North Ayrshire Council welcome the opportunity to make comment on the impact of Brexit on the Scottish Budget.

(1) Are there any indications of a differential economic impact in Scotland separately from rUK?

Our membership of the European Union influences our economy, including trade and business regulation, our laws, governance and human rights. There is considerable uncertainty over the implications of the decision to leave the EU and current information around the economic impact is variable and complex.

It is too early to know the implications of the decision to leave the EU for trade and investment, and any implications will be dependent on the terms negotiated, however, there are fears over rising material costs for business, skills shortages and delay in inward investment decisions. The removal of access to European Structural Funds (ERDF and ESF) could leave a policy and funding vacuum.

Focus will be required to ensure the Ayrshire economy is 'Brexit-ready' for any impact, including but not limited to: public finances, loss of structural funds, supporting businesses to export, encouraging inward investment, and skills supply. Brexit may also present opportunities for Ayrshire businesses and these will need to be explored further.

Fraser of Allander research on the ‘Long Term Economic Implications of Brexit’ modelled a range of scenarios regarding the UK's future trading relationship with the EU and concluded that, under all modelled scenarios, Brexit was predicted to have a negative impact on Scotland’s economy. The range of impacts were driven by the nature of any post-Brexit relationship between the UK and the EU – the stronger the economic integration with the EU, the smaller the negative impact. The report also notes that, in addition to the direct impact of becoming less integrated with the EU, there are also important spill-over effects from a slower rest of UK economy feeding through to Scottish sectors and firms. The scale of long-term impact depends on the precise trading arrangements negotiated post-Brexit.¹

Recently published research by the LSE’s Centre for Economic Performance (CEP) and Centre for Cities indicates that even though the immediate negative impacts are predicted to be smaller in poorer regions, households in those areas start off poorer and may experience considerably more difficulty in adapting to those negative changes. Therefore, in the longer term the greatest impact may be felt in regions which are less economically resilient. The difference in a region’s ability to adapt to Brexit-related changes is likely to widen regional economic gaps in the long run. This was certainly the experience following the 2008 financial crisis and for which a post-Brexit parallel may be helpfully drawn, specifically in the contrast between the immediate and long term impacts. The 2008 crisis saw London and the South East hit hardest before recovering much more strongly than other areas of the UK. Areas

¹ Fraser of Allander Institute, Long-term Economic Implications of Brexit – A report for the Scottish Parliament, October 2016
with higher wages, larger pools of graduate labour and a more innovative business base tended to be less negatively affected once the economy had adjusted.²

The North Ayrshire economy has taken significantly longer to recover from the 2008 financial crash than other areas in Scotland and the economy has still not returned to pre-2008 levels. Given this, we can estimate that any future downturn would be felt more severely in an already fragile North Ayrshire economy.

It is also important to note that the recent devolution of powers to the Scottish Parliament through the Smith Commission process now means that, although the Barnett formula is maintained, the total Scottish budget will now depend also on the revenue performance of the Scottish economy relative to the rest of the UK. Given the structural challenges for the Scottish economy, including poor productivity growth which is feeding into weakened pay growth putting downward pressure on household incomes³, it is important, at both UK and Scottish levels, that measures are designed to address longer term impacts of Brexit, not short term impacts alone.

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(2) What additional spending pressures are there on the public finances as a consequence of Brexit?

The EU is not the source of all the money Scottish Councils’ spend on economic development, but it still makes a significant contribution (15-25%). If regional and national efforts to grow a strong, inclusive economy are to continue, replacement funding has to be found to replace the EU’s regional, competition and innovation programmes.

Looked at from a local perspective, North Ayrshire was awarded over £40m from the 1997-2013 EU Structural Funds programmes, underpinning around £100m investment in the area. Awards from the current EU 2014-2020 Structural and Investment Funds (ESIF) programmes include:

- £2.1m for North Ayrshire’s Youth Employment Initiative
- £2m for North Ayrshire’s Employability Pipeline
- £1.25m for Business Competitiveness (Ayrshire wide)
- £0.6m for Poverty & Social Inclusion activity in North Ayrshire
- £1.27m for Hunterston Energy Storage Project

Further to this, North Ayrshire Council worked with local third sector partners to successfully secure £3m from the Big Lottery Fund/European Social Funds Financial Inclusion programme for the Better Off North Ayrshire project. The Council is also working with national partners to secure ESIF support for local initiatives on green infrastructure and low carbon transport, and with local communities to secure EU LEADER programme support for rural and community development projects.

² LSE Centre for Economic Performance (CEP) and Centre for Cities, Brexit, trade and the economic impacts on UK Cities, July 2017
³ Fraser of Allander Institute, Economy Commentary, June 2017
Following Scottish Government’s recent review of ESIF programmes, and subject to their successful negotiation with the European Commission this autumn, Ayrshire Councils are also working to promote EU investment in innovative infrastructure projects linked to the Ayrshire Growth Deal which would benefit the national economy, as well as seeking to secure extensions to existing strategic interventions on business competitiveness and employability.

If domestic funding arrangements fail to compensate for the loss of EU funds, the ability of local authorities and other partners to support these types of activity, which plays a key role in our efforts to achieve inclusive growth and adapt our economy and infrastructure, will be seriously diminished.

