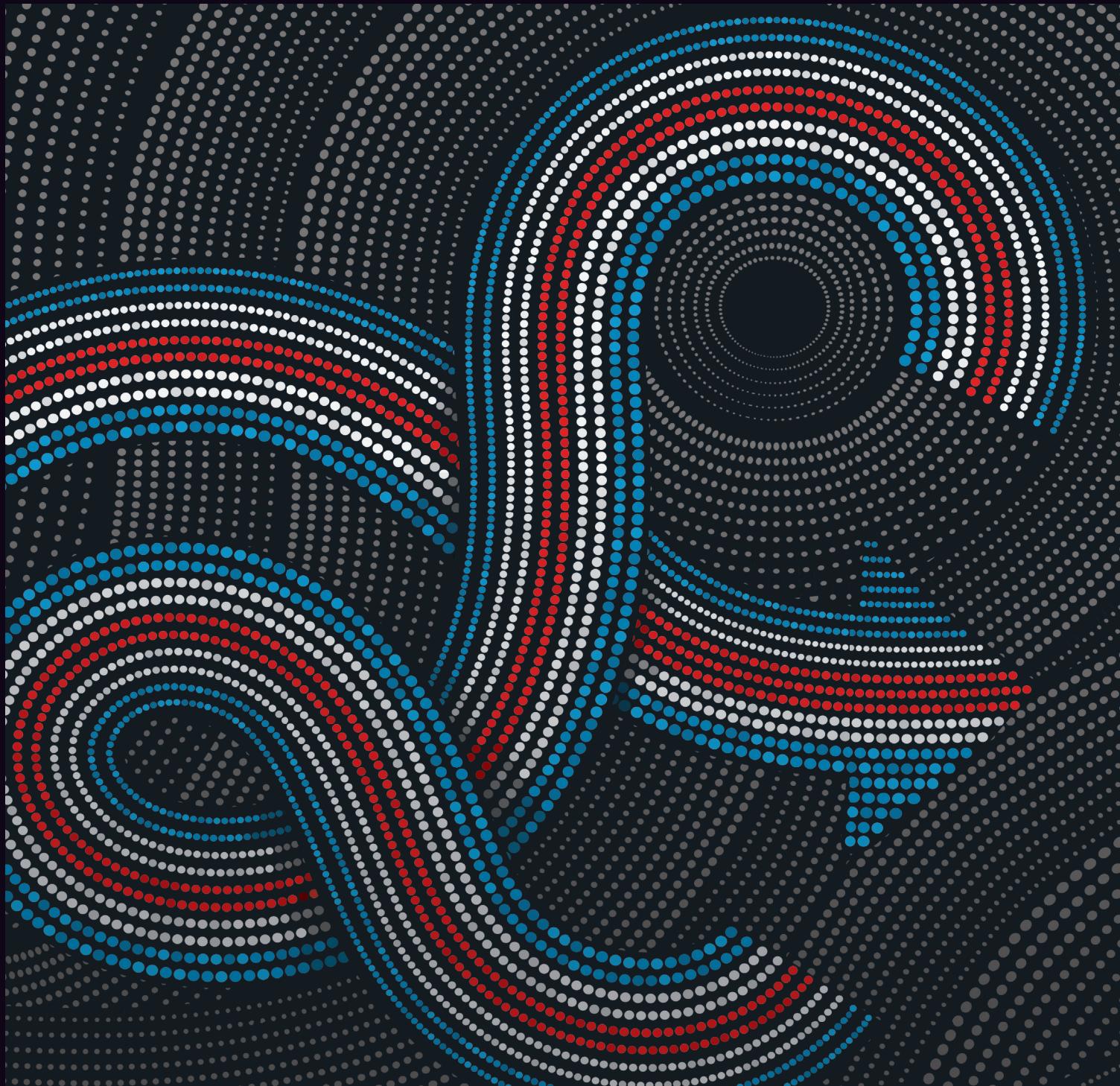


# The Brexit balance sheet

Weighing up the  
public sector costs



This is the fifth in a series of *PF Perspectives*, produced by CIPFA and *Public Finance*. They are designed to stimulate discussion on key public finance and policy issues. These essays, by leading public sector practitioners and experts, examine the far-reaching implications of Brexit for central and local government and across the public sector

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# FOREWORD



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## The people have spoken. Britain is exiting the EU. And, with the triggering of Article 50, the transition from planning to execution has begun.

So what does this mean for public services? Brexit's impact will be felt across the public sector, from Whitehall to town hall and beyond, affecting everything from staffing and funding to procurement and taxation.

It will be a truly transformative moment, with significant legal, technical, economic and constitutional implications.

For public finance professionals, the issue is not whether to respond to such radical change. They are well used to a fast-shifting world, in which demographic, technological and economic pressures daily put public services to the test.

It is, rather, how to engage with the continuing uncertainties that will surround the Brexit process – and how to make the challenge a positive force for change.

This is the subject matter of this important collection of *PF Perspectives* essays.

The authors explore the fiscal context within which Brexit is taking place, and the considerable changes being demanded of an already cash-strapped sector.

But they also discuss some of the ways in which the post-Brexit scenario could be a catalyst for much-needed public service reform.

One example might be its impact on regional funding – long due an overhaul – once EU structural funding has ceased. Another could be a rethink on public sector procurement.

Given the economic significance of the public sector, it is vital that all these issues, and the risks and the opportunities, are kept in the foreground as the UK renegotiates its relationship with the EU.

This is where the Brexit Advisory Commission on Public Services comes in. It is an independent body, facilitated by CIPFA, which I am very pleased to have been invited to chair.

Composed of senior government officials, public sector leaders, experts and economists, it will examine the issues that are critical to public services.

Whether we are talking about workforce needs in the NHS and care sectors, the future of higher education and research, or the implications of Brexit for environmental policy, the advisory commission will seek to help develop the case for the best possible public sector deal.

The wide-ranging views collected here are an important starting point for this initiative and one that I hope will contribute towards establishing a powerful voice for the public sector at the negotiating table.

The people have spoken on Brexit. But, for public services, the discussion has only just begun.

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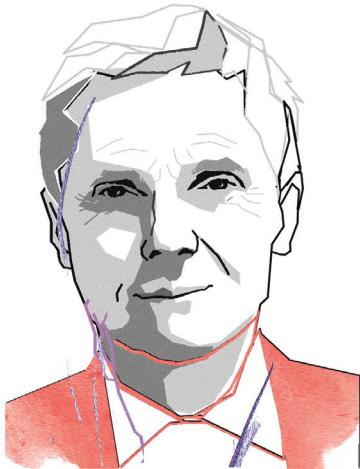
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INTO THE  
UNKNOWN

# An article of faith

ESSAY



BY TONY TRAVERS

As Brexit negotiations get under way, public sector organisations face an uncertain future. They need to assert themselves



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THE TRIGGERING OF ARTICLE 50 is upon us. Britain may never be the same again. Yet local government has enough to worry about without spending over much time on Brexit. Or at least that is what most councillors and officers might think. As local government resources drain away, the question of how councils should respond to the medium-term consequences of Britain quitting the EU is lower down most lists of priority; funding adult social care or refuse collection is more important.

But councils are leaders of their communities. By the end of the decade, they will receive all their revenue income from council tax and business rates. Any threat to the local economy will, by 2020, be a threat to day-to-day income. The government's new trading and migration relationships with the rest of the world will have different impacts from area to area. So councils actually have a profound vested interest in the shape and content of the particular trade deals to be struck by the Department for Exiting the European Union (Dexeu).

A local authority that has a high concentration of employment and economic activity in, say, aerospace, agriculture or financial services would need to have a view on the government's approach to trade deals affecting those sectors. Many commentators are sceptical about the possibility that Theresa May can strike sector-by-sector deals, particularly with the EU-27 states. An all-encompassing deal affecting all trade, tariffs, non-tariff barriers and the customs union would have a more or less random impact on the economy from place to place within the UK.

One approach would have been to use the new industrial strategy to set out a government-approved economic outcome for the negotiations that lie ahead. As it is, the strategy is an optimistic wish list for changes to the UK economy, including more tech jobs, better skills training and higher productivity. A more convincing one would have spelled out which industrial sectors were to be promoted, and in which parts of the country new trade-driven growth was expected. What will the detailed post-Brexit negotiations do for Blackpool and Hartlepool? How will such policy be determined by those doing deals with trade ministers from Wellington and Washington DC?

Long before the British government arrives in foreign capitals to do deals, local government will have to decide how to deal with Whitehall. While the administrations in Scotland, Wales and Northern Ireland have their own access to UK ministers, England does not. As is so often the case, it is assumed that the UK government can fully represent the English. Given the large population of England, it is difficult to see how the cabinet can effectively represent all parts of the country in a locally sensitive way. Local government, and certainly counties and city regions, have the best chance of getting a hearing within the Brexit process.

## What's the plan?

But where to begin? In theory, Dexeu is in charge. Its publicity suggests ministers have recently been on a charm offensive, particularly with smaller states. The Department for International Trade's website is filled with press notices about World Trade Organisation agreements and inward investment. And what about the Department for Business, Energy

& Industrial Strategy? Its web pages recently talked of “boosting the space industry” – a deal with Turkey about fighter planes and aerospace investment. Then there are the Foreign Office (tax deals) and the Department for International Development (red tape and trade). The media suggest that most Brexit-related research and position-taking is done by 10 Downing Street – specifically by the prime minister and her closest advisers. Inevitably, these departments will be competing with each other for political space and influence.

It is hard to see how even the Local Government Association could get regular meetings with any or all of these departments at the core of Whitehall. For individual authorities or even city regions, it seems likely that the departments themselves would feel overwhelmed if many groups of councils started to demand meetings. Moreover, it is impossible to know whether the government as a whole has a developed position.

Because the prime minister wishes to keep her negotiating position secret, no one outside No 10 can realistically know whether the government has a brilliant, fully developed plan or not. Books will be published in years to come about the way the government and civil servants managed the immediate fall-out from the 2016 referendum. We will discover how far discretion and silence meant “comprehensive plan” or “no plan”. Past studies of policy failure (and this is not to argue that Brexit will be such) show that governments always pretend everything is going perfectly until a change of personnel at the top allows the truth to emerge.

For example, as late as October 1990, six months after the poll tax riots had occurred and Conservative backbenchers were terrified about the impact of the charge on their electoral prospects, local government minister Michael Portillo boldly claimed: “The community charge is a courageous, fair and sensible solution. Far from being a vote loser ... it will be a vote winner.” Privately, we now know, ministers believed the poll tax would be a disaster. Margaret Thatcher’s ousting in November of that year allowed the government to admit to its catastrophic blunder. Intriguingly, Michael Heseltine, one of Brexit’s most powerful Conservative opponents, was the agent of Thatcher’s downfall and the minister who invented the council tax. But that’s another story.

So, we have no idea about how well the government is prepared for the process of leaving the EU. Indeed, no one can know because negotiating deals with so many blocs and countries will be an iterative process which, in all likelihood, will take years to complete. But this does not mean that there is no ferocious lobbying of ministers and officials. Business, in particular, has been making its case powerfully about freedom of movement and the need for customs-free trade.

### **Local goes global**

Local government has similar requirements, both as the most important economic planner for an area and as an employer. In many parts of the country, there are private companies that depend on EU and other migrant workers to fill jobs. In addition, as discussed earlier, any trade deal struck by the government may have direct effects on a particular area. A bad deal with the EU-27 member states or the US in relation to aerospace could, for example, be bad news for Wolverhampton and other parts of the West Midlands. The new combined authority and city regional mayor will doubtless wish to make this case directly to Whitehall, assuming they can find out who to lobby.

