity dimensions and the trade-off between risks/challenges that are economically, socially and politically acceptable.

3. Ensure clear roles for CROs, CJsCs and local authorities in the economic region(s)

- Establish a close working partnership between CROs and their team(s) and CJsCs, where CROs play an enabling and consultative role but not a decision-making or authoritative role over CJsCs.
- Ensure a clear role and scope of authority for CJsCs and local authorities in regional development and foster local-level ownership, accountability and empowerment to act in their region(s).

- Secure strong CJC governance and accountability by ensuring that the decision-making bodies of CJsCs consist of local politicians (council members).
- Ensure that CROs and their offices have strong local-level knowledge.

4. Pilot a Mid Wales economic region to support a place-based approach to productivity, growth and regional well-being

- Establish a clear timeframe for the pilot (e.g. five years) then carefully evaluate the impact.
- Base the final decision of continuing with a four-region model or to merge Mid Wales with South West Wales on an independent evaluation of results achieved.
- Use the pilot to determine whether three or four CROs and teams is optimal.

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Notes

¹ Four service categories have been defined as potential tasks of CJs: i) transport; ii) economic development; iii) strategic planning for the development and use of land; and iv) improving education. The exact combination of services for the planning regions will be decided later, however (<https://gov.wales/sites/default/files/publications/2019-02/regional-economic-development.pdf>).

² Revenue expenditure data. While user fee revenue is not included in this data, adding them would not change the conclusion.

³ This section focuses on spending at the Welsh local authority level. Chapter 4 discusses spending by the UK government, Welsh Government and Welsh local authorities.

⁴ This theoretical discussion aims to show the usual fiscal federalism recommendation on spending assignments between levels of government. In the Welsh context, the levels of government considered are the UK government, Welsh Government and local authorities. For example, the responsibility of stabilisation and monetary policy is with the UK government but many tasks have also been devolved to the Welsh Government, which finances, regulates and monitors the local authorities.

⁵ During the COVID-19 crisis, however, the usually stable revenue from NDR has been weakened.

⁶ The economics literature on revenue assignment usually argues that when local residents self-finance local services through local taxes and charges, they have an incentive to evaluate the costs and benefits of local service provision, and benchmark local government performance against neighbouring jurisdictions. Such “yardstick competition” can encourage local politicians to maximise the welfare of local residents instead of promoting their own self-interested goals.

⁷ Exclusion principle means that a consumer can be excluded from using the service if they are not willing to pay for its use.

⁸ The central government could maintain control of the rate levied, with lower and upper bounds of rates for example, to prevent competition for business eroding the tax base.

⁹ As was mentioned in the beginning of the report, four service categories have been defined as potential tasks of CJs: i) transport; ii) economic development; iii) strategic planning for the development and use of land; and iv) improving education.

¹⁰ In some Welsh Government documents, they are called “economic regions”.

¹¹ The number of deaths has been higher than the number of births in the combined Mid and South West Wales area.

¹² For more information, see <https://stats.wales.gov.wales/Catalogue/Business-Economy-and-Labour-Market/People-and-Work/Employment/Persons-Employed/employmentrate-by-welshlocalarea-year-gender>.

¹³ Employment rates are defined as a measure of the extent to which available labour resources (people available to work) are being used. They are calculated as the ratio of the employed to the working age population. The unemployment rate is the number of unemployed people as a percentage of the labour force, where the latter consists of the unemployed plus those in paid or self-employment.

¹⁴ The rate of self-employment is high in Mid and South West Wales compared with Wales in general, and it is particularly high in Powys (26%) and Ceredigion (28%). Entrepreneurship and self-employment may partly explain the comparatively low unemployment in Mid Wales.

¹⁵ This index is the Welsh Government's official measure of relative deprivation for small areas in Wales. It uses the Office for National Statistics "Lower Super Output Area" (LSOA) geography as its reporting unit, which sub-divides Wales into 1 909 separate geographical areas with an average population of 1 600.

¹⁶ Powys has argued that the indicator does not sufficiently account for deprivation in sparsely populated rural areas.

¹⁷ The universal service obligation includes the following targets: a minimum download "sync" speed of at least 10Mbps (Megabits per second), a minimum upload "sync" speed of at least 1Mbps, a medium response time with end-to-end latency of no more than 200ms for speech applications, a maximum sharing between customers (contention ratio) of 50:1, a minimum data allowance of 100GB, a technology neutrality design (can be delivered via a mix of fibre based and/or wireless solutions).

¹⁸ It is possible that, in the future, CJsCs may be eligible for investment funding through funds and processes similar to EU funds now, though this matter is still to be decided.

¹⁹ Provinces in Finland were administrative areas for central government deconcentrated functions. The provinces were abolished in 2010.

²⁰ The biggest group of in-migration has consisted mainly of retired people or persons in their mid-life (50-64 years of age) from the urban areas of England (Stockdale, 2014^[35]).

