

Evidence Paper to External Affairs & Additional Legislative Committee – 20 March 2017

Regional Policy in Wales

Background

1. We set out in our White Paper, *Securing Wales' Future*, the Welsh Government's key priorities for Wales for the upcoming EU negotiations, including the following of direct relevance to the Committee's inquiry:
 - Replacement of the £370m a year of ESI funds¹ over the long term by a revision to the Block Grant.
 - Powers already devolved to Wales – agriculture, fisheries, regional development and environment, for example – will in future be exercised in Wales without an EU regulatory framework.
 - Wales should continue to benefit from access to EU programmes operating on an international basis, such as Horizon 2020, ERASMUS+, Creative Europe and the Wales-Ireland Programme.
 - The UK Government should prioritise, in the Article 50 negotiations, a transitional phase after our formal exit from the EU, to avoid the chaos and uncertainty which would arise from a sudden 'cliff edge' departure.
 - Reserved powers which would, in principle, be exercised at UK level (for example, on international trade or competition) have the potential to impact adversely on devolved policies in Wales. This requires new ways of working between the UK Government and the devolved administrations, which should be subject to independent arbitration.
2. Some of these priorities were subsequently reflected in the UK Government White Paper, *The United Kingdom's exit from and new partnership with the European Union*, such as recognition of the need for "a smooth, orderly exit from the EU" and avoidance of a "cliff-edge". The UK White Paper also provides assurances around devolved competences, asserting that "no decisions currently taken by the devolved administrations will be removed from them and... that more decisions are devolved". We are seeking confirmation that this provides for decisions currently made at an EU level, such as those around regional policy, being retained at the devolved administrations, along with appropriate and adequate replacement funding.
3. We also continue to make strong progress in delivering our agreed 2014-2020 EU programmes and these remain important investments for individuals, businesses and communities across Wales. The uncertainty of

¹ Comprising the structural (ERDF and ESF), rural development (EAFRD), and fisheries (EMFF) funds

the outcome of negotiations following the triggering of Article 50 creates unprecedented challenges to delivery, but these are being managed via close working with the UK Government.

4. This Committee's inquiry is very timely, and I have also begun discussions on the future of regional policy with the European Advisory Group and the European Structural Investment (ESI) funds Programme Monitoring Committee. Now is the right time to be considering our options, despite the considerable uncertainty around the fiscal and legislative context in which any future regional policy arrangements will operate.

Update on progress of 2014-2020 programmes

5. Wales has been a major beneficiary of ESI funds, which represents £370m a year of the total of £650m a year of overall EU funding that currently flows into Wales. This funding is provided to support structural, rural and fisheries interventions:
 - £295 million a year for Structural Funds (for investments in businesses, people, infrastructure and research)
 - £80 million a year for the Rural Development Plan² (for investments in land management and the rural economy)
 - £2 million a year from the European Maritime and Fisheries Fund
6. These programmes, in turn, lever additional Welsh Government resources and funding from other sources, including from the private sector.
7. I wrote to the Committee on 22 February to provide an update on the implementation of the ESI funds in Wales, highlighting that around two thirds of ESI funds were committed to date. These figures have also been reported to the ESI funds Programme Monitoring Committee (PMC) which met on 22 February. The detailed PMC reports include further information on the progress against a range of monitoring indicators: for example, supported projects will assist over 41,500 businesses, and provide training / employment support to over 396,800 people. These reports are published in full on the Welsh Government website³.
8. The European Maritime and Fisheries Fund is also now fully open and is helping us deliver against our commitment to safeguard fishing industry jobs and develop a vibrant, competitive and sustainable fishing sector in Wales. Strong project pipelines are in place, and Wales is the only part of the UK to put in place support for small fisheries businesses to access funding.

² Note: includes a transfer from Pillar 1 of the CAP, and covers both socio-economic investments and environmental investments in land-management and biodiversity

³ Available at: <http://gov.wales/funding/eu-funds/2014-2020/programme-monitoring-committee/?lang=en>

9. Delivery to date compares favourably with performance from the equivalent period in the previous 2007-2013 programmes with many 2017 spending targets already met. We remain confident of bringing the entire EU funding available to Wales under the 2014–2020 programmes within the scope of the UK Government’s guarantee to fully fund all projects approved before the UK leaves the EU. With a strong pipeline of further investments under development, our aim is to invest 80 per cent of ESI funds by the end of this calendar year, with all remaining funds being allocated by early 2019.
10. We are also continuing engagement with, and encouraging participation in, other EU programmes. The Ireland-Wales programme continues to make considerable progress with 50% (€40m) of funds committed to date. Wales has also attracted over €54m from the Horizon 2020 programme with 112 participations.

