Agenda - External Affairs and Additional Legislation Committee

Meeting Venue:	For further information contact:
Committee Room 2 - Senedd	**Alun Davidson**
Meeting date: Monday, 27 February 2017	Committee Clerk
Meeting time: 14.30	0300 200 6565
	SeneddEAAL@assembly.wales

Private pre-meeting (14.15 - 14.30)

1 Introductions, apologies, substitutions and declarations of interest

(14.30)

2 Inquiry into regional policy - what next for Wales? - evidence session 1

(14.30 - 15.30) (Pages 1 - 31)

Professor Sascha Becker, Warwick University
Professor David Bell, Stirling University

Break (15.30 - 15.40)

3 Inquiry into regional policy - what next for Wales? - evidence session 2

(15.40 - 16.40) (Pages 32 - 42)

Dr Jayne Woolford, Cardiff University
Professor Kevin Morgan, Cardiff University

Cynulliad Cenedlaethol Cymru
National Assembly for Wales

4 Paper(s) to note

(16.40)

Leaving the European Union: implications for Wales - additional information from the Cabinet Secretary for Finance and Local Government

(Pages 43 - 44)

5 Motion under Standing Order 17.42(vi) to resolve to exclude the public for the remainder of the meeting

(16.40)

6 Inquiry into regional policy - what next for Wales? - consideration of evidence

(16.40 - 17.00)

By virtue of paragraph(s) vi of Standing Order 17.42

Agenda Item 2

Document is Restricted

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Coventry, 13 Feb 2017

Summary of research findings on the effect of EU Structural Funds on Regional Growth, across the EU as a whole, and highlighting whether/where the UK effects differ from the EU average

The following note summarizes joint research by Sascha O. Becker (CAGE, University of Warwick Warwick), Peter H. Egger (ETH Zurich) and Maximilian von Ehrlich (University of Bern). We have looked at the effect EU Structural Funds on regional growth over the four programming periods 1989-1993, 1994-1999, 2000-2006, 2007-2013 with a special focus on Objective 1 funds ("Objective 1" now renamed "Cohesion Objective"), but also looking at any EU regional transfers.

Main points:

- Generally, very difficult to find "causal effect" of EU transfers on regional growth because poor regions (the main recipients) might have different growth rates than rich regions also in the absence of EU structural funds
- Objective 1 funds are "interesting" because they are assigned by a clearly defined rule: NUTS2 regions, whose GDP per capita is less than 75% if EU average, are eligible
- Assignment of funds to regions to the left and right of the 75% threshold is, from a statistical perspective, in the vicinity of the 75% threshold, like "flipping a coin" and can be exploited in statistical analysis
- Finding: Objective 1 funds are, <u>on average</u>, helping recipient regions to grow faster, but multiplier around 1, i.e. on average "you get out what you put in", but not more than that
- See Becker, Egger, von Ehrlich (2010)

- Going away from effects on average, are there differences in the growth effects of Objective 1 funds, depending on region characteristics? In other words: is there <u>heterogeneity</u> across regions?
- Answer: yes, endowment with human capital and a high quality of government matter
- Only regions with more educated work force and regions with high quality of governance are able to turn transfers under the Union's Objective 1 Structural Funds programme into faster growth.
- Those regions are the ones who are responsible for a positive average effect of the programme.
- See Becker, Egger, von Ehrlich (2013)

- As for EU Structural Funds as a whole, do more funds mean more growth?
- Answer: no, there are <u>decreasing returns</u>, i.e. after a certain point, *additional* funds do not lead to *additional* growth.
- See Becker, Egger, von Ehrlich (2012)

- Research by Becker, Egger, von Ehrlich (2016, 2017) updates these earlier findings to include the latest data and confirms the patterns described above; looking at whether the UK recipient regions follow the same pattern as recipient regions in other EU countries, we find that the UK has benefited (or not) from EU transfers in a similar way to other EU regions.

(see overleaf for references and abstracts)

Underlying research papers on the effects of EU Structural Funds on Regional Growth

Becker, Sascha O., Peter H. Egger and Maximilian von Ehrlich (2010) "Going NUTS: The Effect of EU Structural Funds on Regional Performance" *Journal of Public Economics* 94(9-10): 578–590. http://dx.doi.org/10.1016/j.jpubeco.2010.06.006

Abstract:
The European Union (EU) provides grants to disadvantaged regions of member states to allow them to catch up with the EU average. Under the Objective 1 scheme, NUTS2 regions with a per capita GDP level below 75% of the EU average qualify for structural funds transfers from the central EU budget. This rule gives rise to a regression-discontinuity design that exploits the discrete jump in the probability of EU transfer receipt at the 75% threshold for identification of causal effects of Objective 1 treatment on outcome such as economic growth of EU regions. We find positive per capita GDP growth effects of Objective 1 transfers, but no employment growth effects.

Becker, Sascha O., Peter H. Egger and Maximilian von Ehrlich (2013) "Absorptive Capacity and the Growth Effects of Regional Transfers: A Regression Discontinuity Design with Heterogeneous Treatment Effects", *American Economic Journal: Economic Policy* 5(4): 29-77. http://dx.doi.org/10.1257/pol.5.4.29

Abstract:
Researchers often estimate average treatment effects of programs without investigating heterogeneity across units. Yet, individuals, firms, regions, or countries vary in their ability to utilize transfers. We analyze Objective 1 transfers of the EU to regions below a certain income level by way of a regression discontinuity design with systematically varying heterogeneous treatment effects. Only about 30 percent and 21 percent of the regions—those with sufficient human capital and good-enough institutions—are able to turn transfers into faster per capita income growth and per capita investment, respectively. In general, the variance of the treatment effect is much bigger than its mean.

Becker, Sascha O., Peter H. Egger and Maximilian von Ehrlich (2012) "Too much of a good thing? On the growth effects of the EU's regional policy", *European Economic Review* 56(4): 648-668. http://dx.doi.org/10.1016/j.euroecorev.2012.03.001

Abstract:
The European Union (EU) provides grants to disadvantaged regions of member states from two pools, the Structural Funds and the Cohesion Fund. The main goal of the associated transfers is to facilitate convergence of poor regions (in terms of per-capita income) to the EU average. We use data at the NUTS3 level from the last two EU budgetary periods (1994–1999 and 2000–2006) and generalized propensity score estimation to analyze to which extent the goal of fostering growth in the target regions was achieved with the funds provided and whether or not more transfers generated stronger growth effects. We find that, overall, EU transfers enable faster growth in the recipient regions as intended, but we estimate that in 36% of the recipient regions the transfer intensity exceeds the aggregate efficiency maximizing level and in 18% of the regions a reduction of transfers would not even reduce their growth. We conclude that some reallocation of the funds across target regions would lead to higher aggregate growth in the EU and could generate even faster convergence than the current scheme does.

Becker, Sascha O., Peter H. Egger and Maximilian von Ehrlich (2016) "Effects of EU Regional Policy: 1989-2013", CAGE Working paper
http://www2.warwick.ac.uk/fac/soc/economics/research/centres/cage/manage/publications/271-2016_becker.pdf
Abstract:
We analyze EU Regional Policy during four programming periods: 1989-1993, 1994-1999, 2000-2006, 2007-2013. When looking at all periods, we focus on the growth, employment and investment effects of Objective 1 treatment status. For the two later periods, we additionally look at the effects of the volume of EU transfers, overall and

in sub-categories, on various outcomes. We also analyze whether the concentration of payments across spending categories affects the effectiveness if EU transfers. Finally, we pay attention to the role of EU funding for UK regions given the current debate in the UK.

Becker, Sascha O., Peter H. Egger and Maximilian von Ehrlich (2017) "EU Regional Policy and the UK", in Nauro F. Campos and Fabrizio Coricelli (eds.): The Economics of the UK-EU Relationship: From the Treaty of Rome to the Vote for Brexit; Palgrave Macmillan, in print.

