Written Evidence on Funding of EU Competences

1. NFU SCOTLAND
2. Nicolo Bird and David Phillips, Institute for Fiscal Studies
3. Prof. David Bell, University of Stirling
4. Prof. Jim Gallagher, Nuffield College, University of Oxford
5. Prof. Michael Keating, Centre on Constitutional Change
6. Prof. Nicola McEwen and Dr Alexandra Remond, Centre on Constitutional Change
7. Scottish Council for Voluntary Organisations
8. Shetland Islands Council
9. The Chartered Institute of Public Finance & Accountancy (CIPFA)
10. The Royal Society of Edinburgh
Scottish Parliament Finance and Constitution Committee
Call for Evidence on Funding of EU Competences
Written Response from NFU SCOTLAND

- NFU Scotland (NFUS) welcomes the opportunity to give evidence to this pertinent inquiry on the funding of EU competences after the UK and Scotland leave the EU.

- With the Common Agricultural Policy (CAP) budget forming almost 40 per cent of the overall EU budget, agriculture has rightfully become a sector of focus as the terms of the Brexit negotiation become clearer. From 2014 to 2020, Scotland would have received around €4.6 billion (£3.5 billion) under the CAP from the EU. The Scottish agriculture sector and the wider rural economy is heavily reliant on CAP funding, with support payments accounting for around two-thirds of total net farm income in Scotland.

- As per previous evidence to the Finance and Constitution Committee\(^1\), NFUS understands that all CAP schemes will be funded through the Brexit transition period and to the end of the UK Parliament in 2022.

- However, leaving the European Union presents the first opportunity in over 40 years to overhaul and rebalance Scottish agricultural policy and NFUS has recently published its proposals for a new, funded Scottish agricultural policy which it would wish to see implemented in Scotland through a transition away from the current CAP system and to a new Scottish agricultural policy which has a strong focus on support for productivity and environmental benefits, and a baseline of financial stability.

- This submission outlines the debate around how such a policy might be funded after EU exit and the expiry of current HM Treasury commitments on agricultural spending.

\(^1\) August 2017, NFU Scotland submission to Finance and Constitution Committee inquiry ‘Impact of Brexit on the Scottish Budget’: www.parliament.scot/S5_Finance/General%20Documents/I_NFU_Scotland_Brexit.pdf
NFUS Priorities

Post-2022, the amount of money the UK decides to spend on farming and farming-related matters will have major consequences for Scotland. NFUS is clear that agriculture must continue to receive at least the same quantum of funding as it currently does under the CAP post-2022. This budget must be ringfenced to agriculture and rural development support.

The NFUS position is that HM Treasury should finance the new agricultural policy on a UK-wide funding framework, but with the devolved administrations given the policy tools and levers to ensure the agricultural policy works for all four parts of the UK. Any approach that drops a ‘Defra-centric’, one-size-fits-all policy on to the devolved nations would not be acceptable.

Under NFUS’ proposals for a new agricultural policy in Scotland, three components of ‘Financial Stability’, ‘Productivity Measures’ and ‘Environmental Measures’ would work together to enable Scottish agriculture to be more competitive, resilient and profitable – forming the essential first link of a dynamic and fair supply chain while also providing essential public benefits.

All sectors of Scottish agriculture have experienced very real challenges over a number of years – often through a combination of poor and volatile market returns, rising costs, and shifting policy demands. Lack of confidence in the sector has been undermined further by the uncertainties cast up in the wake of the UK’s decision to leave the EU, and the chaotic political process that has since taken over.

Not only is farming and crofting in Scotland inherently risky, due to a host of physical challenges, in an uncertain and unpredictable economic environment NFUS considers that there will be a role for direct payments (‘financial stability’) to provide a vital safety net – at least in the short-to-medium term.

________________________

In addition to financial stability within any future Scottish agricultural policy, funding to enable productivity gains, building more resilience, and delivering more environmental benefit is vital. NFUS is equally unequivocal that all future support to Scottish agriculture must be properly targeted at active farmers and crofters.

The Barnett Formula

A significant concern of NFUS is what budget will be committed to agricultural support after this time. With successive UK governments showing a preference away from direct (Pillar 1) support, there has also been no reassurance given to the sector as yet whether agricultural spending will be maintained and ring-fenced.

Should the existing Barnett formula be used rather than another means of farm support budget allocation, then NFUS considers that the implications for agricultural support in Scotland could be severe.

The Barnett formula has historically been used to calculate the block grant funding that each devolved administration receives from the UK government. It aims to give the Devolved Administrations (DAs) the same pounds per person change in funding as the change in funding for comparable government services in England.

The formula takes the change in a UK government department’s budget (DEL) and applies two figures that take into account the relative population of the devolved administrations (population proportion) and the extent to which the UK government department’s services are devolved (comparability percentage).

\[
 Barnett \ formula = \\
 \Delta UK \ government \ department's \ budget \times \ comparability \ percentage \times \ appropriate \ population \ percentage
\]

For Scotland these figures are 99.8 per cent (Defra comparability percentage) and 9.85 per cent (population percentage). The change to the block grant for Scotland after a change in Defra’s budget would therefore be:
The Barnett formula only affects the change in a UK government department’s budget. It therefore requires a historic baseline value. The UK government currently has no baseline value for agricultural funding because in the past this funding has come directly from the EU in the form of the CAP.

As outlined, after the UK leaves the EU it is unclear whether the UK government will maintain the current CAP funding levels. If the UK government were to maintain these funding levels then Defra would receive a large increase in its budget.

For example, in 2016 the UK received €3.15bn in CAP direct payments. To maintain this level of funding post-2022, the budget of Defra would have to increase to the value of €3.15bn.

Figure 1 shows what would happen to Scotland’s funding for Pillar 1 payments if the €3.15bn increase in Defra’s budget was allocated under the Barnett formula (assuming the €3.15bn is considered a net increase to the Defra budget). Scotland currently receives around €522m for Pillar 1 payments. NFUS argues that the baseline should be at least set at this figure.
The Barnett formula would therefore only be an acceptable means to allocate CAP funding if a fair baseline level was previously agreed for each devolved administration.

**Alternative mechanisms to distribute agricultural funding in the UK**

The level of CAP funding that each devolved administration in the UK receives has previously been allocated on the basis of historic values that do not reflect the different agricultural conditions in each of the four nations.

85 per cent of Scotland’s landmass is deemed to be ‘Less Favoured Area’ (disadvantaged or severely disadvantaged) compared to only 15 per cent in England. For many years, NFUS has argued that the natural disadvantage of Scotland’s landscape should be recognised within the funding envelope awarded via the CAP – indeed, it was due to Scotland’s lower-than-average payment rate per hectare under the previous CAP reform that the UK was awarded a convergence uplift in 2013 in order to bring parity of payments across the UK.

Despite this, Scotland currently only receives 17 per cent of the UK’s ‘envelope’ of CAP funding.

NFUS considers that Brexit provides the opportunity to evaluate how agricultural funding is distributed to the devolved administrations.

Figure 2\(^3\) compares how EU Pillar 1 funding would be distributed if it was based on 5 different indicators (utilisable agricultural area (UAA), grassland, less favoured area (LFA), farm woodland, organic farming area (OFA)) instead of historic shares.

---

\(^3\) Cao, Y., Elliott, J., Moxey, A. and Zahrt V. (2010) Alternative Allocation Keys for EU CAP Funding. SNH.
Compared with its current share of Pillar 1 payments, Scotland gains under every indicator.

![Figure 2: Allocation of UK CAP Under Different Measures](image)

**Governing future distribution of funding**

In a recent paper\(^4\), the Institute for Government has identified that the UK Government and the DAs will need to agree a new funding framework to ensure agricultural support is not just consistent with the constraints of international and EU obligations, but which also maintains the integrity of the UK internal market. It also outlines that such agreement must respect commitments that have been made to preserve the DAs current levels of flexibility.

NFUS agrees with the sentiment outlined in this paper. NFUS is concerned that, to date, it appears that the Joint Ministerial Committee framework has proven inadequate to reach appropriate agreement on key issues regarding EU exit and the administration of agricultural support. Funding will undoubtedly form a large part of future negotiations and it is vital that a mechanism is found which allows decisions on these important topics to be made in a manner palatable to all around the table.

NFUS is interested in the concept of a strengthened Joint Ministerial Committee, or an emulated Council of Ministers, which allows qualified majority voting and better dispute resolution procedures to minimise political infighting over these issues.

Once common agreement on a new financial framework has been found, and the UK has transitioned out of the EU, it will be for the UK to decide how agricultural spend is audited (i.e. which body will currently have oversight, governance and enforcement powers over how the agricultural framework operates). NFUS has not yet undertaken serious analysis of this, however is aware that the National Audit Office has been suggested as a possible, pre-existing body which could take on such a role.
Scottish Parliament Finance and Constitution Committee
Call for Evidence on Funding of EU Competences
Written Response from Nicolo Bird and David Phillips, Institute for Fiscal Studies

Note

David Phillips is an Associate Director at the Institute for Fiscal Studies, with responsibility for leading analysis of local and devolved government finance, and taxation in developing countries. Nicolo Bird is a project research officer at the Institute for Fiscal Studies. However, the views and opinions expressed here are those of the authors only; the IFS has no corporate views.

Summary

This note is a response to the consultation from the Finance and Constitution Committee of the Scottish Parliament concerning the funding of devolved competences which are currently funded at a European Union (EU) level, and options available for how these funds will be distributed across the UK.

The key points made by this note are:

- EU funds are currently either pre-allocated to member states or the case of structural funds particular regions within them according to formulae based on state/regional characteristics; or are competitive funds that can be bid for by governments, universities, businesses and other organisations.

- Scotland is due to receive 5.6 billion Euros in funding from the pre-allocated funds for the 2014–2020 EU budget period. It has recently received more than a population share of funds from some of the main competitive funds.

- The UK (and therefore Scotland) will continue to operate existing EU schemes until at least the end of 2020 (and perhaps June 2022 in the case of farm payments). But beyond that decisions will need to be
taken about whether to replace these schemes, and if so, the level of funding and the way that funding is allocated.

- The Barnett Formula is simple and well understood. The Scottish Government also has significant flexibility over how it spends annual increments to its funding as a result of the application of the Barnett formula. But the formula has design flaws which mean its use the allocation of funding to replace current EU schemes should be avoided. In particular it takes no account of differences in population growth, or differences in the initial levels of funding. The latter results from its use of nominal cash-terms changes in English budgets per person as the basis of changes in allocations to devolved governments. This can lead in the long-run to spending levels to converge between England and the devolved nations: the so-called Barnett squeeze.

- An Indexed Per Capita (IPC) formula could be used that avoided this problem. But the UK and Scottish governments may want to allocate funding in ways that account for more than just relative population growth and initial levels of funding. This could include using local, regional or national level characteristics, and competitive bidding processes. There are also decisions to be taken as to whether funding schemes will be designed and operated at the UK level, devolved government level, or some other level (e.g. city-region).

- Different ways of allocating money would involve different incentives – including for growth and development and environmental improvements. They may also be associated with different outcomes. The optimum allocation method and governmental level for allocation decisions is likely to differ between funding purposes (e.g. between regional development funds and research funds).

1. Introduction

This note is a response to the consultation from the Finance and Constitution Committee of the Scottish Parliament concerning the funding of devolved competences which are currently funded at a European Union (EU) level, and options available for how these funds will be distributed across the UK. This response covers the following areas:

- How existing EU funds are allocated and how much Scotland receives.
• The Barnett formula, including how it works, and its appropriateness as a way of allocating replacement funds.

• Some of the pros and cons of other ways of allocating funding post-Brexit.

At the start, it is worthwhile highlighting that the likely ending of the UK’s current contributions to and receipts from the EU budget is only one of the effects Brexit is expected have on the UK’s (and hence Scotland’s) public finances. Indeed, if Brexit affects the size and composition of the economy, the effect of this on the public finances (via both spending and revenues) could be larger than the impact of changes in contributions to and receipts from the EU budget. Indeed, in its assessment in the 2016 Autumn Economic and Fiscal Outlook, the Office for Budget (OBR) responsibility forecast that in 2020–21, the economic effects of Brexit would lead to an increase in borrowing of £15 billion—larger than the UK’s net contribution to the EU budget of around £10 billion.1 Note also that in the draft agreement with the EU, the UK has agreed to take part in EU programmes until the end of 2020, and continue contributions to the EU for liabilities incurred up until the end of this period. The OBR estimates that incorporating these, the UK will still be contributing a net £5 billion to the EU in 2022–23.2 This wider fiscal context should be borne in mind when considering the likely impact of Brexit on government spending in Scotland, and the funding available for schemes to replace existing EU programmes.

2. An overview of major EU funding schemes

Broadly speaking, there are two different types of funding that the UK and Scottish governments may want to replace post-Brexit: pre-allocated funds, such as the common agricultural policy (CAP) and the structural funds for economic development, that are agreed to at the outset of the EU’s seven year budget cycle (the multi-annual finance framework (MFF)), and; competitive funds, e.g. Horizon 2020 and Erasmus+, which involve competitive bidding for funding against other projects across the EU.

---


Pre-allocated funds are largely aimed at disadvantaged geographical areas or economic sectors. Therefore, pre-allocated funds are most likely based on some characteristics linked to specific needs or priority areas (for instance, promoting growth in less developed regions, or investing in agricultural sustainability). Conversely, competitive funds are aimed to support the best projects available across Europe, sometimes regardless of needs or location. For example, high-quality research might have significant positive externalities from which the entire EU - and indeed world - can benefit.

Table 1. shows the amount of EU funds pre-allocated to the UK over the 2014–2020 period. The sources of EU spending are divided into two broad categories: European Structural and Investment Funds (ESIFs), and Common Agricultural Policy (CAP).

<table>
<thead>
<tr>
<th>Table 1. Pre-allocated EU funding in the UK over the 2014–20 period</th>
<th>€bn 2014-20</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>European Structural and Investment Funds</strong></td>
<td>17.2</td>
</tr>
<tr>
<td>European Regional Development Fund</td>
<td>5.8</td>
</tr>
<tr>
<td>European Social Fund</td>
<td>4.9</td>
</tr>
<tr>
<td>Youth Employment Initiative</td>
<td>0.2</td>
</tr>
<tr>
<td>European Maritime and Fisheries Fund</td>
<td>0.2</td>
</tr>
<tr>
<td>European Agricultural Fund for Rural Development / CAP, Pillar 2</td>
<td>5.2</td>
</tr>
<tr>
<td><strong>European Agricultural Guarantee Fund / CAP, Pillar 1</strong></td>
<td>22.5</td>
</tr>
</tbody>
</table>

Source: Table 1 from Ayers and Brien (2018).

**Structural funds**

The European Regional Development Fund (ERDF) and the European Social Fund (ESF) together are referred to as the structural funds. The ERDF is focused on innovation and research, support for SMEs, improving digital infrastructure and decarbonising the economy. Meanwhile, the ESF funds projects to increase labour market mobility, education and skills and enhance institutional capacity. How these funds are spent depends on both decisions taken at a European and national (and sub-national) level. After initial allocations of funds are made by the EU, member state governments (and sub-national governments to which authority is devolved to) have significant autonomy in managing the allocated funds.
Structural funds are allocated by the EU to regions within member states largely depending on their GDP per capita:

- Regions with GDP per capita below 75% of the EU average are designated as ‘less developed regions’ and are receiving 52% of total structural funds in the current MFF period covering the period 2014–2020;
- Regions whose GDP per capita is between 75% and 90% of the EU average are designated ‘transition regions’ and are receiving 12%;
- Regions with GDP per capita above 90% of the EU average are receiving 16%.

There are other elements to the rules for determining exact regional entitlement to these funds which depend on a combination of regional employment rates, number of unemployed people, population size and density, and educational attainment.\(^3\)

Importantly, these rules can create big discontinuities, as slight GDP or GNI per capita increases can lead to dramatic drops in funding. The discontinuity between less developed and transition regions is particularly salient. Governments can however re-balance how structural funds from the EU formula are allocated with the consent of the European Commission. For instance, during the 2014–2020 allocation of structural funds, the UK Government deviated from the framework set out by the EU formula by re-allocating funds to devolved governments, due to the considerable budget cuts to these administrations that would have otherwise occurred following the new EU formula used for that MFF period.

