Senedd Cymru
Pwyllgor yr Economi, Masnach a Materion Gwledig
Cyllid datblygu rhanbarthol wedi'r UE
RDF21
Ymateb gan: Sefydliad Astudiaethau Cyllid

Welsh Parliament
Economy, Trade, and Rural Affairs Committee
Post-EU regional development funding

Evidence from: Institute for Fiscal Studies

Post-EU regional development funding

Written evidence for the Economy, Trade and Rural Affairs Committee's Inquiry

Preamble

1. This is a response to the Economy, Trade and Rural Affairs Committee's inquiry call for written evidence on issues related to post-EU regional development funding by David Phillips, an Associate Director at the Institute for Fiscal Studies. All views are his own; the IFS has no corporate views on these or other issues.

Academic evidence on the impact of EU regional development funding

2. An academic literature considers the impact of EU regional development funding on economic outcomes, and the factors associated with better performance. This evidence is not specific to Wales, instead relying largely on comparisons between places that did and did not receive funding across Europe – especially those either side of the former 75% of average GDP cliff-edge in funding levels.
3. Becker et al. (2018) find significant positive effects of the receipt of EU development funds on annual per capita income growth rates of 1–2%. However, there is significant variability within these estimates, and the effect seems to be much lower over the most recent funding cycles they examine (2000–13).
4. Becker et al. (2018) also find that regions that lose access to ESI funding (either because the GDP threshold moves or because regional GDP moves above the threshold) see lower economic growth. This suggests that the positive growth effects seen from funding are not permanent and that funding either boosts growth via demand-side effects or has only temporary effects on the supply-side of the economy.
5. There are two notable studies specific to the UK, although the research design means the results should be treated with caution. Evidence presented in Di Cataldo (2017) suggests an aggregate positive impact of structural funding on regional GDP per capita. However, Di Cataldo and Monastriotis (2020) suggest that this effect is only temporary and disappears when funding is withdrawn, as was seen with comparisons across the wider EU.