Measuring impact

11. These combined resources are vital to Wales. Since 2000, the investment of EU funds alongside domestic resources has helped to arrest the decline in Wales’s economic performance and has laid foundations for more sustainable prosperity, in particular for the West Wales and the Valleys region where the bulk of the funding has been targeted. As described in *Securing Wales’ Future* we have seen significant progress in many areas targeted by EU regional policy programmes such as: some narrowing of gaps, both within Wales and with the UK, in employment and economic inactivity rates; an improving qualifications profile; and significantly increased levels of R&D investment.
12. These improvements represent a combination of investment, not just that from the ESI funds, with progress the result of a whole Government and cross-sector approach to target these areas across Wales. The ESI funds remain a key tool, however, and have injected much needed investment in a period of fiscal austerity.
13. We have made significant progress via investments in skills, research, innovation, enabling infrastructure, community development, and supporting businesses to start-up, increase resilience and to grow. It is not possible, however, to identify a direct causal link between the investment of ESI funds and the overall performance of the Welsh economy (as measured by GVA), which is more likely to be affected by UK macro-economic policy. The scale of the ESI funds compared to wider investment programmes and the economy as a whole makes such links difficult. The outputs and results of EU investments, complemented by evaluation and case study evidence, do however demonstrate a clear impact on the prospects for individuals, communities and businesses across the whole of Wales.
14. Our experience in managing successive programmes has provided greater clarity around the scale of direct impact that we might realistically

associate with regional policy interventions and has facilitated development of a range of more specific result indicators which focus on very specific outcomes and which are now at the core of current EU programmes in Wales.

EU Transition and Closure Arrangements

15. Immediately following the referendum the Welsh Government sought an urgent guarantee from the UK Government that Wales would not lose a penny of its agreed EU funding as a result of Brexit. The UK Treasury (August 2016 and October 2016) responded by providing a guarantee which underwrites all EU funding committed to projects before the UK leaves the EU (including agri-environment schemes under the Rural Development Plan). The Treasury also confirmed that the current level of direct farm payments (CAP pillar 1) will be supported until 2020.
16. We are forced to prepare for EU transition on the basis of significant uncertainty, and the further forward one looks clearly the greater that uncertainty is. The EU legislative framework will continue to apply while the UK remains a member of the EU, and the Welsh Government is working closely with the UK Government and the other devolved administrations to ensure Wales' interests are protected and to secure the smoothest possible transition period. My officials are taking part in a number of work-streams with the UK Government which have been established to consider the implications of EU transition, including those associated with the Great Repeal Bill, given projects will be funded to end of 2023.

The future of regional policy in Wales

17. Should the EU funding Wales currently receives be replaced in full, as promised by those campaigning for 'leave' during the referendum campaign, and devolved competences be properly respected by the UK Government, we will have an important opportunity to revisit both the role and function of regional policy in Wales. In doing so, we need to build on the learning and the evidence of what has worked from our involvement in successive EU programmes to date and to learn also from how other countries, across the world, are responding to their own challenges and opportunities.
18. Successive Welsh programmes have led to increased strategic focus and targeting, attempting to better define realistic outcomes of investment and moving away from unrealistic macro-economic expectations linked to GVA. Despite the progress to date long-term challenges remain, and appropriate long-term needs-based funding is essential to continue to invest in addressing those regional disparities.
19. Our ambitions for greater cross-Government working described in *Taking Wales Forward*, and the principles set out in the *Wellbeing of Future Generations Act*, will require future regional policy to be an integral part of

joined-up Welsh Government approaches to sustainable and inclusive investment over the long-term. Regional policy cannot stand alone and must be a fully integrated part of our regional planning and investment approach across Government.

20. Free from specific EU regulations, a 'made in Wales' regional policy could define more relevant and tailored objectives and outcomes and be focussed on delivering what matters most to our citizens and communities. Importantly, there is the opportunity to achieve real integration between regional policy interventions, broader Welsh Government investments, and those made by our public, private and third sector partners across Wales. This includes opportunities to link planning and delivery more effectively and to reflect emerging regional structures and approaches within Wales, as set out in our proposals for local government reform.
21. The removal of current geographic inflexibilities, such as the artificial separation of West and East Wales or urban and rural areas would give an opportunity to design a more coherent approach that works for all parts of Wales, reflecting local and regional opportunities and needs.
22. I have been clear in discussions with the European Advisory Group and the PMC that genuine partnership working is critical to any future approach to regional policy in Wales. This should build on the strengths of the partnership working developed over previous ESI programmes but should also explore how we can do more, such as working with the new functional and systematic regional areas described in our local government reform agenda.
23. The chance to revisit regional policy in the round also provides us with the opportunity to learn from what works from around the world, as well as what works within the EU. I am pleased, therefore, that this is part of this inquiry's terms of reference. We have already begun to look at how regional policy is delivered in developed nations outside the EU and I have included a summary of some of this early work in Annex A.

