European and External Relations Committee

The EU referendum and its implications for Scotland

Written submission from the West of Scotland European Forum (WOSEF)

Recommendations: it is recommended that the Forum:

(a) Make representations to the UK Treasury seeking equal treatment for structural fund and rural development programmes as those announced for Pillar One Common Agricultural Fund payments; and

(b) Make representations to the Scottish Government seeking greater flexibility in the management of operations that have already been formally approved to ensure maximum drawdown of fund covered by the Treasury Guarantee as it currently stands. This would include granting time extensions to these operations where appropriate

(c) Forward this report to the Scottish Parliament European and External Affairs Committee for its interest.

1.0 Introduction

1.1 On 23rd June 2016 the referendum on the United Kingdom’s continued membership of the European Union took place. The result was, at UK level, a decision to leave the EU by a margin of about 52% to 48%. There were however wide variations in the results both at regional and especially at local authority (counting area) level. Scotland, Northern Ireland and London voted to remain while Wales and the English regions voted to leave. Detailed results for the West of Scotland, Scotland and the UK are appended to this report.

1.2 The result occasioned wide ranging changes in the UK governmental and political systems. Not only has there been a substantial change of UK ministerial personnel (including a new Prime Minister) but there have been significant changes to the structure of the UK Government with two new cabinet positions, covering respectively International Trade and Exiting the EU being created.

1.3 The Scottish Government, in addition to setting up a Standing Council on Europe in the days after the referendum has also designated Mike Russell MSP as the Scottish Minister responsible for negotiating with the UK Government on matters relating to “Brexit”.

1.4 There have also been consequences for the EU institutions – one development being the appointment of former Commissioner Michel Barnier as the European Commission’s chief “Brexit” negotiator.

1.5 In the period following the referendum there has been much debate about when and how “Article 50” would be invoked. Article 50 lays down the procedures by which a Member State can leave the EU and was introduced in the Lisbon Treaty of 2007. It has never previously been used and there is
therefore no precedent available to follow. The only past examples of territories leaving the EU were Algeria (upon receiving independence from France in 1962) and Greenland (following a referendum in 1982). Neither case, given the legal and institutional development of the EU since the mid 1980s, gives much guidance that is relevant for the UK situation. Interestingly however, Greenland’s formal withdrawal from the EU was not completed until 1985.

2.0 General financial implications

2.1 Since joining the then EC in 1973 the UK has generally been a large contributor to the EU budget and a very helpful summary of the history of the UK’s budgetary relationship with the EU was published by the House of Commons Library on 12th August 2016.

2.2 In the course of the referendum campaign there was a lively debate on which measure of the UK’s contribution was the most appropriate. Depending on this choice the figure for the UK’s contribution in 2015 varied from £8.5bn to £17.8bn. By way of comparison total UK public expenditure in 2015/16 was about £750bn.

2.3 On 23rd August 2016 the Scottish Government published its Government Expenditure and Revenue Scotland report for 2015/16. This included an estimation (Box 3.2 pages 34-36) of Scottish contributions and payments to the EU over recent years. This concluded that in 2015/16 Scotland’s net contribution was around £500m. This excludes payments to Higher Education Institutions of around £100m. By way of comparison total Public Expenditure in Scotland amounted to just under £69bn.

2.4 From the above it will be apparent that the scale of EU contributions from the UK/Scotland is relatively modest set against the totality of public expenditure in those territories.

2.5 In theory once the process of exiting the EU is finally completed (which may take some years) the UK Government will not be required to make payments to the EU. The UK government could then use this “windfall” in a number of ways, namely

- Reducing public sector debt;
- Cutting taxes; or
- Reallocating the saving to other areas of expenditure

A combination of these approaches could of course also be used.

2.6 Reducing debt would have no direct impact on Scottish public sector finances, the impact of tax cuts would depend on whether these taxes were reserved (such as VAT and corporation tax) or devolved (such as Air Passenger Duty). Similarly increases in some areas of expenditure (such as health and

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1. [http://researchbriefings.parliament.uk/ResearchBriefing/Summary/SN06455]
education) would have some knock on Barnett consequentials for the Scottish budget but others (for instance national security and defence) would not.

2.7 Any increase in the Scottish Government budget arising from Brexit would of course be at the disposal of the Scottish Government to spend on its own priorities and there would be no obligation on it to allocate sums to activities or organisations previously supported by EU funds.

