

Written Response by the Welsh Government to the report of the External Affairs and Additional Legislation Committee entitled Future of Regional Policy

Context

Our White Paper *Securing Wales' Future* (Jan 2017) set out the broad challenges for Wales associated with the UK leaving the European Union (EU). We argue for continued full and unfettered access to the Single Market as the cornerstone for our future prosperity. Linked to this is a dynamic policy for regional economic development across Wales.

Currently Wales benefits from some £680m a year of EU investment, including around £370 million a year from the European Structural and Investment Funds for regional economic development. These funds have helped to improve significantly Wales' economy and labour market, increase research capacity and improve infrastructure. Despite this important progress, parts of Wales continue to face structural challenges. Our poorer communities lag the better performing UK regions in a number of ways, with this seen in lower productivity and lower skill levels for example. These long-term challenges will not disappear as the UK leaves the EU. We will continue to need high levels of investment based on economic need and must take the opportunity now to develop a strong regional policy to prepare for the transition away from the EU. We continue to call on the UK Government to honour commitments given during the referendum that Wales will not be a penny worse off as a result of leaving the EU.

There have been references to the creation of a 'UK shared prosperity fund' to replace European Structural and Investment Funds. We reject any notion of a UK centralisation of regional economic development policy. Any such approach would be materially damaging to communities and unreflective of voters' intentions in the EU referendum. A majority in Wales voted to leave the EU. They did not vote to become poorer and they did not vote to reduce or undermine devolution in Wales. Any proposed outcomes which leave Wales worse off financially, or with reduced powers, will be unacceptable.

I welcome the report of the External Affairs and Additional Legislation Committee, which I see as an important and constructive contribution in support of our work to shape the future of Wales.

Detailed Responses to the report's recommendations are set out below:

Recommendation 1:

We recommend that the Welsh Government sets out in its response to this report the steps it will take in preparation for any possible future currency fluctuations

Response: Accept

The approach to monitoring ongoing exchange rate risks varies between the different European Structural and Investment funds given different programme arrangements and rules. WEFO manages the risk for the Structural Funds and the Agriculture, Food and Marine Directorate manages the risk for the Rural Development Programme (RDP).

WEFO and the Directorate closely monitor exchange rates throughout the programme period. Planning rates are used for future planning and scenarios are reviewed across a range of exchange rates. At the current rate of approvals there are sufficient funds at a wide range of potential exchange rates. For the RDP, changes to the planning rate can lead to programme modification to reflect the associated impact on domestic cofinancing.

We are working with HM Treasury to establish the rules for transitioning to UK funding for all of our programmes, and a key part of that will be about agreeing how we will set the Sterling value of any committed but unclaimed EU funding at the point at which we leave the EU. This will inform the extent to which we should consider over-programming (to allow for the possibility of some projects falling short of their targets).

Until commitment levels start approaching about 80% of the estimated programme value, the risk of over-commitment is low. If the Euro were to be substantially devalued in the next few years, the principal risk becomes a planning risk; that new funding commitments will need to slow down or stop before the end of the 2014–2020 programming period, disappointing expectations in several areas.

Financial Implications – None directly arising from the response set out above to the recommendation, though there are notable financial risks in this area as outlined.

Recommendation 2:

We recommend that the Welsh Government clarifies how programme closure will operate post Brexit, and whether those programmes will be subject to EU law and raises these questions with UK counterparts to ensure that they are adequately addressed as part of any withdrawal agreement.

Response: Accept in principle

The nature of programme closure will be subject to the specific content of the withdrawal agreement the UK Government negotiates with the EU. Current EU legislation on the ESI funds does not deal explicitly with what will happen in the event that a Member State exits the EU. The question of whether the programmes will continue to be subject to EU law post exit, therefore, is dependent on the exit negotiations and terms of the withdrawal agreement or any related legislation.

The Welsh Government has taken every opportunity to raise these concerns with UK counterparts and will continue to do so.

The UK Government confirmed in October 2016 that it will guarantee expenditure to all ESI projects approved before the UK leaves the EU. This provides assurances for Welsh beneficiaries about availability of funding for those projects. The terms and conditions of current funding agreements with the Welsh Ministers will remain applicable until completion of those projects.

