Llywodraeth Cymru
Welsh Government

A brighter future for Wales

Why we should remain in the EU

Contents

1 First Minister's Foreword

Mark Drakeford AM
First Minister of Wales

Three years on from the 2016 referendum, the UK Government's own survey of public opinion shows that, for very many people, a 'no deal' Brexit is still thought of as meaning 'no difference' – that everything will stay as it is, if and when we leave the EU.

Nothing could be further from the truth, as this paper demonstrates. No deal will involve significant disruption in the short term, and in the longer-term risks undermining Wales' economy in a way not seen since the reckless destruction of our industrial base by the Thatcher Government in the 1980s. And, like the damage to our economy then, no deal will be self-inflicted, the result of a political choice. It will increase poverty, undermine the quality of life of all of us, and damage still further public services, while doing nothing to address the huge challenge of the climate emergency.

Moreover, the single greatest fallacy of Boris Johnson's 'no deal' Brexit is that it will avoid the need for negotiations with the EU and, in the longer term, a deal.

The day after a disorderly, crash-out Brexit, the need for a strategic, positive relationship with our largest and nearest market will remain.

The UK Government talks loudly about developing a deep and wide free trade agreement. Before they, or any of the Brexit extremists they have gathered around them, can even step through the door in Brussels, the EU will require a settlement of the three outstanding issues in the Withdrawal Agreement which they dismiss – citizens' rights, paying our bills, and the border on the island of Ireland. Leaving on October 31 without a deal will leave a legacy of acrimony and bitterness which will make it even harder to reach agreement.

The UK Government proceeds on the assumption that holding a gun to the head of the UK economy will bring the EU to heel. The first two years after the referendum were wasted by acting in this arrogant way.

Faced by the imminent threat of a no deal Brexit, the Welsh Government and the National Assembly for Wales are clear, that the decision should go back to the people, and that it is in the interests of all the people of Wales for the UK to remain in the EU. This paper sets out why and also explains how, within the EU, we can still pursue the necessary changes and reforms to secure Wales' long-term prosperity and stability.

2 Executive Summary

In the referendum in 2016, both Wales and the UK voted, albeit narrowly, in favour of leaving the European Union (EU). In the wake of that vote, although the Welsh Government had strongly advocated remaining, we accepted the outcome and focused on the form, not the fact of Brexit.

We set out to identify a way forward which would both respect the result and ensure that the people and the economy of Wales were not significantly damaged by the inevitable upheaval caused by leaving the most integrated international economic, political and legal community in the world.

The result was the White Paper, **Securing Wales' Future** which we published, jointly with Plaid Cymru in January 2017.

In essence, we advocated a form of Brexit which maintained the closest economic links between the UK and the EU compatible with no longer being a member state.

For more than two years, we pursued that goal energetically and with some success.

But with the prospect and now the fact of Boris Johnson as Prime Minister, it became clear that that strategy has reached the end of the road. Under this UK Government the choice facing the UK has narrowed to one between a no deal Brexit and remaining in the EU.

In this paper, we explain why the Welsh Government is convinced that remaining in the EU is, in these circumstances, the best option for Wales.

In particular, we set out the evidence for why a no deal Brexit would be a disaster for Wales, and why, should we remain in the EU, it would still be possible to address some of the concerns which fuelled the vote to leave.

We focus on those policy areas where the Welsh Government has a direct responsibility, but it is important to remember that leaving the EU with no deal also poses real risks in terms of our internal and external security.

We consider each of the six priorities set out in **Securing Wales' Future**.

In terms of the **economy**, there is compelling evidence that any Brexit which involves severing our ties with the Single Market and Customs Union would do significant economic damage across the whole economy, but in particular to our manufacturing sector and agri-food, where jobs and investment would be likely to be severely hit.

As well as short-term disruption, the Government's own estimates suggest that, with a no deal Brexit, the economy would be around 9% smaller in 15 years' time than it otherwise would have been, and living standards will suffer as prices at home and the cost of travel abroad increase as a result of devaluation and tariffs. This is on top of the damage which has already been done, with the Bank of England estimating that every person in Wales is already £1,000 worse off than they would have been as a result of Brexit uncertainty.

If we remain in the EU, the pall of uncertainty would be lifted and we would continue to be fully engaged with setting the standards and regulations which shape our economy. We would also work with other like-minded governments and political actors to bring about progressive reform including setting much more ambitious targets for reducing and eliminating net carbon emissions and supporting the circular economy; stronger protection for labour market rights; introducing effective taxation on multi-national corporations; reforming the Common Agricultural Policy (CAP) and championing rules-based international trade.

In terms of **migration** policy, the UK Government's approach threatens to undermine the access of employers in the public and private sector to key skills, increase the vulnerability of workers admitted on short-term visas to exploitation and undermine the security of European Economic Area (EEA) citizens who are already settled here and who make a significant contribution to our economy.

Should we remain in the EU, it would be possible to implement many of the changes we advocated in our policy document 'Fair Movement', to address the concerns which figured large in the 2016 referendum. These changes include a much more radical approach to enforcing measures against the exploitation of workers, particularly the low paid, and enforcing EU regulations which permit member-states to remove EU migrants who cannot support themselves and have failed to find work.

Turning to **Funding and Investment**, the UK Government has failed to provide any reassurance that, in a no deal Brexit, Wales would be 'not a penny' worse off, as the 2016 Leave campaign claimed. There is no guarantee of full replacement funding for the European Structural and Investment Funds (ESIF) which, over 20 years, have played such a significant part in improving Wales' skills base and employment rate and strengthening our research base. Similarly in terms of the CAP, there is no guarantee that, beyond 2022, the UK Government will continue to support agriculture to the same extent or continue to provide

Wales with the same proportion of overall UK agriculture spend. We would be cut off from EU funding schemes such as Horizon Europe and Erasmus+ which play a key role in supporting our research and education system, and from the European Investment Bank, which has played and is playing a key role in supporting infrastructure investment in Wales.

Within the EU, Wales would continue to be a net beneficiary of EU funding, benefiting from the highest level of support under the ESIF. We would be able to continue to build on the learning from 20 years of successfully using the funds, and press for further reform to the over-bureaucratic management systems.

It is increasingly clear that the current UK Government would walk away from the commitments made by Theresa May to maintain alignment with existing EU **social and environmental protections and values** and use a no deal Brexit as a justification for a 'slash and burn' approach to these protections. With the UK Government pressing forwards with a radical deregulatory agenda in England, the devolved nations would come under huge pressure to follow a similar course. As well as the threat of the erosion of rights at work and our environmental standards, we would notice less dramatic but more immediate changes such as it becoming more difficult and much more complicated to travel within the EU, particularly with pets or by car.

By contrast, within the EU, we would retain our existing environmental and social protections and be able to exert a strong influence in favour of a much more ambitious approach towards addressing the climate change emergency and fight for existing and enhanced commitments to equalities policies and practices throughout Europe.

In terms of **constitutional affairs and devolution,** the experience of the last three years has only served to highlight the inadequacy of our constitutional arrangements to cope with the pressures Brexit will bring while simultaneously removing the capacity of the UK Government to satisfactorily turn its mind to these issues. It has also demonstrated the fundamental weaknesses of the UK's constitution and added fuel to the fire of popular disenchantment with our political system.

A no deal Brexit poses a fundamental threat to the future of the UK, with significant pressures for a further Scottish independence referendum and a border poll in Northern Ireland.

Were we to remain within the EU, then the problems with our system of devolution would become less acute, but they would not go away. We would therefore continue to call for a constitutional convention to address these issues. Brexit has also highlighted the need for the devolved institutions be more fully engaged in the discussion of trade policy. Within the EU, we would need to develop more robust mechanisms for the devolved governments to agree the position of the UK Government in respect of ongoing trade negotiations being undertaken by the European Commission, in line with the arrangements which have always operated in respect of agriculture, fisheries and regional development.

Finally, in respect to **transition**, there would simply be no transition period in a no deal Brexit, with little prospect of the EU agreeing to any 'mini-deals' or to open future negotiations without resolving the issues of citizens' rights, our financial liabilities and the Northern Ireland border.

If we remain within the EU, also, there would be no formal transition period but we would need to invest seriously in the effort of rebuilding the UK's credibility. In this the Welsh Government could play a significant part, since Wales continues to have a good reputation with the EU institutions as a nation which respects the rules and implements EU funding regimes efficiently and effectively.

3 Introduction

In the referendum in 2016, both Wales and the UK voted, albeit narrowly, in favour of leaving the European Union (EU). In the wake of that vote, although the Welsh Government had strongly advocated remaining in the EU, we accepted the outcome and focused on the form, not the fact of Brexit.

We set out to identify a way forward which would both respect the result and ensure that the people and the economy of Wales were not significantly damaged by the inevitable upheaval caused by leaving the most integrated international economic, political and legal community in the world.

The result was the White Paper, **Securing Wales' Future** which we published, jointly with Plaid Cymru in January 2017. This set out six priorities:

- the importance of full and unfettered access to the **Single Market** to support businesses, and secure jobs and the future prosperity of Wales;
- a pragmatic and principled future **migration** policy, compatible with continued participation in the Single Market and linked to employment while cracking down on the exploitation of workers;
- on **finance and investment**, the need for the UK Government to make good on promises made during the referendum campaign that Wales would not lose a penny in funding as a result of the UK leaving the EU;
- the need for a fundamentally different **constitutional** relationship between the devolved governments and the UK Government – based on mutual respect, reaching agreement through consent, and a new, independent dispute resolution mechanism – once the UK leaves the EU;
- the need to maintain the **social and environmental protections and values** that we prize in Wales, in particular workers' rights, once these are no longer guaranteed through the UK's membership of the EU; and
- the importance of considering **transitional arrangements** to ensure the UK does not fall off a cliff edge in its economic and wider relationship with the EU if longer-term arrangements have not been agreed at the point of exit.

In essence, we advocated a form of Brexit which maintained the closest economic links between the UK and the EU compatible with no longer being a member state, thus reflecting the focus of the 2016 Leave campaign on retaining close economic ties while withdrawing from the political structures which were alleged to constrain our freedom to run our own affairs.

In publishing **Securing Wales' Future** and the series of more detailed documents (Annex A) which followed it, we avoided the trap which the UK Government, under Theresa May, fell into. We did not over-estimate the strength of the UK's negotiating hand, nor pretend to the electorate that we could have all the benefits of EU membership without paying the price (both literally and metaphorically) which went with it.

On the contrary, we were clear that from an economic perspective, no Brexit scenario would provide equivalent or better outcomes for Wales than remaining in the EU and that continued participation in the Single Market was essential to minimise the potential damage to Welsh jobs and livelihoods. We were also clear that this would mean we would have to retain alignment in terms of single market rules and regulations, while losing our role in the political institutions which determined them.

"Continued Single Market participation means, of course, that the UK would have a continuing need to ensure that the domestic regulatory regime for goods and services within the UK are compatible with those of the EU and that suitable dispute resolution arrangements are in place. We firmly believe that this is a price worth paying for the economic benefits which can only be secured by strong continued participation in the Single Market."[1]

1 Quote taken from the Securing Wales' Future paper

For more than two years, we pursued that goal energetically and with some success. The consensus position was moving ever closer to ours and the UK Government had been forced to abandon some of its damaging early 'red lines'.

However, it is now more than three long years since the referendum and more than two and a half years since we published **Securing Wales' Future**.

In that time, Theresa May as Prime Minister:

- first set out a wholly unrealistic, if sketchy, prospectus for Brexit at Lancaster House and in the Article 50 notification, focused largely on what the UK wanted to jettison, not what it wanted to achieve;
- then slowly was forced to move in the direction of a 'softer' Brexit while still pretending this was compatible with her 'red lines';
- found that – having raised the expectations of the hardline Brexiteers within her ranks – she could not garner sufficient support from her own MPs to deliver the deal she had made with the EU27; and
- having failed to create any cross-party consensus before negotiating or agreeing the withdrawal deal or build bridges in a bitterly divided country, made a half-hearted attempt to reach agreement with the Opposition before it became clear that what was on offer was too little, too late to convince any other parties in the House of Commons.

Meanwhile, the prospect and uncertainty of the UK leaving the EU is having a significant negative impact on the economy: according to the Bank of England, lower growth as a result of this uncertainty it has already cost each of us living in Wales more than £1,000 since 2016.

