

REPLACING EU FUNDING IN WALES

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

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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.

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