Agenda - Finance Committee

Meeting Venue:	For further information contact:
Committee Room 3 - The Senedd	**Bethan Davies**
Meeting date: 21 June 2018	Committee Clerk
Meeting time: 09.30	0300 200 6372
	SeneddFinance@assembly.wales

1 Introductions, apologies, substitutions and declarations of interest

(09.30)

2 Paper(s) to note

(09.30) (Pages 1 - 4)

3 Inquiry into preparations for replacing EU funding for Wales: Evidence session 4 (Bevan Foundation)

(09.30-10.15) (Pages 5 - 23)

Victoria Winckler, Director of the Bevan Foundation

Paper 1 - Written evidence: Bevan Foundation

4 Inquiry into preparations for replacing EU funding for Wales: Evidence session 5 (Chartered Institute of Public Finance and Accountancy)

(10.15-11.00) (Pages 24 - 33)

Alan Bermingham, Chartered Institute of Public Finance and Accountancy

Paper 2 - Written evidence: Chartered Institute of Public Finance and Accountancy

5 Inquiry into preparations for replacing EU funding for Wales: Evidence session 6

(11.00-11.45) (Pages 34 - 54)

Cynulliad Cenedlaethol Cymru
National Assembly for Wales

Professor Steve Fothergill, Sheffield Hallam University

Professor David Bell, University of Stirling

Professor Terry Marsden, Cardiff University

Paper 3 – Written evidence: Professor Steve Fothergill

Paper 4 – Written evidence: Professor David Bell

6 Motion under Standing Order 17.42 to resolve to exclude the public from the remainder of the meeting

(11.45)

7 Inquiry into preparations for replacing EU funding for Wales: Consideration of evidence

(11.45–12.00)

8 Approach to scrutiny of the Welsh Government's Draft Budget 2019–20

(12.00–12.30) (Pages 55 – 66)

Paper 5 – Approach to scrutiny of the Welsh Government's Draft Budget 2019–20

Concise Minutes - Finance Committee

Meeting Venue:

Committee Room 2 - The Senedd

Meeting date: Wednesday, 13 June 2018

Meeting time: 09.01 - 11.46

This meeting can be viewed on [Senedd TV](http://senedd.tv/en/4839) at:

http://senedd.tv/en/4839

Attendance

Category	Names
Assembly Members:	Simon Thomas AM (Chair) Neil Hamilton AM Mike Hedges AM Jane Hutt AM Nick Ramsay AM David Rees AM
Witnesses:	Huw Irranca-Davies AM, Minister for Children, Older People and Social Care Owain Lloyd, Welsh Government Faye Gracey, Welsh Government Julie Morgan AM Dr Grahame Guilford Sioned Evans, Welsh Government Dr Tim Peppin, Welsh Local Government Association Rob Stewart, Welsh Local Government Association
Committee Staff:	Bethan Davies (Clerk)

	Leanne Hatcher (Second Clerk) Georgina Owen (Deputy Clerk) Owen Holzinger (Researcher) Christian Tipples (Researcher) Gareth David Thomas (Researcher)

1 Introductions, apologies, substitutions and declarations of interest

1.1 The Chair welcomed Members to the meeting.

1.2 Apologies were received from Steffan Lewis AM.

2 Paper(s) to note

2.1 The papers were noted.

2.1 PTN1 - Letter from Secretary of State to Chair - Inquiry into the preparations for replacing EU funding for Wales - 21 May 2018

2.2 PTN2 - Letter from Cabinet Secretary for Finance and Local Government to the Chair - Celebrating 10 years of Fiscal Devolution - 24 May 2018

2.3 PTN3 - Letter from the Chair to the Cabinet Secretary for Finance - Celebrating 10 years of Fiscal Devolution - 25 May 2018

2.4 PTN4 - Letter from the Cabinet Secretary for Finance - Public Health (Minimum Price for Alcohol) (Wales) Bill: Fiscal Framework - 4 June 2018

2.5 PTN5 - Letter from the Cabinet Secretary for Finance - Implications for the 2019-2020 and 2020-2021 Budgets - 7 June 2018

3 Childcare Funding (Wales) Bill: Evidence session

3.1 The Committee took evidence from Huw Irranca-Davies AM, Minister for Children, Older People and Social Care; Owain Lloyd, Deputy Director, Childcare, Play and Early Years Division, Welsh Government; and Faye Gracey, Head of Policy Analysis, Welsh Government on the Childcare Funding (Wales) Bill.

4 Motion under Standing Order 17.42 to resolve to exclude the public from items 5, 9 and 10

4.1 The motion was agreed.

5 Childcare Funding (Wales) Bill: Consideration of evidence

5.1 The Committee considered the evidence received.

6 Inquiry into preparations for replacing EU funding for Wales: Evidence session 1 (Wales Programme Monitoring Committee)

6.1 The Committee took evidence from Julie Morgan AM, Chair of the Wales Programme Monitoring Committee; Dr Grahame Guilford, EU Funding Ambassador; and Sioned Evans, Chief Executive, Welsh European Funding Office on its inquiry into preparations for replacing EU funding for Wales.

7 Inquiry into preparations for replacing EU funding for Wales: Evidence session 2 (Welsh Local Government Association)

7.1 The Committee took evidence from Councillor Rob Stewart, Leader, Swansea Council and Welsh Local Government Association Deputy Leader and spokesperson on Economic Development, Europe and Energy; and Tim Peppin, Director of Regeneration and Sustainable Development, Welsh Local Government Association on its inquiry into preparations for replacing EU funding for Wales.

8 Inquiry into preparations for replacing EU funding for Wales: Evidence session 3 (Hywel Ceri Jones)

8.1 The Committee's evidence session with Dr Hywel Ceri Jones, Former EU Funding Ambassador was cancelled due to illness. Dr Hywel Ceri Jones instead submitted written evidence to inform the Committee's inquiry.

9 Inquiry into preparations for replacing EU funding for Wales: Consideration of evidence

9.1 The Committee considered the evidence received.

10 Inquiry on the Remuneration Board's Determination Underspend: Consideration of the Assembly Commission's response

10.1 The Committee noted the Assembly Commission's response and the outcome of the Remuneration Board's review of staffing support for Members.

National Assembly for Wales Finance Committee

Inquiry into preparations for replacing EU funding for Wales

Response by the Bevan Foundation

1. The Bevan Foundation develops solutions to some of Wales' most challenging problems. We are a registered charity and independent of government and any political party. We are grateful for the opportunity to contribute to this inquiry.

2. Our comments draw on work undertaken in partnership with the Welsh Local Government Association on regional policy after Brexit in 2017.[1] It is also informed by the experience of our Director, Victoria Winckler, who drafted numerous EU programmes including the former Objective 2 and Rechar programmes, was instrumental in securing Objective 1 status for West Wales and the Valleys and in the creation of an arms-length body to administer EU funds.

3. The Bevan Foundation is not involved in current EU programmes in any capacity.

Financial Planning

4. We are not engaged in or aware of any planning for replacing EU funding or in any scenarios created, but this is not to say that they are not underway. Given the importance of EU funding to several policy areas and the adjustment that may well be required it would appear to be sensible to make preparations, no matter how uncertain the situation.

Alternative administrative arrangements

5. The current arrangements for administering EU funds are the product of 30 years' sometimes bitter experience, and some principles that underpin the current approach should be retained:

   a. Administration should be independent, transparent and accountable, so that people and organisations have confidence that funds are allocated fairly, without favour. We would suggest that administration should be by an arms-length body, although not one necessarily that covers the whole of Wales.

   b. Prioritise the areas of greatest need: those areas with the greatest economic challenges should be the focus of greatest investment. This principle that secured EU funding in the first place should continue to apply and do so within Wales.

6. There are also important lessons to be learned from the current approach, as follows:

   a. **Link with regional policy:** successful use of regional development funding requires that there are clearly articulated economic plans. Many past EU funding programmes have had to operate in a policy vacuum, resulting in a patchwork of loosely-connected projects and sometimes duplication of effort. A clear blue-print

[1] After Brexit: Regional economic policy in Wales October 2017. Available at: https://www.bevanfoundation.org/publications/brexit-regional-economic-policy-wales/

for the appropriate parts of Wales, showing key investments by a range of partners, is therefore key.

b. **Allow for variation between areas:** different parts of Wales have different socio-economic needs and potential. A framework for rural mid-Wales should be very different to one for the Heads of the Valleys. An all-Wales approach, or even a four-regions approach, is not necessarily the most appropriate geographical scale for planning purposes.

c. **Timely decision-making**: the early days of almost all programmes were characterised by very considerable delays in decision-making. It is vital that there is a quick turn-around in decisions about future funding.

d. **Focus on long-term outcomes**: replacement funds should be focused on achieving tangible improvements in prosperity over the longer term, particularly for the least well-off people and places. This points to a focus on boosting productivity, low pay and job quality and increasing the skills and prospects of those with the fewest qualifications; and recognition of the importance of the foundational economy as well as high tech sectors.

7. Last, while it is outside the terms of reference of the Committee, a period of very significant economic adjustment is likely to occur in the years after Brexit, as industries adapt to changes in their markets, new competition, potentially new product requirements and possible changes in their workforce e.g. if zero net-migration is achieved. Any new administrative arrangements and forward planning will need to be both imaginative and highly responsive to new and potentially pressing circumstances.

