



Public Policy Institute for Wales
Sefydliad Polisi Cyhoeddus i Gymru

PPIW Discussion Paper on the 'Brexit Premium'
Prepared for the European Advisory Group

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Introduction

The First Minister has asked the Public Policy Institute for Wales (PPIW) to provide analytical support to the European Advisory Group (EAG). The Institute's work will complement analysis conducted by Welsh Government officials and others.

At its first meeting several members of the EAG identified the 'Brexit premium' as an important issue. We agreed with officials that the PPIW would provide an initial note on this topic to help inform discussion at the EAG's meeting on 28th November.

This note summarises the findings of a very rapid and partial review of the issues relating to a Brexit premium. We have not had sufficient time to undertake an in depth analysis and have not been able to identify much rigorous analysis of this subject. Most of what has been written or said about it is opinion rather than evidence based. Moreover, the nature and size of the premium will depend on the type of relationship that the UK negotiates with the EU and on how funding and policy decisions are distributed between the UK government and the devolved administrations post-Brexit.

This note offers some initial reflections on five issues:

- What is meant by a Brexit Premium;
- The potential for a fiscal premium to Wales;
- Areas in which there might in theory be policy premium;
- What is known about the potential premium in higher education;
- The potential for a premium in the agricultural sector.

What is a Brexit Premium?

We have identified two forms of potential 'Brexit Premium'. The first is the fiscal benefit that could arise from the UK no longer having to fund EU budgets and programmes. The second is what we have called the 'policy premium' which could result from the ability of the Welsh Government to take control of policies that are currently designed at EU level so that they are better tailored to Welsh needs and priorities.

There are many potential kinds of policy premium. In this note we offer some initial reflections on two sectoral examples – higher education and agriculture. It is worth noting that negotiations with the EU could involve trade-offs between maximising potential fiscal and policy premia and other possible priorities such as securing continued access to the



single market which are likely to require a degree of harmonisation of policy and regulatory regimes and possibly continuing contributions to EU budgets. It is also worth noting that it is impossible to predict with certainty at this point how much influence the Welsh Government will be able to exercise over decisions about these trade-offs.

Fiscal premium

The extent of any future UK participation in EU funding and financing programmes will be a part of the Brexit negotiations, which means that the ‘fiscal premium’ will be determined by whatever agreement is reached about the UK’s future relationship with the EU.

Whether there is a fiscal premium will also depend on the health of the UK economy and the state of public finances post-Brexit. A recent IFS analysis suggests that out to 2019-20 any ‘fiscal premium’ resulting from reduced contributions to EU budgets is likely to be diminished by a loss in tax revenue following a slowing in economic activity (although it should be noted that this work makes various assumptions about both economic forecasts and the UK Government’s response).

Accurately calculating the net fiscal position is complicated, not just because of the myriad EU funding and finance streams and uncertainty about which (if any) of these the UK or Wales might continue to participate in, but also because data are not readily available (for example we have not been able to find comprehensive data on direct private sector support¹).

Of the various types of UK contribution to EU funding and finance², the most analysed is the EU’s Budget.

According to a House of Commons (2016) [briefing paper](#), the UK Government made an estimated *net contribution* to the EU Budget (i.e. contribution minus receipts for the Common Agricultural Policy, EU regional funding and budget rebate) of £8.5 billion in 2015. This is equivalent to around 1% of total UK public expenditure and 0.5% of GDP.

However, research by Cardiff University suggests that Wales is a *net beneficiary* of EU funds: the amount of EU Budget funding flowing in to the public sector in Wales exceeds estimations of the ‘Welsh share’ of the contribution which the UK Government makes from the Consolidated Fund. Recent analysis by the [Wales Governance Centre](#) (2016) estimated

¹ HM Treasury provided an estimate for 2013 of £1.4bn of direct payments to the UK private sector.