Even more worryingly, far from the country coming together, the divisions within our society have deepened. And increasingly, those who believe that we need to leave the EU have lost patience and are arguing for a 'no deal' Brexit – something which is very far from the picture painted by Leave campaigners three years ago, when they promised that the negotiation of a free trade agreement would be 'the easiest in history'.

So after three wasted years, with the new Prime Minister set on leaving the EU on 31 October regardless of the consequences, earlier this year we took a long hard look at our Brexit policy. We were clear that there was hardly any or no prospect of a Government led by Boris Johnson convincing the EU27 to fundamentally depart from the Withdrawal Agreement negotiated with Theresa May – a view which we have so far seen little reason to change.

Faced with options narrowing to a binary choice between a no deal Brexit and reopening the question posed by the referendum in 2016, we reached the conclusion that the likelihood of building a consensus around an economically literate Brexit had become very small. And that, as a government which had to put the interests of the people of Wales first, the right thing to do was for Welsh Ministers to campaign to remain in the EU and call for a referendum to achieve that goal.

In this paper, we set out the evidence which led us to reach that conclusion, and explain the two alternatives facing our country. In particular, we set out the evidence for why a no deal Brexit would be a disaster for Wales, and why, should we remain in the EU, it would still be possible to address some of the concerns which fuelled the vote to leave.

In doing so, we focus largely on the medium to long-term damage which would result from a no deal outcome, rather than the probable problems of short-term disruption, for example related to the supply routes of fresh food and medicines, which were set out powerfully in the published 'Operation Yellowhammer' planning assumptions.

We revisit each of the six priorities we set in **Securing Wales' Future** and explain what has happened since the referendum to shape our views; what a no deal Brexit would mean; and how remaining in the EU would help us build a brighter future for Wales. In other words, how it will enable us to pursue our goal of building a Wales which is more prosperous, more equal and more sustainable, in line with our commitments in the Well-Being of Future Generations Act.

4 The Economy; The Single Market and International Trade

WHAT WE SAID IN SECURING WALES' FUTURE

In **Securing Wales' Future,** we clearly set out the economic implications of leaving the EU for Wales, the benefits to the Welsh and UK economies of participation in the Single Market and the case for continued full and unfettered access to its 500 million customers, without new tariff or non-tariff barriers. We also demonstrated how accessing the Single Market has been a key factor in attracting overseas investment to Wales from around the world and how the introduction of new barriers to trade would likely lead to disinvestment, particularly in the case of businesses with complex cross-border supply chains.

In **Securing Wales' Future** we highlighted the high proportion of goods exports from Wales which are sent directly to the EU (currently around 60% of the total value of all direct goods exports from Wales). We demonstrated how all credible economic forecasters predicted that replacing Single Market participation with trade on WTO terms would result in a UK economy up to 10% smaller than it otherwise would have been.

We also made the case for the UK remaining part of the Customs Union to enable frictionless trade with the EU and more than 50 countries with which the EU has free trade agreements.

WHAT WE HAVE LEARNT

Since we published **Securing Wales' Future**, evidence has continued to mount about the likely negative impact of a no deal Brexit on the economic prospects for Wales and the UK.

While much of the focus of concern about no deal has been on the short-term disruption, even more serious is the likely longer-term damage that such an outcome would mean for our whole economy. In particular, it would have a hugely negative impact for manufacturing, which, to a large extent, relies on complex and integrated supply chains across the EU and also the agri-food sector.

The UK Government's own analysis of the impact of various Brexit scenarios, suggested that:

- A no deal Brexit was by some margin, the most economically damaging of all the scenarios considered. This form of Brexit, would result in Gross Domestic Product (GDP) being around 7.7% lower by 2033 than it otherwise would have been, if there were no change to current migration policies and around 9.3% lower in the event of there being net zero migration from the European Economic Area (EEA) countries.
- While new tariffs would create fresh barriers and burdens for many sectors of the economy, the adverse impact of non-tariff barriers would be even greater. Such barriers would include additional checks at the border which would slow and add an element of unpredictability into freight transport and administrative requirements, such as certification of confirmation to EU standards for goods exported from the UK.
- On a per capita basis, GDP would be around 7.6% lower in the event of a no deal Brexit with no change to migration policies and 8.1% lower where a no deal Brexit was accompanied by policies leading to zero net migration from the EEA. This is equivalent to around £2,500 at current prices for every person.
- A no deal outcome would also lead to a significant hit to the public finances, with an increase in the government deficit of 3.1% of GDP in the scenario where net EEA migration reduced to zero. At current prices, this would mean that the equivalent of around £60 billion would need to be found in extra taxes or financed by additional budget cuts, causing deep damage to public services: this is roughly the entire revenue budgets of the Welsh and Scottish Governments and Northern Ireland Executive combined.

- Even a significant increase in access to new markets outside the EU as a result of a highly ambitious global trade policy would not provide any significant mitigation, despite what is claimed by the current Government. The total potential increase is estimated at 0.2% of GDP after 15 years – in no way making up for a loss of nearly 10%.

As set out in Annex B, other analyses broadly echo these forecasts. For example, the Bank of England estimates that in a 'disorderly' no deal Brexit, GDP over a five year horizon would be negatively impacted to a greater degree, at 5.5 % below the level that would otherwise have been the case.

For those who doubt the capacity of economic forecasters to 'get it right', there have also been some salutary real-world lessons.

The Bank of England and other economic analysts have concluded that the slow-down in the UK economy as a result of the decision to leave the EU has already cost the UK economy over £80 billion – or over £1,000 per head – since the 2016 referendum.

Meanwhile, investment has slowed dramatically, since the EU referendum. The Bank of England has cited evidence indicating the level of investment is around 6%-14% lower than it would have been in the absence of Brexit uncertainties.

There has also been a series of high-profile business closures or large-scale redundancies with significant impact on Wales which we believe at least in part can be attributed to the pall of uncertainty generated by the Brexit negotiations for example:

- The decision to shut the Ford engine plant at Bridgend (with 1,700 job losses).
- The closure of Schaeffler in Llanelli (with more than 200 job losses).
- The insolvency of the two construction companies, Dawnus (700 jobs lost) and Jiscourt (60 jobs lost).
- The decision to shut the Honda plant in Swindon, which puts at risk some 2,000 jobs in the supply chain in Wales: already Calsonic Kansei, for whom Honda was a major customer has cut 95 jobs.

Meanwhile, there have been hard lessons for the UK Government in terms of international trade negotiations. It was assumed that 'transitioning' existing EU Free Trade Agreements (FTAs) with 'third countries' so that the UK would continue to benefit from the same terms would be straightforward.

The reality is that many countries have seen this as an opportunity to wring concessions from the UK, with some, such as Japan and Canada, refusing to conclude similar FTAs until the form of Brexit is clear. In all, fewer than half of these agreements have so far been transitioned and in some cases where agreements have been reached, such as with Switzerland, significant elements of the existing EU agreement have been omitted, reducing their value.

At the same time, threats to the global, rules-based trading environment have become increasingly obvious, as the Trump administration pursues an aggressive policy of imposing tariffs on imports to the US in response to real and perceived threats from other countries' trade policies, which in turn has triggered reciprocal measures from the EU, China and other major trading economies.

WHAT NO DEAL WOULD MEAN

The main economic consequences of a no deal exit would be:

In the short term

- The immediate imposition of World Trade Organisation (WTO) tariffs on UK exports to the EU.
- Disruption and delays at the borders, particularly at the Channel ports, as the result of new customs and regulatory controls in France, leading to problems in the retail and logistics sectors; and also potential delays at Welsh ports at Holyhead, Fishguard, and Pembroke Dock.
- Significant disruption in the manufacturing sector, with supply chains no longer functioning smoothly because of new regulatory checks and likely short-term stoppages, leading to cash flow difficulties. The UK Trade Policy Observatory estimates that changes to the trading relationship with the EU and the need to align tariff levels for 'third countries' with those for the EU27 would lead to a loss of income for the UK manufacturing sector of £18 billion – or more

than £7,000 per employee. This would be bound to lead to redundancies.
- A major crisis in the agri-food sector, with a collapse in the market for Welsh lamb as a result of EU tariffs and with the Welsh seafood sector – which exports 90% of its production – critically undermined by probable delays and constrictions in freight transport to the EU27. This would in turn lead to a real crisis in our rural communities, with a resulting impact on the vitality of the Welsh language.
- All of us as consumers suffering a cut to our standard of living as a result of inflation triggered by yet further devaluation of the pound, increasing prices at home and making holidays abroad significantly more expensive and the introduction of tariffs on some imports.
- The high risk of immediate recession and contraction of the economy as a whole.

In the long term

- Without rapid progress to a new trading relationship with the EU, we will see a further contraction of the manufacturing sector, with progressive disinvestment, particularly from international businesses with significant export markets in the EU.
- Unilateral trade liberalisation through no deal tariffs will increase competition for UK manufacturers or processors who sell only in the UK market if tariffs disappear on competing imports from low cost producers from countries without equivalent labour market and environmental standards.
- Below trend growth rates in the UK economy, leading to stagnating living standards.
- Significant pressures on the public finances, leading to higher taxes, even lower public spending or a combination of the two.
- A likely negative impact on productivity because of reduced specialisation.

All this will be taking place at a time when we potentially face a break-down of the rules-based international trading system. The US has threatened to withdraw from the World Trade Organisation and is vetoing appointments to the WTO's 'Appellate Body' which is critical to resolving trade disputes while there are growing concerns about the extent to which China's state-owned enterprises operate within market disciplines.

While a no deal Brexit would impact negatively on the whole of the UK, many economic analyses suggest it would impact most on areas where the economy retains a significant reliance on manufacturing.

WHY WE ADVOCATE REMAIN AND REFORM

The main argument for remaining in the EU is simply that as Annex B shows, any form of Brexit will do economic damage to the Welsh and UK economy.

The Bank of England and the Treasury suggest that lifting the uncertainty from Brexit which has cast a dark shadow over economic confidence would lead to a significant stimulus to the economy, which would also aid the public finances and give scope for a more expansionary fiscal policy.

Within the EU, which is increasingly setting global norms in terms of product standards, we would continue to be able to influence the regulatory environment which shapes our economy. This would enable us to work with other like-minded governments and political actors to bring about progressive reform to include:

- Ambitious targets for reducing and eliminating net carbon emissions and a focus on 'green growth' and the circular economy, based on a new long-term EU Investment Plan, which will help secure economic growth while not depleting non-renewable resources
- A progressive approach to taxation – in particular, taxing the profits of the multinational corporations.
- Continued championing of rules-based international trade – driving forward the EU's efforts to work with other like-minded countries to revive the WTO.
- Pressing for continued opening up of the Single Market in services.
- Stronger protection of labour market rights, including minimum wages across the EU, ending zero-hours contracts and fake self-employment, and creating a strong European Labour Authority to ensure that mobility of labour within the EU does not lead to undermining terms of conditions of workers within the UK.

- Continued pressure to reform the Common Agricultural Policy (CAP) in order to put a much stronger focus on rewarding the production of environmental goods in place of automatic ‘basic payments’.
- Continued efforts to increase the transparency of decision-making within the EU, in particular the proceedings of the Council of Ministers where national governments act as a ‘co-legislator’ with the directly-elected European Parliament.

No-deal warnings across sectors

The UK’s car industry has warned that a no-deal scenario could cost them £50,000 a minute in border delays. The Society of Motor Manufacturers and Traders (SMMT) said delays to shipments of parts to production plants combined with World Trade Organisation tariffs, which could come into force if the UK left the EU without a deal, would deliver “a knockout blow to the sector’s competitiveness”. June 2019

The British Retail Consortium warned the October 31 deadline would come at the “worst possible time for retail”. Chief executive Helen Dickinson said the new deadline coincides with the “height of preparations for Christmas and Black Friday, which are peak trading periods, threatening to cause disruption for consumers and businesses, and making further stockpiling of goods almost impossible”. July 2019

Analysis by Hybu Cig Cymru suggesting 92.5% of our lamb export trade could disappear if we go over the Brexit cliff on 31st October. July 2019

Make UK recently wrote to the Prime Minister telling him that a no deal outcome would be a disaster for manufacturing, decimating those small and medium sized companies that form the backbone of UK business. 24 July 2019

Research by the CBI has concluded that many of the consequences of no deal will be felt for years to come – acting as a self-inflicted drag on the UK’s economy for the next decade and more. July 2019

Research by the Federation of Small Businesses found that over one in ten (11%) smaller firms say that they would stop exporting to the EU altogether if they had to complete additional customs declarations. August 2018

5 Migration

WHAT WE SAID IN SECURING WALES' FUTURE

In **Securing Wales' Future**, we set out to shape a policy which would be compatible with the broad principles of the Single Market, while also seeking to address the concerns about low wages and poor working conditions which clearly fuelled the Leave vote in 2016. The main driver for this was to enable a future relationship with the EU27 which secured full and unfettered access to the Single Market, given the EU's insistence that the four freedoms (of capital, goods, services and labour) were indivisible.