Councils, the NHS and other public sector employers, particularly in London and the South East, have themselves come to depend heavily on EU and other immigrant workers. It would not be exaggerating to argue that the government has, since 2010, mitigated the impacts of public sector austerity by the use of low-wage migrant labour. Care for the elderly in London and its region depends heavily on immigrants to deliver services. If most of these workers gradually cease to be available, there will need to be significant wage rises to attract UK-born staff, possibly from outside the South East. Recent British Medical Association research suggests many EU/EEA doctors might leave Britain following Brexit.

So local government will need to put the case for its own, its contractors’ and other public service employers’ needs. The alternative – and there is no magic money tree to pay for this – will be a radical increase in public expenditure to train and then employ UK-born people to do the jobs now filled by immigrants. Or services can be cut.

Rural councils face a particular challenge. Despite the dependence of much countryside employment on Common Agricultural Policy (CAP) subsidies and the big EU structural fund resources given to rural areas, these places voted strongly for Brexit. Over 2014-20, UK agriculture will receive over €25bn from the CAP. UK receipts from structural funds will be almost €7bn in the same period, with Wales being a major recipient. Neither funding stream is guaranteed beyond 2020. ▶

**‘Leaving the EU will test the British political and governmental system to the limits. Nothing similar has happened since 1945’**

Counties and districts representing agricultural areas, particularly in Wales, Scotland and Northern Ireland, will doubtless wish to work with the farming and countryside lobbies to secure a financially sound future. But this job will be difficult: the government's commitment to "global free trade" will inevitably encourage food imports from places such as New Zealand, the US, Africa and Latin America, which will often be cheaper than British products.

Several Northern Ireland councils, in addition, face the potential problem of the need to close the border with the Republic of Ireland, with potential consequences for trade, tourism and travel. The constitutional implications of the final Brexit deal for the Good Friday Agreement will also spill back into authorities on the border. In a similar vein, if negotiations go badly, councils such as Kent, Dover and Shepway could see a major part of the UK/French border moved across the Channel from Calais and Paris.

Sadiq Khan, the mayor of London, has taken a high profile in lobbying about the potential downsides of exiting the EU on behalf of the capital and its businesses. When other city regional mayors take office on 5 May, they will surely begin to make the case for Greater Manchester, Liverpool City Region, the West Midlands (Birmingham), Tees Valley, West of England (Bristol) and Cambridgeshire & Peterborough. Each of these city metro areas has different needs in relation to trade and migration deals, though they all share a common concern about being heard within Whitehall.

### **Take back control**

Local government professionals face uncertainty, too. The future of accounting standards and the regulation of a range of public provision will be affected by the UK's decision to leave the EU and its legislative framework. The environment, food standards and animal welfare are among spheres of local regulation that will inevitably change.

While the government's proposed Great Repeal Bill will in the short term adopt most existing EU laws and rules into UK legislation, there will be pressures for reform thereafter. Lobbies will immediately emerge for "less red tape" and "taking back control" of regulation.

Leaving the EU will test the British political and governmental system to the limits. Nothing similar has happened since 1945. Confected enthusiasm and optimism cannot disguise the long, hard slog that lies ahead for civil servants and ministers. Theresa May and her colleagues will spend thousands of hours in cramped rooms negotiating with blocs and countries about particular economic sectors. The longer the process takes to complete, the greater the risk of a corrosive effect on the economy and public services.

As this long drama unfolds, local authorities will need to keep tabs on the process and make the case for rational outcomes for their areas. The Department for Business, Energy & Industrial Strategy and its minister Greg Clark are probably the best targets for a sympathetic hearing. The Department for Communities & Local Government has not, thus far, appeared to take a particularly visible role in the Brexit process.

Leaving the EU could end up well or badly. It is hard to believe that anyone who voted to leave the EU seriously wanted further power-hoarding by Whitehall. Councils are electorally empowered to protect their communities and businesses as the Brexit process gets under way. The triggering of Article 50 should also be a trigger for UK local government to assert itself - and start the process of "taking back control" from the centre. ●

**'The longer the Brexit negotiation process takes to complete, the greater the risk of a corrosive effect on the economy and public services'**

# Follow the money



BY PAUL JOHNSON

Whatever the post-Brexit state of the economy and public finances, there are some fiscal fundamentals that need to be addressed

IT'S EASY TO LOSE sight of the big picture when it comes to the public finances. Borrowing this year is projected to be significantly lower than was expected back in November, and even a few billion lower than suggested in the March 2016 Budget.

That is good news, but it needs to be kept in perspective. After seven years of austerity, borrowing this year as a fraction of national income will still be higher than it was in the great majority of years since the Second World War. And we are still set for a £20bn deficit in 2020, not the £10bn surplus that George Osborne was planning less than a year ago. According to the Office for Budget Responsibility, Brexit is in large part to blame for that.

Even so, the deficit has fallen by two thirds relative to its 2010 maximum. While this is nowhere near what George Osborne intended when he set out his initial plan back in 2010, that is still some considerable achievement, not least given the feeble economic growth over this period.

Spending has been squeezed in a way unprecedented in modern times in the UK. Public service spending has fallen in real terms, as well as in relation to national income. Spending by the Department for Communities & Local Government, the Home Office, the Ministry of Justice and others has been cut by more than 20%. Spending on the health service has risen, but less quickly than at any time in more than 60 years.

And we have many more years of austerity to go. The new chancellor may have abandoned his predecessor's aim of achieving a budget surplus during this parliament, but he still wants to get there during the next period of government. More likely than not, that is going to require an extension of austerity well into the 2020s, with spending growing more slowly than national income, or tax rising more quickly.

## The long shadow

So spending has been squeezed; we all know that. But there are bigger stories here too – ones that deserve far more attention than they generally receive, particularly if we are to make sense of possible post-Brexit scenarios.

First is the precise role that the crisis and the subsequent poor economic performance have played in all this. There is one straightforward answer to the question of why we are still borrowing so much, and that is that the economy has done far less well than had been expected back in 2010. Productivity and earnings have performed less well than in any comparable period in many, many decades. The financial crisis and great recession may feel increasingly distant but they still cast a long shadow over the economy, our incomes and the public finances.

Second, it follows that the most important determinant of the path of the public finances in future will be the performance of the economy. Both the Bank of England and the OBR have downgraded their forecasts in light of the Brexit vote. They have not been dramatic downgrades, but they were downgrades from what were in any case pretty modest forecasts for growth. And both have stressed the unprecedented levels of uncertainty around the future path of the economy.

While these arise principally from the uncertain consequences of the Brexit vote,



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we should not forget the difficulty in predicting the path of an economy that has been behaving so atypically and has been subject to such an unusual policy response.

Not only have we had the worst period of earnings and productivity growth in perhaps more than a century, and the biggest deficit and deficit reduction programme since the war, but also the Bank of England base rate has stuck close to zero for the first time in its more than 300-year history. This is in addition to an experiment in hundreds of billions of pounds worth of quantitative easing. It is not just the effects of Brexit that should give us pause before making confident predictions over the path of the economy and the public finances.

Third, while spending has been squeezed, it remains the case that public spending is higher as a fraction of national income today than it was immediately before the crisis in 2007-08. Until now, at least any pain felt as a result of spending cuts is not because we have reduced the size of the state, but rather because of the much reduced size of the economy relative to expectations. Looking ahead, however, the Conservative government plans to get spending down at least a little relative to where it was before the crisis. In doing that, the pace of public service spending cuts is actually due to accelerate over the next couple of years.

Fourth, while most of the public finance story over the past seven years has been about spending cuts, taxes are ever so gradually rising as a fraction of national income. Despite headline-grabbing increases to the income tax personal allowance and cuts to the main rate of corporation tax, other taxes have been increased – the main rate of VAT, taxes on pension contributions, employer national insurance contributions and many others. The result is that, by the end of this parliament, the overall tax burden is set to be at its highest level since the mid 1980s.

Fifth, and perhaps most profoundly, the shape of the state is changing considerably over this period. While spending is set to be 1% of national income lower in 2020 than in 2007, spending on health and pensions will actually be higher as a fraction of national income in 2020 than in 2007. Spending on defence, schools and public order and safety will be considerably lower. Indeed, this is broadly consistent with a much longer-term change in the shape of the state. Health and pensions spending seems always to rise faster than other spending, and so takes up more and more of the available resources.

Which brings us to the last crucial point – the public finance challenges, whatever the outcome of negotiations with the EU, are not going to go away. The ageing population is real – it is ageing right now. There will be two million more people over the age of 65 in 2020 than there were in 2010. That's one reason why the planned increases in spending on the NHS won't even be enough to keep up with the growing and ageing population, let alone pressures from increased costs and other increased demands.

Looking further ahead, the ageing population will automatically result in some increase in spending on pensions, but even more dramatic will be the pressure on health spending. The OBR estimates that we will need to increase health spending by tens of billions of pounds over the coming decades to meet growing demand.

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**'The unprecedented levels of uncertainty around the future path of the economy arise principally from the uncertain consequences of the Brexit vote'**

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### Beyond Brexit

That poses fundamental questions. Whatever the many imponderables facing the post-Brexit economy, it is clear that we will have to do one of the following three things: cut spending further on areas other than health and pensions; substantially cut or reform our health and pension systems to reduce spending per person; or increase taxes to cover the increased demands for spending on health and pensions. There really is not a fourth alternative.

Some things could make this easier – higher rates of economic growth prime among them. Also very handy is a high level of immigration. Immigrants tend to be relatively young and hence pay a lot more in taxes than they take out in services and benefits. To the extent that we follow policies that limit growth and immigration, we will bring the difficult political and economic trade-offs more clearly to the fore.

Over the past 40 years, we have made space for more spending on health and pensions by cutting spending on defence, industrial support and housing very dramatically. We have effectively privatised a lot of spending on higher education. From our current vantage point, it is not clear what the equivalent changes could be over the next 40 years. In this uncertain economic climate, it is time we started looking beyond the current decade and a half of austerity and started planning for the next half century. ●

**'To the extent that we follow policies that limit growth and immigration, we will bring difficult political and economic trade-offs to the fore'**

# Fantasy island?



BY JONATHAN PORTES

The idea that a more restrictive migration system will help public services recruit and retain the workers they need is ill founded



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BREXIT IS ALREADY all consuming for senior civil servants in Whitehall, and not just in the most obvious departments. I was told recently that there are 740 separate Brexit-related workstreams in progress – a number that is undoubtedly out of date by now.

For those involved in delivering public services in local authorities or the NHS, Brexit will not have had much of a direct impact as yet. But that will change. Its effects and associated changes to immigration policy have already been anticipated, even ahead of Article 50 notification now beginning the official process of leaving the EU.

First, some basic statistics. The public sector is, on average, slightly less dependent on European Economic Area nationals than the private sector; for example, about 5% of NHS employees in England come from other EEA states, whereas EEA nationals make up about 6-7% of the overall UK workforce. The proportion in the education sector (both schools and higher education) appears to be similar; in public administration overall it is somewhat lower.

These relatively low overall employee figures do not show that some parts of the public sector have become increasingly dependent on EU workers for their flow of new recruits. For example, in social care, only about 5% of the current workforce is from the EEA but the figure for new recruits is much higher. So Brexit is likely to have a considerably greater impact on employers looking to recruit than the raw workforce numbers might suggest.

The Brexit vote – even before any actual policy changes – has made the UK less attractive to EU citizens as a place to work. That is not because their rights have changed – they haven't – but because moving here has become less appealing both economically and psychologically. The fall in sterling after the referendum has reduced the value of the pound relative to the euro (and other European currencies) by about 10%. More important are the non-economic impacts; these are not just the occasional outbreaks of xenophobia but also a more general sense that EU citizens are less welcome here.

This is not just about how people feel. Previously, EU citizens could come here knowing not only that they were entitled to work but also that they could live here indefinitely, use the NHS and education system, and bring their spouses and children. That sense of security about future prospects is no longer there. That matters more to skilled workers planning to move here for the long term, such as nurses, teachers or academics, than it does to people who are coming for only a short time or for seasonal work.