Abstract:
This chapter sheds light on the effectiveness of EU Regional Policy with a particular focus on the UK. Some taxpayers in the UK might be concerned whether the EU spends their contributions to the EU Regional Policy budget wisely, independent of whether EU money returns to the UK or not. Also, some UK taxpayers might wonder whether the UK has benefited itself from EU funding. Finally, some UK citizens might be concerned about what would replace EU Regional Policy transfers to some regions in the UK, if the UK were to leave the EU. We address all of these questions and complement our analysis with some historical background on EU Regional Policy.

Brexit, EU Area-based Policies, and the Devolved Governments

David Bell
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February 2017

Introduction

Since the EU referendum, the post-Brexit future for agricultural, regional and rural policies in the UK have been hotly debated. Few of these debates have taken account of the role of the devolved governments in relation to these policies. Although agriculture, regional and rural policy have been heavily influenced by the EU for decades, the devolved governments have played an important role in their development and administration. Repatriating the policies to the UK will pose many political and economic challenges. This paper discusses alternative futures for these policies, taking into account the potential role of the devolved governments. There is little doubt that decisions over their future will affect the relationship between the UK government in Westminster and the devolved governments in Scotland, Wales and Northern Ireland.

Clearly, the UK government is the prime actor in decisions over policy repatriation. It is about to embark on negotiations with the EU which will result in the withdrawal of the UK from these ***area-based*** policies - policies that are linked to specific locations within the UK, such as those dealing with agriculture, regional and rural issues. It will soon be negotiating trade deals with the EU and with other countries. It must decide how it will treat issues such as agricultural support in these negotiations. Agriculture is often a difficult issue in trade negotiations. Changes to agricultural tariffs and income support mechanisms will also affect the budgets of the devolved governments. They will wish to have a significant influence on the U.K.'s negotiating stance in relation to these policies, since the outcomes from trade negotiations may affect their competences.

Continuation of area-based policies along the same, or similar, lines to the present structure is not guaranteed. Some argue that existing EU regional and rural policies do not provide value for money anyway and have consistently failed to achieve their objectives, such as reducing spatial inequality or increasing national growth. If the UK government accepts such arguments and redirects funding to other priorities[1], conflict with the devolved governments is inevitable.

Even if the UK government decides to continue with area-based policies, important decisions must be made about the allocation of responsibility for their design, administration and evaluation. These will involve the UK government and the devolved governments since a significant proportion of the EU funding is already administered by the devolved governments. Conflicts around these decisions have the potential to disrupt the relationship between different levels of government within the UK.

To motivate the discussion, and to get an idea of the resources involved, we begin by considering the most recent EU budget which shows the magnitude of EU-funded, area-based policies in the UK. In the following section, we examine the choices that the UK Government and devolved governments might make once these financial flows from the EU come to a halt. The final section concludes.

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[1] Some of the supporters of Brexit advocated redirecting all UK contributions to the EU (some of which cover the area-based policies) to the NHS. Unfortunately, their claim was based on the gross contribution rather than the net contribution and therefore the argument that the NHS budget could be increased by £350 million per week was fallacious.

The EU budget 2015

The U.K.'s budget with the EU for 2015 is shown in Table 1 below. Annual averages for the 2019-2020 budget round are also listed. These confirm that 2015 was a representative year during the current budget round. The UK's gross contribution to the EU in 2015 was £19.6 billion (£377 million per week). This comprised customs duties, a contribution from VAT receipts, and the largest contribution which related to the size of the UK economy (Gross National Income).

Set against these contributions, £9.2 billion was received from the EU. The largest part was the UK's rebate which was worth £4.9 billion. Area-based policies received £3.5 billion. The largest of these were payments through the Common Agricultural Policy and the Agricultural Fund for Regional Development - £2.5 billion. The Structural Funds (The European Regional Development Fund and the European Social Fund) accounted for a further £1 billion. Thus, excluding the rebate, 80.9 % of the money received by the UK from the EU was allocated to area-based policies. This proportion averaged 83.6% between 2010 and 2014, implying that 2015 was not an outlier relative to recent history.

Distribution of the area-based funds is largely the responsibility of the devolved governments. For example, the Scottish Government is the "formally accredited EU Paying Agency for spending in Scotland and is responsible for all aspects of the administration of the measures"[2]. The Welsh and Northern Irish Assemblies have similar roles. The devolved governments are heavily involved in the distribution of EU funding and are understandably concerned about these roles may change after Brexit. In the next section, we discuss possible scenarios for such roles.

Table 1: UK's net financial position with EU institutions (£m)

Payments	***2015***	***Average (2010-2014)***	***Receipts***	***2015***	***Average (2010-2014)***
Customs Duties	3,087	2,933	Common Agricultural Policy (Direct Payments)	2,030	2,722
VAT	2715	2,251	European Social Fund (ESF)	556	425
Gross national income	13,791	12,212	European Regional Development Fund (ERDF)	454	630
Total Contribution	19,593	17396	Agricultural Fund for Regional Development (EARDF)	461	467.2
less Rebate	-4,913	-3,479	Other	826	830
less Total Receipts	-4,327	-5,074	**Total Receipts**	4,327	5,074
gives Net Contribution	10,353	8,843			

Source: ONS, Pink Book

[2] See: http://www.gov.scot/Topics/Government/Finance/spfm/eufunding Para 9.

Issues for the UK Government and the Devolved Governments

The UK government is about to embark on a series of negotiations that are likely to involve the dismantling and/or redesign of existing area-based policies. Whether they will continue into a post-Brexit world will depend first, on whether the UK government is willing to sacrifice them as part of its negotiation strategy, and second, on whether the UK government takes the view that they are an appropriate use of scarce public resources. Obviously, these decisions will be of special interest to the devolved governments.

First consider agriculture. When it enters trade talks with other countries and trading blocs, the UK must decide whether to include agricultural tariffs and subsidies within its negotiation strategy. The first set of negotiations are likely to be between the UK and the EU. The EU is the major destination for UK agricultural exports and the main source of its agricultural imports. In 2014, 61% of UK agricultural exports were sent to the EU and 71% of agricultural imports came from the EU. Therefore, coming to an agreement over agricultural policies with the EU is a high priority.

Nevertheless, the issues surrounding such agreement are Byzantine in their complexity. For example, following Brexit the UK will be leaving a customs union which has a specific tariff schedule for agricultural products. There are also tariff rate quotas (TRQ) agreed with third countries by the EU which set differential tariff rates for imports and exports below and above agreed amounts (quotas). Normally, tariffs are set low for imports below quota and much higher once quota is exceeded. It is not clear how these might be rolled back following Brexit[3], since there is no useful precedent for the breakup of a customs union.

Given that many Brexit supporters advocate completely free trade[4], the UK government is likely to come under pressure to reduce direct payments to farmers. Cogent arguments for reducing agricultural support have been made by Deiter Helm[5]. However, adopting such a policy would mean that even if there were tariff free trade between the UK and EU, UK farmers would be at a competitive disadvantage to their EU counterparts who would continue to receive direct payments from the CAP.

The UK will receive around €3.5 billion for agricultural and rural support each year between now and 2020. These payments cover both the Common Agricultural Policy and the Agricultural Fund for Regional Development. Table 2 below shows the shares that the component parts of the UK will receive from these funds alongside the corresponding population shares.

Table 2: Agriculture Funding and Population Shares for the Component Nations of the UK

	Share of EU agricultural funding (direct aids & EAFRD[6])	Population share
England	58.9%	84%
Scotland	18.5%	8%
Wales	13.8%	5%
Northern Ireland	8.8%	3%

[3] See: http://capreform.eu/wto-dimensions-of-a-uk-brexit-and-agricultural-trade/
[4] See: http://brexitcentral.com/patrick-minford-unilateral-free-trade-far-attractive-membership-single-market/
[5] See: http://www.dieterhelm.co.uk/natural-capital/environment/agricultural-policy-after-brexit/
[6] The Common Agricultural Policy (CAP) comprises direct aids (e.g. the Single Farm Payment) to farmers and the European Agricultural Fund for Rural Development (EAFRD), which is intended to stimulate economic, social and environmental development in rural communities.