Victoria Winckler

Bevan Foundation

17th May 2018

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

Document is Restricted

CIPFA The Chartered Institute of Public Finance & Accountancy

The National Assembly for Wales – Finance Committee

Inquiry into preparations for replacing EU funding for Wales

A Submission by:

The Chartered Institute of Public Finance and Accountancy

May 2018

the people in public finance

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. CIPFA shows the way in public finance globally, standing up for sound public financial management and good governance around the world as the leading commentator on managing and accounting for public money.

Further information about CIPFA can be obtained at www.cipfa.org

Any questions arising from this submission should be directed to:

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1. Executive Summary

1.1 Within this submission, CIPFA will assess the nature and quantum of EU funding relevant to Wales. We will consider the governance arrangements for this funding and discuss potential models of funding post brexit.

1.2 The current method of funding from the UK Government to the Welsh Government is through the provision of block grant adjusted via the Barnett Formula. CIPFA views this funding mechanism to be an inappropriate model for funding any EU competences repatriated post brexit.

1.3 Structural and Investment funds received from the EU into Wales amount to €3.1bn over the funding period 2014 to 2020. These EU funds leverage additional finance for projects and infrastructure, raising the total funds available to €4.7bn over this period. Reaching agreement between the Welsh and UK governments on structural and investment funding post brexit needs to take place quickly, in order to offset any uncertainty and mitigate delays in project planning and implementation due to future funding concerns.

1.4 CIPFA sees an opportunity to improve the co-ordination and governance arrangements for funding between the Welsh and UK Governments. The opportunity is for revised and strengthened governance arrangements and partnership agreements through the current Joint Ministerial Committee with the UK Devolved Governments.

1.5 The new arrangements on funding should be codified in the form of an agreement and should set out the arrangements and measures for funding alongside how disputes would be resolved. Further these agreements should allow for the appropriate scrutiny to take place in the respective parliaments and devolved assemblies.

1.6 Agriculture is a devolved matter for the Welsh Government and as such CIPFA supports the view that post brexit the Welsh Government should have flexibility to develop its own specific funding practices based on its objectives for the sector. Nationally there should be agreement on funding for agriculture support and distribution and within its scope should be a review of the current system of direct payments. This inclusion would be looking to improving the transparency, fairness and efficiency of the current system of payments.

1.7 Research funding should continue to remain at arms-length from government. CIPFA advocates that the existing national arrangements for research funding and funding councils, including the Welsh funding bodies, should be maintained with no diminution in funding levels post brexit.

1.8 It would be important for the Welsh Government to press for resolution on whether there will be access to EU research funding post brexit and; if not available a case should be made to ensure UK research bodies can continue to support research developments to at least the existing pre-brexit levels.

2. Nature of EU Funding in Wales

2.1 The primary sources of funding from the EU consist of Structural and Investment Funds and funding for Agriculture. Structural and Investment Funding for Wales over the period 2014 to 2020 can be summarised as follows:[1]

Funds (€m's)	**EU Funding**	**National Co-Financing**	**Total Funding**
European Agricultural Fund for Rural Development (EAFRD)	651	315	966
European Regional Development Fund (ERDF)	1,409	827	2,236
European Social Fund (ESF)	1,008	486	1,494
Total Funding	**3,068**	**1,628**	**4,696**

2.2 An important aspect of the funds received from the EU is the leverage that this funding brings in terms of raising additional national financing from both public and private sources. In relation to the ERDF and ESF, co-financing is split 70:30 between public and private sector sources respectively.[2] National co-financing adds 53% to the level of resources available from the EU into Wales over the funding framework period.

2.3 In August 2016[3] the UK Chancellor announced measures to ensure funding would be underwritten by the UK Government for projects agreed prior to the autumn statement 2016. This also applies to certain funds agreed post the autumn statement while the UK is still a member of the EU. This effective funding guarantee is valuable for projects underway or about to be agreed, however it leaves the position post 2020 unresolved.

2.4 Alongside the EU Structural and Investments funds, there are other areas of EU funding to consider. There is the replacement of the Common Agriculture Payments (CAP), were Wales is expected to receive €1.95 billion for Pillar 1 direct payments from the EU. This equates to an average of €279m per annum over the funding period 2014 to 2020.[4] The UK Government has also confirmed that current levels of funding are guaranteed until 2020. But again, beyond that the future is uncertain and

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[1] European Union, Structural and Investment Funds, EU Data Portal: https://cohesiondata.ec.europa.eu/countries/UK

[2] Welsh Government, Welsh European Funding Office - A Summary of the ERDF and ESF Structural Fund Programmes in Wales: January 2015

[3] HM Treasury and Department for Exiting the European Union: Further certainty on EU funding for hundreds of British projects announced by the Chancellor – October 2016 www.gov.uk

[4] National Assembly for Wales, Climate Change, Environment and Rural Affairs Committee - The future of land management in Wales: March 2017

represents a further issue to be addressed for Wales which has significant Agri-food and Farming sectors.

2.5 What is known is that Wales will receive approximately 8.8% of CAP pillar 1 payments allocated in the period 2014-2020, compared to its population share of 5.7%.[5] This means that if this funding were to be administered via the population share based Barnett formula going forward, this would result in a significant reduction in funding post 2020. Use of the Barnett Formula funding mechanism would also not recognise the different nature and support needs of some farmers in Wales compared to elsewhere in the UK.

2.6 Evidence given to the House of Lords[6] noted that 80% of Wales was an EU-designated Less Favoured Area which attracts increased funding. Therefore the risks for Welsh farmers are correspondingly greater than for English farmers. Further evidence also noted that 80% of Welsh farm income also came from EU funds, this in turn feeds through to spending in rural communities in Wales. The conclusion being that not continuing with this level of funding, including structural funds, could lead to a significant adverse impact on rural life in Wales.

2.7 Further to the above there is the question over future availability of access to financing from the European Investment Bank (EIB). Between 2014 and 2017 the EIB had signed finance contracts relating to projects in the UK totalling €23.6bn.[7] This funding included a number of projects in Wales including, the Swansea University campus optimisation project and infrastructure for Welsh Water.

2.8 Smaller funds available to Wales include the European Maritime and Fisheries Fund (EMFF). Projects approved under this fund in Wales totalled £1.5m of eligible expenditure.[8] Of this figure, over £1.0m was the contribution from the EU towards these costs.

2.9 Horizon 2020 is the EU's directly managed research and innovation programme with total funding of €80bn available over the funding period 2014 to 2020. Wales has successfully accessed this fund, with €83m of funding contributing to projects across the business and higher education sectors.[9] Accessing this funding helps to underpin development of Wales as a destination for investment and to support future employment growth.

2.10 This information tells us that EU funding should not just been seen as funds received from the EU but also what leverage those funds provide to bring

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[5] Figures obtained from Department for Environment, Food and Rural Affairs press release: UK CAP allocations announced, November 2013. https://www.gov.uk/government/news/uk-cap-allocations-announced

[6] House of Lords European Union Committee, 4th Report of Session 2017–19 – Brexit and Devolution: July 2017

[7] European Investment Bank – Finance Contracts Signed by Region: http://www.eib.org/projects/loan/regions/1?from=2014&to=2017

[8] EMFF approved projects in Wales as at December 2017. Published by the Welsh Government in January 2018.

[9] The Welsh Government, Regional Investment in Wales after Brexit – securing Wales future: 2017

in additional funding and support for projects. Further we can also see that the current mechanism for UK government funding to Wales through the Barnett arrangements is likely to be unsuitable in the post brexit environment.

2.11 With the date for the UK's exit from the EU at the end of March 2019 fast approaching, it is imperative that agreements are reached between the Welsh Government and UK Governments soon in order to offset any uncertainty in key sectors. Reaching agreement soon will also help to mitigate any delay in projects being planned coming through to implementation due to uncertainty on future funding streams.

3. Current Governance Arrangements in Wales for EU Funding

3.1 The Welsh Government provides a wide range of support and performance assessment for the two European Structural and Investment Funds (ESIFs) in Wales:[10]

- the European Regional Development Fund (ERDF), which aims to strengthen economic and social cohesion by correcting imbalances between regions and;
- the European Social Fund (ESF), which aims to help people improve their lives by learning new skills and finding better jobs.

3.2 In practice, this means the Welsh Government has a role in distribution of funds to lead partners who handle applications for funds and in turn distribute the funding between individual projects and organisations. Performance of programmes is monitored by the Programme Monitoring Committee of the Welsh Government (PMC).[11]

3.3 The PMC monitors programmes against specific milestones and targets, however the performance is measured in regards to its contribution to the strategic aims of the EU's growth strategy as set out in the Europe's 2020 strategy.[12]

3.4 The 2020 strategy sets out the EU's agenda for growth and jobs for the current decade. It is primarily concerned with addressing structural weaknesses in the European economy. The overall governance arrangements does raise questions for the post brexit environment.

- Firstly, would the objectives for any replacement funding streams change post brexit and;
- secondly, what post brexit funding streams should be managed in Wales alongside current or future devolved competences.

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[10] Welsh European Funding Office, https://gov.wales/funding/eu-funds/wefo-online/?lang=en
[11] Wales Programme Monitoring Committee - https://gov.wales/funding/eu-funds/2014-2020/programme-monitoring-committee/?lang=en
[12] Europe 2020 strategy

3.5 In many respects the post brexit governance environment calls for better coordination and cooperation between the UK and Welsh Governments. This is due to balancing the need for preservation and, where possible, increasing devolved competences to Wales with the need for coordination of UK wide frameworks for trade purposes.

3.6 The UK currently manages these funds with the EU through its partnership agreement in place with the EU. This agreements sets out the quantum of funds available as well as objectives and expected results for the funding streams. There is the opportunity to use revised and strengthened arrangements through the current Joint Ministerial Committee (JMC) to put in place agreements with the UK's devolved governments on new funding arrangements similar to the current UK and EU Partnership agreements.

