



Llywodraeth Cymru
Welsh Government

POLICY AND STRATEGY

The future UK/EU relationship: negotiating priorities for Wales

Welsh Government analysis of the UK government Political Declaration.

First published: 23 January 2020

Last updated: 23 January 2020

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1. First Minister's foreword

Since the EU referendum of 2016 the Welsh Government has been guided by the clear intention of protecting Wales' future in whatever circumstances Brexit creates. It is now clear that as the UK is leaving the European Union, although it is not on the terms we would wish, our focus must look to the future.

The UK government will soon begin negotiations with the EU on a permanent long-term agreement. This agreement is of vital importance to Wales. It will

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determine the basis of our future trade, and our broader relationship with the EU, for decades to come. The UK government will base its negotiation strategy on the platform set out in the Political Declaration, yet the evidence is clear that the further the UK moves away from the economic integration provided by the EU Single Market and Customs Union the greater will be the economic damage. The EU has been and will continue to be our most important trading partner. The stakes could not be higher.

Given this, we will continue to challenge any approach to the negotiations which prioritises the ability of the UK to diverge from EU regulatory standards. Such an approach would be deeply flawed and would seriously damage Wales. Rather, we need to preserve the best of what Europe has achieved. This includes alignment with the highest standards of environmental protection which have delivered cleaner air, beaches and water and maintaining or improving levels of protection for workers.

The UK government claims it wants to maintain high standards and we will hold them to their word. We will therefore oppose any agenda of deregulation, which will damage consumers' interests. We reject a version of Brexit based on a low-wage, low job security, low regulation Britain, chained to an economic model of growing inequality.

We want a post-Brexit future for Wales of respect for all our citizens and communities. Wales embraces Europe, its citizens and the wider world. We recognise the valuable contribution that EU citizens have made and will continue to make to our economy, to the delivery of public services and to our communities.

We want an economic relationship based on partnership with our European neighbours and competition based on a level playing field. We encourage our businesses to trade globally and benefit from our rapid growth, and we continue to welcome, value and support investors from around the world.

To make all this happen, it is essential that the Welsh Government is involved in the negotiations to protect the interests of Wales, including the manufacturing sector, agri-food and traded services. We need an agreement which reflects the interests of Wales and the United Kingdom. And the UK needs to continue as an

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economic union underpinned by mutual respect for the responsibilities of all governments of the Union.

We do not believe it is possible to achieve the right agreement in only a few months of negotiations. The insistence that the UK government will not seek an extension to the transition period if it is needed is reckless and underplays the challenges that lie ahead. We will continue to argue that the government should leave open the possibility for an extension beyond the arbitrary deadline of December 2020 as provided for by the Withdrawal Agreement so that the priority is the best negotiated deal, not adhering to a random deadline.

In this paper, we explain how all this can be best taken forward in a way which protects vital Welsh interest. We make it clear that changes are needed to protect the economic, social and environmental interests of Wales and the whole UK. We will continue to seek to influence the UK position and continue to call for a formal end-to-end role in the negotiations, starting from agreeing the negotiation mandates through to final agreement. The UK government alone cannot speak on behalf of the whole UK: the voice of the devolved governments must be heard.

2. Summary

With the UK set to leave the EU on 31 January, the negotiations on the UK's future relationship with the EU will begin.

We strongly believe the timetable for those negotiations should be flexible enough to support both parties reaching the right agreement. The decision by the UK government to rule out extending the transition period is reckless and only serves to artificially constrain the negotiations. We must rule out the possibility of a cliff edge in December 2020 should a comprehensive agreement not be reached over the coming year.

The Welsh Government recognises that the UK government has a mandate to base the UK's future relationship on the Political Declaration agreed with the EU in October 2019. However, given the importance of our relationships with the EU we believe in a number of important areas the UK's future relationship with the

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EU needs to be closer and deeper than as set out in the Political Declaration.

These are summarised in the following points:

- Given the overwhelming importance of the EU markets to our economy particularly Wales' manufacturing, agriculture and services sectors the UK must prioritise EU markets over trade arrangements with other countries.
- While we recognise our future relationship with the EU will be based on a Free Trade Agreement, the UK must have the fullest access to EU markets without tariffs and non-tariff barriers must be minimised. This means:
 - agreeing to a broad level playing field with the EU to ensure open and fair competition including alignment on environmental, social and labour market standards
 - dynamic alignment with EU rules and regulations necessary to ensure no new trade barriers come into force
 - participation in EU bodies and agencies such as the European Chemicals Agency to support dynamic alignment
 - ensuring that the choices regarding governance of our future relationship, and the UK's future immigration framework reflect the prioritisation of EU markets.
- The fullest possible future security partnership that replicates as far as possible current arrangements including internal and external cooperation
- Continued participation in important EU programmes, including but not limited to, Erasmus+, Horizon Europe, Creative Europe and INTERREG.
- Recognition that devolved governments may seek to be involved in EU programmes even if some or all of the rest of the United Kingdom does not choose to
- Urgent need to obtain a positive adequacy assessment from the EU to secure data flows
- Finally, the devolved governments must be fully involved in the negotiations and in the Joint Committee that will oversee the implementation of the agreements.