**Common Agriculture Policy**

Pillar 1, the European Agricultural Guarantee Fund, supports farmers’ incomes in the form of direct payments and market-support measures according to the regulations set by the EU, while Pillar 2, the European Agricultural Rural Development Fund, provides more flexible support to promote development objectives in rural areas.

---


CAP funds are allocated to member states and are then distributed within the member state. There is also an option to transfer funding to, or from, their respective national rural development allocations. In the UK, CAP budgets are first allocated by Westminster, after which these are administered by the devolved governments. They can then decide which of the various direct payment schemes to finance from this allocation subject to certain legislative limits. There are also a set of fixed rules that apply to all member states:

- 30 percent of payments must be conditional on farmer engaging in ‘greening activities’ covering at least 5 percent of the eligible area.
- Member states must increase payments to young farmers by at least 25 percent, though these payments must not exceed 2 percent of the total spending on direct payments.
- Member states must undertake some form of redistribution between those entitled to large and small direct payments.⁴

The joint aims of the two Pillars of the CAP are to: support viable food production, with a particular focus on income support for farmers; promote sustainable management of agricultural land, including boosting biodiversity and reducing greenhouse gas emissions; and lastly, boost employment and growth and tackle poverty in rural areas.

It is worth noting that although the first pillar is entirely financed by the EU, the second pillar programmes are co-financed by EU funds, and regional, national or local funds.⁵ Although the rules for determining how much each country receives from the overall CAP budget are not published, allocations to EU member states for direct payments were historically based on farm production. However, this practise was ended in the early 2000s, and allocations are converging towards a common amount per hectare of agricultural land.⁶

**Other Funds**

Other pre-allocated investment funds include the Youth Employment Initiative (YEI) and the European Maritime and Fisheries Fund (EMFF),

---

⁶ The distribution is based on historical entitlements but with an adjustment over the current MFF period such that member states who previously received less than 90% of the average payment per hectare make up one third of the gap to 90% of the average by 2020, and all member states receive at least €196 per hectare in the same year. This is offset by a reduction in the per hectare amount for those member states who receive more than the EU average.
which promote labour-market outcomes for under 25 year olds and support fishing communities, respectively.

In addition to the pre-allocated funding for Member States to manage, there are many different competitive funds that connect programme participants directly to the source of funding (there are no designated country allocations). In general, organisations apply to agencies of the European Commission for funding from these streams following calls for applications. Some of the most important programmes of the 2014-2020 period are Horizon 2020 (H2020) with a budget of €77 billion, the Connecting Europe Facility with €22 billion and Erasmus+ with €15 billion.7

3. Current EU funding in Scotland

Table 2. shows the main areas of European funding in Scotland between 2014 and 2020. At €3,729 million, the majority of EU funding comes from Pillar 1 of the CAP.8 €941 million was allocated to structural funds to promote economic development in Scotland, although as of 2016 nearly €530m of this was still to be committed. €845m was allocated towards CAP Pillar 2 and €108m to the European Maritime and Fisheries Fund. Total funding over the 2014–2020 period amounts to over €5.6 billion.

Information on EU competitive funding secured by Scottish organisations is scarce although, at least recently, Scotland has been relatively successful in accessing competitive funds. Mclver and Wakefield (2016) found that by July 2016, Scottish organisations had secured €250 million of Horizon 2020 funding, which represents 11.4 percent of the total secured by the UK.9 Scotland has also benefitted from €65 million in Erasmus+ funding over the 2014–2017 period, which represents 12.8 percent of the total secured by the UK.10

---

7 On top of the abovementioned programmes, the EU’s budget also provides funding to other areas, where it often shares responsibility with national governments including: science and technology; market regulation; consumer protection; transnational policing; border control, migration and asylum; and foreign aid. Central administrative costs make up around 6% of the budget – a figure which excludes the costs countries themselves bear to administer EU spending and policy.

8 Note that this figure and the figure for Pillar 2 of the CAP account for the fact that the Scottish Government decided to transfer €367m from Pillar 1 to Pillar 2 funding.


Table 2. EU Funding in Scotland, 2014-2020

<table>
<thead>
<tr>
<th>Fund</th>
<th>€m 2014–2020</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>European Structural and Investment Funds</strong></td>
<td></td>
</tr>
<tr>
<td>Structural Funds</td>
<td>1,894</td>
</tr>
<tr>
<td>European Maritime and Fisheries Fund</td>
<td>941</td>
</tr>
<tr>
<td>European Agricultural Fund for Rural Development / CAP, Pillar 2</td>
<td>108</td>
</tr>
<tr>
<td>European Agricultural Guarantee Fund / CAP, Pillar 1</td>
<td>845</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>3,729</td>
</tr>
</tbody>
</table>

Note: Structural Funds are comprised of the ERDF and ESF combined. The figures account for €367m transferred from Pillar 1 to Pillar 2 of the CAP. Source: McIver and Wakefield, *ibid*, 2016.

4. Should the Barnett formula play a role in allocating funding to replace existing EU funding streams?

The draft agreement between the EU and UK on the UK’s withdrawal from the EU states that the UK will continue to take part in EU programmes until the end of the current MFF in December 2020. Furthermore, the UK government’s environment secretary has said that direct payments to farmers would be guaranteed at their current level until the 2022 UK general election in England, with funding for devolved governments to continue with their schemes until this date too. However, beyond that point there are big decisions to be taken about how to allocate any funding that will replace these EU schemes.

The consultation issued by the Finance and Constitution Committee asks for views on “the extent to which the Barnett formula would provide an appropriate mechanism for funding competences returning from the EU to the Scottish budget”. In this section we briefly discuss the Barnett formula and its appropriateness as a mechanism for allocating funding that is returning from the EU.

---

What is the Barnett formula?
The *Barnett formula* was introduced in 1979 to mechanically determine the year-to-year changes in the block grant funding the Scottish Government receives from Westminster. Since the devolution of a number of additional taxes, commencing in 2015-16, this block grant has been adjusted to account for these new revenue streams. However, the Barnett formula continues to be used to determine the changes in the *underlying* block grant (prior to these adjustments) each year.

The underlying block grant in any year consists of the prior year’s block grant plus a change in the amount calculated using the Barnett formula. Under the formula, the change in the block grant depends on changes in the departmental expenditure limits (DELs) of UK government departments; the share of that department’s functions that are devolved to Scotland (summarised by a ‘comparability percentage’); and Scotland’s population as a proportion of England’s (or England and Wales).

\[
\text{Cash change in DEL of UK government department} \times \text{Department’s comparability percentage} \times \text{Scotland’s population share}
\]

The overall change is then the sum of the changes implied by changes in the DEL of each UK government department.

The *Barnett formula is inappropriate for allocating replacement funding*

The Barnett formula therefore aims at providing an equal pounds-per-person increase in funding for the Scottish Government as the change in funding for comparable public services in England. But this can be a problem, and there is another flaw which means that the *Barnett Formula is inappropriate for use in allocating funding to replace existing EU funding streams*. To summarise, the key issues with using the Barnett formula are:

- First, the Barnett formula simply calculates changes in funding year-to-year. **It does not say how the initial level of funding should be determined.**
- Second, if initial allocations were similar to existing EU allocations, Scotland’s allocation per person would be substantially higher than England’s. If the replacement funds increased in cash terms over time,
the equal pounds-per-person increase provided by the Barnett Formula would represent a smaller percentage increase in Scottish funding. Thus, over time, funding per person in Scotland would converge towards funding per person in England. This convergence is known as the ‘Barnett Squeeze’.

- In practice, lower population growth in Scotland has largely prevented the “Barnett Squeeze” from happening for existing funding allocated according to the Formula. This relates to another flaw in the formula: it does not properly take into account (differences in) population growth. Under the Barnett formula, the funding per person received by Scotland would be lower the higher is population growth relative to England’s.

So over time, the use of the Barnett formula could lead to a relative squeeze on the amount of funding Scotland receives to replace EU funding; and the amount received per person would be sensitive to relative population growth in Scotland. This all seems undesirable.

5. The pros and cons of different post-Brexit funding options

It would be possible to use an amended formula that did not suffer from the issues identified above. For instance, if one wanted to deliver the same percentage change in funding per person in Scotland as in England, the Indexed Per Capita (IPC) formula used as part of the new Fiscal Framework could be adopted.

However, this is not the only option available. And the choice of how to index any replacement funds over time is just one of several choices that need to be made. Other key choices include:

- How to determine initial level of replacement funds for the UK as a whole, and how to allocate these funds between different parts of the UK;

- Whether funding allocations are hypothecated for particular purposes (as under current EU programmes) or whether they become part of general funding;

- Whether existing political geographies are the most appropriate basis for any funding calculations and allocations or whether new political

---

This reflects the fact that while the population shares used to calculate changes in the block grant are updated, the existing level of the block grant is not updated as relative population shares change.
geographies should be used instead (e.g. based on functional economic areas).

• And whether the UK (or perhaps parts of the UK) continues to take part in particular European funding programmes.

Different options will have different pros and cons, and will entail different fiscal incentives for the replacement schemes. The best choice seems likely to differ between funding purposes (e.g. between regional development and general scientific research).

In this section we discuss the issues and options for different funding areas: regional development; agricultural funding; and research and innovation. We motivate this discussion by discussing the pros and cons of using the IPC method to index the replacement funding (putting to the side, to begin with, the other key decisions that need to be taken).

**The pros and cons of indexing funding using the IPC method**

There would be a number of benefits from using the IPC approach to index the replacement funding over time:

• **Simplicity**: Similar to the Barnett Formula, it provides a quite simple mechanical framework that could help avoid disputes over year-to-year budget allocations.

• **Flexibility**: If based on the Barnett Formula, the funding increments provided under this approach could be spent by the Scottish Government as it saw fit, providing maximum budget flexibility and discretion.

• **Changes in population**: In contrast to the original Barnett formula, it would account for needs arising from population changes over time in Scotland.

• **No disincentives for growth**: By basing the formula on population growth and public spending in England, it doesn't create disincentives for economic growth that could arise under more complex formulas that took into account updated socio-economic conditions (note that this also applies to the Barnett formula).

However, there are also some more drawbacks worth considering. These include:
• **Needs and disadvantage:** By basing changes in funding only on changes in funding in England and changes in population, such an approach would not take account of changes in Scotland's relative need for funding. For instance, if areas of Scotland became relatively more economically disadvantaged, there would be no increase in funding for regional economic development (unlike under existing EU schemes).

• **Other policy objectives:** More generally, such a mechanical approach means the allocation to Scotland would not really take into account the purpose for which the funding is ultimately being used for. This includes things like promoting economic growth, environmental sustainability, or more broadly areas which might have positive externalities. There could also be scope for more competitive or outcome-based criteria.

There is therefore a trade-off between simplicity, flexibility and discretion on the one hand, and targeting of funding at particular areas or particular outcomes on the other. We now discuss considerations related to these for the different policy areas currently funded by EU programmes.

**Options and issues for regional development funding**

The first question to address is whether EU funding aimed at promoting economic development, particularly in disadvantaged regions, should be replaced by new UK or devolved government schemes. Related to this it will be important to consider what the objectives of any such funding are such as: promoting and supporting economic growth; reducing regional disparities; reducing intra-regional socio-economic inequalities; and promoting environmentally sustainable development; etc.

Alongside this it will be important to consider how any post-Brexit funding sits alongside other elements of UK and Scottish economic and regional policy. This includes schemes operated by the UK government (such as City Deals and the Industrial Strategy) and schemes operated by the Scottish Government (such as the Scottish Business Pledge, Scottish Economic Strategy and Highlands and Islands Enterprise). Bachtler and Begg (2017), highlight how regional development policy has suffered from instability and inconsistency in approaches.\(^{13}\)

There are further practical issues that would need to be addressed in designing regional funding policy:

---

What characteristics should be used for assessing ‘need’ for regional funding, and at what geographical level should such assessments take place? As already mentioned, allocations of EU funding to regions are based on GDP per capita, as well as regional employment and unemployment rates, population size and density, educational attainment and geographical remoteness. An obvious question is therefore whether these are the right characteristics to base funding allocations on, or whether there are other characteristics that should be used. This could include measures of deprivation (such as the Index of Multiple Deprivation), inequality measures (such as inequalities in earnings, or household incomes) and updated measures more suitable for UK or Scottish contexts (such as different measures of population sparseness or geographical remoteness).

There is also then the question of the geographic level at which assessments should take place. Currently, allocations of EU funding are based on so-called NUTS2 regions, of which there are four in Scotland: Eastern, South Western, North Eastern, and Highlands and Islands. The larger the geographical areas used, the greater the extent to which there could be significant inequalities within areas. If it were felt economic disadvantage is determined by local characteristics, and that positive (and negative) spillovers between locales are fairly limited, assessment and allocation of funding to smaller geographical areas may be beneficial. On the other hand, if it were felt that spillovers are greater, and there are benefits from choosing from the bigger pool of potential projects larger areas can support, there may be benefits from keeping relatively large geographic areas. There would remain the question of whether existing geographies are appropriate or some other geographies – such as functional economic areas – would be more appropriate.

How redistributive/‘targeted’ should the funding be? Current EU schemes have a high degree of targeting at areas with low levels of GDP per capita. This reflects the splitting of regions into three categories – less developed, transitional, and more developed based on their GDP per capita. In particular, there is a cliff-edge in support at 75% of GDP per capita: the threshold where regions move from “less developed” to “transitional” status. Figure 1 below illustrates this for the UK as a whole, with the two less developed regions (West Wales and the Valleys and Cornwall) receiving much higher levels of funding per capita than other regions. Highlands and Islands is a transitional region; the other Scottish regions are classified as more economically developed.
Figure 1. Regional GDP per capita (2015) and funding per capita (2014–2020)

Note: Data excludes London and Scotland (except Highlands and the Islands). Funding decisions were based on GDP per capita in the period 2007–2009. If based in 2015 figures, two further regions (Tees Valley and South Yorkshire) would have been defined as less developed regions, while Cornwall would have been defined as a transitional region.

A system that was less redistributive across the UK and, in particular, did not have such a cliff edge, would likely benefit Scotland financially. However, depending on which level funding allocations were assessed and allocated to, it might not benefit all Scottish regions, with big differences in GDP per capita and funding allocations between the Highlands and Islands (allocated 386 euros per person under current EU schemes) and the rest of Scotland (allocated 132 euros).

The question of how redistributive/targeted the funding should be links to its purpose: e.g. whether it is aimed at reducing geographical socioeconomic inequalities, or boosting growth more generally.

- At what level of government should decisions on allocations of funding to broad thematic areas and particular projects be taken?

Currently, for instance, the Scottish Government’s European Structure Fund Division makes allocations (each of more than €15 million) to other government departments, agencies and local authorities, structured around specific themes and aims. These organisations (termed ‘lead partners’) then allocate funds to particular projects and other organisations (‘implementing partners’). Post-Brexit there will be a decision of whether this approach is correct. Should strategic decisions
be taken at a higher level (e.g. the UK level) or at a lower level (e.g. a regional level within Scotland)? Should decisions about specific projects be taken at a higher or lower level than now (e.g. at the Scottish Government level, or at sub-local authority level)? One benefit of taking decisions at a higher level is that it may allow better value for money and greater impact as the best projects from a wider geographic area will be considered and funded. However, taking decisions at a lower level may allow funding to be targeted more at particular areas, and local knowledge to be taken into account when allocating funds.

- **Should the funding be ring-fenced for developmental purposes or should the organisations (such as Scottish Government or local authorities) to whom funding is allocated have much more discretion over its uses?** Ring-fencing funding for projects with a clear focus on socio-economic development may aid in the evaluation and transparency of funds. However, allowing greater discretion would allow government bodies (such as the Scottish Government or (groups of) local authorities) to spend money on areas they deem to be local priorities. This could include services not generally thought of as being related to economic development (such as health, social care, or general education) but which nonetheless could have significant impacts on economic and more general wellbeing.

