LEAVE ALLIANCE

Brexit Monograph 3

Financial contributions after Brexit

31 July 2016
(corrected)

Introduction
There have been many different figures offered as to the financial contributions that will have to be made to the EU following our withdrawal from the EU, with estimates ranging from zero to a figure higher than the net payments currently made.

The timescale is also highly variable with some advocating immediate cessation of all payments to the EU, while others take the view that a phased reduction will be necessary.

As to estimating the actual amount which will be paid, this will depend on the nature of the exit settlement. But it cannot be zero. The UK is a contributor to a number of ongoing EU programmes vital to British interests. Funding for these, at the very least, will have to be continued.

The most logical way forward is to work from the known, using the Efta/EEA (Norway) option as a baseline on which to make estimates, then modifying the outcome to provide estimates for costs of other scenarios, namely the free trade (bespoke) option and the WTO option.

The Efta/EEA (Norway) option
Although it is convenient to talk in general terms of the Efta/EEA option, under the EEA Agreement, the separate Efta states each have their own financial arrangements with the EU. Therefore, it is easier when assessing the situation to talk in terms of individual countries.

In this respect, should the UK adopt the Efta/EEA option, then the experience of the largest country of the group, Norway, is the most appropriate to explore.

Norway, like the others, does not make a single payment to the EU in terms of a budgetary contribution, and some of the payments – although required by the EEA Agreement – are not even made to the EU. Of the several categories of payments made, there are the Norway Grants, the EEA Grants (handled together), the programme payments, and a direct subscription to Efta, some of which is used to manage the EEA.

The Norway Grants are settled by way of a formal agreement with the EU (which has the status of a bilateral treaty).[1] They are made by Norway directly to eastern enlargement countries to help with their post-Communist economic rehabilitation.

In the period 2009-14, these grants amounted to a total of €804 million over the period, supporting 61 programmes in 13 countries in Europe including the member countries that joined in 2004 and 2007.[2] Updated for the 2014-2021 period, Norway is committing €391 million annually by way of Norway and EEA grants.[3,4]

The money is not remitted to the EU and is not part of the EU budget. It is administered separately, under the aegis of the Norwegian Ministry of Foreign Affairs.

As to the EEA Grants, these are paid collectively by the three Efta/EEA states, although Norway provides the bulk of the funding (95 percent). Norway and EEA grants collectively amounted to €1.8bn over the 2009-14 period, of which €1.71bn was paid by Norway.[5] As with the Norway grants, the EEA grants are not part of the EU budget. They are administered by the independent Financial Mechanism Committee.[6]

These payments are part of the EEA agreement but they are not specifically for participation in the Single Market.[7] They are effectively part of Norway's foreign aid budget, comprising a core part of its strategy for co-operation with the EU.[8]

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[1] See: http://ec.europa.eu/world/agreements/downloadFile.do?fullText=yes&treatyTransId=14423
[2] http://eeagrants.org/Who-we-are/Norway-Grants
[3] http://www.eu-norway.org/eu/Financial-contribution/#.V4QCwdQrKHs
[4] Figure are quoted in NOK so euro values vary: https://www.regjeringen.no/en/aktuelt/agreement-norway-eu-grants/id2427805/
[5] http://eeagrants.org/
[6] http://eeagrants.org/Who-we-are/Our-organisation
[7] http://www.efta.int/media/documents/legal-texts/eea/the-eea-agreement/Main%20Text%20of%20the%20Agreement/EEAagreement.pdf
[8] https://www.regjeringen.no/en/dokumenter/norway_in_europe/id762511/

These, of course, are totally separate from the programme costs, which are paid directly to the EU, effectively as fees for participation in EU programmes.[9] As of 2014, Norway participated in twelve, including Horizon 2020, Erasmus +, the Consumer Programme and the Copernicus programme. It also has a bilateral arrangement for participation in interregional programmes under the EU's Regional Policy.[10]

Additionally, it takes part in the activities of 27 EU agencies. These include the Education, Audiovisual and Culture Executive Agency (EACEA), the European Agency for the Management of Operational Cooperation at the External Borders (Frontex), the European Agency for Safety and Health at Work (EU-OSHA), the European Chemicals Agency (ECHA), the European Defence Agency (EDA), the Executive Agency for Health and Consumers (EAHC), the Research Executive Agency (REA) and the European Police College (Cepol).

