WALES AND THE EU COHESION POLICY

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This report is one of a series examining the implications of EU membership for Wales, and the legal and policy considerations presented by the EU referendum vote. The full set can be found at http://sites.cardiff.ac.uk/wgc/eu/

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COHESION POLICY

The referendum on 23rd June 2016 will determine whether the UK remains a member of the European Union (EU). This paper on Cohesion, or Regional Policy is one in a series of briefs which outline what the EU's powers are in this area, those of the UK Government and of the authorities in Wales. It will establish where those powers and responsibilities would return to on a possible Brexit and provide an impartial evidence-based overview of the issues and consequences of a Leave or Remain vote from the perspective of Wales. It forms part of a set of financially focussed papers alongside one on the EU budget.

IN BRIEF

- Cohesion Policy aims to reduce economic disparities across the EU territory. Regions are categorized according to their level of development and receive allocations of resources from up to three different funds with distinct priorities for action.

- Under the 2014-2020 programming period Wales has been allocated 2.4 billion euros, more than 20% of all funding available to the UK. Wales enjoys significantly higher levels of funding than other UK regions and is, as a result, a net beneficiary of EU membership

- Responsibility for implementation of cohesion policy is delegated to the Member States in line with their different institutional frameworks. In the UK, the administration of the funds in Wales falls under the responsibility of Welsh Ministers.

- In the event of Brexit, if Wales is to continue to receive similar levels of funding for economic development, this would have to come from domestic sources. Whether or not such funding is made available will have implications for economic strategy in Wales.

- Alternative models for UK-EU relationships could involve the UK contributing to a form of cohesion policy, though it may be unable to gain receipts for its own 'less developed regions' such as West Wales and the Valleys.

- As the significance of this policy is far greater for Wales than the UK as a whole, **this is an area where Wales will need to ensure its interests are fully reflected in any Brexit negotiations.**

- If the vote is to remain, **Wales will need to participate as fully as possible in negotiations around future policy design for 2021 onwards.**

WHAT DOES THE EU DO IN THIS AREA?

The European Union promotes balanced economic development across the EU territory with its regional policy, also known as cohesion policy. Article 174 of the Treaty on the Functioning of the European Union (TFEU) states that the European Union shall seek to promote 'harmonious development', strengthen economic, social and territorial cohesion and reduce disparities in levels of regional development. The achievement of these objectives is foreseen through action under the European Structural and Investment Funds (ESIF), alongside the European Investment Bank (EIB) and other financial instruments.

Cohesion Policy covers three funds – the European Regional Development Fund (ERDF), the European Social Fund (ESF) and the Cohesion Fund. Only the first two are relevant for Wales:

> **European Regional Development Fund (ERDF)** - Article 176 TFEU states the fund helps redress regional imbalances within the Union through development and structural adjustment of regions whose development lags behind and the conversion of declining industrial regions;
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> **European Social Fund (ESF)** - Article 162 TFEU establishes that the fund aims to improve employment opportunities for workers, make their employment easier, increase their geographical and occupational mobility, and facilitate their adaptation to industrial and production changes.

The precise tasks, priority objectives and organisation of the funds are defined in a series of laws agreed by the Council (Member State governments) and European Parliament (directly elected members) as co-legislators.[1] The European Economic and Social Committee and the Committee of the Regions, in which Welsh stakeholders

[1] Decision making takes place here in accordance with the EUs 'ordinary legislative procedure'. See for an explanation of the EUs institutions and its law making procedures http://ukandeu.ac.uk/explainers/the-european-union-the-institutional-system-explained/.

are represented, are consulted. The main Regulations[2] are accompanied by further implementing and delegated acts that supplement the non-essential elements of the main legislation.[3]

Under Cohesion Policy a system of 'shared management' means that whilst the Commission has overall responsibility for the EU budget, implementation is delegated to the Member States. The Common Provisions Regulation (CPR) is an EU law covering all the funds which states that, in accordance with the principle of subsidiarity,[4] the objective of achieving economic, social and territorial cohesion can be better achieved at EU level. Nevertheless, this involves Member State implementation and control of the programmes established under the funds, the rules on which are set out in the EU Regulation. Furthermore, rather than a one-size-fits-all approach, the implementation of the funds must respect 'the specificities of the Member States' different institutional and legal frameworks'.