In **Securing Wales' Future** and our more detailed policy document, **Brexit and Fair Movement** we argued for a flexible, but managed approach to migration, which would support our future ambitions for full and unfettered access to the Single Market, whilst outlining the ways in which exploitation of workers could be tackled more effectively.

In particular, we argued that:

- Our future relationship with Europe should include a differentiated and preferential approach to immigration for EEA and Swiss nationals.
- Future migration from Europe to the UK should be more closely linked to employment – either the offer of a job, or the ability to find one quickly. People would still be able to move here to start their own businesses, but there would be more rigorous checks to ensure that this was genuine self-employment and to prevent abuses of the system.
- EU migrants and their families should continue to be able to access the safety net of the benefits system and our public services in broadly the same way as they do now.
- It was important to address the genuine concerns that some people had about migration for a number of reasons, including perceived pressures on public services, access to employment opportunities and the extent to which migration could have a negative effect on wages and conditions.
- While all the economic evidence suggested migration was unlikely itself to have a negative effect on wages in Wales, there remained a significant issue of exploitation of workers which undermined wages and conditions, due to unscrupulous employers and inadequate legal protections. Tackling this exploitation would improve wages and conditions for all workers.
- It was essential to guarantee the rights of EU citizens who have already made Wales their home – a group which the UK Government has treated like pawns in a game.

WHAT WE HAVE LEARNT

In **Brexit and Fair Movement** we provided a great deal of detailed evidence on the importance of workers from elsewhere in the EEA to a wide range of sectors and public services. These include:

- NHS and Social Care
- Higher Education and Further Education
- Agri-food, particularly vets and abattoir workers
- Hospitality
- Advanced Manufacturing

EU migrants contribute immensely to Wales' economy and society. In Wales, 78.8% of working age EU born residents are in work, compared with 73.2% of the total working age population. Only 9.8% of working age EU born residents in Wales claim working age benefits compared to 20.7% of UK born residents in Wales.

The NHS is Wales is reliant on EU workers at every level. In September 2016, 1,313 EU nationals were directly employed by the NHS in Wales, with 7% of doctors working in Wales coming from the EU.

7% of Higher Education staff are from the EU and are key to ensuring the teaching quality offered in Wales' Higher Educations Institutions (HEIs), as well as facilitating international research collaborations. Around 17% of students in Welsh HEIs are from overseas, representing a significant source of income for our institutions.

The food and drink sector is heavily reliant on migrant workers; 27% of those employed in food and drink manufacture in Wales were born in the EU. 90% of meat inspection occupational vets in the UK are non-UK citizens making this sector particularly reliant on workers from overseas and 44% of all newly registered veterinary surgeons qualified in EU veterinary schools.

5% of those who work in the tourism sector in Wales are from the EU, undertaking roles that the British Hospitality Sector report would be problematic to meet from the UK resident population in the short to medium term.

Work by Professor Jonathan Portes[1] has also shown that, while EEA workers form a smaller proportion of the workforce in Wales than in the UK as a whole, the majority, including many in skilled, professional jobs, earn less than £30,000 per annum, which the UK Government has suggested might be the threshold for future immigration.

Over the last three years, there has also been increasing evidence of pressures in the labour market, despite the economic slowdown as EEA in-migration has fallen to the lowest level in a decade. The Chartered Institute of Personnel and Development (CIPD)'s latest quarterly survey showed that 61% of employers seeking to fill vacancies had found at least one post hard to fill, while 41% reported it was becoming more difficult to fill vacancies, compared to only 6% who were saying it was becoming easier.

Meanwhile, the UK Government has failed to provide unequivocal guarantees on the retention of the current rights of EEA citizens living in the UK such as that to family re-unification. This is despite the launch of the EU Settlement Scheme (which will provide all EEA citizens already in the UK before the date of exit with the opportunity to secure the right to continued residence). There are also serious concerns that the lack of any physical proof of Settled Status could lead to discrimination by employers and landlords.

At the same time, the Windrush scandal, with citizens of the Commonwealth who had clearly been given the right to remain in the UK being denied re-entry or access to public services has legitimately fed a suspicion that the Home Office cannot be trusted effectively to protect the rights of such residents.

The past three years have also seen insufficient progress in terms of protecting the rights of UK citizens who are permanently resident in the EU27. In a huge failure of negotiating strategy, the UK Government even failed in the Withdrawal Agreement to secure the right of such UK citizens to exercise their rights to onward free movement to other member-states post-Brexit. Should the UK leave without a deal, the rights of such citizens will essentially depend on the discretion and good-will of individual member-states.

WHAT NO DEAL WOULD MEAN

In many ways, the impact of no deal on migration remains unclear because the critical issue will be choices the UK Government makes about a new immigration regime which is intended to come into effect in January 2021. While the shape of the current UK Government's likely legislative proposals on this have yet to emerge, it seems clear that the UK Government would scrap free movement – possibly as soon as 31 October of this year – and remove any specific preference for EEA citizens in our immigration system.

The UK Government's current position is set out in the White Paper, **The UK's Future Skills-Based Immigration System** (December 2018)[2]. This includes:

- The removal of free movement rights from EEA citizens.
- The introduction of a single route for skilled worker migration based on an overhaul of the current 'Tier 2' scheme. This would only permit immigration to the UK from individuals with a specific job offer, who had qualifications at NVQ level 3 or above, and who would be earning above a salary threshold, which it was indicated might be set at £30,000 p.a, subject to further consultation.

1 Portes, J and Forte, G, Wales Centre for Public Policy, 'Migration in Wales: the impact of post-brexit policy changes' February 2017.
2 At the time of going to press it is unclear the UK Government has said that it will make changes to the previous UK government's plans for a new system (set out in the immigration White Paper) and will set out its plans shortly.

- The abolition of the requirement to apply for a skilled visa from outside the UK, the quantitative ceiling on the number of Tier 2 visas to be granted, and the 'resident labour market test' (which requires employers to prove the job cannot be filled within the UK labour market) in order to simplify the system for the employers. But the likely retention of the Immigration Skills Charge and the Immigration Health Surcharge, which add significantly to employers' costs, as well as visa fees.
- A six month post-study leave to remain for most students, with the right to switch to the skilled visa route up to three months before the end of their course.
- Applying current rules on family reunification to those on skilled work visas.
- The introduction of a new temporary worker scheme, until 2025, allowing individuals from certain 'low-risk' countries to come to the UK to work for a maximum 12 month period, after which they would be required to observe a 'cooling off' period of 12 months before they were able to return to the UK. These individuals would have no recourse to public funds and no ability to bring family members with them.
- The potential opportunity for Wales, as well as Scotland, to have a specific 'Shortage Occupation List' to set priorities in terms of skilled migration. However, since these occupations would not have exemptions from the skills and salary thresholds, and in the absence of a quantitative limit on the number of visas to be given in any one year, it is not clear how useful this would be.

Unlike EEA citizens already here before exit date, those arriving after EU exit would not acquire the right to Settled or Pre-Settled Status. After the 31 December 2020, they would have no right to remain, unless they were eligible to apply for a visa under the new migration system or if they had applied for the EU Temporary Leave to Remain Scheme (EUTLR) which would enable them to remain for three years from the date of application.

For EEA citizens already living and working in the UK, while the Settled Status scheme would continue to provide security with regard to the right to remaining in the UK, in a no deal situation, their rights would be less than they would under the Withdrawal Agreement. In particular, those wishing to bring family members to the UK would be subject to the same rules (which require proof of a given level of earnings) as UK Citizens from 2022 rather than retaining the more generous family reunification rights guaranteed under EU law.

Since taking office, the Prime Minister Boris Johnson has suggested a different view of migration, suggesting the introduction of an Australian points-based system, which potentially could lead to a more flexible approach compared to that set out in the White Paper. Moreover, there has been strong resistance from the business community – as well as from the Welsh and Scottish Governments – to the suggestion of a £30,000 threshold.

However, on the basis of the current proposals, it seems clear that:

- Employers would find it much more difficult for to recruit semi-skilled and unskilled labour from outside the UK, while if the £30,000 threshold were retained, many skilled jobs, including in manufacturing, would also be excluded. This would impact negatively on the Welsh economy. The estimated fall in net migration to Wales of 57% over the next decade is projected to result in a reduction of GDP of between 1.1% and 1.6% and 0.8%, of GDP per capita over 10 years.
- There would be particular problems for public services, principally health and social care, with the social care system becoming highly vulnerable to labour shortages. The argument of the Migration Advisory Committee is that this would force wage levels in the social care sector up to encourage local recruitment, but this would then exacerbate the public funding crisis for care services.
- In the case of skilled workers (such as doctors, vets and engineers), where there are labour shortages, migration from EEA countries is likely to be replaced by migration from the developing world, which arguably will both deprive those countries of much needed skills and not address the perception of large-scale migration.

- The temporary workers scheme, reminiscent of the reviled German 'gastarbeiter' scheme of the 1950s and 1960s, which did much to undermine social and community cohesion, is hugely problematic. It is likely to encourage the exploitation of labour and undermine labour rights to a far greater extent than freedom of movement. Workers with no right to remain beyond 12 months, no rights to benefits, and subject to a 'cooling off period' after leaving the UK will have no incentive to complain about working conditions, however appalling. And such a scheme will be particularly unsuitable for care settings where clients above all need certainty and continuity of staff if they are to feel secure.
- EEA nationals who come to the UK after 31 October, will in the short term, be able to live, work and study in the UK. However they will lose this right in 2021. This is likely to lead to a sharp and immediate fall in EEA migration. It will impact particularly severely on recruitment to posts in the NHS and Higher Education where international competition can be intense. Indeed, Welsh Higher Education Institutions already report incidences where job offers to EEA citizens have been turned down because of the lack of clarity over their future rights to remain.
- The limit of the proposed European Temporary Leave to Remain to three years will also be highly problematic in terms of student recruitment. While this is a particular problem in Scotland, where undergraduate degree courses are routinely for four years, it will also undermine the viability of certain study routes in Wales, particularly those with a strong vocational focus. The recent UK Government announcement of a two year post-study visa does not solve the problem for those who courses last more than three years.
- Uncertainty over the rights of EEA citizens resident within the UK, including their right to remain beyond 2021 could lead to landlords and employers discriminating against EEA citizens settled in this country, encouraging them to return to their countries of origin and exacerbating labour and skills shortages. This is because by no means all of those EU citizens already living and working here will have acquired Settled Status and even those who have will not have physical evidence of their status. They will thus find it difficult to distinguish themselves from EEA citizens who have only arrived after 31 October 2019 and will have no certainty of being able to remain after 2021.

Separately, in the case of a no deal Brexit, the European Commission will not be able to negotiate about the rights of UK citizens in the EU27 because immigration rules for 'third countries' are a matter for each national government, not the EU. Many of the EU member-states, such as Spain and Germany, have made unilateral offers to secure the rights of UK citizens currently resident within them. But the UK Government recognises that issues such as the lack of security with regard to access to health services could cause a significant flow of UK citizens, particularly those who are elderly and with limited resources back to the UK. This is likely to put a real strain on already stretched public services in Wales.

WHY WE ADVOCATE REMAIN AND REFORM

Remaining in the EU would, of course, provide immediate reassurance to EEA citizens in the UK, and indeed, UK citizens who have made their home elsewhere in the EU. The disincentive for EEA citizens to move to the UK, because of Brexit uncertainty, would be removed, helping employers to recruit skilled labour and providing an economic boost.

However, the retention of free movement would not mean that there was no opportunity to reform our system in the way set out in Brexit and Fair Movement.