As to the budget contribution for these activities, over the 2007-2013 multi-annual period, total EU spending was around €70 billion, of which the estimated Efta contribution was in the order of €1.7 billion – averaging approximately €250 million a year. Norway carried 95.77 percent of that cost (€1.63bn).[11] This cash is for services rendered and, even then, the funding was not one-way. Around €1.01bn was returned from EU funds, making the seven-year net contribution in the order of €620m - or about €90 million a year.

In the Seventh Framework (research) Programme, for instance, Icelandic and Norwegian participants, including many small and medium-sized enterprises (SMEs), were involved. Icelandic researchers contributed to 217 projects, receiving funding of nearly €70 million. Norwegian researchers, from more than 1,400 projects, received €712 million. Both Iceland and Norway signed up to the successor programme, Horizon 2020.[12]

Currently, though, in the new MFF (Multi-annual Financial Framework), new levels of contributions apply. Updated for the 2014-2021 period, programme contributions amount to an average annual commitment of €447 million. Additionally, there is €6 million for cooperation with the EU in the field of justice and home affairs, including participation in the Schengen, and around €25 million annually for the contribution in programmes under the European Territorial Cooperation Interreg.

As to the specific Efta contributions paid for the functioning of the Single Market, these come out of the Efta budget.[13] Norway pays a contribution to this budget. There is no direct payment to the EU.[14]

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[9] http://www.eu-norway.org/eu/Coopperation-in-programmes-and-agencies/#.VR2GJ_zF-NM
[10] http://www.efta.int/eea/eu-programmes
[11] http://www.efta.int/sites/default/files/publications/bulletins/bulletin-programmes-2010.pdf
[12] http://europa.eu/rapid/press-release_IP-14-566_en.htm
[13] http://www.efta.int/about-efta/efta-budget
[14] http://www.eu-norway.org/eu/Financial-contribution/#.VR1ohPzF-NM

Currently the annual (2014) budget is 22,360,000 Swiss Francs (about £16 million), of which 55 percent is borne by Norway. This includes categories defined as EEA related activities, EU/Efta statistical cooperation and EU/Efta cooperation programmes. That, strictly, is the cost of Single Market participation which, on a pro-rata basis, would cost the UK less than £100 million per annum.

The totality of the fees paid by Norway, however, are substantial. Collectively, they run to €869 million, per annum – approximately £750 million. Scaled up on a *per capita* basis, that amounts to around £9.6bn. With an estimated gross outturn (less rebate) of £12.9bn for 2015, we would be looking at the UK in the EEA paying about 74 percent of its current gross level.[15] It is not possible, at this stage, to calculate net contributions.

To be properly comparable, though, scaling up should be on a GDP basis – as this is the basis for calculation.[16] – the UK payment could be in the order of £4.3 billion, about a third of the 2015 payment. That is probably close to what we might be paying if we adopted the Efta/EEA option.

Free Trade Agreement payments

A common refrain, heard when referring to the merits of a free trade option along the lines of the Canada deal, is that those countries which enjoy such deals have access to the Union markets, but do not pay for it.

The problem with this argument is that it fails to acknowledge that the European Union is very much more than a trading agreement. It covers a huge range of cooperative activities and initiatives which are not directly related to the administration of a Customs Union.

Crucially, the UK is part of the Single European Sky programme, the European Defence Agency (which manages the RAF's A-400M airlifter programme), the European space programme, the research programme and the Erasmus student exchange programme, the European Medicines Agency (EMA) – and many more programmes/agencies which are vital to its national interests.

The EMA is a particularly interesting case. Based in London, it began operating in 1995 and is currently responsible for the evaluation, supervision and safety monitoring of medicines developed by pharmaceutical companies for use in the EU.[17] Brexit raises questions as to whether the Agency can continue to be based in London.

