HOUSE OF COMMONS

Welsh Affairs Committee

Oral evidence: Shared Prosperity Fund, HC 639

Wednesday 7 September 2022

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Watch the meeting

Members present: Stephen Crabb (Chair); Virginia Crosbie; Wayne David; Geraint Davies; Ruth Jones; Ben Lake; Rob Roberts; Beth Winter.

Questions 23 - 31

Witnesses

II: David Phillips, Associate Director, Local and Devolved Finance, Institute for Fiscal Studies.

Written evidence from witnesses:

– Welsh Local Government Association (WLGA)

Examination of witness

Witness: David Phillips.

Q23 **Chair:** We will move across, seamlessly I hope, to our second panel. David Phillips, from the Institute for Fiscal Studies, is here in the room with us. To our guests who have joined us online, thank you very much. Mr Phillips is on the screen—I beg your pardon, I got that completely wrong. Mr Phillips, welcome.

David Phillips: Good morning. I am sorry I cannot be there in person. I had another meeting just before this.

Chair: Thank you for joining us. I do not know how much of that previous discussion you have heard.

David Phillips: I only caught the last moments as I did have another meeting, I am afraid.

Q24 **Chair:** Okay. We will go straight into it. I will start by asking a fairly broad-brush question. Do you have much confidence that the Shared Prosperity Fund will make a lasting difference to the Welsh economy and society?

David Phillips: I think that there are two parts to answer on that question. The first is to look at what evidence we have about previous schemes for regional development and, in particular, the EU funding that was provided under Objective 1 and following programmes. The evidence is that the funding provided did have an impact on the economic growth in areas that received substantial pots of funding. Estimates suggest that it may have boosted growth by up to 1% a year in areas that received the highest level of funding compared to those that did not.

There are two caveats to that. The first is that a lot of the evidence suggests that when funding was cut back that growth then was reduced. The impact on the economy was not a permanent increase in the size of the economy for areas that received funding. It was partly a temporary increase in the size of the economy, suggesting that aspects of the EU funding scheme did not really boost in the long term the supply side of the economy, the capacity of the economy through skills, infrastructure and so on. It was actually quite a demand effect. It boosted it while the funding was coming in. It pumped more money into the economy. It did not necessarily boost the long-term capacity of the economy.

The other thing is that the evidence suggests that two aspects of local areas affected how effective the funding was. One was the existing levels of skills in an area. There is evidence that the EU funding was more effective in areas that had relatively high skills to start with—it was an issue of underemployment, underutilisation of the skills that were already there—and also areas that had good governance and local discretion to decide the priorities not just of this funding but of other funding streams.

There is evidence from previous programmes that this could have an impact, but there is also evidence about what needs to be a priority for the programme. One is looking at the long-term drivers of economic performance, which suggests that a focus on skills could be very important, and because areas that have higher skills to start with did better, that is another reason to focus on skills. I also think that plenty of local autonomy to decide what is done with the funding is somewhat of a change to the EU schemes. We can come on to this if you want, but there is some additional flexibility in this compared to the EU schemes.

Chair: Mr Phillips, thank you very much. That is a helpful introduction and overview.

Q25 **Geraint Davies:** From the previous witnesses we heard that some local authorities, in particular Swansea, Cardiff and Rhondda Cynon Taff, would lose something like £29 million. Do you think that there is any justification at all for not giving the money where the people are with the deprivation as opposed to just this index of deprivation? Do you think that the Government should revisit that formula?

David Phillips: I think that you are referring to the figures that I produced in a short briefing note a couple of months ago, looking at the UK SPF allocations to Wales. You are right, the strange thing in the formula for Wales is that while its population is taken account of, there is an element based just on population, there is an element based on this wider basket of needs, which also accounts for not just the level of need but the level of need per person. Then there is deprivation, which is only effectively the rank in the deprivation measure, not weighted by population. The UK Government have said that the justification for this is that population varies less in Wales than across local authorities in England. That is true but it still varies a lot. Cardiff I think is about six times as big as Merthyr Tydfil; RCT is about four or four and a half times as big as Merthyr Tydfil.

They also said that it was through consultation with local stakeholders. My understanding at least is that it was not what the Welsh Government were expecting the formula to look like. I am not sure if it was through consultation with other local stakeholders. My own view is that it does not make sense to allocate a portion of funding based just on deprivation. Let’s imagine that there were two areas of Wales that had the same measure of wider needs, they had the same deprivation but their populations were different. This way of allocating it would mean that even though they look identical apart from population, the area with the smaller population would get more money per person. I don’t think that you can justify that approach.