3.7 CIPFA believes that in implementing any revised arrangements through the JMC there needs to be appropriate methods for scrutiny. The Welsh and the UK Government need to consider how appropriate supporting scrutiny can be put in place. This will ensure the respective parliaments and assemblies can review what would be non-legislative arrangements implemented through the JMC.

4. Development of new models of funding

4.1 For the purpose of our analysis, CIPFA has taken the approach of splitting the range of EU funding into three core areas. These are Structural and Investment Funding, Agriculture and Research. This section of our submission will look at options and models for managing these funding streams post brexit.

Structural and Investment Funding

4.2 CIPFA believes that brexit does provide an opportunity to renew the arrangements for structural and Investment funding that previously came from the EU to the UK. We support the view that the UK Government should put in place funds for investment in the UK based on recognised measures of need that support identified and agreed objectives for the funding.

4.3 As these funds would be UK wide, it is central to their operation that the Devolved Governments of Wales, Scotland and Northern Ireland are party to the agreement of the aims and objectives for the funds. We advocate that this can be achieved through a strengthened and renewed role for JMC.

4.4 Once aims and objectives for funding and appropriate measures of need are agreed for distribution of funds, the Structural and Investment funding should be administered regionally by the Welsh Government in support of its own well-being outcomes and national programme for government.

4.5 CIPFA would see a role for elements of this funding to be co-ordinated with the work of the Development Bank of Wales. This is in support of providing patient capital to assist in boosting local investment in support of economic growth measures.

4.6 The JMC should codify arrangements between the UK Government and the Devolved Governments of the UK in the form of an agreement. This agreement would set out the arrangements and measures for this funding alongside how any dispute resolution arrangements would work. The agreement would also be used to assist in appropriate scrutiny of arrangements and how funding is achieving its aims by the respective devolved parliaments and assemblies.

4.7 The nature of structural and investment funding demands that agreements made should provide for multi-year funding settlements. The will underpin and provide confidence over funding for longer-term structural investment in Wales.

Agriculture

4.8 While agriculture is a devolved matter the issue of agreeing a replacement mechanism post brexit for CAP payments is complex. From CIPFA's perspective CAP payments are received and distributed by the public sector, however the scheme benefits farmers and is not directly related to core provision of services or public financial management issues. With that in mind, CIPFA has restricted its comments to observations on concepts and ideas that should be considered for any post brexit funding model.

4.9 Our research indicates there is concern over whether or not the current system of Agricultural support payments through CAP is fit for purpose.[13] The process of brexit therefore provides the UK with an opportunity to reassess and radically rethink the system of agricultural support to where it is most needed and to support objectives in the areas of sustainability of farming, environmental concerns, innovation and efficiency as well as healthy consumption.[14]

4.10 The concepts and principles underpinning any new model of funding should include consideration of the following:

- There should be no erosion of the Welsh Governments devolved powers for Agriculture. In fact, depending in the nature of the future relationship with the EU and wider trade requirements, Wales should have flexibility to develop Welsh specific funding practices based on its own objectives for the sector.
- Nationally there should be agreement of a new policy for agriculture support. The scope of this policy revision should include the current system of area based direct farm payments,

[13] The Future of the CAP: An urgent need for a truly sustainable agriculture, land and food policy, European Environmental Bureau (EEB) – September 2017
[14] The Future of Farming: UK agricultural policy after brexit - A Policy Network Paper, January 2018

with a view to addressing concerns over its inefficiency and fairness.[15]

- Policy measures need to be developed that promote rural sustainability alongside environmental protection, farming innovation and efficiency, as well as protecting the biodiversity of our eco system. There should be clear links from these policy objectives to payments.

Research

4.11 Research funding in the UK can come from a wide range of sources.[16] These range from the public sector, also a large amount of funding for research comes from non-public organisations. These include charities, the European Commission and industrial and commercial organisations in the UK and overseas. This is mostly in the form of grants and contracts for specific research projects.

4.12 Public sector funding is co-ordinated in the UK through seven Research Councils, Innovate UK and Research England. Wales also has a number of funding bodies providing research funding supporting higher education in Wales and health and social care. The UK bodies are now under the umbrella of UK Research and Innovation which operates a combined budget of more than £6bn.[17]

4.13 In essence the UK infrastructure for funding research is in place across both public and private sectors. Evidence available would strongly suggest that research work is not like trade or finance.[18] High-quality research partnerships may be enabled by international agreement, but they are implemented via the willing and mutually beneficial agreement of principal investigators and their research groups.

4.14 With that in mind, CIPFA support the view that post brexit, research and innovation funding should continue to be kept at arm's length from government and that decisions about what to spend research funds on should be made by researchers rather than led by politicians.[19]

4.15 CIPFA would see a positive role for government in ensuring and facilitating international research collaboration, both outside the EU and with EU countries and institutions. This could include:

- Better information on the capabilities and research strengths of both UK-based researchers and research organisations and potential collaborators;

[15] Greenpeace (2016). Common Agricultural Policy: Rich List receive millions in EU subsidies. https://unearthed.greenpeace.org/2017/06/30/rich-list-billionaires-scoop-millions-farm-subsidy-payments/
[16] Examples can be sourced from the University of Cambridge Research Operations Office - https://www.research-operations.admin.cam.ac.uk/major-funders
[17] UK Research and Innovation - https://www.ukri.org/about-us/
[18] Universities UK: International research collaboration after the UK leaves the European Union, April 2017
[19] Maintaining what is known as the Haldane Principle currently in place in the UK.

- the need to better understand and mitigate cultural barriers to international research collaborations; and
- the importance of both policy and funding stability in nurturing effective research partnerships need to be recognised.

4.16 Maintaining or increasing the level of research funding is important in the context of economic growth post brexit. This includes supporting developments in health, education and other spheres underpinning the long-term wellbeing of society.

4.17 While the final deal on the future relationship with the EU post brexit is not concluded, it would be important for the Welsh Government to raise the question of access to EU research funding and collaboration post brexit in the deal. If access to funding is not available, there should be a case made to increase the funding to UK based research funding bodies to ensure no diminution of funding post brexit.

Agenda Item 5

REPLACING EU FUNDING IN WALES

Submission to the inquiry by the Welsh Assembly's Finance Committee

Prof Steve Fothergill
Centre for Regional Economic and Social Research
Sheffield Hallam University

Basis of this submission

I have been invited by the Committee to appear as a witness at its hearing on 21 June. The present note is intended to set out a number of strategic issues that it might be helpful for the Committee to pursue at this particular hearing and in the inquiry more generally.

As an academic, I have more than four decades' research experience on UK urban and regional development, including on many issues applying to Wales. On the EU Structural Funds, my engagement extends back to the late 1980s. I helped construct the RECHAR programme of EU aid to coalmining areas (which ran from 1990 to 2000) and I provided, I hope, an important input to the frameworks for EU funding to the UK in the 2000-6, 2007-13 and 2014-20 spending rounds.

However, as some Committee members may be aware I also occupy a second role as National Director of the Industrial Communities Alliance, the all-party association of local authorities in the industrial areas of England, Scotland and Wales. In this capacity I have been centrally involved in the development of proposals on *Post-Brexit Regional Policy* which have been widely circulated and debated. I am aware that my colleagues in ICA Wales – the Welsh wing of the Alliance – have submitted written evidence to the Committee's inquiry and that this draws on these proposals.

My purpose here, therefore, is not to repeat the proposals that the Committee will receive from ICA Wales, which I recommend are given close consideration, but rather to make a number of general observations, based on my experience and knowledge, to help inform the Committee's deliberations.

1. Importance of the EU funds

It would be fair to say that the EU Structural Funds are currently the principal arm of regional policy in the UK, including in Wales. By 'regional policy' I mean policies intended to promote growth and jobs in less prosperous local economies. Many other policies also impinge on regional and local economic development but the contribution of the EU Structural Funds is not only substantial – in the present 2014-20 spending round it is worth £1.3bn a year to the UK – but it is also strongly targeted at weaker local economies. All parts of the UK receive money from the EU Structural Funds but in the least prosperous local economies the per capita funding is many times higher than in the most prosperous parts of southern England.

Wales benefits substantially from the EU Structural Funds: in the present spending round it is set to receive a total of around £2.1bn (at the current exchange rate), which is approaching a quarter of all the funding coming to the UK. This large share is of course principally the result of the funding earmarked for West Wales & the Valleys (almost £1.8bn) as a result of its exceptionally low GDP statistics. Since EU regional policies were ramped up in the late 1980s, West Wales & the Valleys has received significantly more in funding than any other UK sub-region. By comparison, domestic UK spending on regional policy has declined over the years.

The point is that if the EU Structural Funds are not replaced – or if the replacement is inadequate – there would be a devastating blow to economic development efforts in Wales.

2. Measuring the impacts

Unfortunately, it is hard to pin down the precise impact of all this EU funding, which inevitably frustrates discussion of 'value for money' or 'cost per job'.

What is clear is that the EU co-finances a vast range of projects, in Wales and elsewhere in the UK, ranging from training and skills development to business support, R&D, infrastructure and environmental improvement. The projects vary greatly in size and in geographical coverage. It is reasonable to assume that in the absence of EU funding hardly any of the projects would have proceeded on the same scale if at all.

Measuring the resulting job creation is more problematic. Most EU-funded projects have to specify outputs such as the number of new jobs but simply adding up the totals – which is unfortunately what often happens – is profoundly misleading. In practice there can be double-counting, deadweight (where something would have happened anyway), displacement and exaggeration on the part of project sponsors.