Indeed, precisely because our proposals were designed to be compatible with freedom of movement principles, they could still be implemented even as an EU member-state.

In particular, as we pointed out in **Brexit and Fair Movement**, there is a significant opportunity to improve the enforcement of legal provisions which should protect workers against exploitation. Indeed, in several key areas, including labour standards inspections and trade union freedoms, the UK falls short in terms of the existing provisions of international treaties and human rights conventions that establish minimum labour standards globally.

Migrant and non-migrant workers are put at risk of exploitation due to the non-enforcement of minimum labour standards set down in legislation; and this risk is enhanced where there are few alternative employment options and where workers are unclear about their right or are unable to enforce them.

The enforcement of employment law in the UK is heavily dependent on the lodging of individual claims at employment tribunal and it is ineffective in the face of worker exploitation and wide-spread employment rights violations. A step-change in labour standards compliance is required, as well as action on enforcement which specifically addresses the needs of workers in Wales.

There is also scope to raise awareness of employment rights and promote good practice across Wales in this regard. Workers' access to justice would be enhanced by support for strategic litigation initiatives and targeted additional resources for advice and advocacy organisations to support individuals bringing Welsh claims about minimum standards so that minimum labour standards disputes are advanced through employment tribunals in Wales.

The Welsh Government is already setting an example here by its ground-breaking approach to Fair Work.

Equally importantly, it is also possible to make progress on ensuring that EEA citizens coming to this country to look for work are not able in effect to remain regardless of whether or not they succeed in doing so, drawing on examples such as Belgium and Norway.

EU law makes clear that freedom of movement is not unrestricted: for those who do not have independent financial means, the right to movement is linked to work. Individuals who have resided in an EU country for more than six months without having found work, and whose prospects for doing so seem limited can be legitimately removed.

This has never been enforced in the UK because of the weakness of our border controls and the lack of any administrative procedures which enable the Government to identify the labour market status of recent EEA migrants.

Should we remain in the EU, there is a strong case for change, in order to address the suspicion – however unfounded – of 'benefit tourism' and that EU migrants are restricting opportunities for UK citizens to find well-paid work.

One important principle of EU law which does have relevance here is, however, non-discrimination. This means that, if the UK remained an EU member state, it could not introduce a scheme of ID cards or requirements in terms of registering residence with the local authority (two techniques routinely used by other EEA countries to keep track of the labour market status of migrants), specifically for EEA citizens, but would instead need to have a system which also covered UK born residents.

Some have argued that a national ID card might be a price worth paying to address concerns about so-called 'uncontrolled' migration from the EEA.

But there are other alternatives. Most clearly, there is a real opportunity to overhaul the current system of National Insurance numbers, which all UK citizens have in order to achieve this. EEA migrants could be required to apply for a number on arrival in the UK, which would enable HMRC to track whether they were in work or had worked during the first six months of residence.

As a member-state, it would also be possible and indeed necessary to work with others to continue progressive reform to 'level up' terms and conditions across different labour markets inside EU. This might include further reform of the Posted Workers' and Temporary Agency Work Directives, to ensure short-term transfers of staff on the terms and conditions of their home countries are not used to undermine those of the host country. It might also include progressing proposals for a new European Social Contract, a new strong European Labour Authority to ensure the enforcement of labour protections across the EU and minimum wage legislation across all member-states.

6 Funding and Investment

WHAT WE SAID IN SECURING WALES' FUTURE

During the 2016 Referendum campaign, leaders of the Leave campaign, who included our current Prime Minister, repeatedly claimed that Wales would not be 'a penny worse off' after Brexit.

This was particularly significant given that, unlike the UK as a whole, Wales has been a net beneficiary of EU funds, reflecting the greater level of economic need, particularly in West Wales and the Valleys.

In **Securing Wales' Future** and the subsequent publications, **Regional Investment after Brexit** and **Reforming UK funding and fiscal arrangements after Brexit** we explained how Wales currently benefits from around £680 million per year from the European Structural and Investment Funds (ESIF), the Common Agricultural Policy (CAP) and specific EU funds for research and development, educational, environmental and cultural exchanges and collaborative projects. In those documents we also set out our principal demands in terms of future funding. We argued that:

- The UK Government must fulfil the Leave campaign promises that Wales would not be one penny worse off as a result of leaving the EU by maintaining levels of funding we would have otherwise expected, through additions to the Welsh Government's annual budget without any top-slicing or conditions attached.
- The UK Government must respect devolution, voted for twice by the people of Wales, and ensure Wales retains the autonomy to develop and deliver successor arrangements for the ESIF, tailored to the distinctive policy, legislative and partnership landscape in Wales.
- Wales must have continued access to important European partnerships and networks that bring sources of finance but also much wider benefits from participation. We should have the opportunity to build on the legacy of programmes such as European Territorial Cooperation Programmes; Horizon 2020; Erasmus+; the Creative Europe Programme; and the Connecting Europe Facility. We also would need continued access to the finance and expertise available from the European Investment Bank.
- The Barnett Formula should be replaced with a new rules-based system which ensures the allocation of resources within the UK is based on relative need.
- A new principles-based approach to UK funding and fiscal networks must be developed, enshrined within a new Fiscal Agreement.
- The UK finance inter-governmental machinery must be reformed to embed collaborations and agreement, including a clear role for independent oversight of these arrangements.

WHAT WE HAVE LEARNT

In short, not a great deal: the UK Government has failed to clarify many important details about future funding arrangements.

In 2016, the then Chancellor of the Exchequer provided a guarantee that any spending which had been legally committed under EU funding schemes by the time we left the EU would be underwritten by the UK Government, so that payments would be made from HM Treasury if they were no longer to be provided by the EU.

In July 2018, the UK Treasury Guarantee was extended to meet any funding commitments to projects made before the end of December 2020, even if the payments fall beyond December 2020 but before 2023; and to guarantee payments at current cash levels under the CAP until the end of the current Parliament in 2022.

While this provides some financial security over the short-term, there is none over the medium term. The UK Government has refused to provide any assurance about levels of agricultural funding or the methodology for allocating it after 2022, with the risk that a UK Government might a) reduce the level of funding across the whole UK and/or b) reduce Wales' share of UK agriculture funding. This would be deeply worrying given that Wales currently receives just under 10% of CAP funding to the UK, significantly greater than our overall share of the UK population as a whole, because of the large proportion of marginal land in Wales.

In the case of regional economic investment to replace the ESIF, the situation is even more unsatisfactory. The Conservative Manifesto in 2017 pledged the introduction of a UK wide Shared Prosperity Fund, with this pledge subsequently followed by promises that a consultation would be launched by the end of 2017 and, when that was delayed, by the end of 2018. Despite considerable pressure from the devolved governments and from other stakeholders, there is still no clarity and no meaningful engagement in preparing the proposed consultation on successor arrangements. UK Government Ministers, have however suggested by-passing the Welsh Government, which would undermine our devolution settlement.

If the current UK Government is unchecked we seem set to leave the EU in October with future funding issues unaddressed, putting the future of livelihoods of businesses, communities and people across Wales at risk.

In stark contrast to the UK Government's approach, the Welsh Government's approach to the development of future regional investment arrangements has been immediate, clear and outward looking. We have had detailed contributions to the debate on successor arrangements in Wales from stakeholders and Assembly Committees. We have also established a Regional Investment Steering Group, drawing on expertise from business, local government, academia and the third sector. We are also looking outwardly, with work underway with the Organisation for Economic Cooperation and Development (OECD) to ensure international best practice on regional development and governance is built into our future plans.

In terms of other funding regimes, it has become increasingly clear that, even if there were to be a Withdrawal Agreement, the UK would be shut out of a number of key financial programmes and institutions, notably the European Investment Bank.

The UK Government has failed to give any assurance that – even in an orderly Brexit – it would opt in to some programmes which are open to 'third countries' and are highly valued by Welsh stakeholders. These include the future Horizon Europe Framework Programme, which looks set to provide €100 billion during the period 2021-2027 for research and development, the Erasmus+ scheme which provides international exchanges and placements for Higher Education, Further Education school and vocational students and staff, and Creative Europe. In the case of Erasmus+, there are concerns the UK Government may develop a replacement scheme for England only, and has yet to guarantee any funding will flow back to Wales to enable us to do likewise.

Perhaps only one thing about future funding has become blindingly apparent. As the UK Government continues to spend billions on no deal preparations, and economists emphasise the huge hit to our economy and public spending which Brexit, particularly a hard, no deal Brexit will do, it is completely clear that there will be no 'Brexit dividend' in terms of public spending. The claims of Leave campaigners that Brexit would free up £350 million a week for the National Health Service were, as stated by the Chair of the UK Statistics Authority, a "clear misuse of official statistics".

WHAT NO DEAL WOULD MEAN

A 'no deal' Brexit – particularly one in which the UK Government were to renege on the commitment to the financial settlement with the EU agreed by Theresa May – would almost inevitably lead to the immediate cessation of European Commission payments to UK projects and programmes. While the UK Treasury Guarantee would mean that the vast majority of projects could continue as before, this would pose particular problems for transnational projects and our collaborative partnership with other nations. So, in the case of the Ireland–Wales Cross-Border Programme, for example, the UK Treasury Guarantee would only provide some certainty for Welsh organisations participating in projects, leaving Irish partners exposed and the future of the programme in doubt. While for Erasmus+, the guarantee would only cover the costs of UK students studying at EU institutions, and not EU students studying in the UK.

Moreover, UK universities and colleges, public sector and third sector organisations, and private companies would all be denied the financial and collaborative benefits of these programmes going forward.

This would have a devastating impact on Welsh research, innovation and our businesses, as explained in **Wales: Protecting Research and Innovation after EU Exit**. The education sector too would be badly hit by the loss of exchange opportunities through Erasmus+. While the UK Government has been considering whether a replacement UK-led scheme could be introduced relatively quickly, we are deeply sceptical as to the extent other countries would be interested in participating in such a scheme alongside, or as an alternative to, the successor to Erasmus+ which is expected to receive a doubling of funds in the coming years.

Most seriously, the lack of any confirmation from the UK Government over long-term regional funding is a huge concern. Over the last 20 years, the ESIF have been hugely significant, supporting improvements in the Welsh economy and labour market, particularly within West Wales and the Valleys where the bulk of funding has been directed. We have achieved this by using these funds to support core Welsh Government priorities for growth and jobs, such as:

- Apprenticeships (the ESIF account for more than half of the total funding for apprenticeships in Wales);
- A wide range of skills development programmes, including Traineeships and the Redundancy Action programme (ReAct);
- Infrastructure improvements, such as the modernisation of the South Wales Metro and the dualling of the Heads of the Valleys road;
- Maintaining and growing our research and innovation base in Wales including Sêr Cymru and our Smart Cymru Programmes and initiatives;
- Business support and investment, through Business Wales and the Development Bank of Wales; and
- The growth of green energy, particularly marine energy and environmental improvements, levering in private investment to develop the potential of tidal and wave technology.

If replacement funding is not made available, or hijacked by the UK Government, Wales would see such key investment areas which are vital for our growth and reducing regional economic disparities undermined. The disappearance of the CAP would also see the potential for a reduction in funding to agriculture and rural development at a time of huge stress for the sector.

In macro-economic terms, as we have seen in Section 4, the impact of a no deal Brexit is likely to have a negative impact on the public finances. Lower growth implies reduced tax revenues: for instance, on the basis of estimates by mainstream economists of up to 10% lower GDP than would be expected, the Welsh population share of the expected reduction in annual tax revenues each year from 2020-21 would be around £1.5 billion, with consequences for the funding of our public services in Wales.

WHY WE ADVOCATE REMAIN AND REFORM

As already noted, Wales has for many years been a net beneficiary of EU funds, unlike the UK as a whole, and this would almost certainly be the case post-2020 were we to remain in the EU.

West Wales and the Valleys would again qualify for the highest level of support from the ESIF, to address the inequalities which persist within the UK and EU and help bring new and better jobs to Wales and give people the skills to do them. Furthermore, the Conference of Peripheral and Maritime Regions (CPMR) believes that the UK as a whole would be in line for a significant increase in its receipts from these Funds overall.