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3. The future UK/EU relationship negotiating priorities for Wales

The "Political Declaration" is a document attached to the EU-UK Agreement on UK Withdrawal from the EU.

The Political Declaration outlines the framework for the future relationship between EU and UK. The document is political in nature and does not form a legally binding part of the agreement; it sets out, rather, the terms within which future negotiations on a longer term deal should take place.

Political Declaration: outline structure

The Political Declaration is structured into 5 parts outlining various aspects of a future relationship between the UK and the EU.

Part 1: Initial provisions

- This part outlines some high level principles for the basis of cooperation between the UK and the EU identifying some cross cutting areas that underpin that cooperation including data flows and participation in EU programmes.

Part 2: Economic partnership

- This part covers the future economic partnership between the UK and the EU covering the movement of goods, services, capital, people and specific sectoral areas of economic interest.

Part 3: Security partnership

- This part outlines the future ambitions for security partnership and coordination covering external and internal, domestic security as well as

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specific areas of thematic security such as health, cyber and civil protection.

Part 4: Institutional and other horizontal agreements

- This part outlines the possible governance arrangements to ensure the proper functioning of the future relationships agreed.

Part 5: Forward process

- The final part outlines the next steps to seek to reach agreement on the matters covered in the other parts of the Political Declaration.

The Welsh Government has mapped out a set of positions which reflect Wales' interests with great consistency over the last years. We described our approach comprehensively in *Securing Wales' Future* (January 2017) which set out the least damaging form of Brexit. In addition, we have provided more detailed policy positions through a range of white papers and documents which are listed at Annex A.

The Welsh Government has consistently identified 6 key points central to Wales' future interests:

- Single Market and International Trade
- Migration
- Finance and investment
- Constitutional issues
- Social and environmental protection
- Transitional arrangements

All of these points will need to be addressed if the economic, social and environmental fabric of Wales is not to be eroded as a result of leaving the EU.

This paper comments on the Political Declaration from the perspective of the Welsh Government. In doing so we recognise that the UK government has a mandate to base the negotiations on the Political Declaration as set out but we also believe that a future agreement with the European Union must reflect and

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protect the interests of Wales and the United Kingdom as a whole.

While there remains the opportunity to shape a range of future relationships with the EU based on the current Political Declaration we urge the UK government to recognise the strength of the arguments advanced by the Welsh Government. We believe that the approach we outline will help protect Welsh and UK prosperity.

We recognise that the Political Declaration is a high level statement of ambition for the future relationship. More detailed issues will need to be resolved in the coming months of negotiation. We will set out the Welsh Government's detailed negotiation positions as these talks between the UK and the EU progress.

Part 1: Initial provisions

Basis for cooperation

The Welsh Government concurs with the core values and rights set out in paragraphs 6 and 7 of the Political Declaration. The UK as part of the EU has developed shared values for human rights and fundamental freedoms, democratic principles, the rule of law and support for non-proliferation. We welcome the commitment that our future relationship will be underpinned by these shared values. We further state that Wales, and the United Kingdom as a whole, is a European nation and that this is a matter of values, economic interests and family and friendship as much as geography.

Areas of shared interest

Paragraph 11 sets out a broad spectrum for potential UK participation in EU programmes and initiatives and recognises the need for 'a fair and appropriate financial contribution' from the UK. The text specifies 'areas such as science and innovation, youth, culture and education'. The Welsh Government has consistently emphasised as a priority the need for continuing access to EU programmes which have brought demonstrable benefits to Wales, such as

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Horizon 2020, Erasmus+ and Creative Europe.

The funding from EU programmes is hugely important to Wales, driving economic growth and jobs. This funding also enables the Welsh Government to leverage additional resources from both public and private sources. During the referendum campaign voters in Wales were assured that leaving the EU would not result in Wales being worse off. It is vital this promise is honoured.

The UK government should be ambitious, and push for unique arrangements with the EU which allow for UK participation in all EU programmes should it choose to and not limited to those topics covered in the Political Declaration. The UK government must recognise the benefits that investment and collaboration from EU programmes have facilitated. A narrow assessment of financial costs and benefits does not capture the value that cooperation brings to both the UK and our European partners.

The future relationship with the EU should explicitly recognise that devolved governments may seek to be involved in EU programmes (current and/or future) directly, even where some or all of the rest of the United Kingdom does not choose to. Where the funding to participate in such programmes has previously been held centrally, we must receive our share of these resources as an additional allocation to the Welsh Government's bloc grant.

In addition, for those programmes where continued participation is not possible, the UK government must replace EU funding that would otherwise have come to Wales. We will oppose any moves by the UK government which would seek to bypass the devolution settlement and take away decisions and funding that has been under Welsh Government control for nearly 20 years.