2.8 As many commentators have however pointed out there are a number of factors which have far more impact on public sector income and expenditure than whether or not the UK/Scotland remains in the EU. The main consideration in this context is the general health of the UK/Scottish economies and this is examined in section 4.

3.0 Financial implications – West of Scotland

3.1 Organisations in the West of Scotland have been major recipients of EU funding for many years and this support has principally been used to support the economic and social regeneration of the region. Levels of EU support – in particular EU structural funds – have declined somewhat in more recent times as the EU has reorientated the structural funds budget towards central and eastern Europe.

3.2 In respect of the 2014-20 European Structural Funds programmes the Scottish Government published notional allocations to local authorities for a number of interventions in 2015. These amounted to nearly £100m and a breakdown is given below:

Table 1 – indicative structural fund allocations – WOSEF authorities

<table>
<thead>
<tr>
<th>INTERVENTION</th>
<th>FUND</th>
<th>ALLOCATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employability</td>
<td>ESF</td>
<td>£48.0m</td>
</tr>
<tr>
<td>Poverty and Social Inclusion</td>
<td>ESF</td>
<td>£11.7m</td>
</tr>
<tr>
<td>Youth Employment</td>
<td>ESF/ YEI</td>
<td>£29.9m</td>
</tr>
<tr>
<td>Business Competitiveness</td>
<td>ERDF</td>
<td>£8.5m*</td>
</tr>
<tr>
<td>TOTAL</td>
<td></td>
<td>£98.1m</td>
</tr>
</tbody>
</table>

- Excluding allocation to Argyll and Bute Council

3.3 Much of the activity supported by these allocations, particularly with respect to ESF operations, will be delivered by the third sector in addition to which Skills Development Scotland are the lead partners for a Scotland wide Competitive Grant fund. Local authorities have or intend to apply for ERDF support under interventions for which Transport Scotland, Scottish Natural Heritage or the Scottish Government itself act as lead partners.
3.4 It is also important to note that these were notional allocations and not legally binding offers of grant. Following the referendum there was widespread concern across the UK about the extent to which monies allocated to 2014-20 EU programmes would be able to be accessed. As well as structural fund programmes other significant EU programmes such as Horizon 2020 and the rural development programmes (including LEADER where the estimated budget for the Local Action Groups in Scotland is about €66m – equivalent to over £55m) were also affected.

3.5 On 12th August 2016 the Chief Secretary to the Treasury wrote a letter (Annexe A) to the Secretary of State for Exiting the EU in which he outlined a number of transitional arrangements for UK stakeholders in EU funding programmes. The letter is attached at Annexe A but the key points are that the Treasury would guarantee the EU funding component of:

- Structural fund operations legally committed by the date of the Autumn Statement to the House of Commons (confirmed on 8th September 2016 as taking place on 23rd November 2016);
- Centrally managed EU programmes such as Horizon 2020 projects up until the point of UK departure; and
- Payments to agricultural sector under Pillar One of the Common Agricultural Policy to 2020.

3.6 In terms of Scottish EU Structural Funds programmes the process of formally approving ERDF and ESF operations only began in 2016. A general requirement to lead partners was that they should only apply for activity up until the end of 2018. This of course meant that not all the funds indicated in table 1 above are presently in a position to be legally committed. Special mention should be made of the Youth Employment initiative where formal offers had to be issued by 31st December 2015 and activity concluded by 30th September 2018. As previously reported to the Forum, the value of YEI funds committed to WOSEF local authorities amounted to about £29.5m (a take up rate of over 98%).

3.7 For other interventions the process of issuing formal approval letters began in the second quarter of 2016. One immediate impact of the referendum was a hiatus in the issuing of grant offer letters to operations that had successfully negotiated the Scottish Government’s appraisal processes. However the Treasury letter appears to have removed this blockage.

3.8 The short term priority is clearly to ensure that formal commitments are optimised before the Autumn Statement. The Scottish Government has indicated that about £290m has been formally approved to date with a further £50m of operations currently “in the pipeline”. In proportionate terms this is equivalent to about 36% of the programme budget already being legally committed rising to about 43% taking into account operations about to be submitted or already in the appraisal process. However to maximise the benefits of the availability of EU funding or the Treasury guarantee it would be helpful if for example time extensions to draw down monies already approved could be made available where possible.
3.9 The terms of the Treasury guarantee are significantly less generous for regional and rural development programmes than for other sources of EU funding. Further information is promised in the Autumn Statement and there is therefore a limited time opportunity to make representations arguing for an improved guarantee for the relevant EU programmes.