This is likely to lead to some reduction in the number of people coming to work here, even in the short term, as we are already seeing for nurses. For some public sector employers, therefore, the impact of Brexit is being felt now, as it becomes more difficult to recruit skilled workers, particularly in regions and sectors where we have become reliant on EEA migrants to fill gaps.

But what about EEA citizens already working here? For them, the prospect is one of a prolonged period of uncertainty. This is not particularly down to a lack of political will to find a solution enabling the vast majority of settled EEA citizens to remain here, should they wish. Politicians across the spectrum, both here and in other EU member states, have generally made their intentions on this clear. However, there are formidable

administrative challenges involved in identifying and processing people. The Home Office is already struggling to cope with the increased volume of applications for permanent residence, which require the completion of a lengthy form, the surrender of applicants' passports and so on. Meanwhile, in the absence of a firm policy, officials have made little progress so far on devising a new system with a much lighter touch.

The most likely outcome is that they will eventually introduce such a system – but this may take years not months and, in the meantime, EEA citizens will be uncertain as to their ultimate status. This is an area where public sector employers can take concrete action now to help their employees. For example, they could actively offer to compile detailed records showing exactly how long they have been working for them so that they can prove residence, or offer help and perhaps financial support to those applying for permanent residence.

### **The known unknowns**

Beyond these transitional issues, what do we know about the new migration system after Brexit? The government has rejected the idea of an Australian-style points system. It has also made clear that it wants immigration policy to be fully under the control of the UK government, which means that even a modified version of free movement is unlikely to be on offer. Instead, we seem to be heading for some sort of system based on permission to work – as for non-EU nationals now – where the government issues work permits to some foreign national workers. However, this still leaves a host of questions unanswered, in particular:

- Will the new system incorporate some form of “European preference”, under which EU citizens get preferential access to the UK labour market over non-EU nationals, or will the new system, as Vote Leave argued, be “non-discriminatory”?
- How restrictive or liberal will the new system be overall, regarding both EU and non-EU nationals? Will the government be designing it so as to meet its “tens of thousands” target – implying sharp cuts in immigration overall – or will it take the opportunity to move towards an approach that recognises the economic reality that the UK benefits significantly from being open to economic migration?
- Will any new system be based – as the current one for non-EU migrants largely is – on prioritising a relatively limited number of migrants who can meet a high threshold for skills, qualifications or earnings, or will it be based on sectors with shortages, to take account of the very high demands in areas such as health and social care?

We don't know the answers to any of these questions because the government doesn't know them either. Some will depend on the course of negotiations with the EU, others on the strength of business and sectoral lobbying. However, some points are worth highlighting now.

**'The view that we can devise an immigration system that allows in only "immigrants that have the skills we need" is fantasy'**

First, and very importantly for employers, immigration control (of EEA nationals) does not (mostly) mean border control; it does not seem likely that we would restrict EEA nationals' right to enter the UK without a visa (as, say, Australia does now). This means that control over how many and which EEA nationals are allowed to work in the UK will not, in practice, be applied at the border in the vast majority of cases. As with other non-visa nationals, like Americans or Australians, it will be applied in the workplace; employers will have to verify that EEA nationals are entitled to work in the UK, just as they currently do for non-EEA nationals.

So talking about "border controls" for EEA nationals or reintroducing "controls" over "who enters the country" misses the point almost entirely. "Taking back control" over immigration will in practice mean a significant increase in burdens on employers, who will be obliged to verify EU nationals' right to work here. Some will have this right and some will not, as they will fall into a confusing variety of categories, depending on when they arrived here and their current status.

Second, it is often claimed that ending free movement for EEA nationals will reduce migration for unskilled and/or low-paid work, while having no impact on skilled migration or even increasing this. This ignores the nature of both migration systems and outcomes. No system can select perfectly, or even close to it. The view that we can devise an immigration system that allows in only "immigrants that have the skills we need" is fantasy.

Moreover, it ignores the fact that migration is not just a matter of the UK choosing migrants; migrants have to choose us. Even if we wish to remain open to skilled migrants from elsewhere in the EU after Brexit, they may not choose to come or remain here.

So, while Brexit hasn't happened yet, its consequences for the public sector workforce are already beginning to manifest themselves. Public sector employers face a series of challenges, both in the short term – coping with recruitment issues and reassuring their existing EEA citizen employees – and, in the longer term, of adapting to a new system that will almost certainly be more restrictive, more bureaucratic and will make it harder and more expensive to find workers at all skill levels. ●

**"Taking back control" over immigration will in practice mean a significant increase in burdens on employers, who will be obliged to verify the right to work of EU nationals'**

# All to play for



BY WARWICK LIGHTFOOT

Brexit offers a chance to re-examine the UK's economic objectives and do things differently. There are many reasons to be cheerful



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WHEN BRITAIN ENTERED the European Economic Community in 1973, there was a tendency to see all of British life through a distorting "European" prism. Yet the major issues that shape English local government are its tax-raising powers and its funding, and these have always been decided at Westminster.

Given the extent to which councils are dependent on government grants – and increasingly on business rates – a major question that Brexit raises is its impact on economic activity and therefore on the tax base. In short, will GDP be lower and, consequently, can the level of public expenditure be sustainably financed in the long term? There are reasons to be optimistic.

## Open economies

The first reason relates to policy and decision-making, and to regulation. There is significant evidence that the economic success of a political community is determined not by its size or scale but by the quality of its decision-making and the effectiveness of its policies. The economies that prosper are those that are open, competitive and flexible, and function within a stable institutional framework of reliable property rights, enforced by the rule of law.

All advanced economies need complex regulation. However, much of it will be defective and will need to be adjusted swiftly to correct mistakes; a capacity to change is a hallmark of a successful economy. The EU finds it difficult to adapt and to correct policy mistakes. Its institutions and policies hinder that process, and reaching agreement among 28 countries is hard. Once a policy or regulation has been agreed, it is difficult to change.

Politically, the EU has exhibited a reflex impulse to regulate in a clumsy, expensive manner that rewards and entrenches the status quo. A good example is the EU directive on chemicals, which simultaneously increased the costs to firms while making it more expensive for competitors to enter their markets.

A second reason to be cheerful concerns prices and trade. From its inception, the European project has been associated with these issues. Many businesses and politicians naively perceived the Common Market and the single market as steps towards free trade.

In practice, however, EU trade policy is much less liberal than imagined, because agriculture and manufacturing are protected by a common external tariff that pushes up prices. Manufactured goods and food prices are higher than world prices as a result. The EU's insistence on protecting agriculture has impeded progress on liberalising international trade in multilateral forums for many years. This has been a major obstacle to the EU achieving trade agreements with countries such as the US, China, Japan and India.

International trade is not a mercantilist opportunity to sell things to foreigners. It offers the opportunity to open up a domestic economy to greater competition so consumers and firms enjoy more choice and benefit from access to the full international division of labour.

Leaving the EU gives the UK opportunities to reduce tariffs and other restraints on trade in manufacturing, agriculture and the food sectors, and to expose the economy to greater competition.

### Growth prospects

Third, there are the prospects for economic growth. The analysis of Brexit undertaken by the Treasury last year, in common with similar work by the International Monetary Fund, relied on the so-called “gravity” models of trade. This approach is analogous to Newtonian physics, where the attraction of planetary bodies is directly proportional to their masses and inversely proportional to the distance between them. Trade analysis tends to reflect this.

The Treasury looked at trade between 120 countries between 1948 and 2013. The impact of EU membership on trade is measured as the differences in actual trade between EU countries and what might have been expected due to gravity model factors.

However, there were issues with the data used. The estimates were based on trade with all countries, including emerging market and former Soviet bloc economies, many of which had defective or nonexistent data. Further estimates about foreign direct investment were based on financial rather than real investment flows and on tenuous correlations between trade and productivity.

A central proposition of the Treasury analysis was that, if the UK left the single market, it would face the full common external tariff, and apply it to trade with the EU and the rest of the world. That was a big assumption and it is inconsistent with the prime minister’s stated objective of placing the UK at the forefront of free trade and trade liberalisation. It is difficult to know how much difference Brexit will make to the performance of the UK economy, but gravity models offer only limited guidance. It is clear though that Brexit will offer opportunities to reduce the costs of regulation and make the economy more flexible.

Since the decision to leave the EU in June, the UK economy has performed not only better than the Bank of England and the Treasury had expected, but better than official forecasts made before the referendum. This outcome was called correctly by Economists for Free Trade. The significant fall in the exchange rate has provided the UK economy with a powerful monetary stimulus in a form that should contribute to correcting the country’s large balance of payments current account deficit.

### Back to basics

The political and economic significance of Brexit cannot be exaggerated, and that goes for local government too. The prospect of leaving the EU is provoking a “Mancur Olson moment” where all economic policy is being examined from first principles, as recommended by the late American economist. For the first time in over four decades, trade and farm policy is being closely scrutinised, not within the constraints of the Common Agricultural Policy or the common external tariff but on the basis of what the UK’s policy objectives should be.

This re-examination is not confined to policies where the UK government has been highly constrained before Brexit – for example, in agriculture and fishing – but also extends to areas such as vocational training and further education.

The scope to look at policy afresh will provide opportunities for local government. For example, the UK will be able to look again at the regulation that governs public sector procurement. The present EU directive imposes expensive, complex and burdensome obligations on local authorities transacting their business. Many of the environmental regulations that local authorities work with in areas such as refuse collection and waste management are EU regulated, including those covered by the EU’s circular economy package. This regulation is expensive and burdensome. After Brexit, it will be possible to see where rules can be modified to meet UK objectives more effectively.

Brexit also means the UK will be able to avoid the EU’s latest proposals on waste. These are poorly focused and serve neither the EU nor the UK well, not least because they will result in an additional £1bn bill for the UK. With Brexit, the UK will be able to closely examine these proposed rules and their costs, and decide whether they are appropriate to our circumstances. (Policy Exchange has published a full analysis of this issue on its website).

Part of the UK’s contribution to the EU budget is returned to spend as structural funds in the UK regions, for example in Cornwall. Even though the government has, rightly, guaranteed the continuation of such spending for the life of this parliament, the UK will be able to examine this expenditure to see whether it is achieving its objectives, and the extent to which it meets the criteria of efficiency, effectiveness and economy.

At the moment, much of this spending is subject to scrutiny that is too soft in focus and lacks rigour. Many regeneration proposals that could imaginatively make use of local public contracts are not feasible because of EU state aid rules. In this area – as in so many others – Brexit means the UK will be able to examine proposals on their merits, rather than merely apply an EU state aid test. ●

‘Since the referendum, the UK economy has performed better than the Bank of England or the Treasury expected’



IN THE  
EXIT LOUNGE

# Business as unusual



BY JOE OWEN

A successful Brexit depends upon ministers and civil servants working effectively together, and facing up to the extraordinary challenges ahead

ESSAY

THE CIVIL SERVICE faces two challenges from Brexit. One is simply to navigate and unravel the sheer complexity of a relationship built up over 45 years of EU membership and 30 years of harmonising the rules and regulations that govern the single market. This has to be done alongside going head to head with experienced trade negotiators all over the globe to deliver on the prime minister's promise of a global Britain.

The second is to confound the scepticism about whether the civil service itself lacks the mindset to deliver Brexit – whether it is too Europhile, too liberal metropolitan elite and too ready to turn its pre-referendum prophecies of doom into a giant post-Brexit “we told you so”.

That latter story dominated the early days of 2017. Only three days after Theresa May’s new year’s message, the resignation of the UK’s ambassador to the EU laid bare a growing faultline between some officials and political leaders. Sir Ivan Rogers, the UK’s top man in Brussels, left making a thinly veiled swipe at the government, accusing it of “muddled thinking”, not working out its objectives for Brexit and not putting processes in place to deliver them.