The English economy is much less dependent on agricultural support payments than are the Celtic nations. England's share of EU financial support is substantially lower than its population share. In contrast, Scotland, Wales, and Northern Ireland all receive more than double their population share in agricultural support payments. This reflects the larger relative size of the agriculture industry in the Celtic nations. Nevertheless, agriculture comprises only a small part of GDP in their respective economies. Even so, abandonment of agricultural support policies would have a more detrimental effect on the budgets of the Celtic nations than in England. The role of CAP payments in supporting the agriculture sector, taking Scotland as an example, is explained in the Box 1.

While CAP payments support farm incomes, the common EU tariffs on agricultural products also protect farming from international competition. Box 2 shows firstly that these tariffs can be relatively large and that they are complex: they are set at a product-by-product level. The UK will no longer have to impose these tariffs if, as expected, it leaves the EU customs union. It may agree tariffs for agricultural products with the EU. It may also seek agreement with other countries where it wishes to form trade partnerships. Failing this, it will fall back on WTO rules for agriculture, which again are complex. Various attempts to liberalise agricultural trade by the WTO have made very slow progress as evidenced by the ability of the EU to charge the very high tariffs shown in Box 2.

The tariff rate quotas pose a particular challenge. These involve importing specified quantities of agricultural products tariff free and then charging a tariff on excess imports. The quantities and rates of tariff vary by product. For example, the EU has agreed with the WTO to import 284,000 tonnes of lamb and mutton tariff free. So if the UK leaves the EU, how much of this tariff-free amount that has been agreed with the WTO should come to the UK? In practice, the UK has imported (mainly from New Zealand) a much larger share of the allowance than its population share within the EU. So should the allocation reflect past patterns of purchase, or some other consideration? These are the sorts of issues that will inevitably impede progress on coming to a trade agreement covering agriculture with the EU.

Box 1: Importance of CAP payments to Scottish Agriculture

This box illustrates the importance of CEP payments to Scotland's agricultural sector. Table 3 is drawn from the Scottish input output tables 2013. It contrasts the size of transactions involving the agricultural sector with those for the Scottish economy as a whole.

Table 3: Agriculture and All Industries Output in Scotland 2013

	Agriculture	All Industries
Total domestic consumption	863.2	60,922.5
Imports from rest of UK	731.0	28,476.4
Imports from rest of world	281.8	16,587.8
Total intermediate consumption at basic prices	1,876.0	105,986.7
Taxes less subsidies on products	46.5	4,575.6
Taxes less subsidies on production	-556.2	1,478.5
Compensation of employees	345.8	69,497.5
Gross operating surplus	1,352.0	51,425.7
Gross value added	1,141.6	122,401.8
Total output at basic prices	3,064.1	232,964.1

Total sales of Scotland agriculture industry in 2013 just exceeded £3 billion. Around £1 billion of these sales were imports, with three quarters of these coming from the rest of the UK and the remainder from the rest of the world. The sector paid out £863 million to suppliers, such as machinery and animal feed (total domestic consumption). It also paid £346 million in wages (compensation of employees). Profits on sales £1.35 billion (gross operating surplus). The total contribution to Gross Value Added (GVA) comprised these profits along with the wages earned by farm workers. However, profits were artificially boosted by CAP subsidies of £556 million. After deducting these, the overall contribution of agriculture to the Scottish economy is £1.1 billion, equivalent to 0.93% Scotland's total Gross Value Added[1]. Clearly Scottish agriculture is heavily dependent on CAP payments which makes up a significant proportion of its total income.

The right-hand column shows the equivalent figures for the Scottish economy as a whole. Clearly, they are of a much larger magnitude, reflecting the small size of the agricultural sector. They also show that, rather than being civilised, these other sectors jointly contribute around £1.5 billion in taxes. Finally, the share of wages in GVA is much larger outside the agriculture sector. Partly due to its high capital intensity, and partly due to its relatively low wages, compensation of employees accounts for 30% in the agriculture sector but 57% of total Scottish GVA.

Box 2: Current EU Agricultural Tariffs

Tariffs are charged on most agricultural products that enter the EU. Table XX below shows examples of such tariffs. These tariffs protect EU agricultural producers (including those in the UK) from external competition. Table 4 illustrates, some tariffs are extremely high and offer very significant protection to EU producers. As part of the Brexit negotiations, the UK and EU will have to agree tariffs for agricultural trade between the UK and EU. The UK will also have to agree agricultural tariffs (if any) when it makes trade agreements with other countries.

Note that the CETA agreement between the EU and Canada involved significant reduction in tariffs, but retention of direct payments to farmers within the EU through the CAP. This outcome was not popular which Canadian farmers, who do not receive direct farm payments and therefore must compete against subsidised European farm products, but given that the population of Canada is less than 1/14th that of the EU, their bargaining position was not strong.

Table 4: Current EU Tariff Rates on a Sample of Agricultural Products

Product	Tariff Rate	Effective Ad Valorem Rate
Fresh/chilled cattle carcasses	12.8% +€176.8/100kg	84%
Frozen beef, boneless	12.8% + €303.4/100kg	87%
Milk and cream, fat content 3-6%	€21.8/100kg	74%
Seed potatoes		4.5%
Fresh/chilled lettuce		10.4%
Barley	€93/tonne	53%
Oats	€89/tonne	30%

Source: Horizon Market Intelligence (2016), "What Might Brexit Mean for UK Trade in Agricultural Products?", October

CAP subsidies provide a significant share of UK agricultural income. If the UK government could negotiate tariff free access to EU agricultural markets, but did not maintain the CAP, many agricultural businesses would founder. However, free trade discussions with other countries will almost certainly include consideration of tariffs and subsidies to agriculture. The EU has one of the most protected agricultural sectors among WTO members. If the UK wishes to do trade deals with other WTO members, then they will wish to see a reduction the protections offered to UK agriculture. The outcome will depend on the relative bargaining strength of the UK and these other countries, but it is unrealistic to assume that agreements will be reached without the UK making concessions. These may involve reductions in support for agriculture if concessions made elsewhere would provide greater benefit to the UK economy. Reducing tariffs on agricultural products and subsidies to farming will likely benefit UK consumers by reducing food prices. But it is likely to cause some significant restructuring of UK agriculture, with producers seeking to raise productivity using more intensive methods. It will likely also lead to withdrawals of marginal producers from the sector. This will be felt particularly keenly in the devolved authorities who will strongly object to having to deal with the negative consequences of trade agreements over which they have little influence.

The Celtic nations are more dependent than England on EU agricultural support. The same is true for the Structural Funds. This is illustrated in Table 5, which gives estimates of annual CAP and Structural

Fund spending for each UK nation during the 2014-2020 budget round. Northern Ireland is particularly dependent on CAP funding – receiving five times more CAP spending per head than England. Wales receives three time more CAP spending per head than England, but 6.5 times more Structural Fund spending per head. Should the UK government choose to withdraw from these area-based policies, the effects would be felt most acutely in Wales and Northern Ireland.