3.10 In addition to European Structural and Investment Funds, organisations in the West of Scotland, in particular its Further and Higher Education Institutes, have been proactive in seeking EU support from programmes that are managed centrally by the European Commission (or an Agency selected by the European Commission). The most prominent of these in financial terms is the Horizon 2020 programme. Research undertaken by Scotland Europa and cited by the Scottish Parliament Research Briefing “The Impact of EU membership in Scotland” (October 2015) suggests that Scottish organisations “punched above their weight” over the first 15 months of Horizon 2020 – securing approvals of around €111m. This is over 10.5% of the total UK “take” and Scotland accounts for only 8.2% of the UK population.

3.11 As indicated in section 3.5 the UK treasury guarantee on these programmes only applies up until the as yet unknown date of a UK departure from the EU. This uncertainty has not been helpful since many of these programmes insist on a collaborative approach involving organisations located in more than one participating country. In many cases it can take some considerable time to assemble a transnational bidding partnership so the lack of long term clarity acts as a significant handicap.

4.0 Economic implications

4.1 Both in the course of the referendum campaign and subsequently there has been a great deal of debate about the economic implications of the UK leaving the EU. Unfortunately this is a highly speculative exercise as it will be very difficult to identify the impact specifically attributable to exiting the EU on changes to key economic indicators such as output, employment and incomes at either UK, Scottish or local levels, particularly over the long term.

4.2 It was widely predicted that a decision to leave the EU would have an immediate short term impact on exchange rates and business confidence, for example as measured by various stock market indices. From 23rd June the pound sterling had indeed fallen substantially – by about 12% relative to both the € and the $ by 1st September 2016. By UK contrast stock market levels, after an initial fall, recovered quite quickly and now stand above pre-referendum levels.

4.3 In this debate the subject of access to the EU single market has often been raised. The issue is not one of whether UK business will be able to continue to trade in the EU but rather the terms and conditions under which they will be able to do so. Up until the point of leaving the EU current arrangements will remain in place.

4.4 A whole range of options as to the future trading relationship with the EU have been identified and have been helpfully summarised by the Institute for
Government\textsuperscript{2}. In essence the message is that the more favourable the access secured to the Single Market the more conditions (relating to free movement, compliance with certain EU legislation and in some cases financial contribution) that come with this level of access.

4.5 This lack of certainty as to the future trading model between the UK and EU makes economic forecasting extremely speculative. Many analysts have therefore presented their findings within a range of scenarios. On the assumption that the future access to the EU Single Market by the UK will be less favourable than at present, most (but not all) commentators have projected a negative impact due to lower levels of trade and less foreign investment (with access to the Single Market restricted the UK becomes a less attractive location for setting up operations aimed at serving the EU market). This will impact on activity and employment levels with knock on consequences for public sector finances.

4.6 On 23\textsuperscript{rd} August 2016, the Scottish Government published a paper outlining the “Potential Implications of the UK leaving the EU on Scotland’s Long Run Economic Performance”. The paper summarised the impact that leaving the EU could have on Scotland’s GDP and public finances up to 2030, based on extrapolating a number of analyses conducted for the UK economy as a whole to the Scottish context. The key conclusions presented by the Scottish Government were that by 2030 “Scottish GDP is projected to be between £1.7 billion and £11.2 billion per year lower than it would have been if Brexit does not occur” and “Tax revenue is projected to be between £1.7 billion and £3.7 billion lower”

4.7 Another aspect is trade with non EU countries. Currently the UK is party to a number of EU negotiated trade agreements with third countries and it is by no means clear that the UK would still be able to benefit from these following a departure from the EU. On the other hand outside the EU, The UK would have the scope to (re)negotiate trade deals with third countries. Doing so would require considerable time and effort but it has been argued that these could be brought to a conclusion more swiftly than has been the case with EU negotiated trade deals.