The manner of Rogers’ going, alongside rumours of clashes with the prime minister and her advisers, sparked accusations from both sides. Former Treasury permanent secretary Lord Macpherson took to Twitter to accuse ministers of “wilful destruction of expertise on Brexit”.

His views were echoed by other former senior civil servants and diplomats, who were concerned that Rogers had been hounded out of office for telling ministers uncomfortable truths. Meanwhile, Brexiteers portrayed him as a dyed-in-the-wool Europhile who was never going to deliver the deal the UK needed.

The truth is ministers need the advice of people steeped in the ways of the EU if they are to get the best exit deal for the UK. That means being prepared to listen. And, despite Rogers’ resignation, there is no evidence of civil service foot-dragging over Brexit. Indeed, many officials, according to cabinet secretary Jeremy Heywood, have “turned on a sixpence” to support the government’s top policy priority.

The new Department for Exiting the EU (Ddexeu) has attracted “the brightest and best” of the civil service, finding no shortage of applicants. It can also draw on the accumulated experience of the UK representation in Brussels – when Rogers stepped down, a Foreign Office mandarin was quick to leap into the breach. Many civil servants relish the intellectual challenge of Brexit.

The danger comes if ministers harbour suspicions that those who know about Europe cannot advise them impartially. Bernard Jenkin, a founder of Vote Leave and chair of the public administration and constitutional affairs committee, says there “can be no substitute for the trust between ministers and civil servants”. He is right. Ministers need to create an environment where civil servants feel able to give their best advice – and where ministers and officials can work together to deliver the best outcomes. That means being prepared to stand up for their officials when they come under unjustified attack from outside.



**Joe Owen** is a researcher at the Institute for Government

That applies to other institutions too: the Bank of England, the Office for Budget Responsibility and the judiciary have all come under attack since the Brexit vote. Ministers were slow to defend the latter after the original High Court decision on Article 50. Independent institutions and an impartial civil service must not become collateral damage in the continuing skirmishes between leave and remain.

### Making it work

The challenge of mobilising the resources, expertise and capacity to prepare, negotiate and deliver Brexit is daunting. Theresa May quickly recalibrated the civil service for the task of Brexit with two new departments, and teams within all departments to drive activity in their policy areas. Dexeu is coordinating efforts and preparing papers, providing ministers with the information to take positions and identify trade-offs.

Preparing for negotiations and understanding the impact of Brexit needs effort not just from Whitehall departments; critical input is also needed from Scotland, Northern Ireland and Wales, while arm's-length bodies are key to understanding the more nuanced implications of exit. With the triggering of Article 50, things will now get more fraught still.

The shape and size of the government will need to be adapted to life outside the EU; some key operations could change substantively and there is limited time in which to do this. We know a new immigration regime will be required to register and regularise the position of the three million EU citizens who have made the UK home, and to check the 35 million border crossings from EEA visitors each year (more than twice the number of non-EEA visitors). How this might work is not yet clear; the system needs time to be designed, developed and implemented.

The prime minister has also given notice that we will leave the customs union. That means change will be required in the management and enforcement of customs. The UK may be aiming for "frictionless" transactions at the border, but that does not mean getting there will be easy. The government's new IT system for customs, announced in 2014 and due to come online in 2019, is expected to need at least three times the capacity it has been designed for.

The UK will also need to replace the Common Agricultural Policy and the Common Fisheries Policy. Plus, there are numerous low-profile areas that depend on European bodies which will need to establish their own capacity, or negotiate continued access. This is a massive task for the civil service to deliver.

### Something must give

It is made no easier by the fact that the civil service is already 20% smaller than it was at the start of the coalition government in 2010, and many departments must deliver further savings over the current parliament. Something needs to give, particularly in departments where Brexit will have the biggest impact.

Take one of them – the Department for Environment, Food & Rural Affairs. It is affected by 1,200 EU laws; distributes over £3bn a year from EU funds; enforces EU environmental standards and regulations through its arm's-length bodies; approves veterinary medicines on behalf of the EU; and enforces fishing quotas under the Common Fisheries Policy. An added complexity is that these issues are all devolved.

Yet Defra is one of the departments most affected by cuts. New policies, legislation and systems will be the responsibility of a workforce that is 35% smaller than it was in 2011, with 34% less spending provision by 2020. This is all above and beyond delivering business as usual.

So ministers and civil servants need another honest conversation – about what is realistically doable within the heroic timetable to which the prime minister is committed. So far, these conversations appear to have ended with very few original priorities and policy pledges dropped. But, for departments like Defra, pretending that nothing can stop is not a sustainable approach to Brexit.

A failure to plan and resource properly is a recipe for bad decisions and poor implementation. The problems that Defra itself has faced in satisfactorily implementing the single farm payment scheme shows just how tricky these system changes can be.

Negotiating and implementing Brexit is ministers' and the civil service's toughest collective challenge since the Second World War. An essential prerequisite for the prime minister's "successful Brexit" is that they work together effectively, identifying and addressing the difficulties they face and being realistic about what can and cannot be delivered.

That cannot happen in an atmosphere of suspicion, suppression and recrimination. ●

**'There should be an honest conversation about what is and is not doable within the prime minister's heroic timetable'**

# A disunited kingdom

ESSAY



BY ALAN BIRMINGHAM

Negotiations with the EU must consider all three devolved nations' views. What is at stake is the union of the UK as we know it



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BEFORE THE EU referendum, many in the UK's devolved governments believed that the vote was advisory – a way to test the water before any legislation was considered. Since the 23 June vote to leave, however, prime minister Theresa May has confirmed that Brexit does indeed mean Brexit and that the vote will be honoured in full.

The referendum result is seen by many as a mandate to leave the EU. However, in the devolved administrations, a more federal view prevails, particularly in Scotland and Northern Ireland.

Wales voted by 52.5% in favour of leaving. But Scotland voted by 62% and Northern Ireland by 55.8% to remain. In effect, these two administrations see the vote to leave as dragging the people of Scotland and Northern Ireland out of the EU on the back of the vote by the people of England and Wales.

In any case, the result means devolved administrations have to consider their options and, with the triggering of Article 50, attempt to influence the UK government's negotiations.

Some issues are common to all the devolved administrations, but there are also specific concerns and requirements. Here, we attempt to identify and examine those that have a particular impact on the economy, public financial management and the devolved administrations' constitutional settlements.

## Rules of engagement

The recent Supreme Court ruling has clarified a number of issues around exiting the EU. These relate to not only its primary judgment on the need for parliamentary authority before Article 50 was triggered but also to the secondary cases brought by the devolved administrations.

Under each devolution settlement, the legislatures in Northern Ireland, Scotland and Wales have to comply with EU law. There is a convention (the Sewel Convention) that the UK parliament will not normally exercise its right to legislate on devolved matters without prior agreement by the relevant legislature.

The Supreme Court ruling has clarified that the UK government does not in principle need to consult devolved legislatures before giving notice. No legal obligation is being breached if the UK government does not take account of their views; parliamentary sovereignty applies.

While this is technically correct, dismissing such a significant convention would strain relations, and the UK government has confirmed it will engage with the devolved administrations over exiting the EU.

It seems that this process will take place through the joint ministerial committee, chaired by the prime minister, that brings together the devolved administrations' leaders. Through this route, they can be directly engaged in the process and in future negotiations with the EU.

They can also be involved through the parliamentary process in the House of Commons, although influence here is restricted by the government's majority, aided by Labour MPs' support for triggering Article 50.

Of more concern to the devolved administrations is the UK government's intention to leave both the single market and the customs union. It plans to pursue a new strategic partnership with the EU, including a comprehensive free trade agreement and a new customs agreement.

The stated aim is to secure the freest trade possible between the UK and the EU. However, all three devolved administrations are convinced of the need to maintain access to the single market and remain in the customs union. This gap in objectives will take some bridging given the limited engagement possible.

### **Common ground**

All three devolved administrations have a significant interest in the future of EU structural and investment funds, as well as funding for research. In 2016, the chancellor said that such funding would be underwritten for projects agreed before that year's Autumn Statement, and for certain other funds agreed while the UK was still in the EU.

This is good news, but it raises questions about what happens after Brexit. For Common Agricultural Policy payments, current funding levels are also guaranteed until 2020. The uncertainty beyond then is a major issue for devolved administrations, all of which have important food and farming sectors.

Then there is the issue of future funding. The current mechanism – the Barnett formula – is essentially a population-based measure that does not reflect the needs of each devolved government in relation to structural investment funding, research and agriculture. This needs to be reviewed, replaced or supplemented in some way.

Concerns over free movement of labour are also significant. All the devolved administrations have relatively large farming, food and drink sectors compared to England; health and social care also form important parts of their economies. Labour restrictions on both EU and non-EU nationals will have a long-term impact on these.

Foreign direct investment (FDI) has been a major contributor to jobs and economic growth in all three administrations. Evidence suggests that access to the European single market has been a major factor in foreign companies' location decisions.

Over the past three years, Wales attracted 277 FDI projects from 34 countries. In 2015, Scotland attracted a record 119 FDI projects. Research indicates that, since 2006, Scotland has created 40,000 jobs through FDI. Northern Ireland sees FDI as a major plank in its programme for government, aided by its ability to set corporation tax rates that encourage firms to locate there and compete with the Republic of Ireland, a eurozone member, for FDI projects.

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**'All three devolved administrations are convinced of the need to maintain access to the single market and remain in the customs union'**

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### **Scotland's single issue**

The biggest area where the Scottish government wants to influence Westminster is access to the single market. The EU is the main destination for Scotland's exports; in 2014, Scottish companies sold £11.6bn of goods and services to the EU. The Centre for Economics & Business Research estimates that Scotland's exports to the EU support over 300,000 jobs.

The Scottish Government is seeking a "differentiated approach" from the rest of the UK. It sees Norway, Iceland and Liechtenstein's position as one option. Through the European Economic Area agreement, these countries are members of the European Free Trade Association and have access to the single market, even though they are not EU members.

Scotland is also pushing for further devolution of powers from Westminster once Brexit has taken place, plus confirmation that it will keep its devolved powers. Its government has identified three areas where this is required.

First, there are the powers that are already devolved to Scotland and will be repatriated from the EU after Brexit. The government wants assurances that it will retain these responsibilities, for example in relation to fishing and farming.

Second, the Scottish Government is asking for powers over areas that enable it to protect key rights of its citizens. This would cover non-devolved areas that would fall back to the UK government from the EU after Brexit, such as employment law.

And third, it wants further devolved powers to support its differentiated approach from the rest of the UK. This would mean powers over immigration and other areas to support continued single market access.

The range of such powers would be extensive. A signal of the government's resolve was the Scottish parliament's vote on 7 February to reject triggering Article 50 – the only parliament/assembly to do this so far. The Scottish Government has seen little progress on attempts to make a deal on Scotland's position after Brexit with the UK government. As a result, first minister Nicola Sturgeon has announced her government's intention to proceed with a second referendum on independence for Scotland in late 2018 or early 2019. ►

### Northern Ireland – a hard border?

Aside from issues over trade, FDI and funding, Northern Ireland has concerns over its border with the Republic of Ireland. Northern Ireland and the Republic have close trading relations and share some public services that are more efficient when run on a cross-border basis.

Then there is the matter of what Brexit means for the Good Friday Agreement, cross-border bodies and the peace process. The Good Friday Agreement is an internationally recognised treaty and is EU compliant. This needs to be considered in the Great Repeal Bill.

The Good Friday Agreement also establishes the right of people in Northern Ireland to Irish citizenship. Many would argue that Brexit makes fundamental changes to Northern Ireland's place in Europe and its citizens' ability to claim British or Irish citizenship, but this has yet to be tested.

While the Northern Ireland Executive and the government of Ireland do not want to return to a hard border, evidence presented to the Northern Ireland Affairs Committee in Westminster suggests the border's status cannot easily be controlled by the UK or Irish government. Ireland will have to abide by decisions on border and customs controls made by the EU.