² In addition to the EU Budget, programmes include the European Investment Bank, and the European Fund for Structural Investment, among others.

public sector receipts in 2014 to be £658m, and Wales' share of the UK contribution (net of the UK rebate) to be £414m; making Wales a net recipient of £245m EU Budget funds in 2014.³

It is also important to note that whether, and to what extent, Wales receives a fiscal premium from Brexit will depend on UK Government decisions about how any funding that is 'devolved' from the EU is allocated within the UK. Clearly if it was distributed on a simple per capita basis, Wales would be worse off than it is now. If on the other hand a funding formula strongly weighted towards needs was used Wales might benefit in fiscal terms from Brexit.

Policy premium

It is impossible to forecast what types of policy premia may result from Brexit because, as noted above, the extent to which Wales gains increased freedom over policy areas which are currently devolved but operate within the context of frameworks determined at the EU level will depend on the terms of the UK's exit. As such, they will be bound up in broader negotiations about future access to the single market (and wider trade policy post-exit), and the movement of people (and wider immigration policy), as well as intra-UK discussions about constitutional arrangements post-Brexit.

Our aim here is to highlight some of the other policy areas which are currently covered by EU policy and law, which might benefit from reorienting towards the Welsh context. These potentially include⁴:

- **Agriculture and rural policy** – the House of Commons paper (2016) notes that leaving the EU will leave the UK with something of a “blank page to be filled for UK agriculture policy and UK farming”. The departure from the Common Agricultural Policy (CAP) and associated EU Budget allocations will be the biggest change. Critics of the CAP argue that funding could be allocated more efficiently and in a way that better reflects domestic interests and priorities.

³ Similar work by the [Centre for European Reform](#) looked at Wales' annual net position for the period 2014-2020, and generated similar results: £395m / annum contribution (net of UK rebate); and £670m / annum receipts, giving a net position of being in receipt of £276m / annum.

⁴ There are many areas where EU policy and law have a significant impact on Wales, but which we have not found evidence of a potential 'policy premium'; these include:

- Food
- Fisheries and marine policy
- Energy and climate change
- Financial services
- Animal health and welfare

- **Competition and procurement** – EU state aid and procurement rules have often been cited as barriers to the public sector using its ‘purchasing power’ to support wider policy objectives. EU procurement processes are also seen as overly bureaucratic. Brexit might, for example, open up new opportunities for the Welsh Government and others to base procurement decisions on social as well as economic value (for example the quality of employment offered by suppliers). It is worth noting, however, that similar (although likely less stringent) provisions to those imposed by EU membership would still apply under, for example, WTO rules. Similarly, access to the single market is likely to be conditional on some continued policy harmonisation in this area.
- **Regional development** – in the current (2014-2020) round of Structural Funds, Wales has been allocated almost £2bn through the European Social Fund and the European Regional Development Fund. It has been suggested that there is the potential for reducing the complexity associated with this funding if freed from EU requirements, and to better focus and tailor related investments to Welsh priorities and needs.
- **Environment** – some have argued that ‘repatriation’ of environmental protection offers the opportunity for simplification of the regulatory framework and (by extension) stimulation of economic activity (for example, the Habitats Directive is seen as a barrier to some major infrastructure development). Of course, attempts to weaken the existing legal framework would be controversial, and may contradict wider policy aims.
- **Health and safety** – as with the environment, some have argued that simplification of the regulatory framework might help stimulate economic activity.
- **Employment law** – as with the environment, some have argued that simplification of the regulatory framework might help stimulate economic activity though there would be concern in many quarters if this led to deterioration in workers’ pay and conditions.

We want to emphasise that we know that this list is not exhaustive nor is it strongly evidence based. At this stage our aim is to provide an indication of some of the areas in which some

agree there might be a premium in order to help inform the EAG's early discussions. We are aware that a number of Welsh Government departments have convened groups to analyse in detail the implications of Brexit in the policy areas for which they have responsibility and it may be that the EAG could usefully draw on these pieces of work as they develop. In the final two sections of this note we sketch out the publicly available evidence that we have been able to access about two sectors.

