Implications of Brexit for UK ESI Fund Programming and Future Regional Policy

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The UK referendum on EU membership resulted in a vote to leave the bloc. The UK and EU are currently in limbo whilst the withdrawing Member State prepares to trigger Article 50 and formally notify its intent to depart. The financial, legal and economic implications are expected to be wide-ranging although the process of unpicking the interlinkages across different policy areas has not yet begun. In the case of Cohesion Policy, the negotiation of an end date for eligibility and the extent to which the established regulatory procedures around N+3 and programme closure will be applied to the departing UK will be crucial, not only in determining the exact financial 'hit' to UK regions of Brexit but also in terms of implications for programming on the ground. Regulatory specificities mean that the withdrawal process could be characterised by regions who voted to leave the EU still spending their EU allocations and required to comply with EU law long after UK withdrawal.

I. Introduction

On 23rd June 2016 in an in/out referendum on EU membership, the UK electorate voted to leave the European Union. The next step is for the UK (Government) to trigger Article 50[1] and commence a two-year countdown period at the end of which the UK would automatically cease to be an EU member[2]. As there is no set timeframe for when the government should begin the process, nor set form it should take, the UK Government has been able to delay. Prime Minister Theresa May has suggested March 2017 as the date for formal notification of the UK's intention to withdraw from the EU.[3]

Brexit is expected to be the "most difficult political transformation"[4] that the UK has undergone in recent times, with wide-ranging financial, economic and legal implications across a range of policy areas. This article seeks to determine the implications of Brexit on ESI Fund programming and regional policy in the UK. It looks at the financial implications, administrative challenges and legal ambiguities before offering some preliminary observations around regional funding and spatial policy under alternative UK-EU relationships.

II. Financial Implications of the Withdrawal of ESI Fund

The end of EU Cohesion Policy is likely to have minimal effect financially on the UK as a whole: the amount received is small in relation to GDP - less than 0.1%.[5] However, EU receipts vary considerably across the UK and the financial implications of their cessation would be territorially diverse. Of the 37 regions of the UK (as classified by the EU NUTS system), 35

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The opinions expressed herein are those of the author and do not necessarily reflect upon the institution for which she works.

1 Art 50 TEU.

2 Unless either a withdrawal agreement sets a different date, or there is a unanimous decision of the 28 Member States to extend that time limit.

3 See <http://www.bbc.com/news/uk-politics-37532364>.

4 See <http://www.independent.co.uk/news/uk/politics/brexit-latest-article-50-parliament-vote-needed-dominic-grieve-eu-referendum-uk-a7141596.html>.

5 See <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/355455/BIS_14_981__Review_of_the_Balance_of_Competences_between_the_United_Kingdom_and_the_European_Union.pdf>.

are *net* contributors, with only West Wales and the Valleys and Cornwall being net beneficiaries.[6] The Welsh Government expects to receive more than €3 billion over the 2014-2020 programming period under across the 4 ESI funds, whilst Cornwall has been allocated more than €600 million. Unsurprisingly, it is these two 'less-developed' regions that have been the most vocal since the referendum in calling for EU funding to be guaranteed or substituted in the event of Brexit. This in spite of the majority of the electorate of both having voted to leave – Cornwall by 56% in favour and Wales by 52%.

The biggest vulnerability in relation to ESI Fund financial allocations and their potential loss to the UK is, of course, the timing and content of Article 50 withdrawal negotiations. The current 2014-2020 programmes have established EU and national budget allocations up until 2020. With the triggering of Article 50 expected in early 2017 and a two-year withdrawal process provided for in the Treaties, it is reasonable to assume that the programming period will be shortened in the UK; an end to EU budgetary contributions is likely to coincide with the withdrawal of ESI Fund allocations to the UK. On current forecasts, the less-developed regions of the UK could forfeit, as a result, up to two years (2019 and 2020) of their ESI funding allocations, equating to more than €860 million and €170 million respectively in Wales and Cornwall. Whilst insignificant in relation to GDP figures, the sums received by the more impoverished areas look more substantial when compared to other forms of UK regional or regeneration funding. Future funding opportunities will also be missed out on. The performance reserve[7] is due to be considered and awarded in 2019 but unlikely to be allocated to regions external to the EU. Potential funding from post-2020 programming periods will be lost, alongside access to the Connecting Europe Facility, the European Fund for Strategic Investments. The impact on financing from bodies such as the European Investment Bank has yet to be determined.