The true measure of the impact of EU funding is the difference between what actually happened (e.g. in terms of output or employment) and what would have happened in the absence of the funding. Establishing the latter – what would have happened anyway – is an extremely difficult task because in all places and at all times so much else is happening simultaneously. In practice, therefore, it is impossible to put a robust figure on the economic impact of the EU Structural Funds.

What we can reasonably assume however, given the scale of the funding, is that the scale of the impact is large.

In the context of the Valleys, in particular, the continuing economic difficulties do not indicate that EU-funded interventions have failed. What needs to be kept in mind is that the entire economic base of many communities needed to be rebuilt following the disappearance of jobs in coal and steel and the closure of many of the factories that moved in during the immediate post-war years. Additionally, the Valleys have been handicapped by their difficult topography and their relatively peripheral location in relation to UK markets and the strategic transport network. The question we should ask, perhaps, is just how bad things would have been in the Valleys in the absence of support from the EU.

3. Challenges

The UK Government has promised to create a UK Shared Prosperity Fund to replace the EU Structural Funds. The promise was first set out in the Conservative manifesto for the 2017 general election and it was repeated in the *Industrial Strategy* White Paper published towards the end of last year. The manifesto said the new Fund is intended "to reduce inequalities between communities across our four nations" and that it "will be cheap to administer, low in bureaucracy and targeted where it is needed most".

This is a welcome commitment. However, at the present time there are no further details. This leaves major unresolved questions:

- *How much will the new Fund be worth?* To match the existing EU Structural Funds coming to the UK, and allowing for inflation, the new UK Shared Prosperity Fund would need to be worth £1.5bn a year. There is no commitment, as yet, to the scale of the new Fund. The danger is that a smaller, token fund could be established, allowing the Treasury to pocket the difference to reduce the budget deficit.

- *How will the Fund be divided up across the UK?* This obviously matters a great deal to Wales. Given the EU Structural Funds' strong skew to less prosperous economies, there are likely to be pressures from some parts of the UK – mainly southern England – to spread the funding more evenly.

- *What can the new Fund be spent on?* The EU Structural Funds have become too restrictive, leaving insufficient room to determine local priorities, so there is a good case for making a fresh start. But defining exactly what the new Fund can be spent on, and how this fits with other UK and Welsh spending streams, is something that will have to be decided.

- *How will the new Fund be managed?* As this will be a UK fund it is only reasonable to expect that the Westminster Government will set the broad objectives to be followed across the UK. The discretion available to Wales remains to be determined. Equally, the management of the new Fund within Wales, including the input of local authorities, will need to be determined.

4. Timescale and budgets

The Committee will be aware that as part of the 'divorce deal' agreed between the UK Government and the EU in December, the UK will continue to participate in the EU Structural Funds as normal up until the end of 2020 (the end of the current EU spending round) even though Brexit itself is likely to occur in March 2019. Following the principle that 'nothing is agreed until everything is agreed', the divorce deal will apply so long as the UK does not fall out of the EU without a wider final deal in place.

Assuming participation in the EU Structural Funds continues up to the end of 2020, this means that new financial commitments to EU-funded projects can be made up until 31 December 2020 and, in turn, EU-funded spending on those projects can continue until the end of 2023. This is, thankfully, a long lead-in time but it does not change the fundamental decisions that still have to be taken about the replacement for the EU funds. These decisions remain an exclusively domestic UK matter, it is worth stressing, not a matter for negotiation with Brussels.

In practice, the new UK Shared Prosperity Fund needs to be fully in place by the end of 2020 so that there is no damaging hiatus in funding. Beyond the end of 2020 it will not be possible to make new EU-funded commitments even though actual spending on EU-funded projects will continue for up to a further three years. The new Fund also needs to be set up on a multi-annual basis, like the EU funds it replaces, if it is to create certainty, foster stability and allow the proper planning of ambitious projects.

The Treasury does not need to find 'new money' to pay for the UK Shared Prosperity Fund. This is money that would have been handed over to Brussels and then returned as EU aid. In its supporting documentation for the Chancellor's 2018 *Spring Statement*, the Office for Budget Responsibility identifies more than £13bn a year that will eventually no longer be paid over to the EU, beginning with £3.0bn in 2020-21 and rising steeply thereafter as spending commitments tail off. Spending always lags well behind new commitments, so expenditure on new projects supported by the UK Shared Prosperity Fund would in any case take some while to build up. The point is that there is plenty of money available.

5. Wales' share of the new Fund

Given the large share of EU funding presently coming to Wales, the allocation of the Shared Prosperity Fund between different parts of the UK is obviously of particular interest. There are two important observations here.

First, if the new fund prioritises less prosperous areas, as promised in the Conservative manifesto, Wales should remain entitled to a substantially larger share than its share of UK population. However, this can only be delivered in practice if the new fund, like the EU funding it replaces, is managed outside the Barnett formula.

Second, a reliance on statistics alone seems unlikely to deliver a Welsh share quite as large as at present. Much depends on the choice of indicators of course. However, if GDP per head continues to be the key criteria the current statistics suggest that at least a couple of large English sub-regions will have a strong claim for enhanced funding because of deteriorating GDP figures, in effect reducing the share of the pot available for Wales. The Welsh Government may in the circumstances prefer to argue for the status quo in terms of the division between the four countries, leaving any redistribution within England to be settled separately.

6. The UK Government's position

I do not claim to have privileged insight into the current thinking of the Westminster Government but I do monitor developments with regard to the EU funds and have a dialogue with the civil servants charged with development of the new UK Shared Prosperity Fund. The Committee may wish to take note of the following observations.

First, it is clear that the funding and architecture of the UK Shared Prosperity Fund remain very much 'up for grabs'. There appears to be no retreat from the commitment made in the Conservative manifesto but, equally, UK ministers have not yet adopted a stance on any of the key downstream questions or, it would seem, yet provided a strong steer. A full-scale public consultation is still expected – as promised in the Conservative manifesto – but probably not until after this year's summer recess. The civil servants' expectation is that the consultation will begin to table proposals rather than simply call for suggestions.

Second, the sensitivity of the division of the Shared Prosperity Fund between the four constituent parts of the UK has certainly been noted. There is presently no decision or indeed proposal on this but there is an awareness that in the absence of compelling economic evidence to make a change the expedient way forward might be to maintain the status quo – i.e. the current division of the EU Structural Funds.

Third, there seems likely to be a significant steer from the UK Government as to how the Shared Prosperity Fund should be spent. For example, there is likely to be departmental resistance to the erosion of the present spending on skills and training (funded by the European Social Fund) which is seen as a key contributor in this field.

Concluding remarks

With so many key decisions regarding the new UK Shared Prosperity Fund still to be taken, the present inquiry is exceptionally timely. There is the opportunity via the work of the Committee and its influence on the emerging position of the Welsh Government to exert an important influence on the UK Government's proposals, to the benefit not only of Wales but also other parts of the UK.

Prof Steve Fothergill
May 2018

Preparations for Replacing EU funding for Wales:

Evidence for the Finance Committee of the National Assembly for Wales

David Bell,

Stirling Management School,

University of Stirling

June 2018

Introduction

As a result of the Brexit process, the Welsh Assembly will gain control over a number of competences from the European Union (EU). Funding to support these competences currently involves complex financial arrangements that are the outcome of decisions taken by the EU, the UK Government and the Welsh Assembly. In the future, new funding arrangements will have to be established to replace existing systems. The EU will no longer directly influence these arrangements, though it may have an indirect role through its interaction with issues such as trade and state aid. Repatriation of the competences provides an opportunity for their redesign, thus opening options to redirect funding to other priorities or to use the funding more efficiently or more equitably.

This paper focuses on how the transfer of these competencies will affect the funding relationships between the Welsh Assembly and UK Government. It is structured as follows: first it considers the scale of existing EU funding streams and their relative importance within public expenditure in Wales. Next it discusses the purposes of current EU funding and the way that funding is allocated to Wales. It also considers different models for the post-Brexit funding relationships between the Welsh Assembly and UK Government that relate to current EU competences. Finally, it discusses some other relevant issues, notably State Aid and the Common Agricultural Policy.

Costs of Funding the Competences

Table 1 shows the allocation of Structural and Investment Funds (SIF[1]) to Wales under the seven year 2014-20 EU Multiannual Financial Framework (MFF). It shows that Wales will receive just over €3 billion from the EU during this period. This amounts to 18.6% of total EU support to the UK through these channels. In particular, Wales is receiving more than 24% of UK ERDF payments and more than 21% of UK ESF payments. Given that the Welsh population comprises 4.7% of the current UK population, Wales clearly receives well above its population share of EU SIF support.

Table 1: 2014-2020 EU Structural and Investment Funds Allocations (€m)

Fund	**rUK**	**Wales**	**Total**	**Wales' Share**
European Agricultural Fund For Rural Development (EAFRD)	4544	652	5195	**12.5%**
European Maritime and Fisheries Fund (EMFF)	243		243	
European Regional Development Fund (ERDF)	4447	1409	5857	**24.1%**
European Social Fund (ESF)	3756	1008	4764	**21.2%**
Youth Employment Initiative YEI	412		412	
Total	**13402**	**3069**	**16471**	**18.6%**

Source: European Commission, Structural and Investment Funds Data

In addition, Wales was allocated €2.2 billion in Pillar One (Direct Payments) agricultural support from the Common Agricultural Policy in the 2014-20 EU MFF. This amounted to 9% of the UK total of €25.1 billion.[2] Again, this significantly exceeds its population share.