All EU regions are eligible for ERDF and ESF funding[5] Regional allocations depend on the categorisation of regions according to their Gross Domestic Product (GDP) per capita, with the majority of resources available to regions lagging behind:

'less developed regions' are those whose GDP per capita is less than 75% of the EU average;[6]

'transition regions' are those who GDP is between 75% and 90% of the EU average;

'more developed regions' have a GDP per capita above 90% of the EU average.[7]

Funding allocated to the UK for the period 2014-2020 is €11.8bn, of which €2.4bn, or over 20% of the total, is destined for Wales. Wales is subdivided into two regions for EU regional policy purposes. West Wales and the Valleys[8] which is currently designated a 'less developed' region has been allocated nearly €2 billion. East Wales is a 'more developed region' and receives an allocation of €406 million.[9] The level of

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[2] For the 2014-2020 programming period these are: the Common Provisions Regulation (1303/2013), the ERDF regulation (1301/2013), the ESF regulation (1304/2013), and the ETC regulation (1299/2013).

[3] http://ec.europa.eu/regional_policy/en/information/legislation/implementing-acts/; http://ec.europa.eu/regional_policy/en/information/legislation/delegated-acts/

[4] Subsidiarity is a principle enshrined in Article 5 of the Treaty on European Union. It seeks to ensure that all decisions are taken as close as possible to the citizen and that the EU will not take action unless it is more effective than action taken at national, regional or local level.

[5] Total available funding under EU cohesion policy for the period 2014-2020 amounts to €351.8 billion.

[6] Under previous programming rounds Convergence (2007-2013) or Objective 1 (2000-2006).

[7] Under previous programming rounds Competitiveness (2007-2013), and Objective 2 (2000-2006) respectively.

[8] West Wales and the Valleys incorporates Anglesey, Blaenau Gwent, Bridgend, Caerphilly, Carmarthenshire, Ceredigion, Conwy, Denbighshire, Gwynedd, Merthyr, Neath Port Talbot, Pembrokeshire Rhondda Cynon Taf, Swansea and Torfaen.

[9] East Wales incorporates the local authorities of Cardiff, Flintshire, Monmouthshire, Newport, Powys, Vale of Glamorgan and Wrexham.

resources and types of activity funded reflect the different designations of the two Welsh regions.

WHAT POWERS DOES THE UK AND WALES HAVE IN THE AREA OF COHESION POLICY?

Member State governments and EU institutions agree the regulatory framework for cohesion policy, and each state agrees a Partnership Agreement with the European Commission, setting out priority areas for action. Wales is able to feed into this process through national channels, and also deals directly with the European Commission in the development and negotiation of Operational Programmes. The Operational Programmes for Wales target research and innovation, SME competitiveness, renewable energy and energy efficiency, and connectivity and urban development.

The implementation of the funds in Wales falls under the responsibility of the Welsh Ministers. The power to administer the funds is conferred upon Welsh Ministers in line with section 2(2) of the European Communities Act 1972 through the *Structural Funds (Welsh Ministers) Regulations 2014* for ERDF and ESF.[10] This instrument allows Welsh Ministers to exercise certain functions in relation to the preparation and implementation of the programmes in Wales and fulfillment of the management control and audit functions.

In line with the Memorandum of Understanding between Central Government and the Devolved Administrations responsibility for the compliance of the Welsh programmes with EU regulatory requirements and for any financial penalties imposed falls directly to the Welsh Ministers.[11] The UK government (a Minister of the Crown) has concurrent power with the Welsh Ministers on a small number of financial / audit functions such as the submission of accounts.

The ERDF and ESF programmes in Wales are managed by the Welsh European Funding Office (WEFO). Projects are co-financed with other public or private sources. Some examples of EU-funded projects include the A465 Heads of the Valleys dualling, Harbour Way in Neat Port Talbot, the Wales Coastal Path and Swansea University new Bay Campus,[12] as well as a variety of skills and training initiatives.[13] The EU also funds agricultural and fisheries programmes in which Wales receives specific allocations and directly manages a series of other financial programmes which Welsh organisations can apply for.

[10] http://www.legislation.gov.uk/uksi/2014/92/contents/made [accessed 25.05.2016]
[11] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/316157/MoU_between_the_UK_and_the_Devolved_Administrations.pdf [accessed 25.05.16]
[12] See: http://gov.wales/funding/eu-funds/?lang=en [accessed 25.05.16]
[13] http://gov.wales/docs/wefo/publications/160506-people-communities.pdf [accessed 13.06.16]

WHERE WOULD POWER AND RESPONSIBILITY FOR COHESION POLICY RETURN TO IN THE EVENT OF BREXIT?