The Celtic nations are also more dependent on the Structural Funds than is England. Their effectiveness is open to debate. A recent review by the Department for Business Innovation and Skills argued that, in relation to the Structural Funds:

> *"at an aggregate level, both in the UK and across the EU, the evidence is inconclusive as to whether the funds have been effective in achieving their objectives. There are several compelling reasons for this, particularly in relation to the structural and cohesion funds."*[7]

The lack of compelling evidence is attributed to: (a) lack of reliable data; (b) difficulty of establishing the counterfactual; (c) measurement problems arising from distinguishing effects among the plethora of interventions occurring simultaneously; (d) relatively small scale of the funding in relation both to overall public spending and GDP; (e) differences in evaluation methodologies leading to potentially different conclusions. Analysis of the effectiveness of the Structural Funds using the Quest DSGE model, which was developed by the EU, gives negative multipliers for the UK, implying that the combination of Structural Fund spending and the UK's contribution to the EU has a negative effect on GDP.[8]

This suggests that the argument that the Structural Funds offer the best possible use of scarce public resources does not have strong empirical justification. Nevertheless, there will be strong political pressure for their retention

Table 5: Average Annual Spending on CAP and on Structural Funds (2014-2020 budget round)

	England	Northern Ireland	Scotland	Wales
CAP total spending (£m)	2,184	317	614	353
CAP spending per capita (£)	31	145	96	96
Structural Funds total spending (£m)	735	54	95	255
Structural Funds spending per capita (£)	13	30	18	83

Source: Centre for European Reform

This message is reinforced by the Centre for European Reform's estimates of the net payments to the EU by country. These add estimates of contribution by country to the spending data from Table 6. Given their higher levels of income, it is not surprising that Table 5 shows England and Scotland making net contributions to the EU, while Northern Ireland and Wales are in deficit on their EU accounts. The bulk of the net payment to the EU is made by England (£8bn), while Scotland contributes £337m per year. In contrast, Northern Ireland receives £171m, while Wales, which voted to leave the EU, receives an average payment of £276m per year.

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[7] Source: Department for Business Innovation and Skills (2014), 'Review of the Balance of Competences between the United Kingdom and the European Union: Cohesion Policy', para 3.18

[8] Varga, J., & in't Veld, J. (2011). A model-based analysis of the impact of Cohesion Policy expenditure 2000–06: Simulations with the QUEST III endogenous R&D model. Economic Modelling, 28(1), 647-663.

Table 6: Average Annual Net Payments by Country to the EU (2014-2020 budget round)

	UK	England	Northern Ireland	Scotland	Wales
Gross Payments (£m)	16,907	14,582	340	1,417	567
Less UK Rebate (£m)	-3,844	-3,271	-102	-299	-172
Net Contribution (£m)	7,985	8,094	-171	337	-276
Net Contribution Per Capita	117	140	-94	64	-90

Source: Centre for European Reform

Clearly UK Government decisions affecting the CAP and the Structural Funds will have significant effects on the devolved governments' budgets. It is possible that the UK government will reduce, or eliminate, agricultural subsidies during trade negotiations. It may do so if it feels that losses in this sector would be compensated by larger gains for other industries. However, closing these sources of funding would be hugely unpopular with the devolved administrations. It would also be problematic because some programs are jointly funded by the EU and the devolved administrations. For example, the Scottish Rural Development Programme is funded jointly by the EU and the Scottish Government.

However, if the UK stopped its contribution to the EU in 2017-18, it could significantly reduce its fiscal deficit. The OBR forecast for the 2017-18 budget deficit is £59bn. The 2017-18 deficit would be reduced by £8 billion if the UK was no longer contributing to the EU budget. Hence, one option for the UK government would be simply to close EU-funded area-based policies following Brexit and use the money saved to reduce the fiscal deficit.

The strategy of reducing financial support for agriculture would be politically unpopular, both with the farming lobby and the devolved governments, but it is also somewhat at odds with the current UK government's political concern for reducing spatial inequalities across the UK. Also, the present Chancellor is less wedded than his predecessor to achieving budget balance. Hence the political desire to continue with such area-based payments, even if the supporting evidence for their efficacy is weak, may outweigh the desire for both fiscal discipline and the efficient use of public funds.

If it decides to continue with some form of area-based funding, the UK government will face a set of issues in deciding how large these funds should be and how they should be allocated and monitored. At present, the allocation of the EU Structural Funds is based on a set of objective rules which define "less developed" regions - those with incomes below 75% of the EU average, "transition" regions - those with incomes between 75% and 90% of the EU average and "more developed" regions - those with incomes greater than 90% of the EU average. The size of such regions within member states determines the overall value of Structural Funds allocated by the EU to that state.

For agriculture, allocations to member states are largely influenced by historical precedent and negotiations that involved the new member states when they acceded to the EU [9]. There are no objective criteria which can be used to justify current levels of CAP support provided to the UK.

Member states can devolve CAP implementation to subnational governments. Thus, England, Scotland, Wales and Northern Ireland have implemented quite different versions of the CAP. Scotland and Wales have adopted similar methods for determining CAP payments; Northern Ireland is using a different method, while England has applied yet another approach. This diversity is permissible within current EU CAP regulations.

[9] See: http://capreform.eu/agreeing-the-allocation-of-cap-funds-between-member-states/

The allocation of CAP funding within the UK to the devolved governments is determined by negotiation. The outcome is largely driven by historical precedent rather than by objective analysis of farming conditions in the UK nations. Thus, for the 2014-2020 budget round:

> *"The UK government has announced that farmers in England, Northern Ireland, Wales and Scotland will receive the same proportion of the €27.6 billion Common Agricultural Policy (CAP) budget over the next seven years as they currently receive."*[10]

Giving each of the devolved governments the same share of the budget as they received in the previous round is simply taking the line of least resistance. This somewhat arbitrary process for determining the funds allocated to the devolved governments does not seem consistent with a process designed to achieve desired social and economic outcomes at minimum cost to the taxpayer.

If area-based policies continue post-Brexit, how should funding be allocated to the devolved governments? We consider three possible solutions:

1. Use the Barnett formula. Additional funding to cover agriculture, regional development and rural policy would be added to each devolved government's budget. The Barnett formula remains the mainstay of financial support for the devolved governments following the transfer of tax-raising powers to Scotland, Wales and Northern Ireland. Additions to the Barnett-determined block grant to take account of these policies would be relatively straightforward once the total cost of these policies is determined.

   Like existing UK area-based policy interventions, the Barnett formula is not based on objective statistical criteria, such as measures of relative need - an argument made by the Welsh Assembly[11] which feels that the formula fails to take account of levels of deprivation and poverty in Wales. However, its operation has become more transparent. HM Treasury now provides the information on which the Barnett formula block grant is calculated[12]. Nevertheless, HM Treasury still retains control over its design and implementation. Thus, as far as the UK government is concerned, using the Barnett formula to allocating funding for area-based policies would be relatively simple to administer. As indicated earlier, the cost of adopting this mechanism for allocating funding to the devolved governments may be outcomes that do not necessarily constitute optimal use of public funds.

   One potential danger for the devolved governments of "Barnettising" agriculture and regional spending is that if these programmes are cut back in England by the UK government, then the devolved governments will come under pressure to follow suit. Although the devolved governments can spend their Barnett block grant as they wish, failure to follow changes in spending priorities in England will require reducing funding to other spending priorities. The political costs to the devolved governments of reducing spending to match cuts being imposed by the UK government are likely to be less than those incurred by cutting elsewhere in order to maintain spending on agriculture and regional programmes.

[10] See: https://www.gov.uk/government/news/uk-cap-allocations-announced
[11] See: http://www.assembly.wales/NAfW%20Documents/ki-004.pdf%20-%2002112011/ki-004-English.pdf
[12] See: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/479717/statement_of_funding_2015_print.pdf

The latter course of action is likely to be more contested than a spending cut which can use similar action in England as a frame of reference.

2. Base allocations on relevant objective statistical measures. For example, support for infrastructure, SMEs and skills development, currently funded through the ERDF and ESF, could be replaced by a UK fund distributed to the devolved governments using objective criteria agreed by the four constituent nations. Similarly, objective measures might be used to allocate funding to agriculture. However, in both cases to avoid claims of political manipulation, the statistical criteria should be objective and transparent.

   Eligibility criteria for domestic UK government area-based policies do not seem to rely on objective statistical criteria. Recent policy measures include “City Deals”, “Devolution Deals” and “Enterprise Zones”. Eligibility for these policies depends on dialogue between different levels of government rather than on objective statistical criteria. This is a clear contrast with EU Structural Fund policies where, for example, the highest levels of support are restricted to those areas where GDP per head is less than 75% of the EU average. One obvious danger of distancing area-based policies from objective statistical measures is that they become exposed to political manipulation. Regions may seek to influence outcomes in their own interest when there is no clear mechanism for ranking eligibility for policy intervention.