Immediately following the referendum, a number of managing authorities in the UK 'paused' issuing new funding agreements.[8] Recent announcements by Her Majesty's Treasury (HMT) have attempted to provide reassurance, initially by indicating that all ESI Fund projects contracted prior to the Autumn Statement would be guaranteed funding, even when those projects continue beyond the UK's departure from the EU. The guarantee was then extended further to incorporate all ESI Fund projects signed before the UK leaves the EU.[9] The level and timing of commitments to projects is increasingly vital therefore in ensuring UK regions benefit as fully as possible. The 2014-2020 programmes were generally late to start (e.g. the England ESF programme was officially launched in January 2016), and commitment levels are low in a number of programmes. The guarantee to substitute domestic funds for projects signed before the UK's formal exit could lead to a deliberate acceleration of programming which would need to be balanced against ensuring due diligence.

III. ESI Fund Programming Implications of Brexit

The conclusion of a withdrawal agreement between the UK and EU within a two-year period is complicated by the regulatory specificities of Cohesion policy. ESI funding is allocated in annual tranches, with expenditure and the submission of a payment application to the European Commission required by the end of the third financial year following the year of budget commitment (N+3). Therefore, whilst *allocations* could cease promptly once the withdrawal process is complete, rules regarding eligibility of *expenditure* will make closure of the policy and programmes far more problematic. Under the current regulatory framework, ESI Fund expenditure could continue in the regions and be reimbursed from the European Commission for three years following the final date of eligibility. Programme closure documentation would be submitted two years later and subject to subsequent agreement with the European Commission.

With Brexit the final date for eligibility of expenditure of 31st December 2023 can be expected to be

6 Open Europe (2012) Off Target, The Case for Bringing Regional Policy Back Home, <http://archive.openeurope.org.uk/Content/Documents/Pdfs/2012EUstructuralfunds.pdf>.

7 The performance reserve is a financial allocation awarded in relation to programme performance and attainment of Union objectives. A review of performance of the programmes is to be undertaken in 2019 in cooperation with the Member States.

8 See <http://www.independent.co.uk/news/uk/politics/european-regional-development-fund-erdf-suspends-treasury-brexit-eu-referendum-a7154526.html>.

9 See <https://www.gov.uk/government/news/further-certainty-on-eu-funding-for-hundreds-of-british-projects>; <https://www.gov.uk/government/news/chancellor-philip-hammond-guarantees-eu-funding-beyond-date-uk-leaves-the-eu>.

bought forward and the timeframe for programme and project implementation reduced. The HMT commitment may be more onerous than it initially appears, requiring coverage of project expenditure not only after but also prior to UK withdrawal. Revenue and expenditure in the EU budget must, in line with Treaty requirements, be in balance.[10] This suggests that, following UK withdrawal, the cessation of UK contributions and consequent reduction of the EU's revenue, the EU will be unable to pay against commitments from the year in question *as well as* those from preceding financial years. The UK could be obliged, as part of the Brexit negotiations, to either continue contributing to the EU budget beyond its departure or else accept a reduction in future payment appropriations. The latter could require HMT to reimburse (unclaimed) EU funds spent by the regions prior to Brexit.

Additionally, the current regulatory framework provides that projects not 'in use' and 'functioning' at the point of the submission of closure documents are not eligible for reimbursement from the EU. In the case of projects not completed in advance of an, *as yet undetermined*, deadline, the UK Treasury must be prepared therefore to cover *total* costs, not just those incurred subsequent to UK withdrawal. Past/previous expenditure for project delivery would have to be removed from payment requests as ineligible for reimbursement from the EU and would seemingly need to be met under the HMT guarantee.[11] Whilst 'phasing' projects across different programming periods or extending the deadline for 'non-functioning projects' is currently possible, a formal request from a departing Member State seems unlikely to be either requested or agreed.[12]

With Brexit looming, projects currently in the pipeline are likely to be reduced in size, scope and funding. Programme modification in favour of less risky revenue-based priorities and activities rather than priority axes dominated by large capital infrastructure projects is probable. Where financial instruments have been established or projects have received advances, EU expenditure may have to be clawed back in the case of inadequate payment or investment. Knock-on effects in terms of meeting requirements around thematic concentration on climate change and urban priorities and implementation milestones could be possible with resultant financial corrections. The risk of decommitment to the UK programmes is exacerbated further by the drop in sterling since the EU referendum and consequent increase in value of the (euro-denominated) programmes and hence national co-financing required. This raises the question as to what extent Brexit could be considered 'force majeure' under the ESI Fund regulations - an extraordinary event or circumstance that affects the implementation of programme priorities and could be invoked to avoid penalising a departing Member State.