In the event of Brexit, it can be assumed that EU Regional Policy and its legislative framework would cease to apply to the UK, in accordance with any relevant provisions of the withdrawal agreement reached between the UK and the EU.

Whilst the Welsh Assembly and Ministers have a range of devolved powers to promote economic development[14] which could be used to develop a local regional policy, it is unlikely that a Welsh-level policy could be envisaged to replace EU Cohesion/Regional Policy in terms of the current levels of financial resources available and its geographical scale. The UK Parliament retains the right to legislate in this area, and it would be likely that the Welsh administration would lobby the UK Government to replace this policy and its funding.

The UK Government's position for a number of years has in fact been to 'renationalise' the policy with richer Member States funding their own policy to reduce regional disparities. Whilst previous UK governments have guaranteed that, should repatriation of the policy take place (as a result of policy reform), domestic funding would match expected EU receipts, the Prime Minister has recently announced that there would be no such guarantee on a possible Brexit.[15]

ISSUES FOR WALES IN RELATION TO REMAINING OR LEAVING THE EU

FINANCIAL CONSEQUENCES

In the event of Brexit, UK regions would cease to be eligible for Cohesion Policy. At UK level the effect is likely to be minimal - the UK is a net contributor to the EU budget and the amount received in relation to GDP is small[16] - in fact 97% of the funds received by a region have been contributed by local taxpayers. Nevertheless, from UK accession in 1973 until the end of the current programming period in 2020 it is estimated that the UK will have received more than €66 billion from the ERDF and

[14] See variously Governance of Wales Act 2006, Schedule 7; Welsh Development Agency Act 1975.
[15] http://www.bbc.co.uk/news/uk-wales-politics-35666731 [accessed 03.05.2016]; http://ukandeu.ac.uk/what-a-difference-a-decade-can-make-cohesion-policy-and-brexit/
[16] For the 2014-2020 programming period under the ERDF and ESF the UK has been allocated an amount equivalent to less than 0.1% of GDP (in real terms it amounts to c. €10 billion).

ESF.[17] EU receipts vary considerably and so any repatriation would have very different effects across the UK. Of the 37 regions in Britain (as defined under the EU's classification system), 35 are *net* contributors to the structural funds, with only West Wales and the Valleys and Cornwall net beneficiaries.[18]

A full analysis at Wales' level is not possible due to the fact that it is the UK as a Member State that contributes to the EU budget whilst the Structural Funds are allocated at the level of the two Welsh programming areas. In terms of receipts Wales enjoys significantly higher levels of funding than other UK regions – the EU contribution for the 2014-2020 programming period across the 4 Welsh ERDF and ESF programmes totals 2.4 billion euros. This follows equivalent levels of investment in the 2007-2013 programming period, and funding for economic and social cohesion programmes dating back to EU accession in 1973.

The Institute of Fiscal Studies calculates that the European Structural and Investment Fund programmes are worth €150 per person per year in West Wales and €50 per person per year in East Wales. Figures from the Centre for European Reform (2015) show that the Welsh Government receives more per capita from the EU than any other part of the UK, and that whilst the net *contribution* per capita for the UK as a whole is £117, for Wales there is a net *benefit* of £273 per person (ESIF and CAP receipts were included in the calculation).[19] Latest research from the Wales Governance Centre show a net benefit to Wales of being in the EU of at least £79 per person per year (this figure excludes EU centrally-managed funding).

In its evidence to the last UK Government's 'Balance of Competences' review, the previous Welsh Government claimed that, whilst EU receipts are modest in relation to economic challenges faced, the support is vital to Wales' ongoing economic transition.[20] The designation of West Wales and the Valleys as Objective 1, Convergence and then a 'less-developed' region in the 2000-2006, 2007-2013 and 2014-2020 programming periods respectively meant receipts of the highest levels of funding. Nevertheless, GDP per head relative to the EU27 fell by 6.3 percentage points in the region between 2004 and 2010. In East Wales over the same period the decline was 17.7 percentage points whilst the UK overall registered a decline of 12.2 percentage points.[21]

The financial implications of Brexit for Wales would depend on the timing agreed within the process of withdrawal for budgetary allocations to the UK to cease. It is possible,

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[17] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/355455/BIS_14_981__Review_of_the_Balance_of_Competences_between_the_United_Kingdom_and_the_European_Union.pdf [accessed 07.02.2016]

[18] Open Europe (2012) Off Target, The Case for Bringing Regional Policy Back Home, http://archive.openeurope.org.uk/Content/Documents/Pdfs/2012EUstructuralfunds.pdf [accessed 03.05.2016]

[19] Centre for European Reform (2014), The economic consequences of leaving the EU, available at: http://www.cer.org.uk/sites/default/files/smc_final_report_june2014.pdf [accessed 07.02.2016].