We have signalled our preference for a transition period in which the 2014-2020 European Structural and Investment funds would be allowed to run their natural course and be subject to the normal closure arrangements. This would offer clarity and consistency for our stakeholders.

Early closure arrangements would introduce significant complexity and uncertainty for partners and we have made clear to the UK Government the importance of early clarification on any such closure arrangements as part of the exit negotiations.

Financial Implications – None directly arising from the response set out above to the recommendation.

Recommendation 3:

We recommend that the Welsh Government keeps us updated with progress on these matters to enable us to assess the direction of travel that is being proposed for the development of future mechanisms for addressing disparities in economic performance in Wales

Response: Accept

The views and interests of Wales are continuously and consistently argued for at a wide range of meetings with UK Ministers and Officials. *Securing Wales' Future* has provided us a sound and constructive platform against which to make our case for continuing needs-based funding for Wales. *Brexit and Devolution* describes the necessary arrangements between the four countries of the UK for effective decision making in areas of shared competence, such as regional assistance, after we leave the EU. We intend to publish a paper on the future of regional economic development after recess setting out our approach to addressing economic disparities beyond the current round of European Structural Investment Funds.

This Committee's report is further evidence of an emerging consensus across Wales, which we will look to build on in the autumn when we will set out our initial thinking in a policy paper and engage with partners across Wales on successor arrangements.

I will continue to report back to this Committee and Plenary regularly on the progress of this work.

Financial Implications – None directly arising from the response set out above to the recommendation.

Recommendation 4:

We are concerned that a one-off adjustment to the Block Grant, whilst acceptable in the short term, may pose risks in the longer term and therefore recommend that the Welsh Government ensures that funding is future proofed and examines the merits of an objective needs-based formula, agreed by all nations of the UK

Response: Accept in principle

Our general position is that there should be a needs-based distribution of funding around the UK. This would require a complete reform of the current Barnett formula system, as proposed by the House of Lords Select Committee on the European Union. This would require a new negotiated settlement.

In the meantime we are pressing for full replacement funding in the baseline of the Welsh Government, giving a permanent uplift to the annual core budget. The Wales fiscal framework provides for a budget floor which offers us some protection. The likely alternative would require Welsh public services to bid into a UK-wide fund alongside every other country and region of the UK, with as yet undefined allocation and reporting criteria. That is not a course of action which we believe to be in Wales' best interest.

Financial Implications – The nature and level of arrangements to replace European Structural and Investment Funds will have a significant impact on the Welsh Government's overall budget position. This forms part of ongoing discussions with the UK Government.

Recommendation 5:

We recommend that the Welsh Government continues to press the UK Government on:

- the need for the UK Government to bring forward proposals for a formal inter-governmental structure for agreeing funding allocations and resolving conflict along the lines of a UK 'Council of Ministers'; and
- the need for clarity from the UK Government on whether their views on the legal status of the powers for regional policy are in accord with the Welsh Government

Response: Accept

Our proposals for strengthened inter-governmental structures were set out in our policy paper *Brexit and Devolution*. We will continue to press the UK Government, alongside our counterparts in the other Devolved Administrations, to work with us to develop these proposals. We want to ensure we have a fit-for-purpose inter-governmental structure that respects devolution and recognises the need for shared sovereignty arrangements within the UK, but outside of the EU.

Financial Implications – None directly arising from the response set out above to the recommendation.

Recommendation 6:

We recommend that the Welsh Government works with all relevant partners to articulate a clear vision and purpose for future regional policy which makes the most of the opportunity for fresh thinking and considers the advantages and disadvantages in drawing up a new industrial strategy for Wales, post Brexit

Response: Accept

We will publish a policy paper in the autumn that sets out our vision for future regional policy in Wales. This will be accompanied by an engagement process that invites new ideas and focusses on ways in which we can better integrate regional economic development approaches with our entire Programme for Government, as set out in *Taking Wales Forward*.