Requirements around verification and on the spot checks, document retention, revenue generation, use of resources paid back to financial instruments, durability and publicity further complicate matters by their required continuation *beyond* the closure of the programmes. This is even more complex in the case of infringements, irregularities, infractions and obligations to pursue recoveries of misappropriated EU funds. How could 'sound financial management' of EU funds be assured and controlled in a post-Brexit UK and by whom?

The closure of EU funding programmes will all play out in a worrying institutional/organisational context where employees depart obsolete EU-related functions and staffing costs are no longer met through Technical Assistance (TA) priorities. Sections of the public sector that rely on EU funding to deliver large portfolios of activity and fund significant staff levels would need to be restructured. The impact on certain organisational structures such as Local Enterprise Partnerships, and on civil service staffing in the Welsh European Funding Office and the Special European Union Programme Body[13] is likely to be significant. In a twist of fate, EU TA funds could potentially be made available to re-train public sector staff in a position of potential redundancy or for other organisational demands driven by Brexit.[14]

10 Art 310.1 TFEU.

11 However, in line with Art 120.6 CPR national public funding cannot exceed more 80% of eligible public expenditure under an individual priority axis.

12 These provisions do not apply across the full range of projects: Productive investments, projects under €5 million and those that cannot be divided into clearly identifiable stages are excluded.

13 The SEUPB manages cross-border European Union Structural Funds programmes in Northern Ireland, the Border Region of Ireland and parts of Western Scotland, see: <http://www.seupb.eu/AboutUs/about-us.aspx>.

14 See for example the REACT programme in Wales: <http://gov.wales/topics/educationandskills/skillsandtraining/reactemployers/?lang=en>.

IV. Legal Implications

The ESI Fund regulations currently have direct application whilst the UK is a member of the EU; upon exit they will need to be transferred into UK law. The proposed 'Great Repeal Act' will repeal the European Communities Act 1972 but freeze all EU law into UK law, maintaining it in force pending a later decision whether to amend or repeal them.

Legal requirements under ESI Fund regulations suggest that, within the context of programme implementation, the UK will still be subject to all relevant aspects of EU law for a period of at least three years following withdrawal from the EU. ESI Fund programmes and projects must demonstrate compliance with 'all applicable Union law'[15] whilst 'all the Commission's and Member States' rights and obligations remain valid in respect of assistance to operations' throughout programme closure.[16]

This raises interesting questions if the UK moves to a looser relationship with the EU such as that of a member of the European Economic Area (EEA) where not all EU Directives are applicable. Directives on nature protection (Habitats and Birds Directives), and some on water protection (bathing water, shellfish waters, surface fresh waters, and fish waters Directives) could legally be removed by the UK Government or one of the Devolved Administrations yet compliance still be required within the ESI Fund framework.

Likewise, should freedom of movement principles be revoked or EU migrants have their status significantly modified in the immediate post-Brexit period, ongoing ESI Fund projects may be hindered in their ability to ensure the 'promotion of equality and non-discrimination' in the operation of the funds.[17] Unless EU nationals are able to participate equally with UK citizens in ESF-funded training courses, for example, a project could be deemed to be in breach of its contractual and legal obligations.

Compliance with the principles of State aid and public procurement will also be complicated by a change in the UK's status. Whilst continued access to the Single Market would mean these legal frameworks would remain in place, a more significant modification of the UK-EU relationship could result in different legal frameworks being applicable to projects depending on the source of their funding. ESI funded projects would arguably be required to follow EU legal provisions with projects funded from other sources subject to alternative legal frameworks such as WTO.