Working across borders

24. Wales cannot operate in isolation from the rest of the UK, with the Welsh economy closely integrated with the wider UK economy, especially England. To deliver balanced economic development within the UK it will be essential that the UK Government uses UK/England and Wales levers (e.g. trade policy, competition policy, labour market policy, rail infrastructure, energy, taxation, etc.) to enable stronger, more inclusive and more balanced distribution of economic growth. Decisions on macro-economic policy within the UK have a significant, and often greater, impact on Wales than domestic micro-economic interventions.
25. We will want to be able to make links with, and invest jointly in, our border areas, for example links between North Wales and the Northern Powerhouse or mid-Wales and markets in England; but this must be done

in a partnership of equals between the Welsh Government and UK Government, not pursued unilaterally. UK Government investments in infrastructure, research and innovation are other examples of where closer cooperation with the Welsh Government is required to ensure UK investments work with, not against, the grain of regional policy and recognise the distinctive Welsh policy context.

26. Our White Paper also calls on the UK Government to commit to continued participation in those EU programmes that involve strong international collaboration. Of particular importance to Wales are the links to our neighbours in Ireland, currently supported via a dedicated Ireland-Wales cooperation programme. We are also seeing increasing success from participation in programmes for research and people exchange via Horizon 2020 and ERASMUS+. We are keen to continue participation in these programmes and therefore welcome the UK Government's commitment to consider payments into the EU budget for continued participation in such programmes.

Working in partnership

27. The First Minister has consistently made clear that the Welsh Government does not have a monopoly on wisdom and we aim to involve partners and stakeholders across Wales in shaping the best approach to regional policy in Wales outside of the EU. This Committee's inquiry will be an important contribution to that discussion.
28. I have begun discussions with the European Advisory Group and the ESI funds Programme Monitoring Committee, to hear initial views on what the future of regional policy might look like. Those discussions made clear there is an appetite to explore all options for reform, learning from best practice across the world, but also learning lessons from previous investments. At the same time there are features of the ESI funding approach that are valued, such as long-term planning, targeting long-term structural weaknesses, and the emphasis on strong partnership working.
29. I am considering this advice, and I will be following closely the progress of this Committee's inquiry to inform our thinking in this area.

Mark Drakeford AM
Cabinet Secretary for Finance and Local Government
March 2017

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ANNEX A: Best practice elsewhere in the world – early findings

In considering options for the future of regional policy in Wales we have begun to look at international best practice in terms of approaches to regional economic development and reducing regional economic disparities. We are keen to learn not only from the experience of implementing EU programmes in Wales over the past two decades, but also how things might be done differently. We have initially focussed on OECD analyses of regional policy approaches, and focussed on four case studies for countries outside of the EU: Norway; New Zealand; Canada; and Iceland. This section summarises our initial findings in this area.

Purpose of regional policy across the OECD

One of the key aims of EU regional funding is to tackle economic, social and territorial disparities between regions. In the EU this is delivered via a needs-based and multi-annual financial allocation determined by relative wealth between those EU regions; reflecting the different challenges faced by different regions. Regional policy in the EU has evolved in recognition that the aggregate economic benefits of integration within the single market, and EU trade policy, would benefit some regions more than others; in particular where those regions faced significant geographical, industrial or labour market challenges. These issues are common to all developed nations, with regional policy in various forms a key response to seek to redress those imbalances.

A comparative report by the OECD⁴ highlights regional policy emerging across its members during a period of growth in the 1950s and 1960s; with the objective of reducing emerging income and investment inequalities between regions (the response predominantly being large public investment programmes). The focus on inequality was broadened to incorporate increasing employment in the 1970s and 1980s, reflecting changing socio-economic challenges. As a result more investment was focussed on firms to influence location and employment decisions.

Current EU policy approaches, reflected in the ESI funds, are broadly similar to those in other developed countries outside of the EU, as described by the OECD. Over recent decades this has involved an increasing policy emphasis towards regional competitiveness; expanding the role of regional policy. This mirrors wider trends for policy and funding decentralisation, and reflects a more proactive approach of supporting regions to build on their strengths, rather than compensate them for disadvantages. Investment approaches thus increasingly focus on the supply-side, via investments to support an accommodating business environment. This involves continued investment in regional capital (both infrastructure and labour) as well as targeting support at firms in areas of endogenous potential (rather than via inward investment alone). The implications of this shift are that regional policy is increasingly

⁴ OECD (2010), *Regional development policies in OECD countries*, OECD. Available at: <http://www.oecd.org/gov/regional-policy/regionaldevelopmentpoliciesinoecdcountries.htm>

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place-based and context-specific, requiring more diversity in investment approaches and partnerships.

Regional policy has been established as a central policy for developed countries, offering a place-based and multi-sectoral growth strategy to complement national economic and labour market strategies. Regional policy objectives vary between countries, but generally aim to tackle disparities, increase employment, and increase competitiveness. The historic focus on lagging regions now also incorporates developing the potential of all regions.