(3) What should the Scottish Government’s priorities be in formulating Draft Budget 2018-19 in response to the initial economic impact of Brexit?

Replacement for EU Funding
The issues identified above remain critical to Ayrshire’s future and any loss of funding would likely impact on the pace of growth, as well as on initiatives tackling poverty and inequality and the region’s productivity and competitiveness. Future support is at risk if alternative sources of funding cannot be found domestically or in negotiations. Scottish Government should use its influence to press UK Government for adequately resourced and targeted replacement funding mechanisms post Brexit. In the interim, this is a key time to invest in Scotland’s Regional Growth, City and, Island Deals to support the development of innovative, smart, productive and inclusive regional economies. The vision of the Ayrshire Growth Deal (AGD) is for Ayrshire to be a vibrant, outward looking, confident region, attractive to investors and visitors, making a major contribution to Scotland’s growth and local well-being, and leading the implementation of digital technologies and the next generation of manufacturing.

Funding for Local Government
Although uncertain and difficult to quantify, the decision to leave the EU is likely to be economically damaging, at least in the short to medium term as noted above. This in turn would result in a reduction in economic growth, reducing Government fiscal receipts and put additional pressure on public spending. It is not unreasonable to conclude that this scenario could result in pressure to reduce funding to local government and ultimately to the Council in the form of its grant. This would have serious consequences for the range of services the Council delivers and supports at a time where local government faces a number of demand led cost pressures as a result of demographic change. This would also have serious consequences for this area and beyond, for a wide range of economic and social services (including health), and pressure to further reduce support to local government must therefore be resisted.

(4) Given that increased inflation is likely to disproportionately impact on the poorest, what measures should the Scottish Government take in its Budget to address this?

A clear focus on growth and jobs in weaker local economies with a commitment to addressing the barriers identified that prevent people to participate in economic growth. This
may become even more important given the potential impact on Scotland’s economy of UK immigration restrictions. Working in partnership with the Scottish Government, North Ayrshire Council is piloting an Inclusive Growth Diagnostic which will seek to identify the key factors that prevent many individuals within the local authority area from benefiting from economic growth. This process has been rolled out to the rest of the Ayrshire region to inform ongoing work on the Ayrshire Growth Deal and the Ayrshire Regional Partnership Pathfinder, as part of the Scottish Government Enterprise and Skills Review.

(5) What issues require to be considered from the loss of EU funding mechanisms arising from Brexit?

Scottish and UK governments can take a number of steps to protect and support the development of Scotland’s regional economies post Brexit. These include:

- investing in Scotland’s regional infrastructure through City, Island and Regional Growth Deals, including the Ayrshire Growth Deal, to support the development of innovative, smart, productive and inclusive regional economies
- establishing funding mechanisms to compensate for the loss of EU funding, and providing additional resources to match the scale of post Brexit challenges
- prioritising support for regional inclusive economic growth in ways that deliver support more efficiently, more flexibly and with more local control
- reforming the rules on financial support to companies to enable the delivery of more effective support in the places that need it most
- ensuring economic and skills agencies develop effective collaboration across agencies and with regions to support higher levels of regional competitiveness, innovation and economic growth
- exploiting the opportunity provided by this major change to align a wider range of public spending with the priority of local and regional economic development

The removal of access to ERDF and ESF (boosted by matched funding from government, local government, private sector and others) could leave a policy vacuum which UK governments must fill to avoid some regions and sectors losing out. The loss will not just be financial, but will also cover strategic planning, multiannual programming and multi-level governance. There is concern that, post Brexit, the UK will not have the funding or policy levers needed to respond effectively to regional economic shocks.

As part of the Scottish Government Enterprise and Skills Review, the Ayrshire Councils were invited to work with partners, particularly Scottish Enterprise (SE) and Skills Development Scotland (SDS), to develop a Pathfinder exploring how regional partnerships can stimulate local economies. This aligns with our joint work on the Ayrshire Growth Deal which we are progressing with both the Scottish and UK Governments.

The Ayrshire Councils actively engage with partners in the Industrial Communities Alliance Scotland, which supports the work of Scottish Parliament’s Cross Party Group on Industrial Communities. In recent times the focus of the CPG has been to identify the key components of industrial and regional policies which will be needed for (post) industrial communities post Brexit. The ICA Post Brexit Regional Policy paper has been produced.

The key asks of the paper arising from the loss of EU funding mechanisms are identified below, and commended to the Committee by Ayrshire Councils:
• Deliver the new UK Shared Prosperity Fund to take over the responsibilities of the EU Structural Funds
• Set the new Fund’s budget at a level that not only compensates for the loss of EU funding (£1.5bn a year) but also provides additional resources to match the scale of the challenge
• Structure the new Fund in ways that deliver support more efficiently, more flexibly and with more local authority control
• Allocate the new Fund in fair and transparent ways that give priority to the development needs of less prosperous regions and local economies
• Reform the rules on financial support to companies to enable the delivery of more effective support in the places that need it most
• Exploit the opportunity provided by this major revision of regional policy to align a wider range of public spending with the priority of local and regional economic development

It is important a replacement for EU Structural Funds aligns to the work underway on Regional Partnerships to achieve inclusive growth and also the UK Government’s Industrial Strategy.