The total allocation by the EU to Wales for the period 2014-2020 amounted to €5.3 billion or around €760 million per annum, which at current exchange rates is worth £670 million per annum. The annual Welsh budget for 2018-19 was set at £15.5 billion of which £6.9 billion is to be spent on

[1] The SIF comprises the European Regional Development Fund (EARDF), the European Social Fund (ESF), the Cohesion Fund (CF), the European Agricultural Fund for Rural Development (EARDF), the European Maritime and Fisheries Fund (EMFF) and the Youth Employment Initiative (YEI).
[2] See: UK CAPD allocations announced

health. Hence, even though Wales receives well above its population share of EU funding, the annual value of this funding to the Welsh Assembly is only worth slightly less than 10% of its health budget.

EU SIF projects generally require match funding from governments or their agencies. Thus, the annual EU contribution understates the commitment of public sector resource to EU projects. The UK as a whole was allocated €16.42 billion of European Structural and Investment Funds (ESI) over the 2014-2020 period and has committed a further €10.87 billion to these schemes in match funding, enhancing the total budget available for schemes prioritised by the EU, implying a UK contribution rate of close to 40%. The match fund contributions required for projects in Wales are shown in Table 2. The total contribution over the seven-year period is €1.63 billion, or £205 million per annum at current exchange rates. This comprises 15.8% of total UK match fund contributions.

Table 2: National Match Funding Contributions to EU Programmes 2014-2020 (€m)

Fund	rUK	Wales	Total	Wales' share
EAFRD	1264.4	314.8	1579.3	**19.9%**
EMFF	66.9		66.9	**0.0%**
ERDF	3673.2	827.1	4500.3	**18.4%**
ESF	3507.9	486.2	3994.1	**12.2%**
YEI	187.8		187.8	**0.0%**
Total	**8700.2**	**1628.1**	**10328.3**	**15.8%**

Source: European Commission, Structural and Investment Funds Data

Thus although Wales receives a relatively high share of EU SIF payments, it also has to find a much larger than its population share of match fund payments. Match funding is not evenly distributed across programs within Wales. Table 3[3] below shows that contribution rates for projects in East Wales are substantially higher than those for rural development across Wales or for the much larger ERDF and ESF projects in West Wales and the Valleys. Thus, while the EU contribution to projects in West Wales and the Valleys is nearly 5 times greater than that in East Wales, the match funding requirement is only 2.2 times larger.

Table 3: Distribution of Match Funding by Area and Programme in Wales

Location	EU Contribution €m)	Match Funding €m)	Match fund share
East Wales	406.6	412.9	50.4%
Rural Development	651.6	314.8	32.6%
West Wales and the Valleys	2010.7	900.4	30.9%

Source: European Commission, Structural and Investment Funds Data

Brexit offers an opportunity to redesign and/or rescale the policies which attract this funding. The UK Government has made some proposals for redesign which we discuss in the next section. Clearly, the Welsh Assembly would prefer to see a continuation or perhaps extension of existing support levels. Ultimately, these are likely to be funded by the UK government and hence its decisions regarding the redesign of these policies are critical to support levels in Wales.

[3] See Appendix 1 for full details of these projects.

Future Arrangements Relating to EU Competences

1 European Structural and Investment Funds

The EU intends that the SIF funds should promote social cohesion, the specific objective of the individual funds include:

1. ERDF – "Promotes balanced development in the different regions of the EU."[4]
2. ESF - "Supports employment-related projects throughout Europe and invests in Europe's human capital – its workers, its young people and all those seeking a job."

Within these overall objectives, individual projects in the 2014-2020 MFF focus on more specific aims. These are listed in Table 4 along with the number of projects in Wales following within each category during the current budget round. Clearly these are priorities set at EU level, which may or may not align with UK Government or Welsh Assembly priorities. Post-Brexit, opportunities to influence such priorities will likely increase, though for the devolved authorities, this will depend on levels of intergovernmental cooperation, though recent experience suggests this has been somewhat variable.

Table 4: Categories of Projects Attracting EU Funding Support

Programme	Number of projects
Climate Change Adaptation & Risk Prevention	26
Competitiveness of SMEs	25
Educational & Vocational Training	32
Environment Protection & Resource Efficiency	30
Information & Communication Technologies	9
Low-Carbon Economy	28
Network Infrastructures in Transport and Energy	2
Research & Innovation	59
Social Inclusion	18
Sustainable & Quality Employment	24
Technical Assistance	23
Total	**276**

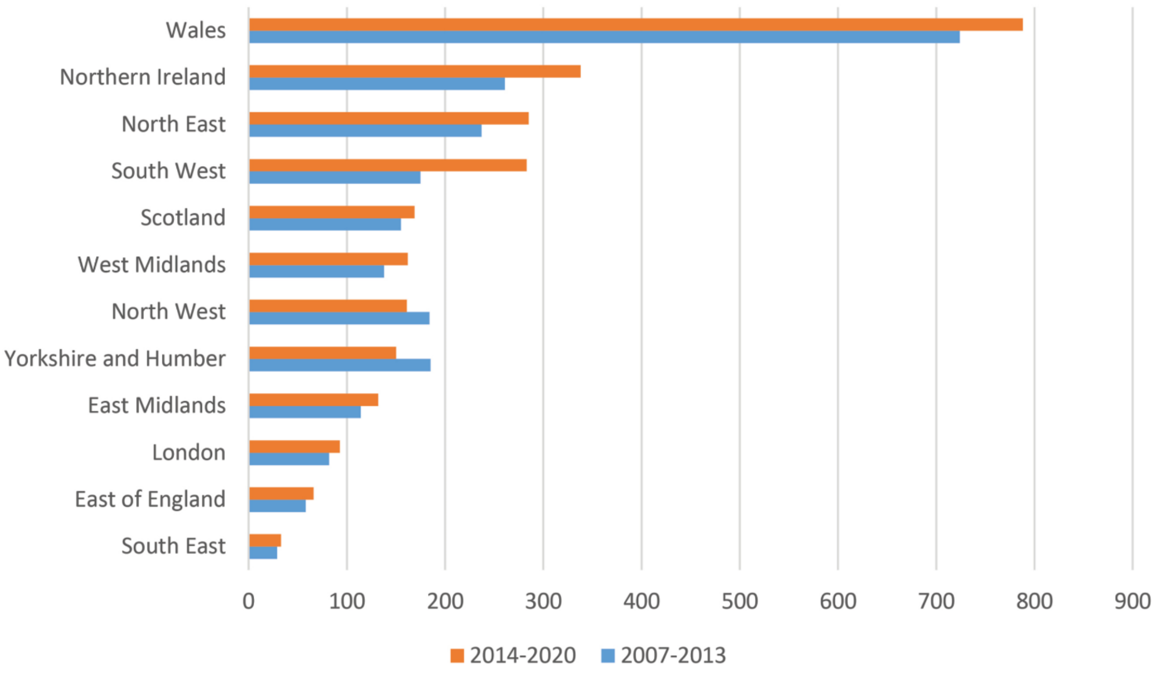
Allocation of the EU SIF funds is largely based on measures of relative need. In the 2014-2020 MFF, the main indicator of need was GDP per head. EU regions were divided into: *less developed regions* (GDP/head < 75% of EU-27 average); *transition regions* (GDP/head between >= 75% and < 90% of EU-27 average) and *more developed regions* (GDP/head >= 90% of EU-27 average). Less developed regions received the highest level of SIF funding, while more developed regions did not qualify. Member states were permitted to vire funding between regions under conditions set by the EU commission. This provision has benefited East Wales, whose GDP per head in 2010 was equal to the EU27 average. In contrast, GDP per head in West Wales and the Valleys was only 70% of the EU27 average, the lowest of any NUTS-2 area in the UK.

Wales has gained more than any other part of the UK from EU SIF funding. Figure 1 from Bell (2017) shows that Wales has been the principal beneficiary of such funding support in both the 2007-2013

[4] See: https://ec.europa.eu/info/funding-tenders/funding-opportunities/funding-programmes/overview-funding-programmes/european-structural-and-investment-funds_en

and the 2014-2020 EU budgets. Measured on a per capita basis, allocations to Wales have been more than double those to any other part of the UK.