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15 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/483344/EU_finances_2015_final_web_09122015.pdf

16 See Article 82(1) of the EEA Agreement http://www.efta.int/media/documents/legal-texts/eea/the-eea-agreement/Main%20Text%20of%20the%20Agreement/EEAagreement.pdf -

17 http://www.ema.europa.eu/ema/index.jsp?curl=pages/about_us/general/general_content_000628.jsp&mid=WC0b01ac058087addd#

Even staying in the EEA puts its future in doubt. Efta states which are also EEA members can participate in EU agencies, but they have no voting rights and only limited management rights.[18] Countries outside the EEA Agreement are not normally given membership rights, although some are permitted to participate in EU programmes. Switzerland, for instance, takes part in the EU Framework Programme for Research, the EU MEDIA programme, Youth in Action and Lifelong Learning.[19]

To have a prestigious EU agency, such as the EMA, located on the territory of a non-EU member might be difficult to justify, and while the prospect of the UK losing voting and management rights would be a huge blow to the UK pharmaceutical industry, for us to be expelled completely would be a serious setback. Without EMA membership, the UK might be forced to rely on inter-agency agreements on the Chinese model, such as the "consultation and cooperation mechanism" between the Directorate-General for Enterprise and the Chinese State Food and Drug Authority.[20]

Whatever arrangements are made, termination of UK involvement in EU programmes and agency participation is not an option. Between sophisticated, open trading economies, a high degree of cross-border cooperation will always be necessary. And in the current security environment, neighbouring nations are seeking to increase rather than reduce joint activities.

A clear, non-European example of this can be seen in Canadian-US cooperation, manifest in the Canada-United States Action Plan for Critical Infrastructure, the Joint Action Plan for the Canada-United States Regulatory Cooperation Council and the US-Canada "Beyond the Border" initiative.[21,22,23]

These joint actions are not as fully institutionalised as their EU equivalents, and the costs are not easy to ascertain. Budgeting is fragmented, costs often lie where they fall, as part of national agency budgets.[24] There is no systematic, year-on-year tracking of costs.[25] However, because there is a lack of transparency and clear budgetary allocation, that does not mean that substantial costs are avoided. From even the fragmentary evidence available, it can be

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[18] http://www.ema.europa.eu/docs/en_GB/document_library/Other/2010/01/WC500038065.pdf
[19] http://eeas.europa.eu/switzerland/index_en.htm
[20] http://www.ema.europa.eu/ema/index.jsp?curl=pages/partners_and_networks/document_listing/document_listing_000232.jsp&mid=WC0b01ac05801f0a03
[21] http://www.publicsafety.gc.ca/cnt/rsrcs/pblctns/cnd-ntdstts-ctnpln/cnd-ntdstts-ctnpln-eng.pdf
[22] https://www.tbs-sct.gc.ca/ip-pi/trans/ar-lr/rcc-ccmr/japrc-paccc-eng.asp
[23] https://www.whitehouse.gov/sites/default/files/us-canada_btb_action_plan3.pdf
[24] See for instance here. This major cross-border initiative has no specific budget allocation: http://www.regionalresilience.org/uploads/2/3/2/9/23295822/maritime_commerce_resumption_packet_-_web.pdf
[25] See p.19 https://www.fraserinstitute.org/sites/default/files/measuring-the-costs-of-the-canada-us-border.pdf

ascertained that the Canadian and US public sector is committed to multi-billion dollar expenditure on cross-border programmes.

Even with a loose, free-trade association between the UK and the EU therefore, it is inconceivable that the UK would drop out of all cross-border cooperation. And since so much of this is institutionalised via EU agencies and programmes, it is inevitable that much of the activity will be channelled through established mechanisms. Unavoidably, this will carry costs. We cannot expect a free ride and the greater the degree of participation, the greater the cost. In 2014 the Swiss payments to the EU budget were €439 million, the bulk of which went to funding the research programme.

In many respects, we might seek participation in agencies and programmes on exactly the same basis as before we left the EU. Should the EU agree to such a relationship, a significant contribution will undoubtedly be required.

Here, we can use Norway as a template, which is paying close to half a billion euros annually for its agency and programme participation. Bearing in mind that the UK would probably require greater participation, we could be looking at £2-2.5 billion a year as contributions to the EU budget, even where our trading relationships were determined by free trade agreements.

As to the Norway/EEA grants, a view will have to be taken on these. Paid to the former Soviet satellite EU enlargement countries, the case could be made that it is in our national interest to support the development of these countries, assisting their return to fully functioning, free-trading democracies.

On that basis, in or out of the EU, it is arguable that we would have funded these countries and would continue to do so. After all, most of the developed world has been supporting these countries emerging from Communist rule. In 2013, the United States was celebrating 20 years of support, and the provision of $20 billion in economic assistance.[26]

Should the UK continue providing financial support, it would make sense to coordinate assistance with the EU, putting it in much the same frame as Norway/EEA grants. The money might still be paid – only the labelling would be different. We might still be committed to an outlay in the order of £4 billion a year.