²¹ For example, in the case of economic development, if it is decentralised from the Welsh Government to CJsCs.

Annex 6.A. Glossary

Agglomeration economies – Occur, at a broad level, when individuals and firms benefit from being near to others. Agglomeration economies are usually discussed in connection with production. It is argued that the physical proximity of firms to other firms, workers and consumers may help firms in the day-to-day business of producing goods and services, leading to higher productivity.

Benefit spill-overs – Externalities that exist when the delivery of services leads to impacts on households that reside outside the administrative boundaries of the jurisdiction responsible for service delivery.

Calculatory tax revenue – A specific method often used in formula-based transfer systems, where each municipality is defined a hypothetical tax revenue using a mean tax rate (over all municipalities) and real tax base for the municipality.

Capacity, administrative – Can be summarised as the combination of capabilities used to achieve effective policies. The capabilities include human resources, organisational structure and governance for example.

Capacity, institutional – Implies empowerment, social capital and an enabling environment, as well as culture, values and power relations.

Centralisation, fiscal – Generally means low spending and revenue powers at subnational government levels.

Centralisation, institutional – Means centralised decision-making and low degree of autonomy at the local government level.

Economic and social integration of geographic areas – A broad description that refers to economic and social links between population and firms in the area, within or across administrative borders.

Equity of taxpayers in different subnational governments – Refers to tax policies that aim for “equal treatment of equals”, i.e. tax rules should treat taxpayers with similar qualities equally, irrespective of their home municipality.

Fiscal federalism – Lays out a general normative framework for assignment of functions to different levels of government and the financial relations among levels of government.

Gross expenditure – A total amount of money the government spends on a particular task, without deducting any revenue that the spending in question will generate for the government. In contrast, net expenditure means the total amount the government spends minus revenues (user fees or sales revenue for example).

Gross value added – The value of output minus the value of intermediate consumption. It can be used to measure the contribution to gross domestic product (GDP) made by an individual producer, industry or sector.

Homogeneous business structure – Refers to a business structure comprising mainly of small- and medium-sized enterprises (SMEs) and a low degree of variation in business sectors.

Inter-municipal unit – A co-operative association or organisation formed by municipalities.

Lack of critical mass (of a region) – Refers to inadequate size, measured by capacities or resources, which may prevent the organisation from operating effectively.

Municipality – An administrative unit with its own government in a local area. A municipality is a basic type of local government and it can be a city, town or rural community.

National redistributive objectives – Refer to government policies to income redistribution.

Nominal terms – Data which have not been adjusted to take inflation into account.

Per capita – Defined as data for each person. For example, per capita public expenditure is the government expenditure averaged across everyone who lives within the territory of the government. At a country level, the expenditure would then be divided by the country's total population.

Real terms – Data that has been adjusted to take inflation into account.

Regional economic development planning – Means a broad spectrum of tasks that focus on planning the economic processes and the use of resources available from a regional perspective. Such tasks include strategic planning, impact analysis, research, co-ordinating, infrastructure and land use planning. In fact, spatial planning and regional economic development planning can be considered as closely linked activities.

Regional equity – See Territorial equity.

Service-tax mix – A combination of local public services offered and tax rates charged for providing the services.

Territorial equity – A general expression usually meaning specific policy goals such as equity in access to standard/minimum level of public services despite regional features. Such policy goals usually require spatial policies targeted at inequalities that are generated by specific regional features. For example, the policy goal for universal provision of public services may entail spending more per capita to maintain services in less populated areas. Territorial equity does not, in general, mean exactly the same level of services in all regions, however.

Vertical tax externalities – Refer to a situation where two or more different levels of government share the same tax base, which may lead to a situation where the different levels of government ignore the effects of their tax rate decision on the tax revenues of other levels of government.

The Future of Regional Development and Public Investment in Wales, United Kingdom

The Welsh Government has set an ambitious and innovative path for regional development and public investment – one focused on generating growth and increasing productivity, while also reducing territorial disparities and ensuring the well-being of citizens, now and in the future. Yet, it faces significant challenges, accentuated by limited fiscal decentralisation and changes to public investment financing post-Brexit. This *OECD Multi-level Governance Studies* report provides the Welsh Government and Welsh local authorities with analysis and recommendations on how to achieve regional development and public investment aims. The report offers insight into how the Welsh Government and Welsh local authorities can increase their fiscal and public investment capacity, and strengthen their governance practices. It stresses that the Welsh Government's ability to coordinate regional development policy and associated public investment is a determining factor in meeting growth and well-being objectives. This report also proposes a variety of mechanisms to strengthen policy and service delivery at the local level. A case study featuring the challenges and benefits of establishing economic regions in Mid and South West Wales sheds a practical light on the various aspects explored throughout the report.



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