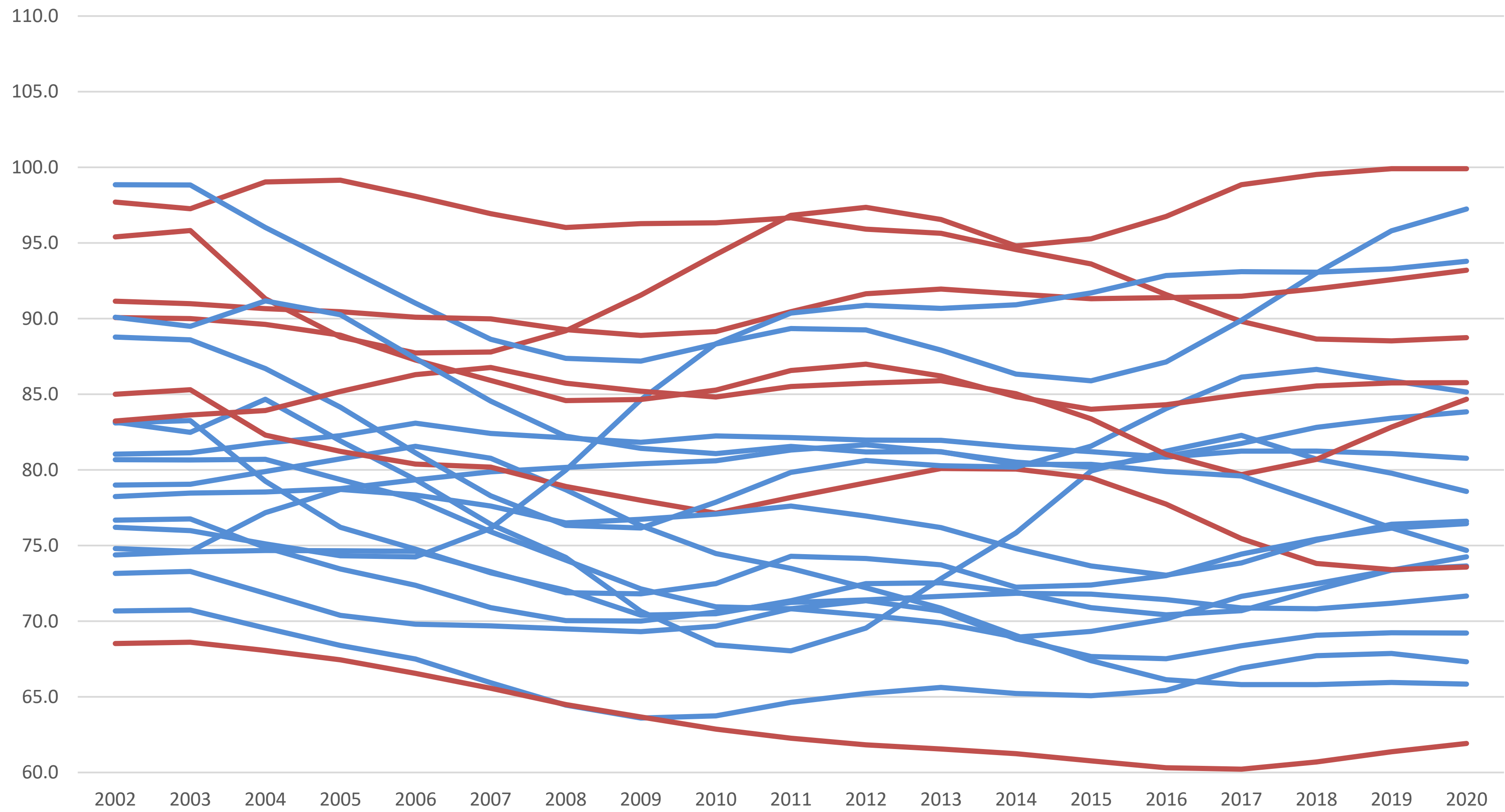
6. A number of studies find that the quality of both human capital and institutions in regions influences the 'absorptive capacity' of regions to use ESI funding effectively. Becker et al. (2013), in particular, find that positive effects on growth are only found in areas with above average human capital and institutional quality. This suggests that a skilled workforce and good-quality governance are needed to take full advantage of regional development funds. Further evidence from Pinho, Carum and Antunes (2015) suggests that 'innovative regions' see a bigger boost to growth from receipt of ESI funds.
7. Bahr (2008) finds that increased subregional autonomy increases the impact of EU development funds. In particular, improved quality of governance on a local level, accompanied by increased 'autonomy' and discretion over spending priorities, leads to better outcomes. Focusing on the UK, Di Cataldo and Monastiriotis (2020) find that alignment between funding efforts towards particular areas and regional needs improves outcomes on receipt of development funding, whereas misalignment has the opposite effect.
8. ***Taken together this evidence has several implications for the post-EU funding regime:***
    a. ***Delivery authorities should redouble efforts to focus on the long-term drivers of productivity growth, including skills, connectivity, and innovation, in order to minimise the risk of impacts fading as funding is reduced following any initial success in boosting economic performance. This is likely to require working across functional economic areas (e.g. Cardiff City Region, Swansea Bay City Region) as opposed to at a local authority level, but at the same time taking account of sub-regional differences in priorities and opportunities. It is also likely to require long-term plans and investments, which may be more difficult if funding cycles remain tied to UK government spending review periods (typically lasting 3-4 years).***
    b. ***It may be worthwhile increasing investment in regional and local economic governance quality, including in capacity to undertake and commission research, consultation and engagement activities to better understand priorities, opportunities and risks.***
    c. ***While there has been much focus on the reduced role for the Welsh Government in post-EU regional development funding, the greater flexibility local areas have in allocating UKSPF funding relative to EU funding may enable them to better align funding with local priorities and opportunities, potentially increasing its impact. The major exception to this is Multiply funding, the ring-fenced amounts for which are far higher than in comparable areas of England (see further discussion below).***