Integral to this will be bringing together ideas for regional development with post-Brexit economic policy for Wales, local government reform and emerging place-based approaches in Wales such as the Valleys Taskforce, City and Growth Deals, housing and regeneration policy and regional skills partnerships.

Financial Implications – None directly arising from the response set out above to the recommendation.

Recommendation 7:

We recommend that any future policy should seek to measure impact using a broader range of indicators than solely economic indicators

Response: Accept

An integrated approach to regional policy will need to reflect a broader understanding of what matters to regions, communities and citizens across Wales. We will build on the work already undertaken in Wales supporting the *Well-being of Future Generations Act*, as well as looking at international best practice.

We have a broad suite of indicators aiming to measure progress against our Programme for Government and associated Well-being Goals and these provide a sound starting point, but indicators must flow from the specific outcomes we are trying to deliver.

Welsh Government officials have also met with the OECD to discuss a range of evidence around regional policy, including how impact can best be measured. We are exploring how we can work with the OECD to ensure we identify the most appropriate indicators, including those that provide the opportunity for international benchmarking with comparator regions.

Financial Implications – None directly arising from the response set out above to the recommendation.

Recommendation 8:

We recommend that the Welsh Government sets out in its response to this report how it will ensure greater simplification and flexibility in the rules governing regional policy after the UK leaves the EU. We would also welcome clarification on which aspects it would seek to retain from the current regime.

Response: Accept

We intend to ensure any rules-based approach to future regional funding in Wales is as simple and flexible as possible. We are not looking to simply replicate EU programmes in Wales and want to see a more integrated approach to regional development. We will set out our initial views in a policy paper in the autumn.

Early discussions with partners and stakeholders, such as the European Advisory Group and the Programme Monitoring Committee for the European Structural and Investment funds, have identified some clear opportunities for simplification as well as some valued benefits of the current regime. These were also reflected in evidence given to the Committee inquiry from a number of stakeholders.

Opportunities for simplification include the potential to dispense with multiple separate funds each driven by different rules and processes. This should provide for a stronger integration with wider investments by the Welsh Government, Local Government, UK Government, HE/FE, the third sector, and the private sector.

Shifting the emphasis away from restricting investment to different types of eligible activity, towards delivering shared outcomes, opens up the possibility of a much simpler set of rules based on results rather than compliance. Rules governing compliance should be consistent across all Welsh Government support wherever possible, avoiding different rules dependant on where funding comes from.

There are also clear opportunities to remove current geographic restrictions, allowing us to target investments at functional economic areas rather than within the NUTS2 boundaries of 'West Wales and the Valleys' and 'East Wales'. This would further support integration, as future regional delivery approaches can be better aligned with local government reform and the regionalisation of wider Welsh Government policies including economic development, skills provision and housing and regeneration. Greater flexibility will also open up more opportunities to work across borders with England and internationally.

In terms of elements of the current approach which we wish to retain, these include a commitment to multi-annual programming and to a rigorous approach to testing the programme logic and credibility of programmes and projects which are brought forward for funding. A strong monitoring and evaluation framework focussed on results and built on a sound evidence base is also a key strength of EU-funded programmes. There are, however, significant opportunities to simplify the approach to indicators to be both clearer about the outcomes we are seeking from investments and avoid disproportionate evidence requirements.

The partnership approach central to EU programmes is also a key benefit we intend to retain, with opportunities to strengthen the involvement of those partners in planning and delivery. This may involve a need for capacity building, aligned with our proposals for local government reform and delivery of other place-based initiatives.

Financial Implications – None directly arising from the response set out above to the recommendation.