- **How frequently and to what extent should allocations be updated to account for changing socio-economic conditions of different areas?** Currently, EU funds are allocated for seven year periods based on characteristics measured several years prior to the start of the funding period: for the 2014–2020 period, these years were 2007–2009. A new assessment is made prior to the start of each MFF period, and the characteristics (and often the rules) are updated at that point, which could lead to changes in the relative funding allocations for different regions. Damping arrangements mean that in the current 2014–2020 period, regions receive at least 60% of the amount they received during the previous MFF period if their updated characteristics imply they would otherwise receive less.

It would be possible to update the assessments more or less frequently under a replacement scheme. There is also the possibility of undertaking partial rather than full reassessments, so that changes in characteristics are only partially taken into account when updating funding.

---

14 There is provision for a reassessment based on GDP in the period 2012–2014, but this does not appear to have been utilised.
assessments. A key trade off here is between redistribution/targeting on the one hand, and incentives on the other. More frequent and fuller updates mean that funding is targeted more closely at areas based on the characteristics felt to reflect their ‘need’ for funding. But this also reduces the incentive for the public bodies allocated funding (such as the Scottish Government and local authorities) from taking action to improve socio-economic characteristics: such improvements see reductions in funding levels in future.

- **Is there a role for ‘outcomes’ as well as ‘characteristics’ in determining funding allocations?** One way to address this concern would be to base some of the funding on ‘outcome’ measures as well as local/regional characteristics. For instance, a fairly mechanical approach could be that as well as negatively depending on the level of GDP (some years prior), re-assessed allocations could depend positively on the growth rate of GDP. They could also depend upon evaluations of the projects funded by previous funding rounds, and more generally, of the economic and other policies of the areas in question; although the more subjective the assessments are made, the greater the scope for disagreement and a lack of transparency.

- **Is there a role for competitive bidding between areas for funding allocations, as well as being projects within those areas?** Under present arrangements, funding is allocated to regions, and formal or informal competitive bidding is used to determine which projects to fund within that region. It would be possible to keep some (or all) funding back under a replacement scheme for competitive bids between regions. This would provide maximum flexibility for the government operating such a scheme (which could be the UK government or Scottish Government) and could improve value for money, but could lead to funding being less targeted at the most disadvantaged areas. Choices in this area should again reflect the overarching aims of any replacement regional development funding.

Finally, it is worth noting that the Conservative Party 2017 election manifesto committed it to a **Shared Prosperity Fund**. It said this fund would be:

---

15 Another trade-off is between targeting and stability/certainty. Fuller and more frequent resets mean funding could be less certain, which might discourage organisations receiving funding from planning long-term interventions, instead going for ‘quicker wins’, in case funding is not continued.
“specifically designed to reduce inequalities between communities across our four nations. The money that is spent will help deliver sustainable, inclusive growth based on our modern industrial strategy. We will consult widely on the design of the fund, including with the devolved administrations, local authorities, businesses and public bodies. The UK Shared Prosperity Fund will be cheap to administer, low in bureaucracy and targeted where it is needed most.”

As yet, no further details on how the scheme will operate and at what level it will operate have been published.

**Options and issues for agricultural funding**

The replacement of CAP funds in the UK is a broad and complex issue which has already been covered in greater detail elsewhere. As highlighted already the UK Government has pledged to maintain the “same cash funds” of support for farmers (as they receive under the CAP) until the UK general 2022 election. What system will be in place beyond that is as yet unclear – although a transition period involving some direct payments is expected to last until at least 2024, and the UK government has stated that future payments to farmers will be based on their contribution “public goods”, most notably environmental enhancement. It has also stated that it will work with the devolved governments to ensure the overall framework for funding to replace the CAP “works for the whole of the UK”.

This brings us to some of the key questions that need to be addressed when designing this replacement funding:

- **What are the purposes of agricultural funding?** The UK government has clearly highlighted the provision of public goods – including environmental enhancements. But there are other potential objectives from such funding, which include: supporting farmers’ incomes; broader rural development; food security; improving animal welfare standards; boosting productivity; and export promotion. There may be trade-offs between these different objectives. For instance, it is possible that environmental enhancements and improved animal welfare standards might reduce agricultural production and therefore impact food security and exports. Transfers aimed at boosting farmers’ incomes may

---


discourage exit of less productive farmers, limiting the scope for entry or expansion of more productive farmers, impacting on productivity.

- **How much flexibility should devolved (or local) governments have over funding?** The most appropriate balance between these different objectives might differ according to local characteristics and preferences. There is therefore a question of how much flexibility devolved (or indeed local or regional) governments should have in the allocation of agricultural funding. The CAP increasingly allows for such flexibility and there is a question of whether a UK scheme should allow more flexibility or less (perhaps on the grounds of ensuring fair competition within the UK market).  

- **How should funding be allocated across the UK?** As discussed, the EU has been aiming to move towards allocating funding to member-states using a common per hectare basis. However, in part as a result of historic allocation systems based on production as opposed to land area, the amount per hectare currently varies significantly across EU member states and within EU member states, including the UK. Scottish Government statistics indicate that Scotland was host to one third of UK agricultural land in 2016 but it received just 17% of CAP Pillar 1 payments in that year. This reflects the fact a large fraction of Scottish agricultural land is grass and rough grazing rather than crop-land, which is concentrated in England.

  The Scottish Government has challenged this allocation of CAP funding and it therefore seems that the rules for determining allocations to devolved governments / parts of the UK are likely to be contentious.

Finally, it is worth noting that the replacement of CAP is just one of several key issues posed by Brexit for the agricultural sector, including tariffs, and market access between the UK and the EU for agricultural products.

**Options and issues for research and innovation funding**

The last area of funding we discuss in this note is research and innovation funding.

---

19 Downing, E. and Coe, S., *ibid*, 2018, argue that under the CAP, the systems in operation in England, Scotland, Wales and Northern Ireland have diverged significantly to reflect differing needs and priorities.

• **What is the purpose of science and innovation funding?** There are different ways in which science and innovation funds can be allocated depending on the objectives of this funding. Possible objectives include:

  o **Producing public goods**: making sure the projects that benefit wider society the most are being funded.

  o **Promoting regional development**: ensuring that organisations engaged in research and innovation in disadvantaged regions benefit relatively more from funding, in an effort to reduce geographical inequalities.

• **At what level should decisions about funding allocations for research and innovation be made?** If the aim policy is to fund research with the highest potential for delivering public goods, then there would be a clear benefit from having competitive funding covering the largest possible geographic area. This could mean funding being determined at the UK level – supplementing the budget of UK Research and Innovating, for instance –, or the UK remaining in existing EU schemes (or their replacements) such as Horizon 2020 and Erasmus+. Some non-EU countries participate in these schemes (such as Norway or Turkey), generally making GNI-based contributions to the schemes overall costs. The possibility of the UK taking part in such arrangements depends upon agreements between the UK government and EU.

As noted previously, Scottish-based organisations have traditionally been relatively successful at winning such funding. In financial terms, Scotland might therefore receive more funding from UK-wide or EU-wide competitions than a Scotland-specific allocation (e.g. based on population), although the Scottish Government would then have relatively little control over funding priorities and decisions.

Note that a UK-wide scheme (as well as a Scottish scheme) could take into account issues such as the promotion of research and development in disadvantaged regions, in addition to scientific quality and overall costs and benefits. However, the UK will have less influence on the priorities and design of future EU schemes from outside the EU even if it takes part in these schemes.
Scottish Parliament Finance and Constitution Committee
Call for Evidence on Funding of EU Competences

Written Response from Prof. David Bell, University of Stirling

Introduction

As a result of the Brexit process, the Scottish Parliament will gain control over a number of competences from the European Union (EU). Funding to support these competences currently involves complex financial arrangements that are the outcome of decisions taken by the EU, and by the UK and Scottish governments. In the future, new funding arrangements will have to be established to replace existing systems. The EU will no longer directly influence these arrangements, though it may have an indirect role through their interaction with issues such as trade and state aid. Repatriation of the competences provides an opportunity for their redesign, thus opening options to redirect funding to other priorities or to use the funding more efficiently.

This paper focuses on how the transfer of these competencies will affect the funding relationships between the Scottish and UK governments. It is structured as follows: first it considers the scale of existing EU funding streams and their relative importance within public expenditure in Scotland. Next it discusses the purposes of current EU funding and the way that funding is allocated to Scotland. Finally, it considers different models for the post-Brexit funding relationships between the Scottish and UK government that relate to current EU competences.

Costs of Funding the Competences

Scotland was scheduled to receive €5.6 billion from the EU during the seven year 2014-20 EU Multiannual Financial Framework (MFF). This amounts to €800 million per annum, which at current exchange rates is equivalent to £696 million per annum. Exchange rates vary and spending is not constant from year to year so there is some variation around this average. Nevertheless, cash transfers from the EU provides only a relatively small share of overall public spending in Scotland.

The Scottish Government budget for 2018-19 was set at £32.7 billion. Therefore, the current level of support through the MFF is equivalent to 2.8% of the current Scottish Government Budget. The most recent estimates of total public expenditure in Scotland, including that by the UK government, suggest that overall spending in 2015-16 amounted to £56.6 billion: EU spending is therefore equivalent to only 1.2% of total public expenditure in, and for, Scotland.

Nevertheless, the amount involved is still significant, amounting to more than gross spending on Scotland’s further education colleges. Further, because EU structural fund projects tend to require match funding from governments or their agencies, the annual EU contribution understates the commitment of public sector resource to EU projects. The UK as a whole was allocated €16.42 billion

---

of European Structural and Investment Funds (ESI\(^3\)) over the 2014-2020 period and has committed a further €10.87 billion to these schemes in match funding, enhancing the total budget available for schemes prioritised by the EU, implying a UK contribution rate of close to 40%. It is likely that a similar proportion will be drawn from the Scottish budget to match fund EU projects.

The allocation of funding to Scotland and that to the UK as a whole for the 2014-20 MFF is shown in Table 1 by programme.

<table>
<thead>
<tr>
<th>Table 1: EU funding allocations to the UK under the 2014-20 MFF</th>
</tr>
</thead>
<tbody>
<tr>
<td>€bn</td>
</tr>
<tr>
<td>UK</td>
</tr>
<tr>
<td>-----------------------------------</td>
</tr>
<tr>
<td>European Structural and Investment Funds (ESIF)</td>
</tr>
<tr>
<td>European Regional Development Fund (ERDF)</td>
</tr>
<tr>
<td>European Social Fund (ESF)</td>
</tr>
<tr>
<td>Youth Employment Initiative</td>
</tr>
<tr>
<td>European Maritime and Fisheries Fund (EMFF)</td>
</tr>
<tr>
<td>European Agricultural Fund For Rural Development (EAFRD)</td>
</tr>
<tr>
<td>European Agricultural Guarantee Fund (EAGF)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
</tr>
</tbody>
</table>

Table 1 shows that Scotland receives 14.8% of EU funding allocated to the UK. Scotland’s share of the UK population is 8.2%. Hence, Scotland receives considerably more than its population share of these funds. However, population share may not be the relevant measure for comparing all of the schemes listed in Table 1. For example, 38% by value of the total catch fish and shellfish landed within the UK Exclusive Economic Zone between 2012 and 2014 was landed by Scottish boats \(^4\). In contrast, English and Welsh boats only accounted for 19% of the value of the catch, while the remaining 43% was landed by other EU boats. Scotland therefore accounts for 66% of the value of fish landings in the UK. Similarly, although it receives 22.5 per cent of EAGF funding, agricultural land in Scotland comprises 33 per cent of the UK total. This again illustrates that population share may not be the appropriate comparator for European funding streams.

Note that in addition to the funds listed in Table 1, Scottish universities and innovative companies have been successful in competing for funds through the EU-funded Horizon 2020 programme. By July 2016, these organisations were participating in projects worth around €250 million \(^5\). It is difficult to put an annual figure on expenditure in Scotland from these projects since they involve many international partners and are spread over different time periods.

Brexit offers an opportunity to redesign and/or rescale all of these policies. The UK government has laid out some proposals for redesign which we discuss in the next section. There has been less discussion of redesign in Scotland, perhaps due to the uncertainty about which powers will be transferred from the EU to the Scottish parliament post-Brexit. This uncertainty derives from the

---

\(^3\) The ESI comprises the European Regional Development Fund (EARDF), the European Social Fund (ESF), the Cohesion Fund (CF), the European Agricultural Fund for Rural Development (EAFRD) and the European Maritime and Fisheries Fund (EMFF).


slow pace of negotiation between the EU and UK government and the lack of clarity over the UK government’s negotiating stance with the EU. We discuss the ways that the funds are allocated at present and how they might develop post-Brexit in the next section. We start with the structural funds and then discuss agriculture.

Present and Future Arrangements Relating to EU Competences

1 European Structural and Investment Funds

The EU intends that the ESIF funds should promote social cohesion, the specific objective of the individual funds include:

1. ERDF – “Promotes balanced development in the different regions of the EU.”
2. ESF – “Supports employment-related projects throughout Europe and invests in Europe’s human capital – its workers, its young people and all those seeking a job.”
3. EMFF – “helps fishermen to adopt sustainable fishing practices and coastal communities to diversify their economies, improving quality of life along European coasts”

From Table 1 it can be seen that Scotland receives slightly less than its population share of ESIF funding. The allocation of these funds is largely “needs-based”. In the 2014-2020 MFF, the main indicator of need was GDP per head. EU regions were divided into: less developed regions (GDP/head < 75% of EU-27 average); transition regions (GDP/head between >= 75% and < 90% of EU-27 average) and more developed regions (GDP/head >= 90% of EU-27 average). Less developed regions received the highest level of ESIF funding, while more developed regions did not qualify. However, member states were permitted to vire funding between regions under conditions set by the EU commission. Needs-based ERDF and ESF funding is intended to reduce inequality (increase cohesion) across EU regions.

Other parts of the UK stand to lose much more if the structural funds (ERDF and ESF) are discontinued post-Brexit. Figure 1 from Bell (2017) shows that Wales has been the principal beneficiary of structural fund support in both the 2007-2013 and the 2014-2020 EU budgets.

---

Needs-based formulae are also used to allocate a large proportion of government funding in both Scotland and England. For example, the allocation of funds to support healthcare provision and local government in Scotland are based on measures that reflect differences in need for these services across Scotland. The Barnett formula and other mechanisms for distributing funding such as City Deals are not based on any direct measure of need.

One of key decisions which must be resolved before implementing a needs-based approach is which level of government should have the responsibility for measuring need. Should it be the UK government or the Scottish government that allocates funding to reduce regional inequalities within Scotland? Clearly, if it is to be the Scottish government’s decision, there must be some prior mechanism to allocate funding from the UK government to Scotland. This could also be based on Scotland’s assessed need relative to other parts of the UK, or it could be based on the Barnett formula. We take up this issue subsequently.

It is worth noting that the UK Government did not simply pass on the allocations proposed by the EU Commission in respect of the 2014-2020 structural funds. Using its power to vire funding between different areas, the UK government cushioned the fall in spending proposed by the EU for the Devolved Administrations. In a press release, the Department for Business Innovation and Skills (BIS) stated:

“As a result of the new EU formula for allocating Structural Funds, agreed by the European Council in February, there would not have been a fair distribution across the UK, with each of the Devolved Administrations set to lose significant funding vital for economic growth.

In view of this, the UK government has decided to re-allocate EU Structural Funds to minimise the impact of sudden and significant cutbacks in Northern Ireland, Scotland and Wales. The Government will require the approval of the European Commission in order to do this.”

---

As a result of this intervention, Scotland’s EU Structural Fund budget was increased by €228 million. A group of nine local authorities in England took BIS to court over this decision. Ultimately, the Supreme Court upheld the BIS allocation.8 Thus, while the EU made the initial allocation of funding to the UK was based on levels of GDP per capita, the UK government was able, within limits, to reallocate funding and in this case did so in favour of Scotland, Wales and Northern Ireland.