Welsh economic performance

9. Between 2000 and the UK's departure from the EU, West Wales and the Valleys received the highest-tier level of EU funding ('Objective 1' and later 'Least Developed Regions' level), whilst East Wales received substantially higher levels of funding than other parts of the UK with comparable levels of economic performance. It is far beyond the scope of this short submission to try to quantify the impact of this funding on regional economic performance. Instead here we provide some summary statistics on productivity by Welsh local authority, to examine trends since the early 2000s. It may also be worthwhile collating figures on employment and earnings for the Committee's report (there was not sufficient time to do this for this evidence submission
10. Figure 1 shows productivity as measured by the gross value added generated per job, by place of employment for the period between 2002 and 2020. It shows that in both 2002 and 2020, five or six of the eight LAs with the highest GVA per job were in East Wales. It also shows that in both years the area with the lowest productivity was also in East Wales: Powys.
11. Over this period, productivity growth in Wales as a whole than in the UK as a whole: this was true both for LAs in West Wales and the Valleys, and East Wales. The decline in West Wales and the Valleys took place during the 2000s and was slightly reversed in the 2010s. There is no evidence that over the period as a whole, productivity grew more or less quickly in LAs in West Wales and the Valleys than those in East Wales, overall.

Figure 1. Productivity as a % of UK average, as measured by gross value added per job, 2002 to 2020, by Welsh NUTS2 region

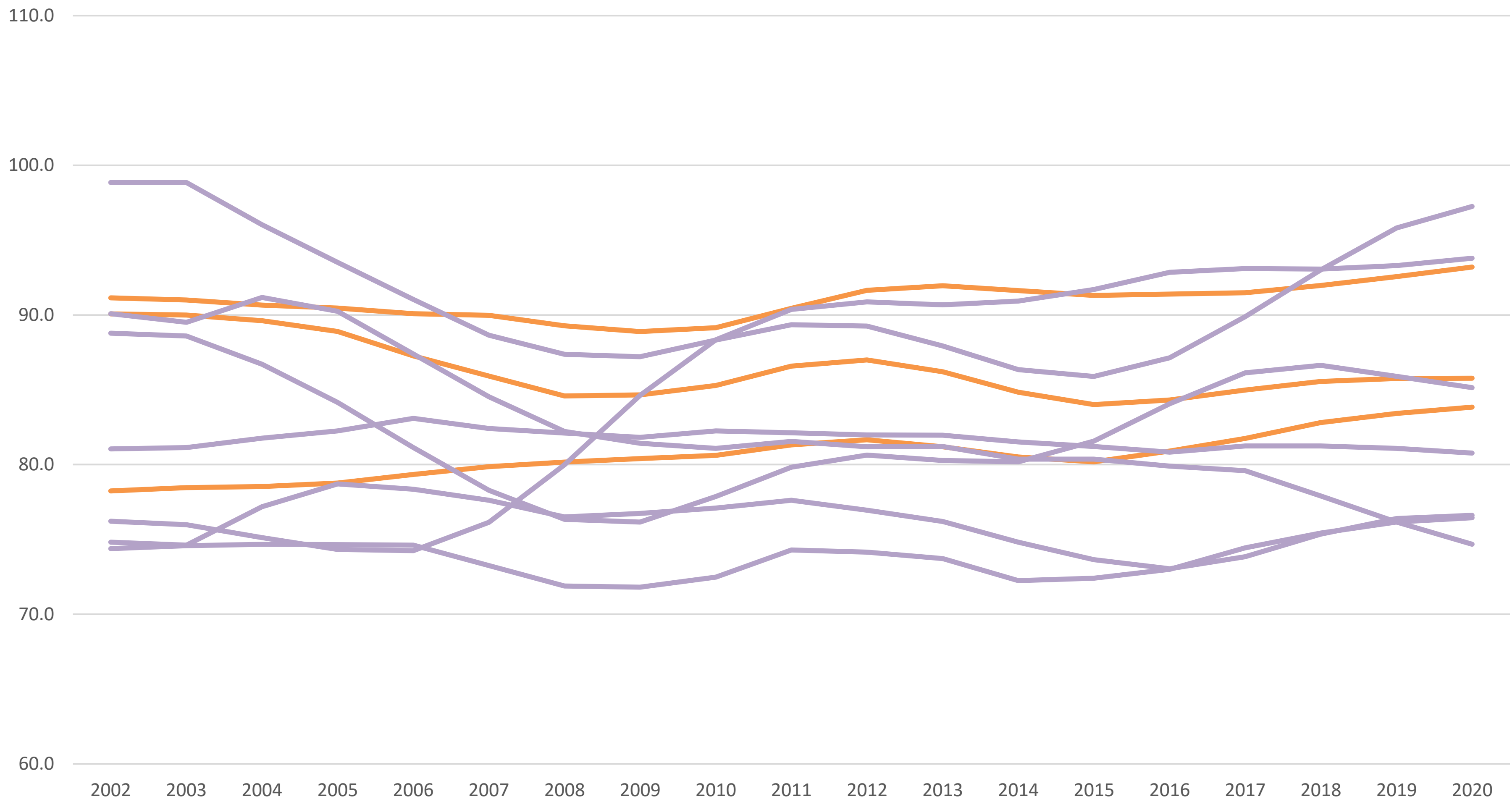
Red = East Wales, Blue = West Wales and the Valleys