We welcome the text indicating the UK intention 'to explore options for a future relationship with the European Investment Bank (EIB)'. The Welsh Government has a strong record of partnership with the EIB and the Bank has provided significant investment in Wales. In our original Brexit White paper, *Securing Wales' Future*, the Welsh Government made a strong case for a continuing partnership with the EIB and we see no reason why this should not also be the ambition of the UK government.

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Wales also shares an interest in maintaining the strong and productive relationships and joint work underpinned by the IrelandWales INTERREG programme. The Welsh Government currently participates in the Ireland-Wales Programme, a strand of INTERREG worth £100 million over the lifetime of the programme (2014-20). This money is invested in mutually beneficial projects across the IrelandWales maritime border and has produced clearly identifiable economic benefits.

The Welsh Government argues that systematic programmed activity across the Irish Sea will be more important, not less, with the UK outside the EU. This East-West dimension will complement the North-South element of the PEACE programme. A continuing Ireland-Wales programme will create opportunities for business links to deepen and expand in a new economic context and help develop prosperity both in Ireland and Wales.

Wales' participation will require the UK government to agree access to this element of INTERREG as part of its forward agreement with the EU and we call on it to do so.

While outside the scope of the negotiations with the EU, Wales also benefits from significant EU investment in the form of EU Structural Funds and Common Agricultural Policy (CAP) payments. The replacements to these funds are now domestic issues for the UK and the Welsh Government has been clear that the promises made during the referendum campaign that Wales would see "not a penny less" must be honoured. In addition the UK government cannot use the replacement funding streams to take back powers that have been exercised by the Welsh Government for 20 years leading the development and implementation of EU structural fund programmes in Wales.

Part 2: Economic partnership

Objectives and principles

The evidence is clear that the further the UK moves away from the economic integration that the Single Market and Customs Union provides the greater the

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economic damage. We continue to believe that a future relationship with the EU based on the UK government's proposed Free Trade Agreement (FTA) model has the potential to do enormous damage to Wales. The EU has been clear that access to EU markets will be reduced if the UK does not commit to a level playing field to ensure there is open and fair competition. The Welsh Government is therefore clear that any future FTA with the EU must prioritise access to EU markets to minimise trade barriers ensuring trade is as frictionless as possible.

The latest analysis summarised in the Welsh Government Chief Economist's report (see Annex B) shows that under any scenario where tariff or non-tariff barriers to trade with the EU are introduced, the UK economy as a whole will suffer negative impact. The greater the barriers the larger the impact.

In Wales 60% of all goods exported internationally from Wales were to the EU, this compares to just under 50% for the UK as a whole. This shows the higher trade dependency that Wales has with the EU. As a result Wales will disproportionately suffer if additional trade barriers are put in place. Analysis also shows that many high value adding sectors in Wales (aerospace, automotive and electrical engineering) are exposed to significant risk if there are additional barriers to trade and a reduction in the access to EU research and innovation.

While the commitment to ensuring there are no tariffs, fees, charges or quantitative restrictions is welcome, nontariff barriers are a particular concern in many sectors that rely on just in time trading arrangements with the EU.

As the UK government develops an independent trade policy for the UK the EU must be the priority market. There is no credible evidence that suggests independent international trade negotiation capacity will compensate for trade lost in Europe or from FTAs with other countries that we access via the Customs Union. Free trade agreements will be complex and difficult to negotiate and the UK's independent negotiating power will inevitably be significantly less than the EU's. The UK government has not published an updated economic assessment of the current deal. But their previous analysis of Theresa May's deal provides an indication of the scale of the economic benefits from new trade deals as being in the region of +0.2% of GDP, compared to a significant economic loss from a looser relationship with the EU (-6.7% of GDP) associated with an FTA

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based arrangements compared to full access to the EU Single Market.

If a FTA is to be the basis of the UK's future relationship with the EU, the UK must seek the closest possible alignment with the EU. The closer this agreement can replicate existing trading arrangements the smaller will be the negative economic impacts. The evidence supports prioritising access to the EU and minimising all tariff and non-tariff barriers to trade.

Goods

The Welsh Government welcomes the commitment that the economic partnership should ensure no tariffs, fees, charges or quantitative restrictions. But we argue the FTA needs to go further to minimise as far as possible any non-tariff barriers to trade. Here we challenge the UK government's approach in pursuing the objective to diverge from EU rules and regulations as this risks frictionless access to EU markets. This is borne out by close reading of the text in paragraph 23 on 'regulatory aspects'. The text says:... the Parties will put in place provisions to promote regulatory approaches that are transparent, efficient, promote avoidance of unnecessary barriers to trade in goods and are compatible to the extent possible' (our emphasis).

The only extent to which this is NOT possible is where the UK imposes difference. At the point when negotiations begin there is 100% alignment and any divergence only occurs where the UK government pursues that as a matter of policy. But for what purpose?