Figure 1: Structural Fund Allocations Per Capita 2007-2020



Source: Bell (2017)

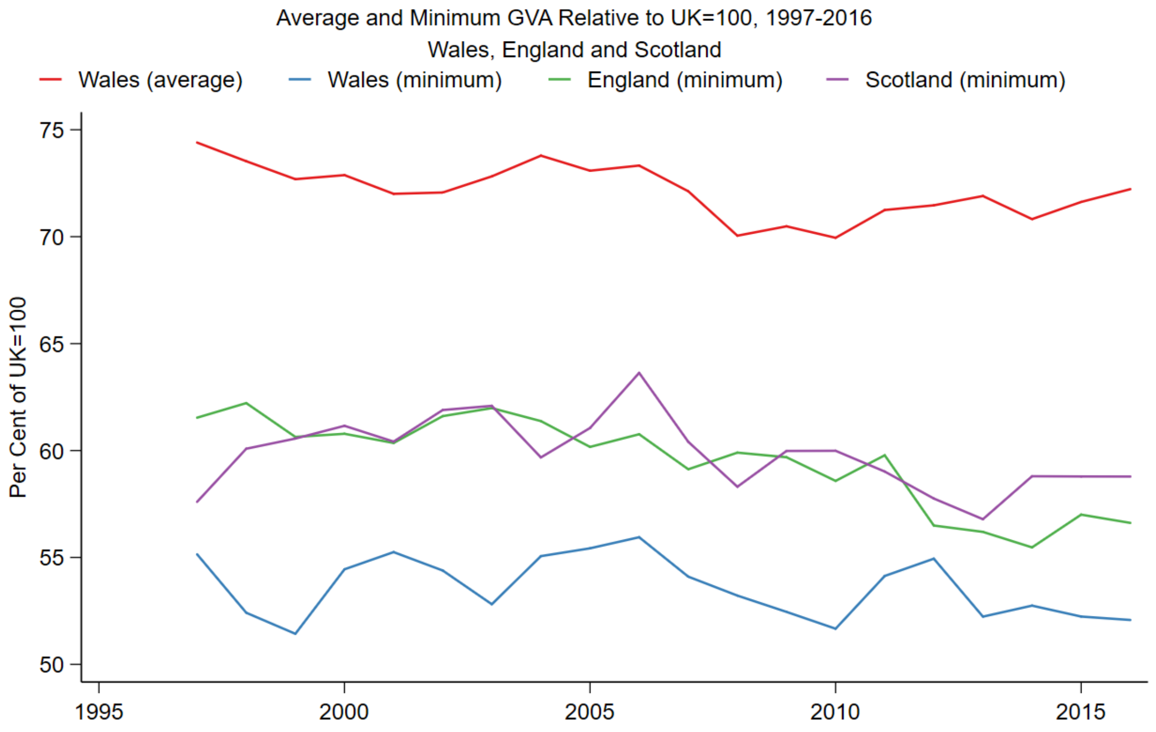
It follows that Wales will continue to benefit if the UK government puts in place policies that allocate support using similar criteria to current arrangements. The evidence that Wales would continue to qualify for support if funds were allocated using GDP per head, or a similar measure of need is compelling. Figure 2 shows the evolution of gross value added (GVA[5]) per head from 1997 to 2016 for different parts of the UK, using NUTS 3 areas. The NUTS 3 classification provides considerably finer detail than the NUTS 2 areas used by the EU to allocate the SIF.

All of the series in Figure 2 are shown relative to the UK as a whole, where the UK = 100. The plots show first, the *average* for all NUTS 3 regions in Wales and then the *minimum* value each period in all of the NUTS 3 regions in Wales, Scotland and England. Thus, while the average level of GVA for Wales as a whole was between 75 and 70 per cent of the UK average over the period, GVA per head in the *lowest* income NUTS 3 regions in Wales was consistently between only 50 and 55 per cent of the UK average. In the poorest parts of Wales, GVA is only around half of the UK average.

In contrast, GVA in the poorest parts of Scotland and England is higher, at around 60 per cent of the UK average. The worst outcome in Wales is consistently worse than that in either England or Scotland. In addition, the gap between the poorest parts of Wales and the UK average seems to have been increasing since 2008 (the same is true of the poorest parts of Scotland and England). Thus, there is no evidence of reductions in the gap between the poorest and richest parts of the UK between 1997 and 2016 – indeed the evidence points more to an increase in inequality.

[5] Gross Value Added (GVA) plus taxes on goods less subsidies on goods *equals* Gross Domestic Product (GDP)

Figure 2: Average and Minimum Gross Value Added Per Capita 1997-2016



Source: ONS

Models for the Post-Brexit Funding Relationships

Now consider policies that have been proposed to replace EU SIF funding and those UK policies that have a clear spatial dimension and are already in place. In terms of general principles, recent UK administrations have moved away from policies that are based on "need". They have also tended to avoid explicitly targeting regional inequalities, a sharp contrast, for example, with the regional policy of the 1970s. Instead, the UK Government has tended to provide support to particular areas on a competitive basis or because incidentally as a result of support for particular industrial sectors. We shall argue that it will be difficult to integrate a policy where eligibility is based on some indicator(s) of need with the existing suite of UK policies that have a regional, or spatial, dimension. The list of current and prospective policies that have spatial implications includes the following:

The UK Industrial Strategy

The UK industrial strategy has been given a pivotal role in enhancing UK productivity and economic growth. As well as focusing on innovation and research, it is expected to play a role in reducing regional disparities. However, the industrial strategy White Paper[6] refers only to regional disparities in education and skills, rather than more regional disparities more generally.

[6] See: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/664563/industrial-strategy-white-paper-web-ready-version.pdf

The industrial strategy's objectives for the UK economy are:

- ideas: the world's most innovative economy
- people: good jobs and greater earning power for all
- infrastructure: a major upgrade to the UK's infrastructure
- business environment: the best place to start and grow a business
- places: prosperous communities across the UK

It is only the last of these objectives which acknowledges the very different economic fortunes of communities in different parts of the UK and suggests that part of the focus of the industrial strategy should be on helping those areas and communities that have been "left behind" due to the effects of globalisation and technical change.

The industrial strategy also includes a number of "Grand Challenges". These relate to how the UK should respond to:

- artificial Intelligence and data
- the ageing society
- clean growth
- future of mobility

The Grand Challenges are likely to be funded on a competitive basis and, as yet, it is not clear how these might specifically benefit Wales. Competitive funding is likely to be awarded partly based on track record, implying that success will be associated with strong existing performance on innovation and research. This is unlikely to benefit the poorer parts of Wales, or indeed the poorer parts of the UK as a whole.

The Shared Prosperity Fund

The Conservative 2017 manifesto promised the introduction of a "Shared Prosperity Fund" after its commitment to meet existing structural fund obligations post-Brexit. The manifesto argued that it would "*use the structural fund money that comes back to the UK following Brexit to create a United Kingdom Shared Prosperity Fund, specifically designed to reduce inequalities between communities across our four nations. The money that is spent will help deliver sustainable, inclusive growth based on our modern industrial strategy*."[7] Further, the fund would be "cheap to administer, low in bureaucracy and targeted where it is needed most". Its commitment to reduce regional inequalities, which in the UK are greater than in any other EU member state, will partly be signalled by the amount of funding that the UK government makes available through the Shared Prosperity Fund. Lord Henley highlighted the link between the Shared Prosperity Fund (SPF) and the industrial strategy, arguing that:

> *"the United Kingdom shared prosperity fund will be introduced domestically to reduce inequalities and raise productivity in line with the industrial strategy[8]"*

The UK government is consulting on the design of the SPF during 2018. The details of this design will be of considerable importance for the future of funding streams to Wales and may influence the future path of the gap in economic performance between Wales and other parts of the UK. Important questions in the design of the SPF which are relevant to Wales include:

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[7] See: https://s3-eu-west-1.amazonaws.com/2017-manifestos/Conservative+Manifesto+2017.pdf
[8] See: Hansard, 12 December 2017

1. At what level of government will it be designed and controlled?
2. What metric will be used to allocate funding?
3. What will be the quantum of funding?
4. How will it interact with other sources of area-based government funding?

We discuss these in turn.

The devolved governments will wish to maximise control over the fund within their jurisdictions, arguing that local control is necessary for the development of policies that are attuned to local circumstances. On a more sceptical note, local control also maximises local political payoff. On the other hand, the UK Government might argue that it is in the best position to design policy to reduce regional inequalities in the UK as a whole and to ensure that such policy is applied uniformly. Further, if it is to be integrated with the UK industrial strategy, then perhaps it needs to be directed at a UK level.

Perhaps in line with this argument, the UK Government recently announced the Strength in Places Fund (SIPF)[9] also viewed as part of the industrial strategy, specifically aimed at enhancing *regional* productivity. It is part of the National Productivity Investment Fund and is described as a "new *competitive* funding scheme that takes a place-based approach to research and innovation funding, to support significant regional growth". It falls within the remit of the recently formed UK Research and Innovation (UKRI). At this stage, the SIPF is intended to support 4 to 8 projects of between £10 million and £50 million to match research excellence and innovation with significant economic impact on regional growth.

Although it will have a spatial dimension, this fund is radically different from the old structural funds. Firstly, it is being allocated on a competitive basis; secondly its focus is on research and innovation, not on human capital and infrastructure; thirdly, the resources allocated to it are relatively small compared with those assigned to the structural funds; finally, the intention is to integrate the SIPF with other aspects of the industrial strategy, such as the SPF. This differs from the EU structural funds, which have tended to operate almost independent of UK government policy. However, how the SIPF and SPF might be integrated is not clear because the structure of the SPF is as yet unknown.

Thus far, it is the UK government that has been the principal architect of both the industrial strategy and its implementation. The devolved governments do not appear to have had a significant role in its design. This may change with the SPF since the devolved governments have always had a significant role in the delivery of the structural funds. If Westminster were to take control over their replacements, it would likely come at the cost of degradation of the relationships with the devolved authorities.

Even if its governance is established, there is no obvious candidate to replace existing EU mechanisms for allocating the SPF to different parts of the UK. While the EU has used objective measures of need (GDP per head) to determine eligibility for funding, the UK government has recently tended to use other mechanisms, such as competitions, to allocate funds to particular areas. However, while some might argue that the EU mechanism may not be the optimal use of public resources to maximise productivity growth, the use of GDP per head to determine eligibility has the attraction of promoting social cohesion by concentrating support on those areas with the lowest incomes.

[9] See: https://www.ukri.org/files/funding/ukri-strength-in-places-fund-programme-overview-pdf/

Obviously, assuming that it qualifies for a significant share of the resources allocated to the SPF, the overall quantum of resources allocated to the fund will be of considerable interest to the Welsh Assembly. On the one hand, issues of inequality and particularly spatial inequality across the UK has risen in political significance recently, which might suggest an increase in funding is warranted. On the other, the UK government may feel that other priorities, such as health and social care are more pressing. Tradeoffs between different priorities are ultimately a matter of political choice. In this case, the tradeoff will be determined by the UK Government, probably within the Treasury, and the Welsh Assembly may only have limited power to affect the outcome.

