THE POTENTIAL €60 BILLION COST TO THE UK OF EXITING THE EU

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The issue of the UK's financial settlement, the so-called 'Brexit Bill', has emerged as the most contentious issue for the first phase of negotiations in the UK's withdrawal from the European Union. The European Commission's negotiating mandate makes clear that a methodology for calculating these liabilities must be agreed before the negotiations can progress to the next phase. For the UK, meanwhile, a substantial exit bill may prove politically difficult. This note examines the possible components of the Brexit Bill, and assesses the widely reported estimate of €60 billion.

The author, Michael G. Tutty, is a Member of the Irish Fiscal Advisory Council. He was appointed as a Commissioner for Energy Regulation in 2004 and was appointed Chairman of the Commission for Energy Regulation in 2008. He was Vice President of the European Investment Bank from 2000 to 2004, immediately prior to which he served as Second Secretary General in the Department of Finance (Budget and Economic Division).

How this issue emerged

In the run-up to the UK referendum, no attention was given to the issue of what the UK might have to pay to the EU on exiting to meet financial commitments undertaken over the years of membership. Presumably nobody on either side in the UK saw this as a significant item.

This position changed when the Financial Times[1] published an article on 14 November 2016 which put the exit cost at up to €60 billion. This was followed up by a more detailed report by Alex Barker, Brussels bureau chief of the Financial Times in February 2017, published by the Centre for European Reform[2] setting out the basis for the €60 billion calculation.

Since then the UK authorities have tended to play down this figure as being an opening bid from the European Commission which they would not accept. On a visit to Dublin on 23 February, UK Conservative MP Karl McCartney, a member of the UK House of Commons committee on Brexit, is reported as saying that the UK would not pay the EU such a sum[3]. Brian Hayes, Irish MEP, was also reported as saying that the demands are an opening gambit, are unrealistic and risk destroying the negotiations at an early stage[4]. The British Brexit Secretary, David Davis, is reported as saying on this issue:

> *We are a country which believes in the rule of law and we take our responsibilities seriously – but we think this is something that needs to be dealt with alongside the issue of markets, the issue of other relationships between us and at the end of this we will come to an amicable agreement. But we are not at that stage.*[5]

The UK House of Lords European Union Committee, after taking evidence from a number of expert witnesses, published a report on 4 March 2017 entitled *Brexit and the EU Budget.*[6]

Basis for the €60 billion figure

The European Commission has not put any specific figure on the cost of exiting. But the reported €60 billion figure

1 'UK faces Brexit bill of up to €60bn as Brussels toughens stance', *The Financial Times*, 14 November 2016
2 'The €60 billion Brexit bill: How to disentangle Britain from the EU budget' by Alex Barker, *Centre for European Reform*, 6 February 2017
3 'Britain will not pay €60bn EU bill after Brexit, TDs told', *The Irish Times*, 24 February 2017
4 'Irish MEP criticises EU over Britain's €60bn Brexit bill', *The Irish Times*, 25 February 2017
5 "May vows to resist changes to Brexit bill proposed by Lords", ***The Irish Times,*** 3 March 2017
6 House of Lords European Union Committee report ***Brexit and the EU Budget*** published 4 March 2017

has not just been plucked out of the air by commentators. There is a basis for it, even though some or all of the items in it could and may be disputed.

It arises to a large extent from the way the budget of the EU is run, particularly with financial commitments being made well in advance of the resulting payments, thus building up future liabilities for the Member States. There is certainly logic in expecting the UK to pay its share of the outstanding commitments – UK bodies with commitments for research and other projects will themselves expect the commitments to be met. If the UK does not pay, then the other Member States will have to increase their contributions.

But, as the House of Lords Committee found, there are differing views on whether the UK has any legal obligation to contribute to any expenditure after it exits. Even if it has, or if political considerations lead to agreement to contribute, there are widely differing views on what that contribution should be and how it should be calculated.