   This approach might achieve better economic and social outcomes for the UK as a whole than use of the Barnett formula. However, given that it is central to the hybrid tax/grant funding mechanism recently implemented for the devolved governments, those governments which are disadvantaged by this method will complain that it is inconsistent with this new funding structure which has retained the Barnett formula as an essential element in devolved government funding. Further objections may be raised if the UK government decides unilaterally to retain control over the allocations. Even if the mechanism is objective, the devolved governments will argue that they should be consulted about the outcomes.

3. Agree the aggregate level of support for area-based policies and then transfer an equivalent amount of tax revenues to the devolved governments. This would provide the devolved governments with a greater degree of autonomy, but would also transfer revenue risk to these bodies. Thus, for example, rather than provide equivalent funding for the CAP and the Structural Funds to the Scottish government, the UK government might transfer the same value of excise duties. This would transfer responsibility for decisions on agricultural support and economic development to the devolved governments. While this increase in autonomy might be welcomed, the devolved governments would also have to accept additional the revenue risk associated with whatever instrument is used to fund the policy. In addition, the budgets would not be ring fenced and hence open to competition with other devolved government priorities.

However, it is worth reiterating that, specifically in relation to agriculture, the autonomy of devolved governments may be curtailed by decisions made by the UK government in its trade negotiations. For example, the devolved governments could not set up their own version of the CAP if the UK government has agreed to open up UK agriculture to competition by removing tariffs and eliminating farming subsidies. It might choose to do so in order to gain concessions for industries deemed to be more important to the UK’s economic prospects. Even if the policy results only in reductions in tariffs, farm incomes are likely will suffer, possibly resulting in increased pressure on devolved governments for compensation.

These alternative mechanisms for the future of area-based funding are summarised in Table 7 below.

Table 7: Alternative Mechanisms for Implementing Area-based Policies Post-Brexit

Policy Action	**UK government**		**Devolved governments**
	For	Against	
Close down EU area-based policies	Limited evidence that policies achieve social and economic objectives	Redistribution to poorer areas may increase social cohesion	Reduction in budget and policy autonomy likely to be very unpopular
Retain area-based policies: allocate on the basis of objective measures	Transparency increases support for policy. Resources ring-fenced to policy objectives.	May not be most efficient use of public resources	Restriction on autonomy may be resented. Losers regret may be a potent political instrument.
Retain area-based policies: allocate using the Barnett formula	Reasonably transparent allocation. No need to micro-manage policy.	Likely to be even less efficient use of public resources	Greater freedom to design local policies, but funding dependent on UK fiscal stance
Retain area-based policies: assign equivalent tax revenues to the devolved administrations	Transfers risk to the devolved administrations. No need to micromanage.	Reduces fiscal flexibility by narrowing UK government tax base	Increased revenue risk, but greater freedom to design policy

(These are not necessarily exhaustive, but do give an idea of the range of UK government reactions to its withdrawal from EU area-based policies)

Conclusion

This paper has examined potential futures for repatriating EU area-based policies to the UK. These comprise policies affecting agriculture, regional and rural development. They are largely administered, and to some extent designed, by the devolved governments, whose budgets are more dependent on these policies than is the case in England.

Decisions about the future of these policies will partly be dependent on future UK trade negotiations. Agriculture is particularly exposed to such effects. Currently, UK agriculture is highly dependent on subsidy from the CAP. It will only remain competitive with the EU, its main trading partner, if it retains a similar level of subsidy to the CAP and has tariff free access to European markets. However, comprehensive trade negotiations with other countries will inevitably consider tariffs and subsidies relating to agricultural products. Objections will almost certainly be raised to the retention of CAP-like subsidies and the UK negotiators must consider whether to sacrifice these to gain concessions for other, more important, industries. Trade negotiations inevitably involve give-and-take: it is unrealistic to assume that the UK will get everything it wants. And agriculture is in a particularly exposed position in that it is currently protected by sizeable tariffs and an extensive subsidy regime. Reduction in barriers to agricultural imports will likely benefit UK consumers through lower food prices, but it is difficult to see how UK agricultural producers can remain competitive both with the EU and other countries without significant restructuring. This is likely to be strongly opposed both by the powerful agriculture industry lobby groups and by the devolved governments, which are more dependent on the existing system of agricultural subsidies than is the case in England.

As far as the Structural Funds are concerned, there will undoubtedly be strong support for their continuation, particularly from those with a vested interest in these policies. This would involve establishing UK-branded versions of the ESF and ERDF. These are in principle affordable because UK contributions to the EU easily cover their costs. However, given that UK fiscal policy is likely to continue to be tight, the effectiveness of such spending will come under close scrutiny. Some will argue that these policies are an inefficient use of public funds because they are not effective in achieving their objectives. Again, this argument will involve the devolved governments who currently administer these funds. They are likely to resist discontinuing the ESF and ERDF, again raising the potential for conflict with the UK government.

If some aspects of the area-based policies are retained, important decision will have to be made about their structure and administration. Possibilities discussed in the paper include following the EU practice of defining eligibility at the UK level using objective statistical measures; allocating additional funding through the Barnett formula and letting the devolved governments deal with the area-based policies; allowing devolved governments to access additional revenue streams to fund the area-based policies. Each approach has advantages and disadvantages both from a UK government perspective and from the perspectives of the devolved governments. There will be many opportunities for intergovernmental conflict as the debates on their design evolve. And while the objective of achieving the best use of public funds should not be set aside, the potential political costs of inflexibility during intergovernmental negotiations to establish post-Brexit agricultural, regional and rural policies should not be underestimated.

Agenda Item 3

Cynulliad Cenedlaethol Cymru | National Assembly for Wales
Y Pwyllgor Materion Allanol a Deddfwriaeth Ychwanegol | External Affairs and Additional Legislation Committee
Y goblygiadau i Gymru wrth i Brydain adael yr Undeb Ewropeaidd | Implications for Wales of Britain exiting the European Union
IOB 47
Ymateb gan Ysgol y Gyfraith a Gwleidyddiaeth, Dr Jayne Woolford
Evidence from Cardiff School of Law and Politics, Dr Jayne Woolford

*The **UK in a Changing Europe** Initiative promotes independent and impartial research into the relationship between the UK and the EU. It explores the key aspects of the UK-EU relationship including the impact of different policies and the implications of any changing relationship with the EU on different parts of the UK.*

*The Wales and EU Hub has been created as part of the **Wales Governance Centre** to provide and disseminate non-partisan and independent research on Wales and the EU.*

I welcome the opportunity to contribute to the work of the External Affairs and Additional Legislation Committee regarding the implications for Wales of the United Kingdom's withdrawal from the European Union in relation to European Structural and Investment Funds (ESIF).[1] This written submission focuses upon financial, programming, legal and policy implications of Brexit upon the programming of ESIF and on regional/spatial policy in Wales.[2] It refers mostly to the European Regional Development Fund (ERDF) and the European Social Fund (ESF), although elements will be relevant across the other funds which share some common provisions.

[1] The European Regional Development Fund (ERDF), European Social Fund (ESF), European Agricultural Fund for Rural Development (EAFRD) and the European Maritime and Fisheries Fund (EMFF). The Cohesion Fund is a fifth ESIF but is not relevant for Wales as the UK is ineligible.
[2] This contribution draws extensively from an article *Woolford, J, 2016, Implications of Brexit for UK ESIF programming and future regional policy,* accepted for the upcoming issue of EStIF (European Structural and Investment Funds Journal, 2016 (Volume 4, Number 3), published by Lexxion Publisher Berlin/Brussels www.lexxion.eu/estif.