The ability to design replacements for the structural funds provides an opportunity to ensure synergistic relationship with other policies. Inclusion within the industrial strategy may enhance such possibilities, but there are already in existence policies that might be difficult to match with a structural fund replacement which retained key elements of its design? These include, for example, City Deals. We discuss these below

City Deals

Wales already has City Deals for the Cardiff City and Swansea City Regions. These are expected to benefit from £2.5 billion worth of funding from the UK government, Welsh Assembly, local authorities and other partners over the next 10 to 15 years[10]. Initiatives to introduce for such deals for the North of Wales and Mid Wales have begun. O'Brien and Pike (2015) argue that City Deals are intended "primarily to incentivise coalitions of local state actors to develop strategies and identify and prioritise propositions to fund, finance and deliver infrastructure and to formulate and implement new initiatives in policy areas such as skills and business support." It is not obvious how City Deals can easily be aligned with the SPF, if it adopts a needs-based approach to support poorer areas along similar lines to existing SIF policies.

Other Issues

We complete the paper by discussing two further issues, State Aid and the Common Agricultural Policy.

State Aid

Depending on the nature of Brexit and even if it receives substantial support from the UK Government to strengthen the weaker parts of the Welsh economy, the Welsh Assembly's freedom to spend money to reduce spatial inequalities or to support particular enterprises may be constrained by state aid rules. Remaining within the EEA or customs union, or even making comprehensive trade agreements with other countries will likely involve guaranteeing to abide by some set of state aid rules, which may preclude giving support to specific companies or sectors.

Crafts (2017) points out that a hard Brexit offers greater opportunities for selective state intervention to support industry. He argues, however, that state intervention should be limited to measures that support industry in *general* – such as government-funded research or skills acquisition – rather than selective intervention to support particular *enterprises*, which he

[10] See: http://senedd.assembly.wales/documents/s68161/Report.pdf

argues should be strictly regulated. He would argue that this is necessary to counter the illusion that the state can “pick winners” for specific support.

The Common Agriculture Policy

EU agriculture policy (the CAP) is intended to “ensure a decent standard of living for farmers, at the same time as setting requirements for animal health and welfare, environmental protection and food safety. Sustainable rural development completes the picture of the EU's common agricultural policy.”[11]

To provide the context for these proposals, the CAP currently comprises

- Direct payments based on area farmed (known as Pillar 1) through the Basic Payment Scheme.
- Rural development funding (known as Pillar 2)

Together, these comprise the largest element of EU funding, as can be seen from Table 1 support payments for agriculture to Wales in the 2014-2020 MFF amount to around €2.8 billion. These payments are extremely important to Welsh farm business incomes, providing the average Welsh dairy farmer of a subsidy worth £23,000 per annum and each Welsh sheep farmer a subsidy of £19.3 thousands per annum[12].

Direct payments are given to farmers in the form of a basic income support based on the number of hectares farmed. Tariffs are applied to imported foodstuffs to help European farmers to compete against competition from elsewhere in the world. However, the CAP no longer boosts farm incomes by subsidising food production or supporting price levels. Reliance only on tariffs accords with the Agriculture Agreement that formed part of the 1994 Uruguay Round of trade talks.

So that the CAP falls within the “Amber Box” to use the World Trade Organisation (WTO) terminology, EU support for farmers has had to be redirected from particular foodstuffs, to direct income payments that are “decoupled” – not linked to output or prices. Countries within the Amber Box, which includes the EU, have made commitments to reduce trade-distorting domestic support – sometimes referred to as “total aggregate measurement of support” (AMS). Decisions around the types of support offered to Welsh agriculture will affect the overall classification of the UK within WTO rules and therefore are likely to influence the nature of future trade negotiations between the UK and other countries. The downside of imposing tariffs on agricultural imports is that domestic consumers pay higher prices for food than if markets were open to competition.

Now consider how agriculture policy may evolve post-Brexit. The UK government has made a radical proposal for England. In its February 2018 consultation paper “Health and Harmony: the future for food, farming and the environment in a Green Brexit”[13], the Department for Environment, Food and Rural Affairs (DEFRA) set out a vision for agricultural support post Brexit.

The main DEFRA proposal follows Helm’s recommendation and is summarised as follows:

> “Our aim is for public money to buy public goods. In 25 years’ time, we want cleaner air and water, richer habitats for more wildlife and an approach to agriculture and land use

[11] See: https://ec.europa.eu/agriculture/cap-overview_en
[12] See: http://sites.cardiff.ac.uk/wgc/files/2016/07/AGRICULTURE.pdf
[13] See: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/684003/future-farming-environment-consult-document.pdf

which puts the environment first. From 2022 onwards, a new environmental land management system will be the cornerstone of our agricultural policy, achieving improved biodiversity, water, air quality, climate change mitigation, and the safeguarding of our historic landscapes. This will allow us to fulfil our manifesto commitment to become the first generation to leave the environment in a better state than we found it." (DEFRA 2018)

If a policy of "public money for public goods" in relation to agriculture is put in place, then the rationale for Pillar 1 (direct payments) disappears. If nothing replaces this funding source, then the equivalent funding stream for Wales would likely be under threat. Environmental groups would like to maintain current levels of support for farmers but switch funding towards sustainable land management[14]. However, the UK government may have other priorities for this funding stream. If future levels of support for agriculture in England change significantly, consequences for Welsh funding are almost inevitable. These will depend on the allocation formula, the issue with which we consider in the next section.

Post-Brexit Funding Mechanisms for the CAP

Withdrawal from the EU opens possibilities for replacement, redesign or removal of the CAP. UK Government policy appears to imply that, for England, the existing system of payments will continue until 2019, and be followed by a five-year transition phase to a new system of agricultural support[15]. The devolved authorities can thus expect that existing payments will be maintained for a short period and then be replaced by a new funding stream. A key issue is how subsequent payments to the devolved authorities for agricultural support will be determined. One option, which has been mooted, is the Barnett Formula which we discuss below.

The Barnett Formula for CAP Payments?

The effect on the Welsh budget of the inclusion of CAP payments depends on how such payments evolve in England and how they interact with the Barnett formula. The UK government has made a radical proposal for agricultural policy in England. In its February 2018 consultation paper "Health and Harmony: the future for food, farming and the environment in a Green Brexit"[16], the Department for Environment, Food and Rural Affairs (DEFRA) sets out a vision for agricultural support post Brexit.

"Our aim is for public money to buy public goods. In 25 years' time, we want cleaner air and water, richer habitats for more wildlife and an approach to agriculture and land use which puts the environment first. From 2022 onwards, a new environmental land management system will be the cornerstone of our agricultural policy, achieving improved biodiversity, water, air quality, climate change mitigation, and the safeguarding of our historic landscapes. This will allow us to fulfil our manifesto commitment to become the first generation to leave the environment in a better state than we found it." (DEFRA 2018)

This proposal would see an end to direct support for farmers, either based on output or on land farmed. Instead support would only be available for environmental schemes that provided public benefits. This would be expected to lead to a reduction in overall spending on agriculture in England,

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[1414] Greener UK, Agriculture at a crossroads: the need for sustainable farming and land use policies, February 2017
[15] See: https://www.parliament.uk/documents/commons-library/Brexit-UK-agriculture-policy-CBP-8218.pdf
[16] See: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/684003/future-farming-environment-consult-document.pdf

and in a depression of farm incomes. Under the Barnett Formula, the Welsh Assembly's ability to react to this development will be determined by how changes in spending on English agriculture affects the Welsh block grant. If spending in England falls, as might be expected if the "Health and Harmony" proposals are implemented and financial support for agriculture in England declines, then the Welsh block grant will also decline, but not as rapidly as the decline in support for agriculture in England. The explanation for this strange behaviour lies with the effect of the "Barnett squeeze" in reverse. Each year, the Welsh block grant is reduced by Wales's population share of the reduction in agriculture spending imposed on England. But since Wales' share of overall agriculture support is larger than its population share, the cut will be proportionately less in Wales than in England. Application of the Barnett formula to a diminishing agricultural support budget in England is likely to be of *relative* benefit to the Welsh budget, though it will still result in a considerable cut to this funding stream.

The reverse effect would occur if spending in England on the CAP payments increased in nominal terms. In this case, the normal Barnett squeeze applies, with Wales receiving a smaller proportionate increase because its population share is less than its share of CAP spending at the outset. Thus, whether using the Barnett Formula to fund the successor to the CAP in Wales very much depends on the expected trajectory of agricultural support payments in England.

What if the Barnett formula was applied to the SPF support? Similar arguments apply. Wales is receiving well above its population share of the current equivalent of the SPF – the EU structural funds. If the SPF increases through time and the Barnett Formula was applied to financial support for the SPF, then the Barnett Squeeze would apply. Wales would only receive its population share of increased funding rather than its (larger) current share. This would lead to a reduction in its overall share of SPF payments.

Note that, once included in the block grant, allocations to agriculture and to the SPF could be competing directly with other Welsh Assembly priorities. This could be avoided if the UK Government mandated the amounts to be spent on these policy areas. However, this might be taken to be undue UK Government interference, which would be resisted by the devolved authorities.