Again the UK government's analysis is clear that the benefits associated with regulatory flexibility (+0.1% of GDP) are far outweighed by the economic costs associated with weakening our access to the EU Single Market (-6.7% of GDP) in an economic relationship based on an FTA.

The benefits of maintaining frictionless access to EU markets far outweigh any perceived benefits from the potential to diverge from EU regulations. The Welsh Government believes that committing to ensuring a level playing field for open and fair competition and alignment to those regulations that ensure goods can continue to be traded without regulatory checks are essential components of any

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FTA with the EU and must be prioritised.

In many areas it is simply not possible or would be highly inefficient to move away from well-established and respected arrangements. The UK government needs to move further than continued cooperation with agencies such as the European Medicines Agency, the European Chemicals Agency and the European Aviation Safety Agency. The Welsh Government believes the UK Government should negotiate continued membership of these agencies as part of a comprehensive deal.

The Welsh Government strongly supports measures to avoid the imposition of a land border in Ireland and we attach the highest value to the preservation of peace. However, we cannot ignore the potential implications for the economy in Wales that could arise from the Protocol on Ireland/Northern Ireland. The arrangements will inevitably impact on trade between Wales and the island of Ireland. Research from the UK Trade Policy Observatory shows that there are significant risks to Wales as a result of the Protocol on Ireland/Northern Ireland with a UK government also intent on pursuing the flexibility to set UK domestic regulations at a lower standard than those set by the EU. Box 2 summarises the main implications for Wales from the protocol arrangements as set out in the Withdrawal Agreement identified in the UKTPO report.

Services and Investment; Financial Services; Digital; Movement of Capital; Intellectual Property

While we accept that the Single Market for services is less well developed than for goods, the evidence is clear that moving away from existing arrangements will damage many parts of the service sector economy. Wales has a number of sectors where additional barriers to trade could be deeply damaging. The largest service sector exports for Wales are in services linked to the supply of manufactured goods. The real economic value of the manufactured goods traded with the EU in sectors such as aerospace and advanced engineering often comes from the significant services contracts sold alongside goods. For many sectors they simply do not distinguish between the supply of goods and services.

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With the service sector making up over three-quarters of the UK economy our future relationship with the EU must seek to ensure service sector exports can continue to access EU markets without costly impositions and reporting requirements. The UK government must ensure services linked to goods can continue to be traded without barriers and people must continue to be able to move between the UK and EU to provide business and consumer services without new barriers.

This highlights the importance of ensuring people are able to move across borders to support the needs of the economy and public services. Underpinning all services sector activity is data accessibility and here we urge the UK government to prioritise the need for a data adequacy agreement and ensuring data can flow freely between the UK and the EU as is currently the case.

We are also clear that public services in Wales should not be put at risk by a UK government seeking new trade deals especially with the USA. The NHS and other key public services must remain fully within the control of the Welsh Government. The NHS must not form part of any future trade agreement with the EU and neither should it form part of any free trade agreement with other countries. The Welsh Government is wholly committed to defending the integrity of NHS Wales.

Recognising the value that Geographic Indicators have provided to important sectors in Wales, including Welsh Lamb and Welsh Beef, we agree with the provisions (para 43) on the need ‘to provide appropriate protection for their geographical indications’.

Public procurement

The Welsh Government supports a generally permissive approach to public procurement in accordance with WTO principles subject to the statement above about the NHS. We believe that there is an appropriate context for public procurement which recognises social and community benefits.

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Mobility

While outside the scope of the Political Declaration, the Welsh Government disagrees with the UK government's approach to immigration and the blunt statement that freedom of movement will no longer apply between the UK and the EU.

In keeping with our position that we should minimise the barriers to the closest possible economic relationship with the EU and the pre-eminent importance of the EU in terms of our trading relationship, we continue to believe there is a strong case for a distinctive approach, on a reciprocal basis, to migration for citizens of EU countries to the UK. We advocate a system of free movement linked to work as the basis of future agreement. We believe that Welsh/UK citizens should have the right to free movement in the EU if they have a job to go to or if they can find a job within a short period of arrival (6 months). We believe EU/EEA citizens should enjoy the same rights, linked to work, in Wales/UK. The Welsh Government believes that this policy has produced mutual benefit and we greatly respect and celebrate the contribution of EU citizens to Wales.

It is deeply disappointing therefore that the UK government has proposed to introduce a skill and salary selective approach to future immigration. We believe this will needlessly exacerbate negative social and economic impacts in Wales after Brexit.

While the Welsh Government supports the requirement for a mobility framework this should be linked to an approach to immigration that supports the needs of the economy and public services. With the right domestic policy in place for immigration there is a much reduced need to engage in detailed negotiations on mobility.

Transport

It is in the general interest for the UK and EU to agree the closest possible coherence of transport arrangements in respect of aviation, road, rail and maritime for both freight and personal travel. It will benefit Wales/UK to agree cooperation as close as possible to that which prevailed within the EU.