Key messages

- The financial implications of Brexit will vary across the UK regions. As a net beneficiary of the EU and allocated €3 billion euros during the 2014-2020 programming period, the loss of ESI funds will be significant for Wales.
- The biggest vulnerability in relation to ESIF financial allocations and their potential loss to Wales relates to the *timing and content of Article 50 withdrawal negotiations.* The negotiation of an end date for programme eligibility and the extent to which the established regulatory procedures around N+3 and programme closure will be applied will be crucial.
- The level and timing of commitments to projects and expenditure on the ground is increasingly vital in ensuring Wales benefits as fully as possible from the funding envelope allocated, especially in light of the recent HMT funding guarantee.
- Uncertainties exist around budget availability for EU reimbursements following Brexit and the conditional nature of the HMT guarantee. It is unclear whether WEFO will make use of flexibilities around programme modification and project reprofiling to manage risk.
- Programme closure in the context of Brexit is additionally complicated by audit requirements that continue beyond the end of the programming period and hence EU membership.
- Legal requirements under ESIF regulations suggest that, *within the context of programme implementation*, the UK will still be subject to all relevant aspects of EU law for a period of at least three years following withdrawal from the EU.
- In terms of designating a future UK spatial policy, the debate can only be informed through the clear identification of the most successful targeting of localities, delivery models, funding priorities and types of initiatives to date – in the context of wider socio-economic policy and political developments. Some general observations are included.

Background

Under the Treaties the EU should aim at reducing regional economic disparities and strengthening economic, social and territorial cohesion. This should be achieved through the ESI funds, which are allocated for a 7-year period under the Multi-Annual Financial Framework – the current programming period being 2014-2020.[3] Funding is designated at NUTS 2 level according to an EU common system of classification and GDP per capita in relation to the EU-28 average.[4] Since 2000, following a review and the modification of NUTS 2 boundaries, the Welsh regional designations have corresponded to the West Wales and the Valleys[5] / East Wales subdivision. The former has throughout this period been designated a 'less developed' (or Convergence/Objective 1) region, and the latter a 'more developed' (or Competitiveness/Objective 2) region.[6] The level of resources and types of activity funded reflect the different designations of the two Welsh regions.

Following the in/out referendum on EU membership on 23rd June 2016 and the vote to leave, the UK Government has stated its intention to trigger Article 50 of the TEU in March 2017. This would commence a two-year countdown period at the end of which the UK would automatically cease to be an EU member.[7] A March 2019 withdrawal from the EU has obvious implications for ESI funding allocated annually to UK regions until the end of 2020 and eligible for expenditure under EU regulations for a subsequent 3-year period.[8] The biggest vulnerability in relation to ESIF financial allocations and their potential loss to Wales relates to the *timing and content of Article 50 withdrawal negotiations.*

Financial implications

[3] http://ec.europa.eu/budget/mff/introduction/index_en.cfm#spendingplan

[4] Regulation (EC) No 1059/2003 of the European Parliament and of the Council of 26 May 2003 on the establishment of a common classification of territorial units for statistics (NUTS) amended by Commission Regulation (EC) No 105/2007. The NUTS classification is hierarchical; it subdivides the economic territory of the Member States into territorial units. NUTS level 1 territorial units (Wales) are subdivided into NUTS level 2 and subsequently into NUTS level 3 territorial units (local authority areas).

[5] West Wales and the Valleys incorporates Anglesey, Blaenau Gwent, Bridgend, Caerphilly, Carmarthenshire, Ceredigion, Conwy, Denbighshire, Gwynedd, Merthyr, Neath Port Talbot, Pembrokeshire Rhondda Cynon Taf, Swansea and Torfaen.

[6] East Wales incorporates the local authorities of Cardiff, Flintshire, Monmouthshire, Newport, Powys, Vale of Glamorgan and Wrexham.

[7] Unless either a withdrawal agreement sets a different date, or there is a unanimous decision of the 28 Member States to extend that time limit.

[8] Under the N+3 rule any part of the budgetary commitment that has not been defrayed and included in a payment claim to the Commission is automatically decommitted by the end of the third year following that of the budgetary commitment (n+3).

At UK level, the end of EU regional policy is likely to have minimal effect financially: the UK is a net contributor to the EU budget and the amount received under ESIF is small in relation to GDP – for example the ERDF and ESF combined equal less than 0.1% of UK GDP.[9] However, EU receipts vary considerably across the UK and the financial implications would be territorially diverse: West Wales and the Valleys and Cornwall, the two UK regions categorized as 'less developed', are both net beneficiaries.[10] Over the 2014-2020 programming period the Welsh Government expects to receive more than 3 billion euros across the 4 ESI funds and two programme areas.[11] Whilst this represents only 0.4% of Welsh GDP, the amounts are significant in the wider UK regional/regeneration funding context.

It can be assumed that an end to UK contributions to the EU budget would coincide with the withdrawal of ESIF allocations to the UK. With Brexit, access to the full range of ESIF funding as well as the Connecting Europe Facility and the European Fund for Strategic Investments will be lost. The impact on financing from bodies such as the European Investment Bank has yet to be determined. Continued Welsh participation in EU Cohesion Policy could only be envisaged under the European Territorial Cooperation programmes where bordering non-Member States (and their regional/local governments) are able to participate. However, Wales would have to fund such activity from its own budget as participation by non-members is reliant upon their contribution of equivalent funding.[12]

Brexit in line with the timetable proposed by the Prime Minister will also result in a shortened programming period and early closure. *The negotiation of an end date for programme eligibility and the extent to which the established regulatory procedures around N+3 and programme closure will be applied to the departing UK will be crucial.* This will determine the exact amount of EU allocation likely to be forfeit at programme level but will also have significant impact on programming processes on the ground.

[9] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/355455/BIS_14_981__Review_of_the_Balance_of_Competences_between_the_United_Kingdom_and_the_European_Union.pdf
[10] Open Europe (2012) Off Target, The Case for Bringing Regional Policy Back Home, http://archive.openeurope.org.uk/Content/Documents/Pdfs/2012EUstructuralfunds.pdf
[11] Cornwall's allocation is considerably lower at 600 million euros.
[12] For example, the North Sea Region Programme and Northern Periphery and Arctic Programme include Norway and Iceland; the North West Europe programme includes Switzerland. Non-Member States participate under programmes such as INTERREG, INTERACT, and URBACT.

Wales could stand to lose (2019 and 2020) ESI funding allocations equating to more than 850m euros.

In determining this final date of eligibility it should be noted that expenditure in the EU budget must, in line with Treaty requirements, be in balance, whilst the ESIF regulations only require the European Commission to reimburse expenditure 'subject to available funding'.[13] Following UK withdrawal and the cessation of UK contributions, there is therefore some question as to whether the EU will be able to pay against commitments from the year in question *as well as* those from preceding financial years. A reduction in the EU's revenue could arguably oblige the UK, as part of the Brexit negotiations, to either continue contributing to the EU budget beyond its departure or else accept a reduction in future payment appropriations.

Programming implications

Recent announcements by Her Majesty's Treasury (HMT) have guaranteed funding for all ESIF projects signed before the UK leaves the EU.[14] In this context, *the level and timing of commitments to projects and expenditure on the ground is increasingly vital in ensuring Wales benefits as fully as possible from the funding envelope allocated.* The 2014-2020 Welsh programmes were launched late - towards the end of 2014 in the case of ERDF and ESF, mid-2015 for EAFRD and February 2016 for EMFF. Commitment levels however are relatively healthy, standing at more than £1 billion for the first 3 funds – 39% of ERDF was reported committed to operations at the last Programme Monitoring Committee, and 46% of ESF. Levels of spend (EU funds only) remain low at £115 million, well below 10% of allocations. Figures included use an exchange rate of £1:€1.25, which with current exchange rate movements could prove rather unrealistic. The drop in sterling since the EU referendum has as a consequence an increase in value of the programmes, and related match-funding requirements, which are denominated in euros.