Sectoral example: Higher Education

[Lenihan and Witherspoon \(2016\)](#) focus on the impact of the decision to leave the EU on higher education. They conclude that the leave vote will have implications for research funding, international collaboration and freedom of movement. In this section we present the evidence that we have been able to access. It may be that the funding councils, universities and the higher education division of the Welsh Government have additional evidence which it might be useful for the EAG to consider at a later stage.

EU research funding

Between 2007 and 2013, the UK was a net recipient of €3.4 billion in terms of funding for R&D and innovation activities (what the UK received minus what it paid in).

The UK has the largest share of signed grant agreements (relative to budget contributions) among the countries involved in Horizon 2020.

EU funding for UK HEIs increased from £331 million to £836 million between 2007/08 and 2014/15. Over the same period, cuts in UK government spending have resulted in a decrease in funding to UK HEIs from research councils.

The social sciences in the UK have been particularly successful in attracting EU funding, attracting more EU Research Council starting grants than any other country between 2007 and 2015.

Future participation in Horizon 2020 will depend on negotiations between the UK and the EU. Norway and Swiss arrangements offer two possible models. There are three broad categories for access:

- **EU countries** have access to €77 billion (2014-20) and have full participation rights.

- **Associate countries** (non-EU but members of EFTA or in process of EU accession) must pay into Horizon 2020 and have the same participation as EU countries except for the fact that they have no vote over content or direction of the fund.
- **Other countries** must negotiate bilateral agreements but do not have the same level of access as EU or associate countries (e.g. principal investigators must be hosted by or engaged with an EU or associate country).

International collaboration

According to a report from [Digital Science](#) (2016) more than half of UK research output now involves international collaboration. Over the last 35 years, the growth in STEM research outputs has come primarily from international collaboration, while in the social sciences it has been due to an increase in both domestic output and international collaboration. Over half of all collaborative papers involve European partners.

Research outputs involving international collaboration have greater citation impacts than the world average (52% higher in 2011).

Freedom of movement – academic staff

Over a quarter of academic staff at UK HEIs are from outside the UK, with 15% of all staff coming from elsewhere in the EU. The proportions are particularly high for STEM subjects, where one in five are from other EU countries, and over a third from outside the UK (Table 1).

Table 1: UK HEI academic staff who are from outside the UK

	% of UK HEI academic staff who are migrants	% of UK HEI academic staff who are EU migrants
All subjects	27%	15%
STEM	36%	19%
Social sciences	28%	16%

Source: Universities UK, cited in Lenihan and Witherspoon (2016)

Freedom of movement has also facilitated UK nationals to find research and teaching jobs across the EU, encouraging international collaboration.

Lenihan and Witherspoon (2016) recommend that future immigration policy should exempt UK HEIs from the salary floor of £35,000 a year if the best international talent is to be hired and, depending on the settlement, for EU academic staff in the UK to remain.

Freedom of movement – students

According to [Universities UK](#) (2014: 38), 'In 2011–12, the UK higher education sector generated £10.7 billion in export earnings. Around 30% of this value came from overseas student fees.'

Around three in ten foreign students studying in the UK (29%) are from the EU. Overall, 6% of all students in UK HEIs are from the EU.

In 2014-15, there were around 5,500 EU students in Welsh universities, accounting for 22 % of all non-UK students (Study in Wales, 2016).

UK/EU students in Wales pay a maximum of £9,000 in annual tuition fees. Fees for international (non-EU) students are higher, and differ by institution and subject. As an example, in 2016/17, Cardiff University charges international students tuition fees of between £14,500 a year (arts-based courses) and £32,250 a year (clinical medicine).

While UK students are less likely to study abroad than their other EU counterparts, those that have done so through the Erasmus programme have improved employability.

Continued access to Erasmus will depend on discussions at a UK and EU level.

Sectoral example: Food and Agriculture

The Group has already received an evidence paper on agriculture, provided by Kevin Roberts, Agriculture Partnership Board, and what follows draws on this and other sources to try to explore the potential 'premia' for the agricultural sector in Wales.