It is very difficult to justify the approach that the UK Government have gone down. I cannot see a clear rationale for that. If you think that deprivation, wider needs and population matter, you should take account of population in all that.

What should they do now? I think that there is an open question. First, they can say, "We have made these allocations. These are the allocations". It would be quite difficult to take funding off areas, given that they have now been making their plans based on the allocations that have already been set out to them. I suppose that the UK Government could top up the allocations just for those areas that have lost out by not accounting for population. That is a political decision for the UK Government to make in the context of their wider budget and in the context of whether there are concerns that that would open up a can of worms with other areas arguing that they require more and so on.

Q26 **Geraint Davies:** Do you accept that overall Wales will get less money than we would have had if we had stayed in the EU and that legacy money is carried over and, combined with that, given that it is not applied to what we are saying now about where the populations are, that it will hit the poorest hardest?

David Phillips: On the population issue, that is a within Wales issue. While some areas lose out from not taking account of population on the deprivation element, other areas have gained. On that issue, areas that are relatively deprived but have big populations have lost out; areas that have high deprivation and small populations have gained from that issue.

On your first question, this comes to the argument between the Welsh Government and the UK Government about whether there is a funding gap because of the way that the UK SPF funding is being ramped up over time. I gave evidence on this to the Senedd a few months ago. It depends on how you think about these allocations. The Welsh Government are correct that the amount of funding that is available for them to allocate to projects will be lower over the next couple of years because the EU funding has effectively stopped. There is no more to allocate to new projects, while the UK SPF funding is only ramping up slowly.

On the other hand, though, if you look at how much can be spent on these projects, the EU funding is continuing to be spent and that is slowly ramping down. If we had stayed in the EU, the amount of funding from the new programme that would have started, while it could have been allocated and decisions made earlier, the actual spending would have slowly ramped up. When you look at spending, I am not sure you are seeing a gap between the EU funding and the UK SPF funding as that ramps up. I think this means that both sides—

Chair: Sorry, Mr Phillips, we will have to move on in the interests of time, if that is okay. I beg your pardon. Thank you for that supplementary, Geraint.

Q27 **Rob Roberts:** Good morning, Mr Phillips. I am interested to know how you feel the Shared Prosperity Fund complements other UK funding streams like the Levelling Up Fund and to what extent programmes are at risk from a lack of evidence and understanding of how funding streams are supposed to be used.

David Phillips: I must say it is an interesting question. If you look at the aims and objectives of the UK SPF, there is a lot of overlap with the aims and objectives of some other funding streams; for example, issues around pride of place and around improvements to local facilities, high streets, infrastructure and so on. Those are fairly similar to the Levelling Up Fund or within England, for example, the high streets fund. I am not necessarily sure that it is a problem that there is an overlap in the aims and objectives. In fact, you could see these funding streams as complementary. The way I see the distinction between the two types of funding is that the objective of the UK SPF is to ensure that all areas have a certain amount of funding, that funding is targeted at areas with higher needs, and that there is funding not just for the place-making initiatives but also skills-based initiatives.

The other UK-wide pots, like the Levelling Up Fund and so on, by using a bid-based process I think the aim there is to fund a smaller number of slightly bigger projects that can demonstrate a particular impact in areas that are assessed to have needs. I think that you can make quite a strong case to have some funding allocated based on a formula—everybody gets at least some and some areas that are needier get more—and then having a competitive element to funding as well. You are trying to maximise two sets of objectives: first, redistribution and, secondly, providing funding to the schemes that propose the biggest bang for the buck.

Q28 **Rob Roberts:** Just on that point, sorry to cut across, is it optimal to have the ways of doing it separately? You have one, the Levelling Up Fund, which is a bidding process, and the SPF, which is a "you have the money, you just need to tell us what you are going to spend it on" process. Is it better to have both of those working together or would it be a more optimal solution to have it all a bidding process or all an allocated process?

David Phillips: I think that the two different processes have different pros and cons. If you were to allocate it just on a bidding process, there is a possibility that some of the most deprived areas may completely lose out on funding because they are unable to craft a bid that successfully satisfies the criteria. There is evidence that it is not just the actual outcomes and the quality of the bid in what is proposed but how the bid is presented to some extent. There is some evidence that that can affect how successful they are. There is a piece of research that showed that the use of colour-coded maps, for example, all else equal, led to a greater chance of getting funding.