Note that the process of determining those areas that are in “need” and therefore worthy of financial support is sensitive to how areas are defined. Maps can be altered to cluster areas of deprivation so as to qualify for funding schemes. In 1998, the Welsh Office was successful in its bid to the EU to reconfigure the regional map of Wales into an east-west split, rather than a north-south split. This helped the western part of Wales qualify for the higher levels of EU support.9

The Conservative party has indicated how it might replace existing structural fund policies post Brexit. Its 2017 manifesto suggested that it would “use the structural fund money that comes back to the UK following Brexit to create a United Kingdom Shared Prosperity Fund, specifically designed to reduce inequalities between communities across our four nations. The money that is spent will help deliver sustainable, inclusive growth based on our modern industrial strategy.”10 Further, the fund would be “cheap to administer, low in bureaucracy and targeted where it is needed most”. Details of the policy are not yet available. It is possible that, like the existing structural funds, financial support will be based on some measure of need. The commitment to reduce regional inequalities, which in the UK are greater than in any other EU member state, will partly be signalled by the amount of funding that the UK government makes available through the Shared Prosperity Fund.

Depending on the nature of Brexit, the Scottish Government’s freedom to spend money to reduce spatial inequalities or to support particular enterprises may be constrained by state aid rules. Remaining within the EEA or customs union, or even making comprehensive trade agreements with other countries will likely involve guaranteeing to abide by some form of state aid rules. These are already well understood by the Scottish Government which has arrangements in place to determine when intervention to support enterprise is/or is not allowable under EU State Aid rules. But, as Crafts (2017) points out, a hard Brexit offers greater opportunities for selective state intervention to support industry. He argues, however, that state intervention should be limited to measures that support industry in general—such as government-funded research or skills acquisition—rather than selective intervention to support particular enterprises, which he argues should be strictly regulated. This is, in effect, a caution against the notion that government can “pick winners”.

2 The Common Agriculture Policy

EU agriculture policy (the CAP) is intended to “ensure a decent standard of living for farmers, at the same time as setting requirements for animal health and welfare, environmental protection and food safety. Sustainable rural development completes the picture of the EU’s common agricultural policy.”11

8 See, for example: https://localgovernmentlawyer.co.uk/index.php?option=com_content&view=article&id=21866%3Alocal-authorities-lose-supreme-court-battle-over-eu-structural-funds&catid=62%3Aprojects-articles&Itemid=30
11 See: https://ec.europa.eu/agriculture/cap-overview_en
To provide the context for these proposals, the CAP currently comprises

- Direct payments based on area farmed (known as Pillar 1) through the Basic Payment Scheme.
- Rural development finding (known as Pillar 2)

Together, these comprise the largest element of EU funding, as can be seen from Table 1. It is expected that total payments to agriculture in 2018-19 from the EU will add £543.6 million to the Scottish government budget\(^{12}\). These payments are extremely important to Scottish farm business income. In 2016-17, average farm income was £26,400: the average subsidy was £41,000. Without subsidy, farms would have made a loss of £14,900 on average. Average income per hour worked was £9.39\(^{13}\). This is above the minimum wage, but not by much. Payments are very unequally distributed with 25 per cent of farmers receiving less than £1748 in terms of direct EAGF payments, while 10 per cent receive more than £49,300. Direct payments in England are as unequally distributed as those in Scotland\(^{14}\).

Direct payments are given to farmers in the form of a basic income support based on the number of hectares farmed. Tariffs are applied to imported foodstuffs to help European farmers to compete against competition from elsewhere in the world. However, the CAP no longer boosts farm incomes by subsidising food production or supporting price levels. Reliance only on tariffs accords with the Agriculture Agreement that formed part of the 1994 Uruguay Round of trade talks. So that the CAP falls within the “Amber Box” to use the World Trade Organisation (WTO) terminology, EU support for farmers has had to be redirected from particular foodstuffs, to direct income payments that are “decoupled” – not linked to output or prices. Countries within the Amber Box, which includes the EU, have made commitments to reduce trade-distorting domestic support – sometimes referred to as “total aggregate measurement of support” (AMS). Decisions around the types of support offered to Scottish agriculture will affect the overall classification of the UK within WTO rules and therefore are likely to influence the nature of future trade negotiations between the UK and other countries. The same would be true for an independent Scotland involved in its own trade talks. The downside of agricultural protectionism is that domestic consumers pay higher prices for food than if markets were open to competition. Nevertheless, small countries can follow protectionist strategies: in its report on Norway in 2000, the WTO argued that

“Norway’s liberal regime is marred by inordinate protection to agriculture and that a few remaining trade and investment distortions, including those that may arise from subsidies for regional and industrial policy reasons” \textbf{WTO(2000)}

Norway is able to offer generous support to agriculture and certain industries due to its considerable oil and gas revenues. However, it has recently \textbf{agreed} a more liberal policy on agricultural products with the EU following two years of negotiation.

Note that the EU is content with significant differences in the way that agriculture is supported in Scotland and England. Policy in England tends to be more concerned with rural development


\(^{14}\) Source: Own calculations of Gini coefficients of direct EAGF payments in Scotland and England using 2016 data
than agriculture per se, while the Scottish approach emphasises the need to support marginal farming enterprises, notably crofting. Now consider how agriculture policy may evolve post-Brexit. The UK government has made a radical proposal for this policy in England. In its February 2018 consultation paper “Health and Harmony: the future for food, farming and the environment in a Green Brexit”, the Department for Environment, Food and Rural Affairs (DEFRA) set out a vision for agricultural support post Brexit.

The main DEFRA proposal follows Helm’s recommendation and is summarised as follows:

“Our aim is for public money to buy public goods. In 25 years’ time, we want cleaner air and water, richer habitats for more wildlife and an approach to agriculture and land use which puts the environment first. From 2022 onwards, a new environmental land management system will be the cornerstone of our agricultural policy, achieving improved biodiversity, water, air quality, climate change mitigation, and the safeguarding of our historic landscapes. This will allow us to fulfil our manifesto commitment to become the first generation to leave the environment in a better state than we found it.” (DEFRA 2018)

If a policy of “public money for public goods” in relation to agriculture is put in place, then the rationale for Pillar 1 (direct payments) disappears. If nothing replaces this funding source, then the equivalent funding stream for Scotland would likely be under threat. Environmental groups would like to maintain current levels of support for farmers but switch funding towards sustainable land management. However, the UK government may have other priorities for this funding stream. If future levels of support for agriculture in England change significantly, consequences for Scottish funding are almost inevitable. These will depend on the allocation formula, the issue with which we consider in the next section.

**Alternative funding mechanisms**

Withdrawal from the EU opens possibilities for replacement, redesign or removal of current EU funded policies, principally the CAP and the structural funds. There are important points of principle about which level of government should have the power to make funding decisions that relate to these policies. However, it is the UK government which currently pays the UK contribution to the EU: it will be the immediate beneficiary of the withdrawal of these contributions. Therefore, it can decide whether and how to allocate the funding which is no longer going to the EU. However, it has committed to respect the Devolution settlement, though as yet it is not clear what agreement, if any, will be reached around those powers to be transferred to the Scottish government from the EU and which will be transferred to the UK government. Clearly, these decisions will have profound consequences for the funding mechanisms described here.

For example, the UK government may allocate funding to the “Shared Prosperity Fund” as a substitute for the structural funds. Aside from the issue of principle of who controls the Shared Prosperity Fund within Scotland, there is a more prosaic question of which funding mechanism will give the best outcome for Scotland. There is no simple answer to this question: it depends on


17 Greener UK, *Agriculture at a crossroads: the need for sustainable farming and land use policies*, February 2017
assessments of how the UK government decides policy will evolve, and how such decisions interact with potential funding mechanisms. We consider three possibilities, the Barnett Formula, needs-based assessment and competition and discuss these in turn.

1. The Barnett Formula

The effect the Scottish budget of the inclusion of the payments listed in Table 1 within the Scottish block grant depends on how the payments evolve at UK level and their interaction with the Barnett formula. Assume that the EAGF funding, which covers Pillar 1 payments, is incorporated within the Scottish baseline at the next Spending Review. The 2018-19 Scottish government budget estimates that these will be worth £438 million. The equivalent payment in England is £1756 million. Suppose that at some point in the future the UK government opts to withdraw Pillar 1 funding (direct payments to farmers) and instead to concentrate on a “public money for public goods” policy.

Suppose also that funding the funding for Pillar 1 payments in England is reduced by equal amounts over a six-year period. What will be the effect on the Scottish block grant under the Barnett Formula? The results are shown in columns 1 and 2 of Table 2 and are based on the assumption that Scotland’s population remains at 9.8% of that in England. Over six years, funding in England disappears, but in Scotland is reduced by less than 50%. Expressed as a share of Pillar 1 funding in England, the amount allocated for Pillar 1 funding to Scotland’s block grant increases from 25% at the outset to 86% by the fifth year.

The explanation for this strange behaviour lies with the effect of the “Barnett squeeze” in reverse. Each year, the Scottish block grant is reduced by Scotland’s population share (9.8%) of the reduction imposed on England. But in the first year, payments to Scottish farmers are equivalent to 25% of the payments made to English farmers. Instead of payments in Scotland being cut by 20%, they are cut by 9.8% of the 20% cut in the English grant. Given that total grant expenditure in England is four times that in Scotland, this implies a cut in Scottish funding of only (0.2*0.098*4) = 7.8%, a much smaller percentage cut. This pattern is repeated as the grant to England is gradually withdrawn, but leaves Scotland with a budget of £266 million by the time the grant to England has been completely extinguished. Application of the Barnett formula to a diminishing agricultural support budget in England is likely to be of relative benefit to the Scottish budget, though it will still result in a considerable cut to this funding stream.

The reverse effect would occur if spending in England on Pillar 1 payments increased in nominal terms. The implications of this unlikely turn of events is shown in columns 5 and 6 of table 2. Here the assumption is that nominal spending in England grows by 5% each year. In this case, the normal Barnett squeeze applies, with Scotland receiving a smaller proportionate increase because its population share is less than its share of Pillar 1 spending at the outset.
Table 2: Effects on Scottish Budget of Different Expenditure Trajectories

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>£1,756m</td>
<td>£438m</td>
<td>25%</td>
<td>£1,756m</td>
<td>£438m</td>
<td>25%</td>
</tr>
<tr>
<td>2</td>
<td>£1,405m</td>
<td>£404m</td>
<td>29%</td>
<td>£1,844m</td>
<td>£447m</td>
<td>24%</td>
</tr>
<tr>
<td>3</td>
<td>£1,054m</td>
<td>£369m</td>
<td>35%</td>
<td>£1,936m</td>
<td>£456m</td>
<td>24%</td>
</tr>
<tr>
<td>4</td>
<td>£702m</td>
<td>£335m</td>
<td>48%</td>
<td>£2,033m</td>
<td>£465m</td>
<td>23%</td>
</tr>
<tr>
<td>5</td>
<td>£351m</td>
<td>£301m</td>
<td>86%</td>
<td>£2,134m</td>
<td>£475m</td>
<td>22%</td>
</tr>
<tr>
<td>6</td>
<td>£0m</td>
<td>£266m</td>
<td>-</td>
<td>£2,241m</td>
<td>£485m</td>
<td>22%</td>
</tr>
</tbody>
</table>

Thus, if the Barnett formula is applied, the size of Scotland’s block grant will be affected by the UK government’s decisions on how agriculture is supported financially in England, with or negative outcomes possible, depending on the direction of UK government agriculture policy.

The application of the Barnett formula to the structural funds would have relatively small consequences for Scotland’s block grant. This is because the allocation to Scotland in the 2014-2020 MFF is close to its population share. Thus, with per capita spending on the structural funds in Scotland differing only slightly from that elsewhere in the UK, application of the Barnett formula, which is based on population shares will have little significant impact.

Further points worth making in relation to Barnett funding are:

- The application of the formula is subject to intergovernmental negotiation, but ultimately is under the control of HM Treasury.
- The Barnett “squeeze”, illustrated above, has received little attention in recent years. Its ultimate effect is to equalise spending per head across all of the constituent parts of the UK. This does not mean it has gone away. The reason for it receiving relatively little publicity is that austerity and low inflation have held nominal budgets in Scotland, Wales and Northern Ireland almost fixed over a long period. The Barnett squeeze becomes an issue during periods of high inflation and/or high-growth. There is always some chance that such circumstances might arise again.
- Once included in the block grant, allocations to agriculture and the structural funds would be competing directly with other Scottish government priorities. While some might argue for establishing clear financial boundaries around these funding priorities, it is not clear why these might be deserving of special treatment compared with other spending programs.

2. Needs-based allocation at UK level

An alternative approach to reallocation of EU funding streams is to use a needs-based formula. The structural funds are already allocated using such a formula. Need is identified using a simple metric - GDP per head. The EU allocates funding using this measure across all of the member states. As already mentioned, funding on priorities such as health and education within the component parts of the UK is allocated using needs-based formulae. Hence this is not an alien concept to the UK or devolved governments. Therefore, the post-Brexit analogue to the EU implementing a needs-based formula is for the UK government to carry out a comparable exercise for the component parts of the UK.
Would such an exercise disadvantage Scotland? Since Scotland currently receives around its population share of the structural funds based on the EU’s needs assessment, it would be unlikely to make a significant difference unless the criteria for assessing need changed radically.

One specific approach might be to mimic the form of needs assessment used by the EU. If qualification limits for structural fund support were set at 90 per cent and 75 per cent of UK (rather than EU) GDP per head, which areas in Scotland would qualify for support as less-developed or transition regions? The results, which are based on ONS estimates of Gross Value Added per head for 2016, are shown in Figure 2. Some are quite surprising. For example, Dundee is the only major city that would qualify in either category, while more areas in the south of the country would qualify compared to those in the north. Note that Figure 2 is merely illustrative, intended to show that the UK could mimic EU processes, at least as far as the structural funds are concerned.

Figure 2: GVA by NUTS 3 Region in the UK (percent relative to UK average)

Would such an approach work for agriculture? Unlikely. Need is not a familiar concept in agriculture although many agricultural funding mechanisms have implicitly been used to support low levels of income among particular groups of farmers. And there is clearly a drive from the WTO to persuade governments to reduce the kind of support which distort agricultural markets. It would perhaps recommend that individuals and households be supported, not because they are farmers, but because their incomes are low.
3. Competition at UK Level

A more radical approach is to propose that some of the funding released by EU withdrawal should be allocated competitively. Though this is not a commonly used funding mechanism, it does have some precedents within current practice. An obvious example is the allocation of funding to science projects, such as Horizon 2020, which is invariably on a competitive basis. Perhaps more pertinent are the City Deals. In its description of City Deals and Growth deals between 2010 and 2015, the UK Government “invited 20 cities and their surrounding areas to compete for the opportunity to negotiate a City Deal. The deals would see government give powers to the city in exchange for the city taking on the responsibility of creating economic growth in its area.”

One argument against needs-based funding is that it fails to reward those who, by effective policy intervention, improve conditions for their local population, and therefore reduce their demand for needs-based support. Competition based on plans to enhance performance avoids this problem, though it is reasonable to ask, in the context of the City and Growth Deals, whether those areas that fail to achieve their growth targets will be punished financially.

How would Scotland perform if some part of EU funding was determined competitively? Difficult to predict. Scotland has traditionally received more that its population share of research council income. For example, between 2010-11 and 2012-13, Scottish HEIs attracted 12.8 per cent of Research Council funding, well above its population share. Almost all of this funding is awarded on a competitive basis. However, this process is generally accepted by Scottish HEIs because it is perceived to be fair. The committees that allocate awards do so on the basis of merit, not geography. It is more difficult to establish a robust and trusted adjudication mechanism when failure to win an award may have serious economic consequences for an area. Politicians may not wish to cede control to such a mechanism even if its outcomes are superior to those needs-based support.

Conclusion

The funding implications of the transfer of competencies from the EU are not massive in relation to public spending in Scotland, but they are significant, particularly for some areas of the economy.