Source: ONS.

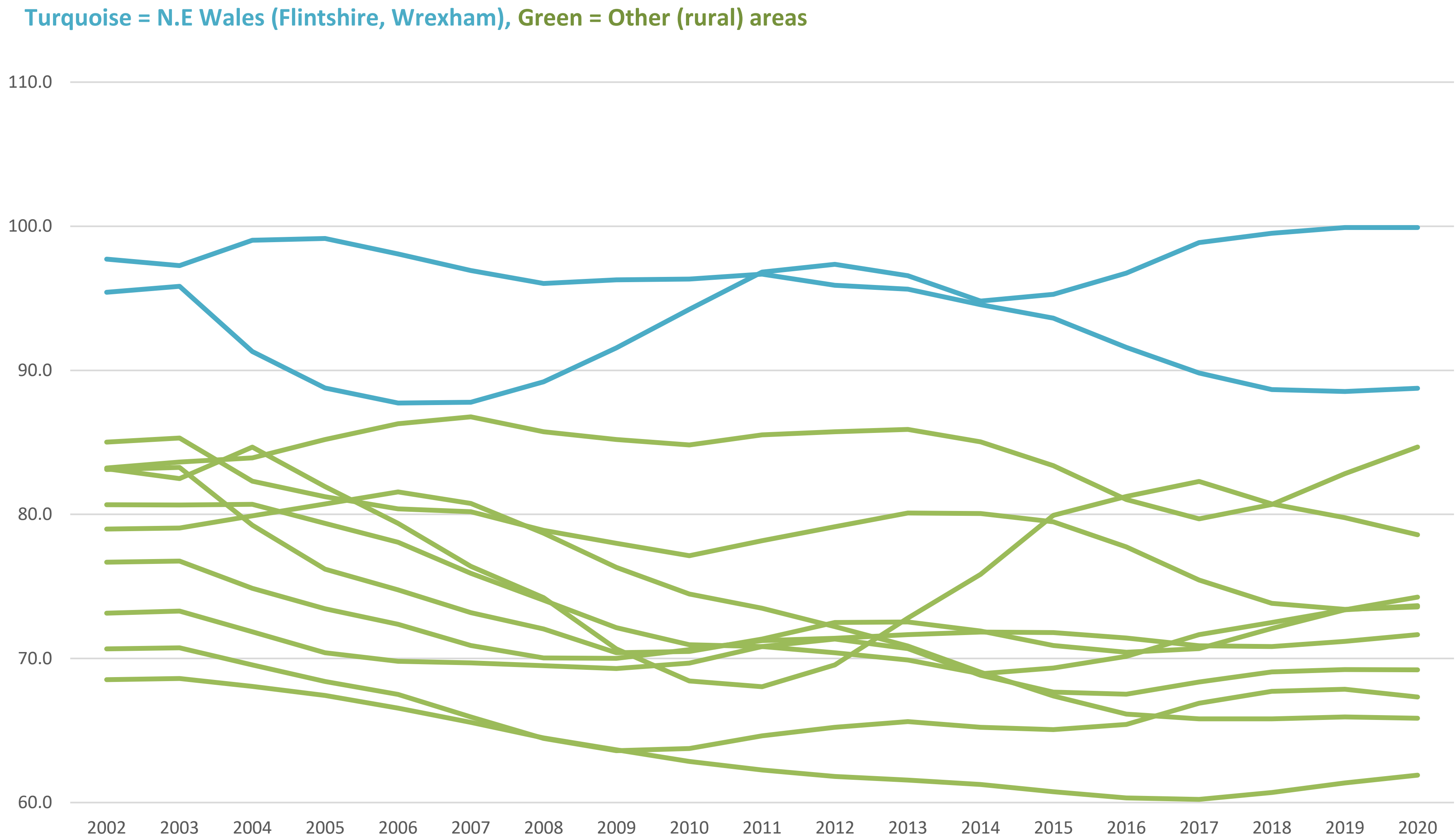
Figure 2a. Productivity as a % of UK average, as measured by gross value added per job, 2002 to 2020, by type of location