Nevertheless, these figures disguise variations across the different priority axes that could be particularly relevant in the context of Brexit and an early programme closure. West

[13] TFEU Article 310.1; Common Provision Regulation Articles 77.1 and 135.5

[14] https://www.gov.uk/government/news/further-certainty-on-eu-funding-for-hundreds-of-british-projects; https://www.gov.uk/government/news/chancellor-philip-hammond-guarantees-eu-funding-beyond-date-uk-leaves-the-eu

Wales and the Valleys ERDF Priority 4 Connectivity and Urban Development, for example, foresees large capital infrastructure projects which will require a lengthy development and notification process to the European Commission, not allowing for possible construction delays. Figures provided at the last Programme Monitoring Committee show only 17% of the ERDF allocation committed.[15] *In the context of an as-yet undetermined final eligibility date, programme modification in favour of less risky revenue-based priorities and activities that can be quickly turned off would arguably be a less risky programming option.* A modification of the programmes or reprogramming would be subject to Commission approval. No information is available externally regarding the delivery timetables of approved projects – an element looking increasingly significant in the context of a shorter implementation period. WEFO have, to date, not publicly offered projects the possibility of 'reprofiling'.

Funding to date has, in line with the 'economic prioritisation framework' established by Welsh Government gone for the most part to 'backbone projects'. These are dominated by Welsh Government and Higher Education organisations (roughly 65%) and include a number of 'repeat' projects building on the back of previous funding. Organisations who were not included in the framework and hence have not been prioritised for funding look increasingly likely to miss out in a shortened programming period. In terms of short term scenarios, the HMT guarantee to substitute domestic funds for projects signed before the UK's formal exit could lead to a deliberate acceleration of programming which would need to be balanced against ensuring due diligence. Conversely, projects currently in the pipeline are, as time progresses, more likely to be reduced in size, scope and funding. It must additionally be taken into consideration that the HMT guarantee is conditional – it refers to project funding being honoured if it demonstrates *good value for money* and alignment with '*domestic strategic priorities'*.[16] No further clarification on these terms is provided yet this seems to allow for HMT, a new UK Government or Government Minister to take a different view to Welsh Government on projects approved in Wales. Financial

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[15] http://gov.wales/funding/eu-funds/2014-2020/programme-monitoring-committee/?lang=en
[16] https://www.gov.uk/government/news/further-certainty-on-eu-funding-for-hundreds-of-british-projects

guarantees from the UK government could be subject to political whims and events in a highly uncertain context.

An additional consideration must be the current regulatory requirement that all projects not 'in use' or 'functioning' at the point of the submission of closure documents will not be eligible for reimbursement from the EU. In the case of this eventuality, past/previous expenditure for project delivery would have to be removed from payment requests as ineligible for reimbursement from the EU. The *total* costs would seemingly need to be met under the HMT guarantee, alongside those incurred subsequent to UK withdrawal.[17] Whilst 'phasing' projects across different programming periods or extending the deadline for 'non-functioning projects' is currently possible, a formal request from a departing Member State seems unlikely to be either requested or agreed.[18] Programme closure in the context of EU withdrawal is additionally complicated by audit requirements that continue beyond the end of the programme – document retention, revenue generation, use of resources paid back to financial instruments, durability, publicity, and obligations to pursue recoveries of misappropriated EU funds for example.

Legal implications

The ESIF regulations currently have direct application whilst the UK is a member of the EU; upon exit they will need to be transferred into UK law. The proposed 'Great Repeal Act' will repeal the European Communities Act 1972 but freeze all EU law into UK law, maintaining it in force pending a later decision whether to amend or repeal them.

Legal requirements under ESIF regulations suggest that, within the context of programme implementation, the UK will still be subject to all relevant aspects of EU law for a period of at least three years following withdrawal from the EU. ESIF programmes and projects must demonstrate compliance with 'all applicable Union law'[19] whilst 'all the Commission's

[17] However, in line with Article 120.6 CPR national public funding cannot exceed more 80% of eligible public expenditure under an individual priority axis.
[18] These provisions do not apply across the full range of projects: productive investments, projects under 5 million euros and those that cannot be divided into clearly identifiable stages are excluded.
[19] in line with Article 6 of Regulation 1303/2013 (Common Provisions Regulation - CPR)

and Member States' rights and obligations remain valid in respect of assistance to operations' throughout programme closure.[20]

This raises interesting questions if the UK moves to a looser relationship with the EU such as that of a member of the European Economic Area (EEA) where not all EU Directives are applicable. Directives on nature protection (Habitats and Birds Directives), and some on water protection (bathing water, shellfish waters, surface fresh waters and fish waters Directives) could legally be removed by the UK Government or one of the Devolved Administrations yet compliance still be required within the ESIF framework.

Likewise, should freedom of movement principles be revoked or EU migrants have their status significantly modified in the immediate post-Brexit period, ongoing ESIF projects may be hindered in their ability to ensure the 'promotion of equality and non-discrimination' in the operation of the funds.[21] Unless EU nationals are able to participate equally with UK citizens in ESF-funded training courses, for example, a project could be deemed to be in breach of its contractual and legal obligations.

Compliance with the principles of state aid and public procurement will also be complicated by a change in the UK's status. Whilst continued access to the Single Market would mean these legal frameworks would remain in place, a more significant modification of the UK-EU relationship could result in different legal frameworks being applicable to projects depending on the source of their funding. ESI funded projects would arguably be required to follow EU legal provisions with projects funded from other sources subject to alternative legal frameworks such as WTO.

The requirement for 'effective application of Union law' in the areas of environment, gender, state aid and public procurement compliance are now an ex-ante conditionality or pre-requisite of programming across ESIF. On that basis, it is questionable whether any modification could be made to these areas of law whilst the programmes were still operating without potentially risking financial and legal repercussions.

[20] C(2013) 1573
[21] Article 7 CPR

Policy implications

Regional disparities in economic performance in the UK are now greater than those found in any other European country[22] and the UK has very little constitutional or policy commitment to the reduction of economic disparities or policy levers to respond to regional economic shocks. EU Cohesion Policy has seemingly provided the most coherent territorial approach in the 90 years of spatial policy within the UK and provides an important role in framing economic development.[23] Following Brexit, a number of scenarios could fill the 'policy vacuum'.[24] Whilst the Welsh Assembly and Ministers have a range of devolved powers to promote economic development[25] and could develop a Welsh regional policy, it seems unlikely based on financial resources and geographical scale. The UK Parliament retains the right to legislate in this area and could develop a UK-level territorial policy. In fact, the UK Government's position for a number of years has been to 're-nationalise' the policy with richer Member States funding their own policy to reduce regional disparities.[26] How should regions be designated in a future UK spatial policy and what should be the focus of the policy and eligible activities? The debate can only be informed through the clear identification of the most successful targeting of localities, delivery models, funding priorities and types of initiatives to date – in the context of wider socio-economic policy and political developments. This section offers some preliminary observations upon which further analysis could be based.