The way that these competencies are distributed between different levels of government will have implications both for the operation of the UK internal market and for the UK’s international trade agreements. Different levels of support for agriculture or for other sectors of the economy may be argued to be distorting the internal market. However, these policies already operate somewhat differently in Scotland compared with the rest of the UK under current EU rules. A key question will be how to establish what are allowable deviations in policy between Scotland and other parts of the UK and how such deviations will be controlled in a way that has the confidence of the UK and Scottish governments. This may be through the courts or some new institutional mechanism: it seems unlikely that the Scottish government would allow the UK government to unilaterally control these issues.

---


In respect of the funding arrangements, use of the Barnett formula has the advantage of familiarity. However, whether this mechanism will maximise funding to the Scottish government depends very much on the likely trajectory of spending post-Brexit and its interaction with the “Barnett squeeze”. The addition of EU funding to the Barnett formula alongside the adjustments that are in train involving the block grant adjustment and its sensitivity to individual tax receipts and benefit spending in the rest of the UK will make Scotland’s funding system even more opaque than it already is. Lack of transparency invites complaints that the system is somehow biased because it is difficult to construct a clear rationale for the way in which it operates.

Nevertheless, the Barnett formula maximises the opportunity for the Scottish government to significantly change its policy in relation to agriculture and regional development. Under the Barnett formula present EU funding will be in competition with other Scottish government priorities. The Scottish government will be able determine its own priorities, provided that these do not undermine the UK internal market or destabilise UK trade arrangements.

Other mechanisms, such as needs-based funding or competition will require a new institutional framework: again, it will be important that all of the governments involved have confidence in these new arrangements. This may partly be determined by the principles and arrangements which underlie the distribution of the Shared Prosperity Fund if this were to be distributed on a UK wide basis either competitively or using a needs-based formula. Whether Scotland does better or worse financially from these alternatives compared to the Barnett formula is difficult to predict. Under the current EU arrangements that determine eligibility for the structural funds, when applied to current UK data, we have shown that several Scottish areas would qualify, but many would not.

Finally, it is worth emphasising that any new funding arrangements should be subject to rigorous evaluation processes in relation to objectives that are clearly established when these arrangements are introduced. It should be clear that funding is made conditional on achieving stated efficiency or equity objectives. Lack of clarity on these issues may result in relevant parties treating such funding as an entitlement, making it more difficult decisions to reallocate to priorities that would be more beneficial to the Scottish people.

---

Note that the arrangements for adjustments already in train to the Barnett formula are due to be reviewed in 2021. See: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/508102/Fiscal_Framework_-_Text_-_Annex_to_the_fiscal_framework_-_15th_March_201....pdf
References


This note considers the options for replacing the two main streams of European Union funding currently in the Scottish budget, agricultural support and structural funds. Different considerations apply to each, but it seems unlikely that the Barnett formula will provide a satisfactory mechanism for allocating resources in future in either case.

**Background**

At present European Union (EU) receipts are in addition to the Scottish budget (as determined by Barnett and the mechanisms for Annually Managed Expenditure) but they are matched and offset by the associated spending. Agricultural support is determined by the Common Agricultural Policy (CAP) rules and is directly managed by the Scottish government. The EU allocates structural funds according to measures of need in different areas, the simplest example being Objective One, historically allocated to areas with less than 75% of the EU average GDP per head. Entitlement is determined by the rules of the various funds and the success of bids against them. Spending is managed by the Scottish government, local authorities and others. Neither programme has ever been part of the Barnett allocation process.

Scotland is a major beneficiary of the CAP, proportionately more so than England because of the significance of agriculture in the economy. Scottish spending per head on agriculture is about 3 times higher than in England. It is roughly the same in Wales, and Northern Ireland’s spending is nearly 6 times higher⁴. The CAP determines virtually all agricultural spending and (assuming the process of leaving the EU is completed) is likely to be completely replaced by domestic programmes. These will be constrained by whatever international trade obligations the UK enters into with the EU and others. The UK government has also indicated that it wishes to preserve an internal UK single market in food and agriculture (as in other areas). This will make obvious sense for Scottish agricultural exporters, and indeed consumers².

Historically Scotland has also done well out of the structural funds, e.g. in the Highlands and former industrial areas, but this is less true now, with Scotland as a whole one of the richer regions of the UK. It is important to realise that under the Scotland Act, economic development is not solely a devolved matter. It is one of the few Ministerial functions that are exercisable by both the Scottish and UK governments if necessary.

---


² I make no assumption here about where responsibility for legislating on the necessary rules will lie.
governments\textsuperscript{3}. Additionally, structural funds are by no means the only regional economic development tool available. More is spent by the Scottish government themselves on economic development than via the structural funds. Those are simply a source of additional money, spent in different ways. All economic development activity, however, is constrained by EU State Aids framework. European rules rightly give priority to areas which have fallen behind economically.

Replacing EU frameworks

If the UK is outside the EU, a replacement set of rules for agricultural support will be needed. In the short run, and certainly during the transition period, this will be very similar if not identical to the CAP rules. It is common ground between the Scottish and UK governments that the new rules will be a UK framework: the present dispute between the governments is essentially about how much influence the Scottish Parliament will have over setting them\textsuperscript{4}. For purposes of this evidence I assume that there will be an agreed UK agricultural support framework.

By contrast, the European structural funds are by no means the only economic development instrument available to government, and are markedly smaller than other economic development budgets, such as the spending through Scottish Enterprise. Although the UK may choose to replicate or replace the structural funds post-Brexit, it is under no obligation to do so. It could simply rely on other existing economic development programmes, perhaps with somewhat larger budgets. Most likely the UK government will wish to set up a UK-wide programme, as it is legally entitled to do under the Scotland Act. In any event, the UK will require a set of State Aids rules. These too will be uniform across the UK, in all likelihood stemming from international obligations, whether WTO rules or whatever trade relationships the UK agrees with Europe.

Funding Agriculture

The resources the EU applies to agricultural support come of course from the member states, via their contributions to the EU budget, mostly from a share of VAT. The UK will no longer make those contributions, and in particular is unlikely to agree to share VAT. Additional tax revenue (other things being equal) will therefore accrue to the UK government, and could be used to fund agriculture. No additional tax income will accrue to the Scottish government as a result of this, hence funding will have to come from London to Edinburgh.

If there is a single UK framework for agricultural support, analogous to the Common Agricultural Policy, then there is a strong argument that resources should be directed to fund the common framework. To the extent that it subsidises production, land management, marginal farming etc, then the resources should be directed towards production, land etc. Even the CAP, however, has a degree of flexibility in it, and it might well be that the UK framework will allow the devolved administrations perhaps

\textsuperscript{3} Scotland Act 1998, section 56.
\textsuperscript{4} If, as the UK government say, agriculture will in due course become a wholly devolved matter, then in effect the Scottish Parliament will in effect have a veto over the UK framework’s application in Scotland.
quite substantial flexibility in how they allocate the resources. In those circumstances a simple formula (so much per hectare, head of cattle or the like) may not work.

An obvious solution would be to adopt for agriculture the same principle as is adopted for Northern Ireland social security expenditure, often referred to as the "parity principle". That is to say that the UK government will fund from UK taxable resources the same level of provision by the devolved administrations as it funds in England, although there is no obligation (within the boundaries of whatever common framework is agreed) on them to spend it in exactly the same way. The devolved administrations could supplement spending (or otherwise) from their other programmes, again so long as this was consistent with the agreed common framework.

The obvious deficiency of the Barnett formula here is that it gives the same per capita change in expenditure, which would be proportionately much smaller than Scottish spending. It has been suggested that agricultural spending will reduce once the UK is out of the EU. (The UK may simply have less money to spend overall, and it may be less inclined than the EU to invest in the agriculture for reasons of food security. Put more bluntly, the sector has less political clout in the UK than in the EU.) So it might be argued Barnett would be tactically advantageous to Scotland as decreases too would be proportionately smaller. This however is designing the funding system to meet tactical need which may or may not emerge. In the very short run, UK ministers seem to indicate that no immediate cash reductions in expenditure are planned. In any event, there is in fact no ‘baseline’ within the Scottish or UK government agriculture budgets to which these increments could be applied.

**Funding regional economic development**

Structural funds were intended to produce greater equality in economic development across the EU. Abolishing them will provide the UK with an opportunity to revise its own regional policies, which over recent decades have struggled to offset increasing disparities, as London and the south-east move further ahead of other parts of the country. Over the five and a half decades from 1963 until around 2008, Scotland stood out against this trend, as GDP per head grew steadily by very slightly more than the UK average. This took Scotland from one of the poorer to one of the richer regions of the UK over this period. Since 2008, Scotland’s growth per head been lagging the UK, but Scotland nevertheless remains one of the country’s richer regions. The contrast with the challenges facing the other devolved administrations in Cardiff and Belfast is very marked.

The UK might simply conclude that existing domestic regional economic development mechanisms and funding (which in financial terms is within the baselines of the relevant Whitehall departments) are adequate. If that is the case, any additional resources allocated to them in the normal day-to-day processes will be subject to the Barnett formula in the usual way.

Alternatively, the UK might introduce a programme to replicate the objectives of the structural funds in directing development resources to poorer parts of the country. Wales, Northern Ireland and much of Northern England might benefit most from this.
While Scotland has poorer areas, overall its needs will be less than those of Wales and Northern Ireland in particular. Allocating such a programme on a per capita basis, in line with the Barnett approach, is unlikely to be seen as fair in either Belfast and Cardiff. Nor would it be consistent with the philosophy of replacing the structural funds. It seems likely that the present UK government might adopt a “challenge fund” approach, which is a mixture of targeting need and development opportunities.

Here the role of a UK regulatory framework is likely to be less significant. State Aids rules or their successors (to some degree mandated by the EU, and most likely set in London) will set constraints on how money is spent, rather than how much is spent. The Scottish government will be free to allocate resources to economic development from whatever source. They already spend around 50% per head more on economic development than in England.

Tactical Considerations

Naturally, the Scottish government will want to maximise the resources available in Scotland to replace these EU funds. For agriculture, their key leverage lies in agreeing the new UK framework, and ensuring it makes explicit reference to those issues that matter most in Scotland. Here it should be possible to make common cause with Wales (and, were there an administration, perhaps Northern Ireland too).

On structural funds, the Scottish government might argue for no direct replacement but rather extra resources for existing economic development programmes, and hope to gain Barnett consequentials. This is unlikely to be attractive in either Cardiff or Belfast, and makes little sense from a strategic UK perspective. Instead they might argue for the replacement programme to be targeted on smaller geographical areas than the structural funds, so the poorer parts of Scotland have a better chance of participating. The Scottish government should also already be well prepared to gain the maximum benefit from any challenge fund approach, given the scale of match funding available in the Scottish budget already.

Conclusion

For different reasons, it seems unlikely that the Barnett formula is the answer to funding agriculture or whatever replaces the structural funds, after EU membership. The UK agricultural support framework to be agreed will give the Scottish government scope to influence spending, and it might sensibly be combined with a “parity principle” to set budgets. If, as seems likely, a new UK-wide programme replaces the structural funds, then the Scottish government should argue for narrow geographical targeting so Scotland’s most needy areas can benefit from it, and ensure that any bids to such a scheme are high quality and well resourced.

Gwylim Gibbon Policy Unit
Nuffield College
Oxford
April 2018
Evidence to Scottish Parliament Finance and Constitution Committee  
Michael Keating, Professor of Politics, University of Aberdeen and Director of the Centre on Constitutional Change

EU Spending in the Nations
After Brexit, EU expenditures revert to the UK. The largest items concern agriculture and cohesion and structural spending. These competences are devolved within the UK. We do not presently know how they will be distributed across the UK. Currently, the devolved governments do rather well in these fields.

<table>
<thead>
<tr>
<th></th>
<th>Per capita Agriculture 2014-20</th>
<th>Per capita Structural Funds 2014-20</th>
</tr>
</thead>
<tbody>
<tr>
<td>England</td>
<td>338</td>
<td>116</td>
</tr>
<tr>
<td>Scotland</td>
<td>863</td>
<td>150</td>
</tr>
<tr>
<td>Wales</td>
<td>866</td>
<td>715</td>
</tr>
<tr>
<td>N. Ireland</td>
<td>1403</td>
<td>253</td>
</tr>
<tr>
<td>UK</td>
<td>437</td>
<td>151</td>
</tr>
</tbody>
</table>

Department of Business, Innovation and Skills, Government sets out how the UK’s allocation of EU Structural Funds will be divided across England, Northern Ireland, Scotland and Wales, Press Release 26 March 2013.

Department for Environment, Food & Rural Affairs, Northern Ireland Office, Scotland Office, Office of the Secretary of State for Wales, UK CAP allocations announced, 2013.

These moneys are not part of the block grant that governs other transfers but are ring-fenced for agriculture and regional development programmes. There is some flexibility within these programmes. In principle, they are governed by European rules.

In practice, matters are more complicated. Like all public finance decisions, they are governed by a mixture of technical criteria, political bargaining and inertia. In both fields, there are de facto national quotas for each member state. A lot of haggling is required to square these with technical criteria and the balance shifts from one spending round to another.

Within the UK, a similar process is at work. The final decision is taken by the UK Government, again squaring these with the EU technical criteria. In the current round (running from 2014-20), the Government gave each nation the same share of both agriculture and structural fund money as in the previous round, within a reduced overall budget. This is typical of incremental budgeting and of the Treasury’s way of dealing with the devolved governments.
The Block Allocation

Most transfers to the devolved governments, on the other hand, are determined by the Barnett Formula, which gives each of the devolved nations the same spending as in the previous round, increased or reduced by the change per head in England on the same services. So if England gets £10 per head extra for education, each of the devolved nations gets an additional £10 per head. The devolved nations do not have to spend that money (known as Barnett consequentials) on education but can spend it any way they like as it is part of their block grant. Cuts are distributed in the same way (generating negative consequentials).

The effect is to preserve relative spending levels, at least in the short run, as population numbers govern only the changes, not the whole transfer. In the longer term, if expenditure is increasing, then spending levels should converge – this is known as the Barnett squeeze. In practice, this has not happened, for a variety of reasons.

If spending is falling, the Barnett squeeze is reversed. As cuts are expressed as a proportion of population figures and not of existing spending levels, the existing beneficiaries suffer less.

When new competences have been transferred to the devolved authorities, the practice has been to set spending at the existing level and then roll it into Barnett. So future spending changes (but not the initial allocation) are governed by population relativities.

Winners and Losers

There is a lot of argument about who wins and loses from Barnett. The Welsh have argued for years that they get a raw deal and have demanded a needs-based system.

In the separate system for allocating European agriculture and structural funds, however, there is no doubt that Wales benefits, as the table shows. So does Northern Ireland, while Scotland gains from agricultural spending and neither wins nor loses from structural funds. Other calculations suggest that Scotland is a net contributor to the EU while Wales and Northern Ireland are net beneficiaries.

After Brexit

There are various options for allocating these funds after Brexit.

a) The present system for allocating these European moneys could be rolled over after Brexit. The devolved administrations would keep their advantage, albeit probably of a smaller total sum. Cuts would be applied in the same percentage across the nations.

b) The moneys could be included in the block grant and subject to the Barnett Formula. As in the first scenario, the devolved nations would keep their historic relativities but any changes would be applied on a pound for pound basis per capita and each pound would represent a smaller proportion of their existing budgets. As the overwhelming probability is that these funds will be cut rather than increased, the
devolved nations would face less severe reductions than under the present system. Contrary to some recent comment, Barnett does not mean that the nations would get only a population-based share of expenditure. Indeed, Barnett would be rather favourable to them. The devolved governments would have the opportunity to use the money as they see fit, irrespective of changes in UK priorities for England. On the other hand, farmers would have to compete with other priorities in order to get continuing support in Scotland. The farming unions are not in favour of this and prefer to retain ring-fenced funding.

c) The moneys could be used for UK programmes or tied to UK policy frameworks. There have been suggestions of a UK Shared Prosperity Fund to handle structural and cohesion funding. This might be the basis of a new UK regional policy, with funding allocated to the devolved nations competitively. This could reproduce the logic of the existing European structural funds. It might work like the City Deals, which selectively fund projects across the UK and require matching funding from devolved and local governments. This could hold political attractions for the UK Government but might distort local priorities and lead to cumbersome intergovernmental structures. At this stage, we know little about what frameworks might be put in place for agricultural support. The UK Government has declared that it will phase out direct support for farmers in England. If agriculture spending were tied to a UK framework, that might mean that direct payments to farmers in Scotland would also have to be phased out. As Scottish farmers are more dependent than those in England on direct support, this would have serious implications for the future of farming in Scotland.

d) The UK might decide to do away with agricultural support and structural policy altogether and retain the money. It could use it for deficit reduction or for reducing taxes. Alternatively, it could increase funding on other services, in which case, depending on the service, the devolved governments would get their Barnett share of that increase.
Executive Summary

This briefing paper focuses on the potential risks Brexit poses for funding Scotland’s devolved competencies related to the environment, energy and climate change.

