

# UNDERSTANDING THE “BREXIT DIVORCE BILL”

Eulalia Rubio | Senior research fellow, Jacques Delors Institute

The UK’s financial settlement, or so-called “Brexit divorce bill”, refers to the expected payment the United Kingdom has to make to the EU to honour its share of the financial commitments jointly undertaken by EU countries while the UK was a member of the European Union.

In media and in public discussions, there is some confusion with regard to the nature of this payment and the legal and political arguments supporting the EU’s claim. The UK media tends to label this payment as an “exit bill” the EU is imposing on the UK to open trade talks. Brexit bill talks are also frequently portrayed as classical, zero-sum money negotiations. In reality, disagreements on the amount of the bill hide more profound discrepancies regarding the nature and composition of this payment and, ultimately, in relation to the nature of EU membership and the purpose of Brexit withdrawal talks.

## 1. What’s in the “bill”?

The basic idea behind the financial settlement is that the UK made some financial commitments when it was a member of the Union and those liabilities will not disappear when it leaves. The clearest example of such financial commitments is the EU’s multi-annual budget, called Multiannual Financial Framework (MFF), through which EU member states unanimously agree on spending commitments over a number of years.

The current MFF started in 2014 and will last until 2020 (that is, one and a half year after the expected Brexit withdrawal date, March 2019). Given that the UK voted for this MFF, it seems fair to ask the UK government to honour the commitments taken at the moment of voting, all the more if we take into account that these commitments have translated into EU’s legal obligations through the adoption of legal acts<sup>1</sup>. Some UK observers argue that the MFF regulation obliges member states to adjust the MFF in the event of an enlargement and that thus, *a contrario*, the

remaining EU-27 should adjust the MFF to reflect the fact that one of the biggest net contributors is leaving. However, enlargement differs from withdrawal in that it is a decision adopted unanimously by EU member states, not imposed by one of them on the others.

It is also important to note that part of spending commitments linked to this MFF will be executed after 2020. This is the famous RAL or “*Reste-à-Liquider*”, that is, the amount of spending authorised in EU annual budgets but still not executed. The existence of an amount of RAL at the end of an MFF is normal, and stems from the multi-annual nature of many EU spending projects (which are approved at a given time but executed progressively in subsequent years). However, the amount of RAL can be larger if there is a shortage of resources in the annual EU budgets for 2019 and 2020. This can oblige the Commission to delay the payment of some bills to subsequent years.

The number of financial obligations jointly undertaken by EU member states goes beyond the current MFF. Member states have jointly undertaken some long-term financial liabilities that are recorded in EU consolidated accounts. This is the case of pensions’ entitlements to EU employees. The EU pension system operates on a “pay-as-you-go” basis, meaning that costs are covered by annual EU budgets as they arise<sup>2</sup>. This constitutes a long-term financial liability for all EU member states. Other types of financial liabilities recorded are the so-called “contingent liabilities”. These are possible financial liabilities which may arise or not depending on the outcome of an uncertain event in the future (e.g. EU bail-out loans to countries which may not be recovered, EU budget guarantees to EIB loans that may be called). As with pensions, this does not represent a huge amount of money, but there is an

1. Even if not all these legal obligations are recognised as EU liabilities in the consolidated accounts of the EU. Consolidated accounts only recognise as liabilities those spending commitments that have translated into the signature of a contract or grant agreement with a beneficiary, such as a national or regional authority (e.g. the signature of Operational Programmes) or a private promoter (e.g. GALILEO, COPERNICUS or long-term infrastructure projects financed by the Connecting Europe Facility).

2. Current EU employees cover one third of the cost of the pension scheme via a compulsory contribution from their salaries, whereas the remaining two-thirds comes from the EU budget.

open question on how to include the cost of these hypothetical liabilities into the calculations. Finally, the settlement should cover any payment resulting from the termination of UK's membership of bodies or institutions such as the European Central Bank (ECB) or the European Investment Bank (EIB), which could present technical difficulties.

## 2. Where do we stand?

The EU presented a detailed negotiating position paper on the financial settlement in June 2017. The paper lists the various financial obligations and liabilities which should be taken into account and proposes a methodology to calculate their amount as well as the UK's share of these different obligations. While the Commission's paper does not name a specific figure, the *Financial Times* did some estimates on the basis of the EU negotiating position and concluded that **the bill could amount to between €91 and €113 billion, corresponding to a net payment of €55-75 billion** after considering the share of EU spending that flows back into the UK. This includes not only the famous "UK rebate"<sup>3</sup>, but all EU transfers to UK beneficiaries (farmers, researchers, regions), which will be maintained until the closure of the programmes if the UK honours the financial commitments linked to the current MFF.

The UK government has not produced an equivalent paper. On some occasions members of the UK government have recognised the existence of financial obligations vis-à-vis the EU, but the UK government has been reluctant to engage constructively in a discussion on which obligations to undertake and how to calculate them. The clearest engagement was taken by Prime Minister Theresa May in her "Florence speech" on the 22nd of September 2017. In this speech, Ms. May declared that no EU country would be required to pay more or receive less over the remainder of the current MFF as a result of Brexit. Ms. May did not provide an exact figure, but her words were interpreted as **an offer amounting to €20 billion**, which roughly corresponds to the payment of UK's annual net contribution to the EU budget from the expected date of withdrawal (mid- 2019) until 2020. More recently,

3. The 'UK rebate' is a correction established in 1985 in favour of the United Kingdom, by which the UK government is reimbursed 66 % of the difference between its contribution to the EU budget and what it receives back from it. The amount of the UK rebate changes every year since it depends on many different variables, but over the last three years (2014-2016) the UK rebate has amounted to €6bn in average. Including the UK rebate in the calculation of the Brexit bill is logical from a legal point of view, as the right to this rebate is granted in the Own Resource Decision, the same legal act that states the UK's obligation to contribute to the financing of the EU budget.

some articles in the UK press have hinted the UK government's willingness to pay up to €60bn, but this has not been formalised yet by a credible offer at the negotiation table.