5.0 Conclusions

5.1 The departure of the UK from the EU has far reaching consequences for almost every area of public policy – hardly surprising since the UK has been a member of the EU for over 40 years. The House of Commons Library published a paper entitled “Brexit: impact across policy areas\textsuperscript{3}” on 26\textsuperscript{th} August 2016. This provides an extremely helpful overview of the subject but extends to 184 pages. In addition it contains no fewer than 681 footnotes, often linking to other publications. In short, despite the relative absence of “hard” information, an enormous amount of material has been produced on the subject.

\textsuperscript{2}http://www.instituteforgovernment.org.uk/sites/default/files/publications/Brexit%20Options%20A3%20final.pdf

\textsuperscript{3}http://researchbriefings.parliament.uk/ResearchBriefing/Summary/CBP-7213
This paper has attempted to summarise the state of play with respect to just 2 aspects of the debate namely the implications for economic development and public finances in in the West of Scotland. There are clearly other important facets to the departure of the UK from the EU that will impact on the West of Scotland. The issue of the future status of EU nationals is one clear example. According to the 2011 Census of Population, over 17,000 Glasgow residents were born in EU countries other than the UK and The Irish Republic.

In terms of its future activities the Forum will need to retain its focus to aspects of “Brexit” where it can make an informed contribution. The Scottish Parliament European and External Affairs Committee has issued a call for evidence from stakeholders with initial contributions to be submitted by 5th September. However the Clerk has indicated that later responses would also be accepted. The Committee’s initial report on this subject was published on 12th September 2016.

6.0 RECOMMENDATIONS

6.1 From the foregoing it is clear that the process of exiting the EU will be both long and complex. This report however identifies a sum of nearly £100m in ERDF and ESF allocated to the West of Scotland that is at risk due to the uncertainties caused by the EU referendum result. When other ERDF and ESF interventions are taken into account alongside monies allocated to rural development initiatives such as LEADER, then this figure can only grow.

6.2 Consequently it is recommended that the Forum:

(a) Make representations to the UK Treasury seeking equal treatment for structural fund and rural development programmes as those announced for Pillar One Common Agricultural Fund payments; and

(b) Make representations to the Scottish Government seeking greater flexibility in the management of operations that have already been formally approved to ensure maximum drawdown of fund covered by the Treasury Guarantee as it currently stands. This would include granting time extensions to these operations where appropriate.

(c) Forward this report to the Scottish Parliament European and External Affairs Committee for its interest.
## EU Referendum – results for WOSEF area

<table>
<thead>
<tr>
<th>LOCAL AUTHORITY</th>
<th>REMAIN VOTES</th>
<th>REMAIN %</th>
<th>LEAVE VOTES</th>
<th>LEAVE %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argyll and Bute</td>
<td>29,494</td>
<td>60.6</td>
<td>19,202</td>
<td>39.4</td>
</tr>
<tr>
<td>East Ayrshire</td>
<td>33,891</td>
<td>58.6</td>
<td>23,942</td>
<td>41.4</td>
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<tr>
<td>East Dunbartonshire</td>
<td>44,634</td>
<td>71.4</td>
<td>17,840</td>
<td>28.6</td>
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<tr>
<td>East Renfrewshire</td>
<td>39,345</td>
<td>74.3</td>
<td>13,595</td>
<td>25.6</td>
</tr>
<tr>
<td>Glasgow</td>
<td>168,335</td>
<td>66.6</td>
<td>84,474</td>
<td>33.4</td>
</tr>
<tr>
<td>Inverclyde</td>
<td>24,688</td>
<td>63.8</td>
<td>14,010</td>
<td>36.2</td>
</tr>
<tr>
<td>North Ayrshire</td>
<td>38,394</td>
<td>56.9</td>
<td>29,110</td>
<td>43.1</td>
</tr>
<tr>
<td>North Lanarkshire</td>
<td>95,549</td>
<td>61.7</td>
<td>59,400</td>
<td>38.3</td>
</tr>
<tr>
<td>Renfrewshire</td>
<td>57,119</td>
<td>64.8</td>
<td>31,010</td>
<td>35.2</td>
</tr>
<tr>
<td>South Ayrshire</td>
<td>36,265</td>
<td>59.0</td>
<td>25,241</td>
<td>41.0</td>
</tr>
<tr>
<td>South Lanarkshire</td>
<td>102,568</td>
<td>63.1</td>
<td>60,024</td>
<td>36.9</td>
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<td>West Dunbartonshire</td>
<td>26,794</td>
<td>62.0</td>
<td>16,426</td>
<td>38.0</td>
</tr>
<tr>
<td>WEST OF SCOTLAND TOTAL</td>
<td>697,076</td>
<td>63.9</td>
<td>394,274</td>
<td>36.1</td>
</tr>
<tr>
<td>SCOTLAND</td>
<td>1,661,191</td>
<td>62.0</td>
<td>1,018,322</td>
<td>38.0</td>
</tr>
<tr>
<td>UNITED KINGDOM</td>
<td>16,141,241</td>
<td>48.1</td>
<td>17,410,742</td>
<td>51.9</td>
</tr>
</tbody>
</table>
HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