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Energy

The Welsh Government agrees the suggested approach to electricity and gas, and civil nuclear cooperation. We further agree close cooperation linking the UK greenhouse gas emissions trading system to the EU Emissions trading system. We agree that the UK should maintain at least parity with the EU standard.

Fishing opportunities

The Welsh Government agrees the need to ratify a new fisheries agreement by 1 July 2020. The Welsh Government has been involved in fisheries negotiations for over two decades and a continued UK-wide approach to negotiations is essential.

Unfettered access to the EU market is also crucially important for the Welsh seafood industries, particularly live shellfish exports, where any delays could be fatal for both the mussels and oysters being exported and our businesses. We need a market trading environment which does not disadvantage Welsh fisheries and aquaculture production businesses compared to current position.

Global cooperation

We agree the text on global cooperation on the 6 fields identified (climate change, sustainable development, crossborder pollution, public health and consumer protection, financial stability, trade protectionism).

Level playing field for open and fair competition

Paragraph 77 of the Political Declaration underlines more graphically than any other the confusion and contortion which lies at the heart of the UK government's stance. The UK government asserts constantly its desire for independent policy capacity while, in this text, recognising the importance of a broad-ranging set of 'common standards' covering 'state aid, competition, social and employment standards, climate change, and relevant tax matters'.

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The breadth of agreement necessary to produce a level playing field for trade – which the Welsh Government supports as a principle – is so marked as to render the UK government’s need for demonstrable variance: practically irrelevant. This contortion can be avoided very simply by adopting the Welsh Government policy of alignment with the EU rules and regulations necessary to ensure trade is frictionless between the UK and EU.

Ireland/Northern Ireland Protocol: Implications for Wales

The Welsh Government commissioned the UK Trade Policy Observatory to identify the main issues that may arise as a result of the adoption of the Protocol on Ireland/Northern Ireland as set out in the Withdrawal Agreement.

UKTPO believe the main implications for Wales from the protocol to be:

- Producers in Great Britain (GB) (including Welsh producers) are likely to lose market share in Northern Ireland (NI) as goods sent from GB to NI will face new customs checks, possibly customs duties, and other regulatory/administrative checks, while NI trade with the EU (notably with the Republic of Ireland - RoI) will remain frictionless.
- If Great Britain relaxes its regulations relative to EU regulations, NI producers might operate under higher costs than GB firms, as NI producers would still need to produce to EU standards. NI firms may therefore struggle to compete in the GB market.
- The more extensive are the trade barriers between the UK and the EU (notably RoI), and the less extensive are the border checks are between GB and NI, the more incentive there will be to divert trade from RoI-GB to NI-GB routes. This will likely impact on the level of freight going through Wales to Ireland. The impact might be felt particularly for consignments which are destined for NI but which are currently sent from Wales via RoI.
- Handling whichever new checks are required on trade with the EU will undoubtedly require increased border infrastructure in Welsh ports such as Holyhead, Pembroke Dock and Fishguard. Delays due to border checks will be particularly problematic for perishable food products, which make up a relatively large share of goods shipped between Holyhead and Dublin.

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[The full report is available here.](#)

Part 3: Security partnership

The Welsh Government supports full and comprehensive cooperation with the EU on the wide spectrum of security-related issues.

Here we call for the UK government to negotiate participation in the tools and cooperation arrangements that keep our citizens safe and support our law enforcement agencies. To support this we call on the EU to look to move beyond third country precedents and to recognise the value that the UK brings to security cooperation across Europe.

Part 4: Institutional and other horizontal arrangements

The Welsh Government recognises that our future relationships with the EU must be underpinned by a strong institutional framework.

This framework needs to reflect the closeness of the relationships negotiated and support the implementation of the agreements reached. The framework must also be supported by appropriate supervision and process to manage any disputes.

The Welsh Government welcomes the commitment for a Joint Committee for managing the implementing arrangements. As the implementation of many aspects of our future relationship is within the competence of the Welsh Government it is essential that we are represented and fully involved in the design and operation of the Joint Committee.

Ill-advised red lines on the role of EU institutions and the Court of Justice of the European Union should not weaken the implementation of the UK's future relationship with the EU nor influence the shape and nature of that relationship.

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Part 5: Forward process

The first step for any responsible UK government is to abandon their wholly unrealistic approach to negotiations and recognise the realities that a truly ambitious future relationship with the EU cannot be properly negotiated under the guillotine of an unalterable December 2020 deadline. We simply do not believe the right agreement can be achieved within a matter of months. The UK government must leave open the possibility for an extension to the transition period beyond December 2020.

The focus during the transition period must be to negotiate the close future relationship with the EU as set out above. The UK government must prioritise the UK's economic relationship with the EU as our closest and most important trading partner. If this means keeping on hold negotiations with the US and other priority countries – so be it.

It is essential that the Welsh Government, and the other devolved governments, are part of the negotiations to shape a future that works for all parts of the UK. The devolved governments to date have been treated as a consultee in the process of setting a UK position. Information sharing and consultation with the devolved governments falls a long way short of the arrangements necessary to ensure UK positions truly reflect the positions of all parts of the Union.