An increasingly important feature of EU regional policy has been a focus on results. This approach aims to identify areas in which genuine change can be both effected and measured; injecting a dose of realism, given GVA and other macro-economic indicators are predominantly affected by levers beyond the direct influence of regional policy. The move away from abstract aggregate indicators is mirrored in OECD reporting, which assesses regional impacts across a broader range of welfare indicators more closely related to improvements in people's lives⁵. The continuing importance of regional policy in developed nations is supported by findings from the OECD that regional policy can be effective not only at supporting growth ambitions, but also in helping address inequalities, particularly in rural and underdeveloped areas.

The remainder of this section of the paper extracts findings specific to the four case studies examined to date.

Common themes and features of approaches to regional policy

Although commonalities and key themes are apparent across most regional policy approaches, it is important to remember that every regional policy is specific to that region, and authentic in the sense that it has been designed with the region in mind. It is thus impossible to select and supplant a regional policy from another country, but it is possible to consider best practice, understand what has worked elsewhere.

The four case studies examined to date provide an insight into current trends and themes regarding regional policy. Inevitably, all regional policy is a combination of funding streams, such as national funding and dedicated place-based funding. At the heart of all regional policy is a motivation seeking to alleviate regional differences to ensure that regardless of where a citizen chooses to reside, they can access public services, secure employment, and utilise a good quality local infrastructure and services.

A place-based approach

In all of the cases that have been studied thus far, a targeted place-based approach to regional policy is prevalent. It is apparent that the dividing up of

⁵ These include 'well-being (income, jobs and housing)' and 'quality of life (health, education, access to services, environment...community, and life satisfaction)' outcome indicators. OECD (2016), *OECD Regions at a Glance 2016*, OECD. Available at: http://dx.doi.org/10.1787/reg_glance-2016-en

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countries into regions provides for a more direct approach. For example, in Norway, “development zones” or “action zones” help to target policy and funding to a specific place; the objective being to make disadvantaged areas an attractive place to live and work. This is also the case in Canada, which again has a focused, place-based approach, which suggests that place-based “zoning” is at the core of regional policy. The nature of such zones varies over time.

A programmatic approach

Regional policy seems to be commonly made up by a variety of programmes. These can be both broad, in a pan-region or national sense, and/or focused on a particular issue. For example, in Iceland in 2015, a 10 year loan facility totalling 12 million EUR for SME borrowing was launched, targeting rural areas across Iceland. In New Zealand, a targeted action plan for the region of Hawke’s Bay area aims to create 1,000 jobs, via a combination of investment programmes. In Canada, in August 2016, the Government announced that it will provide \$86million in stable funding over the next three years to again support the growth of SMEs and foster local economic development in Quebec. In all examples, funding for economic development is made up of both regional and/or national programmes, providing funding over a period of time with set goals in mind; for example, reducing unemployment, assisting SME start-ups and so on.

Investment approaches seem to be focusing on helping business, including through continued investment in infrastructure and labour, as well as targeting investment in firms in areas of endogenous potential, rather than via inward investment alone. The implications of this shift are that regional policy is increasingly context-specific, requiring more diversity in investments and partnerships.

Bodies or agencies

In many instances, each sub-region will have an agency or body that will understand what local issues and development needs are, and be able to redirect funding to address this. In Iceland, the Icelandic Regional Development Institute, known locally as the Byggdastofnun, implements government policy and looks after regional strategy. In Canada, regional development agencies (RDAs) serve the entire country, with specific agencies covering certain territory, due to the vast landmass of Canada. Two examples are the Atlantic Canada Opportunities Agency (ACOA), which covers the most easterly point of Canada and the Canada Economic Development for Quebec Regions (CED) which covers the Quebec region. There is clearly a need to have an overarching body which covers regional policy and administers / manages the funding of programmes, with the ability to adapt to the needs and opportunities of different regions.

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Overarching Policy

In most instances, an overarching strategy or policy seems to direct the focus of regional policy and funding. In New Zealand the “Regional Growth Programme” looks at the economies of the regions, and sets the priorities and programmes. Much the same, in Canada, the “Building Canada Plan” (which ended in 2014), set the tone for policy and funding in the regions. It seems a central and core policy sets the approach for regional policy and funding, and can perhaps provide the public and stakeholders with confirmation of the Government’s priorities for the following period.

Policy Trends

Key policy trends across all of the regions seem to be improving access to employment, encouraging innovation and supporting SMEs (via funding, tax breaks and so on), and ensuring that local communities can rely on medium term and stable sources of funding. The OECD also notes that, across all of its members, regional policies have an ability to respond to new ideas about economic growth in all areas, and so responding to the needs of different regions seems to be an important tool to respond to those imbalances.