Recommendation 9:

To inform the design and delivery of future regional policy in Wales, we recommend that the Welsh Government:

- commissions expert research on the effectiveness of its current policies and brings forward proposals for new policies based on best practice from across the globe;
- sets out in its response to our report how it will ensure that all relevant officials learn from international best practice

The Welsh Government should set out the anticipated timescales for this research in its response to this report

Response: Accept

The European Structural and Investment funds in Wales have their own dedicated programme of research and evaluation set out in evaluation plans, which are published on our website. These plans are discussed at the Programme Monitoring Committee on a regular basis, and informed by a specialist Monitoring and Evaluation Advisory Group consisting of experts from within and outside of the Welsh Government. This research and evaluation programme includes ongoing analysis of the effectiveness of individual projects as well as of different parts of each programme. Our research and evaluation programme broadly covers:

- Each 'operation' supported must carry out an independent evaluation assessing the effectiveness of the specific intervention against what it is intended to deliver. Findings must be addressed and taken into account for any related projects or successor projects.
- Dedicated surveys and associated analysis are carried out on the effectiveness of different forms of support for individuals and for businesses. Wherever possible this incorporates counterfactual and longitudinal analysis.
- Programme-wide evaluations are carried out at the end of each programme period to assess the overall effectiveness of the programmes and learn lessons. The analysis of the 2007-2013 programmes is due later this year.
- Process evaluations are carried out to identify areas in which improvements can be made to implementation systems and identify best practice.
- Ad-hoc research and evaluation is also commissioned in specific areas of interest.

The effectiveness of the EU model of regional policy is also one of the most evaluated policies in the world, with a wealth of evidence available at both an EU and UK level: WEFO has been actively involved in contributing to, and learning from, good practice in monitoring and evaluation of such interventions across the EU. The European Commission is publishing a range of evaluation studies to inform the

discussion on the future of EU regional policy post-2020. Welsh Government officials are also part of international networks which carry out research and identify and share best practice.

The OECD has undertaken a wide range of research on the role and use of different regional policy approaches across its members. Welsh Government officials have met with the OECD to discuss how international best practice can inform development work on regional policy and we will continue this dialogue as we develop proposals further.

There are also a range of contributions emerging on this debate from representative organisations, think tanks and academics. We are assessing the range of research already completed, our existing plans, and those of our stakeholders, in order to identify any potential gaps.

Timescales for already planned research are set out in the evaluation plans for each programme and reported to the Programme Monitoring Committee, with revisions made annually.

For future regional policy, where the evidence is relatively weak, we intend to promote an experimental approach to new regional policy developments.

Financial Implications – None directly arising from the response set out above to the recommendation.

Recommendation 10:

We recommend that the Welsh Government evaluates whether more robust mechanisms for data collection and analysis are required for the purposes of designing and evaluating future regional policy and that the Welsh Government works with international experts, such as the OECD, in order to do this

Response: Accept

As noted above, the EU has led the way in the evaluation of regional development policies and Wales has been heavily involved with contributing to and learning from good practice in evaluating Structural Fund interventions.

At the same time, Welsh Government officials have opened a dialogue with the OECD to discuss approaches to regional economic development in the context of international good practice. Part of this discussion involves monitoring and evaluation approaches, including identifying and evidencing appropriate indicators. We will continue this dialogue.

We want to ensure a consistent approach across the whole of Government and different policy areas, recognising there has been significant work carried out to inform reporting against the Well-being Goals and Programme for Government.

Recommendation 11:

We recommend that the Welsh Government sets out how it will ensure that new regional structures in Wales are transparent and accountable to local people. Furthermore, the Welsh Government should ensure that rural areas in mid and west Wales are properly accounted for in the future design and delivery of regional policy

Response: Accept

We will consult on options for future regional economic development approaches. We recognise that there are already regional structures across Wales and there is an opportunity to join-up an approach that can deliver policy in each place.

In particular we will ensure that our approach to future regional policy closely reflects our approach to local government reform, regional economic development, regional skills, regeneration policy, and place-based approaches such as the Valleys Taskforce, City and Growth deals, Enterprise Zones, Local Growth Zones, and other partnership groups.

We also recognise the importance of ensuring rural areas are a key part of this integrated place-based approach. To make this work we will need to ensure rural priorities are given sufficient emphasis in the design of regional policy, including the links between rural and urban areas. This will require the inclusion of appropriate outcomes and indicators, as well as ensuring partnership approaches are appropriately representative.

Financial Implications – None directly arising from the response set out above to the recommendation.