Some in Wales are, of course, sceptical about whether we have benefited as much as we should have from European funding, and it is true that our understanding of how to use these funds most effectively and most strategically has improved over successive Programmes. Remaining in the EU would allow us to build directly on this experience.

In recent years, Wales has had an excellent track-record in delivering the ESIF, which is recognised by the European Commission and Wales Audit Office. For example, our declared expenditure for the current ESIF programmes continues to perform above EU and UK averages, and our commitment levels are among the highest in the UK.

Any system put in place by the EU to reward good performance – which was introduced in a modest way for the current ESIF programmes – would therefore be likely to reward Wales.

Should we remain in the EU, the work currently well underway to develop successor arrangements for regional economic investment would be put to good use in helping to shape future Welsh ESIF Programmes for delivery from early 2021.

In terms of the CAP, as already noted, structural factors mean that Wales receives far more than a per capita allocation of these funds, and again this would be expected to continue. Proposals within the EU to limit the support paid to the largest farms would almost certainly increase Wales' share of UK CAP receipts still further.

Within the EU, we would also continue to benefit from full participation in new EU funding programmes, such as the successors to Horizon 2020 and Erasmus+, programmes which are likely to see very significant increases in funding. We would continue to be shareholders in, and eligible for funding from, the European Investment Bank, which has provided vital funding for a wide range of projects in Wales, including the Swansea University Innovation Campus and improvements to water supply and waste management treatment in Wales. In line with our emerging International Strategy, we would build on the legacy of our engagement in the European Territorial Cooperation programmes and our work with important European partnerships and networks to maximise Wales' influence on the European stage and the benefits that accrue from that.

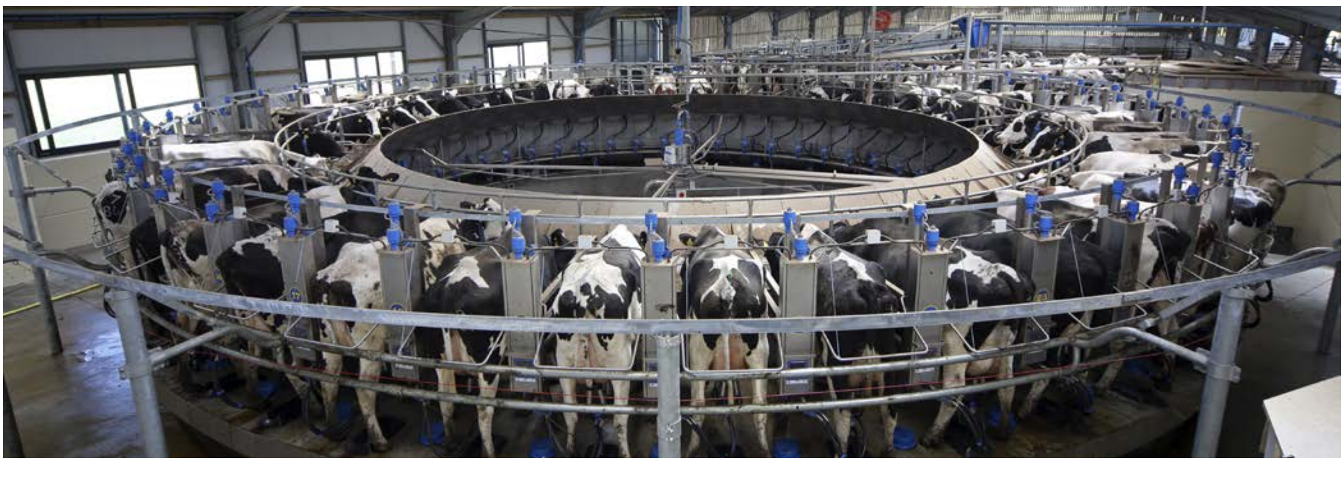
We would of course need to work with others to press for continued reform of both the ESIF and the CAP.

For the ESIF, we would maintain pressures on the EU to reduce bureaucracy and encourage a more risk-based approach to monitoring and audit, as our current compliance levels in Wales are far higher than elsewhere.

We would also wish to make a powerful case for the continued eligibility of areas with maritime borders, such as Ireland and Wales, for the European Territorial Cooperation programmes; this is under threat, because of the lack of UK influence in developing future EU regulations governing the ESIF.

For the future of agricultural policy, we would, as already noted press for significant reform of CAP to enable a much stronger focus on environmental goods. And to the extent that it proves impossible to achieve a major shift, we would expect to be able to use flexibilities as we do now to transfer a significant share of our receipts from farm support to rural development (Pillar 1 to Pillar 2).

Finally, building on the strategic success of developing complementarity between ESIF and Horizon 2020, as described in **Wales: Protecting Research and Innovation after EU Exit**, within the EU we would ensure Wales continues to up its game in terms of accessing funding from the new Framework Programme for collaborative international research, Horizon Europe.



7 Social and Environmental Protections and Values

WHAT WE SAID IN SECURING WALES' FUTURE

In **Securing Wales' Future** we made clear our view that, at a minimum, the UK needed to commit to maintaining current consumer, environmental and social protections, including labour market rights.

Decades of EU membership have secured meaningful standards for these vital quality of life issues. We are particularly proud of the progress we have made on environmental outcomes as a direct result of EU legislation and funding and in **Securing Wales' Future** we affirmed our commitment to green growth as a means of fostering economic growth and development. The high standards of our food and drink sector, rights to reciprocal healthcare, employment and social protections, equalities and consumer protections have all been underpinned by a substantial body of EU legislation which protects our environmental and social wellbeing and in **Securing Wales' Future** we made it clear that we would accept no rolling back of these.

Respect for equality and human rights is embedded in the DNA of the Welsh Government. In **Securing Wales' Future** we recognised the achievements of equality campaigners since the UK joined the EU and established as a guiding principle that leaving the EU should in no way reduce our focus on promoting equalities and challenging discrimination wherever it exists. Recognising the close links between inequality and poverty, we also committed to investing in measures to tackle poverty and increase social inclusion.

WHAT WE HAVE LEARNT

Once negotiations began with the EU, it quickly became clear that the EU27 would require the UK to maintain a strong alignment of labour market and environmental standards with the EU as the price of a comprehensive negotiated Future Economic Partnership. Such standards are seen as crucial to preserve a 'level playing field' between the UK and the EU – and indeed, international trade negotiations increasingly focus on such issues.

Partly as a result of these clear signals, the UK Government under Theresa May repeatedly pledged to maintain the rights and protections we currently enjoy as a result of European legislation. Thus in the White Paper on the Future Relationship with the EU, the Government pledged that:

- In the case of state aid, we would continue to operate rules equivalent to those within the EU, and update our legislative framework in line with the evolution of the EU regime.
- In environmental and labour market standards, we would guarantee 'non-regression' compared to the status quo at the point of departure;
- On climate change, we would maintain high standards noting the UK's world leading ambitions.
- The UK would maintain 'high levels' of consumer protection.
- Our security relationship should be underpinned by respect for human rights.

It is not at all clear the current UK Government feels bound by these commitments, indeed it has indicated that the UK wishes to walk away from the 'level playing field' commitments.

There is much evidence that UK Government intends to follow the prescriptions of some think-tanks, that the UK should undertake a dramatic programme of deregulation, cutting environmental and labour market standards in order to compete more cheaply in the global economy: in other words, to turn the UK into a European Singapore.

For example:

- the Institute for Economic Affairs has argued that “EU regulation is becoming more damaging to consumer welfare and growth, placing the innovative SMEs that are the lifeblood of our future economy at a disadvantage to large incumbents”.
- Open Europe has proposed ‘that so-called level playing field requirements must be minimised as they would limit the Government’s ability to regulate areas including employment, taxation and the environment”

Key figures from such think-tanks are now at the heart of Government.

The last three years have also suggested how difficult it might be to replicate current environmental standards outside the EU. Non-governmental organisations have rightly expressed significant concerns that the proposals of the UK Government in respect of England in the Environment Bill provide none of the legal routes available within the EU for individual citizens to take legal action where governments’ implementation and enforcement of environmental principles and legislation is inadequate. Similarly the proposed replacement of the EU-wide Emissions Trading System with a tax in the short-term post Brexit would represent a weakening of measures to combat climate change, just at the time when global populations are increasingly looking for intensified action.

The EU referendum has created divisions in families, communities and society, which will take a generation to heal. In some cases it has led to increased tensions in communities and increasing instances of hate crime. With the additional uncertainty of no deal Brexit, these tensions could be further exacerbated. That is why we are investing strongly in work to promote community cohesion, reassure groups at greatest risk of hate crime and support victims.

WHAT NO DEAL WOULD MEAN

It is almost certain that given the huge pressure on the UK economy after a no deal Brexit, the ideological position of the UK Government and the lack of constraint in the absence of a negotiated free trade agreement with the EU, the UK Government would be tempted to try to compete by undercutting EU standards.

Even if this did not happen, it seems almost inevitable that the UK would fairly rapidly fall behind as the EU policy agenda moves forward.

While environmental protection is a devolved competence, such a development would be highly damaging. The economic pressure on the Welsh Government to follow suit, should the UK Government deregulate in respect of England, would be very significant. The National Assembly and the Welsh Government would be faced with hard choices between losing economic investment and maintaining standards which are consistent with our values and aspirations.

In terms of labour market standards, which in general are reserved matters, deregulation by the UK Government would undermine efforts to promote social justice and Fair Work.

In terms of consumer protection, existing rights of individual citizens would certainly be diminished by a no deal Brexit. Redress for defective products supplied by sellers located elsewhere in the EU could no longer be sought through the UK courts, in practice making it riskier to purchase goods from EU –based vendors. The likely reduction in choice and competition would almost certainly lead to higher prices.

At the same time, a number of broader rights which we take for granted would be put in question by a no deal Brexit. As the UK Government has itself highlighted, travel to the EU will likely become more complicated, particularly for those with pets, which will no longer benefit from ‘pet passports’ and for those travelling by car, where green cards and international driving permits will be needed. UK citizens will no longer be guaranteed mobile roaming rights in EU27 countries, will not have access to free medical care when abroad and will likely face increased delays and controls at EU borders.

Moreover, the UK Government has not provided sufficient assurance that individual human rights protections will be maintained after Brexit. The UK Government has chosen not to incorporate the EU Charter of Fundamental Rights into domestic law. Consequently, the Human Rights Act 1998 and European Convention on Human Rights will be integral in ensuring the continued protection of the Charter rights following the withdrawal from the EU. However, members of the UK Government have discussed the intention to repeal the Act and derogate from the Convention.

WHY WE ADVOCATE REMAIN AND REFORM

Were we to remain in the EU, we would obviously continue to implement the same social and environmental standards as other member-states – and indeed have the opportunity to press for progressive changes in line with our own policy priorities, such as Fair Work.

Perhaps more importantly, remaining within the EU would provide a real opportunity to exert strong influence in favour of a much more ambitious approach towards addressing the climate change emergency. Wales and the UK have already committed ambitious targets, with Wales now aiming for at least 95% emissions reduction by 2050 with ambition to reach net zero emissions, while the EU has yet to do so. Full participation in the EU Council of Ministers would make it much more likely that a majority could be reached in favour of taking this minimum step towards tackling global warming.

And of course, given that the EU accounts for some 9.6% of global emissions, action at European level would have a much more significant impact both directly on emissions and indirectly in terms of exerting pressure on other nations to take similar steps.

Similarly, at a time of growing right-wing populist attacks on diversity and respect for minorities, remaining in the EU would provide the opportunity to fight for existing and enhanced commitments to equalities policies and practices throughout Europe.

We recognise that, given the depth of the divisions and antagonism which Brexit has created, any outcome to the Brexit process, including our preferred one, will be deeply unpopular with a significant proportion of the population. If we remain in the EU, there will need to be a concerted effort, at UK level, here in Wales and in our individual communities to heal these divisions and find a way to 'move on'.

8 Constitutional and Devolution Issues

WHAT WE SAID IN SECURING WALES' FUTURE

In **Securing Wales' Future**, we explained how, although not part of the negotiations with the EU27, any form of Brexit would require a significant re-think of inter-governmental relations. We expanded on our proposals for change in **Brexit and Devolution**, published in June 2017.

In summary, it set out our proposals for action to be taken in response to the new constitutional and inter-governmental challenges should we leave the EU in order to achieve the sustained cooperation between governments that would be needed.