Firstly, in terms of overall performance the Welsh programmes have not proved 'transformational'. As Objective 1, Convergence and then a 'less-developed' region in the 2000-2006, 2007-2013 and 2014-2020 programming periods respectively West Wales and the Valleys had the highest levels of funding receipts. Nevertheless, GDP per head relative to the EU27 fell by 6.3 percentage points in the region between 2004 and 2010. In East Wales over the same period the decline was 17.7 percentage points. [27] Whilst it

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[22] http://www.regionalstudies.org/uploads/documents/SRTUKE_v16_PRINT.pdf
[23] http://www.eprc.strath.ac.uk/news/20160620_Brexit_blog_post.pdf
[24] http://ukandeu.ac.uk/what-a-difference-a-decade-can-make-cohesion-policy-and-brexit/; http://sites.cardiff.ac.uk/wgc/files/2016/07/COHESION.pdf;
[25] See variously Governance of Wales Act 2006, Schedule 7; Welsh Development Agency Act 1975.
[26] Hunt, J, Minto, R and Woolford, J, 2016, Winners and Losers: the EU Referendum Vote and its Consequences for Wales, Journal of Contemporary European Research *(forthcoming)*
[27] The UK overall registered a decline of 12.2 percentage points

cannot be forgotten that the programmes operate in a broader socio-economic context and this period has coincided with one of financial crisis and austerity, higher funding levels in Wales have not led to greater performance or results against key economic indicators such as jobs created and new businesses[28]. In Wales, projects funded under the ERDF are estimated to have created 36,640 new jobs and 11,900 new businesses in the 2007-13 period. The equivalent figures for Scotland are 44,311 and 17,474 respectively despite a funding package of only 36% of the Welsh one.[29]

Secondly, in terms of types of interventions, it is notable that at EU level, and specifically amongst older Member States, regional policy has moved increasingly away from old-style infrastructure interventions and been re-orientated towards the knowledge economy. Academic research has consistently concluded that the choice of intervention is strongly correlated with the impact of the funding, with people-focused interventions having a greater impact than place-based infrastructure investment.[30] The OECD identifies human capital, and specifically reducing the reducing the proportion of people in a region with very low skills as the most important factor in supporting regional growth.[31] Nevertheless, more than 29% of funding under the West Wales and the Valleys ERDF Convergence programme for 2007-2013 was allocated to transport and telephone infrastructure. Equivalent allocations from other UK regions are considerably lower, although it is likely a final quantification exercise will be undertaken on the basis of actual expenditure. The funding of 'repeat' projects also leads to questions around the 'transformational' effect, additionality[32] and 'added value'[33] of programme interventions.

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https://www.gov.uk/government/consultations/review-of-uk-and-eu-balance-of-competences-call-for-evidence-on-cohesion-policy

[28] http://speri.dept.shef.ac.uk/wp-content/uploads/2016/05/Brief24-UK-regions-and-European-structural-and-investment-funds.pdf

[29] The combined ERDF and ESF allocation to Scotland for 2007-2013 was 820 million euros compared to 2218 million euros for Wales .http://speri.dept.shef.ac.uk/wp-content/uploads/2016/05/Brief24-UK-regions-and-European-structural-and-investment-funds.pdf; http://www.gov.scot/Topics/Education/skills-strategy/progress/sg/economicimprovement/EuropeanStructuralFunds

[30] https://www.chathamhouse.org/sites/files/chathamhouse/public/Research/International%20Economics/1212bp_becker.pdf

[31] http://www.oecd.org/regional/regional-policy/promoting-growth-in-all-regions-9789264174634-en.htm

[32] Article 95.2 CPR states: Support from the Funds for the Investment for growth and jobs goal shall not replace public or equivalent structural expenditure by a Member State.

[33] "European added value is the value resulting from an EU intervention which is additional to the value that would have been otherwise created by Member State action alone"

Academic research additionally highlights the impact of quality of government on delivery of the EU regional funds including wider territorial governance. One of the most recent policy reforms allowed for the use of territorial bottom-up instruments such as Community-Led Local Development (CLLD), which looks to boost the impact of EU funding at the local level through cooperation, engagement and cross-fund integration.[34] Despite a general policy trend towards local ownership, the Welsh programmes have arguably become increasingly centralized at the regional level since devolution. New territorial models for delivery were not incorporated into the 2014-2020 programmes despite their coverage of areas with some of the sparsest population densities in the UK and Europe. The potential benefits of these approaches could be considered in designing a more effective and popular regional policy for Wales post-Brexit.

There are other idiosyncrasies of the policy that are relevant: the Welsh regions designated under Cohesion policy are economically incoherent and utilised solely for the purpose of the policy. Moves to recognize or incorporate more functionally relevant areas such as the Cardiff city-region in the 2014-2020 period may lead to more territorially appropriate responses and interventions under the programmes and could inform any future policy development. A new economic development policy would also enable a focus upon the parts of Wales that were camouflaged within the NUTS 2 regional categorisations. The performance of the Powys economy has been more akin to that of a 'Less Developed Region' with a (falling) GDP per capita of 63% of the EU 27 average[35] in 2013, well below the East Wales average figure of 97%.

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http://ec.europa.eu/budget/library/biblio/documents/fin_fwk1420/working_paper_added_value_EU_budget_SEC-867_en.pdf

[34] https://webgate.ec.europa.eu/fpfis/cms/farnet/et/implementing-clld-across-esi-funds-edinburgh-uk-8-10-december-2015

[35] Not including Croatia who joined in July 2013.

Mark Drakeford AM/AC
Ysgrifennydd y Cabinet dros Gyllid a Llywodraeth Leol
Cabinet Secretary for Finance and Local Government

Llywodraeth Cymru
Welsh Government

Eich cyf/Your ref MA/P/MD/0550/17
Ein cyf/Our

David Rees AM
Chair of External Affairs
and Additional Legislation Committee
National Assembly for Wales
Cardiff Bay
CF99 1NA

22 February 2017

Dear David,

I am writing in response to the request made at the External Affairs and Additional Legislation Committee meeting I attended on 23 January for further information on the commitment of EU funds.

I agreed to provide a breakdown of EU funding investments made to date across the current EU programmes managed by the Welsh Government.

The details are as follows:

Structural Funds 2014-2020: Commitment by Programme

£ Millions

Programme	Allocation		Committed		Share of allocation	
	Total	EU Grant	Total	EU Grant	Total	EU Grant
West Wales and the Valleys ERDF	1,562	1,029	1,126	603	72%	59%
East Wales ERDF	348	174	234	107	67%	62%
West Wales and the Valleys ESF	922	686	802	514	87%	75%
East Wales ESF	353	174	337	99	95%	57%
Total	**3,184**	**2,062**	**2,500**	**1,324**	**78%**	**64%**

Source: WEFO, 15/01/2017

[1] Based on a conversion rate of £1:€1.17

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Ireland Wales programme 2014–2020

The Ireland Wales programme is also progressing well. As of end of January 2017, we have invested €40 million of EU funds, representing 50.4% of the total EU funding allocation.

Rural Development Programme 2014–2020

Finally, under the Rural Development Programme, £394 million of EU funds has been invested in schemes worth over £547 million (57% of the programme).

Future funding

I would also like to take this opportunity to clarify a point I made to the Committee regarding a guarantee of future funding from the UK Treasury beyond 2020 to meet Wales' economic needs. I noted at the meeting that even if Wales had not qualified for the next round of Structural Funds, by the UK being part of the EU, Wales would have been eligible for transitional funding. I suggested that, in the current round, that would have produced 70% of the previous round's allocation.

To put this into context, although negotiations are not yet fully underway to determine the policy and distribution of EU Cohesion Funding post 2020, should GDP per capita be again used as the main qualification criteria, it is highly likely that West Wales and the Valleys would again qualify for the highest level of Structural Funds and Assisted Area coverage rather than any transitional funding. This is due to the UK as a whole growing slower than poorer EU Member States and its relative position declining as a consequence. In addition, East Wales would probably have continued to receive funding, which although at a lower level, could still bring the total for Wales to around existing levels.

At the very least, the West Wales and the Valleys region would have qualified for Structural Fund support as a 'transitional region' which under 2014–2020 programme regulations attracts some 60% of the funding available to less developed regions. Combined with a similar East Wales allocation to that under the current programming period, this would see Wales attract some 67% of its current allocation.

However, EU funding allocations are made to Member States and in the UK are subject to further discussions with UK Government before final allocations are made to devolved administrations. Since 2007 this has resulted in all nations of the UK having the same proportional allocation of overall funding to the UK and maintaining this would be a reasonable expectation for post-2020 given broadly similar needs existing.

In summary, therefore, Wales could reasonably expect to receive between 67% and 100% of its current Structural Funds allocation post 2020 and probably more towards the higher end of this range. I hope this explanation is helpful to the Committee in carrying out its further work on the future of Regional Policy.

Best wishes,

Mark

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