Recommendation 12:

We recommend that the Welsh Government considers which structural changes may be necessary or desirable to ensure that the structures in place for delivery of regional policy are fit for purpose after the UK leaves the EU

Response: Accept

We accept that structural changes may be necessary to deliver a refreshed regional policy, particularly if regional partnerships are to have a greater role in planning and delivery. We do not underestimate the importance of ensuring the right institutional arrangements are in place, supported by sound governance and appropriate capacity.

We will work with each of the regions to assess existing, and build future, capacity and capability. This approach should enable each region to tailor investment plans to their needs and opportunities, whilst complementing national and cross-border investments. The Welsh Government will set out a strategic framework for this approach that will allow all actors to focus on delivering shared outcomes for the whole of Wales.

We will do this across the whole of Government, so our approach to building regional capacity is able to support not only future regional policy, but all relevant policies and planning frameworks.

Financial Implications – None directly arising from the response set out above to the recommendation.

Recommendation 13:

We recommend that the Welsh Government retains strategic oversight and sets the direction for future regional policy in Wales whilst ensuring that future policy is responsive to local needs and that responsibility for delivery is clearly delineated

Response: Accept

We agree the Welsh Government is best placed to provide strategic direction and to retain oversight of future regional policy.

We also recognise the strengths of the existing EU partnership, and will explore a range of options in terms of delegating delivery responsibility to the most appropriate level. There are lessons to learn from the different approaches deployed with the separate EU programmes: from the LEADER approach for community-led local development in the RDP, to the regional prioritisation process in Structural Funds and regional and rural proofing of national interventions.

There is a debate to be had about the most appropriate level of intervention for different types of investments. There will still be some areas in which a Wales-wide approach is most appropriate, such as for apprenticeships, whilst also looking at how they can be more regionally and locally relevant. Other areas of intervention are best planned and delivered at a regional or local level; using local expertise and knowledge to better inform investment approaches.

We will consult on these issues later this year in order to inform a delivery approach that is clear where responsibilities for decisions rest and ensures those decisions are made at the most appropriate level.

Financial Implications – None directly arising from the response set out above to the recommendation.

Recommendation 14:

We recommend that the Welsh Government sets out how it intends, in addition to the strategies that are already in place, to work with the private sector to boost spending on research and development in Wales to ensure that innovation and productivity gains are central to future regional and economic development policy

Response: Accept

Raising productivity levels in Wales will be even more important after we leave the EU. We need to ensure that as well as investing in the foundations of our economy, we will work to enhance further skill levels and to intensify research and development in Wales. Investing in factors known to help improve productivity and promoting the growth of indigenous Welsh companies will be core planks of the strategic approach we will set out for the future. We will further strengthen collaborations between government, universities and business to build on research excellence that can lead to new Welsh industries and create high skilled jobs, eg developing compound semi-conductor technology in Southeast Wales. In “*Securing Wales’ Future*” we argue strongly for continued participation in the EU’s Horizon 2020 programme after the UK has withdrawn from EU membership. This continuity is the best possible way to maintain World class innovation and enhance domestic research and development investments in collaboration with the private sector and we will continue to make this case vigorously.

There are also significant opportunities to support a greater adoption and diffusion of innovation across the economy as a means of helping close productivity gaps between leading firms and the rest; raising overall productivity levels in the economy.

Financial Implications – None directly arising from the response set out above to the recommendation.

Recommendation 15:

We recommend that the Welsh Government sets out in its response to this report how it will take forward an innovation and engagement strategy in Wales after the UK leaves the EU

Response: Accept

As we leave the EU will need to strengthen innovation and engagement across higher education and industry. A White paper consultation on the role of a new Tertiary Education and Research Commission and its functions which include research and innovation is open until October 23rd 2017- The results of the consultation will inform a further technical consultation in Spring 2018. The technical consultation will be consistent with the Welsh Government response to the Diamond Review, which acknowledged the importance of knowledge transfer and the availability of dual funding.

We repeat that our policy aim is for the United Kingdom to retain participation in the EU's Horizon 2020 programme after we have withdrawn from EU membership. There is ample precedent for this approach and we are clear that this represents a fundamentally beneficial approach to innovation.

Financial Implications – None directly arising from the response set out above to the recommendation.