We called for a shared governance approach developed on the basis of agreement between the four governments, and building on the traditions of cooperation built up during years of membership of the EU. In particular, we argued that the development of new UK frameworks would need to be done on the basis of consensus, using arbitration if necessary.

We argued how the UK's inter-governmental machinery should be reformed on the basis of equality and respect between the different governments by the creation of a new UK Council of Ministers to strengthen decision making supported by an independent secretariat.

We also repeated our long-standing demand for a Convention on the Future of the UK to be set up to develop and gain consensus on a long-term, sustainable UK constitution.

WHAT WE HAVE LEARNT

The experience of the last three years has only served to highlight the inadequacy of our constitutional arrangements to cope with the pressures Brexit will bring while simultaneously apparently limiting the capacity of the UK Government to satisfactorily turn its mind to these issues. Progress on a review of the Joint Ministerial Committee system, established in March 2018, has been very slow, with the UK Government reluctant to commit even to relatively modest proposals such as putting in place even-handed dispute resolution processes.

Despite agreeing to set up the Joint Ministerial Committee (EU Negotiations) with an explicit mandate to agree an approach to Brexit between the UK Government and the devolved governments, the UK Government has signally failed to honour this commitment. The Welsh and Scottish Governments were not consulted on or even given advance sight of a succession of key initiatives including:

- the terms of the Article 50 notification letter;
- the December 2017 agreement between the UK and the EU27;
- the then Prime Minister's speeches in Florence and at the Mansion House;
- the Chequers agreement and the subsequent Future Relationship White Paper; and
- the Withdrawal Agreement and the Political Declaration.

Perhaps most significantly, there was no substantial consultation on the original EU (Withdrawal) Bill, which initially would have imposed sweeping restrictions on the powers of the devolved institutions to legislate in areas of devolved competence previously subject to the EU law restriction.

After an extremely energetic campaign both in Parliament and outside, the Welsh and Scottish Governments were able to force the UK Government to accept that all powers related to devolved competence should rest with the devolved institutions, except where the UK Parliament had actively decided to 'freeze' them temporarily. As a result, the Welsh Government was able to sign an Inter-governmental Agreement (IGA). So far, this has worked reasonably well, underpinning the work to develop 'common frameworks' in areas formally covered by EU law which all Governments agree need an element of consistency across the UK going forwards. No powers have thus far been 'frozen'.

Nevertheless, the experience of the EU (Withdrawal) Bill has highlighted the fragility of our current devolution arrangements. The EU (Withdrawal) Bill was enacted, despite the fact that the Scottish Parliament had refused its consent, and without Parliament being given any opportunity to debate this constitutional departure.

Moreover, the Supreme Court subsequently judged that, while the Scottish Parliament's own Withdrawal Bill, though largely within competence at the time it was passed by Holyrood could no longer be brought into operation because the UK Government had 'moved the goalposts'

The identification of the need for 'common frameworks', covering issues such as agricultural support, hazardous chemicals and fisheries which are within devolved competence has highlighted the fact that outside the EU, the binary model of devolution will not be fit for purpose. There will need to be areas of 'shared governance' with agreed rules and processes to adopt, implement, review and update the inter-governmental agreements underpinning the common frameworks.

More generally, Brexit has reinforced a widespread perception that British politics is broken:

- A YouGov poll conducted in February 2019, found that 82% of respondents thought that British politics was working poorly with only 9% thinking it is working well.
- The Hansard Society's Audit of Political Engagement (conducted in November – December 2018) stated that 72% of respondents said the system of governing needs 'quite a lot' or 'a great deal of improvement', and 54% said that Britain needs a strong leader who is willing to break the rules.

WHAT NO DEAL WOULD MEAN

It is impossible to be sure how a no deal Brexit would play out in terms of the internal functioning of the UK. The experience to date suggests that the UK Government would simply not have the bandwidth to both deal with the short-term disruption and long-term damage to the economy and to address the constitutional crisis which might follow in its wake. In other words, there would be an intensification of the trend we have seen over the last three years of there being an increasing need for constitutional reform but a decreasing capacity of the UK Government to engage with it.

In the sort of cliff-edge no deal Brexit which we appear to be heading for, a particular threat would come from the UK Government's concern to reach international trade agreements very quickly.

It has become increasingly evident that the interface between international relations and devolved competence is a point of serious tension in internal UK inter-governmental relations. Many of the areas which are at the heart of trade negotiations, for example environmental standards, agricultural subsidies and access to markets, state aid, and public procurement, are within devolved competence. While the conduct of international relations is principally a matter for the UK Government, implementation of international agreements is a devolved competence.

Under Theresa May, some progress had been made in persuading UK ministers to recognise the risk of a constitutional crisis at the point at which new international agreements necessitated changes to legislation within devolved competence which the devolved governments and legislatures were uncomfortable with and to accept that the way to mitigate this risk was to involve the devolved governments at all stages of the negotiating process, where devolved issues were at stake.

It is not clear that the current administration in Whitehall shares this view. Even if they do, the risk is high that in desperation to agree a trade deal with the USA or Australia, the UK Government agrees policies e.g. on permitting imports of chlorinated chicken or removing restrictions on GM crops which one or more of the devolved countries finds unacceptable.

It is certainly not shroud-waving to suggest that the risk to the Union would be very real in these circumstances.

Even before Brexit becomes a reality, the prospect of Scotland being taken out of the EU despite the fact a clear majority of voters there supported Remain in 2016 and opinion polls suggest an even larger majority do so now, is fuelling demands for a further referendum on Scotland's independence.

In Northern Ireland, some opinion polls have shown that a majority of voters would favour reunification of the province with the Republic of Ireland in the event of a hard Brexit. In these circumstances, it is difficult to see how the Secretary of State could refuse to agree to a border poll, given the requirements of the Good Friday Agreement.

For Wales, secession by either or both of Scotland or Northern Ireland would fundamentally destabilise the current constitutional settlement and make it more difficult to assert the rights of the devolved institutions against encroachment from Westminster and Whitehall.

WHY WE ADVOCATE REMAIN AND REFORM

As has already been noted, the constitutional issues are not at the heart of the debate as to whether or not we should remain in the EU: they are rather an inevitable consequence of implementing the Brexit decision.

Were we to remain within the EU, then these problems would become less acute, but they would not go away. Indeed, to a very real extent, Brexit has only highlighted the need for a fundamental review of constitutional arrangements to put them on a more equitable basis, one which is based on parity of esteem between the different governments within the UK. We will shortly be publishing a fuller set of proposals in this regard.

One specific issue which has become clear through the Brexit discussion – and following on from the intense interest in the now-abandoned negotiations about the Transatlantic Trade and Investment Partnership – is that the devolved institutions need to be more fully engaged in the discussion of trade policy.

If we remain within the EU, we will need to develop more robust mechanisms for the devolved governments to agree the position of the UK Government in respect of ongoing trade negotiations being undertaken by the European Commission, in line with the arrangements which have always operated in respect of agriculture, fisheries and regional development.

More generally, should a referendum or General Election result in the UK remaining in the EU, we would clearly need to work very hard to address the sense of disconnect which has fuelled and continues to fuel Brexit as a touchstone for dissatisfaction with the political class.

9 Transition

WHAT WE SAID IN SECURING WALES' FUTURE

The Welsh Government was amongst the very first organisations to argue that any Brexit would require a period of transition in order to minimise the damage from the massive change which leaving the EU would represent. In **Securing Wales' Future** we argued that a transitional period was essential as it would be impossible to both negotiate a withdrawal agreement and put in place the basis of a future relationship with the EU, including ratification processes, within two years. We cited businesses' grave concerns at the prospect of a "cliff edge" and therefore argued for transition arrangements to secure access to the Single Market and Customs Union with minimal changes to our trading relationships until a new, deeper economic relationship could be negotiated and come into effect.

WHAT WE HAVE LEARNT

With the insistence of the EU27 that the details of a Future Economic Partnership can only be negotiated once we have left the EU, it has become increasingly clear that a transition period is essential to enable such negotiations to take place without major economic upheaval.

For the EU, the pre-requisites for such a transition period and an orderly Brexit have long been clear:

- agreement on the future rights of EU citizens in the UK;
- a financial settlement to ensure that the EU27 can complete the current budgetary period (to December 2020) without cutting back on expenditure or increasing the contribution from other member-states;
- guarantees on arrangements in Ireland which are compatible with the Good Friday Agreement and which ensure the avoidance of a hard land border on the island of Ireland; and
- the continued application of all current EU legislation during the transition period.

From the EU's perspective, the Withdrawal Agreement reached with the UK Government in December 2018 fulfilled these criteria.

However, the new UK Government now insists that a Withdrawal Agreement can only be supported, if the 'Irish backstop' (which aims to ensure no border controls are necessary on the island of Ireland) is taken off the table. For its part, the EU insists that the backstop, or precisely-defined, credible alternative arrangements mirroring the objectives of the backstop, must be included in Agreement. As a result, it now seems highly unlikely that the UK will have the benefit of a transition period.

WHAT NO DEAL WOULD MEAN

A no deal Brexit would therefore mean no transition period.

The UK Government believes that in such circumstances the EU would be prevailed upon to negotiate a succession of 'mini-deals', but at the time of writing this seems highly unlikely. While the EU has legislated for a number of transitional arrangements, for example to allow UK freight operators to continue to carry freight to and from the EU27, or for UK airlines to continue to fly to EU airports, these have been determined unilaterally, and are generally time-limited.

It is often argued that it would be possible to enter transition after a no deal crash-out. This neglects the fact that once the UK has left the EU it is a 'third country' and the special arrangements for negotiations envisaged under Article 50 of the Treaty no longer apply.

Chapter 4, set out what such a no deal Brexit would mean for the economy. It is important to be clear that once the UK has left the EU and has gone over the 'cliff-edge', there is no easy way back to the current status quo.

The recent publication of the UK Government's 'Operation Yellowhammer' contingency planning assumption has also served to highlight the short term risks of a crash-out Brexit, without a transition period, including the possibility of:

- Problems in access to medicines and medical supplies.
- A significant reduction in consumer choice in terms of fresh food and vegetables.
- Significant inflation, due to the devaluation of the pound, with particularly negative effects for those on low incomes and increasing pressure on hard-pressed public services.
- A collapse in the market for lamb and Welsh seafood.
- Significant cash-flow difficulties for small and medium sized businesses whose business model is dependent on integrated international supply chains.

WHY WE ADVOCATE REMAIN AND REFORM

Remaining within the EU would obviously remove the need for transition to a new relationship with the EU as a 'third country'.

But after three wasted years, we would undoubtedly need a different form of transition. The UK's reputation with its EU partners has been hugely damaged by the incompetence, and arrogance of the approach of the UK Government to the negotiations.

Were we to remain as a member-state, we would need to invest seriously in the effort of rebuilding the UK's credibility – and in this the Welsh Government could play a significant part, since Wales continues to have a good reputation with the EU institutions as a nation which respects the rules and implements EU funding regimes efficiently and effectively.

Equally important, for the last three years, the UK has had neither the capacity nor the credibility to engage on a series of vital negotiations on the future direction and policies of the EU. We would need very rapidly to engage on such issues as:

- the size and shape of the new Multi-Annual Financial Framework (the EU's budget for the period 2021-2026);
- the revised regulations for the ESIF for the same period;
- negotiations on the future shape of the CAP; and
- negotiations on the priorities and financing of the successor programmes to Horizon 2020, Erasmus+, Creative Europe and a host of other programmes that are significant to stakeholders within Wales.

Finally, the experience of last three and a half years should have proved that pro-Europeans have been too reluctant over the last 40 years to challenge Euro-scepticism and stand up for the benefits of EU membership. A successful campaign to remain should lead to a new European movement in the UK.

10 Conclusion

This paper has concentrated largely on economic and social issues because those are ones where Brexit – and particularly a damaging no deal Brexit – would impact most directly on our responsibilities as a devolved Government.