The WTO option

The third possibility of defining the UK-EU trading relationship might be via the WTO Option, which has been explored in depth in Monograph 2. Again, though, one must state that this relationship – even if feasible – defines only cross-border trade. Unless it is argued that the UK is going to retreat into

[26] https://www.usaid.gov/news-information/press-releases/usaid-report-twenty-years-us-economic-assistance-eastern-europe-eurasia

isolation, on a scale equivalent to North Korea, it must be assumed that cross-border cooperation in other areas will continue.

Should that be the case, then there will be cost implications. While there might be some flexibility in describing the allocations (they will not, for instance, be called EU Budget contributions), and payments can be fragmented and "lost" in departmental budgets, the fact is that cross-border cooperation costs money.

Depending on the outcome of negotiations (and one assumes there will be negotiations), there could be little difference in cost terms as between the WTO and "free trade" option – or even between the WTO and Norway option. Even if overall costs are kept to the minimum, none of the options are going to be entirely cost free.

Strictly, though, adoption of the WTO Option involves the UK taking a unilateral position, where there is no agreed (or other) Article 50 settlement. If that is the case, then external costs (i.e., direct payments to the EU) might be nil. The costs incurred, however, might be significantly greater, reflected in the loss of GDP through reduced trading opportunities, and duplication of functions otherwise carried out by the EU.

MFF future commitments (RAL)
What must also be factored into future payments are the Multi-annual Financial Framework (MFF) for the period 2021-2027. The UK will be entitled to take a full part in these talks, up until its point of departure.

Of particular concern are outstanding commitments at the end of the previous MFF period, known as RAL, from the French *reste à liquider*. In 2012, the figure was being reported by an alarmed European Parliament as €217 billion.[27] Together with other liabilities (mostly for purchases and staff pensions) of €103.4 billion excluding borrowings, this requires a carry-over into the EU budget for the 2014-2020 MFF of some €326 billion.

As of 31 December 2013, the budgetary RAL was reported at a lower figure – approximately €222 billion.[28] But, since the overall budget was trimmed below Commission expectations, yet commitments are escalating, it is hard to see the EU emerging from this current MMF with the liabilities reduced. RAL plus the staff pensions and other payments could easily exceed €350 billion. We must also be aware that we are not seeing consolidated accounts, and the EU agencies are also declaring their own, separate budgetary RAL figures, creating a further potential liability.[29]

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[27] http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-%2F%2FEP%2F%2FNONSGML%2BCOMPARL%2BPE-489.663%2B01%2BDOC%2BPDF%2BV0%2F%2FEN
[28] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52014XC1113(02)&from=EN
[29] http://www.era.europa.eu/Document-Register/Documents/Annex1%20Final%20accounts%202015.pdf

This is a speculative and highly disputed figure, but one which warrants further investigation. Since costs were incurred while the UK was an EU member (largely), it could be argued that there was a strict UK liability for repayment as it was instrumental in authorising the payments. Of any liability as it currently stands, the UK's responsibility runs to about 13 percent, which in sterling terms, could make the liability as high as £30 billion.

How much of that will have to be paid will undoubtedly be a matter for discussion during the Article 50 negotiations. One scenario is that we could be required to make staged payments over the MFF period to come, which would amount to about £4 billion a year. If that was imposed, it could represent a significant and unwelcome additional burden.

Other payments

According to the Institute of Fiscal Studies (based on official figures), last year (2015), the gross payment to the EU before rebate was £17.8 billion.[30] That equates to about £342 million a week. However, from that was returned £4.9 billion as the UK rebate. This sum has no conditions attached and is absorbed back into Treasury funds. It is already accounted for and is not available for re-allocation.

Effectively, for the year, the gross payments less rebate was just under £13 billion, which can be taken as a typical payment – although there are considerable variations, year-on-year.

To come to a net figure, there must be deducted the £4.4 billion returned for spending on EU policy areas. This includes the Common Agricultural Policy (CAP) and rural development. An amount goes to regional funds, and some goes to government bodies for distribution as research funding.

There are then the private sector receipts which go straight to the private sector and other non-governmental organisations such as universities. Annually, the figure is about £1.5 billion.