Orange = Cities (Cardiff, Newport, Swansea), Purple = Valleys



Source: ONS.

Figure 2b. Productivity as a % of UK average, as measured by gross value added per job, 2002 to 2020, by type of location



Source: ONS.

12. Figure 2a shows that productivity in the LAs covering Wales cities and the South Wales Valleys has, on average, broadly kept pace with productivity growth in the UK as a whole. There has been some significant churn within these groups though, with productivity in Rhondda Cynon Taf substantially increasing (mostly during the late 2000s) from around 76% to 94% of the UK average, while productivity in Merthyr Tydfil falling from 90% to 75% of the UK average. Productivity has grown faster than the UK average in Swansea, slightly faster in Cardiff, and slower in Newport.
13. Figure 2b shows that productivity in N.E Wales is much higher than other areas outside S.E Wales. Indeed, Flintshire has the highest productivity in all of Wales, overtaking Bridgend and Wrexham over the last 20 years. Productivity is both low and has performed worse in other, largely rural areas of Wales. For example, productivity has fallen from 68% to 62% of the UK average in Powys, 79% to 66% in Gwynedd, 83% to 74% in Carmarthenshire, and 85% to 74% in the Vale of Glamorgan.
14. ***Because we do not know what would have happened to productivity growth (let alone employment and earnings growth, and broader measures of socio-economic performance) in the absence of EU funding, we cannot infer the success (or lack of success) of the policy from this evidence. However, it shows that the big dividing line in productivity growth in Wales over the last 20 years has therefore not been between West Wales and the Valleys and East Wales, per se, but between more urbanised areas of Wales (where productivity growth has typically been higher) and more rural area of Wales (where it has typically been lower).***