The aim of this paper is to set out and explain the basis for the €60 billion calculation. No official figure has been published so far by the European Commission so the paper draws heavily on the Alex Barber paper and the House of Lords Committee report.

How is the €60 billion calculated?

There are three main elements of the estimate:

- Unpaid budget commitments, known as "reste á liquider" or "yet to be paid".
- Yet to be used national allocations of investment spending approved for the 2014-2020 period.
- Pension liabilities for EU officials.

There are also other liabilities which could arise from loans and guarantees and from the remaining period of the EU Multiannual Financial Framework (MFF) 2014-2020 after the UK exit. These liabilities may be offset to some extent by the UK share of EU assets such as buildings.

1. Unpaid EU budget commitments

The EU budget operates on a different basis from the Irish budget. Each year the EU budget is divided into **commitment appropriations** and **payment appropriations.** The commitment appropriations limit the amount of commitments to further expenditure that can be made. They are generally higher than the payment appropriations, which limit the amount of actual expenditure that can take place. It is the payments which determine how much the Member States pay into the EU budget each year. But the commitments build up a liability which will have to be met later.

The gap between the commitment appropriations and the payment appropriations – known as "reste á liquider" – has been building up over the years, particularly since 2000. It is estimated to reach €241billion at end-2018.

2. Approved investment spending

Apart from the commitment appropriations in the annual budget, the EU makes binding commitments to future expenditure also through multi-annual programmes such as the structural funds. These come within the agreed EU multi-annual budget, the MFF 2014-2020. Once the European Commission agrees these programmes with individual Member States, they are a binding EU legal commitment under the "Common Provisions" Regulation[7]. To the extent that this expenditure takes place after the UK leaves the EU, the UK has been part of the legally binding decision process and could therefore be seen as liable to pay its share of the expenditure.

The amount involved under this heading is estimated at about €172billion.

7 Regulation No. 1303/2013

3. Pension liabilities

The pension scheme for EU officials is run on a pay-as-you-go basis and is not funded. There is therefore a significant accrued liability for these pensions which will be paid out over a long period. This liability is estimated at about €64 billion. EU staff pay about 9% of their salary as a pension contribution but this covers only about one-third of their pension.

The UK will certainly have to pay some of the cost of pensions – otherwise UK nationals might find that their pension payments were no longer arriving post-Brexit! They could dispute their liability for staff service before the UK entered the EU, but this would be small compared with the period since their accession. But then countries which joined later could argue that the UK should pay a higher share of pension liabilities for the time before the new countries joined, so it not a straightforward issue.

Presumably the future staff contributions to the pension costs should be taken into account in determining the UK liability.

4. Remaining years of Multiannual Financial Framework

The current EU Multiannual Financial Framework (MFF), which sets the budget figures for the EU, runs until end-2020. The UK has committed to this MFF and some would argue that it should complete its contributions (and its receipts) to end-2020.

The UK Government obviously do not envisage this as it has guaranteed to replace EU funding domestically until 2020 for some items, such as the current level of agricultural funding.

The MFF provides that it can be amended in "unforeseen circumstances" so the remaining Member States could adjust it for the remaining period after the UK leaves, as they see fit.

5. Loans and Guarantees

The EU has given substantial loans and guarantees over the years, such as loans to Ireland and other countries under the European Financial Stabilisation Mechanism. These could give rise to liabilities for the EU budget in the future if there is a default on any loans. While it would be unrealistic to estimate the size of the risk and charge the UK appropriately, there would be a case for calling on the UK to fund any losses which arise in the future.

6. Assets

The EU accounts, per Barker, show about €22 billion of assets that are property, plant and equipment and other assets available for sale. The UK could have a right to its share of these assets, though the House of Lords Committee report concludes that, since the EU has a distinct legal personality, the UK would not have a legal claim on the assets.

The UK also has a shareholding in the European Investment Bank which it could seek to cash in. It has €3.5 billion of paid-in capital but the UK share of the net worth of the EIB is estimated by the House of Lords Committee at €10 billion.