Needs-based allocation at UK level

It is difficult to imagine using a needs-based system for allocating agricultural support. Need is not a familiar concept in agriculture although many agricultural funding mechanisms have implicitly been used to support low levels of income among particular groups of farmers. However, there is clearly a drive from the WTO to persuade governments to reduce the kind of support which distort agricultural markets. This line of argument might suggest commend that individuals and households should be financially supported, not because they are farmers, but because their incomes are low.

Conclusion

The funding implications of the transfer of competencies from the EU are of considerable importance for public spending in Wales. The way that these competencies are distributed between different levels of government will have implications both for the operation of the UK internal market and for the UK's international trade agreements. Different levels of support for agriculture or for other sectors of the economy may be argued to be distorting the internal market. However, these policies already operate somewhat differently in Wales compared with the rest of the UK under current EU rules. A key question will be how to establish what are allowable deviations in policy between Wales and other parts of the UK and how such deviations will be controlled in a way that has the confidence of the UK and Welsh Assemblys. This may be through the courts or some new institutional mechanism: it seems unlikely that the Welsh Assembly would allow the UK government to unilaterally control these issues.

In respect of the funding arrangements, use of the Barnett formula has the advantage of familiarity. However, whether this mechanism will maximise funding to the Welsh Assembly depends very much on the likely trajectory of spending post-Brexit and its interaction with the "Barnett squeeze". The addition of EU funding to the Barnett formula alongside the adjustments that are in train involving the block grant adjustment and its sensitivity to tax receipts in the rest of the UK will make Wales's funding system even more opaque than it already is[17]. Lack of transparency invites complaints that the system is somehow biased because it is difficult to construct a clear rationale for the way in which it operates.

Under the Barnett formula, present EU funding will be in competition with other Welsh Assembly priorities. The Welsh Assembly will be able determine its own priorities, provided that these do not undermine the UK internal market or destabilise UK trade arrangements.

Finally, it is worth emphasising that any new funding arrangements should be subject to rigorous evaluation processes in relation to objectives that are clearly established when these arrangements are introduced. It should be clear that funding is made conditional on achieving stated efficiency or equity objectives. Lack of clarity on these issues may result in relevant parties treating such funding as an entitlement, making it more difficult decisions to reallocate to priorities that would be more beneficial to the Welsh people.

[17] Note that the arrangements for adjustments already in train to the Barnett formula are due to be reviewed in 2021. See: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/508102/Fiscal_Framework_-_Text_-_Annex_to_the_fiscal_framework_-_15th_March_201....pdf

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Appendix 1: Specific Strategic Investment Fund Programs in Wales Approved under the 2014-2020 EU Multiannual Financial Framework

Location and Fund	Programme	EU Contribution €m)	Match Funding €m)	Matchfund share
East Wales - ERDF	Low-Carbon Economy	22.4	22.4	50.0%
East Wales - ERDF	Low-Carbon Economy	36.1	36.1	50.0%
East Wales - ERDF	Competitiveness of SMEs	36.6	36.6	50.0%
East Wales - ERDF	Information & Communication Technologies	11.8	11.8	50.0%
East Wales - ERDF	Technical Assistance	4.1	4.1	50.0%
East Wales - ERDF	Research & Innovation	3.3	3.3	50.0%
East Wales - ERDF	Research & Innovation	89.1	89.1	50.0%
East Wales - ESF	Sustainable & Quality Employment	45.0	45.0	50.0%
East Wales - ESF	Educational & Vocational Training	15.0	15.0	50.0%
East Wales - ESF	Educational & Vocational Training	90.6	96.8	51.7%
East Wales - ESF	Sustainable & Quality Employment	4.9	4.9	50.0%
East Wales - ESF	Technical Assistance	4.1	4.1	50.0%
East Wales - ESF	Social Inclusion	43.8	43.8	50.0%
Total East Wales		**406.6**	**412.9**	50.4%
Wales - Rural Development	Low-Carbon Economy	6.3	5.5	46.4%
Wales - Rural Development	Information & Communication Technologies	1.6	1.5	47.0%
Wales - Rural Development	Environment Protection & Resource Efficiency	0.1	0.1	47.0%
Wales - Rural Development	Climate Change Adaptation & Risk Prevention	13.2	0.0	0.0%
Wales - Rural Development	Research & Innovation	19.8	13.3	40.2%
Wales - Rural Development	Low-Carbon Economy	4.4	3.9	47.0%
Wales - Rural Development	Educational & Vocational Training	0.6	0.5	47.0%
Wales - Rural Development	Research & Innovation	0.6	0.5	41.6%
Wales - Rural Development	Research & Innovation	39.2	25.2	39.2%
Wales - Rural Development	Educational & Vocational Training	0.6	0.5	47.0%
Wales - Rural Development	Environment Protection & Resource Efficiency	9.4	3.1	24.6%
Wales - Rural Development	Climate Change Adaptation & Risk Prevention	83.9	29.2	25.8%
Wales - Rural Development	Low-Carbon Economy	10.2	9.0	47.0%
Wales - Rural Development	Research & Innovation	0.2	0.2	47.0%
Wales - Rural Development	Research & Innovation	4.5	4.0	47.0%
Wales - Rural Development	Research & Innovation	3.5	3.1	47.0%
Wales - Rural Development	Research & Innovation	0.7	0.6	47.0%
Wales - Rural Development	Competitiveness of SMEs	54.5	15.6	22.2%
Wales - Rural Development	Climate Change Adaptation & Risk Prevention	9.4	3.1	24.6%
Wales - Rural Development	Research & Innovation	10.3	3.5	25.4%
Wales - Rural Development	Climate Change Adaptation & Risk Prevention	0.1	0.1	47.0%
Wales - Rural Development	Sustainable & Quality Employment	1.0	0.8	47.0%
Wales - Rural Development	Educational & Vocational Training	22.6	20.0	47.0%
Wales - Rural Development	Sustainable & Quality Employment	12.9	11.5	47.0%
Wales - Rural Development	Low-Carbon Economy	0.3	0.0	13.3%
Wales - Rural Development	Research & Innovation	0.1	0.1	47.0%
Wales - Rural Development	Climate Change Adaptation & Risk Prevention	41.4	12.3	22.9%
Wales - Rural Development	Educational & Vocational Training	0.3	0.3	47.0%
Wales - Rural Development	Research & Innovation	0.1	0.1	47.0%
Wales - Rural Development	Educational & Vocational Training	15.8	14.0	47.0%
Wales - Rural Development	Research & Innovation	0.5	0.4	47.0%
Wales - Rural Development	Educational & Vocational Training	2.6	2.3	47.0%
Wales - Rural Development	Low-Carbon Economy	6.4	1.8	22.2%
Wales - Rural Development	Low-Carbon Economy	0.8	0.2	22.0%
Wales - Rural Development	Low-Carbon Economy	3.3	0.9	22.0%

Wales - Rural Development	Competitiveness of SMEs	30.1	14.7	32.8%
Wales - Rural Development	Educational & Vocational Training	0.6	0.5	47.0%
Wales - Rural Development	Environment Protection & Resource Efficiency	83.9	29.2	25.8%
Wales - Rural Development	Environment Protection & Resource Efficiency	13.2	0.0	0.0%
Wales - Rural Development	Research & Innovation	0.1	0.1	47.0%
Wales - Rural Development	Research & Innovation	1.2	1.1	47.0%
Wales - Rural Development	Social Inclusion	27.3	24.2	47.0%
Wales - Rural Development	Research & Innovation	0.3	0.2	47.0%
Wales - Rural Development	Low-Carbon Economy	11.1	5.3	32.4%
Wales - Rural Development	Research & Innovation	0.1	0.1	47.0%
Wales - Rural Development	Research & Innovation	0.3	0.2	42.8%
Wales - Rural Development	Social Inclusion	39.0	20.5	34.5%
Wales - Rural Development	Environment Protection & Resource Efficiency	41.4	12.3	22.9%
Wales - Rural Development	Research & Innovation	0.2	0.1	40.2%
Wales - Rural Development	Educational & Vocational Training	0.6	0.5	47.0%
Wales - Rural Development	Technical Assistance	20.6	18.3	47.0%
Total - Rural Development		**651.6**	**314.8**	**32.6%**
West Wales and The Valleys - ERDF	Technical Assistance	24.1	8.2	25.4%
West Wales and The Valleys - ERDF	Sustainable & Quality Employment	167.1	87.4	34.3%
West Wales and The Valleys - ERDF	Competitiveness of SMEs	188.1	113.3	37.6%
West Wales and The Valleys - ERDF	Information & Communication Technologies	55.7	29.1	34.3%
West Wales and The Valleys - ERDF	Research & Innovation	301.9	152.9	33.6%
West Wales and The Valleys - ERDF	Research & Innovation	19.9	12.0	37.6%
West Wales and The Valleys - ERDF	Low-Carbon Economy	172.1	90.0	34.3%
West Wales and The Valleys - ERDF	Network Infrastructures in Transport and Energy	106.4	55.6	34.3%
West Wales and The Valleys - ERDF	Low-Carbon Economy	170.8	75.2	30.6%
West Wales and the Valleys - ESF	Sustainable & Quality Employment	21.4	7.4	25.6%
West Wales and the Valleys - ESF	Educational & Vocational Training	326.4	127.2	28.0%
West Wales and the Valleys - ESF	Technical Assistance	16.0	5.5	25.6%
West Wales and the Valleys - ESF	Educational & Vocational Training	110.1	38.0	25.6%
West Wales and the Valleys - ESF	Sustainable & Quality Employment	134.6	46.4	25.6%
West Wales and the Valleys - ESF	Social Inclusion	196.0	52.2	21.0%
Total - West Wales and the Valleys		**2010.7**	**900.4**	**30.9%**

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