But there are many other reasons why, as a Welsh Government, we believe that continued EU membership is the right choice for Wales in any future referendum:

- The EU has played a vital role in maintaining peace on the continent of Europe – the reason why leaders from Winston Churchill on have supported a united Europe. It helped Western Europe to avoid repeating the disastrous mistakes of the aftermath of the First World Was where a desire for revenge and reparations on the part of the victors sowed the seeds of the next World War; and provided the basis after 1989 for rebuilding a sense of a common European identity across what had been the Iron Curtain.
- The EU, and the fact that the UK and the Republic of Ireland are both member-states, has provided stability in Northern Ireland, after decades of violence, which spilled onto the streets of Great Britain.
- In a world where we are increasingly inter-dependent, it makes little sense to withdraw from an EU which, if it chooses, has the potential to shape the global agenda on addressing the Climate Emergency and which is the largest multi-lateral aid donor.
- We in Wales have benefited disproportionately from the deeply embedded solidarity between nations which is at the root of the European ideal, with a focus on using common resources to support the economically most vulnerable countries, regions and people across the whole EU.
- Our young people, in particular, hugely value the opportunity to travel, work, study, live and enjoy what other parts of Europe have to offer, without visas and work permits.
- Working with other EU partners has made us safer. There is a huge threat to our internal security from an abrupt break in our cooperation with other EU partners, for example cutting off our access to vital databases, losing access to the European Arrest Warrant, making it more difficult to extradite suspects from other EU countries, and intelligence cooperation. Former Security Minister, now Defence Secretary of State Ben Wallace warned in November 2018 that:

  "We and Europe know, from bitter experience, that often when there is a mistake or when something has been missed that we find, time and time again, that it has been due to a failure of cooperation. A no-deal situation would have a real impact on our ability to work with our European partners to protect the public."
- The fact that a no deal Brexit would lead to the loss of civil judicial cooperation with implications for businesses' capacity to get redress and for cross- border family breakdown cases to be resolved swiftly.

In this paper, we have put forward the evidence why the Welsh Government now believes passionately that remaining in the EU is the best option for Wales and the UK as a whole.

A no deal Brexit would be a disaster with the risks to our well-being growing, not diminishing overtime. It would do fundamental damage to our economy in the same way that the Thatcher Government did in the 1980s; threaten our rights at work; undermine our environmental standards and protections; weaken our public services by reducing the tax-base and the access to skills; reduce our access to funding for investment in our infrastructure, our research base, and our skills, including, critically, apprenticeships; and threaten devolution.

By contrast, in an increasingly inter-dependent world, remaining in the EU would provide us with a platform of economic stability and an opportunity to work with others to increase action to combat the environmental emergency and improve rights at work. Wales would continue to be a net beneficiary of EU funds and Welsh citizens would continue to be able to take advantage of the right to travel, live and work across Europe.

11 Annex A – Overview of Brexit policy papers

Through our White Paper – **Securing Wales' Future** and subsequent policy papers on trade, migration, regional investment and devolution, we have published evidence, analysis and detailed proposals for a Brexit that would protect jobs and the Welsh economy if the UK leaves the EU.

In **Brexit and Fair Movement of People** we set out proposals for a new migration system that links migration more closely to employment.

Our vision for a fundamentally different constitutional relationship between the devolved governments and the UK Government was outlined in **Brexit and Devolution**

In **Regional Investment after Brexit** we set out our call for regional funding and decisions to remain with the Welsh Government post-Brexit and for Wales not to lose a penny of funding.

Through our paper **Trade Policy: the issues for Wales** we set out proposals for trade with the EU post-Brexit and made the case for the UK retaining full access to the European Single Market and membership of a customs union.

A radical change to the way the nations of the UK are funded is among the proposals contained in **Reforming UK funding and fiscal arrangements after Brexit**. The paper calls for the design of a new funding system which promotes fairness across the UK, encourages balanced economic growth across all parts of the country and is based on the consent of all the nations of the UK.

In **Wales: Protecting research and innovation after EU exit** we set out how Wales' success in research and innovation must not be damaged by Brexit.

Brexit and Our Seas aims to secure a sustainable future for Welsh seas and the fishing industry.

Plans for a new post-Brexit farming scheme in Wales were unveiled in **Sustainable Farming and our Land**. The detailed proposals aim to protect the land and the environment for future generations whilst providing a stable income for farmers through a new Sustainable Farming Scheme.

12 Annex B – Exiting the EU: Updated Economic Assessment of the Impact on Wales

KEY MESSAGES

- This paper provides a summary assessment of the economic impact on Wales of exiting the EU, with a particular focus on leaving without a deal on 31 October 2019.
- Uncertainties and interdependencies mean it is not possible to rely on one precise quantified estimate of the economic effects. It is important to draw on a range of evidence to understand the likely magnitude of the impacts.
- For similar reasons, it is not feasible to produce definitive estimates of which places or population groups will be most affected.
- With these caveats, robust empirical evidence on key economic relationships demonstrate it is virtually certain leaving the EU without a deal or transition period will produce a severe economic slowdown in the UK, with, in the worst case, a recession that approaches in depth the one experienced in 2008-09.
- A slowdown of this magnitude might mean a reduction in Welsh employment equivalent to 40-50,000 jobs.
- While certain sectors of manufacturing and agriculture will suffer particularly from specific initial shocks associated with new trade barriers, the lesson of previous recessions is that the largest negative effects are likely to be experienced by the construction industry, consumer-facing services and those sections of manufacturing most exposed to consumer and investment demand.
- Similarly, the people most likely to be adversely affected are those who are already most disadvantaged in labour market terms (particularly those with lower skills, disability or illness).
- The places most at risk are those with high concentrations of such people, particularly where the wider economy is less resilient.
- There is no reason to revise previous assessments of the likely longer run effects of Brexit. The economy in Wales is likely to be up to around 10 per cent smaller than otherwise over the long term, depending on the nature of new trading relationships that are introduced over time and the speed of adjustment to those new relationships.
- Lower economic growth will have associated effects on the tax base and therefore the scope to fund public services.

INTRODUCTION AND CONTEXT

This paper provides an updated summary assessment of the impact on Wales of the UK exiting the EU.

The paper published by the Welsh Government on 4 December 2018[1] reviewed the results of the economic analysis provided by the UK Government on the longer run economic consequences of the UK leaving the European Union. The UK Government's conclusions were compared with those of credible, independent, researchers and found to be broadly consistent.

The Welsh Government published an update of that analysis, drawing on material released subsequently and focusing particularly on shorter run impacts, on 31 March 2019[2].

This paper provides a further update, and considers particularly the short and longer run economic implications of a "no-deal" scenario, with the UK exiting the EU on 31 October 2019 and then immediately trading with the EU and the bloc's trading partners on WTO terms.

As with previous assessments, the approach adopted here is to synthesise the most credible evidence from a variety of sources. Much of this evidence relates to the UK as a whole. This approach is valid as economic activity in Wales is closely integrated into the wider UK economy and over the short to medium term the economic performance of Wales tracks that of the wider UK relatively closely. It is not feasible to analyse, and still less to model, Welsh economic performance in isolation from this wider context.

KEY ECONOMIC DEVELOPMENTS FOLLOWING THE REFERENDUM IN 2016

There is a broad consensus amongst independent analysts that economic growth in the UK since the referendum has been lower than would otherwise have been expected. For example, the Office for Budget Responsibility (OBR) has stated:

"In our first post-referendum forecast in November 2016, we judged that the vote to leave the EU would result in a period of lower real GDP growth and this appears to have been borne out."[3]

Analysis, including comparisons with past trends and with other countries, including the EU-28, has indicated that the growth penalty so far could have reached 2 per cent of annual GDP. For illustrative purposes this would be equivalent to over £400 per person each year in Wales. As the penalty has cumulated over the three years since the referendum, the total loss so far could be approaching £1000 per person.

The reduced rate of growth since the referendum reflects, in part, lower than expected business investment. The Bank of England has concluded that this lower investment is largely a consequence of heightened uncertainty related to Brexit.

UK citizens have been adversely affected by the deprecation of sterling that followed the referendum. The exchange rate reflects international investors' assessment of expected UK future growth. Expected lower growth results in reduced demand for UK assets and consequently the demand for sterling, leading to currency deprecation. Such depreciation increases the prices of imported inputs and consumer goods, resulting in lower real incomes, with economy-wide effects as consumer spending is lower than it otherwise would have been. The costs of essentials – such as food and fuels – are particularly sensitive to exchange rate movements, and an increase in such costs impacts disproportionately on those with low incomes.

Of course, depreciation can benefit exporting (and import competing) businesses. This is part of the process whereby the economy adjusts to lower growth in domestic incomes and is more than offset by the negative effects, so is not in itself "good news". And, of course, currency depreciation does little or nothing to alter the fundamental determinants of economic prosperity – a suitably skilled workforce, good institutions and infrastructure and so on.

1 https://beta.gov.wales/economic-analysis-uk-governments-proposals-eu-exit
2 https://gov.wales/written-statement-updated-analysis-economic-implications-uks-exit-european-unio
3 https://cdn.obr.uk/March-2019_EFO_Web-Accessible.pdf. See para 3.3 on page 2.

It should also be noted that the depreciation of sterling following the referendum has not been followed by improved international trade performance. This may reflect, in part, the complex nature of supply chains, where exporting businesses are adversely affected by higher input costs. Firms may simply be "banking" higher profits rather than reducing prices. It is also likely in part to reflect an unwillingness to invest due to Brexit-related uncertainty.

SHORT RUN EFFECTS OF LEAVING WITHOUT A DEAL

If the UK leaves the EU without a deal, the economic damage will be imposed through several channels. These include direct impacts, indirect effects and economy-wide ("macroeconomic") consequences:

- Obstruction of, and disruption to, the export of goods and services from tariffs and non-tariff barriers. The severity of these impacts will vary across sectors.
- Similar potential barriers to accessing imported inputs.
- Higher costs for imported inputs.
- Supply chain effects, which may be very diffuse and hard to attribute.
- Labour shortages as a result of reduced migration.
- Economy-wide reductions in demand resulting from decreases in both consumer spending and business investment in response to negative expectations.
- Reductions in the productivity, and hence earnings, of the factors of production used to produce goods and services, traded internationally, in which the UK can no longer trade competitively.
- Spending reductions resulting from the impact of currency depreciation on the real cost of consumer goods and hence on living standards. This will affect particularly those on low incomes.
- For Wales in particular, the withdrawal of EU funding.

While in some cases it may be possible to attribute specific impacts on individual industries or locations to Brexit, the nature and scale of many of the indirect effects is impossible to predict with any precision.

In some cases, the impacts will depend on specific choices made by the UK and other governments, for example, about how procedures such as customs checks are put in place and what mitigation measures are taken.

More generally, analysis suggests the indirect and macroeconomic channels are likely to result in negative economic effects that are larger than the direct impacts on specific industries.

The economy is a dynamic system, always in a state of "churn", with large numbers of jobs being both lost and created and businesses opening and closing. For example, each week in Wales, around 2,000 jobs are both lost and created. This means that in many cases the indirect economic effects of Brexit will represent just one influence amongst many others on individual business decisions. Therefore even negative consequences that are very large in aggregate will often be impossible to identify at the level of individual businesses or locations.

For these reasons, while it may be feasible to identify certain industries and, by association, locations that will be disproportionately affects by initial impacts (for example where there is high exposure to particularly vulnerable exporting sectors in manufacturing and agriculture), this could well prove a misleading guide to overall effects.

SCALE OF SHORT RUN IMPACT

If the UK leaves the EU without a deal, there is a wide range of potential scenarios. As just noted, the strength and nature of effects will depend heavily on the specific circumstances that apply in the period after leaving. It is therefore not appropriate to seek to produce a single numerical forecast for Wales.

Key issues in the event of a no-deal exit include the length of the period that people expect to elapse before there are further changes to the UK's trading relationships with the EU (and other trading partners)[4], expectations about what those changes might be, and the implications of any political uncertainty. These factors would be expected to have major but unpredictable implications for business investment decisions and consumer behaviour. A deep and protracted recession is one plausible outcome, and is considered further below.

The nature and scale of any impacts will also depend heavily on any macroeconomic measures taken by the UK Government and the Bank of England to prepare for and mitigate negative effects. The scope for standard monetary policy responses is uncertain, with bank rates at historically low levels. Sustained fiscal consolidation has brought the public deficit below two percent of GDP for the first time in 16 years but as discussed below, an economic downturn will have a significant impact on the UK's public finances.

Moreover, Brexit is taking place against a backdrop of slowing global economic growth and changes in technology and regulations. The level of preparedness of businesses and infrastructure (such as ports, excise and customs systems and transport operations) will be important in determining how the economy adjusts to new barriers. This combination of factors means that precise prediction in these areas is impossible.