7. UK rebate and share

The UK receives a rebate on its budget contribution, following the intervention of Margaret Thatcher. This is paid a year in arrears, so the year after Brexit the UK will be in line for a further rebate of about €5-6 billion, which will help towards its exit payment - though if the UK were not making a contribution to the EU Budget for past commitments, this rebate would be unlikely to be paid.

There is not even agreement on what share the UK should pay of any outstanding commitments. Should it be based on the UK share before (about 15%) or after (about 12%) the rebate? Logically it should take account of the rebate. Different shares for different elements have also been suggested.

Legal Position

The evidence presented to the House of Lords Committee showed different interpretations of the legal position. Some argued that Article 70.1(b) of the Vienna Convention on the Law of Treaties applies, which provides that unless otherwise agreed, termination of a Treaty

> *Does not affect any right, obligation or legal situation of the parties created through the execution of the treaty prior to its termination.*

The House of Lords Committee agreed with an alternative view, that Article 50 provides for termination after two years if no agreement is reached and does not provide for any contributions to be made after exit without agreement.

However, the House of Lords Committee concluded that the political and economic consequences of no agreement being reached on a budget contribution when the UK is seeking a good trading relationship with the EU and transitional arrangements have to be taken into account.

Commission Working Paper on Essential Principles on Financial Settlement

On 24 May the EU Commission published a Working Paper "Essential Principles on Financial Settlement"[8] for discussion at the Council working Party on Article 50. This sets out the main principles of the EU position, without putting forward any figures.

It states that the Union and the United Kingdom should both respect in full the financial obligations resulting from the whole period of the United Kingdom membership in the Union. There should be a single financial settlement related to:

- The Union budget;
- The termination of the membership of the United Kingdom of all bodies or institutions established by the Treaties; and
- The participation of the United Kingdom in specific funds and facilities related to the Union policies.

One interesting item listed in this paper which has not been mentioned before now is the specific costs related to the withdrawal process. This should include, for example, the cost related to the termination of contracts for housing agencies that have to move as a consequence of the withdrawal, the costs related to the move itself and the costs related to installation in the new location.

Conclusion

The three main categories set out above where UK commitments may arise come to:

	€ billion
Unpaid budget commitments	241
Approved investment spending	172
Pension liabilities	64
	477

8 https://ec.europa.eu/commission/sites/beta-political/files/financial-settlement-essential-principles-draft-position-paper_en.pdf

Taking a UK share of these liabilities at about 12% brings us close to the €60 billion figure which the European Commission is reported to be seeking. The cost would likely be spread over a number of years (or even decades for the pension liabilities) in line with the actual EU expenditure.

Since this situation of a country exiting the EU has not previously arisen, there is no precedent to call on to guide the outcome. Both legal and political considerations will arise in settling it. The EU will focus on the overhang of legally binding expenditure commitments entered into while the UK was a member, but the UK could seek to take the line that payments after it exits are a matter for the remaining Member States.

It is not possible to have a win-win situation as the less the UK pays, the more the remaining Member States will have to pay. So an interesting battle is likely to ensue.

It may be useful to finish with the final paragraphs of the House of Lords European Union Committee report (p53), which suggest that a pragmatic approach will be needed:

> *204. We hope that there is a desire on both sides to use the Article 50 process to reach an acceptable agreement on the terms of the UK's withdrawal from the EU. Among a wide range of subjects for discussion in the negotiation, the issue of continued UK contributions to the EU budget will be an important factor.*

> *205. But this is more than a negotiation on withdrawal, and more than a trial of strength. It is also a negotiation about establishing a stable, cooperative and amicable relationship between the UK and the EU, so as to promote the security, safety and well-being of all the peoples of Europe. Such a relationship is inconceivable without goodwill. The Government will need to approach the forthcoming negotiations in that spirit.*

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