A second major issue is the Common Travel Area. This existed before the UK entered Europe and provides for passport-free travel and the status and rights of Irish citizens in the UK. Brexit secretary David Davis, on a recent visit to Ireland, reiterated the UK government's commitment to maintaining the Common Travel Area. However, many fear this will not be possible if there is a hard Brexit.

There is much debate within Northern Ireland and the Republic of Ireland about whether the former's future might best be served as part of the Republic. Should support for this be visible, the secretary of state for Northern Ireland has the power to call for a border poll under the terms of the Good Friday Agreement.

### The Welsh conundrum

Although the people of Wales voted to leave, the politicians of its main parties – Labour and Plaid Cymru – are in favour of remaining in the EU. Wales is a net beneficiary of EU membership and funding by an estimated £680m a year.

The Welsh economy is closely integrated with the single market; approximately two thirds of its exports go to EU countries. The Welsh Government views participation in the single market and the EU customs union as essential, but both have been ruled out in their current form by Theresa May.

The Welsh Government also wants the baseline of its Barnett formula funding to be readjusted to reflect the actual loss of funds when it leaves the EU.

A debate is simmering over Wales' constitutional set-up within the UK after Brexit, although sentiments are not as strongly felt as in Scotland or Northern Ireland. The debate is particularly active in Plaid Cymru circles. As the country's second-largest party, it intends to write a response to the Brexit white paper with the Welsh Government, to present to the joint ministerial committee on EU negotiations.

In conclusion, if politics is the art of the possible, then possible will mean huge compromises to keep the devolved nations on board. Negotiations over the UK's relationship with the EU must consider all three nations' views if they are to succeed.

Ignoring the Sewel Convention – and failing to fully consult or give enough weight to the devolved administrations' concerns – may lead to constitutional uncertainty. What is at stake is nothing less than the union of the UK as we know it today. ●

**'The Barnett formula does not reflect the needs of each devolved government in relation to structural investment, funding, research and agriculture'**

# Climates of change

ESSAY



BY MARY CREAGH

EU legislation has helped clean up the UK's act since the days when it was the 'dirty man' of Europe. So how will environmental issues be tackled after Brexit?



Mary Creagh MP is chair of parliament's environmental audit committee

WITH SO MUCH uncertainty about what Brexit means for the environment, parliament's environmental audit committee (EAC) has been busy exploring the main challenges and making recommendations to address them, while holding the government to account.

The main principles guiding EU action on the environment are set out in the 2007 Lisbon Treaty. They are: the precautionary principle; the principle of dealing with the damage at source; and the "polluter pays" principle. There is no equivalent statement of environmental principles in UK law.

Before the referendum, the EAC concluded that EU membership had helped the UK clean up its act since the 1970s, when we were dubbed the "dirty man" of Europe. Our recent report, *The Future of the Natural Environment after the EU Referendum*, raises concerns that 40 years of environmental progress could be put at risk when the UK leaves the EU.

EU membership has meant we swim alongside cleaner beaches, drive more fuel-efficient cars and can hold the government to account on air pollution. My office looks out over the Thames, which, before we joined the EU, had been declared "biologically dead". It is now home to a variety of fish and even the occasional seal or dolphin, although I have yet to spot one.

EU environmental law covers a broad range of issues. In 1996, the EU introduced its first air pollution legislation and limits for a range of air pollutants such as nitrogen dioxide. The EU has legislated to protect water quality in rivers, lakes, estuaries, coastal waters and groundwater, requiring member states to monitor the safety and cleanliness of beaches and inland sites, and to prevent discharges of untreated water.

It has also introduced directives to protect habitats, fauna, wild birds and the marine environment. EU directives on waste, landfill, packaging and certain waste streams established a hierarchy for how waste should be managed, introduced the polluter pays principle, extended producer responsibility and set recycling targets for 2020.

On the safe use of chemicals, the EU's key overarching regulatory framework, REACH (Registration, Evaluation, Authorisation and Restriction of Chemicals) was agreed with UK input in 2007. It requires that substances manufactured or imported into the EU are registered, tested and evaluated for safe use. Other regulations focus on pesticides and biocides.

On renewable energy and climate change, the EU has set ambitious targets to drive the deployment of wind farms, solar panels and cleaner cars.

## Making it happen

Enforcement is key to all this. Take air quality. The UK has been subject to European Court of Justice infringement proceedings because of the government's failure to meet the nitrogen dioxide limits in 16 of its 40 air quality zones. Leaving the EU means these enforcement mechanisms will no longer apply, and UK governments will not face censure or fines for not meeting air quality obligations.

The UK's failure to meet air pollution targets was recently emphasised by the UN's special rapporteur on hazardous substances and waste. He stated that EU withdrawal should not diminish the UK's resolve to address its air pollution problems, which are estimated to cause between 30,000 and 40,000 early deaths a year.

The EU provides grants to support the implementation of environmental policies and initiatives, and the government has guaranteed some of this funding to 2020. The Treasury has also said it will guarantee projects signed after the 2016 Autumn Statement if they are in line with “UK priorities”, but has not given any detail about what these priorities are.

The EAC found EU membership had been positive for the UK’s environment. Businesses and NGOs fear that EU withdrawal may remove regulatory certainty, while leaving the UK subject to EU rules over which it will no longer have significant influence. The UK will be a rule taker, not a rule maker.

Committee witnesses have also stressed the EU’s ability to solve environmental problems in a multilateral way; it is party to over 55 multilateral environmental treaties. EU membership has given the UK a platform to pursue its environmental objectives internationally. Witnesses argued the UK’s voice was louder at the Paris climate change conference because of it.

The committee concluded the UK’s membership had ensured that environmental action had been taken more quickly and thoroughly than would have otherwise been the case. A YouGov poll in August 2016 demonstrated public support for EU environmental policies, with only 4% of those surveyed favouring weaker regulations.

There has been some expectation that, if the UK remained in the single market, some areas of UK environmental law might remain subject to EU oversight, such as those governing water and air quality. However, in the Brexit white paper, the prime minister ruled out UK participation in the single market, piling uncertainty onto uncertainty.

Leaving the EU is the biggest administrative and constitutional task since the Second World War. Our report on the future of the natural environment expressed particular concern that Defra lacks the resources to step up and do the job of multiple EU agencies. Defra’s budget is being reduced by 15% between 2015-16 and 2019-20, and 900 posts were cut in 2014-15 alone.

### **Mind the gaps**

EU law is integrated with domestic law developed by both the UK and devolved governments, and a key issue to be addressed is how EU legislation will continue after Brexit. Some environmental legislation is self-contained UK legislation but much of it depends on EU laws, obligations and references. For instance, the Conservation of Habitats and Species Regulations 2010, which consolidates the Habitats Directive in UK law, contains more than a 100 references to EU laws.

The government initially said that the Great Repeal Bill – in reality the Great Incorporation Bill – would retain all existing environmental law. However, the secretary of state for environment, food and rural affairs, Andrea Leadsom, has said that one third of EU environmental legislation could not easily be cut and pasted into UK law. This problem must be addressed before the UK leaves the EU because it means EU legislation transposed into UK law may no longer be updated and enforced, and the law could be open to erosion by secondary legislation with minimal parliamentary scrutiny.

We recommend that the government introduces a new environmental protection act before the UK leaves the EU to address these legislative and regulatory gaps. We were particularly concerned to find that Defra had carried out little contingency planning, which makes swift action imperative. We are still awaiting the government’s formal response to our report, but Defra minister Therese Coffey told me the government saw “no need for future legislation”, which suggests ministers are unprepared to address the scale of the problem.

EU directives have provided a framework within which the UK’s devolved governments have been able to develop different approaches to achieve common environmental objectives. As we leave the EU, the government will have to think through how to coordinate environment issues between the countries of the UK. The Royal Society for the Protection of Birds told my committee that the Great Repeal Bill will need to amend the Scotland Act 1998. Lord Krebs, chair of the committee on climate change, has called upon the devolved administrations to also prepare for the environmental consequences of Brexit.

In addition, the overseas territories, which did not have a vote in the referendum and receive funding for biodiversity projects from the EU, will need that funding replaced by the UK government.

### **Triple jeopardy**

There are genuine concerns that, as EU oversight is removed, the UK could set less stringent environmental standards. There is the potential for the UK, as it seeks new trade deals, to compromise on food safety, animal welfare and environmental protection to open

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‘There is the potential for the UK to compromise on food safety, animal welfare and environmental protection in order to open up its markets’

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up its markets. One immediate concern is UK farmers, who face a triple jeopardy.

First, they face uncertainty over exports. For example, about 95% of lamb exports currently go to the EU. If the EU and UK impose mutual custom duties, UK lamb could be exposed to tariffs in excess of 40%, putting farmers out of business. Second, UK farmers receive £3.5bn a year from the Common Agricultural Policy. CAP provides 50-60% of the average farmer's income. While the government has pledged to maintain that spending to 2020, any reduction beyond that threatens the viability of farm businesses. Finally, UK farmers could be exposed to new trade deals with non-EU states, putting them at a competitive disadvantage if such countries have lower food, animal welfare and environmental protection standards. We have called on the government to ensure that any future subsidy system is based on the principle of public funding for public goods, such as restoring peat bogs and preventing flooding.

The UK will continue to be a signatory to a number of international environment agreements. It will be important to see how the UK is held accountable. For instance, the UK signed up to the Paris agreement as a nation state and as part of the EU bloc. However, the committee on climate change in October 2016 reported that the UK was on course to cut emissions by only half the amount required by 2030, prompting it to state that carbon emissions targets "must continue to be met after the UK has left the EU".

The government has not said whether the UK will continue to participate in Europe's flagship climate change policy, the Emissions Trading Scheme, which is the world's biggest cap-and-trade system to reduce greenhouse gas emissions.

In July 2016, the then secretary of state for energy and climate change, Amber Rudd, said the UK's commitment to "protect the environment, tackle climate change and provide homes and businesses across the country with secure and clean energy ... has not changed and will not change". Environment secretary Andrea Leadsom is preparing two 25-year plans, one for the natural environment and one for food, farming and fisheries. The government has committed itself to "leave the environment in a better state than it found it" for the first time since the industrial revolution.

To do this, the government must produce a fully coordinated strategy with the resources and governance structures to implement it. Our preferred option is a new environmental protection act, enacted before we leave the EU. (The amendments that I tabled to the Article 50 bill would have required the government to publish its assessment of the impact of leaving the EU on a range of environmental issues.)

In the meantime, the EAC will examine how leaving the EU will affect particular areas and sectors. We are looking at chemicals regulation and the chemicals industry, which is our second largest sector in terms of exports to the EU, worth almost £15bn a year. Yet, in a leaked document, the government has said this sector is a "medium priority" for the Brexit negotiations.

Without a transitional deal, there is a risk of a market freeze in the chemicals industry, while leaving REACH presents the threat of supply chain disruption for the automotive industry, defence and technology sectors, and loss of market share for UK businesses. As the committee carries out its scrutiny role, it will aim to educate the public and the government on how best to fill the inevitable policy and regulatory gaps. ●

**'Before we joined the EU, the Thames had been declared "biologically dead". It is now home to a variety of fish and even the occasional seal or dolphin'**

# 2020 vision for the regions



BY DAVID BELL

The ending of EU structural funding after 2020 is an opportunity for a rethink on UK regional aid. What might a post-Brexit policy look like?

ONCE BRITAIN HAS left the EU, it will no longer have access to European structural funds. The government will have to decide whether to continue with regional aid policies based on the EU model, withdraw from this type of area-based intervention or develop new policies to address regional disparities in other ways.

The structural fund budget for the UK in the 2014-20 round is €10.9bn. This amount is determined by the proportion of the UK population living in regions that are “less developed” (incomes below 75% of the EU average), in “transition” (incomes between 75% and 90% of the EU average) or “more developed” (incomes greater than 90% of the EU average).