Recommendation 16:

We call upon the Welsh Government, in its response to this report, to set out its preferred ambitions for the future of state aid and procurement rules after the UK leaves the EU

Response: Accept

The purpose of State aid rules is to avoid destructive market distortions. *Securing Wales' Future* sets out our position. The first order issue for Wales is to secure full and unfettered access to the EU Single Market. This is likely to require the UK to adopt a similar form of State aid framework as that of the EU: the EU's negotiation priorities indicate that this will be a requirement of any trade deal.

Clearly, should the UK decide to become part of the European Free Trade Association (EFTA), for example, as part of transition arrangements, then the rules would need to be copied wholesale with the EFTA Surveillance Authority and Court stepping into the roles of the Commission and European Court of Justice (ECJ). Under this arrangement the UK would also need to implement any future changes to the rules.

Should a bespoke deal be negotiated then it may be possible to diverge, in limited ways, from the EU State rules when setting up a UK State aid framework. Should the UK be able to develop its own State aid framework it is vital that there are high levels of transparency about any subsidies provided. Any such arrangement will require strong intergovernmental coordination and cooperation, along the lines set out in our document *Brexit and Devolution*.

Under current assisted area status, we (and the EU) are allowed to make targeted support in deprived regions of Wales. Without this status, such interventions would not be permissible under competition rules. Any changes post-EU to our approach to regional aid in the UK need to be:

- jointly negotiated and agreed across the UK to avoid destructive inter-regional competition and ensure a well-functioning market; and
- aligned as closely as possible to EU rules to avoid creating any barriers that would reduce UK-EU trade access.

As with State aid, it is unclear at this point what impact leaving the EU will have on public procurement rules. If the agreement on the UK's exit involves retaining full and unfettered access to the Single Market, then this might mean that the existing EU procurement regime would continue to apply to Welsh public sector contracts. If the terms of the UK's exit mean that the UK does not have to comply with the EU public procurement regime or something directly analogous, then this could provide flexibility to review the rules. Even in this scenario, rules to govern public procurement would still be required – and such rules would require effective

intergovernmental coordination and oversight by the four countries of the UK. In the first instance, the UK Government has indicated that it intends to freeze the existing legislation at the point of leaving the EU, with minor amendments being made to address any aspects which may become legally inoperable (e.g. the need to advertise public procurements in the Official Journal of the European Union). In the event that the EU procurement regime would no longer apply, there may be opportunity to simplify procurement rules to focus on delivering wider outcomes instead of process and to identify opportunities to further drive up economic benefit from third party expenditure.

Financial Implications – None directly arising from the response set out above to the recommendation.

Recommendation 17:

We recommend that future regional policy in Wales includes:

- continued support for education, skills and human capital;
- continued support for investment in both physical and digital infrastructure;
- improved collaboration between local authorities; further and higher education; local health boards; the private and third sectors;
- sustained private sector engagement wherever possible; and
- a more strategic approach to maximising the potential of procurement in stimulating economic development

Response: Accept

We will set out in our policy paper our initial view on the approach to future regional policy. This will provide an opportunity to get more detailed views from a wide range of partners and stakeholders, including the private sector.

There is already a broad degree of consensus on the priority areas for future regional policy which includes the above types of investment; all of which are recognised as important in supporting productivity gains.

A new approach to regional policy that focusses on the outcomes we are seeking might also allow greater flexibility in the types of activities being funded. In turn this should encourage more innovative approaches - either by not attempting to prejudge the solution to addressing specific challenges, or by taking advantage of particular opportunities.

We are committed to strengthening the already strong partnership approach that has built-up over successive EU-funded regional investment programmes. There are opportunities to broaden and deepen this collaboration in the future through better integration and coordination with different policy areas.

A less administratively complex set of arrangements and a further shift towards an outcome-focus should also help encourage greater private sector involvement in both planning and delivery.

Subject to the considerations outlined in response to Recommendation 16 above, it may be possible to develop a more strategic and flexible approach to the use of procurement and we will seek to use any such possibility in such a way as to maximise the economic development benefit of public procurement.

Financial Implications – None directly arising from the response set out above to the recommendation.