But that is not the end of it. There is also the question of overseas aid. Roughly £1.2 billion of the £11 billion aid budget is managed by the EU and paid as part of the annual contribution. Despite that, it goes towards the UK's self-imposed 0.7 percent GDP quota. If the sum was not paid to the EU, it would still have to be allocated to the aid budget. That £1.2 billion, therefore, is not available for redistribution.

As a working assumption, these sums will still be paid, although the budget lines will be repatriated. Therefore, the Treasury might be expected to fund the £4.4 billion otherwise paid to the EU. It will also have to fund the "net government contribution" of £1.5 billion and the £1.2 billion currently paid as

[30] http://www.ifs.org.uk/uploads/publications/bns/BN181.pdf

part of the EU aid budget. This makes for baseline annual payments in the order of £7 billion – paid directly to recipients rather than via the EU.

Cessation of payments

There are those who would have the UK cease payments (some or all) to the EU with immediate effect. However, Member State EU contributions are agreed on a multi-annual basis by the European Council, currently for the seven-year period 2014-2020 (inclusive).

Maximum annual budgets are agreed by the European Council in what is known as the Multi-annual Financial Framework (MFF) decision. The current legal base is Council Decision 5602/14 on the system of own resources of the European Union, of 12 February 2014, implemented by Council Regulation 5600/14, of the same date, laying down implementing measures for the system of own resources of the European Union.[31,32] There is also Council Regulation 5603/14 on the methods and procedure for making available the traditional, VAT and GNI-based own resources and on the measures to meet cash requirements (Recast).[33]

This "own resource package" amounts to a binding legal commitment, which the UK would be obliged to honour at least to the end of 2020 – a commitment that probably would remain even if the UK was to leave the EU before then. Effectively, we are locked into payments until the end of 2020.

Premature termination of payments would amount to a "material breach" of the EU Treaties, permitting the parties (EU-27) to invoke Article 60 of the Vienna Convention on the Law of Treaties, as a ground for terminating the treaty or suspending its operation in whole or in part.[34] This could have very serious effects on a wide range of policy issues, with costs that substantially outweigh any savings.

Furthermore, depending on the timing of the Article 50 negotiations and their duration, it is quite possible that the UK will become enmeshed in the negotiations for the next MMF (covering 2021-2027), while it remains a member of the EU. UK commitments for further payments may well be established by this means, then to be folded into the Article 50 settlement.

Conclusions

Depending on the degree of participation in EU agencies and programmes, the UK might expect to be paying – probably at an irreducible minimum – about £2 billion annually to the EU as a direct contribution

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[31] http://register.consilium.europa.eu/doc/srv?l=EN&f=ST%205602%202014%20INIT

[32] http://register.consilium.europa.eu/doc/srv?l=EN&f=ST%205600%202014%20INIT

[33] http://register.consilium.europa.eu/doc/srv?l=EN&f=ST%205603%202014%20INIT

[34] https://treaties.un.org/doc/Publication/UNTS/Volume%201155/volume-1155-I-18232-English.pdf

It is unlikely – at least in the short-term – that it would be politically astute to terminate aid to Eastern and Central European enlargement countries, not least as the UK may be seeking their support on measures to limit the free movement of persons. It is not, therefore, unrealistic to expect that, post-Brexit, the UK may fund the equivalent of Norway/EEA grants, even if only on a voluntary basis, to the extent of £2 billion annually, or thereabouts.

If one then adds the £7 million direct payments, to which the UK will be committed, with the possibility of £4 billion in RAL payments for the next MFF period, the UK is potentially looking at total annual payments of £15 billion until at least 2027, perhaps tapering off from there.

On the face of it, this could lead to an anomalous situation, with the UK actually paying more outside the EU than it would as a full member, despite reduced access and privileges. Even without the RAL payments, the headline figure would be £11 billion. This would make for a marginal overall saving, in the order of £2 billion a year or about £40 million a week – a far cry from the £350 million a week saving claimed during the referendum campaign.[35]

There is little scope for reducing the core £7 billion direct payments and while and RAL liability might be questionable (and negotiable), there seem to be limited opportunities for reducing programme and agency costs.

On the other hand, the headline figure could be massaged downwards by allocating £1.2 million of the direct payments and the Norway/EEA equivalent payments to the overseas aid budget, giving us a reduced headline £8 billion figure for annual commitments – about three-quarters of the current gross payment (after deduction of rebate).

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[35] http://www.voteleavetakecontrol.org/briefing_cost