- The EU has devoted around 20% of its expenditure to protecting national environments, promoting sustainable energy, and tackle climate change. Environmental considerations are incorporated into all funding streams across the Union’s budget, making it very difficult to get a comprehensive figure for the EU’s environmental spending in Scotland.
- Scotland has one of the world’s most ambitious climate strategies and has been very successful in creating new jobs and developing innovative projects in this sector in part thanks to available EU funding.
- Funding in this sector comes from a variety of sources and is often made available on a competitive basis. If this funding is not maintained or replaced, and potentially increased, the Scottish Government may struggle to meet its climate change and environmental objectives.
- The extent to which Brexit will affect funding opportunities is unclear and is dependent on the nature of the UK-EU relationship and the degree of participation in EU projects and programmes it permits.

1. EU Funding in Environment, Energy and Climate Change

1.1 Structural funds represent the largest share of EU money within this sector. The first funding route is through the European Agricultural Fund for Rural Development (EAFRD), and the CAP funding allocated by the UK Government. The devolved governments can determine the proportion to go to pillar II which emphasises rural development and sustainable environmental land management. CAP Pillar II in Scotland represents €478m (vs. €4096m for pillar I).  

1.2 The Scottish Government has also been allocated up to €941m through the European Structural and Investment Funds programmes for the period 2014-2020. This is split between the European Regional Development Fund (ERDF) (€476m) and European Social Fund (ESF) €464m. This funding is targeted through a series of ‘Strategic Interventions’ in line with EU policy objectives around environment, climate change and sustainable energy.

---

| **ERDF for Environment, Energy and Climate Change** |
|---------------------------------|-----------------|
| Green Infrastructure, Innovation, Low Carbon Infrastructure Transition Fund | £33 million |
| Low Carbon Travel and Transport | £13.9 million |
| Green Infrastructure | £8.2 million |
| Resource Efficiency and Circular Economy | £30.7 million |


1.3 The EU also provides for specific funding on a competitive basis to tackle climate change, develop sustainable energy and improve the environment. There are at least 106 EU funds available for environmental protection alone. The principal EU funding instrument dedicated to the environment is the LIFE (Financial Instrument for the Environment) programme. The Scottish Environment Protection Agency (SEPA), for example, secured €2.35 million from this programme between 2011 and 2015.

1.4 Scottish bids have been also particularly successful in attracting funding for research and innovation. For instance, Scottish universities and businesses have attracted €296m in funding through the Horizon 2020 programme for Research and Innovation. This represents 11 percent of the UK total, equivalent to €55 euros per capita compared to the UK average of €40 euro per capita. Horizon 2020 funding has been particularly important for supporting low carbon energy research and innovation. Around a quarter of programme funds in the current round are dedicated to climate and energy research.

1.5 Other avenues of funding include programmes for small to medium size enterprise (e.g. Competitiveness of Enterprises and Small and Medium-sized Enterprises (SMEs) - COSME) and Smart cities which can compete for money based on their ability to meet EU key priority areas that include promoting a low-carbon economy.

2. The European Investment Bank has also been a key source of finance for environmental and low carbon energy projects, especially high cost, high-risk capital projects. 90% of EIB loans go to EU member-states, and the UK has been one of its biggest recipients. EIB loans have been a crucial source of funding for ambitious low carbon energy projects in Scotland. For example, in 2016, the EIB agreed a loan of £525m toward the construction of the Beatrice offshore wind farm 14km off the coast of Caithness - the largest single EIB loan for an offshore wind project. This 19 year-long loan was awarded under the European Fund for Strategic Investments, set up in 2015 by the EIB and the European Commission, to boost projects aligned with the EU’s strategic objectives.

2.1 EU Structural and Investment Funds (ESI Funds), with the exception of the European Agricultural Fund for Rural Development, generally require national co-financing from either public or private sources. The ERDF rules require national co-financing of all supported

---

3 Nielson et al. May 2017, The role of EU funding in UK research and innovation, technopolis group, p4.
4 The Smart City’ ERDF Strategic Intervention provided a grant of £10 million to finance the Smart Cities alliance to improve Scottish cities and support public safety, mobility and improve waste management among other things. C.f. Urban Foresight Report for Scottish Cities Alliance - [Smart Cities Scotland Blueprint](https://www.smartcities.scot/), July 2016.
projects, from either public or private sources. Importantly, those funds must be additional to, and not a replacement for, existing national funding. These funds are not part of the Block Grant, and are thus not subject to the Barnett formula or block grant adjustment rules.

2.2 The responsibility for managing the delivery of funding rests with Managing Authorities. Based on the Partnership Agreement, each Managing Authority has produced an operational programme that contains further detail on what the fund will support, and how it will provide, manage and assess funding. The Scottish Government is the Managing Authority of ESI funds for Scotland.

3. AFTER BREXIT

3.1 The extent to which EU funding targeted at the environment, climate change and low carbon energy will be maintained, replaced, reduced or removed remains unclear.

(i) The UK-EU deal may include participation for the UK as a whole (or, theoretically, for one or more of its territories) in EU programmes, including Horizon 2020, securing the continued right of access to competitive funding. The Prime Minister’s Mansion House speech included a commitment to ‘a far-reaching science and innovation pact with the EU’ to enable the UK to participate in key programmes alongside EU partners. She also committed to exploring options for the UK’s continued participation in the EU’s internal energy market. This could ensure that the UK’s energy objectives remain strategically aligned with the EU’s, which may facilitate continued access to EIB loan funding and other EU energy infrastructure funding (e.g. Connecting Europe). This is, of course, subject to negotiation and may require obligations of compliance and jurisdiction beyond which the UK Government is willing to go.

(ii) In considering the fate of ESI funds, it is important to include both the EU receipts and the match-funding component that is a requirement under additionality rules. The extent to which these funds will be replaced in full or in part remains uncertain, as is the method of allocation.

(iii) Assuming funds are maintained to some degree from general taxation, the present system of allocating funds could be rolled over, with the Scottish Government remaining the Managing Authority for Scotland. Alternatively, funds could be incorporated into the block grant, with subsequent changes subject to Barnett.

(iv) The UK Government may instead opt to centralise funds. The Conservative Party manifesto in the 2017 General Election included a commitment to ‘use the structural fund money that comes back to the UK following Brexit’ to set up a UK Shared Prosperity Fund. The manifesto went on to say that this would be ‘specifically designed to reduce inequalities between communities across our four nations’, and would include funds to support sustainable, inclusive growth in line with the UK industrial strategy. It’s not clear what is meant by reducing inequality, nor is it clear the extent to which the devolved governments would continue to be involved in determining the distribution of funds within their territories.
Scottish Parliament Finance and Constitution Committee

Call for Evidence on Funding of EU Competences

Written Response from Scottish Council for Voluntary Organisations

[SCVO is a named stakeholder in the current European Structural and Investment Funds, and also a member of a UK-wide group exploring successor arrangements to EU funding.

Based on this experience:

There should be no regression in future successor funding to the status quo. We need to build on the opportunities that ESIF funding brings to social inclusion, combating poverty, growth of the social economy, labour market mobility and employability.

The current single Managing Authority (Scottish Government) approach to this type of funding is not necessary or ambitious enough. We advocate for multiple bespoke arrangements and the introduction of a dedicated civil society fund.

Transitional funding will be needed to mitigate human costs arising from gaps in funding during transition to successor arrangements.

SCVO supports common approaches across the UK to successor funding e.g. in how funding is managed and disbursed, but not common frameworks for specific policy areas as this could undermine devolution.

There is an opportunity for successor arrangements to learn best current practice from other funders and indeed from across the UK and internationally.

We would support a cross party group or Ministerial Convention on Europe/Brexit with a single focus on funding.]

Our response

SCVO is named in the Operational Programmes to deliver the European Structural and Investment Funds in Scotland as a stakeholder and was one of a range of stakeholders consulted in the identification of the spending priorities.

SCVO is also part of a UK working group looking at the proposed “Shared Prosperity Fund” announced by PM Teresa May. This group consists of SCVO’s sister councils across England, Wales and Northern Ireland and over 50 organisations delivering projects and programmes under the DWP Employability and anti-poverty programmes in England. The group is discussing the framework for successor funds i.e. whether to support a UK framework devolved but managed by different organisations with similar themes OR a “Barnetted” approach to the successor funds where devolved administrations decide on governance arrangements, spending priorities and allocations.
Based on this experience, we provide the following responses:

The extent to which the Barnett formula would provide an appropriate mechanism for funding competences returning from the EU to the Scottish budget

Barnett would only be appropriate if the value of returning funds did not regress from the status quo of approx. 900 million euros. Depending therefore on what the UK Government decide is the final amount of money “returning” to the UK then Barnett potentially could be beneficial to Scotland.

Colleagues in Wales currently receive more European Structural and Investment Funding (ESIF) than a Barnett calculation, provided in a like for like replacement of ESIF. This may lead to internal complications amongst the devolved nations.

However, there are risks to pursuing the Barnett route;

Owing to a failure to spend in the current ESIF programmes there is a high risk that there will be no additional funding from the UK government. The danger is that UK Treasury may arrive at the assumption that Scotland does not need a Successor Fund because they don’t spend what they have.

The biggest concern is that ESIF replacements have been assumed here. Without membership of the EU, there would be no public spending equivalent to account for. The Successor Fund is not a guaranteed future spending commitment. Even if it is created, until it allocates resources to UK departments whose policy functions are devolved in Scotland, there is no guarantee of the use of Barnett.

Alternative mechanisms of funding of EU competences

What MUST happen is no regression on the status quo. The investment priorities of social inclusion, combating poverty, growth of the social economy, labour market mobility and employability must be ring-fenced and indeed enhanced. It is critical that these policy areas are not left bereft of investment after the end of this programme and post-Brexit.

By contrast, many improvements could be made as we could be potentially starting with a clean sheet and pot of money. There will be no requirement to follow the current Scottish European Funds National Rules and a more sensible grant facility could be introduced where compliance regulations are related to the amount of grant. There is a potential to introduce a Successor Fund Grant Scheme, which is 100% funding and provides advance payments to organisations. The level of the grant available should be proportionate to the overall size of the project e.g. current range is from £3000 to £3 million.

There is an in-built assumption to current debates in Scotland that only a level of government can decide, allocate and be accountable for successor funding. SCVO would strongly disagree that this is necessary. We would like to see significant funds being managed by the third sector for the third sector. Our colleagues at the Welsh Council for Voluntary Action in Wales currently manage, allocate and are accountable for over £75 million of ESIF out to the sector. The funds are all committed and on target for spend. Investing in the sector and its priorities is low risk, high value and provides maximum outcomes. Our colleagues in Romania (FDSC) are the managing authority for all civil
society funding. We need to be more ambitious in Scotland and learn from others. The current managers of ESIF in Scotland do not have a strong track record of good governance and management.

**What mechanisms may be required to be put in place to support the funding of obligations and commitments arising from common frameworks?**

**Obligations:** Gap/bridge/hiatus funding needs to be put in place to ensure a smooth transition from the existing arrangement to the new arrangements. History tells us that this does not go well and vital services and projects are left high and dry. As there would be a real human cost to this, the impact on people directly affected needs to be understood and mitigated.

**Common Frameworks:** It is not entirely clear what is meant here but if it means a UK common approach to a fund or set of funds then I refer to our previous answer about funds being managed by the sector for the sector.

SCVO is working in partnership with its counterparts across the UK and is supportive of a common approach to improving the accessibility of funding for the third sector. But we would not wish to agree a common framework to specific policy areas, for example to employability policy if it undermined the policy approach taken in devolved policy priorities. In Scotland for example, many in the third sector rejected the UK approach to employability as regressive, detrimental, sanction-led and excluding the easiest to ignore groups.

Now is the time for Innovation in genuine co-production with stakeholders. The third sector can provide a channel for this. But Scottish Government will need to appropriately resource the third sector to engage fully in consultations and working groups on a Successor Fund(s) or being part of UK Frameworks to build new funds. This needs to be done now.

**What funding mechanisms should be used to replace EU funds that currently operate in Scotland?**

We support multiple bespoke mechanisms to manage areas of policy and funding. We find that the model of one Managing Authority and large bodies managing large amounts of money and complex policy areas struggle with transparency, accountability and customer service. Arms-length arrangements which are independent and promote understanding of the relevant policy areas can really deliver transformational change.

In our view, the current Managing Authority have failed in their delivery of the programme. This is evidenced by both the 2007 - 2013 and the 2014 to 2020 programmes having had payments to Scotland suspended by the European Commission. In the 2007 - 2013 programme there was a significant amount of underspend and at the end of the programme the Commission identified some £12.3m of funds that had been paid to project holders by the Managing Authority during the programme which they would not reimburse. Hence these funds were totally lost to Scottish organisations.
Three years into the current programme there has already been £22.2m lost from the ESIF programme and with the N+3 rule being implemented this year it is quite possible that considerably more of the ESIF funds will be lost to Scotland. Organisations receiving funding from LEADER also report a heavy bureaucratic burden to reclaim, what is relatively small sums of money. It is therefore clear that the types of systems operated by the current Managing Authority are not fit for purpose.

We would be in favour of a UK arrangement with WCVA, NICVA and NCVO for example to manage and support a civil society fund. We would equally be in favour of co-producing these funding arrangements with the Scottish Government or relevant government agencies.

The EU operates a range of governance, enforcement and dispute resolution arrangements as part of EU funding support. What similar mechanisms will be required for post-Brexit Funding?

A change of mind-set is required as any successor fund should be collaborative, inclusive and work with partners to achieve outcomes. Many instances of good practices exist in other funds such as Children in Need, the Lottery or Trusts such as Esme Fairburn who work with organisations in a collaborative manner to achieve good outcomes. Successor funding will have no need to be punitive and consider enforcement as it would surely be a much more collaborative process.

Any Successor Fund must learn from the myriad of good grant funders already operating in Scotland.

What opportunities and risks does this process present to the funding of devolved competences that currently reside at an EU level

Opportunities

There is a potential to introduce a Successor Fund Grant Scheme, which is 100% funding and provides advance payments to organisations. The level of the grant available should be proportionate to the overall size of the project, which in the current programme can range from £3000 to £3million. There should also be flexibility to change priorities, focus and allocations depending on environmental factors and societal challenges.

In employability there is an opportunity to fund 100% projects targeted at stage one clients and pre-stage one clients. A much needed area of investment particularly when levels of employment are higher and national programmes do not provide for them.

Transnational activity can be much more explicitly supported for volunteer and staff exchanges, learning, networking and sharing given that we are likely to be excluded from ERASMUS+ or have limited access. In addition the Scottish/UK third sector will no longer have European Commission support through framework grants to collaborate and cooperate with civil society across Europe on the big policy issues and innovation. Successor funding must ensure this vital collaboration continues.
Risks

The UK government consultation on the UK Shared Prosperity Fund has been postponed until later this year (possibly early autumn) and there is deep concern about the timescale for replacing ESIF and the potential for a gap in funding. The Scottish Government (Managing Authority in Scotland) are not even discussing mitigation/hiatus proposals with key stakeholders.