[20] Evidence to 'Balance of Competences' review of Cohesion Policy available at: https://www.gov.uk/government/consultations/review-of-uk-and-eu-balance-of-competences-call-for-evidence-on-cohesion-policy [accessed 07.02.2016]

[21] Welsh Government response to Balance of Competence Review on Cohesion Policy, available at: https://www.gov.uk/government/consultations/review-of-uk-and-eu-balance-of-competences-call-for-evidence-on-cohesion-policy [accessed 03.05.2016]

though unlikely, that all financial obligations would cease to apply to the UK by summer 2018. This would be the case if the withdrawal process envisaged under Article 50 TEU is formally commenced in summer 2016, and is completed within a two-year deadline. In this situation, the 2019 and 2020 allocations could be lost to Wales, which would amount to at least €723 million of EU receipts.

However, the majority of government commentators suggest that a UK withdrawal could take up to a decade to negotiate and finalise. This suggests that there is *a possibility* that the €2.4bn Welsh allocation for the 2014-2020 programming period would not be affected although this would be one item of many to be determined and negotiated by the UK government. As the significance of this policy is far greater for Wales than the UK as a whole, **this is an area where Wales will need to ensure it participates fully in any negotiations.**

In terms of impact on the ground, a UK withdrawal has potential implications for programme and project management. An early closure of programmes of such significant size without financial commitment from either Her Majesty's Treasury (HMT) or Welsh Government to replace funding could result in a reconsideration of economic focus and strategy on the part of Welsh Government and potential restructuring in areas or sectors particularly reliant on EU funding, such as the Third Sector. Individual grant contracts and project scope may need to be modified in order to ensure activities are completed within the revised eligibility period. This is even more complex where financial instruments have been established and pre-financing released for example.

On the other hand, the costs of administrating the funds would be saved. In 2008 the UK government estimated that (additional) administrative costs across the whole of the UK for the funds were £28 million/year, or about 2% of the £1.2 billion/year worth of receipts.[22]

Loss of future funding under subsequent programming periods cannot be quantified or estimated at this point as there is no clarity as to the future form EU policy may take, or the future eligibility of the Welsh programming areas under the different categories of regions. If there is no significant change in the policy approach, budgetary envelope and categorization of Welsh regions, similar receipts could be expected.[23] However, an increasing focus on the use of Financial Instruments (loans, guarantees etc) as part of Cohesion Policy may be expected. **If the UK remains in the EU, Wales will need to participate as fully possible in the design of the new policy, at both national and EU level.**

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[22] http://www.publications.parliament.uk/pa/ld200708/ldselect/ldeucom/141/14107.htm [accessed 05.05.2016]

[23] To date, Cohesion Policy regulations have provided for minimum (regional and Member State level) levels of support in each programming period in relation to previous receipts. This ensures that funds do not decline too significantly as regions transition from 'less developed' to 'more developed' status – see Additional provisions under Annex VII of Regulation 1303/2013.

ECONOMIC CONSEQUENCES

The effectiveness of EU Cohesion policy and evidence of its contribution to Treaty objectives and value for money is inconclusive. Nevertheless, the UK Government's Balance of Competence Review, which sought to audit what the EU does and how this affects the UK and UK national interests, concluded that a policy to address economic development disparities between Member States was necessary to ensure the effective functioning of the internal market.[24] The funds also arguably add value in areas where EU funding has different principles from domestic funding streams and enable activities that would be unlikely to otherwise proceed, for example, transnational cooperation projects under the Ireland-Wales programme. Cohesion Policy receipts in other EU Member States potentially benefit Welsh companies who are able to bid for contracts to deliver projects. Improved economic growth in Member States that are net beneficiaries of the policy leads to greater export opportunities. Less tangible benefits of Cohesion Policy included the emphasis on partnership and the multi-annual programming approach which allows stability and certainty in planning strategic interventions over a 7-year period.