Funding

Under the 2014-2020 Common Agricultural Policy (CAP) programming period Wales has been allocated more than 2.2 billion euros and on average more than 80% of farming income in Wales is derived from EU funding.

The CAP has two pillars. Pillar 1 funds direct payments to farmers and is 100% EU-financed. Pillar 2 finances rural development more broadly and requires national resources to match EU funding. The Welsh Government is responsible for the management of CAP

funding in Wales but receipt of CAP funding is tied to farmers' compliance with a range of regulatory requirements, relating to, for example, environmental concerns, and animal welfare ('cross compliance').

Alongside the CAP, agricultural communities benefit from other sources of EU finance such as Cohesion funding, and Horizon 2020.

The CAP is accused of being "misdirected, cumbersome, costly and bureaucratic [...] subsidising inefficient agriculture, and preventing the development of a more modern competitive farming sector" (Woolford and Hunt, 2016). The UK Government has long been an advocate for reform of the CAP and it has been suggested that 'devolving' funding to Wales would enable it to be better tailored to the needs of the Welsh agricultural sector.

Trade and its interaction with wider policy

The UK is a net importer of agri-food products from the EU, importing nearly twice as much as it exports to the EU. Nevertheless, the EU is a key market for Welsh food and drink producers.

In 2014, food and drink exports from Wales to the EU were worth £274.2 million. They accounted for 90.7% of total sector exports (i.e. Welsh food and drink exports) and more than 20% of the UK's agri-food exports to the EU. Exports from the sector increased 132% between 1999 and 2013 with 1 in 10 businesses in the sector now exporting.

There is a very substantial body of regulatory requirements on farmers, affecting all aspects of farming life, including environmental considerations, including rules on the permitted use of pesticides; animal welfare; plant protection; food safety, and traceability of products in the food chain. Compliance with these regulatory standards gives access to the single market for agricultural products. Standards are often higher than international competitors, but it is argued that this supports the EU's reputation for high-quality produce.

The EU system of quality marks – for example the Protected Designated Origin (Anglesey Sea Salt) and Protected Geographical Indication (Pembrokeshire Earlies, Welsh Lamb and Welsh Beef) – benefit Welsh producers. Although the UK could choose to continue to provide accreditation outside of the EU (Woolford and Hunt, 2016)

The weakening of the pound immediately after the EU referendum makes Welsh food and drink exports more price competitive, and imports less so. If sustained, these conditions might stimulate demand for domestic producers. However, if they presage a weakening economy, the impact of a downturn could offset any benefits to exporters.

Labour and free movement

In 2014, the food and farming sector in Wales employed 84,200 people (including all farmers and agricultural workers). The sector's share of total regional employment in 2015 was higher in Wales at 4.1% than across the UK as a whole (1.4%).

According to [the NFU](#), in 2014 there were 34,000 non-UK born workers in the UK agriculture sector excluding seasonal workers. It argues that "access to non-UK labour is crucial for British farmers and growers".

Summary

Overall, the EU currently has a great deal of control over the food and agriculture sector in the Wales.

The CAP system is seen as ripe for reform, and there is considerable potential for any domestic successor to be more efficient and more targeted at Wales' needs.

However, there is a risk that any domestic equivalent would not be as generous as the current EU system – successive UK Governments have used EU Budget negotiations to argue for a reduction in CAP payments. The extent to which the policy could be tailored to Wales' needs would depend on how funding and policy decisions are distributed between the UK government and the devolved administrations post Brexit.

The wider legislative framework is less obviously flawed (although it has been criticised for being too burdensome) and elements of it would need to survive in some form if the UK is to be able to continue exporting to the EU (its main trading partner for agri-food products).

In terms of free movement, there is strong anecdotal evidence that non-UK born labour is vital to the sector, particularly seasonal and temporary workers.

Next steps

This paper is the result of an initial rapid scan of publicly available material which considers the 'fiscal premium' and 'policy premium' with a particular focus on higher education and agriculture.

EAG members may wish to consider whether they would like the PPIW and/or others to investigate these issues in more detail, and if so which sectors and subjects it wishes to focus on.

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