The implementation of the future relationship with the EU is, in many areas, the responsibility of the devolved governments and the integrity of the Union depends on joint working to reach collective agreement on UK negotiating positions. We cannot be expected to cooperate on the implementation of obligations in devolved areas if we have not been fully involved in the determination of those obligations. The UK government must set out a clear process for agreeing UK wide positions. This will require joint work between the governments of the UK at official level with a clear process for agreement at ministerial level and process for dispute resolution if required. This must begin at the start of the process agreeing the negotiating mandates and continue throughout the negotiations until their conclusion.

We have been clear that the UK government should not normally proceed with

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UK positions in areas of our competence without our agreement and the UK government must commit to proceeding on that basis.

The EU are fully aware of the role the devolved governments have in implementing the future relationship. Failure to work with the devolved governments will only undermine the UK position with the EU. Equally, full involvement of devolved governments in the negotiating process will help produce agreement underpinned by solid and shared commitment across all parts of the United Kingdom.

The joint work on negotiations will also support effective development and implementation of UK domestic policy outside the EU.

The Welsh Government has taken an evidence based approach to the UK's exit from the EU to best protect Wales' interests. We will continue to take every opportunity available to influence the negotiations to seek the best possible outcome within the new context set out by the Political Declaration and underpinned by the General Election result. We recognise the need to work together across the governments of the UK and we will remain a constructive partner in this process.

Annex A: Welsh Government EU exit publications

Securing Wales' Future

Brexit and Devolution

Brexit and fair movement of people

Regional investment in Wales after Brexit

Trade policy: the issues for Wales

Reforming UK funding and fiscal arrangements after Brexit

Economic analysis of UK government's proposals for EU exit

Wales: Protecting research and innovation after EU exit

A brighter future for Wales: Why we should remain in the EU

Annex B: UK government proposals for post-Brexit EU trading arrangements: economic

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implications

Context and purpose

Previous reports have set out the established consensus amongst mainstream academic and professional economists on the economic implications of Brexit ([Footnote 1](#)).

This consensus is that both short and long term economic effects will be negative for both the UK as a whole and its constituent countries and regions.

The extent of the economic damage over the longer term will be broadly proportionate to the scale of the additional barriers that are created to trade with the EU. Tariffs, quotas and (other) non-tariff barriers are all important, with some research suggesting that non-tariff barriers arising from divergences in regulation can be even more damaging to trade than tariffs.

Over the shorter term, adverse effects will be driven by anticipation of the longer term consequences and by the disruption created by the transition process.

There is also a consensus that benefits of new trade deals, including with the USA, would be much smaller than the losses incurred from additional barriers to trade with the EU. This reflects the fact that countries trade much more intensively with partners that are close geographically.

The way in which the sterling exchange rate has reacted to “news” about Brexit indicates that market participants share this analysis.

The broad conclusions just summarised remain valid. This note includes the findings of some more recent analysis, which are consistent with the pre-existing consensus, and draws out the implications for assessing the economic effects the UK government’s proposals for its future trading relationship with the EU, in so far as this is currently known.

Withdrawal Agreement Bill and short term prospects

On the assumption that the Withdrawal Agreement Bill (WAB) completes its progress through Parliament on schedule, an abrupt exit from the EU without a transition period at the end of January 2020 appears unlikely. However, if agreement on future trading relations with the EU is not reached during 2020, a disruptive exit, followed by trading on WTO terms, at the end of the transition period in December 2020 remains possible.

Analysis by the Office for Budget Responsibility (OBR), the Bank of England, and others has indicated that the UK economy is now probably at least two per cent smaller than was expected prior to the referendum result.

The bulk of this shortfall is accounted for by weak levels of business investment, which has barely grown in the UK since the referendum, in contrast to the position across the EU and other comparator countries. Both the Bank of England and the National Institute of Economic and Social Research (NIESR) estimate that Brexit-related uncertainty has been associated with a reduction in business investment, with the level in 2019 being around 15 per cent lower than it would otherwise have been.

Weak business investment has been a key factor in the continued lacklustre performance of the UK economy in terms of the growth in productivity and real wages (the latter being driven by the former over the longer term).

In addition, since 2016, consumers have seen their spending power eroded by the effects of the depreciation of sterling on prices. Analysis by the Centre for Economic Performance has shown that this has had the largest effects on people with low incomes, and hence on places with higher concentrations of such people, including Wales.

Nevertheless, consumer confidence and spending has held up relatively well in this adverse context, perhaps reflecting the scepticism of a large segment of the population about the evidence of negative economic consequences from Brexit.

In round terms, the combined effects of reduced business investment and lower consumer spending power means that in 2019 each person in Wales probably

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had on average real income that was around £450 lower than it would otherwise have been.

Assuming that the WAB passes as scheduled and the UK leaves the EU at the end of January 2020 with the agreement in place, there should be some reduction in the uncertainty facing businesses and consumers. This may lead to some revival in business investment and help maintain consumer confidence.