It comprises mainly the European Regional Development Fund (ERDF) and the European Social Fund (ESF). ESF funding supports activities designed to integrate people who are excluded from the labour market and promote equal opportunities. The current ERDF round supports innovation and research, digital growth, small and medium-sized enterprises and the low carbon economy.

For the current budget round, only two areas qualify as less developed regions – West Wales and Cornwall. The EU has an emphasis on supporting the accession states in Eastern Europe, where incomes are low; plus, to some extent, the Mediterranean states, where economic performance continues to be weak.

While these funds are administered separately by the nations that comprise the UK, Westminster decides on the allocation to each nation, as well as the divisions between the Highlands & Islands and the rest of Scotland, and between west Wales and east Wales. Funding is not restricted to less developed and transition regions. In the current budget round, London receives €754.4m in funding for ERDF and ESF projects. These are administered by the London Enterprise Partnership.

The process for selecting areas for funding is transparent and objective. The UK has been a supporter of structural funds in the past, to some extent as a counterbalance to the EU budgets’ focus on agriculture. Structural funds have perhaps substituted for domestic spending on regional aid which, in comparison to the range and magnitude of regional interventions during the 1970s, has been weak under recent administrations.

Should the UK leave the EU before 2020, the government has agreed to meet ERDF and ESF commitments until the end of the 2014-20 budget round. No assurances have been given as to what might happen after that. Therefore, there will be a period during which the merits of existing schemes and alternative policy stances can be debated. After 2020, given that the UK will no longer be making contributions to the EU budget, there will be an opportunity to continue directing some government spending towards regional priorities.

## What kind of regional policy?

It only makes sense to design area-based policies if reducing existing regional disparities is in the national interest. This begs the question, though, as to what the forms and extent of regional disparities are within the UK – and what the potential alternatives to the European model for regional support might be.

During the 1970s, regional policy was a form of Keynesian intervention designed to reduce widespread regional disparities in inactivity and unemployment rates. Measures included subsidies to labour (the regional employment premium), capital grants and subsidies to firms (regional selective assistance) and controls over firms' location (industrial development certificates).

At present, differences in, for example, regional unemployment rates are much less pronounced than they were during the 1970s and 1980s. However, disparities in income, wealth and gross value added are more extreme.

It is not immediately obvious, though, that regional policies along the lines of those that support existing structural funds are necessarily the best instruments to deal with such disparities. Differences in income and, to a lesser extent, wealth are moderated by the effects of the tax and benefit system. Blanket support for incomes in specified areas inevitably results in some deadweight loss because, even in the poorest areas, there tend to be some high-income people.

Policies intended to reduce disparities in gross value added per person in particular areas implicitly focus on supply conditions. Thus, policies to increase investment in infrastructure, skills and industrial support are warranted within this framework. These arguments may provide the strongest case for a continuation of intervention along the lines of the EU funds system.

So what direction should UK regional economic policy take after 2020? This will not be easy to resolve given there are widely differing views on the effectiveness of existing mechanisms. Measures to decrease regional disparities may come at the expense of reducing national economic growth.

A body of literature described as "new economic geography" or "new urban economics" tends to emphasise the importance of "agglomeration" economies: that is, the notion that concentrating industry in urban agglomerations leads to faster productivity increases than policies that spread economic activity more widely.

These arguments have won some UK government support. In 2007, the Treasury argued that regional concentration of economic activity increases national growth: "As long as economies of scale, knowledge spillovers and a local pool of skilled labour result in productivity gains that outweigh congestion costs, the economy will benefit from agglomeration."

This line of reasoning can be used to justify interventions at "city" level, but provides little justification for supporting rural incomes and businesses, since these do not generate agglomeration economies. It follows that one option the UK government will need to consider after 2020 is the abandonment of area-based regional intervention along the lines of the EU model. With little evidence that this has significantly reduced regional disparities or contributed to national economic growth, its continuation must be under threat.

Cutting back on this funding would provide options in other areas of government spending.

An alternative model might be to redirect funding previously destined for the structural funds towards the myriad area-based policies that have been introduced since 2010. These include city deals, enterprise zones, devolution deals and the Growth Fund. A general difficulty with these is that their operation has been much less transparent than that of the structural funds, where eligibility is controlled by a strict, open process. As a result, their effectiveness is very difficult to evaluate. The communities and local government committee argued in 2016 that the government's approach lacked rigour, with no clear, measurable objectives, a rushed timetable, and a lack of openness and transparency.

Until there is greater rigour in the design and evaluation of these policies, the case for redirecting monies previously assigned to the structural funds is weak.

### The wider picture

There are also wider dimensions to consider. The structural funds are administered separately by the four nations that comprise the UK. Given the priority that the prime minister has placed on maintaining unity within the UK during the Brexit process, removing those monies previously assigned to Scotland, Wales and Northern Ireland would court political disaster.

Over the 2014-20 period, structural fund spending per head in Wales will be £800, well in excess of any other part of the UK. Removing it would allow the remain camp to argue that Brexit, which received strong backing in Wales, had ended up impoverishing the local population. Meanwhile, removing the relatively small amounts of structural funding from Scotland would be used as an argument to support the case for another independence referendum.

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**'The government has agreed to meet structural fund commitments until 2020. No assurances have been given after that.'**

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Then there is the impact that a long period of tight fiscal policy, combined with lax monetary policy, has had on regional disparities in wealth, arguably eroding further opportunities for growth. Quantitative easing has contributed to a substantial increase in asset prices, notably for housing, especially in the South East region of England. These vast differences in housing costs in turn reduce opportunities for efficiency-enhancing migration within the UK.

However, changes in the spatial distribution of wealth are of no particular interest to the Bank of England, which controls monetary policy, because its remit is to target the aggregate rate of price inflation. Responsibility for the more general consequences of monetary policy falls on central government. So one potentially efficient use of structural fund monies, at least in England, could be to use them to expand the supply of housing, particularly in areas influenced by the south east's residential market.

There will undoubtedly be strong support – particularly from those with a vested interest in continuing existing policies – for establishing UK-branded versions of the ESF and ERDF. In theory, these are affordable because UK contributions to the EU easily cover their costs.

However, given that fiscal policy is likely to continue to be tight, the effectiveness of such spending will come under close scrutiny. Some will argue that these area-based initiatives are an inefficient use of public funds because they do not take account of agglomeration economies. This will be countered by those who see structural funds as a mechanism for reducing regional disparities. Yet one of the clearest current forms of regional disparity is that caused by imbalances in the property market.

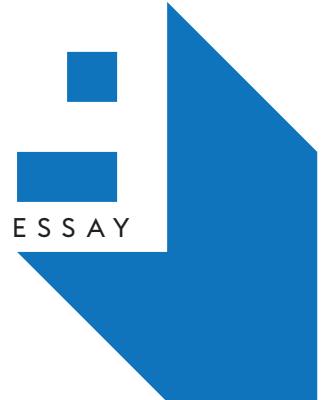
The difference between average incomes and average house prices in some areas is threatening the sustainability of local economies, Cornwall being a good example. Using the resources previously allocated to the structural funds to boost the supply side of the local housing market might be a more effective use of this funding. ●

**'There is little evidence that regional intervention using the EU model has reduced regional disparities'**



The background consists of a grid of small, dark blue 3D cubes arranged in a staggered pattern. A single, larger, solid blue cube stands prominently in the center-left, casting a soft shadow on the grid below it. The lighting creates a sense of depth and perspective through the shadows cast by the individual cubes.  
**THE NEW  
ORDER**

# Countdown for healthcare



BY SAFFRON CORDERY

The NHS needs to bang the drum for patient access, its workforce and clinical care in the EU negotiations



**Saffron Cordery** is  
director of policy  
and strategy at NHS  
Providers

The UK finds itself at the start of the negotiations to leave the EU, and potentially at the start of seismic changes in the union between England and Scotland too.

Writing that sentence would have seemed impossible a year ago. But that is the stark reality. Assuming that current plans for Brexit continue, in five years' time, we will be living in a different world. Whether you voted leave or remain, you may by now be bracing yourself for the substantial changes that will unfold.

For healthcare these changes are, indeed, substantial. Unlike environment, agriculture or transport, health itself is not a core EU competency. Brussels and Strasbourg do not have any direct legal jurisdiction over our health policy and how we deliver it. However, there are so many elements connected to European legislation and investment that affect health – employment law, research and development, competition – they render that fact irrelevant.

As with any long-term relationship, having been part of the “ever closer union” for over 40 years, we take a lot for granted. We are closely entwined with the other countries in the EU, and unpicking matters such as reciprocal benefits and treatment approval processes will be an important part of the negotiations.

There are five key issues that the healthcare sector needs to consider very carefully indeed: reciprocal healthcare; medicines regulation; competition and procurement law; the workforce; and funding.

## Rights of access

The ongoing right of UK nationals visiting other EU countries or resident in them to access healthcare benefits must be negotiated. The European Health Insurance Card (the EHIC scheme, or E111 in old language) has formed an important part of free movement for UK citizens: people can travel “worry free” in terms of healthcare. If the UK cannot negotiate future involvement in the EHIC scheme, we will need alternative arrangements.

These are likely, by definition, to be more complex than applying for a health insurance card that is valid for five years, and will involve the same level of insurance that you would consider when travelling beyond the EU. We could also hazard a guess that it will be more expensive.

More importantly for the healthcare sector is how we then manage access to health services by non-UK citizens currently covered by the reciprocal arrangements. Following the excellent BBC documentary, *Hospital*, media and political activity focused on how non-EU citizens pay for healthcare. It is clear that the process is bureaucratically burdensome and also somewhat at odds with the “care for all” ethos of those practising in the NHS. Although the NHS is now preparing for upfront charging for elective care, the resource implications of broadening this out to cover a larger population – either resident in or visiting the UK – could be considerable. We need to factor this very active monitoring into our thinking.

Meanwhile, media stories about timely access to life-saving medicines after Brexit have recently been ramping up. A red line for the government in any negotiations is that the

UK will no longer be under the jurisdiction of the European Court of Justice. If this red line holds, it prevents our ongoing membership of the European Medicines Agency.

Currently, as a member of this agency, the UK (as part of the EU) enjoys “tier 1” market status. This means that pharmaceutical and device companies launch their products here first, alongside other large markets such as the US and Japan. The intention is for our Medicines & Healthcare Products Regulatory Agency (MHRA) to achieve regulatory equivalence with the European Medicines Agency. But this is not guaranteed. The UK agency is a small player compared to the might of the EU. So outside the European Medicines Agency, our market reach will be small.

NHS patient access to new treatments could be delayed by a year or longer. This is bad for patients and it affects the NHS’s ability to provide cutting-edge treatments, which supports its world-leading healthcare system status.

Before the referendum last June, NHS Providers surveyed NHS trusts about their views on the consequences of leaving or remaining in a number of areas. Competition and procurement law stood alone as areas where trust leaders felt that leaving would be beneficial. It would support greater efficiency and cut through the mass of red tape with which the EU is so closely associated.

Outside the EU, the UK has an opportunity to review the application of competition law and, perhaps, better align this with the collaborative approach to health and care delivery to which the NHS has moved in recent years. Similarly, there would be the potential to review procurement law and tailor its application to the NHS. The legislative burden of these changes would not be small but it could well have positive outcomes.

### **People first**

Healthcare is a people business – first and foremost. The most immediate response to Brexit in the NHS was about how we support and protect our workforce, a substantial part of which is made up of EU nationals. Their status is now unclear and this is problematic. Not only is it deeply unsettling for those affected but it also creates uncertainty in terms of retention and recruitment. We rely on EU workers but we cannot repay that with guarantees; there is no clarity about status in the period between the “cut off date” for UK-resident EU nationals and the introduction of a new immigration system. This could be a deterrent.