In general, evaluations show that the effective use of Structural Funds is reliant upon the quality of governance in the region concerned.[25] The UK was one of only 6 Member States where the Structural Funds were found to demonstrate significant evidence of boosting investment.[26] Impacts of the funding are also arguably greater with people-focused interventions rather than place-based infrastructure investment and in regions with higher levels of education.[27] Access to funding in Wales has been criticized for being driven more by process rather than outcome. The European Court of Auditors conclude that, in general, and despite moves towards simplification, the arrangements for cohesion spending are complex with six layers of EU rules supplemented on occasion by national legislative requirements.[28] There is no reason therefore why an alternative future UK regional policy could not be successfully implemented, but to date there is no information about what that could look like and the implications on Welsh Government policy and strategy.

PARTICIPATION POST-BREXIT

In the event of Brexit, the most likely area where continued Welsh participation in EU Cohesion Policy could be envisaged is under European Territorial Cooperation (ETC) programmes. Here non-Member States (and their regional/local governments) are

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[24] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/355455/BIS_14_981__Review_of_the_Balance_of_Competences_between_the_United_Kingdom_and_the_European_Union.pdf [accessed 07.02.2016]
[25] Sascha Becker, 'EU structural funds: Do they generate more growth?', Chatham House, December 2012, quoted in Centre for European Reform (2014), The economic consequences of leaving the EU, available at: http://www.cer.org.uk/sites/default/files/smc_final_report_june2014.pdf [accessed 07.02.2016]
[26] http://www.ifs.org.uk/uploads/publications/bns/BN181.pdf [accessed 06.05.2016]
[27] Centre for European Reform (2014), The economic consequences of leaving the EU, available at: http://www.cer.org.uk/sites/default/files/smc_final_report_june2014.pdf [accessed 07.02.2016]
[28] European Court of Auditors, Opinion 7/2011.

able to participate in cross-border, inter-regional and transnational cooperation projects where they share a land or sea border with an EU member.[29] Wales currently participates in the Ireland-Wales, and Atlantic Area programmes. Whilst it could be envisaged that Welsh participation in these and other ETC programmes could continue, Wales would have to fund such activity from its own budget as, participation by non-members is reliant upon their financial contribution (ERDF equivalent funding).

Other EU funding mechanisms for non-Member States bordering the Union would also be unlikely to be relevant to the UK context. The EU's Neighbourhood Policy forms part of the EU's foreign policy and focuses on Eastern or Southern states bordering the EU that agree a commitment to 'common' values such as democracy and rule of law and promote political, social and economic integration with the European project. These countries are able to participate in EU Cohesion Policy programmes, including ETC and the Instrument for Pre-Accession (IPA). It seems evident that this avenue is not one that would be likely to be open to a withdrawing Member State with the UK's characteristics.

In a potential scenario whereby the UK negotiates an alternative relationship with the EU, the Swiss and Norwegian models are most frequently-quoted alternatives. There is no equivalent to Cohesion Policy in the European Free Trade Association (EFTA) and hence the Swiss model has no equivalent to Cohesion Policy. The European Economic Area (EEA) has an EEA financial mechanism and a separate Norwegian Financial Mechanism also exists. The mechanisms mirror the functioning of Cohesion Policy in the EU in terms of investing in priority themes under multi-annual programmes to reduce economic and social disparities and promote internal trade and economic relationships. In financial terms the contributions are significant - over 2009-2014 the EEA financial mechanism contributed EUR 988,5 million, and the Norwegian Financial Mechanism EUR 800 million to the reduction of regional disparities in the eligible Member States; Norway provides approximately 97% of all funding under these mechanisms. For the period 2014-2021 the Norwegian contribution will be over 390 million euros per year.[30]

No part of the UK would be eligible to receive funds under these mechanisms which are targeted at *Member States* with a GNI of less than 90% of the EU average. As there have been no previous examples of opt-outs in this area, it would seem likely that the UK would be expected to contribute towards this externally-focused form of Cohesion Policy as well as establish and fund an alternative regional policy internal to the UK. In addition, under EEA membership future regional interventions would still be subject to the EU state aid rules limiting the freedom of domestic authorities to invest in businesses and activities.

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[29] For example, the North Sea Region Programme and Northern Periphery Programme include Norway and Iceland; the North West Europe programme includes Switzerland. Non-Member States participate under programmes such as INTERREG, INTERACT, and URBACT.

[30] https://www.regjeringen.no/en/aktuelt/eos-midlene-sammen-for-et-gront-konkurransedyktig-og-inkluderende-europa/id2499146/ [accessed 25.05.2016]