On the other hand, if you do it all based on needs assessments and formula based, there could be some concern that areas may not have the strongest incentives to improve their outcomes if that means losing funding down the line. I think that the different objectives need two different approaches. The issue is that by having two different approaches, does the bureaucracy of applying for two different schemes with different objectives and trying to satisfy the documentation and the requirements of both outweigh the benefits potentially of having two schemes that try to target different types of benefits, the incentives and the outcomes versus the redistribution? That is a question I am not sure of, but I can see in principle why there are benefits of having some that is based on needs and some that is based on the quality of bids.

Rob Roberts: Understood. Thank you very much.

Q29 **Wayne David:** Following on from that, one of the things that was said about the EU structural funds, Objective 1, coherence funding and so on was that there was too much emphasis on individual projects and not enough emphasis on strategy. In some ways, the criticism could be levelled at what we have before us with the Shared Prosperity Fund, too, because although the Government have put to one side competition and the initial ideas they had about allocation, nevertheless, although they talk about need, they have not taken into account population size. The danger could be that you would have large sums of money allocated to very poor areas like Merthyr Tydfil and Blaenau Gwent that would have difficulty spending the money in a short timescale. It could also be argued that spending money in a relatively small area like those areas is not the best way to have a regional approach. What do you say about that?

David Phillips: I think that you are right that there is an issue about geographical scale. The way I tend to think about this is that the different types of issues you are targeting tend to be better addressed at different scales of geography. If you are thinking about real pride of place and community facilities or you are thinking about, for example, pockets of real deprivation, usually allocating funding to local areas, small areas, is the best approach to tackle those. The interventions often need to be at a community level. The local communities have the best knowledge about what is needed in their area. For other things, potentially higher-level skills or infrastructure and so on, you might want to allocate to a higher level where you need to think about what the labour market for this area is. Clearly, you want to have good jobs in as many communities as possible, but how do you help people to access those jobs in neighbouring communities?

I hope you would see that the groups of local authorities that are working together to produce plans are thinking about how funding can be channelled to different levels within their area, some potentially being used at the regional level, for example the Cardiff capital region, the Swansea region, mid Wales and north Wales, and so on, some interventions operating across those regions and potentially pooling some funding across regions. That might mean, for example, Merthyr Tydfil saying, "To help our citizens in Merthyr Tydfil part of it is about making it easier to access jobs on the M4 corridor and in the south of the region", but then also saying, "We do have real issues with the lack of facilities in some of our deprived communities and that funding stays in the local area".

I hope that there is flexibility within the scheme to allow that way of working, but I completely agree with you that there is a risk. If each area gets its own pot of money, why would it want to collaborate with other areas if that means losing some money to another area? Part of me wonders if there should have been a two-tier allocation, where there is some allocation to local areas for these place-based interventions, and then an allocation for the broader issues to the more regional areas. The last point I will say on that is—

Wayne David: If I could come in on that point, as I understand it if a local authority does not use its allocation there is no facility for it to be transferred elsewhere. It will simply go back to central government.

David Phillips: Okay. Is that true even if there is a formal collaboration agreement for cross-authority projects? If that is the case it would be problematic. If there is no possibility of Merthyr Tydfil saying, "We think this scheme benefits the residents of Merthyr even though its physical location is in Rhondda Cynon Taff", for example, I think that would be a problem with the design of the scheme.

Wayne David: That is something for the Committee to look into.

David Phillips: Yes.

Wayne David: My understanding is that there is not, but there might be.

David Phillips: The last point I was going to make was that for some of these community facility type interventions, which were coming up at the end of the last evidence session, to me it seems that that is better suited to general local government funding as opposed to a specific scheme that has all these conditions attached to it. Again, what is needed for sports facilities or health facilities and so on is better determined by councils through the democratic process of the local area rather than through deals with central government.

Q30 **Ruth Jones:** Thank you, Mr Phillips, for your time this morning. You have mentioned already the funding allocation of the Shared Prosperity Fund. It is fair to say that there is a tension between the UK Government and the Welsh Government on the figures and the argument as to whether there are losses or not, as the case may be. Why do you think these differences have arisen? Could it be due to the EU funding, as you have mentioned, tapering off and insufficient knowledge of the data or lack of transparency? What do you think is the cause of this difference?

David Phillips: I think that there are probably two causes for the difference. The first one is that even if spending is not going to taper off because as the EU spending tapers off the UK SPF funding tapers in, the fact that the amount that can be allocated each year is lower now. The fact that it is a three-year duration as opposed to a seven-year duration means that it is harder for the Welsh Government and potentially the delivery partners in Wales, the local authorities and so on, to plan and potentially to ramp up funding because they have had uncertainty until very recently about how much funding they will have to spend this year and next.