Any new system must be flexible to ensure the health and social care system can recruit domestically, from our European neighbours and globally. The government’s aim is workforce self-sufficiency for the NHS. Achieving this in a reasonable timeframe needs a simple, unbureaucratic immigration system. There is a common feeling across the health sector that the EU workforce must be protected. NHS Providers is a leading member of the Cavendish Coalition, which is campaigning for permanent leave to remain for all EU nationals resident in the UK as well as a future immigration system fit for purpose for the needs of the health and care system

Finally, we get to the money. This is where one thing is clear: we really do not know what the impact of Brexit will be on our economy and by extension on the budget available to support the NHS. The £350m a week promised during the referendum campaign has disappeared into thin air, and our economic fortunes are likely to fluctuate during the two-year negotiation period. Depending on the deal agreed with the EU upon the UK’s withdrawal, these varying economic conditions could continue long beyond this. The prudence of the 2017 Budget demonstrates how much the chancellor needs to give himself room to smooth the economic bumps – austerity will rule until the mid 2020s.

NHS trusts are only just coping with rising demand now; the prospect of a sustained period of low investment will fundamentally challenge the viability of the NHS’s current model. Farmers who are direct recipients of Common Agricultural Policy funding and regions of the country that rely on infrastructure funding from the EU will be lobbying hard for replacement support. We in the NHS must make sure we beat the drum about the financial impact on healthcare of leaving the EU.

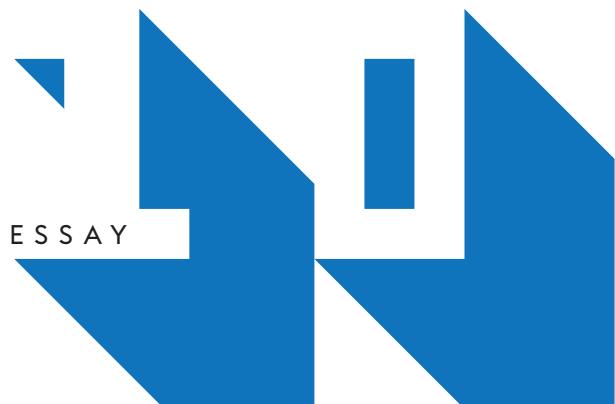
Prediction is a fool’s game, but it is time to start preparing for what we know, and don’t know, is just around the corner. ●

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**‘NHS access to new treatments could be delayed by a year or longer. This is bad for patients and damages the status of our healthcare system’**

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# The post-Brexit learning curve



BY PETER SCOTT

Leaving the EU has major consequences for higher education. The long-term challenges are the most serious

SOME OF THE IMPLICATIONS of Brexit for higher education can be quickly identified and, in most cases, quantified. Others are more difficult to pinpoint – and certainly more difficult to measure. But the latter are probably more important than the former.

This means that the long-term consequences for UK universities, colleges and research establishments of the decision to leave the EU will be a slow-burn affair. Of course, that is likely to be the case with Brexit as a whole.

The identifiable implications can be grouped under four headings: student exchanges, principally through the Erasmus programme; recruitment of students from other EU countries; employment of academic and research staff from the rest of the EU; and research grants and income – both directly, from EU-funded Framework and Horizon 2020 programmes, and from public bodies and private companies in other EU countries. Although separate, all four are linked.

In terms of student exchanges, the UK is a net importer. In other words, more students from other EU countries want to come to the UK than UK students want to study in other parts of the EU. However, because these programmes are funded by the EU, this imbalance has no negative financial consequences for the UK.

Several explanations have been offered for this disparity. One is that UK students are reluctant to learn and study in other languages, although in practice many courses in other European universities are now taught in English. The second is that there is a powerful reverse effect. Other European students are keen to learn and study in English, which many are already well equipped to do, and they are also attracted by the very high academic reputations of many UK universities. The third is that England, but not Scotland, has shorter three-year undergraduate degrees, which leave less time for exchanges.

Two additional points need to be emphasised. First, the imbalance is largely the result of the reluctance of UK students to take up the opportunities offered by Erasmus, although those that do have an overwhelmingly positive experience (and almost certainly a pay-off in terms of their attractiveness to future employers). This general linguistic and, especially, cultural timidity cannot be viewed in a positive light. Second, although these are short-term exchanges, they provide a significant gateway to UK higher education for other Europeans. There are many examples of highly regarded scholars and researchers in UK universities who are citizens of other EU states who had their first exposure to the UK through Erasmus exchanges.

## Demand deficits

The second identifiable area, the recruitment of other EU students by UK universities and colleges, has similar implications. The presence of other EU students has compensated for deficits in domestic demand, especially in some key science and technology subjects. Like the NHS's reliance on importing workers from other countries (a significant proportion of the NHS's more highly qualified workforce, especially in clinical fields, has come from elsewhere in the EU), so the recruitment of other EU students has enabled UK higher



**Peter Scott** is professor of higher education studies at the UCL Institute of Education

education to sustain its capacity in some key areas. In terms of the intellectual and scientific balance sheet, the UK has been a net beneficiary.

In financial terms, the picture is less clear cut. As long as the UK remains a member of the EU, it is obliged to treat other EU students in exactly the same way as UK students. So other EU students in England are charged the same £9,000 fee as English students, rather than the higher fee charged to international students. (In Scotland, higher education is free to other EU students as it is for Scottish students although, by a quirk, students from the rest of the UK have to pay fees.)

After Brexit, universities will be able to charge other EU students higher fees, although some may be reluctant to do so. Applications from other EU students have already begun to decline, so any financial benefit from the ability to charge non-EU students higher fees is likely to be limited. It is very unlikely to compensate for the significant academic loss that a reduced presence of other Europeans in UK universities would represent.

The third issue, the recruitment of academic staff from the rest of the EU, is closely linked to the second. A significant proportion of other EU staff first came to the UK as students, notably as research students before becoming early career researchers. Some, of course, were recruited later to fill senior academic positions.

Just over two thirds of academic staff in UK higher education are British. The next largest group – 17% – are from the rest of the EU, as opposed to 12% from the rest of the world. Almost a quarter of academic staff in humanities are from other EU countries; this is partly because languages are included in that category. However, almost as high a proportion of other EU staff can be found in biological, mathematical and physical sciences.

Brexit is likely to make the UK a less attractive destination in the future, partly because Europeans will no longer benefit from free movement. Even if the UK government introduces immigration controls that favour the highly skilled, they will face new legal obstacles. In addition, the UK will be perceived as a less welcoming host.

The fourth area, research funding and income, is one where the UK is almost certain to be a clear loser after Brexit. At present, UK universities gain a much greater share of cash from EU-funded research programmes than the UK government contributes to the cost of these programmes. Exact figures are difficult to calculate because much of the funding goes to consortia of universities from several European countries. Even so, the imbalance in favour of UK universities is substantial.

For example, the UK has the largest number of projects funded by the European Research Council – over 10% more than its nearest rival, Germany, and 40% more than France. Of course, the UK government could decide to continue to contribute to European research programmes, which would mean UK institutions would remain eligible to receive grants, as Switzerland does. But there is little evidence that this is the intention of the UK government or that other EU member states would agree to this in the fraught Brexit negotiations that lie ahead.

### **Getting the message**

However, these direct and largely quantifiable losses are likely to be outweighed by indirect losses that are more difficult to quantify and will extend over a longer time period. The dilemma can be simply stated: will the post-Brexit UK be regarded as “Global Britain”, as the government ostensibly supposes, or will it be seen as “Little England”?

It would be bold to predict that, after it leaves the EU, the UK will become a more rather than less desirable destination for international students, who will now include those from the EU. The government has already made it clear that curbing immigration is its top priority, and – however illogical this may seem – international students are included in the immigration total.

There are already signs they are getting the message, and applications have dipped. This is a serious matter because the financial sustainability of many UK universities depends on recruiting more, not fewer, international students.

But most serious of all is the potential impact on the creativity and productivity of UK science and scholarship. It is not just that the UK will be seen as a less attractive place for the best and the brightest from other countries to make their careers, to the disadvantage of the UK. It is also that the freer rein given to populism, nativism and even xenophobia will have a chilling effect on the quality of intellectual and scientific life in the UK.

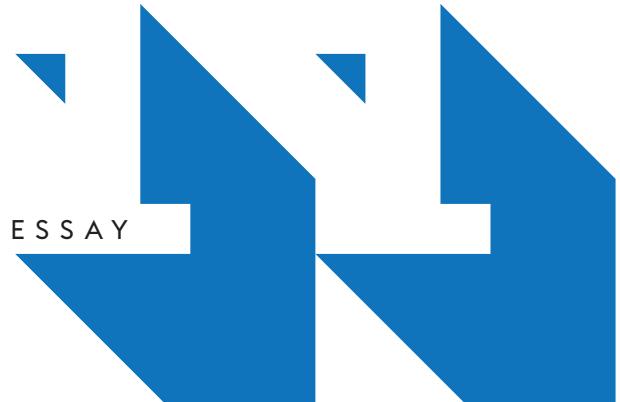
Universities could go on paying the price of the narrow 52:48 decision to leave the EU for many years to come, and the price is likely to increase not diminish as the decades go by. ●

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‘Will the post-Brexit UK be regarded as ‘Global Britain’, as the government supposes, or will it be seen as ‘Little England?’’

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# Buying into the future



BY COLIN CRAM

Brexit could mean radical changes to local government procurement. What are the potential opportunities and costs in this new world?



**Colin Cram** is former director of the North West Centre of Excellence

LOCAL GOVERNMENT IS beginning to pay a price for Brexit. The cost of some products has risen due to the 20% fall in value of the pound against the US dollar.

Further increases in the prices of products, services and building materials can be expected as the full impact of the pound's fall in value is felt. Construction costs will be particularly affected.

It will take time for UK prices to react fully to supply chain and import price increases. If the pound remains at its current low level, local government will really start to feel the pinch later in 2017. IT prices will rise as they contain many components as well as licences from overseas. Energy costs will rise as UK generation relies partly on imported fuel.

Outsourcing companies that have some operations overseas will either have to absorb higher costs or try to negotiate price increases from local government. In the event of a Brexit without EU agreement, the pound could be destabilised and fall further, increasing the pressure on prices. That would damage local government's finances even more and therefore its ability to provide satisfactory services.

For residential care, the biggest risk could be the loss of immigrant workers to fill jobs. This could mean higher costs, and hence higher prices plus less care home accommodation, leading to more delayed discharges from hospital. Local government will need to lobby hard to persuade the government to grant exemption to the social care sector from tighter migration controls.

## Mitigating factors

There are ways, however, in which local government can mitigate some of the potential costs of Brexit. The scale of its procurement spend means that the better it is managed overall, the more ably it can offset the pressures of the ongoing financial squeeze. The communities and local government committee, in its 2014 report on council procurement, has estimated that potential savings from a fully integrated approach to procurement (excluding social care) could be as high as £4.8bn annually.

Significant savings have since been achieved through greater collaboration and an increase in the expertise and quality of many procurement teams, although this improvement has been uneven.

For residential care accommodation, a high-quality comprehensive national procurement strategy could also mitigate matters. For example, a guarantee of 100% occupancy for some homes would enable them to plan cost savings and pass them on to local authorities. Local government could insist on higher standards in return.

The potential savings and opportunities may still be greater than the overall potential price increases caused by Brexit, but they will require some radical changes to local government procurement.

Housing associations too are increasingly collaborating on procurement; taking a more integrated approach could help mitigate their cost increases.

It may also be possible to direct more of this huge expenditure on procurement to support the development of local economies, for example, through encouraging the setting

up of new businesses and developing existing ones. With local authorities increasingly dependent on business rates to fund their activities, this would seem an obvious thing to attempt. It is possible to do this under or despite EU and UK procurement legislation, but a post-Brexit amendment to UK procurement legislation would make this easier.