The requirement for 'effective application of Union law' in the areas of environment, gender, State aid and public procurement compliance are now an *ex-ante* conditionality or pre-requisite of programming across ESI Fund. On that basis, it is questionable whether any modification could be made to these areas of law whilst the programmes were still operating without potentially risking financial and legal repercussions.

These scenarios are rather simplistic in their assumption that the UK seamlessly moves from its current status as an EU Member State to a new 'status' within an already-existing organisation or framework. Similarly, whilst it may seem more coherent to do so, there is no reason to assume that ESI funds will be subject to the same conditions under the withdrawal agreement. It is not necessarily the case that the relevant European Commission Directorate-Generals or UK Government departments would wish to ensure consistent rules across them. Either side may instead prefer to respect certain fund specificities or implementation peculiarities. Likewise, financial guarantees from the UK government could be subject to political whims and events in a highly uncertain context.

V. Policy Implications Post-Brexit

UK participation in ESI Fund could be envisaged to continue only under European Territorial Cooperation (ETC) programmes. Here non-Member States (and their regional/local governments) are able to participate in cross-border, inter-regional and transnational cooperation projects (for the most part) where they share a land or sea border with an EU member.[18] Nevertheless, participation by non-members is reliant upon their financial contribution (ERDF equiv-

15 in line with Art 6 CPR 1303/2013.

16 C(2013) 1573.

17 Art 7 CPR.

18 For example, the North Sea Region Programme and Northern Periphery Programme include Norway and Iceland; the North West Europe programme includes Switzerland. Non-Member States participate under INTERREG, INTERACT, URBACT for example. See <http://sites.cardiff.ac.uk/wgc/files/2016/07/COHESION.pdf>.

alent funding) rather than receipt of EU funds. Other EU funding mechanisms for non-Member States bordering the Union such as the EU's Neighbourhood Policy and the Instrument for Pre-Accession would not be relevant in the context of a withdrawing Member State. Alternative relationships with the EU that involve access to the Single Market such as the EEA require payments through 'financial mechanisms' that mirror the functioning of Cohesion Policy. For the period 2014-2021 the Norwegian contribution will be over €390 million per year yet the contributing states are ineligible for EU receipts.

The loss of EU Cohesion Policy receipts is likely to result in a reconsideration of economic focus and strategy. The UK will need to establish and fund an alternative regional policy internal to the UK. Regional disparities in economic performance in the UK are now greater than those found in any other European country[19] and the UK has little constitutional or policy commitment to the reduction of economic disparities or policy levers to respond to regional economic shocks. EU Cohesion Policy has seemingly provided the most coherent territorial approach in the 90 years of spatial policy within the UK and provides an important role in framing economic development.[20] The Welsh Secretary of State, Alun Cairns, was quick to suggest that the results of the referendum showed that those purported to benefit the most from European aid 'did not want what was being offered to them' and that to simply replace one source of funding with another ie using domestic funds to substitute EU funds, missed the point.[21] Nevertheless, the haphazard dismantling of EU Cohesion Policy without an alternative policy and financial framework in place could prove ruinous for territories receiving larger financial rewards. Similarly, a failure to integrate any new national spatial policy with final investments taking place under the ESI Fund programmes and build on the legacy of 25 years of Cohesion Policy would prove short-sighted.

VI. Conclusion

Recent political events in the UK have caused significant vulnerability around the ESI Fund programmes and funding. It seems unlikely that the current round of funding will come to a natural end in the exiting Member State and financial, administrative and policy implications will be complex. On the basis of current regulatory requirements for programme implementation the UK will still be subject to all relevant aspects of EU law following withdrawal from the EU. How these rules could continue to operate in the context of a departing/ed Member State and whether regions who voted to leave the EU will still be spending their EU allocations and required to comply with EU law long after UK withdrawal is uncertain. However, a deeper question arises as to whether these longer-term requirements, should they exist under multiple regulatory or policy frameworks, would impact on the ability or speed of the UK to shake off the 'burden' of EU membership and regulation and move to new relationships and roles within the wider international framework.

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19 See <http://www.regionalstudies.org/uploads/documents/SRTUKE_v16_PRINT.pdf>.

20 See <http://www.eprc.strath.ac.uk/news/20160620_Brexit_blog_post.pdf>.

21 See <https://hansard.parliament.uk/commons/2016-07-13/debates/16071330000005/OralAnswersToQuestions>.