However, any such effects are likely to be very modest, and could easily be more than offset by renewed uncertainty about the future trading arrangements that would follow the end of the transition period. If this happens, the previously cited reduction in business investment could continue.

Additional uncertainty could arise from the likelihood that not everything will be agreed by December 2020. For instance, Michel Barnier recently stated that:

“ “It is unrealistic that a global negotiation can be done in 11 months, so we can't do it all.” ”

There is a real risk that, as a result of continuing uncertainty, some businesses which have held back on major investment decisions over the last few years may reach a 'tipping point' and decide that significant downscaling, or even closure, is the rational response.

The NIESR has estimated that, over the next few years, uncertainty associated with the Brexit process could result in UK national income being 2 to 3% lower than it would otherwise have been.

Should the UK fail to reach an agreement on future trading relations with the EU by December 2020 and starts to trade on WTO terms in 2021, the risk of recession in 2021 would be high.

In any event, the constrained levels of business investment experienced over the last few years will leave a legacy in terms of weakness in productivity growth unless or until the shortfall is made good.

The Bank of England's most recent forecasts indicate that growth over the next

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few years will be lower than previously assumed even if the UK government's apparent preference for a limited Free Trade deal is implemented as planned. The previous forecasts were based on an average of possible outcomes for post Brexit trading relationship with the EU and the Bank attributes some of the reduction in growth to the fact that effects of the proposed arrangements are worse than this average.

Future trading relations with the EU and longer term prospects

Despite the publication of the WAB and the existence of the Political Declaration about future trading relations between the UK and the EU, these relations remain a matter of considerable uncertainty. The Political Declaration is not binding, and the real intentions of the UK government are unclear, and could change, as various constraints and consequences emerge during the negotiation period.

Furthermore, while there is a consensus about the nature and broad scale of the longer term negative effects of different forms of trading relationship, as described above, mainstream analysis has yielded a range of numerical estimates for each option. The nature of economic modelling and the unavoidable uncertainties make this lack of precision inevitable. However, this should not undermine confidence in the broad messages, which are grounded in well-established economic theory and confirmed empirically on the basis of changes in outcomes where trading relationships have changed in other cases.

Selected recent estimates of long run effects from the CEP and NIESR are shown in Table 1. Estimates from analysis undertaken for the previous UK government are also included for comparison. The figures in the table represent annual effects in around 10 years' time.

These estimates are representative of the range of estimates made by mainstream analysts. No estimate is shown for the combination of Efta/EEA membership with participation in a Customs Union. In economic terms, this combination (which in the table would combine the first row with elements of the second row) would result in minimal negative economic effects when compared

with remaining in the EU.

The effects shown in the table can be interpreted as the impact on the annual real incomes of UK citizens. Over the longer term, these effects will be felt mainly in terms of lower real wages, rather than lower employment, as wages adjust to reflect productivity that is lower than it otherwise would be. Reduced funding for, and hence poorer, public services also seem an inevitable consequence of a weaker tax base.

It should be noted that the figures in Table 1 reflect the difference that Brexit is expected to make to UK economic outcomes over a ten to fifteen year period, rather than a forecast of those outcomes themselves. Economic forecasting of the latter kind is extremely challenging and has a poor track record.

Table 1: Estimates of long run economic effects of Brexit

Long run change in income per head (per year)

	CEP*	UK govt**	NIESR***
Efta/EEA	-4.3%	-1.4%	n/a
May's deal	-4.8%	-2.1%	-1.9%
Current deal/FTA	-6.4%	-4.9%	-3.0%
WTO	-8.1%	-7.6%	-3.7%

* Centre for Economic Performance. Equivalent results also obtained by UK in a Changing Europe, using a similar modelling approach.

** Long Term Economic Analysis, published November 2018. Assumes no change in migration and “more realistic” scenario for May’s deal.

*** National Institute for Economic and Social Research. Effects are lower than CEP and UK government as wider evidence on productivity effects is not included.

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The estimates in the table include some effects on productivity. There is good evidence that open markets, wider and deeper competition, and trade are all good for productivity (and hence real wages) over the long run. The scale of the effects are particularly difficult to estimate with precision but should be included because analysis suggests they are large. The estimates made by NIESR are more cautious in this respect, and may represent an underestimate.

As just noted, it is currently unclear which form of trading relationship the UK government and EU will eventually agree. Present indications are that the UK government's intention is to pursue a limited free trade agreement (FTA) which would have an impact on real incomes of up to around 6% per annum in the longer run, as indicated by the column in the table. In today's terms, this would be equivalent to around £1,300 per head each year in Wales.

With a limited FTA with the EU the UK government would be free to pursue its own free trade deals with other countries. Economic analysis undertaken by the previous UK government has shown that any positive effect on incomes would be small, perhaps 0.2%, and very far from compensating for the losses associated with Brexit. Similarly, analysis shows that the benefits of any changes to UK regulations would be very small (if they exist at all).