Due to the failure to spend in the current ESIF programmes there could be no additional funding from the UK government. All monies to Scotland will be in the block grant and this may not be a good thing nor additional. Currently we receive approx. 940 million euros/£800 million pounds in European Regional Development Fund (ERDF) and European Social Fund (ESF). This is genuinely at risk. It is difficult to identify who is responsible and who has ownership and oversight of the big picture. It is beyond comprehension that the Managing Authority are so unaccountable and the inextricable links between ESIF and Brexit for Scotland are being ignored.

SCVO have invested a considerable amount of staff time at our own cost to try and influence this process and to help accelerate spending in the current programme and to avoid money being handed back. Money has been handed back and more decommitment is likely therefore allowing the UK Treasury to arrive at the assumption that Scotland does not need a Successor Fund because they don’t spend what they currently have. We have been ignored, not listened to, and dismissed. SCVO staff have extensive experience and expertise in this area and are highly skilled. We made genuine offers to help and our “expert advice” was not even acknowledged on occasions.

What arrangements will be required to ensure parliamentary oversight of post-Brexit funding arrangements?

SCVO have also responded to a call for evidence from the Economy, Jobs and Fair Work Committee who are asking largely the same questions and with the same deadline. Whilst we very much welcome both these opportunities it is perhaps an indication of not only the horizontal nature of Brexit but how Scottish Parliamentary oversight on the current ESIF programme issues and their implications for Scotland and Successor Funding post Brexit appears incoherent.

SCVO is part of a UK working group that has met with BIS, DEXU, DCMS and DWP on the Shared Prosperity Fund. Scottish Government are having conversations about the Shared Prosperity Fund. Whilst we understand the politics have a long way to go the PM announced this fund as the Successor Fund quite some time ago and in Scotland it is not even discussed. We must prepare for this being a reality and what we would like from it.

The landscape changes frequently on Brexit and the imperatives for successor funding with it. Parliamentary oversight cannot be a one off thing until this is over the line. It needs to be an ongoing, iterative process involving the expertise within the country. There is an urgent need for clarity from the Scottish Government on what will happen when this programme ends in 2020 with 2022 for final payments/approvals.

We would therefore support a cross party group or Ministerial Convention on Europe/Brexit with a single focus on funding. Our colleagues in England managed to secure an inquiry carried out by the Work and Pensions Select Committee on the future of ESIF.
About us

The Scottish Council for Voluntary Organisations (SCVO) is the national body representing the third sector. There are over 45,000 voluntary organisations in Scotland involving around 138,000 paid staff and approximately 1.3 million volunteers. The sector manages an income of £5.3 billion.

SCVO works in partnership with the third sector in Scotland to advance our shared values and interests. We have over 1,900 members who range from individuals and grassroots groups, to Scotland-wide organisations and intermediary bodies.

As the only inclusive representative umbrella organisation for the sector SCVO:

- has the largest Scotland-wide membership from the sector – our 1,900 members include charities, community groups, social enterprises and voluntary organisations of all shapes and sizes
- our governance and membership structures are democratic and accountable - with an elected board and policy committee from the sector, we are managed by the sector, for the sector
- brings together organisations and networks connecting across the whole of Scotland
- SCVO works to support people to take voluntary action to help themselves and others, and to bring about social change.
- Further details about SCVO can be found at www.scvo.org.uk.

Contact

Ruchir Shah, Head of Policy and Alison Cairns, Head of European Affairs

Scottish Council for Voluntary Organisations,

Mansfield Traquair Centre,

Web: www.scvo.org.uk
The post-Brexit replacement for the EU Structural Funds, fisheries, agricultural and community development support programmes (for example LEADER) must strike a balance between meeting local economic and social development aspirations and ensure that the more strategic regional and national outcomes are also met. Regional programmes offer the opportunity to recognise and address regional disparities, as well as challenges and opportunities. It’s essential that there is flexibility built in to tailor funding priorities to changing economic circumstances. However, we are wary of a post-Brexit regional policy being too closely aligned to a UK Industrial Strategy as this may have negative implications for remote, rural and island areas.

The EU programme delivery mechanisms that seem to have worked best for Shetland in the past were: community programmes such Leader and community level EMFF with local decision making and applications closely linked to a set of agreed Shetland priorities; and regional decisions on larger scale projects taken at Highlands and Islands level as was the case during the pre-2014 Structural Funds Programmes. This approach provided a better-targeted use of funding with appropriate levels of scrutiny. Larger scale Shetland projects could make bids for the regional funds and decision-making at regional level meant that there was consistent policy applied. Having such decisions made at Highlands and Islands level also meant that funds were allocated against the agreed regional priorities and were not subsumed into central Government programmes.

Delivery of projects funded under the current ESIF programmes is extremely bureaucratic and audit intensive, using cumbersome IT systems. Post-Brexit programmes offer an opportunity to streamline application and claims procedures with level of audit proportionate to the scale of the project. There needs to be a greater focus on what projects are achieving and contributing to economic sustainability and growth, rather than on audit compliance.
Scottish Parliament Finance and Constitution Committee

Call for Evidence on Funding of EU Competences

Written Response from the Chartered Institute of Public Finance & Accountancy (CIPFA)

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. CIPFA shows the way in public finance globally, standing up for sound public financial management and good governance around the world as the leading commentator on managing and accounting for public money.

Further information about CIPFA can be obtained at www.cipfa.org

Any questions arising from this submission should be directed to:

Don Peebles
Head of Policy and Technical
CIPFA

Alan Bermingham
Policy Manager - Governments
CIPFA

1. Executive Summary

1.1 Within this submission, CIPFA will assess the nature and quantum of EU funding relevant to Scotland. We will consider the governance arrangements for this funding and discuss potential models of funding post brexit.

1.2 The current method of funding from the UK Government to the Scottish Government is through the provision of block grant adjusted via the Barnett Formula. CIPFA views this funding mechanism to be an inappropriate model for funding any EU competences repatriated post brexit.

1.3 Structural and Investment funds received from the EU into Scotland amount to £1.8bn over the funding period 2014 to 2020. These EU funds leverage additional finance for projects and infrastructure, raising the total funds available to £3.3bn over this period. Reaching agreement between the Scottish and UK governments on structural and investment funding post brexit needs to take place quickly, in order to offset any uncertainty
and mitigate delays in project planning and implementation due to future funding concerns.

1.4 CIPFA sees an opportunity to improve the co-ordination and governance arrangements for funding between the Scottish and UK Governments. The opportunity is for revised and strengthened governance arrangements and partnership agreements through the current Joint Ministerial Committee with the UK Devolved Governments.

1.5 The new arrangements on funding should be codified in the form of an agreement and should set out the arrangements and measures for funding alongside how disputes would be resolved. Further these agreements should allow for the appropriate scrutiny to take place in the respective devolved parliaments and assemblies.

1.6 Agriculture is a devolved matter for the Scottish Government and as such CIPFA supports the view that post brexit the Scottish Government should have flexibility to develop its own specific funding practices based on its objectives for the sector. Nationally there should be agreement on funding for agriculture support and distribution and within its scope should be a review of the current system of direct payments. This inclusion would be looking to improving the transparency, fairness and efficiency of the current system of payments.

1.7 Research funding should continue to remain at arms-length from government. CIPFA advocates that the existing national arrangements for research funding and funding councils, including the Scottish Funding Council, should be maintained with no diminution in funding levels post brexit.

1.8 It would be important for the Scottish Government to press for resolution on whether there will be access to EU research funding post brexit and; if not available a case should be made to ensure UK research bodies can continue to support research developments to at least the existing pre brexit levels.
2. **Nature of EU Funding in Scotland**

2.1 The primary sources of funding from the EU consist of Structural and Investment Funds and funding for Agriculture. Structural and Investment Funding for Scotland over the period 2014 to 2020 can be summarised as follows:¹

<table>
<thead>
<tr>
<th>Funds (€m’s)</th>
<th>EU Funding</th>
<th>National Co-Financing</th>
<th>Total Funding</th>
</tr>
</thead>
<tbody>
<tr>
<td>European Agricultural Fund for Rural Development (EAFRD)</td>
<td>845</td>
<td>577</td>
<td>1,422</td>
</tr>
<tr>
<td>European Regional Development Fund (ERDF)</td>
<td>479</td>
<td>525</td>
<td>1,004</td>
</tr>
<tr>
<td>European Social Fund (ESF)</td>
<td>373</td>
<td>399</td>
<td>772</td>
</tr>
<tr>
<td>Youth Employment Initiative (YEI)</td>
<td>93</td>
<td>46</td>
<td>139</td>
</tr>
<tr>
<td>Total Funding</td>
<td>1,790</td>
<td>1,547</td>
<td>3,337</td>
</tr>
</tbody>
</table>

2.2 An important aspect of the funds received from the EU is the leverage that this funding brings in terms of raising additional national financing from both public and private sources. National co-financing almost doubles the level of resources available in Scotland over the funding framework period.

2.3 In August 2016² the UK Chancellor announced measures to ensure funding would be underwritten by the UK Government for projects agreed prior to the autumn statement 2016. This also applies to certain funds agreed post the autumn statement while the UK is still a member of the EU. This effective funding guarantee is valuable for projects underway or about to be agreed, however it leaves the position post 2020 unresolved.

2.4 Alongside the EU Structural and Investments funds, there are other areas of EU funding to consider. There is the replacement of the Common Agriculture Payments (CAP), were Scotland is expected to receive €4.1bn in the funding period 2014 to 2020.³ The UK Government has also confirmed that current levels of funding are guaranteed until 2020. But again, beyond that the future is uncertain and represents a further issue.

---


² HM Treasury and Department for Exiting the European Union: Further certainty on EU funding for hundreds of British projects announced by the Chancellor – October 2016 [www.gov.uk](http://www.gov.uk)

³ House of Lords European Union Select Committee: 20th Report of Session 2016-17 - published 3 May 2017; Chapter 5: Withdrawing from CAP financial support
to be addressed for Scotland which has significant Agri-food and Farming sectors.

2.5 What is known is that Scotland will receive approximately 16.3% of CAP pillar 1 payments allocated in the period 2014-2020, compared to its population share of 8.5%. This means that if this funding were to be administered via the population share based Barnett formula going forward, this would result in a significant reduction in funding post 2020. Use of the Barnett Formula funding mechanism would also not recognise the different nature and support needs of some farmers in Scotland compared to elsewhere in the UK.

2.6 CAP pillar 1 payments do consider what is termed ‘less favoured areas’. This is a term used to describe an area with natural handicaps (lack of water, climate, short crop season and tendencies of depopulation), or that is mountainous or hilly, as defined by its altitude and slope. In Scotland, 85 per cent of land is classified as less favoured area; whereas the converse is true south of the Border in England. As a consequence, the value of agricultural support payments made up around 70 per cent of average Scottish farm incomes in 2016.

2.7 Another fund available in Scotland is the European Maritime and Fisheries Fund (EMFF). In total for the UK this amounts to €243m, excluding any national contributions, over the period 2014 to 2020. The Scottish Government announced in December 2017 that due to unprecedented demand, there are limited remaining funds under EMFF Union Priority 1. Priority 1 aims at striking the right balance between fisheries activities, environmental protection and thus contributing to the sustainable development of the fisheries sector.

2.8 Further to the above there is the question over future availability of access to financing from the European Investment Bank (EIB). Between 2014 and 2017 the EIB had signed finance contracts relating to projects in the UK totalling €23.6bn. Explain this ... lead in This funding included a number of projects in Scotland including, the University of Edinburgh’s Data Technology Institute and new support for social housing and support for renewable energy related investment in Scotland.

2.9 This information tells us that EU funding should not just been seen as funds received from the EU but also what leverage those funds provide to bring in additional funding and support for projects. Further we can also see that the current mechanism for UK government funding to Scotland

---

Footnotes:

5 Total EU allocations of European Maritime and Fisheries Fund 2014-2020 (unit €, current prices)
7 European Investment Bank, Financed Projects – Breakdown by Region: http://www.eib.org/projects/loan/regions/1?from=2014&to=2017
through the Barnett arrangements is likely to be unsuitable in the post brexit environment.

2.10 With the date for the UK’s exit from the EU fast approaching, WITHIN CURRENT YEAR it is imperative that agreements are reached between the Scottish Government and UK Governments soon in order to offset any uncertainty in key sectors. Reaching agreement soon will also help to mitigate any delay in projects being planned coming through to implementation due to uncertainty on future funding streams.

3. Current Governance Arrangements in Scotland for EU Funding

3.1 The Scottish Government is the Managing Authority for the two European Structural and Investment Funds (ESIFs) in Scotland:  

- the European Regional Development Fund (ERDF), which aims to strengthen economic and social cohesion by correcting imbalances between regions and;  
- the European Social Fund (ESF), which aims to help people improve their lives by learning new skills and finding better jobs.

3.2 In practice, this means the Scottish Government has a role in distribution of funds to lead partners who handle applications for funds and in turn distribute the funding between individual projects and organisations. Performance of programmes is monitored by the Joint Programme Monitoring Committee of the Scottish Government (JPMC).

3.3 The JPMC monitors programmes against specific milestones and targets, however the performance is measured in regards to its contribution to the strategic aims of the EU’s growth strategy as set out in the Europe’s 2020 strategy.  

3.4 The 2020 strategy sets out the EU’s agenda for growth and jobs for the current decade. It is primarily concerned with addressing structural weaknesses in the European economy. The overall governance arrangements does raise questions for the post brexit environment.  

- Firstly, would the objectives for any replacement funding streams change post brexit and;  
- secondly, what post brexit funding streams should be managed in Scotland alongside current or future devolved competences.

3.5 In many respects the post brexit governance environment calls for better coordination and cooperation between the UK and Scottish Governments. This is due to balancing the need for preservation and, where possible,
increasing devolved competences to Scotland with the need for coordination of UK wide frameworks for trade purposes.

3.6 The UK currently manages these funds with the EU through its partnership agreement in place with the EU. This agreements sets out the quantum of funds available as well as objectives and expected results for the funding streams. There is the opportunity to use revised and strengthened arrangements through the current Joint Ministerial Committee (JMC) to put in place agreements with the UK’s devolved governments on new funding arrangements similar to the current UK and EU Partnership agreements.

3.7 CIPFA believes that in implementing any revised arrangements through the JMC there needs to be appropriate methods for scrutiny. The Scottish and the UK Government need to consider how appropriate supporting scrutiny can be put in place. This will ensure the respective parliaments and assemblies can review what would be non-legislative arrangements implemented through the JMC.

4. Development of new models of funding

4.1 For the purpose of our analysis, CIPFA has taken the approach of splitting the range of EU funding into three core areas. These are Structural and Investment Funding, Agriculture and Research. This section of our submission will look at options and models for managing these funding streams post brexit.

Structural and Investment Funding

4.2 CIPFA believes that brexit does provide an opportunity to renew the arrangements for structural and Investment funding that previous came from the EU to the UK. We support the view that the UK Government should put in place funds for investment in the UK based on recognised measures of need that support identified and agreed objectives for the funding.

4.3 As these funds would be UK wide, it is central to their operation that the Devolved Government of Scotland, Wales and Northern Ireland are party to the agreement of the aims and objectives for the funds. We advocate that this can be achieved through a strengthened and renewed role for JMC.

4.4 Once aims and objectives for funding and appropriate measures of need are agreed for distribution of funds, the Structural and Investment funding should be administered by the Scottish Government in support of its own outcomes and national performance framework.

4.5 CIPFA would see a role for this elements of this funding to be co-ordinated with the work of the Scottish National Investment Bank. This is in support
of providing patient capital to assist in boosting local investment in support of economic growth measures.

4.6 The JMC should codify arrangements between the UK Government and the Devolved Governments of the UK in the form of an agreement. This agreement would set out the arrangements and measures for this funding alongside how any dispute resolution arrangements would work. The agreement would also be used to assist in appropriate scrutiny of arrangements and how funding is achieving its aims by the respective devolved parliaments and assemblies.

4.7 The nature of structural and investment funding demands that agreements made should provide for multi-year funding settlements. The will underpin and provide confidence over funding for longer-term structural investment in Scotland.