Comparing funding levels under EU regional development funding and the UKSPF

15. Whether the UK government is delivering on its commitment for the UKSPF to at least match receipts from EU structure funds is a highly contentious issue politically. The UK government claims that it is, while the devolved governments claim that their countries are being short-changed to the tune of hundreds of millions of pounds.
16. When fully rolled out the SPF will be £1.5 billion per year, which at least given forecasts for inflation from the OBR's March 2022 forecasts slightly exceeded the average annual amount allocated under the 2014 – 2020 EU budget in real-terms. Inflation has now turned out to be higher than forecast last March, so this may no longer be the case. However, it is worth noting that EU funding was not adjusted when inflation exceeded forecasts (or for movement in exchange rates, for example).
17. The main point of contention between the UK and devolved governments seems to relate to the phase in of SPF spending. The UK government argues that because EU funding is still being spent, the amount of spending covered by the UKSPF can ramp up over time as the EU spending ramps down. The devolved governments reject

this and highlight how under EU schemes, they were able to "commit" funding more quickly in the first years of the multi-year budget period. They allege they are therefore missing out on hundreds of millions in the intervening years.

18. If the UKSPF were to work like the EU schemes, with many years between when the funding was allocated and when it was actually spent, I think the devolved governments would be correct. But the intention with the UKSPF is that the amounts listed for each year are what will actually be spent in that year. In this case I think the UK government's position is more reasonable. EU funding is still being spent and this UKSPF funding can therefore ramp up as EU funded spending ends. Indeed, that is exactly what would have happened if we had remained in the EU – the spending funded by the 2021-2027 multi-year budget would have slowly ramped up too.
19. Whether there is a 'gap' in the amount that is spent, therefore depends on whether the delivery authorities are actually able to spend their allocations at the pace assumed by the UK government. That should be straightforward for many parts of the UK and particularly England where allocations are quite low. It could be harder for areas where allocations are high – like Cornwall, and large parts of Wales.
20. Existing rules say if they can't spend it in-year they have to hand it back. That clearly is undesirable as it could mean money is lost or is spent on things that can be done quickly but do not represent the best value for money. Relaxing this rule may, by potentially slowing down spending, mean that the profile of spending is lower in the short-term than previous EU spending levels.
21. ***In summary, it is my view that the UK can meet its pledge of matching EU fund levels with the ramping up of funding and spending planned under the UKSPF. However, it would undoubtedly have been preferable to confirm the UKSPF allocations much earlier so that councils and existing and potential beneficiaries of regional development funding could have planned more effectively.***

The allocation of UKSPF funding across Wales

22. The UK government chose to allocate to each nation of the UK and each LEP area of England the same share of UKSPF funding as was received of EU funding. Politically, this avoids creating obvious losers, who would be much more vocal than areas gaining funding. Practically, also avoids areas having to suddenly cut back or ramp up spending which can be very challenging – although that is normally better dealt with via transitional arrangements, rather than continuing indefinitely historic funding allocations.
23. Wales, as a whole, clearly benefits from this decision, because it means that Wales continued to benefit from the high levels of funding received by West Wales and the Valleys under the cliff edge in EU funding. This could be seen as inequitable by large parts of England: areas just above this threshold like South Yorkshire and Lincolnshire received as little as 1/8th of the EU funding per capita as areas below

the threshold like Cornwall and West Wales and the Valleys, and will continue to receive substantially less funding.

24. Within Wales, the cliff edge has been removed though, and funding is based on LA characteristics. The factors (population, deprivation and an index of economic need) and weights (40%, 30% and 30%) chosen have redistributed funding from West Wales and the Valleys to East Wales. Whereas West Wales and the Valleys received 83% of EU funding (and almost three times as much per person) as East Wales under the EU funding, it will receive 73% (and 1.6 times as much per person) under the UKSPF. (Source: PEU 14 Wales Fiscal Analysis.pdf (senedd.wales))

25. It is not currently possible to make comparisons of funding at an LA-level, because data is not published at this level for EU regional development funding. However, the weight placed on deprivation, which is concentrated in more urban areas and the South Wales Valleys, *may* mean a shift in funding from rural areas. This will also depend on replacements for rural development funding previously provided under Pillar 2 of the Common Agriculture Policy.