The future approach of the UK government to migration will also impact on the level of national income. The estimates in the table assume only limited changes to total levels of migration. While more restrictive migration would reduce total national income, its effect on real income per head for existing residents would be much more modest.

Lower growth will result in a tax base, and tax revenues, that are smaller than they would otherwise be. This means that either public spending has to be lower or government borrowing has to be higher. Broad estimates of the annual shortfall in UK government revenues, expressed in today's terms are shown in Table 2. These estimates are based on analysis by the organisations stated, but not necessarily expressed by them in the same terms.

Table 2: Estimates of long run economic effects of Brexit on UK tax revenues

Long run change in tax revenues (per year)

	CEP	UK govt	NIESR
Efta/EEA	-£39 billion	-£13 billion	n/a
May's deal	-£44 billion	-£19 billion	-£17 billion
Current deal/FTA	-£56 billion	-£45 billion	-£27 billion
WTO	-£74 billion	-£69 billion	-£34 billion

Purely for illustration, the Welsh “population share” of the annual tax revenue reduction estimated by the CEP to occur under a deal of the kind currently proposed would be around £2.7 billion.

Sectoral and spatial impacts

The analysis described above has been undertaken at the UK level. The effects in Wales are expected to be broadly similar in both nature and scale.

The economy in Wales is deeply embedded within the wider UK economy, with important linkages arising from ([Footnote 2](#)):

- businesses engaged in production across the boundary
- cross border supply chains
- trade flows of finished goods and services
- commuting flows and labour market interdependencies
- fiscal transfers
- a common monetary and fiscal policy framework
- sterling exchange rate effects, which erode real incomes and spending power across the UK.

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Unsurprisingly in this context, over the short to medium term, and when assessed on a “per head” basis (**Footnote 3**), the economy in Wales follows a similar trajectory to that of the UK as whole, albeit with some random variation from one period to next (**Footnote 4**).

Some analysis has indicated that the adverse effects of Brexit on Wales could be rather greater than the average for the UK as a whole. This is because the sectors within manufacturing in which Wales specialises are particularly dependent on European markets. However, much depends on the form that Brexit takes and the nature of the additional frictions that are introduced.

Reflecting this, analysis of an outcome in which near-single market arrangements are retained for goods, but not services, suggests the greatest impacts could be in regions that are serviced-dominated, particularly London. On the other hand, were significant barriers imposed on trade in goods, the impact would be felt most in areas that specialise most in manufacturing, including of course Wales.

In addition, research undertaken for the Welsh Government by Cardiff Business School indicated that business-specific factors (such as their specific role in particular supply chains) could be more important for their prospects than the broad sector to which they belong.

Such considerations limit the value of simple assessments of spatial effects across Wales based on sectoral exposure. The linkages described above result in the transmission of effects geographically, with, in most places, indirect and economy-wide effects likely to dominate direct local impacts (**Footnote 5**).

Furthermore, over the long run, the impact of the more adverse Brexit scenarios is likely to take the form of reductions in investment and lower productivity growth, rather than easily identifiable job losses and plant closures.

Even where such losses and closures occur, it will often be difficult to attribute them unambiguously to Brexit. The economy is in a constant state of 'churn' and restructuring, with around 2,000 jobs both lost and created in a typical week in Wales. In general, this churn is accommodated within local labour markets through the process of creative destruction.

The lesson of both previous economic slowdowns and periods of heightened structural change (such as in the 1980s), is that the people who suffer most are those who are already most disadvantaged in labour market terms – typically those with lower skill levels and with disability or ill health or who are from equality groups that suffer adverse labour market outcomes. The places that suffer most tend to be those which have the highest concentrations of people with the characteristics just described.

The most severe effects are likely to be found in places where such concentrations of disadvantage combine with a high share of employment in adversely affected businesses and a local economy which is less resilient. However, the complexities described above in identifying vulnerable businesses imply that case specific analysis is a more realistic way of identifying heightened vulnerability than generic modelling.

A key consequence of the reduced growth expected under the new trading arrangements is a tax base that is weaker than otherwise. It is therefore likely that less affluent areas that are disproportionately dependent on public funds will suffer the most. This obviously includes Wales, and such effects would be compounded if the funding Wales currently receives from the EU was not to be fully replaced by the UK government on a continuing basis.

**[1] Economic analysis of UK government's proposals for EU exit
Written Statement: Updated analysis of the economic implications of the
UK's exit from the European Union**

[2] For the first 3 of the factors that follow, the existence of a legal and regulatory context that is largely common to Wales and England and geographic proximity are the key enablers.

[3] Both population and total GVA have grown more slowly in Wales than is the case for the UK as a whole.

[4] The Welsh Government holds crucial policy levers, but these operate mainly on the 'supply' side of the economy and would be expected to impact mostly over the medium to long term.

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[5] There may be important exceptions where a sector, or even individual business is highly dominant in a less resilient local economy.

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