## 3. More than a technical issue

Ms. May's Florence speech implied a change of strategy from the UK side. Since then, the UK government had taken a defensive and narrowly legalistic approach, with constant assertions that no more would be paid than legally owed and statements questioning the legal basis of the financial settlement. In Florence, Ms. May recognised for the first time that **settling these financial obligations is not only a legal obligation but, more importantly, an act of political responsibility to minimise the cost of the disruption Brexit will create for the rest of the EU member states** (in EU jargon, to ensure "an orderly withdrawal"). The tricky question now is "What does it mean, from a financial point of view, to leave no Member State worse off because of Brexit?."

The EU is right in saying that this should not only refer to covering UK's net contribution to the EU budget for 2019 and 2020. A case in point is RAL. If the UK does not cover **its share of the RAL pending in 2020** (which could amount to €30 billion<sup>4</sup>), this would have to be paid by the remaining EU27 in subsequent EU annual budgets. The latter would complicate negotiations about the future MFF, which will already be difficult given the need to adjust to the permanent annual gap of around €10 billion<sup>5</sup> left by Brexit. Moreover, there is a strong political argument to make the UK pay for a share of RAL. One should not forget that the UK government played a significant role in the final stage of MFF negotiations, forcing a reduction of the level of payments. The result was an MFF with a level for payments well below the level of agreed commitments. If we end up with a significant RAL at the end of 2020, this will be partly due to this gap between authorised payments and commitments.<sup>6</sup>

4. The RAL in 2020 is expected to reach €254 billion (Commission Staff Working Document accompanying the Commission's communication on the Mid-term Review, SWD(2016) 299 final, 14.9.2016). UK's share would be €31.7 billion, if the share is calculated (as proposed by the Commission) according to UK's share in financing the EU budget after the application of the UK rebate.

5. Jörg Haas and Eulalia Rubio, "Brexit and the EU budget: threat or opportunity?", Policy Paper No.183, Jacques Delors Institute, January 2017

6. EU spending is entered in differentiated figures, first as commitment appropriations (legal pledges to provide funds) and later on as payment appropriations (cash or bank transfers to the beneficiaries). The MFF set annual ceilings for both commitments and payments. Commitment ceilings are usually bigger than payment ceilings, because it is assumed that part of the commitments taken in one year will not be executed at all or will be executed and paid later. However, a very low level of payment appropriations in one year may translate into an overhang of unpaid commitments, and ultimately an increase in the amount of RAL.

In other aspects, there is space for constructive win-win discussions. On the EIB, for instance, there is a common interest in avoiding an abrupt UK's departure from the Bank. This would threaten Bank's triple A rating, but would also be harmful for the UK economy, which does not have an equivalent powerful national development bank. On contingent liabilities, the EU's preferred option is to receive a lump-sum payment upfront and to reimburse the UK government over time if the event does not materialise. Another option, more favourable for the UK, would be to share the costs of contingent liabilities as they arise in future. The latter however is only imaginable if there is a prospect of cooperation after Brexit.

#### 4. The link with a hypothetical future transitional agreement

Many UK observers have argued that the easiest way to get out of the current Brexit bill deadlock would be to extend the UK's current annual net contribution to the EU budget over several years in the context of a transitional agreement. It is also argued that the financial settlement would be more easily accepted by the British public opinion if presented as a sort of

implementation payment, linked to a transitional period and not as the settlement of past debts. The UK government has endorsed this vision, and insists that negotiations on the financial settlement should be part of a broader discussion of a transitional arrangement.

The EU is careful about making this link, and rightly so. Moving to the second stage without any clear agreement on the payment could enable the UK to use money as a bargaining chip in future negotiations. That being said, one cannot deny that different possible transitional arrangements may have different budgetary implications. The latter will obviously have an impact on the size and composition of the UK's single payment to the EU.

Without abandoning the "sequencing approach", there is a case to make connections between the financial settlement and future transition agreement. An option would be for the UK and EU to agree on the financial obligations to be included in the payment and the way of calculating them, and to develop different scenarios concerning the specific amounts and modalities of payment of these financial obligations, conditioned to different possible transitional arrangements.

On the same themes...

THE POSSIBLE IMPACT OF BREXIT ON THE EU BUDGET AND CAP FUNDING

Eulalia Rubio et Jörg Haas, European Parliament, Committee on Agriculture and Rural Development, Brussels, November 2017

BREXIT AND THE AREA OF FREEDOM, SECURITY AND JUSTICE

Funda Tekin, Policy Paper No.205, Jacques Delors Institute - Berlin, September 2017

BREXIT AND THE FREEDOM OF MOVEMENT

Dr. Federico Fabbrini, Interview, Jacques Delors Institute - Berlin, September 2017

BREXIT AND THE EU BUDGET: THREAT OR OPPORTUNITY?

Jörg Haas and Eulalia Rubio, Policy Paper No.183, Jacques Delors Institute, January 2017

Managing Editor: Sébastien Maillard • The document may be reproduced in part or in full on the dual condition that its meaning is not distorted and that the source is mentioned • The views expressed are those of the author(s) and do not necessarily reflect those of the publisher • The Jacques Delors Institute cannot be held responsible for the use which any third party may make of the document • Original version • © Jacques Delors Institute