26. As discussed in an IFS observation in 2022 (UK Shared Prosperity Fund allocations for Welsh councils are flawed, costing some areas millions | Institute for Fiscal Studies (ifs.org.uk)), the 30% share of UKSPF divided between Welsh LAs on the basis of deprivation takes no account of differences in population. It means that two areas with the same levels of deprivation receive the same *total* funding from this element of the funding formula, irrespective of how big their populations are. This contrasts with the approach taken for the share allocated using the broader index of economic need, where two areas the same levels of assessed need receive the same funding *per person*.

27. This matters because the population of different council areas in Wales varies substantially: the population of Cardiff was estimated to be over 6 times as large of that of Merthyr Tydfil as of mid-2020 (the population figures used elsewhere in the UKSPF allocation formulas). Rhondda Cynon Taff gets just 21% as much funding per person (£44) between 2022-23 and 2024-25 from the deprivation element of the formula as Merthyr Tydfil (£208) despite being only a little bit less deprived, because its population is 4 four times larger.

28. if the deprivation element accounted for population differences and all other elements of the formula remained the same, Cardiff, Rhondda Cynon Taff and Swansea would have received £15.5m, £7.9m and £5.8m more funding, respectively, between 2022-23 and 2024-25 than under the formula actually being used. Merthyr Tydfil, Blaenau Gwent and Torfaen would have received £9.1m, £8.5m and £4.2m less funding, respectively, than they are actually set to receive. This flaw is therefore shifting tens of millions of pounds from Welsh councils with large populations to those with small populations.

29. We cannot say that a formula where the deprivation element accounted for population differences and all other elements remained the same as now would

be the 'right' formula. There is no 'right' formula as people can reasonably differ on how targeted they think funding should be at the areas with the highest funding needs, and how to measure those needs. However, the deprivation element should clearly account for population: not doing so is indefensible. Compensating those that have lost out while letting those who have gained keep their gains would cost £34 million.

Funding for the Multiply Programme

30. Multiply is a new numeracy programme that will be funded by a ring-fenced share of the UKSPF across the UK. Some will be retained by the UK government for a centrally managed online numeracy training platform. Most is allocated to councils to help improve numeracy in their areas, with the ultimate goal of enhancing job opportunities and boosting productivity.
31. Each nation, LEP area and council is set to receive the same share of multiply funding as it will receive in core UKSPF funding. This means that Wales, which will receive a large share of UKSPF funding given the large share of funding it receives from EU schemes, will receive almost 7 times as much funding per person for Multiply than England.
32. Improving numeracy skills may have benefits in terms of employment, earnings and productivity. But while Wales does have lower levels of employment, earnings and productivity than England, it seems highly unlikely that spending seven times as much per person on numeracy skills is the best way to address this. Indeed, as of the early 2010s, levels of numeracy in Wales and England were almost identical (in both cases, poor). (Source: https://www.nationalnumeracy.org.uk/what-numeracy/what-issue).
33. ***Given UK government commitments to match previous EU levels of funding for each of the nations of the UK, the UK government could not just have reduced how much Multiply funding it gives Wales (this would definitely have broken its pledge). But if it had engaged more with the Welsh Government at an earlier stage, it may have realised that it made sense to ring-fence a smaller proportion of total UKSPF funding to Multiply in Wales, allowing more to be spent on other types of economic development policies. It may still be possible to revise this decision.***
34. ***The Department of Education is undertaking an evaluation of the Multiply Programme. It is not fully clear whether this will include evaluating its impact in Wales. Ideally it would, as it is a UK-wide programme. Moreover, the much higher-levels of funding received by Welsh LAs (given the way UKSPF funding levels have been rolled over from EU funding levels) relative to comparable English LAs offers a chance to learn about how the intensity/scale of the programme affects its impacts. This would help determine whether the programme is worthwhile, and at what intensity it should operate at.***