# Preparations for Replacing EU funding for Wales:

# Evidence for the Finance Committee of the National Assembly for Wales

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## 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** |

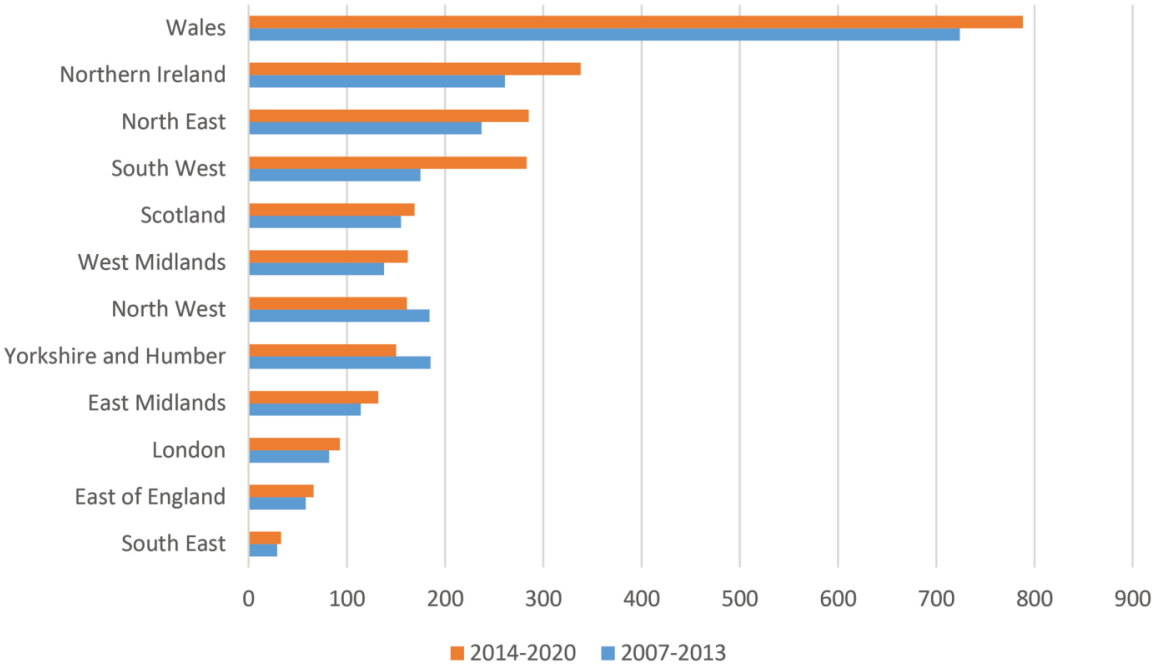
Allocation of the EU SIF funds is largely based on measures of relative need. In the 2014-2020 MFF, the main indicator of need was GDP per head. EU regions were divided into: *less developed regions* (GDP/head < 75% of EU-27 average); *transition regions* (GDP/head between >= 75% and < 90% of EU-27 average) 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)

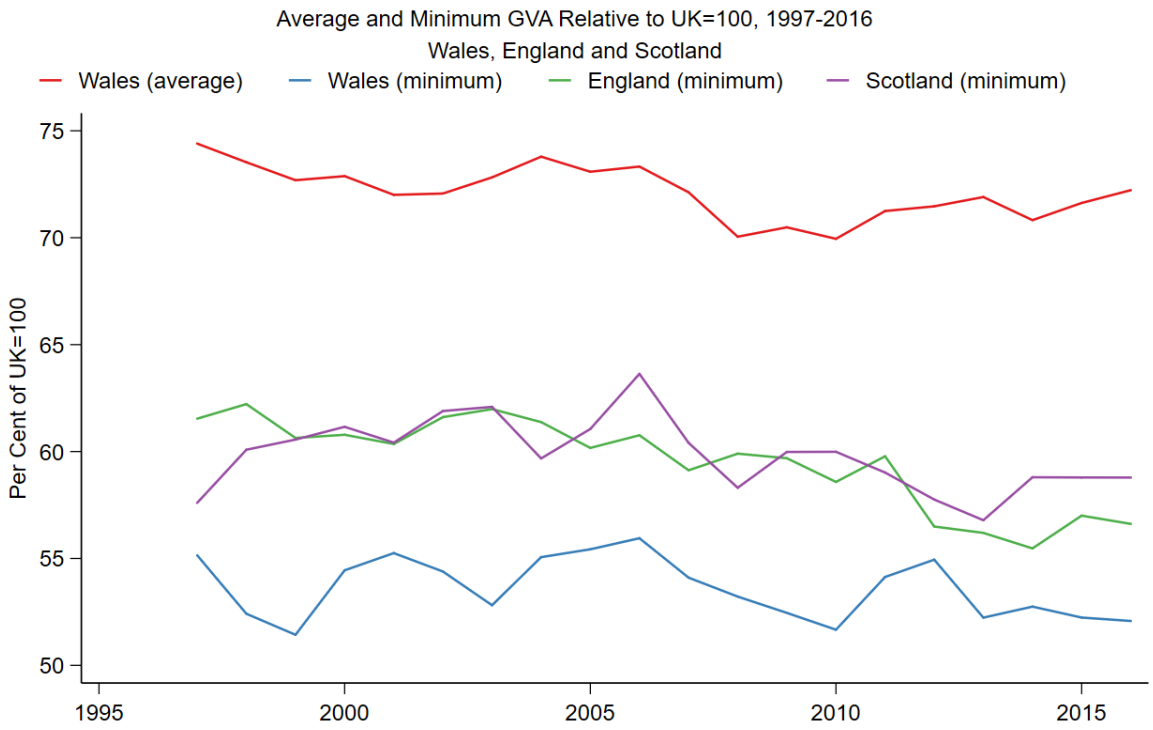
It follows that Wales will continue to benefit if the UK government puts in place policies that allocate support using similar criteria to current arrangements. The evidence that Wales would continue to qualify for support if funds were allocated using GDP per head, or a similar measure of need is compelling. 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:

[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%** |