Rt Hon David Davis MP
Secretary of State for Exiting the European Union
Department for Exiting the European Union
London
SW1A 2AG

12 August 2016

Dear David

EU FUNDING

1. The result of the referendum has caused uncertainty for a number of sectors and organisations which currently receive a range of different EU funding streams. I want to update you on the steps Treasury will be taking now to address this uncertainty for recipients of all these funding streams.

2. First, many individuals and organisations bid for and carry out multi-year projects funded by European Structural and Investment Funds (ESIFs) and administered by government. ESIFs include agri-environment, employment, and regional development schemes. These individuals and organisations face immediate decisions about starting, or progressing, such multi-year projects, and some are nervous about proceeding given concerns about what will happen when we leave the EU.

3. In the short term, I can confirm that the Treasury will give an assurance that all multi-year projects administered by government with signed contracts or funding agreements in place, and projects to be signed in the ordinary course of business before the Autumn Statement, will be fully funded, even when these projects continue beyond the UK’s departure from the EU. In the medium term, the Treasury will work with departments, Local Enterprise Partnerships and other
relevant stakeholders to put in place arrangements for considering those ESIF projects that might be signed after the Autumn Statement but while we still remain a member of the EU. Further detail will be set out ahead of the Autumn Statement and we will ensure those spending commitments remain consistent with value for money and our own domestic priorities.

4. Second, a number of UK organisations bid directly to the European Commission on a competitive basis for EU funded multi-year projects. Partner institutions in other EU countries have raised concerns about whether to collaborate with UK institutions on EU funding projects, such as universities and businesses participating in Horizon 2020, and some UK participants are concerned about longer-term participation.

5. The Commission have made it clear that the referendum result changes nothing about eligibility for these funds. UK businesses and universities should continue to bid for competitive EU funds while we remain a member of the EU and we will work with the Commission to ensure payment when funds are awarded. The Treasury will underwrite the payment of such awards, even when specific projects continue beyond the UK's departure from the EU. The UK will continue to be a world leader in international research and innovation collaboration, and we expect to ensure that close collaboration between the UK and the EU in science continues.

6. Third, the UK agricultural sector receives annual direct payments through Pillar 1 of the Common Agricultural Policy (CAP). The Treasury will therefore reassure the agricultural sector that it will receive the same level of funding that it would have received under Pillar 1 of CAP until end of the Multiannual Financial Framework in 2020, alongside considering the options for long-term reform beyond that point. The government will work closely with stakeholders to ensure that funding in the period immediately after exit is used to help the agricultural sector.
sector transition effectively to a new domestic policy framework. These funds will be allocated using the principles of CAP Pillar 1, and we will of course consider the opportunities post-exit for making any short-term improvements to the way the system operates once we cease to be bound by EU rules.

7. Naturally, we will need to address the future of all programmes that are currently EU-funded, once we have left the EU. Leaving the EU means we will want to take our own decisions about how to deliver the policy objectives previously targeted by EU funding. Over the coming months, we will consult closely with stakeholders to review all EU funding schemes in the round, to ensure that any ongoing funding commitments best serve the UK’s national interest, while ensuring appropriate investor certainty.

8. The administration of EU funding is largely devolved. We are offering the devolved administrations the same level of reassurance as we are offering to UK government departments in relation to programmes they administer but for which they expected to rely on EU funding. We will also work with the devolved administrations on subsequent funding arrangements to allow them to prioritise projects within their devolved responsibilities.

9. I am copying this letter to Cabinet colleagues.

[Signature]

DAVID GAUKIE