**Agriculture**

4.8 While Agriculture is a devolved matter the issue of agreeing a replacement mechanism post brexit for CAP payments is complex. From CIPFA’s perspective CAP payments are received and distributed by the public sector, however the scheme benefits farmers and is not directly related to core provision of services or public financial management issues. With that in mind, CIPFA has restricted its comments to observations on concepts and ideas that should be considered for any post brexit funding model.

4.9 Our research indicates there is concern over whether or not the current system of Agricultural support payments through CAP is fit for purpose.\(^{11}\) The process of brexit therefore provides the UK with an opportunity to reassess and radically rethink the system of agricultural support to where it is most needed and to support objectives in the areas of sustainability of farming, environmental concerns, innovation and efficiency as well as healthy consumption.\(^{12}\)

4.10 The concepts and principles underpinning any new model of funding should include consideration of the following:

- There should be no erosion of the Scottish Government devolved powers for Agriculture. In fact, depending in the nature of the future relationship with the EU and wider trade requirements, Scotland should have flexibility to develop Scottish specific funding practices based on its own objectives for the sector.
- Nationally there should be agreement of a new policy for agriculture support. The scope of this policy revision should include the current system of areas based direct farm payments,

\(^{11}\) The Future of the CAP: An urgent need for a truly sustainable agriculture, land and food policy, European Environmental Bureau (EEB) – September 2017

\(^{12}\) The Future of Farming: UK agricultural policy after brexit - A Policy Network Paper, January 2018
with a view to addressing concerns over its inefficiency and fairness.13

- Policy measures need to be developed that promote rural sustainability alongside environmental protection, farming innovation and efficiency, as well as protecting the biodiversity of our eco system. There should be clear links from these policy objectives to payments.

**Research**

4.11 Research funding in the UK can come from a wide range of source.14 These range from the public sector, also a large amount of funding for research comes from non-public organisations. These include charities, the European Commission and industrial and commercial organisations in the UK and overseas. This is mostly in the form of grants and contracts for specific research projects.

4.12 Public sector funding is co-ordinated in the UK through seven Research Councils, Innovate UK and Research England. In Scotland the Scottish Funding Council also provides research funding support to Scotland’s universities and colleges and is investing around £1.8bn annually.15 The UK bodies are now under the umbrella of UK Research and Innovation which operates a combined budget of more than £6bn.16

4.13 In essence the UK infrastructure for funding research in place across both public and private sectors. Evidence available would strongly suggest that research work is not like trade or finance.17 High-quality research partnerships may be enabled by international agreement, but they are implemented via the willing and mutually beneficial agreement of principal investigators and their research groups.

4.14 With that in mind, CIPFA support the view that post brexit, research and innovation funding should continue to be kept at arm’s length from government and that decisions about what to spend research funds on should be made by researchers rather than led by politicians.18

4.15 CIPFA would see a positive role for government in ensuring and facilitating international research collaboration, both outside the EU and with EU countries and institutions. This could include:

- Better information on the capabilities and research strengths of both UK-based researchers and research organisations and potential collaborators;

---


14 Examples can be sourced from the University of Cambridge Research Operations Office - [https://www.research-operations.admin.cam.ac.uk/major-funders](https://www.research-operations.admin.cam.ac.uk/major-funders)


16 UK Research and Innovation - [https://www.ukri.org/about-us/](https://www.ukri.org/about-us/)

17 Universities UK: International research collaboration after the UK leaves the European Union, April 2017

18 Maintaining what is known as the Haldane Principle currently in place in the UK.
• the need to better understand and mitigate cultural barriers to international research collaborations; and
• the importance of both policy and funding stability in nurturing effective research partnerships need to be recognised.

4.16 Maintaining or increasing the level of research funding is important in the context of economic growth post brexit as well as supporting developments in health, education and other spheres underpinning the long-term wellbeing of society.

4.17 While the final deal on the future relationship with the EU post brexit is not concluded, it would be important for the Scottish Government to raise the question of access to EU research funding and collaboration post brexit in the deal. If access to funding is not available, there should be a case made to increase the funding to UK research funding bodies to ensure no diminution of funding post brexit.
Introduction
1. The Royal Society of Edinburgh welcomes the opportunity to submit a response to the Scottish Parliament’s Finance and Constitution Committee inquiry into the Funding of EU Competences post Brexit.

2. The RSE has been involved in the Brexit discussion since the beginning of the referendum campaign. Since the decision to leave the EU in 2016, the RSE has become more active in the discussion due to the uncertainties after Brexit. The RSE brought together an EU Strategy Group chaired by Sir John Elvidge which oversees the work of 4 subgroups covering Constitutional Law & Government; Economy, Public Finance & Industrial Strategy; Research & Innovation; and Migration & Rights. These groups have produced papers which identified the challenges and opportunities from Brexit in each area (RSE, 2017). These groups are continuing to work and facilitate responses to inform and engage in the debate.

3. The Economy, Public Finance and Industrial Strategy sub-group has also facilitated a response to a previous inquiry by the Finance and Constitution Committee on the Impact of Brexit on the Scottish Budget (RSE, 2017).

4. In producing this response, the RSE has drawn from the previous work of the Economy, Public Finance and Industrial Strategy sub-group, creating a working group that draws from the expertise of its Fellowship, with the majority of members being involved with the EU Strategy Group work. The group was Chaired by Professor David Ulph and the paper has been approved by the General Secretary of the RSE, Dr Alison Elliot.

Current situation
5. Currently the European Union funding is added to the Scottish Budget and is matched and offset by the associated spending. Over the funding period from 2014 -2020 Scotland is due to receive a total €5.6 billion. This includes structural and Common Agricultural Policy (CAP) funds as well as European Maritime Fisheries Fund (EMFF) which are all determined by the EU. The CAP makes up the bulk of the funding while structural funds are much less but still considerably more than the EMFF.

6. The structural funds are allocated on a needs basis in different areas; in total most of the funding goes towards Objective One, which allocates funding to areas where the per capita gross domestic product (GDP) is less than 75% of the EU average. If an area is eligible under one of the structural funds objectives then funding is then allocated within the area through a bidding process, with the projects that are successful obtaining EU funds that are then matched by Scottish Government. The Scottish Government along with local authorities and others manage the spending, with the programme being out-with the Barnett formula.

7. Since 1988 the structural funds through the EU Cohesion Policy have played an influential role in addressing regional and social disparities. Historically Scotland has disproportionately benefited from the design and implementation of structural funds in comparison to England (Bachtler, Begg 2017). In the early years, areas in Scotland were considered as some of the poorest in the EU. Regions such as the Highlands and Islands, and Ayrshire have particularly benefited from increased funding. However, with Scotland as a while now
considered as among the richer regions of the EU and the UK, funding and consequently benefits have decreased.

8. In the UK, as elsewhere, the EU structural funds are not the only method governments can use for economic and social development. Economic development is not fully devolved to the Scottish Parliament. It is shared ministerial function and therefore both UK and Scottish Governments can create and implement economic development policies in Scotland. All such policies are restricted by state aid law (UK Government, 1998). Despite the significant contribution of structural funds to economic development, the Scottish Government spends more on economic development through other means. From 2016-17 spending on economic development projects was around £1 billion, not including transport, housing and agriculture (Scottish Government 2017).

9. Since joining the EU in 1976 the UK has contributed to and received funds via the CAP. The CAP is the biggest element in the EU budget, with a total of €408 billion for the funding period 2014-2020. Of this Scotland will receive €4.6 billion (SPICe, 2016). Scotland has benefited from the CAP disproportionately in comparison to England, given that Scottish spending per capita on agriculture is 3 times higher than England (PESA 2017). This reflects the more significant role of agriculture in the Scottish economy compared to England. Unlike the structural funds, the CAP makes up 100% of agricultural funding in the UK. The CAP has been in place since 1962, periodically undergoing reform and being developed through a process of negotiation to meet the varied needs of the whole of the EU, with a resulting set of funding rules and mechanisms...

Replacing frameworks: General Considerations

10. When the UK leaves the EU, it will look to replace the frameworks already in place. Ultimately the replacement frameworks will depend in part on the final deal the UK agrees with the EU, and whatever new trade deals are negotiated with other countries. They will also be subject to WTO rules which limit the amount of direct subsidies that can be given to production.

11. In developing replacement frameworks, the UK and the four nations have the opportunity to re-examine the rationale for the existing frameworks and re-shape both the levels and focus of funding. For example, in agriculture EU funding was initially justified by a concern with food security although over time priorities have shifted more in the direction of environmental management, especially in the UK. The size of the CAP has reflected the greater economic importance of agriculture in other various EU states than in the UK. So, when agricultural support becomes a purely UK policy, the level of support may well fall over time. Future funding policy could also reflect other concerns about the role played by food consumption in health, and the environmental impact of certain types of food production. How these various considerations affect future policy may differ across the four nations depending on both the nature of their agricultural systems and the priorities given to a variety of different policy concerns.

12. There are two key matters to be determined in the new funding frameworks: (i) the levels of funding to be spent by each country; (ii) how precisely these funds will be spent.

13. In order to provide continuity and certainty, in the immediate aftermath of leaving the EU, it will be sensible to essentially mimic the existing frameworks. Over time these frameworks can develop within and between the four countries in a way that reflects their different patterns of agriculture, industry etc. and their different policy objectives and priorities.

14. There is an opportunity to develop these spending policies within a common agreed UK approach, requiring mutual trust and respect between the governments.
Farming
15. The CAP funds are provided via the EU budget which member states contribute to, mostly from a share of VAT. When the UK exits the EU, it is likely to stop these contributions and all additional tax revenue will go to the UK budget. This means that money will need to be transferred from London to Edinburgh to fund a new agriculture policy. This is dependent on the final deal the UK and the EU agree; but it seems highly unlikely that the UK will remain in the CAP in the long term.

16. Agriculture is a fully devolved area but has been dealt with through the EU. The UK Government has made clear its intention that the powers recovered from the EU will be passed to the Scottish Parliament after Brexit (Jack et al, 2018). The four nations recognise that agreements will be required to manage some devolved policy areas. Once agriculture is fully devolved the Scottish Government would have a veto of any policy changes in this area affecting Scotland and hence over many aspects of the UK framework.

17. As noted above the CAP has developed throughout the years of UK membership. It is a complex system, which allocates funding to farms based on categorisation such as production, land management and environment. Therefore, in the interest of simplicity the UK Government may choose to mimic the CAP through its own domestic policy in the short term. This policy should have a common framework agreed by the four governments. The framework will determine what the resources will be directed towards. There could be some flexibility within this framework allowing devolved governments to allocate the resources to farms through a categorisation that is based on their own objectives. An advantage to this system would be that it reduces any increase in complexity immediately after Brexit and could offer increased flexibility for the devolved administrations.

18. One obvious option would be to determine spending by following through the implication of the policies in the framework as the CAP now does. To allow a degree of variation (within that framework) the UK Government could adopt the same approach it does with the social security budget and expenditure to Northern Ireland. The parity principle is that the UK Government will fund from UK resources the same benefits as in the UK, that allows the Northern Irish Executive to use its provision of powers to set its own priorities and fund all transferred services from its own resources. Therefore, for agriculture the UK Government might fund from UK taxable resources the same level of provision by the devolved administrations as it funds in England but the Scottish Government has no obligation to spend it in the same way and can increase spending from other programmes as long as this was in line with the common framework.

19. A deficiency of the Barnett formula in agriculture funding is that it gives the same per capita change in expenditure to Scotland as to the rest of the UK, while Scotland currently spends three times as much as England. At the same time, this could be argued to be an advantage for Scotland as decreases in funding would be proportionately smaller and have less impact in Scotland.

20. Alternatively, to allow the devolved administrations to have full control over their agricultural spending, the UK Government could chose to distribute the CAP funds through the block grant. The CAP currently changes after 6-year period while Barnett changes annually; funds would be added and locked into the block grant over this 6-year period. Within this model there could be a common framework for spending but it would offer the devolved governments more flexibility. This approach would allow the devolved governments the opportunity to review their agriculture spending more broadly and redistribute to/from other programmes according to their objectives.

Structural Funds
21. Replacing frameworks for European structural funds may be easier in comparison to CAP, as the structural funds are a smaller sum and are not the only method of economic development. In replacing the structural funds, it will be up to the UK to replace, replicate or redistribute the money elsewhere; the UK has no obligation to continue this funding. There are currently several other economic development policies and tools which can be relied on in the UK, such as city deals and enterprise agencies. However, it is likely that the UK will wish to set up a new UK wide programme.

22. This might have the same overall objectives as the EU structural funds of reducing regional economic and social disparities but it need not use the same mechanisms. The UK is currently one of the most unequal countries in Europe; economic and social disparities have increased between London and the South-East compared to the rest of the UK. Up until the financial crisis in 2008 Scotland went against this trend and experienced gradual GDP per capita growth just above the UK average but below the London and South-East average. Despite slowing growth Scotland still remains one of the UK’s richer regions. However, across the UK there are starker contrasts across the UK which the UK Government may choose to address.

23. In the funding period 2014-20 Scotland received a good settlement, obtaining around £200 million in excess of what some calculations suggest ‘should have been received’ (Bachtler & Begg 2017). Due to this several English regions lost out and will not want to see this replicated in a post-Brexit model. While Scotland may not receive the same level of funding post-Brexit it will be crucial that any post-Brexit deal maintains the current devolution settlement.

24. Within Scotland and in the rest of the UK, a key problem is the lack of a domestic ‘regional policy’ framework in terms of both well specified policy objectives and institutional arrangements to promote and co-ordinate sub-national development that could guide decisions on the areas listed by the Committee. There is some work through the Enterprise and Skills review and on regional partnerships that might lead to improvement but it is ad hoc.

25. The lack of regional policy objectives may encourage the UK Government to develop a UK wide policy approach that replicates the objectives of the structural funds in directing resources to poorer areas. This would help to provide frameworks where policy issues of common concern might be agreed. A UK cohesion approach would be rules based; the four governments could agree these rules. The allocation of funds within this framework could be needs based, using an index similar to the multiple deprivation index (MDI), in such a way that would help the areas which need support the most. For this to be successful it would need to be designed and implemented by all four governments in which development is focused to shared regional objectives.

26. Alternatively, in order to decentralise funding, the UK Government could distribute the funds directly to the devolved nations through the block grant. For example, the current funding formula could be used which would lead to extra funding then being added to the Scottish Government’s block grant. The Scottish Government would then be free to spend it how it wishes allowing them to focus more on their economic and social objectives.

27. However, given that the funding from structural funds are comparatively lower than the CAP funding and that it is not the only method to improve economic development it may be viewed that these funds are of relatively lower priority. Therefore, the UK Government might decide that current domestic economic development methods and funding are adequate. There is no necessity to transfer the funds not being sent to the EU; any increase of funding for these policies would be subject to a UK Government decision and then subject to the Barnett formula rules. This may not be the most desirable option for Scotland as it reduces
the power of the Scottish government to spend its money in accordance to its economic and social strategy.

28. In any model the role of the UK regulatory model framework is likely to be less significant. It is unclear what state aid rules will be in place but it is likely that the Scottish Government will have limited control over these, as they will be either set by UK Government, EU or WTO. UK Government decisions can be challenged by the Scottish Government and it is likely that any disputes would go through the current UK legal institutions.

Conclusion
29. It appears likely that in the short term, the UK will use a similar method to CAP for funding agriculture. This would be the sensible option to reduce complexities and disputes while a new policy is developed in cooperation with the four governments. It is unlikely that funding agriculture will be done via the Barnett Formula. The most likely and sensible approach after a transition period would be the development of a UK agricultural support framework which would be agreed via the four governments and could use the ‘parity principle’ to set budgets. This would give the Scottish Government the capacity to influence spending. If it is likely that a UK wide cohesion policy replaces the structural funds, then the Scottish government should argue that these funds should be narrowly targeted based on needs. Using the MDI as an indicator would ensure funding goes to the areas that need it most.

References


Additional Information
This Advice Paper has been signed off by the General Secretary of the RSE.