However, despite some excellent initiatives in several urban areas, notably Manchester, the risk is that opportunities may be uneven and not as great as many believe. This could result in a dogfight between councils, with those that are most powerful and with the best infrastructure winning, as they will be more attractive to new businesses; the less powerful will lose out. And, although a bias towards using local businesses may help existing ones, a more active approach will be needed to expand their numbers.

### New directives

Taking a more commercial and collaborative approach to local government procurement to secure better value for money and support economic development became much easier with the 2014 EU Public Contracts Directive. Procedures have been simplified; tendering timescales can be just a few days and e-procurement is becoming mandatory. New procedures have been introduced for letting the most complex contracts, as well as advanced procurement techniques for doing so. The principle of total cost of ownership is strongly preferred to that of lowest price.

Collaboration between contracting authorities and the centralisation of procurement activity is also being encouraged, as is the use of small to medium-sized enterprises – even to the extent of breaking up procurement contracts into lots to achieve this. The UK government was instrumental in achieving this radical updating of the procurement directive and it was put into UK law in 2015. Lord Young's recommendations on how to make it easier for SMEs to gain public sector business were also incorporated.

A further addition to UK law was the 2013 Social Value Act, which requires public sector organisations, including local authorities, to think about how they secure wider social, economic and environmental benefits when letting service contracts. This could include, for example, supporting the creation of apprenticeships.

### Own worst enemies

However, few local authorities seem to be taking full advantage of the opportunities encouraged by the EU directive and the 2015 UK law. A recent survey indicated that 77% of council chief executives want a change in procurement law to give greater local flexibility, which suggests widespread misunderstanding about the opportunities that already exist.

The result is that local authorities can be their own worst enemies when it comes to taking a more commercial and entrepreneurial approach to procurement. Their standing orders can be far more restrictive than legally required. For example, they frequently insist on tendering for far smaller contracts than the EU directive requires, in some cases for contracts valued at only a few tens of thousand pounds. (EU and UK procurement legislation requires tendering only for contracts greater than £164,176 for goods and most services – excluding social care – and £4,104,394 for construction.)

For social care services, the full procedures required by the law apply only to contracts worth over £589,148 and these amount to little more than announcements that a contract is to be and has been let. Although the principles of fairness and transparency must apply and be capable of being demonstrated, it could not be simpler.

So, why do so many SMEs complain about the difficulty of bidding for local government business? The 2014 report into council procurement by the communities and local government committee identified the problem: the different rules, procedures and processes used by local authorities. SMEs rarely have the resources or time to understand them all, which means their chance of submitting compliant, good-quality tenders is small.

Winning business from local government often depends on how you tell it more than anything else. One mid-sized business I advised increased its win rate from one in 20 to one in four by establishing a full-time professional tendering team. However, smaller businesses cannot afford to do that, so can suffer inadvertent discrimination. Harmonising local authority standing orders and practices is long overdue.

The prime minister sees harnessing public procurement to support economic growth as an important part of the UK's industrial strategy. Theresa May recently called for the rollout of the “balanced scorecard” to ensure the impact of procurement on small businesses, UK supply chains, skills and apprenticeships is taken into account when considering the value for money offered by government contracts.

**‘In the rush towards Brexit, councils would be wise to continue specifying products that use EU standards to help local businesses maintain work in Europe.’**

However, there is insufficient analysis to understand the potential impact of this aspiration. Investment through procurement into “local” or UK businesses, whether directly or through main contractors, must be done intelligently. Many local or UK businesses are little more than shopfronts for importers or companies providing services from overseas, with little local or UK added value. Investment should be focused on businesses that add value to the local economy and are most likely to generate local employment.

### **Going local**

Will a policy of buying locally produce sufficient benefits to justify councils supporting local businesses over achieving a lower price? Some, such as Greater Manchester Combined Authority members, have an advantage because of their huge economic footprint, transport links and existing range of businesses. Many others, particularly district councils, might be better off focusing on lowest cost or price.

Local authorities need to recognise they could inadvertently put SMEs at a disadvantage by including requirements such as taking on apprenticeships, as implied in the Social Value Act. Many small, innovative businesses cannot afford to do this.

In the rush towards Brexit, councils would be wise to continue specifying products using EU standards to help local businesses find or maintain work in Europe. In addition, they should consider abiding by the rules of the EU digital single market. The European Commission envisages that the creation of this market will boost the EU economy by €415bn a year.

Regardless of whether this is the case, if the UK were to withdraw from it, many UK businesses could be at a disadvantage when they try to trade with the EU. Whatever happens over the final Brexit agreement, local government will need to operate as if it is part of the single digital market.

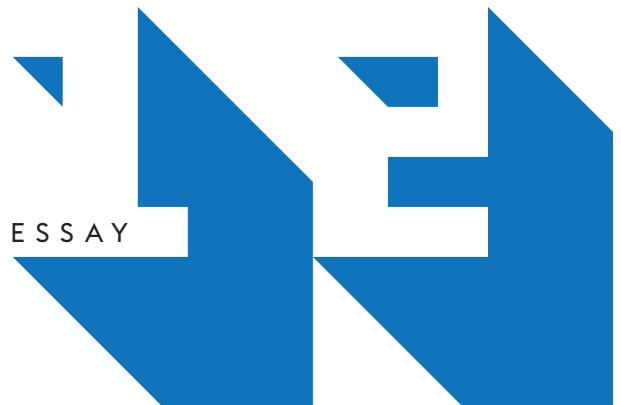
Local government also needs to have some serious discussions with central government about credit facilities and other measures to support new business development, particularly in view of the question marks over UK and EU-funded bodies that play this role.

In summary, the main impact of Brexit on local government procurement will be higher prices for construction, energy, certain IT products and services. A “cliff-edge” Brexit would be much more serious than a properly managed one.

However, through creating an integrated approach to the management of procurement, the price increases caused by the fall in the pound could be mitigated. And, by supporting local economic growth, taking full advantage of the existing legal framework for procurement – and seeking help from central government to support UK businesses – local authorities can create opportunities to generate additional income. ●

**‘Local authorities can be their own worst enemies when it comes to a more commercial and entrepreneurial approach to procurement’**

# A taxing question



BY JUDITH FREEDMAN

Rumours of the UK's post-Brexit tax haven status have been exaggerated. But politicians must resist public pressure to make short-termist tax changes on other fronts



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AS WE MOVE INEXORABLY towards Brexit, taxation may not seem to be the most pressing problem we face. Trade tariffs clearly are a central matter, but this is more of a trading and political question than purely a taxation one, even though customs duties and tariffs are administered by HMRC.

Nevertheless, there are concerns about the readiness of government to deal with the challenges thrown up by Brexit, and customs duties are a case in point. There has been little need to focus on trade tariffs in recent years. However, the removal of tariff-free trade within the EU, if that happens, will mean millions more customs declarations will require policing. Skills in this area will need to be built up and new IT equipment will have to be acquired – an expensive and time-consuming exercise. No doubt it can all be done, although maybe not within the unrealistic timescale demanded by the current political situation.

The EU external affairs committee of the House of Lords has noted that administering UK-EU tariffs and non-tariff barriers after Brexit would “significantly increase the work of HMRC, a task for which it is not currently resourced”. The department’s new customs computer system is meant to be ready by December 2018. But, as with most government IT projects, there are questions about whether that deadline will be met. Peers have called on the government to set out its plans for reviewing and if necessary making resources available to deal with this problem. However, until the nature of the agreements to be entered into with the EU and others are known, planning is difficult if not impossible.

## Tax haven or not?

Beyond the important administrative issue of customs duties, the overriding tax question to have caught the public’s attention is whether the UK will become a “tax haven” once it has left the EU. This notion has gained currency thanks to some pronouncements by the chancellor and the prime minister.

After Brexit, the UK will need to attract investment, and this does turn politicians’ minds to low tax rates and other tax incentives. However, the need to pay for Brexit – on top of all the other existing commitments and debts, global constraints on governments in the area of taxation, and the need to reach trade agreements with other jurisdictions – makes a wholesale move towards tax haven status both inadvisable and unlikely. If anything, the new circumstances will make reductions in corporation tax more difficult than if we had remained in the EU.

The issue is, in fact, something of a red herring, since the EU has no minimum corporation tax rate, as we can see from the Irish rate of 12.5%. Despite speculation that there might be a further cut, in his 2017 spring Budget, the chancellor kept to the pre-Brexit plan of reducing the corporation tax rate to 17% in 2020. Cutting this further is unlikely to be viable given the need for revenue and the structural problems of having a low corporation tax rate.

There is little evidence that the larger businesses the UK wants to attract are overly influenced by corporation tax rates in deciding where to locate. Of course they will

be concerned about tariffs, as the car industry has made clear, but stability, certainty and ease of administration may be more important than further tax cuts. Lurching towards unsustainable tax rates and tax giveaways would be less attractive and even counterproductive.

### **Profit shifting**

It should be noted that, despite talk of lowering corporation tax rates, the UK has been at the forefront of international efforts to limit corporate tax reduction through base erosion and profit shifting (BEPS). The OECD has led on this, with significant input from the UK. The OECD's agreed actions increase tax transparency and reduce opportunities to shift profits and minimise taxation. The chancellor has shown no sign of backing away from planned tax reforms in the UK to implement major aspects of the OECD action plan.

For example, he has ploughed ahead in the 2017 Finance Bill with limiting tax deductions for interest payments by corporations, despite a lot of pressure not to do so. Some measures to prevent tax avoidance may even be strengthened once the four EU freedoms no longer apply; the UK may choose to go further than previously permitted in some instances. Reports that the UK is moving towards tax haven status are exaggerated.

Despite not clamouring for lower corporation tax rates, companies are interested in tax incentives for research and development, investment in capital equipment and in new enterprise zones or other location incentives, such as business rate reliefs. There may be new opportunities to increase these reliefs once the UK is outside the constraints of EU tax law.

Although in theory EU member states have sovereignty over their direct taxation, in practice limitations are imposed by the Court of Justice and by EU state aid rules. This may change with Brexit, although this depends on the form any agreement reached with the EU takes. Other EU member states and MEPs have warned they will not be pressured, and there will be no deal on the table without agreement to retain many or all of these rules. It remains to be seen what kind of agreement can be reached in this regard.

Even if the arrangements ultimately reached with the EU do not involve restrictions of this kind, new tax reliefs might still have to meet World Trade Organization rules (although these are likely to be much less stringent than the EU rules and are less likely to be applied).

### **Under pressure**

Once the UK is outside the EU, there will also be opportunities to introduce new exemptions and differential rates for VAT. Given that VAT works best with few or no special rates and exemptions, this will be unfortunate, but it is hard to see politicians resisting the opportunity to play to the gallery when they are under such pressure from voters.

More generally, after Brexit, politicians may relish having more freedom to be creative with taxation than at the moment. However, they may come to regret it when the floodgates open to pressure from special interest groups, the media and the public. We are already in a situation where the media and pressure groups can cause a U-turn on tax policy. EU limitations provide some protection from this – protection that will be removed by Brexit. A situation in which it is hard to resist these pressures could result in an even more complex tax system and a less fair one.

Good tax policy design often requires fewer reliefs and exemptions, not more. A new freedom to make tax policy could quickly become a significant burden. In post-Brexit Britain, a steady and sustainable tax strategy will be important.

We can only hope that tax policymaking will improve sufficiently for this to be the case. For that to happen, there are going to have to be some important changes - including a strong and well-trained HMRC and Treasury. ●

**'There may be opportunities outside the constraints of EU tax law to increase business rate reliefs and other incentives'**

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### The Brexit balance sheet

This is the fifth in a series of *PF Perspectives*, produced by CIPFA and *Public Finance*. They are designed to stimulate discussion on key public finance and policy issues. These essays, by leading public sector practitioners and experts, examine the far-reaching implications of Brexit for central and local government and across the public sector

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