Stockpiling, in anticipation of the initial exit date, provided a temporary boost to GDP in the first quarter of 2019. However, how much this will be replicated in the run-up to the October exit date is uncertain.

Both the OBR and the Bank of England have considered the potential short to medium term economic effects on the UK of a no-deal Brexit.

In its most recent Fiscal Risks Report, published in July 2019 [5], the OBR undertook a fiscal stress test based on a scenario for the UK exiting the EU without a deal. This scenario (based on one devised by the IMF) was not intended to represent the worst case, and assumed, for example, only limited disruption at the borders, a temporary recognition scheme for some financial services and a fairly modest reduction in immigration of 25,000 a year.

On this basis, the OBR judged that the UK would enter a year-long recession in the fourth quarter (October-December) of 2019. Real GDP would fall by just over 2 per cent (around the same as in the early 1990s recession and about a third of what was seen in the financial crisis). Employment would fall and unemployment rise, with the latter peaking at just over 5 per cent in 2021. Productivity and earnings growth would be weaker than otherwise, and combined with the effect of depreciation on the price level, this would result in real wages being 2.5 per cent lower than otherwise at the start of 2024. Government borrowing would around £30 billion a year higher from 2020-21 onwards (much larger than any savings from eliminating contributions to the EU budget).

In 2018, the Bank of England produced several Brexit scenarios, one of which focus on worst case outcomes. These scenarios were updated in a letter from the Governor of the Bank of England to the Chair of the House of Commons Treasury Committee on 3 September 2019[6]. In this letter the Governor noted that the preparedness measures that had been put in place had reduced the Bank's estimates of the shorter run economic costs associated with its most adverse scenario for a "no-deal no-transition" exit. He stated that under this scenario there could be an initial peak-to-trough decline of GDP of 5.5 percent, a rise in unemployment to 7 percent and an increase in inflation which would reach a peak of 5.25 percent.

4 It is worth noting that it took the EU and Canada seven years to agree trade deal.
5 https://obr.uk/frr/fiscal-risks-report-july-2019/
6 https://www.bankofengland.co.uk/-/media/boe/files/letter/2019/governor-letter-to-chair-of-tsc-re-updated-brexit-scenarios.pdf?la=en&hash=2E567C985959FCF2D80A4F803A7D17392E2855DE

These impacts are – unsurprisingly – considerably more adverse than those estimated by the OBR under more benign assumptions about the extent of the disruption associated with exit.

Consistent with the points made earlier, the Governor has cautioned on the uncertainty and "false precision" inherent in such quantified estimates. However, for illustrative purposes, the scale of the impact estimated by the Bank of England under these adverse scenarios would, in very broad terms, be comparable to, if somewhat less than, that of the recession of 2008-9, where the peak-to-trough decline in GDP was around 6 percent.

These estimates are, of course, for the UK as a whole. Evidence on the close integration of the economy in Wales with the rest of the UK, and previous experience, indicate that an impact of a broadly similar order of magnitude could be expected in Wales.

Over the last 10-20 years, in broad terms, the economy in Wales has tracked the UK as a whole quite closely when economic outcomes are measured relative to the total population. In particular, the major recession of 2008-9 had an impact of similar scale on Wales and the UK as a whole. While GVA[7] per head fell somewhat more in Wales than the UK in 2008, this shortfall was largely recovered over the subsequent two years, and it is unclear how far this pattern reflected real rather than statistical effects. In any case, the scale of the divergence was modest in comparison to the absolute reduction in GVA.

While the greater exposure of Welsh exports to EU markets might be expected to imply the impacts from a Brexit-induced recession would be somewhat greater in Wales, it is not possible to make an evidence-based assessment of such differential effects due to the range of other factors affecting outcomes (as set out above).

However, and again in broad terms, if the impact of a worst case scenario was of the magnitude implied by the Bank of England, experience of the last recession suggests that it might result in a reduction in employment in Wales of around three per cent, with some of this reduction reflected in higher unemployment and the remainder in higher inactivity. This would be equivalent to around 40-50 thousand fewer people in work with the risk of higher structural unemployment as workers separated from the highly-affected industries only move slowly to less-affected industries.

There would, of course, be a range of other adverse consequences, including reduced job creation, lower business investment and lower business formation. The last two factors would in turn have longer run implications for future productivity growth.

SHORT TERM SPATIAL AND DISTRIBUTIONAL EFFECTS

The sudden introduction of new trade barriers and reduction in labour mobility would, of course, affect some industries more than others, with particularly strong effects on some parts of the manufacturing sector (including food processing), tourism and agriculture, especially over the shorter term.

Analysis undertaken by Cardiff University for the Welsh Government has set out how new trade barriers could affect specific manufacturing industries[8]. The research highlighted particular risks for industries such as aerospace, automotive and chemical sectors.

However, the authors concluded that often the particular circumstances facing individual business and the characteristics of the business can be more important than the sector to which they belong. And, as previously noted, outcomes will be also influenced by supply chain effects, impacts on imported inputs and by the potentially large macroeconomic consequences.

These considerations also mean that it is not possible to produce evidence-based assessments of spatial impacts with any precision.

---

7 GVA is conceptually and quantitatively similar to GDP – there are relatively minor differences due to the treatment of certain taxes.
8 https://gov.wales/docs/det/publications/180202-eu-transition-and-economic-prospects-for-large-and-medium-sized-firms-in-wales-en.pdf

However, especially adverse initial impacts are most likely in places where affected businesses represent a very large share of local employment and where the local economy is less resilient. This might imply particular concern for more remote rural areas dependent on sheep farming, and those parts of the south Wales Valleys and of North East Wales that are highly dependent on more vulnerable parts of the manufacturing sector.

In terms of assessing local effects, it also needs to be borne in mind that commuting and the separation of ownership and production means impacts can be quite widely diffused.

Experience of previous recessions, particularly the major one of 2008-9, which was also accompanied by a large currency deprecation, suggests several broad lessons in respect of the wider effects:

- Much of the impact will be felt by consumer facing services, construction, and those aspects of manufacturing which are impacted by reduced consumer demand and lower investment.
- In respect of people, the biggest impacts will be on those disadvantaged groups with the weakest attachment to the labour market – particularly those with lower skills and/or experiencing disability or poor health and those on fixed nominal incomes, which are vulnerable to accelerations in inflation.
- Places with high concentrations of such people will consequentially be particularly hard hit.
- In the earlies stages of a recession, the largest impact on the labour market comes from businesses shedding labour, but soon this is replaced by the effect of reduced hiring.
- In part, a recession acts to accelerate structural change which would in case occur, albeit to a slower timescale.
- Therefore, supporting the conditions for job creation and business success, while supporting people who cannot find work (particularly through education and training), is likely to be more effective than seeking to preserve existing industries or jobs.
- However, cross-country evidence suggests that support to firms to promote short time working rather than redundancy can have lasting benefits, provided this is focused on businesses whose viability is fundamentally strong.

The high level of uncertainty about future trading relations likely to remain in immediate aftermath of the UK leaving further reinforces the case for government intervening in ways that retain a sound rationale across a wide range of plausible scenarios. Such interventions are likely to include (as already noted) effective action on education and (transferrable) skills and on economic infrastructure that facilitates trade and the matching of labour demand and supply including increasing the availability of suitable housing.

LONG RUN EFFECTS

The longer run analysis assumes any short run effects from a disorderly or disruptive Brexit, even if severe, will be only temporary and therefore do not influence the results after 10-15 years. This may be optimistic in the worst case scenario. Most researchers think that one reason productivity growth remains very sluggish is the “scarring” effects of the last recession on business investment and human capital formation.

The general approach adopted in the analysis reviewed here is one of assessing what difference exiting the EU and trading on WTO terms would be likely to make to economic outcomes relative to existing trading arrangements, not one of forecasting what the outcomes facing the UK will actually be. Such a forecast would have to take account of wide range of other factors influencing the economy over the long term[9].

Even on this basis, quantifying the economic effects of leaving the EU represents a major challenge.

9 The track record of such forecasts, sometimes termed “unconditional forecasts” is poor, reflecting inevitable uncertainty about the future. Making an evidence-based assessment of what difference a particular change might make, sometimes termed a “conditional forecast”, remains challenging but is a fundamentally more feasible proposition.

There is a strong consensus amongst economists about the key principles, particularly:

- barriers to trade impose economic costs - a virtually frictionless border has allowed UK firms to specialise in activities in which they have comparative advantage and the greatest value added. EU membership had also stimulated foreign direct investment as firms invested in the UK as a means of accessing the single market, while the free movement of labour has allowed employers in the UK to hire talent from across the EU;
- distance itself is a barrier, and trade is generally more intensive with partners who are proximate both geographically and in terms of their stage of economic development;
- non-tariff barriers (including regulations, checks and even congestion) are in many cases at least as important as tariffs, and often more so.

However, assessing the extent to which additional barriers will arise under the new trading arrangements, and still more quantifying their impact, is extremely difficult - not least because there is no precedent of a major economy leaving a large trading block.

A variety of techniques have been employed by analysts to assess and quantify such effects. These include formal modelling of different kinds and the synthesis of evidence from a range of empirical studies.

A wide range of studies have now been published by academics, governmental and inter-governmental bodies, consultancies and financial institutions.

The Office for Budget Responsibility (OBR) has recently undertaken a "stress test" of the impact of trading with the EU on WTO terms and has drawn on published analysis reflecting the approach adopted by mainstream analysis [10]. The estimated long run impacts on UK annual GDP are set out in Table 1.

Contribution to long run impact on UK annual GDP from trading with the EU on WTO terms (percentage points)

		UK Government			LSE	
	IMF	Unchanged migration policy	Zero net EEA migration	NIESR	Static productivity	Dynamic productivity
Migration	-1.2	-0.2	-1.8	n/a	-1.4	-1.8
Productivity	-4.7	-7.5	-7.5	n/a	-3.3	-8.1
Total	-5.9	-7.7	-9.3	-5.5	-4.7	-9.9

Source: Office for Budget Responsibility

Given the inevitable limitations of this kind of analysis, it is very important to recognise that quantified estimates of impact should be taken "in the round" as indicative of the potential scale of magnitude, and not seen as precise estimates.

10 https://obr.uk/frr/fiscal-risks-report-july-2019/

These broad estimates are unchanged from those reported previously – annual GDP could be up to around 10 per cent lower than it would otherwise have been as a result of a decision to leave the EU and trade on WTO terms.

Again in very broad terms and purely for illustrative purposes, in today's terms, this represents around £2,000 every year for each person in Wales.

Of course, lower growth also implies reduced tax revenues. For example, on the basis of the scenario adopted by the OBR for their stress test, the Welsh population share of the expected reduction in annual tax revenues each year from 2020-21 would be around £1.5 billion, with obvious consequences for the funding of public services in Wales.

Analysis undertaken by the UK Government shows that the economic benefits from new FTAs made possible under the White Paper or under "No Deal" would be minimal compared to the losses associated with leaving the EU [11]. Again, this is unsurprising given the economic principles set out above as many new FTAs are with countries that are not geographically proximal to the UK. In addition the analysis shows that the potential economic benefits associated with the ability for the UK to set regulations independently of the EU are negligible (+0.1% of GDP).

Previous independent studies that have looked at the longer run effects of Brexit at country and regional level within the UK have found differing results depending in part on whether new non-tariff barriers are assessed to impact more severely on goods or services. In general, however, the close integration of the economy in Wales with the wider UK, and experience, suggests, over the longer run, negative effects are likely to be of broadly similar orders of magnitude.

However, in assessing the likely outturn it is necessary to take account of other factors influencing relative rates of growth. In particular, the population aged 16-64 is projected to fall in Wales over coming decades while it increases across the UK as a whole. This would be expected to result in lower growth in both Welsh economic output and in the Welsh tax base, over and above the impact of Brexit.

11 Some previous work which has examined the beneficial effects of new trade deals for the EU as a whole has indicated larger positive effects. However, the results are not comparable because they were intended to show the maximum potential benefit, assuming all NTBs were eliminated (which is probably unrealistic). In addition, the EU is a much larger market than is the UK, so the scope to exploit some of the gains from trade is also greater.

gov.wales