EXECUTIVE SUMMARY

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

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

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

The value of indicator systems for regional policy actors extends beyond generating and distributing information. These systems promote learning and orient stakeholders toward results. They provide information to enhance decision making throughout the policy cycle from resource allocation decisions to policy or programme adjustments. When carefully coupled with specific incentive mechanisms and realistic targets, indicators can stimulate and focus actors’ efforts in critical areas. In addition, engaging in the design and use of indicator systems, as well as in efforts to achieve targets can help promote capacity development and good management practices. Finally, effective use of indicator systems can improve transparency in the public sector and enhance accountability of stakeholders at all levels of government.

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

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

- **Indicator systems promote learning.** The process of developing and using indicator systems exposes stakeholders to information that they did not have at the outset – about programme performance, about actors’ capabilities, and about the feasibility of a particular indicator system. The feedback provided by the use of indicator systems should be used for continuous improvement both in terms of policy but also in terms of the indicator system itself. For evolution to occur, the systems must be sufficiently flexible to accommodate user feedback, as well as policy and programming changes.

- **There is no “optimal” design for a performance indicator system.** The design and use of the system will depend heavily on the objectives established for the monitoring system and policy/programme objectives under consideration. As such, establishing clear objectives from the outset will greatly facilitate indicator selection, choices regarding incentives, and the proper use of information.

- **Incentives are inevitable with the use of indicator systems.** The strength of incentives depends on how information will be used and by whom. Attaching explicit rewards (or sanctions) to performance data can be a powerful way to encourage effort and improvement; however an explicit monetary incentive is not a sufficient condition for success. The use of incentives can be challenging and important conditions must be met for such an approach to work effectively. As such, careful consideration should be given to the effects generated by the incentives in an indicator system.

- **Partnership between central and sub-central levels of government is crucial.** Vertical interactions between institutional levels, as well as horizontal co-operation and peer processes facilitate formulating precise objectives, identifying relevant indicators, setting realistic stretch targets, and devising appropriate incentive mechanisms. Moreover, rewards and sanctions are more likely to create the intended incentive effects if there is strong ex ante commitment from all levels of government to rigorous assessment of performance. In the absence of collaboration, a top-down approach to design and use of indicators by the central government can be perceived as an ex post substitute for ex ante control of regional economic development, producing resistance and jeopardising the long-term sustainability of the system.

- **Indicator systems should help inform short-term decisions, as well as long-term strategy.** Regional development policy produces outcomes that materialise over an extended period of time. Orienting an indicator system toward these outcomes can be beneficial, but excessive focus on outcomes can produce a deficit of information that is needed for strategic short- and medium-term decision making. Thus, even where policy makers are oriented toward outcomes, indicator systems should strive to produce information on inputs, processes, and outputs that is relevant for ongoing monitoring activities.

These findings emerge from analysis of the literature on performance indicator systems, discussions with experts, and the four case studies presented in this report. The case studies and their major findings are:
• **The European Union (EU) Structural Funds:** This case examines mechanisms for monitoring the performance of EU Structural Funds during the 2000-06 programming period, with a specific focus on the “performance reserve”. The reserve was an inventive mechanism that aimed to provoke performance improvement by attaching explicit financial incentives to indicators and targets. It was implemented in a larger EU context of monitoring and evaluation activities that included a mid-term evaluation process and a de-commitment (N+2) rule. The reserve set aside 4% of a programme’s total budget and distributed it only if some specific objectives were achieved. In consultation with the European Commission, member states selected their own indicators, chose their own approach to assessment, and used the mechanism differently. The case study reveals the political and technical challenges of implementing such a system, while also highlighting the learning effects which took place. Although the mechanism is no longer compulsory, while it was in effect it helped to raise awareness of the importance of monitoring and evaluation, as well as the need to improve monitoring systems and capacity. It was a learning experience at both the EU and national levels in terms of designing systems, selecting indicators, achieving targets, and using explicit financial incentives.

• **The Italian national performance reserve:** Italy is a unique national example of the use of explicit incentives to improve the performance of regional development policy. During the 2000-06 programming period for the EU Structural Funds, Italy extended and reinforced the logic of the EU performance reserve by adopting a national performance reserve aimed at promoting modernisation of public administration. This reserve, which set aside 6% of a programme’s budget, was developed collaboratively between the central government and regional actors. Specific arrangements were made to ensure transparency and enforcement of the approach. The extent to which the results of the national performance reserve translated into improved regional economic performance is unclear. However, Italy was sufficiently satisfied with the results that it has since developed a new incentive mechanism that moves beyond process and output targets, and focuses on rewarding achievement of outcomes.

• **The monitoring system for England’s regional development agencies (RDAs):** The case of England highlights the dynamic nature of performance indicator systems. Since being established in 1998, the English RDAs have been subject to a number of different approaches to monitoring. With each change, the national government has aimed to enhance the quality of the monitoring process. Over time, the system has become increasingly flexible and accommodated feedback from the RDAs themselves. The most recent shift has been to allow RDAs to decide how best to measure their progress towards overall regional policy targets. Under this new approach, outputs are expected to demonstrate short term results and form the basis for impact information gained through evaluation.

• **The monitoring system for the US Economic Development Administration (EDA):** The case of the US EDA demonstrates the importance of using indicators to generate information that can be used for decision making on both a short and a long-term basis. As a national agency, the EDA is subject to the US Government Performance and Results Act, which requires all federal agencies report to Congress regarding the achievement of specific goals. To do so, the EDA requires data collection from regional and local grantees. This can be somewhat costly and challenging, as the results of EDA investments often materialise over a number of years. One solution has been to project and report on indicators which track outcomes three, six, and nine years after programme investments have been made. However, these and other data produced for GPRA are of limited use for short- to medium-term decision making. To meet their strategic information needs, the EDA couples reporting to Congress with the use of an internal Balanced Scorecard to monitor short-term progress.
Overall, this report suggests that indicator systems are an important tool in the larger toolkit of good governance practices. While implementation is not without challenges, indicator systems can bridge information gaps, generate a common point of reference for stakeholders, reveal where good practice occurs, and stimulate effort in particular areas. Most importantly they provide an opportunity for ongoing learning and adjustment, about policies, programmes, and good governance itself. This is especially critical for enhancing relationships between levels of government, a key ingredient for effective regional development policy.