Part of it is that it is not just spending amounts that matter. There is also the amount you can allocate and hence plan on, which will affect the success of delivery and the ability potentially to spend money. I know, for instance, that there has been a debate about the extent to which if funding cannot all be spent within the years it is allocated that it could be rolled over into subsequent years. On the one hand, rolling it over to subsequent years would make sense because you do not want to waste money or you do not want to spend it on things that are less high priority just because you can get it out the door quicker. On the other hand, when you push that money forward into future years, spending will taper off. There is a bit of a tension there.

Being very frank as well, another reason for this disagreement has been political: on the one hand, a lack of communication about this from the UK Government; on the other hand, a clear political incentive for the Welsh Government to make use of this situation and the lack of information to score potential political points out of this. Having said that, I think that there is a genuine issue about the lack of certainty and the ability to plan. It is on the actual amounts being spent where I think that the truth is probably a little bit closer to the UK Government's position on this than the Welsh Government's position on this.

Ruth Jones: Okay, thank you for your time.

Chair: Rob Roberts has a final question. We are running out of time for our allocated session, so you need to be very brief, Rob, please.

Q31 **Rob Roberts:** I shall be very quick. In the previous session, I challenged the leader of Rhondda Council because they are always in the top two or three of per capita funding in Wales each year. Currently, my council of Flintshire is always in the bottom three. Surely, if that is done based on measure of deprivation, you would expect that to equalise over time and you would not have the same top three every single year getting the lion's share of the funding. Based on how the SPF has been allocated—which is very similar, looking at the numbers per head—would you expect those numbers to equalise over time rather than having one local authority area or two or three always getting the lion's share of the funding?

David Phillips: I think that may be a question about the extent to which you would expect the higher levels of funding for more deprived areas to end up reducing deprivation and, therefore, they do not need so much funding in future. Is that the question you are asking?

Rob Roberts: The question I am asking is: they always get more funding per head but they are always the number one most deprived area. Is it inadequate use of the funding? Is funding not enough? Is more money not the answer? What is the problem in why they are always number one?

David Phillips: Yes, that is an important question. The deprivation of certain areas like, say, the south Wales valleys or similar areas in England and Scotland is through a combination of factors. It will be the skills mix of the people, the mix of the infrastructure and then the interactions of that in how that affects the businesses in the area and so on.

The hope is that providing additional funding would do two things. One is that it would offset the fact that areas of high deprivation tend to have higher needs. Even if you are not thinking about reducing and closing the gaps between areas, if you are more deprived more people will require social services care. More people will require support with council tax payments, more intense educational support and so on. There is more demand and it is costly to deliver the services in areas where there are high levels of deprivation.

However, you would also hope that that support would over time improve the quality of outcomes in those areas to reduce gaps between those areas and more affluent or maybe less deprived parts of the country. On local government, it is only the first element that is taken into account. Local government funding in Wales, when they allocate funding, tries to adjust for differences in how much is needed, given differences in deprivation and other factors, but there is no explicit element that is designed to say, "Let's give a bit more on top of that to the deprived areas so they can close the gap". That differs, for example, from the approach taken in the NHS in England where not only do they adjust for needs, they also give a bit more on top again for the most deprived areas to try to close those gaps. Local government funding in England certainly does not do that. In Wales it doesn't do it either, as far as I am aware.

The UK SPF is designed to do that because it is skewing the funding to the areas with the most deprivation in the explicit aim of trying to tackle those inequalities. I think you are right that in future, with the investment in UK SPF, if there is further investment in levelling up and so on, if you are not seeing those improvements then, there will be an issue. You are also correct that it is not just local government funding, it is not just in the future with UK SPF. Under EU funding the south Wales valleys got a lot more than, for example, north-east Wales. You did see a bit of a relative improvement in the productivity of the south Wales valleys compared to other parts of Wales over the last 20 years or so, but you have not seen the commensurate significant decline in levels of deprivation in the south Wales valleys. Is there a disconnect between what is happening with productivity and what is happening with local incomes? I don't know.

Chair: Thank you very much. Mr Phillips, forgive me, we slightly ran over our schedule so we have to vacate the room and, in any case, business in the main Chamber is just starting and I know that colleagues want to get in there, particularly ahead of Prime Minister's Question Time. Can I say a huge thank you to you for giving us your time and your expertise this morning? We do appreciate that. Thank you to my colleagues and welcome back to the new term.